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EFFECTS OF THE ENTRANCE OF FOREIGN CAPITAL IN THE MACEDONIAN BANKING SECTOR

Abstract

Internationalization of the banking sector has had a tremendous impact on financial integration and economical development. It offers banks the possibility to determine and establish their optimum size, to provide economies of scale and range, to diversify their activities and to increase their revenue and profitability.

The purpose of this paper is to determine the effects of the entry of foreign capital in the banking sector in the Republic of Macedonia.

The results of the research show that despite of the large number of conflicting opinions in relation to the benefits from FDI in banking, in the case of the Republic of Macedonia, it can be concluded that in general, the effects were relatively positive and they appeared in the form of increased loans, modernization of the equipment and technology used by the banks, as well as greater availability of services to banks, due to the investments in the opening of new branches and offices in the country. The entrance of foreign banks and groupations in the Macedonian banking sector resulted in higher competition, decreased prices of banking products and services and lower number of banks on the market. The consolidation of the banking industry stimulated strong competition, where competitors are more capable, offer better quality of the bank services and products, as well as new products and services.

Keywords: FDI, foreign capital, commercial banks, Republic of Macedonia, banking

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Introduction

In the past three decades, as a result of the globalization, liberalization and deregulation, the world (and especially the former socialist countries) has faced an increased entry of foreign capital in their financial sectors, especially in the banking sectors as the most profitable and most dominant sectors in the economies of these countries.

The theory suggests that there is a relation between the FDI and the economic growth of the host country. FDI in the banking sector are even more interesting for research, considering the fact that the banking sector is a key part of the financial system and has a tremendous influence on the financial stability of the country.

Crossborder (international) banking not only brings benefits to the host economy, but it actually gives banks opportunity to determine their optimum size, to achieve economies of scale and scope, to diversify their activities and to increase their income. With bank internalization, these benefits are expected to expand in the whole banking sector, leading to better and more efficient banking practices, better integration, greater depth, width and liquidity of markets. When foreign banks invest in transition countries, they bring their expertise and best risk management practices in order to reduce the risk of the acquired banks. They have more experience and more sophisticated financial systems, and thereby, they have much bigger chance and probability to increase the pressure on the local authorities to reform the financial system and make it more efficient.

In the extensive literature regarding this subject, there are many studies analyzing the effects of M&As with foreign banks and the banks' performance and efficiency after the acquisition (Figuera and Nellis 2009). According to Fraser and Zhong, (2009), in the short term, the acquisitions of banks by foreign banks have positive effects on the performances and the profitability of the bank, due to the expected long term positive effects of the transaction and the reaction of the market. Foreign banks that penetrate the transition markets improve the stability and the performance of the acquired banks and thereby strengthen the local financial stability. (Crystal, Dages and Goldberg, 2001). Proponents of FDI in the banking sector claim that the foreign banks can achieve better economies of scale

and higher diversification of risk in comparison with the domestic banks, by introducing new technologies (especially in risk management), better supervision and regulation and higher competition. (Detragiache, Gupta and Tressel, 2006).

This paper analyses the benefits and the negative aspects Macedonian banks have experienced ever since their internalization. It will also give an historical overview of the entrance of foreign capital in the country's banking sector. There are many studies which have examined the effects of the entrance of foreign capital in the banking industry; however, these studies have concentrated on developed markets and transition markets, but there are very few findings regarding the Macedonian banking sector. Our study contributes to the literature by researching how the FDI have influenced the banking sector in the country.

1. HISTORICAL OVERVIEW OF THE ENTRANCE OF FDI IN THE MACEDONIAN BANKING SECTOR

At the time of the monetary independence, there were only 5 banks operating in the Republic of Macedonia. However, as a result of the more liberal regulation to opening banks, in just one year, in 1993, this number climbed to 20 banks. In those first transition years, Macedonia (as well as the other neighboring countries) has introduced a liberal approach to establishing new banks. (Trpeski, 2003) This approach has required a small amount of capital and a quite simple procedure for issuing license. This has resulted in entrance of speculative capital in the banking sector, which easily enters the country but also easily exits it. (Pozzolo, 2009)

At the end of 1998, there were 22 commercial banks, 2 branches of foreign banks and 18 saving houses in the banking sector. What is interesting is the fact that until 31.12.1998, the participation of the foreign capital in the total capital in the Macedonian banks has been 15.5%.

In year 2000, strategic foreign investors entered the banking sector. This is the year with most FDI in the banking sector ever since the independence. Furthermore, 2000 is the year when NLB Group from Slovenia bought the majority shares in Tutunska banka and the NBG from Greece acquired Stopanska banka AD Skopje. Thereby, the participation of the foreign capital in the total capital in the banking sector has risen from 19.3% in 1999 to 40.8%. (NBRM, 2001)

The process of consolidation of the banking sector has been initiated by these acquisitions, and it has continued in the later years, followed by higher and fiercer competition, lower number of banking institutions but growth of the banking system, as well as reforms in the payment system.

In 2007, “Ohridska banka” AD Ohrid has been acquired by “Societè Generale” s.a. Pariz, “Komercijalno investiciona banka” AD Kumanovo by “Milestone” ehf Rejkjavik and “Internacionalna privatna banka” AD Skopje has been acquired by “Alfa Finance Holding” Sofija, after which the bank has been renamed into “Kapital banka” AD Skopje.

In 2008, Invest banka AD Skopje has been acquired by the Austrian Steiermärkische Sparkasse, which led to the creation of Sparkasse Makedonija AD Skopje. Other than this acquisition, Bulgarian CKB AD Sofija has taken over Sileks banka AD Skopje, and renamed it into CKB AD Skopje.

The Global financial crisis that occurred 2008 has inevitably left its mark on the Macedonian economy, thus the banking sector. Even though the effects of the crisis have occurred with a time lag, and were probably not as severe as the economies with developed financial markets, still, it has showed its impact. Even though the Macedonian financial markets are not well-developed, the crisis has had deep impact on the economy and the bank’s performances. What were recognized were slower growth of the financial system of the country, slowing of the process of entry of new foreign capital in the financial institutions as well as slower growth of the assets of the banking sector.

The banking system in Macedonia has remained stable, liquid and well capitalized. While NPLs continued to increase somewhat, they remained more than fully covered by provisions. The Macedonian banks (including subsidiaries of parent banks from the euro zone) are mostly financed by domestic resident deposits, do not depend on external wholesale funding, and have very limited credit exposure to countries or clients from the euro zone.¹

In 2009, more negative effects of the global financial crisis occurred, in the form of aversion to savings (at the side of the deponents) and psychological pressures while making decisions regarding financing clients (at the side of the banks). This has led to smaller financing and

¹ **Hafizi D., Bushi I.**, „Global Crisis Impact in Banking System for Western Balkan Countries“, *Economic Questions, Issues and Problems*, 2014, pp.117

lowering the amounts of loans approved in the economy.

In 2010, the banking activities have improved and have risen, due to the revival of the domestic economy. In 2012, Ziraat banka was acquired by Halk bank AD Skopje, and later in 2014 Postenska banka has been acquired by Eurostandard banka AD Skopje. In May 2016, a Swiss investment fund has taken over the small group bank Alpha banka AD Skopje. The acquisition was 1.2 million euros and the bank has been renamed in Silk Road Bank AD Skopje soon afterwards.

Nowadays, more than two decades after the monetary and country independence, the financial system of the Republic of Macedonia is characterized with very simple market structure, no complex financial groupations or cross-ownership between different sectors. It can be concluded that banks are the only institutions who dictate 'the rules of the game' and actually have a say and influence on the economy. (Fotova, 2011)

In the case of Macedonia, the consolidation of the banking sector has contributed to higher competition between more capable opponents, better quality of the services, cheaper cost of capital, introduction of new products and services and expansion of the financing offer. At the time of the introduction of the Macedonian currency (which was the same period of the basis of the Macedonian banking sector), the banking sector in 1992 was relatively underdeveloped and there were only 5 banks operating in the market.

Table 1: The restructurings in the Macedonian banking sector in the period of 1998-2015

<i>Number of banks in the Republic of Macedonia</i>		
<i>Year</i>	<i>Banks</i>	<i>Additional remarks</i>
1998	22+2	The license of „Aka Banka,, AD Skopje has been withdrawn. Two new institutions appear in the banking markets: MBDP- Macedonian Bank for Development Promotion and an affiliation of "Ziraat Bankasi".
1999	22+1	22 banks + 1 affiliation of a foreign bank

2000	22	Issued license for the International Commercial Bank of the People's Republic of China-Taiwan. Tutunska banka AD Skopje has become a part of the Slovenian NLB Group. Greek NBG has acquired Stopanska banka AD Skopje, whereas Alpha bank AE Athens has acquired Alpha bank AD Skopje.
2001	21	In 2001, NBRM has issued license to Eurosviss banka AD Skopje. Furthermore, NBRM has issued 3 licenses for status changes: merging of Zemjodelska banka AD Skopje to Sileks banka AD Skopje, merging of Pelagoniska banka AD Prilep to Komercijalna banka a.d. Skopje, as well as merging of Teteks banka AD Skopje to Kreditna banka AD Bitola.
2002	21	No changes in the structure.
2003	21	No changes in the structure.
2004	21	No changes in the structure.
2005	20	The license of "Radobank" AD Skopje is withdrawn and the saving house „Maleshevka,, AD Berovo has been acquired by „Invest Banka,, AD Skopje.
2006	19	Merging of „Tetovska Banka,, AD Tetovo and „Teteks-Kreditna Banka,, AD Skopje, thus creating "TTK banka" AD Skopje. The saving house „Makedonska stedilnica,, AD Skopje has been acquired by "Invest Banka,, AD Skopje
2007	18	The license of „Makedonska Banka,, AD Skopje is withdrawn. This year, Ohridska banka AD Skopje has become a part of the Societe Generale Group. Bulgarian Alfa Finance Holding takes over Capital bank AD Skopje.
2008	18	09/2008- Steiermärkische Sparkasse takes over Sparkasse Bank Makedonija AD Skopje (previously Invest banka AD Skopje), and CKB AD Sofija takes over CKB Banka AD Skopje.
2009	18	No changes in the structure.

2010	18	No changes in the structure.
2011	17	In January 2011, "Stater Bank" AD Kumanovo has merged into "Centralna Kooperativna Banka" AD Skopje. Halk Bank AD Skopje has bought the control package in IK Banka AD Skopje.
2012	16	Merging of „Ziraat Banka" AD Skopje and „Halk Bank,, AD Skopje.
2013	16	No changes in the structure.
2014	15	Postenska Banka AD Skopje has merged with Euro-standard Banka AD Skopje at 01.07.2014.
2015	15	No changes in the structure.
2016	15	In May 2016, Alpha Bank AD Skopje (a part of the Alpha bank AE Athens, Greece) has been acquired by a Swiss investment fund for 1.2 million EUR and has been renamed as Silk Road Bank AD Skopje.

Source: Fotova Čiković K., Fotov R., “Consolidation of the banking sector in Macedonia: effects and benefits”, International Conference on Economic Recovery in the Post Crisis Period, May 29-30 2015, Skopje

With these restructures and takeovers in the sector, the number of banks in the group of banks has changed (see table 2).

Table 2: Participation of foreign capital in the total banking capital in Macedonia (in %) from 1998-2015

Participation of foreign capital in the total banking capital in Macedonia (in %)	
1998	15,5
1999	19,3
2000	40,8
2001	40,1
2002	44,4

2003	48,6
2004	47,5
2005	52,5
2006	56,1
2007	69,1
2008	74,3
2009	68,6
2010	72,9
2011	74,7
2012	75,2
2013	75,2
2014	76,2
2015	74,8

Source: NBRM, Annual reports, 1998-2015

The participation of the foreign capital in 1998 has been 15.5%, and in 2015 it has reached an impressive participation of 74.8%. The biggest influx has been noted in year 2000, when the capitalization of Tutunska banka AD Skopje (Nova Ljubljanska Banka Ljubljana and LHB Frankfurt), Kreditna banka AD Skopje (Alpha Credit bank, Greece) and Stopanska banka AD Skopje (National bank of Greece, EBRD, IFC) occurred.

2. BENEFITS OF THE FDI FOR THE MACEDONIAN BANKS

Even though there are many opposite opinions regarding the benefits and effects of the internalization of the banks, in the case of Macedonia the effects were relatively positive. The consolidation of the banking sector has brought many foreign players in the market- around 71.8% of the shareholders are from the EU. (NBRM, 2014)

Due to this fact, it was inevitable for banks to modernize their marketing approaches as well as the technology they use and diversify the banking products and services. (Fotova Čiković, Fotov, 2015)

Table 3: Technology offered by the Macedonian banks

List of Banks	Technologies offered
Komercijalna Banka A.D. Skopje	Internet Bank, SMS Banking (for individuals and legal entities), m-Banka mobile application
Stopanska Banka A.D. Skopje	i-Bank (for individuals) with digital certificate, m-banking mobile application, e-banking (for legal entities), Phone banking
NLB Tutunska Banka A.D. Skopje	NLB klik using token, NLB Mobipay, NLB SMS Notification, NLB Proklik using token, NLB mKlik-mobile application
Halk Bank A.D. Skopje	PayPass contactless cards, SMS notification, mobile banking, E-Banking
Sparkasse Banka A.D. Skopje	IndividualNet, NidividualNet Plus, IndividualNet Plus- sToken
TTK Banka a.d. Skopje	e Banking; Web, e-mail & SMS notification
Ohridska Banka A.D.	<u>OBSGN@t- E-Banking</u>
Uni Banka A.D. Skopje	E- UNIBank (virtual bank)
Eurostandard Banka A.D. Skopje	E- Banking
Centralna Kooperativna Banka A.D. Skopje	E-Banking by using digital certificate for electronic signature
Alpha Banka A.D. Skopje	Alpha Web Banking (Web banking after the acquisition in 2016)
Stopanska Banka A.D. Bitola	E-Banking
Capital Bank A.D. Skopje	Microsoft CAPICOM- E- Banking
ProCredit Banka A.D. Skopje¹	E-Banking, Phone Banking and SMS Notifications

Source: Fotova Čiković K., Fotov R., “Consolidation of the banking sector in Macedonia: effects and benefits”, International Conference on Economic Recovery in the Post Crisis Period, May 29-30 2015, Skopje

As shown in table 3, we have conducted a research on the technologies currently used in Macedonian commercial banks. What we found out is that there is a positive correlation between the advanced technologies used by the banks (i.e. the more options for clients, the more software options and channels used) and their affiliation in a foreign group of banks, who are interested in the market and therefore investing in it. This review would actually confirm the fact that the Macedonian banks have benefited the merging by implementing new and modern technologies. This table shows the channels and types of software/technologies used by the banks. For instance, it can be concluded that NLB Tutunska Banka AD Skopje, Stopanska banka AD Skopje, Sparkasse Banka AD Skopje, Komercijalna banka AD Skopje and Halk Bank AD Skopje have been investing heavily in new channels and adjusting their offers to the market's needs. This only led us to the ultimate conclusion: the banks belonging to the group of big and middle-sized banks in the Republic of Macedonia can afford to offer modern technologies, software and gadgets to their customers, following the trends in the industry and the region, but that is not the case with the banks belonging to the group of small banks. (Fotova Čiković, Fotov, 2015)

This way, the Macedonian banks have gained access to innovation in banking, new assortment of banking products and services, different distribution channels, therefore higher growth of profits and customer base, by being a part of a bigger group of banks and having access to bigger funds, know-how and already applied software solutions. The consolidation of the banking industry has also stimulated fierce competition with more capable opponents, better quality of the services, lower cost of capital, and expansion of the financing offer.

3. NEGATIVE ASPECTS OF THE INTERNATIONALIZATION OF MACEDONIAN BANKS

There are many studies that show the positive effects of FDI and claim that FDI are crucial for the economical development, such as Crystal, Dages and Goldberg, 2001; Detragiache, Gupta and Tressel, 2006; Moreno and Villar, 2006. Then again, there are more and more studies in the literature that relate the negative consequences in the economy with the FDI. For instance, Claessens, Demirgüç-Kunt and Huizinga claim that the higher the participation of foreign investors, the lower the profitability

and the margins for the domestic banks. Vogel and Winkler (2011) point out that the foreign banks could transfer the financial disaster from their own countries into the host country.

The potentially negative effects of the internationalization of the banking sector are the possible reputational risks that acquired banks face. That way, the banks could lose their market power and position as well as their clientele.

In Macedonia, the reputational risk has increased in the case of NLB Tutunska banka, Stopanska banka and Alpha banka AD Skopje, the three of them in foreign ownership of banks coming from Slovenia and Greece, at the time when Slovenian and Greek economies weren't at ease.

In the case of NLB Tutunska banka AD Skopje, the bank has experienced reputation and security issues on more occasions. The first impact was in September 2012, when the media had published that the NLB d.d. Ljubljana's management has been under investigation, and the fact that the mother company is facing major losses due to the NPLs. The second impact the bank experienced was a larger-scale impact which had made deponents insecure and questioning the bank's ability to operate.

In June 2011, due to the crisis in the Greek economy, the Governor of the National Bank of the Republic of Macedonia had felt it was necessary to reassure the deponents in Stopanska banka AD Skopje (member of the Greek NBG Group) and Alpha bank AD Skopje (member of the Greek Alpha bank AE, Athens) that despite the crisis in Greece, the liquidity and capital adequacy of the two banks are high and there is no need to worry.²

Even though these turbulences did not leave long-term implications on the stability of these banks, they were actually a threat to the stability and efficiency of the whole banking system.

In order to determine whether this reputational risk has had an impact on these banks, we have analyzed the ratios of ROA and ROE of these three analyzed banks. The results (see table 4) show that the reputational risk they faced had no impact on their profitability, at least in the case of the big banks.

Namely, in the case of NLB Tutunska banka and Stopanska banka AD Skopje, the ratios ROA and ROE are constantly growing, even after

² **Fotova Čiković K., Fotov R.**, "Consolidation of the banking sector in Macedonia: effects and benefits", International Conference on Economic Recovery in the Post Crisis Period, May 29-30 2015, Skopje

2011/2012, the period when their mother banks were facing crisis.

Unlike them, Alpha banka AD Skopje (which enters the small banks' group) has experienced dramatic decrease in ROA and ROE in 2012, as a result of the net loss registered in the same year. Analyzing deeper in the financial statements of Alpha banka, we have found that in 2012 the bank has experienced decrease in interest income of 15% compared to 2011, while the interest expense stayed relatively unchanged. However, this loss is a result of the loan impairment charges in 2012. Thereby, it can be concluded that the Macedonian banks owned by Slovenian and Greek banks did not experience a decline in their profitability as a result of the crisis their mother banks faced.

Table 4: ROA and ROE of analyzed Macedonian banks in the period of 2009-2014

ROA						
	<i>2009</i>	<i>2010</i>	<i>2011</i>	<i>2012</i>	<i>2013</i>	<i>2014</i>
NLB Tutunska banka	0,82	1,1	1,06	0,85	1,06	1,23
Alpha banka	-5,09	-8,14	-1,53	-8,34	-1,45	0,28
Stopanska banka AD Skopje	1,2	1,2	0,94	1,1	1,3	2,1

ROE						
	<i>2009</i>	<i>2010</i>	<i>2011</i>	<i>2012</i>	<i>2013</i>	<i>2014</i>
NLB Tutunska banka	11,12	11,3	15,5	10,1	11,2	12,04
Alpha banka	-43,09	-75,73	-13,31	-96,96	-18,14	3,71
Stopanska banka AD Skopje	9,8	10,2	7,5	8,6	9,8	14,8

Source: Financial statements of the banks, 2009-2014

The negative aspects and the issues banks are facing as a result of the reputation of the mother-bank should not be underestimated and it is useful to create teams within the banks to actively manage these risks at all times.

However, according to Moura and Forte (2010), the effects of FDI on the economic growth depend on the existing internal conditions in the host country (the economic, political, social, cultural etc.). Thereby, the authorities in the host country play a crucial role in the creation of the conditions which will enable maximization of the benefits and minimization of the negative effects and their consequences.

Conclusion

The subject of this paper is to determine some of effects of the entrance of foreign capital in the banking sector as well as to give another perspective of some of the aspects that the banking sector has faced through internalization.

The results from the research show that in spite of the many different opinions regarding the benefits of FDI in banking, they actually brought more obvious benefits, in the form of increased financing, higher financial intermediation in the banking sector, modernization of the equipment and the technology used, as well as greater availability of banks' products and services (due to the expansion of the branch network of the acquired Macedonian banks).

The internationalized banks got an access to innovation in banking technologies, new assortment of banking products and services, various sales channels and higher growth of profits and clientele. They could not have possibly achieved this without having access to greater funds, know-how and already proven software solutions and market products and services.

However, it is worthwhile mentioning that there were some negative effects that some banks had to face, like the reputational risks Slovenian and Greek-owned banks in Macedonia had to experience. That has only temporarily "shaded" the benefits Macedonian banks experienced by the FDI in banking.

No doubt, the foreign capital in the banking sector in Macedonia has helped restore the clients trust in the banking and financial system. They have also established modern techniques for risk management and improved corporate management, and thereby contribute to a more stable banking system. It should come as no surprise that all the acquired banks by foreign investors and groups have led to a changed and improved IT system shortly after the acquisitions.

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