ORBIS
Revista Científica Electrónica de Ciencias Humanas / Scientific e-journal of Human Sciences /
PPX200502ZU1935 / ISSN 1856-1594 / By Fundación Unamuno /
Anton Lisin (2020)
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www.revistaorbis.org.ve / núm 45 (año 15) 53-63

VALUATION OF THE ACTIVITIES OF FOREIGN BANKS IN THE RUSSIAN BANKING SECTOR

VALORACIÓN DE LAS ACTIVIDADES EN LOS BANCOS EXTRANJEROS DEL SISTEMA BANCARIO RUSO



Anton Lisin

RESUMEN
El objetivo del documento es analizar las actividades de los bancos extranjeros en el sector bancario de Rusia. Se utilizaron métodos analíticos basados en estadísticas bancarias de revisión documental de 1991 a 2017. Los resultados indicaron que, el volumen de capital de los bancos extranjeros en la Federación de Rusia está aumentando. También se determinó que las instituciones financieras extranjeras pueden tener resultados contradictorios. Ayudan a redistribuir recursos en el mercado financiero y, en consecuencia, están asociados con altos niveles de riesgo.
Palabras clave: bancos extranjeros, sector financiero bancario, mercados financieros, recursos financieros.

ABSTRACT
The objective of the article is to analyze the activities of foreign banks in the Russian banking sector. Analytical methods based on documentary review bank statistics from 1991 to 2017 were used. The results indicated that the volume of capital of foreign banks in the Russian Federation is increasing. It was also determined that foreign financial institutions may have conflicting results. They help to redistribute resources in the financial market and, consequently, they are associated with high levels of risk.
Keywords: foreign banks, banking financial sector, financial markets, financial resources.

Fecha de recepción: enero 2020
Fecha de aprobación: febrero 2020

DOI:https://doi.org/10.5281/zenodo.8118333

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INTRODUCTION

The presence of foreign capital in the Russian banking sector is a direct result of integration with international financial markets. The country's modern banking system is developing qualitatively new conditions for increasing competition from foreign credit organizations and transnational banking institutions. Therefore, it is necessary to study the effect of the expansion of foreign banks onto the banking system of the Russian Federation.

Russian laws determine a credit organization to be foreign if it is considered a bank in the country in which it is registered. The existence of foreign banks today is a phenomenon associated and linked with the deepening of globalization of the world economy. Therefore, sooner or later, each country must solve the problem of the role and function of foreign banks in the national market and economy. This problem, in turn, forces the host country to evaluate and regulate the activities of foreign banks that the interests of the country itself and its citizens are not violated, in particular this applies to developing countries or countries with economies in transition.

The following research paper examines the conditions in which foreign banks operate in Russia and analyzes the possible threats and prospects accompanied by developing foreign credit organizations' activities. The highlighted problems also deserve more attention due to today's political climate, which is characterized by tense relationships between some of the world's most influential countries

LITERATURE REVIEW

Historical experience demonstrates that the active expansion of foreign banking capital in the economy of the host country leads to mixed results, which are manifested both at the microeconomic level (specific commercial banks) and at the macroeconomic level (of the entire banking system of the country). It has both positive and negative character (Manevich, 2017; Tatuev, Shash & Borodin, 2014; Karas & Vernikov, 2016).

Researchers have found that the introduction of foreign banks into the financial system of the Russian Federation can be divided into three main stages:

Stage 1 (from 1993 to 1999) - foreign banks gain presence in the Russian financial market. This stage was characterized by the appearance of the first foreign banks, which had been wary of operations with Russian clients, but gained a positive outlook (Singer, 2007).

Stage 2 (from 2000 to 2008) – positioning of foreign banks in the Russian banking market and devising strategic plans of development. In the aftermath of the 1998 crisis, the public and many Russian companies began to consider subsidiary foreign banks as stable credit institutions that were trustworthy. And

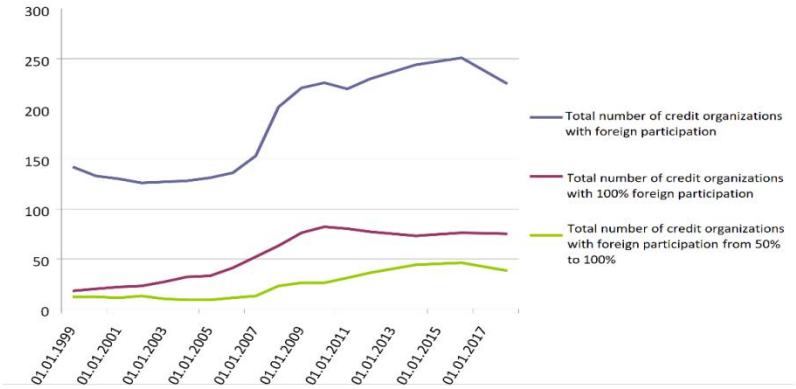
so people began to transfer their accounts to these foreign banks. This led to the restoration of the positions of non-resident banks and an increase in their share in the Russian banking sector (Speranskaya 2009; Schoors 2003).

Stage 3 (from 2009 to the present) - reducing profitability and increasing competition in the market. Foreign banks began to actively compete in the Russian market, while expanding their business line (Morozko, Morozko & Didenko, 2018a; Morozko, Morozko & Didenko, 2018b).

Many of those, who have researched this topic, noted that there is a certain cyclical nature associated with the development of foreign banks in the Russian economy. There is an increase in the activity of foreign banks during a period of economic growth, and their reduction during crisis events as the interests of foreign investors are directly related to the investment climate, institutional conditions and the development of the economy as a whole (Morozko, Morozko & Didenko, 2018c; Morozko, Morozko & Didenko, 2018d). This behavior from foreign banks is characteristic to any country.

A number of stages of growth and stagnation of the economy should be distinguished when analyzing the dynamics of the penetration of banks with foreign capital into the national banking system (Figure 1).

Figure 1. Dynamics of the number of credit organizations with foreign participation in the authorized capital in Russia in 1999-2017.



Source: Bank of Russia (2019)

Initially the presence of foreign banking capital was minimal during the development of the Russian banking system, which distinguished it from other countries with economies in transition (Eastern Europe and Latin America). The quota for the participation of non-residents in the capital of the Russian banking system is 12%. For a short period of time in 1993 this quota could not be claimed due to the conditions that Russia faced at that point in time (Rock & Solodkov, 2001; Sprenger, 2010).

This was due to the policy of the Bank of Russia aimed at regulating the banking system. This position was actively supported by Russian banks and banking associations, operating in terms of a "national security" and their own non-competitiveness. The investment climate and the peculiarities of the way business was done did not favor the expansion of foreign banking capital either. As the Bank of Russia first and foremost prioritized adapting the economy to the changes that had been occurring as a result of the transition to the Russian Federation (Mikhaylov & Sokolinskaya, 2019; Mikhaylov et al, 2020).

METHODOLOGY

In order to evaluate the conditions in which foreign banks operate in the Russian Federation, the technique of document review was applied, Hurtado (2012) "document review is a process that covers the location, collection, selection, revision, analysis, extraction and registration of information contained in documents". (p.851). In this sense, a category matrix was applied as a data collection tool, to organize the information obtained through the review and analysis of documents, using verified sources, predominantly works, studies and statistics published by the Bank of Russia and Thomson Reuters, it was possible to determine some key factors and stages of development of the activities of foreign credit organizations in the country. Data were collected for the period 1991-2017 as in the latest research (Johansen, 1991; Yumashev and Mikhaylov, 2020).

Foreign banks would actively expand in the country in the periods from 1991 to 1998, from 2003 to 2009, and from 2011 to 2017. The first period (1991-1998) was associated with the liberalization of the entry of foreign capital into the Russian banking system. Foreign banks, implementing the strategy of "following the client" sought to help their traditional customers in the development of the Russian market. By the end of this period, 145 commercial banks with foreign participation were present in Russia (10 of them with 100% participation).

The second period (2003-2009) was characterized by a general increase in the investment attractiveness of Russia against the background of stabilization of the economic and political situation. Foreign banks have reoriented themselves towards servicing and actively attracting Russian customers, both corporate and private. The number of foreign credit organizations has increased significantly to 221 (80 of which with 100% participation). Penetration was carried out mainly through the absorption of existing Russian commercial banks through the works in the oil market.

The third period (2011-2017) was associated with Russia's entry into the WTO, which further accelerated the process of non-residents entering the national banking system, creating additional favorable conditions for foreign capital (Table 1).

Table 1. Factors of foreign banks analysis for 2 and 3 stage.

Stage	Factors
Stage 2 (from 1999 to 2009)	Key rate of the Bank of Russia exceeds the inflation rate.
	Change of cash in circulation corresponds to the needs of the economy.
	Change in the balances of the extended government's accounts with the Bank of Russia is stable.
	Bank of Russia's Regulation of mandatory reserves of credit institutions ensures immunity to external shocks.
	Balance of the Bank of Russia's liquidity operations is increasing.
	Largest Russian funds are less likely than others to revise the portfolio structure.
	Level of commissions for Fund management is reduced.
Stage 3 (from 2009 to the present)	Seasonal structure of mutual Fund flows is consistent with the individual psychology of the investor: they become more risk-averse in the fall.
	Investors benefit from the concept of social responsibility when annual returns are positive.
	Transformation of the financial sector contributes to new forms of capital raising and significant cost savings arising from standard transactions.

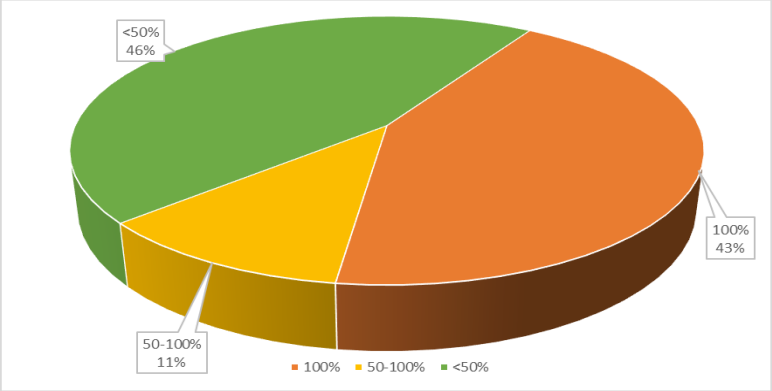
Source: Bank of Russia (2019)

The reduction of credit institutions with foreign participation occurred during periods of fluctuations and crises that influenced the banking system of Russia (1995, 1998, 2004, 2009, and 2014). In addition to the general reduction in the number of banks with foreign participation, the merging and acquisitional processes of banks, as well as the alienation of 100% of the shares in favor of residents, were actively taking place. However, the availability of the use of funds from parent credit organizations was associated with non-resident-controlled credit institutions turning out to be, as in any economy, more resistant to local crisis phenomena than domestic banks (Altman, 1968; Altman & Saunders, 1997).

RESULTS

Despite the cyclical penetration of foreign banks into the Russian market, the number of banks with foreign capital is still relative stability. So, as of January 1, 2019, 141 banks with non-residents are licensed by the Central Bank of Russia. Of these, 61 - 100% - foreign capital, 17 – 50-100% - foreign capital (Figure 2).

Figure 2. The structure of credit institutions with foreign participation by the share of non-residents in the authorized capital in Russia as of 01.01.2019.

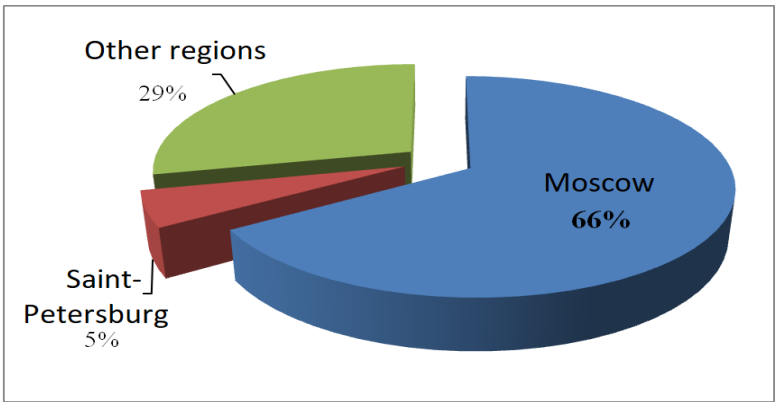


Source: Bank of Russia (2019)

At the same time, 113 credit organizations with the participation of non-residents, or 80.4% of their total number, operate in the form of a joint-stock company, of which 29 credit organizations changed their name in accordance with the requirements of the Civil Code of the Russian Federation, including 14 - joint-stock companies and 15 - public joint-stock companies.

Territorial credit organizations with foreign participation are represented in 37 regions of the Russian Federation, but they are especially dense in the Central Federal District, and in particular in Moscow, in which 93 of 141 banks with non-residents are registered (Figure 3).

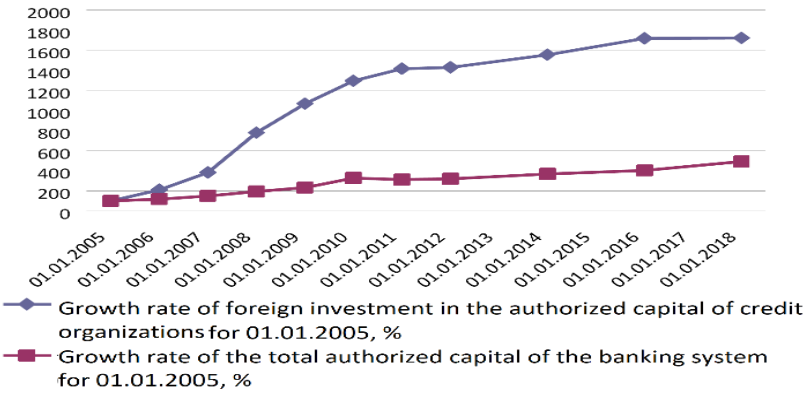
Figure 3. Territorial diversification of credit organizations with foreign capital in Russia as of 01.01.2019.



Source: Bank of Russia (2019)

The quantitative component of foreign banks is not the only element that is necessary to analyze for the complete picture of the participation of credit organization in the banking system of Russia. We must also observe their direct participation in the formation of authorized capital of credit organizations. The data past 10 years presented in Figures 3 and 4 shows a significant increase of the investments of banks with foreign capital into the banking system of Russia and their share in the total authorized capital.

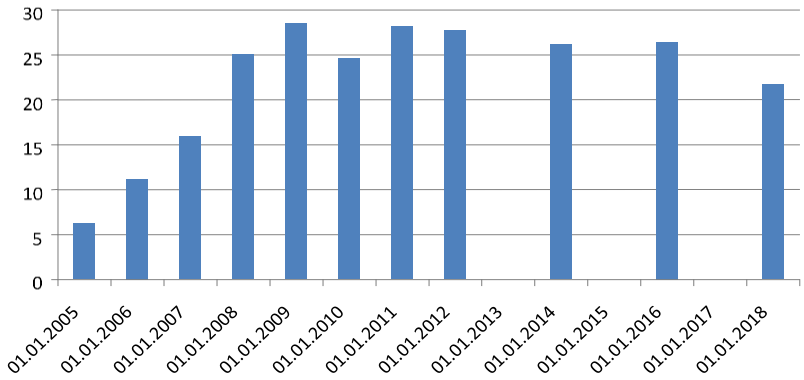
Figure 4. Dynamics of growth of foreign investment in the authorized capital of credit organizations and the total capital of the banking system, %.



Source: Bank of Russia (2019)

Most foreign investments in the banking system of Russia came from Western Europe and the United States. However, the trend of countries' investments in the past few years has shifted towards the Asian states. In 2013, the Bank of Russia registered China Construction Bank (registered capital of 0.05 [billion USD]), and in September 2014 - "Chaynaselhozbank" (share capital of 0.02 [billion. USD]), the "Daughter" Agricultural Bank of China, which is the third biggest bank in the magazine "The Banker".

Figure 5. Dynamics of the share of non-residents in the total authorized capital of the banking system, %.



Source: Bank of Russia (2019)
The active development of foreign banks in the Russian market is associated with some of their exclusive benefits. The key unique and specific traits of foreign banks include:

- Foreign banks take part in large-scale projects and attract large clients to serve them due to their large size of capital and the possibility of rapid increase.

- Cheap financial resources attracted from international markets, attracted for long periods, make it possible to provide loans on incredibly favorable terms.
- Foreign banks apply a global approach to their activities and use their international experience when assessing risks.
- The parent structures of foreign banks can allow their “daughters” to work in the new country for several years without profit, and sometimes at a loss, for a consistent analysis of the market situation and the elaboration of future bank policies (Mamonov & Vernikov, 2017).
- The presence of innovative banking technologies allows foreign banks to strengthen their positions to offer their customers a wide range of products supplementing the offers of national credit organizations (such as investment banking), as well as provide qualified assistance to their clients when they enter the international financial markets not only by providing loans, but also advising on various issues related procedures (Klinova & Sidorova, 2014).
- Subsidiaries use modern management and marketing methods that have already been researched in detail in other emerging markets, also strive and motivate to provide their customers with an exceptional and outstanding service based on the corporate values of the parent company crisis (Abramov, Radygin & Chernova, 2017).

In these matters, the activities of foreign banks bring many positive effects for the development of the banking sector and the Russian economy as a whole.

The inflow of foreign capital promotes a culture of corporate governance in credit organizations, provides access to the Russian banking market for modern technologies of new financial products, develops competition and improves modern banking, which leads to higher quality and lower prices for services, as well as increased openness and investment appeal of Russia (Fungáčová, Solanko & Weill, 2010).

Despite these advantages, the wide expansion of foreign financial institutions is inextricably linked with increased interdependence of national economies of various countries and sensitivity to global financial crises, as it would in the economy of any country. The growth of foreign investors in the banking market causes increased volatility of capital, which in turn can lead to destabilization of the corporate loan market and the stock market.

CONCLUSION

The article has investigated the possibilities and status of foreign banks in the Russian Federation. The role of non-resident major banks was examined through the analysis of their statistics. Using this information from the Bank of Russia, the results of the active participation of foreign banks in the Russian market were evaluated. Thus, credit organizations controlled by non-residents are active participants in the Russian banking sector today. They are of great importance in the redistribution of resources in the financial market of Russia and thus carry both prospects and, subsequently, risks to the development of

the Russian banking system (Alwaelya, Yousif & Mikhaylov, 2020; Dayong et al., 2020).

Only the existence of a stable, mature and independent national banking system helps to overcome the risks associated with the expansion of foreign capital and is the key to economic growth and development of any country and, in the context of this research paper, Russia. In this regard, the government and the Central Bank of the Russian Federation have been increasing the competitiveness of domestic credit organizations and improving discipline in the banking sector. Regulation and supervision over this market, especially the role and participation of non-residents is also incredibly important (Karagiannis, 2014).

This paper is significant contribution in literature about foreign banks activity in Russian banking system. The finding about high level of independence of the national banking system is significant for future researches in banking and finance. The Central Bank of the Russian Federation has created a level playing field for national and foreign banks, making foreign investment capital a real and valuable possibility. Russian banks, in turn, adopt the best of the experience of foreign banks, gradually becoming transnational, initially winning the trust of Russian enterprises as their main customers, and then, with their growth, clients beyond the Russian border (Alkassim, 2005; Belousova & Kozyr, 2016).

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