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THE PRESENCE OF FOREIGN BANKS AT THE UKRAINIAN MARKET

Abstract: in the article the presence of banks with foreign capital at the financial market of Ukraine was investigated, the comparative analysis of national and foreign banks was made and the main differences between them were identified. The conclusions concerning the motives of foreign banks' entering the Ukrainian market of financial services were provided.

Key words: foreign banks, foreign capital, banking system, motives of market entry.

I. Introduction

Modern tendencies of international banking market are characterized by large-scale processes of integration, mergers and acquisitions in the result of the new markets entries of large foreign banks and universalization of banking capital. Today the Eastern European market is one of the priorities for the expansion of international financial market players. The Ukrainian market is not the exception. The reasons for this integration process and the phenomenon of the growing of foreign capital influence on the banking system of Ukraine are actively explored by such foreign and domestic scientists as J. Keynes, D. Kiduel, R. Peterson, G. Marshall, C. Green [6], R. Rinutro, R. Levine, A. Aslund [1], O. Dzyublyuk, O. Chub [3], R. Nabok [8], A. Philipenko, O. Baranovskyy [2], V. Geyets [5], N. Sheludko [11]. Today the need to conduct a comparative analysis of activity of foreign and domestic banks and to determine the motives of foreign banks' rapid capture of the financial services market of Ukraine stays relevant.

II. Problem statement

The purpose of writing the article is the research of the positioning and location of banks with foreign capital at the Ukrainian bank services market, the determination of the motives of foreign banks' entering the Ukrainian market. The historical, statistical and the method of comparative analysis were used for the research.

III. Results

To analyze the current tendencies of the foreign banks presence in the domestic market the evolution of foreign investors' penetration on the financial market of Ukraine should be explored.

The process of development of the Ukrainian banking sector by foreign banks began in 1994 (see Chart 1). Only during one year 12 banks were opened with the help of foreign investments. By 1999 its' number was increased up to 30, including banks with 100% foreign capital – 8. Moreover, the market maintained a clear tendency of domestic banks reduction (from 1995 to 2000 the number of registered banks decreased by 15%), while the expansion of foreign investment in the banking sector of Ukraine for the same period increased rapidly by 58%.

Since 2001, due to the narrowing of the government securities market, inflation declining and decreasing of banking operations profitability, foreign investors preferred to exit the Ukrainian market, and thus till the end of 2004 the number of banks with foreign capital reduced rapidly by one third from 28 to 19 banks [10, p. 42].

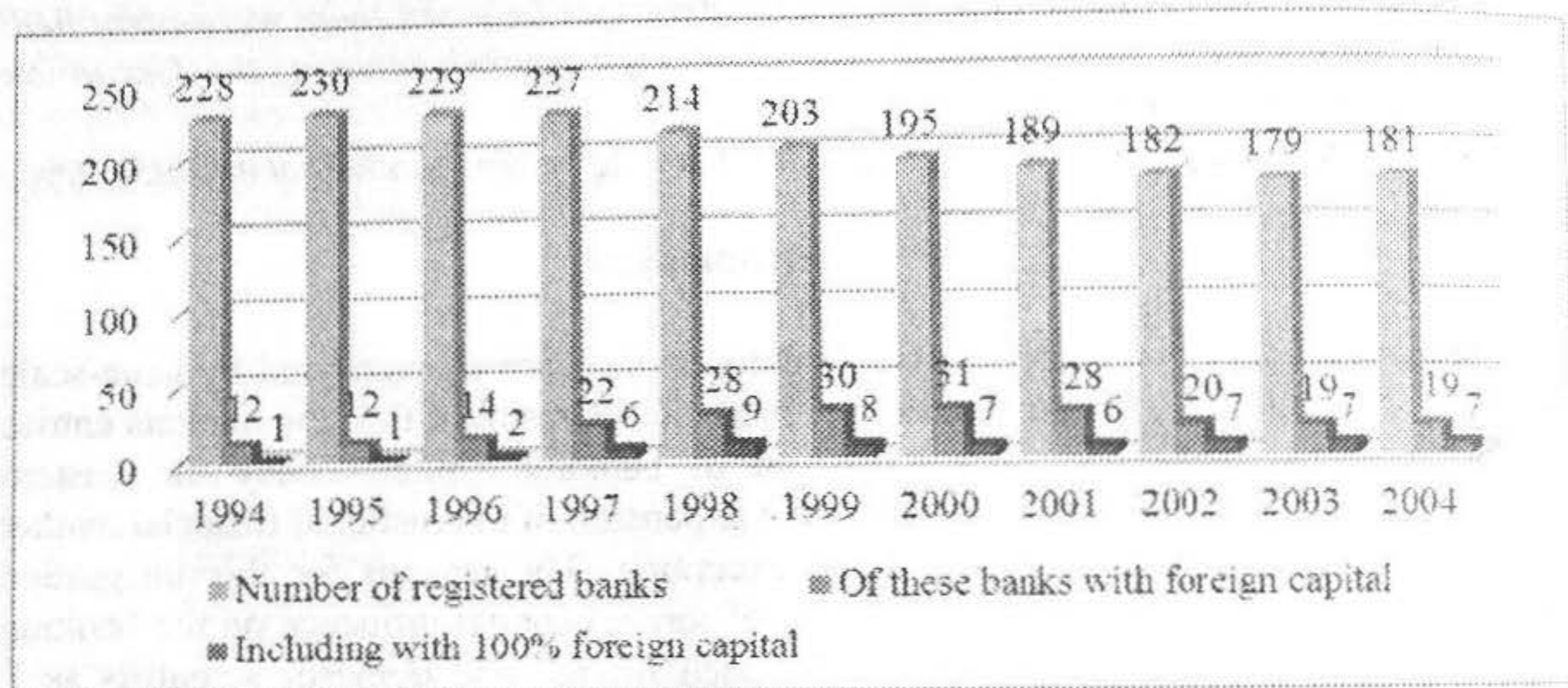


Chart 1. The dynamics of foreign capital in the banking system of Ukraine, 1994 – 2004, % [9]

With the further development of market relations, since 2005, foreign banks intensified their efforts in the financial market of Ukraine. Thus, after analyzing the dynamics of foreign banks presence in the financial market of Ukraine, we can say that in 2007 the growth of the presence of banks with foreign capital averaged was 30%. After examining the dynamics of the number of banks with foreign capital in Ukraine, it is possible to see that by 2009 their number increased in both absolute (from 19 banks in 2004 to 53 in 2008) and in relative terms (from 11,9% to 28,8%).

Period from 2009 to 2010, which was characterized by financial and economic crisis, had a negative impact on investors' attitude to doing business in Ukraine, and in 2009 foreign banks began to phase out their business, and as the result in the end of 2010 the number of officially registered foreign banks decreased by 2 compared to the same period in 2009.

Figure 1 The dynamics of the number of banks with foreign capital, 2004 – December 2012

| Indicator | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 01.12.12 |
|--|------|------|------|------|------|------|------|------|----------|
| The number of registered banks | 181 | 186 | 193 | 198 | 198 | 197 | 194 | 198 | 176 |
| The number of banks with the banking license | 160 | 165 | 170 | 175 | 184 | 182 | 176 | 176 | 176 |
| Of these banks with foreign capital | 19 | 23 | 35 | 47 | 53 | 51 | 55 | 53 | 54 |
| Including banks with 100% foreign capital | 7 | 9 | 13 | 17 | 17 | 18 | 20 | 22 | 22 |
| The share of foreign capital in the authorized capital of banks, % | 9,6 | 19,5 | 27,6 | 35,0 | 36,7 | 35,8 | 40,6 | 41,9 | 39,0 |

Source: [9]

However, in 2011 the share of foreign capital in the authorized capital of Ukrainian banks increased by 4,8% to 40,6% (see Figure 1). A high share of foreign capital in the authorized capital of Ukrainian banks in the total indicates that mainly large banks are under the control of foreign financial institutions. Such large international banking groups are far superior in terms of the competitiveness than small and medium-sized domestic banks.

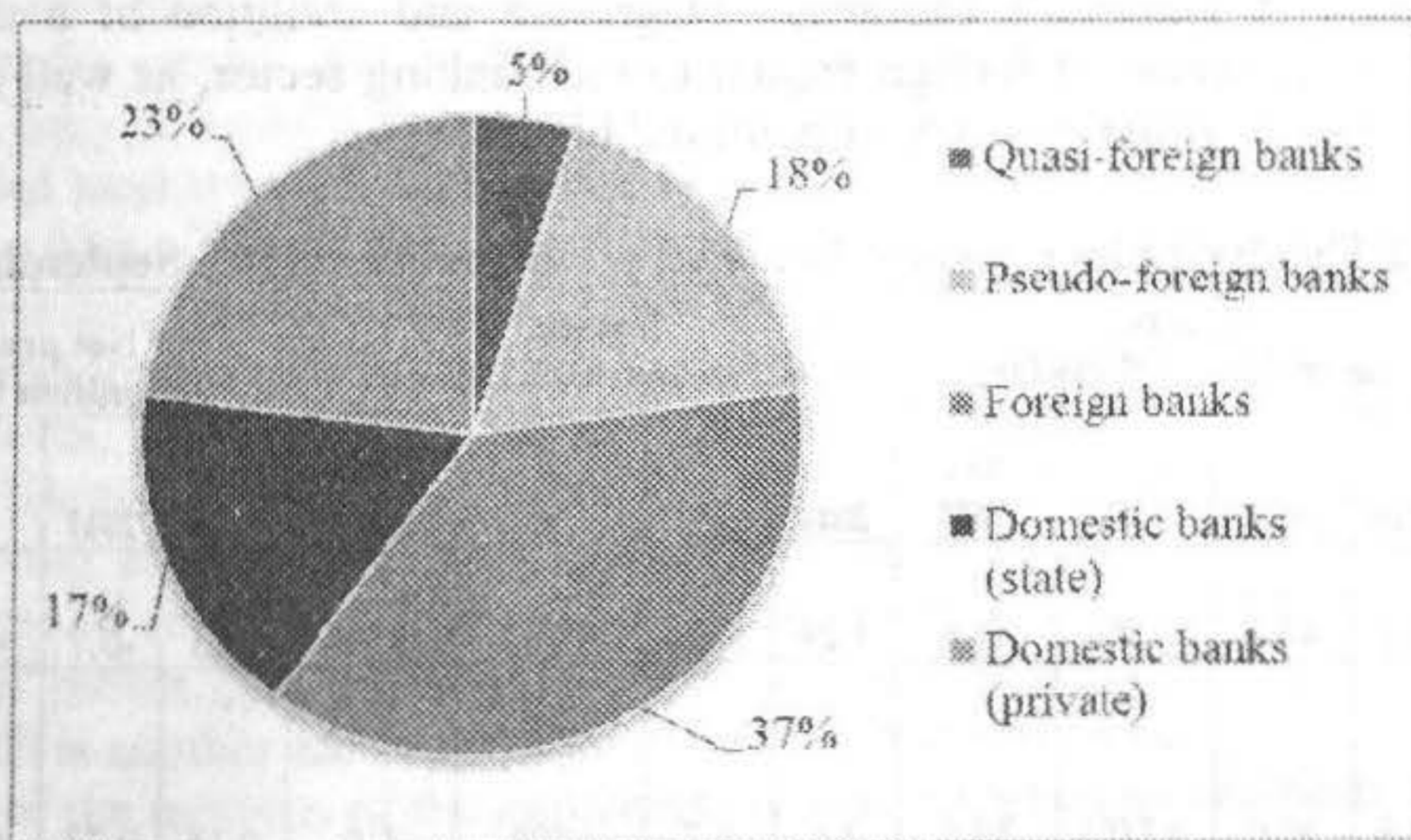


Chart 2. The structure of banks in allocating by the owners of share capital in 2011, % [4]

The reason for the growth of the share of foreign capital in 2011 was the presence of quasi-foreign and pseudo-foreign banks at the Ukrainian market (see Chart 2).

5% of the market belongs to the quasi-foreign banks, which in essence are foreign credit institutions with minority part of share capital from foreign investors. However, actually their foreign owners may be removed from strategic control over the management of the financial institution because of not significant share in the authorized capital of the bank. So 4,2% of shares of PJSC «Ukrainian joint-stock bank» owns a resident of Russia, 11,1% of shares of PJSC «Industrialbank» – resident of Austria, 4,2% of shares of PJSC «Bank «Contract» – resident of USA.

Pseudo-foreign banks are the lenders, directly owned by foreign companies, which in their turn are owned by domestic investors. Specifically it is about the owners of banks registered as residents in offshore areas, which is a method of tax optimization [4]. 18% of banks in Ukraine has nominally foreign but actually domestic owners. The residents of Cyprus are the owners of the next banks: PJSC «Privat» – 30% of the share capital, PJSC «Commercial bank «Expobank» – 31,2%, PJSC «Bank «Kyivska Rus» – 39,9%.

As at 1 December, 2012 there are 54 banks with foreign investments, including 22 banks, 100% owned by a foreign investor, in Ukraine, that is 30% of all banks registered in the domestic market are controlled by foreign owners. The share of foreign capital in national banks' authorized capital declined by 2%. However, it should be noted that in reality, the proportion of banks with foreign investments, operating in Ukraine, is much higher, because many banks have foreign investors through affiliated entities. Information about such entities is not submitted for the reporting of the National Bank of Ukraine and sometimes is not distributed at all, so it can not be confirmed.

Such tendency of the share of foreign capital growth in Ukrainian banks caused by the decision of Ukraine's European integration and abolition of a number of restrictions on the access of foreign capital to the banking sector, as well as finding investments to support the liquidity of domestic banks [8].

Figure 2 The dynamics of banks' financial performance, 2010 – September 2012*

| Banks | Assets, eq. million U.S. dollars | | | | Equity, eq. million U.S. dollars | | | | Net profit/loss, eq. million U.S. dollars | | | |
|--|-------------------------------------|------|------|-------------|-------------------------------------|------|------|-------------|--|------|------|-------------|
| | 2010 | 2011 | % | 9m. 2012 | 2010 | 2011 | % | 9m. 2012 | 2010 | 2011 | % | 9m. 2012 |
| With 100% foreign capital | 42,7 | 43,1 | +1% | 43,6 | 5,24 | 5,28 | +1% | 5,76 | -1,3 | -0,7 | +50% | 63 |
| With the share of for- eign invest- ments | 29,9 | 36,0 | +21% | 39,5 | 3,4 | 4,7 | +39% | 5,0 | 0,16 | 0,23 | +44% | 126 |
| With 100% Ukrainian capital | 41,7 | 51,8 | +24% | 55,2 | 8,1 | 9,3 | +15% | 9,7 | 0,49 | 0,47 | -3% | 156 |

* The error in the calculation is less than 3%, due to the incomplete disclosure by banks the information about the owners of shares in the authorized capital (including owners- individuals).

Source: calculated by the author based on data from the NBU- [7]

As shown by the statistics (see Figure 2) by the results of the end of 2011 assets of banks with foreign investments form 60% of the assets of all banks operating at the Ukrainian market. Besides in comparison to figures of 2010 assets of foreign banks grew by 25%. The share of assets of national banks is 40%. As at 1 October, 2012 total assets of foreign banks made 83,1 million U.S. dollars. The results of banks for the year 2011 shows that the equity of banks with foreign investment makes 50% of the total capital of banks operating in Ukraine, which indicates a rather high level of foreign investment impact on the national banking system. In addition, the level of foreign banks' equity is growing twice as fast compared to the growth rate of domestic banks' equity.

However, banks with 100% foreign capital were unprofitable in 2011 (net loss amounted to 0,7 million U.S. dollars), as well as national banks (net loss – 0,47 million U.S. dollars). However, unlike domestic banks, which lack of resources while having losses is felt on doing business, foreign banks with the support of parent companies can afford to work occasionally without profits, that will not result in additional risks to the bank.

After examining the process of foreign banks' entering the Ukrainian market, the actual positioning of banks with foreign capital at the market and after comparing their performance with the performance of domestic banks, it is necessary to pay attention to the factors that influenced the decision of foreign investors to enter the market of banking services of Ukraine.

At the initial stage of development of the banking system of Ukraine motive of entering the new market was the fact that the main activity of foreign banks was to provide services to customers from the mother country (strategy of defensive expansion). At that time, these target customers were more solvent than even large domestic companies. So, foreign capital primarily supported foreign business activities, thereby expanding its presence in the country and creating conditions for the export of its profits [2, c. 258]. Therefore, entry of banks with foreign capital at the Ukrainian market was characterized by the so-called market-based motive, that is the desire to capture new markets. Moreover financial markets of Czech Republic, Hungary and Poland had the similar nature. So many banks are breaking into foreign markets just because their traditional customers, with whom the close relations were established in the country of origin, started doing business there.

However, since the analysis has shown that the presence of foreign banking capital in Ukraine is high, then today more significant motive for entering the market is not serving foreign customers, but competing with national banks and obtaining new sources of revenue. So besides focusing on service for customers who are the resident of parent country, foreign banks are also seeking to expand its customer base, which is another motive of penetrating the national market.

One of the motives of the expansion of banks owned by residents of developed countries in Europe, to the financial markets of developing countries, particularly to Eastern Europe (including the Ukrainian market) was following the example of other market participants, that was more likely establishing the relationships with new clients than economic efficiency, which promotes international expansion [6].

Also the important motive is capturing the markets of Central and Eastern Europe by foreign banks. The regulatory environment and the imperfect system of regulatory privileges facilitate the process of market entry. The process of implementation the international standards of regulation [1], and the system of supervision and control of banks with foreign investments in Ukraine is not completed. This situation gives foreign banks extremely strong regulatory incentive to enhance their entry into the financial and credit markets.

Furthermore, the additional motive that can be selected is limited number of financially reliable banks in Ukraine, as well as the fact that the competitiveness of the banking system of Ukraine is very low, that allows foreign banks to take a favorable competitive position.

One of the main motivating factors is also obtaining market benefits. The volume of banking services in Ukraine is much lower than in developed economies. One of the typical signs of market opening is «skimming»: powerful foreign banks, while selling more complex services, easily attract the best customers, that makes the lowest risks and in results impede the competition for other banks.

After all, the motive may also be the presence for the sake of presence. Banks, claiming to the status of global players tend to «mark» in many countries in order to have an advantage in the areas of real intensity of their business.

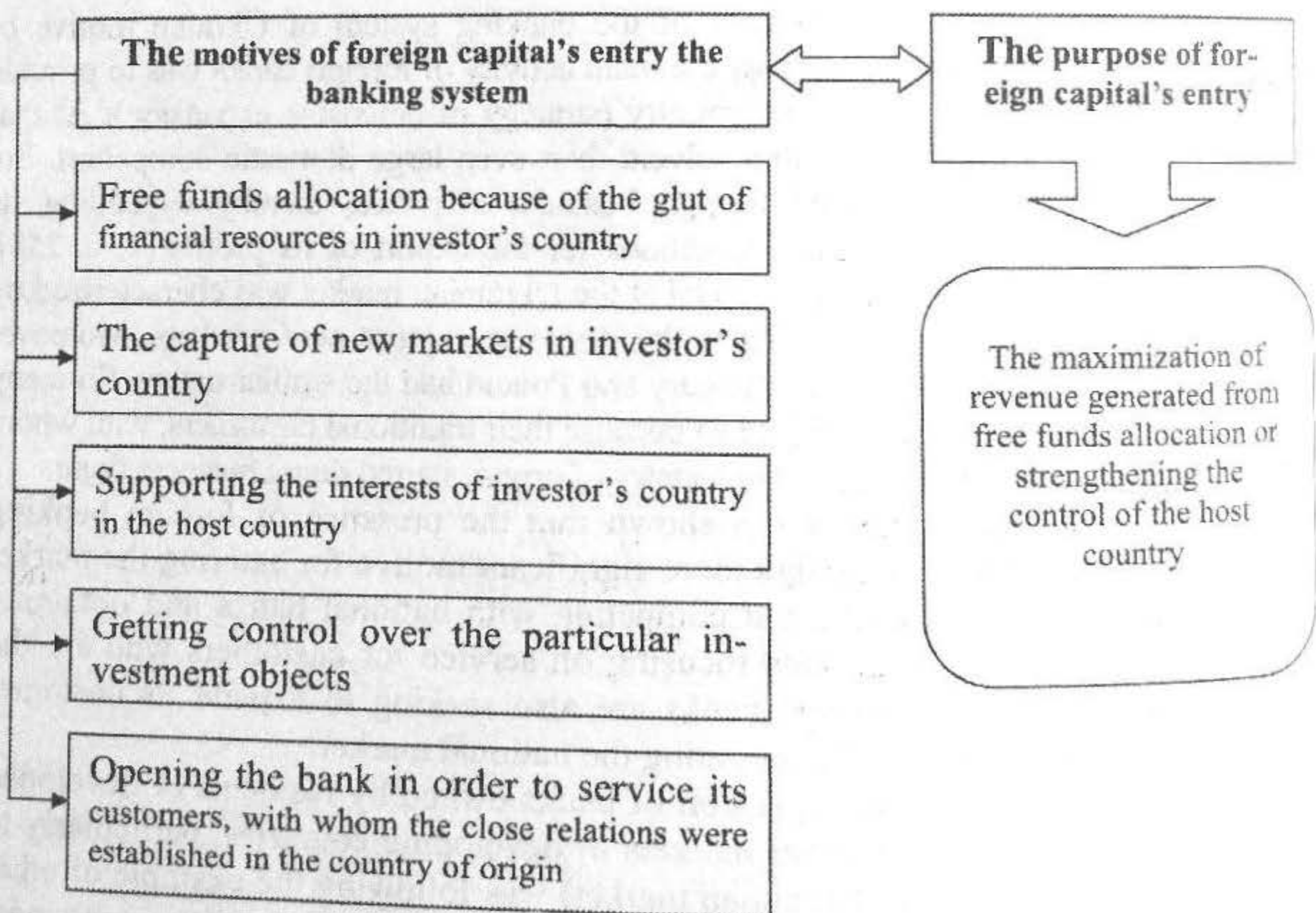


Chart 3. The motives of foreign capital's entry the banking system of Ukraine, [8]

However, in today's Ukrainian financial and credit environment, taking into account the financial performance, the main factor in the attractiveness of the national banking system for foreign banks and the purpose of foreign capital's entry the Ukrainian market is getting higher profits, that is the maximization of income in the conditions of acceptable risk (see Chart 3). So among the main strategic reasons for foreign banks' entrance into the Ukrainian market it is also possible to point out the desire to capture new markets, as mentioned earlier, and to get the high profit [2, p. 258].

Achieving such level of profit is possible due to the favorable economic environment, financial support from the parent company, the existence and growth of a competitive and loyal to foreign investors client base, cheap foreign resources, foreign practice of usage the new financial products and services, experience in customer servicing and also the factor that foreign banking capital doesn't usually bear those costs, which are related to the performance of informal duties of local banks under political structures and the participation in the shadow mechanisms.

IV. Conclusions

In the period of economic growth there was an active inflow of foreign capital in the banking system of Ukraine, and in recent years the presence of powerful foreign banks is only expanding. Since 2004 the number of banks with foreign capital in Ukraine has increased by 34. Over the last year the share of foreign capital in the authorized capital of national banks declined by 2%. As at 1 December, 2012 there are 54 banks with foreign investments, including 22 banks, 100% owned by a foreign investor, operating in Ukraine. The motives of entry and financial activity of foreign banks in the domestic market at an early stage of Ukrainian banking system development differ from today's ones. The primary reasons for entering the market are the need for service businesses and customers from the mother country that limits the capital flight. Banks with foreign investments motivate their entry the Ukrainian market by using the more favorable business environment in the part of relatively weak bank supervision and incomplete regulation, and also the ability to compete with national banks at the high level. One of the motives of the penetration to the domestic market is capturing of new territories and expenditure of scales of foreign bank's business. After examining the financial performance of banks, it is possible to make the conclusions that at the present stage of economic relations development at the international banking market, the purpose of gaining a new market is the maximization of profits, that banks could achieve with the help of parent bank's experience and the appearance at the national market with new products and prices on them. That is why today national banks are not always able to compete with banks with foreign capital because of the lack of available resources in particular and the scale of activities in general.

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