



The Penetration of Foreign Capital into the Banking Sector in Central and Eastern Europe's Countries

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ABSTRACT

The purpose of this paper is to analyze the degree of the penetration of foreign banks in the banking system of some countries in Central and Eastern Europe, with special reference to Romania. This is done using two significant indicators, such as: the share of foreign banks in the total of the banks in a country and the share of foreign bank assets in the total bank assets in a country. It will also analyze the global character of the activity of foreign banks in Romania and their international character, with the focus on how these two aspects have evolved over time. This will be achieved by analyzing the indicator: FOREIGN claims of BIS reporting banks towards Romania.

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1. Introduction

Over the past two decades, foreign banks have entered the emerging countries of Central and Eastern Europe (CEE), banking activity experienced an unprecedented trend towards globalization.

The penetration of foreign capital into emerging countries is a topic widely debated in the literature mainly due to the influence it has on the banking systems of host countries. Some research highlights the positive effects produced including the increased efficiency, competition and the quality within the banking systems. Thus, foreign banks contribute to the introduction of new banking and financial innovation, strengthening the banking system because of their knowledge and experience in financial activities, improving the competitive environment, improving the financial system infrastructure, attracting foreign direct investment and at increasing financing for internal projects. In the event that „a subsidiary of a foreign financial institution fails, supposedly for to keep reputable, parent bank will ensure the solvency of its subsidiary; in the case of branches or agencies has a legal obligation to do this.”

Instead critics expose various risks for the stability of the banking system in the conditions of some credit offers much more volatile. The subsidiaries are not completely autonomous they largely depend on the policies of the parent banks. The entry of foreign banks in emerging markets, diminishes customer portfolio of domestic banks, which can not compete with multinational bank subsidiaries, which has a diversified portfolio of assets at the international level. Foreign banks react to worsening economic environment in the country of origin and can thus affect the stability and proper functioning of the banking system in the host country and the whole economy. This also raises fears that a crisis in one country can affect other countries, mainly through investment decisions of foreign banks, which might be more interested in promoting exports from their countries of origin or to support projects undertaken by companies in the country of origin.

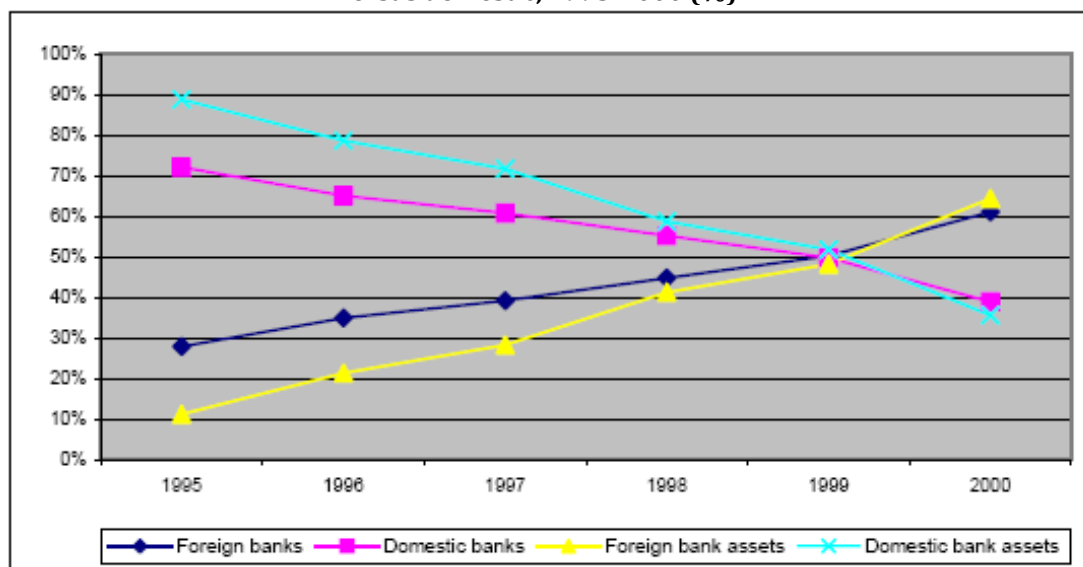
2. The penetration of foreign banks in Central and Eastern Europe

Since 1995 and until the manifestation of the crisis in the analyzed countries of Central and Eastern Europe the share of foreign banks in total banks in these countries has increased considerably, leading to a significant share of foreign bank assets in total bank assets (Table 1 and Table 2). The penetration and the presence of foreign capital in the banking system of a country is outlined and quantified using significant indicators such as the share of foreign banks in total banks in a country and the share of foreign bank assets in total bank assets in a country.

In Graph 1 it can be seen the rise in the number of foreign banks and their assets in the countries of Central and Eastern Europe. If in 1995 the number of foreign banks in total banks' share was below 30%, predominantly local banks, in 2000 exceeded 60% of foreign banks and domestic banks were below the percentage of 40%. In this way the assets held by them increased from 10% at the start of the period to over 60% in 2000.

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Graph 1. Number of banks and total bank assets in Central and Eastern European countries: foreign versus domestic, 1995-2000 (%)



Source: CESifo working paper

The share of foreign banks increased in Central and Eastern Europe and in the next period (Table 1). In 2009, in countries such as Slovakia and Romania the number of foreign banks exceeded the 80% and in Hungary accounted for 92% of all banks, but in this country since 1995, 67% of banks were foreign banks. A notable development recorded it also in Lithuania. If in 1995 there was no foreign bank in the country, the banking system consisting only of local banks, some fourteen years later their share was only 30%, the rest being foreign banks.

Table 1. Share of foreign banks in total banks from a country in Central and Eastern Europe

	1995	2000	2005	2009
Croatia	4	30	32	43
Estonia	9	50	71	71
Latvia	13	29	45	67
Lithuania	0	50	67	70
Romania	19	57	74	81
Slovenia	13	22	35	35
Czech Republic	39	52	55	67
Hungary	67	78	85	92
Poland	30	62	75	69
Slovakia	41	58	89	87

Source: International Monetary Fund

Regarding the share of foreign bank assets in total bank assets in the countries of Central and Eastern Europe, it is noteworthy that in 2009, countries such as Croatia, Estonia, Lithuania, Romania, the Czech Republic and Slovakia recorded a rate of over 80% (in Estonia even reaching 99%) of total bank assets. This upward movement was a consequence of privatization insignia of local banks in these countries. A lower level of foreign assets was recorded in Slovenia, namely 25%, the assets of local banks maintaining dominance (Table 2).

Table 2. Share of foreign bank assets in total bank assets from a country in Central and Eastern Europe

	2004	2005	2006	2007	2008	2009
Croatia	88	92	90	90	90	91
Estonia	95	99	98	97	99	99
Latvia	51	58	64	65	66	66
Lithuania	91	92	92	92	93	92
Romania	54	55	87	89	89	85
Slovenia	21	25	25	24	26	25
Czech	84	83	84	85	84	86

	2004	2005	2006	2007	2008	2009
Republic						
Hungary	65	63	61	64	67	64
Poland	72	76	75	74	72	68
Slovakia	95	94	93	92	92	88

Source: International Monetary Fund

In conclusion, over the last two decades, banking activity has experienced trend towards globalization unprecedented. In Central and Eastern Europe, the presence of international bank capital is at a high level. Banks in the rest of Europe expanded markets in former communist countries during large-scale privatization programs of domestic banks by the state, and the results were significant.

3. The presence of foreign capital in the Romanian banking system

In Romania the banking reform started after the change of political regime communist socialist in 1989. Thus in December 1990 the National Bank of Romania has received the status of the central bank and the powers held until then were transferred to exercise Romanian Commercial Bank. The aim was to create a modern banking system, based on the principle of universality banks, after the model of developed States; the banking legislation is drafted in accordance with European Directives.

After 1995, the banking system has experienced a major restructuring. There have been a series of bankruptcies of banks and " from the perspective of restructuring the banking system, a key element is the changes in the nature of ownership, distinguished by a sustained increase in private banking companies and the share of private capital Romanian banking industry and, in particular, foreign capital ".

The first state-owned banks were privatized in 1999 were BancPost by purchasing the shares by EFG Eurobank Ergasia, Bank Portuguesdo Investimento and General Electric Corporation and the Romanian Bank for Development through acquisition by Société Générale majority and EBRD (European Bank for Reconstruction and Development). This was followed in 2001 by the privatization of the Agricultural Bank acquisition of shares by Raiffeisen Bank International and Romanian-American Investment Fund. In 2002 the privatization of the Romanian Commercial Bank continued with the purchase by the EBRD, IFC (International Finance Corporation), SIF Oltenia, SIF Muntenia, SIF Moldova, SIF Transilvania and SIF Banat Crişana. A pack of about 8% was subsequently taken BCR employees. Since 2005, Erste Group Bank Austria became the main shareholder of the Romanian Commercial Bank.

The accession to EU, banking market liberalization and implementation of the single banking license increased presence of foreign capital in the Romanian banking system.

At the end of 2012, the romanian capital banks account for only 10% of the total net aggregate balance sheet of the banking system, while the share of foreign owned banks, including foreign branches, reached 89,9%. In this context, the share of assets owned private banks, including branches of foreign banks was 91,4% of total net aggregate balance sheet and state owned banks had a share of only 8,4%.

In Table 3 it can be seen the reduce of the number of private banks as a result of reducing the number of banks with majority domestic capital, while the number of banks with majority foreign capital remained constant. The latter, along with foreign banks composed, at the end of 2012, 85% of the Romanian banking system, while local banks owned or majority state and the private capital accounted for only 12,5 % of all credit institutions.

Table 3. Credit Institutions by Ownership

number of banks, end of period

	2011	2012
Banks, Romanian legal entities, <i>of which:</i>	32	31
Fully or majority state-owned capital	2	2
Banks with majority private capital, <i>of which:</i>	30	29
– with majority domestic capital	4	3
– with majority foreign capital	26	26
Foreign bank branches	8	8
Total banks and foreign bank branches	40	39
CREDITCOOP	1	1
Total credit institutions	41	40

Source: Banca Națională a României

In table 4 is remarkable expansion of foreign claims from BIS reporting banks since 1995 and explodes during 1998-2012, mainly as a result of the wave of privatizations after 1998. Therefore, foreign claims increased between 1998 and the year 2012 by approximately 30 times, increase who was largely sustained by the local implantation of foreign banks. Local currency claims on local residents have risen this way about 114 times, while international claims had a less rapid growth rate compared to local, namely about 22 times. The global character of the activity of foreign banks in Romania has become more prominent than the international character.

Table 4. Foreign claims of BIS reporting banks towards Romania (millions of dollars)

Romania	1995	1998	2005	2012
Total foreign claims	2277	3544	31575	106647
-international claims	2264	3249	21831	72999
-local currency claims on local residents	13	295	9744	33648

Source: Bank for International Settlements

In terms of share of international claims and the local currency on local residents, in the total foreign claims (Table 5), it can be seen a decrease in the percentage of international claims from 99,43% in 1995 to 91,68% in 1998, reaching finally to 68,45% in 2012. Opposite local currency claims on local residents recorded a significant increase from 0,57% in 1995 to 8,32% in 1998 until 31,55% in 2012. Thus claims subsidiaries and local branches of foreign banks increased implanted after 1995 and especially after 1998, to the detriment of international claims, so that gradual, penetration of foreign capital was made more on global way and less on international way.

Table 5. The share of international claims and local currency claims on local residents in the total foreign claims (%)

Romania	1995	1998	2005	2012
Total foreign claims	100	100	100	100
-international claims	99,43	91,68	69,14	68,45
-local currency claims on local residents	0,57	8,32	30,86	31,55

Source: author calculations according to data from Table 4

At the end of 2011, foreign capital aggregate the entire banking system was 79% (Table 6). Foreign banks with the largest shareholding credit institutions in Romania are: Greece (22,9%), Austria (20,8%), and the Netherlands (11,5%), which hold together 55,2% of the share Total credit institutions. Overall, it can be seen that the bulk of foreign capital is held by European banks.

The situation has not changed much in the next period, so that at the end of 2012, Greece (21,2%), still occupy the first investment position, followed by Austria (20,8%) and the Netherlands (11,5%) .

Tabel 6. Foreign Participations in the Share Capital of Credit Institutions in Romania as at 31 December 2011

	lei mill.	%
Greece	4,192.5	22.9
Austria	3,795.8	20.8
The Netherlands	2,102.3	11.5
Italy	899.5	4.9
Hungary	661.2	3.6
Cyprus	653.9	3.6
France	578.5	3.2
EBRD	361.7	2.0
Other	350.6	1.7
Portugal	267.1	1.5
Israel	247.8	1.4
Germany	191.9	1.1
USA	152.2	0.8
Aggregate foreign capital of the banking system	14,455.0	79.0
Total capital of credit institutions	18,289.4	100.0

Source: Banca Națională a României

The phenomenon of globalization makes its presence felt more strongly in the banking system more than in any other field of activity. Thus the last two decades in the domestic banking system were numerous changes to both its hierarchy and its structure as a result of the restructuring process and especially privatization and Romania's accession to the European Union. Gradual, penetration of foreign capital was made more on global way and less on international way.

4. Conclusions

Over the past two decades, banking activity has experienced an unprecedented trend towards globalization. The countries analyzed the presence of international bank capital is at a high level. Banks in the rest of Europe have expanded on markets in former communist countries during large-scale privatization programs of domestic banks by the state, and the results were significant. If in 1995 the number of foreign banks in total banks' share was below 30%, predominantly local banks, in 2000 exceeded 60% of foreign banks and domestic banks were below the percentage of 40%. In this way the assets held by them increased from 10% at the start of the period to over 60% in 2000. During 2009, in countries such as Slovakia and Romania the number of foreign banks exceeded the 80% and in Hungary had a share of 92%. Regarding the share of foreign bank assets in total bank assets in the countries of Central and Eastern Europe, it is noteworthy that in 2009, countries such as Croatia, Estonia, Lithuania, Romania, the Czech Republic and Slovakia recorded a rate of over 80% (in Estonia even reaching 99%) of total bank assets. Restructuring and especially privatization and Romania's accession to the European Union had a major impact on the banking system. There is a expansion of foreign claims from BIS reporting banks since 1995 and continuing their strong amplification in the period 1998-2012, mainly as a result of the wave of privatizations after 1998. The global character of the activity of foreign banks in Romania has become more prominent than the international character.

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