EXTENDED ABSTRACT

Title: The impact of foreign banks on eastern European banking in the new era of uncertainty

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Subject area: *(please, indicate the subject area which corresponds to the paper)*

Efficiency; Banking sector; Visegrád Group

Abstract: *(minimum1500 words)*

The globalization of the World financial system is the most dynamic component of the overall process of modernity and is playing a growing role in global development. The banking system is a guarantor of financial security of states, its dependence on world markets makes it more sensitive to global financial crises. As the economic growth of the state depends on the efficiency of the international banking sector, the scientific assessment of the processes of expansion of foreign capital of the national market of banking services in the context of globalization is becoming increasingly important.

The objective of this article is twofold: on the one hand, it attempts to analyze whether foreign commercial banks have been more or less active in Eastern European markets after the financial crisis of 2008-2012. On the other hand, this research tries to show whether this greater or lesser external activity has translated into a more or less efficient behavior within the banking industry in Eastern Europe.

To do this, first of all, we have delimited the set of countries under analysis to the Visegrád Group. These four Central and Eastern European countries (Czech Republic, Hungary, Poland and Slovakia) share a cultural and political alliance that aims to develop advanced economic cooperation as well as enhance their integration with the EU. All four states are also members of the European Union (EU) and the North Atlantic Treaty Organization (NATO). Next, we have determined the period of time between the recovery from the global financial crisis and the beginning of the next social and economic crisis that caused the coronavirus disease throughout the world. Finally, we have identified the origin of the global ultimate owners of these banks, in order to shed light on how foreign banks are influencing domestic banks in these markets, and more specifically, which foreign nationalities are leading these markets.

With regard to the unlucky war situation between Ukraine and Russia, the human and economic damage is of huge magnitude and its effects for the Central and Eastern European countries economy are uncertain due to their close ties with Russia. In the short term it is likely that the invasion and connected events will create upward pressure on inflation and will be passed on to banking and economic activity. In this sense, it would be necessary for the Central and Eastern European countries banking sectors to reorganize before the complexity of the current economic situation.

There are also other causes of the current economic situation. The persistence of the economic effects of Covid-19 prevented for a completed economic recovery before the Russian invasion. The increase in fuel prices linked to the war between Russia and Ukraine has contributed negatively to the region economy in many ways.

The banking system covers all banking institutions (including commercial banks) and the standards that define their interconnections and relations with the environment. Commercial banks, diversified in terms of their functions and tasks, as well as operational activities, form the banking sector, which, acting on the basis of various legal acts, as well as the tradition and culture of banking, determines the model of financial intermediation in a given country. The issue of the evolution of the banking sector is not only interesting in itself, but above all it is influential in the context of the relationship between the development of the financial system, including the banking system, and economic growth and development. Basically, it is argued in theory and empirical research that financial development can stimulate or inhibit economic growth.

However, the views that the above categories are not causally related to each other can be found much less frequently. If the activities of banks lead to a better allocation of resources in the economy, the banking sector is stable and economically effective; it favors social and economic development. Banks increase the welfare of consumers (allowing them to distribute consumption more favorably over time) and contribute to the growth of production and efficiency in the entire economy by supplying economic processes with capital. On the other hand, the negative role of banks in the context of the recent financial and economic crises is emphasized. Banks, in a good economic situation and the influx of significant money resources, developed financial engineering and used aggressive sales techniques. They offered access to cheap consumer loans and complex financial products, not paying sufficient attention to the creditworthiness of customers and their low knowledge of financial news. The evolution of the banking sector is in the socio-economic interest, but the experiences of the recent financial crisis prove that this extension should be assessed not only in terms of the size of the banking sector and the scope of its activities, but also in terms of effectiveness in performing the financial intermediation function and financial stability.

The study of the development of banking systems of Central and East European countries attracts the attention of a large number of scientists. In particular, T. Derkach and etc. (2021), E. Horvatova (2018), S. Kozak (2021) and F. Cikovic (2021) explored the role of banking industry in economic growth and also assessed the financial stability of different categories of banks in the Central Eastern region of Europe in the face of the ongoing negative effects of the recent crises. S. Kozak (2021), R. Istaiteyeh (2022) and M. Doğan (2013) also considered in detail which category of commercial banks (foreign or domestic) are more efficient and on what economic factors it depends.

F.J. Saez-Fernandez and etc. (2021) conducted a study of the Brazilian banking system and revealed how the risks associated with banking activities affect the efficiency of different categories of banks (including commercial and investment, foreign and domestic, public and private banks). An extensive sample of 124 different Brazilian banks was used for the study. The study showed that in the period 2014-2019, investment banks were more efficient and risk-tolerant than commercial banks, due, among other things, to more efficient management. The same was true for foreign banks, whose activities turned out to be more efficient than domestic banks.

S. Kozak (2021) studied the influence of banking market concentration on the efficiency of banks in the countries of South-Eastern Europe. For the study, a selection of 150 banks from 20 EU and non-EU countries. In fact, banks with foreign capital in developing countries are considered to be more manageable and technologically advanced than domestically controlled banks, and thus achieve higher profit efficiency and stronger competitiveness. But more recently, domestic banks in SEE countries are catching up with foreign banks in terms of good management practices or technology in the 2000s and therefore become no less competitive than foreign banks. The results for the entire sample and for domestic and foreign banks show that concentration has a positive and non-linear effect on bank performance in both EU and non-EU countries.

R. Istaiteyeh (2022) conducted a detailed comparative analysis of the financial performance of foreign and domestic banks, and also identified which macroeconomic variables (special for banks) most affect their profitability (in the period 2001-2015). 16 Jordanian banks (10 domestic and 6 foreign) were included in the analysis. The results of the study showed that credit risk, financing costs, management efficiency and GDP are important factors in the profitability of Jordanian local banks. The high profitability of domestic banks is associated with lower funding costs, lower credit risk and management efficiency. It was also concluded that bank size, liquidity and GDP are important determinants of the profitability of foreign banks. Domestic banks should upgrade their human capital, invest more in advanced technology, capture economies of scale through mergers, improve cost management and monitor credit risk.

M. Doğan (2013) also considered in detail which category of commercial banks (foreign or domestic) are more efficient. In his study, he used the financial performance of 10 foreign and 10 domestic banks in the period 2005-2011. The study showed that foreign banks were more efficient in terms of return on assets, but in terms of return on equity, domestic banks were already more efficient. Indicators of management efficiency and more efficient use of non-performing loans were also higher for home banks. However, the indicator of the efficiency of doing business (cost-to-income ratio) turned out to be higher for foreign banks.

The methodology that we use in this work is based on the metafrontier approach suggested by O'Donnell et al. (2008) and later extended by Sáez-Fernández et al. (2012) with DEA (Charnes et al., 1978). In order to implement the methodology, we first observe a sample of banks, foreign and domestic commercial banks, which make use of a set of inputs to produce a set of good outputs. The technology used by the banking industry to transform inputs into outputs is called metatechnology. Next, we consider that banks in the sample can be split into two groups according to their ownership origin (Group frontiers): foreign or domestic. The significant question here is that belonging to a particular group might guide banks from take advantage the whole of technologically-feasible production plans contained in the metatechnology. Finally, the calculation of a metatechnology ratio would measure how close the technological frontier of one particular group is to the metafrontier, which characterizes the physical, social and economic environment of one particular group.

With our results we will try to show whether foreign banks have gained or lost presence in Eastern European banking markets, both from the point of view of the number of entities and the weight that total assets represent within these industries. In this sense, we will try to answer the question: Which areas of the world (America, Europe, Asia, Russia) have behaved better in this region of Eastern Europe?

Keywords: *(maximum 6 words)*
JEL codes: G21, H21, O18