

# **THE BEYOND BOUNDARIES BANKING INTEGRATION. FOREIGN BANKS' PART IN THE CONSOLIDATION OF THE BANKING SYSTEMS**

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*The paper approaches the merchant banks activity in the context in which the financial markets integration degree and the political boundaries have become less and less relevant to the banking institutions due to the globalization, to the banks international opening, to the financial and technological innovations, to the deregulation and the process of European integration.*

*Key words: foreign banks, banking integration, banking performances, financial stability*

## **1.Introduction in the foreign banks activity**

The banking activity often acquired an international dimension which outlined itself for the first time in the Renaissance period, moment in which appeared the first banks that unrolled an international activity, such as the Doctor's Banks from Florence. The process continued in time, so that the industrialized world undergoes nowadays the third wave of banking internationalization. The first wave includes the international movement of the capitals, which took place from 1870 until the beginning of the First World War, a period in which the English colonial banks owned the supremacy. The second wave took place, as temporal setting, between the two World Wars, being underlined by the distinctive feature of the Anglo-American financial rivalry and by the New York's supremacy over London, a tendency stopped by the economical crisis from 1929.

At the beginning of the 60's of the last century, the American big commercial banks initiated the third wave of banking internationalization. As their activity was constrained by a very rigid national regulation from the ending of the 19'th century, strengthened after the stock crash on the Wall Street, in 1929 which hindered their inside activities development and diversification, the American banks established themselves in London City, which enjoyed a free banking legislation. This situation led to the creation of a real offshore market, of the Eurodollars, situated in London. The big American banks could therefore help the development of the American multinationals, by assuring the capitals necessary to the investment financing in Europe. The example was rapidly copied by their homologues from the British colonies, by the Japanese, French, who yet did not manage to prejudice the American banks reputation. At the beginning of the 80's of the last century, the banking internationalization process acquired a new shape due to the indebtedness crisis of the developing countries and to the deflation which caused the decrease of the nominal interest rate and which allowed the resuming of the bond markets' activity to the prejudice of the international banking mediation. This process brings forward in the international stage foreground the American investment banks, the English merchant banks and the Japanese title banks, and constrains the commercial banks to modify their international strategy. With this respect, the commercial banks strengthen their position on the capitals international market, developing activities specific to the merchant banks. This last phase of the internationalization is inseparable to the development of the title transactions and led to the American, European and Japanese banks consolidation. Japan became in the 80's of the last century the first world creditor and Tokyo the second financial world market, its stock capitalization outrunning the one of New York (during 1989-1990).

We add the fact that, if in the 19'th century, the multinational banks branches were highly concentrated in the developing countries, starting with 1960, the multinational banks proved to be much more interested in the already developed countries. Moreover, another characteristic of the contemporary multinational banks is the tendency of giving up to the retail banking activity, existing nowadays the widely spread conviction

that it would not be best for a foreign bank to follow up this kind of strategy, excepting the purchasing of a local bank.

In the last years, the financial markets integration degree increased and the political boundaries became less and less relevant for the financial institutions, due both to the rapid increase of the foreign investments in this field in the most part of the world countries, and to the changes occurred in the juridical field, which eased the access on various markets. In this context, the globalization, the markets international opening, the financial and technological innovations, the deregulation and the process of European integration modified in a decisive way the competitive field of the banking institutions, making them up-to-date their development strategies.

## **2. Considerations regarding the transnational banking activity**

The extension of the bank's activity overseas by opening units in other countries than the origin one, has the final purpose of developing the activity and increasing the incomes, but the reasons that can made them act in this sense differ from case to case, as such:

- in order to follow and sustain its big exporting clients (this was the main reason for the developing the activity of the British banks like Overseas Banks and Clearing Banks), the biggest part of the banks activity being related to the national enterprises activity overseas;
- the intention of the banks specialized in certain operations to practise their banking activity in other countries, where these operations are not, or are insufficiently practiced (it is the case of the American merchant banks activity, of the international acceptance activity of the British banks or of the French financial institutions which developed their leasing activities in Italy and Spain);
- the extension in the insufficiently developed countries from the banking point of view (the case of the new industrialized countries or of the countries from Central and East Europe);
- the extension in the countries with an intense financial activity, hoping to easily obtain the profits (the establishment of banks in London at the end of the 19<sup>th</sup> century, in New York at the end of the World War II or in Tokyo almost 20 years ago).

Among the factors that contributed to the transnational activity development distinguish the following:

- - the activity's restrictive regulation in the residence country - in this case the bank develops, on the foreign countries, activities that are forbidden on the national market. An example is given by the way in which both the Japanese banks and the American banks got involved in the European capital markets, activities which they couldn't develop on the national markets because of a more restrictive legislation. This factor tends to stimulate the creation of foreign branches in the financial centres where the legislative background is permissive;
- the risk diversification – a strategical factor is represented by the banking activities diversification through the multinational operations. Therefore, the banks can reduce the risks by diversifying the disposals and directing them towards fields which are not correlated one to another, but, in case of a recession, all the markets are affected. By applying the diversification principle at the international level, the banks try to reduce the impact of a recession felt on a country's market, by extending the activity on other markets, hoping that these will not confront themselves with recession periods at the same time with the national market. Yet, the experience of the 1990 years shows that the diversification done by the banks from the developed countries by entering on the markets of the developing countries or on the markets in development, can sometimes lead to the increase of the exposing risk, especially by the increased ratio of the non-performant credits;
- the expansion of the international commerce – in many cases the banks try to provide global services to the clients who develop international operations, by opening branches in the countries in which the big industrial companies extended their activity. The main reason for this attitude is that the value of the transactions unrolled with this type of clients will become significant. The bank will want to maintain its position, therefore, will not want that an operation unrolled overseas by its clients be taken over by another bank, especially if it is a branch of a competing bank;

- the capital export – the activity's extension overseas is caused by the valorization of the capital's offer on the internal market. The banks from the developed countries, such as the United States and Japan, extended their activity overseas as a means of identifying some new investment opportunities. This objective is best accomplished by a continuous presence at the international level, so that the opportunities actively be identified and not just passively accepted in the moment in which they appear;
- the jurisdictional area – the risks afferent to the external credits considerably reduce by creating a new branch in the residence countries of the credit beneficiaries. For example, regarding the credit guarantess, the afferent documents and the creation procedure can be implemented in conformity with the local legislation, a fact that will not raise problems in their carrying out process ( if the debtor does not respect his payment obligations). Thus, a branch's costs overseas can be justified by a high level of the redeeming rate, the presence on a foreign country contributing to the improvement of the credit portofolio quality. The reason would be not only the possibility of a better evaluation of the credit request, but also the discouragement of the fraudulent tendencies due to the possibility of easily taking legal proceedings of this kind of documents;
- the participation on the market – many banks extend their activities at the international level in order to participate on different markets that can represent: either sources of additional funds, modalities for the valorization of the available funds, or a combination of the two. In the first case, a bank from a developing country can establish a branch in a developed country in order to absorb funds for investments in the residence country. In the second case, a bank that possesses resources can enter on a flourishing foreign market in order to take advantage of the existent opportunities. Moreover, the banks which have international activity can participate on a foreign market in order to beneficiate of stability and a high degree of liquidities (like the London market of the eurocurrency). In case a bank anticipates the appearance of a future opportunity on a certain market, it will want to be present on that market in advance, thus many banks open branches overseas.

A banking society, willing to extend itself on foreign financial markets by opening banking unities on the other countries' territories, confront itself with a series of „ barriers”, of which the most representatif are the following:

- *the technological barriers*: the establishment of a new banking society implies the alignment to the technologies used by the banks from that country. This aspect is important in the unrollment of the relations with the other banks, by using the existent technologies which refer to: payments, the transfer of the messages of payments made through the existent network in that country, so on. Yet, the technological networks imply high investments, with long term redeeming.
- *the notoriety barriers*: which refer to the resonance that the banking society has or not in the respective banking system;
- *the mobility barriers*: these refer to the bank's capacity of penetrating the territory and getting close to the clients, the extension of the network implying yet important costs and a period of establishment, which represents a barrier for the new created banking societies;
- *the strategical barriers*: refer to the bank's development perspectives depending on the respective market's conditions and on the general climate;

### **3. The functioning of the foreign banks**

A bank's modalities representation and functioning on the international markets can take one of the following shapes:

- *The subsidiaries*: - are those banking units implemented by the „ mother bank” in other countries than the origin one and are characterised by the fact that they have juridical personality;
- *The branches* – operate under the mother-bank responsability (without having a separate juridical statute). In the main, the simplicity of this fact is only illusory, because, due to the

fiscal or even administrative reasons, the operations done in a foreign country have to be recorded separately as if it was all about a distinct society;

- *The representation offices or the „representances”* (known in the United States under the name of Loan Production Offices) – can not unroll transaction activities, being exactly what results from their denomination, that is only a representation centre of the central headquarter in a different country. These collaborate especially with the clients who have businesses in the bank's origin country. The representations' opening procedure is, generally, very simple and does not demand many formalities, often being the prelude of agencies or subsidiaries' opening or of banking acquisitions in the respective country.

In the context the European market opening, a significant number of banks tried to create a beyond boundaries banking network on the European Union territory, this internationalization being followed by an increase of the rivalry and, implicitly, as a response to this one, by a concentration of the banking field.

**In France** they are considered foreign banks, those banks at which foreigners, and particularly the foreign banks, possess the majority of the capital. At the beginning of the year 2000 there existed more than 165 foreign banks, of which 61 hailed from the European Union. Moreover, in the following period, there were registered requests from many foreign institutions, their increasing number in the French banking system getting close to 300. It is observed at the same time a strong presence of the British banks, a relatively recent implantation of the Italian banks (1988) and a weak presence of the German banks.

The development of the foreign banks' activity **in Germany** was tardier and less important than the one in France, due also to the fact that the German banks participate in a great measure at the big enterprises' capital. The foreign banks mostly serve the clients who share their nationality.

The implantation of some foreign banks **in Italy** was, for a quite long period of time, very weak, due to the fact that the opening of some new banks was strictly regulated, and also because these ones were subjected to some administrative constraints imposed to the banks. In 1985, after a regulation, the foreign banks were no longer restricted from buying an Italian bank and, also, the foreign banks could open themselves branches in Italy under the same conditions in which the Italian banks could open units in the respective countries, conditions which regarded the balance sheet total, the organization's solidity, the staff's competence, so on. Subsequently, the number of the foreign banks' subsidiaries increased, especially of those that have France and Germany as origin countries. After 1987, as a result of the Italian banking system deregulation and passing to private possession which stimulated the rivalry, certain foreign banks withdrew their branches (especially the specialised institutions). Moreover, the big Italian banks underwent a decline period also because they centered only on the big enterprises and did not direct on the retail market too, considering the fact that these big enterprises began borrowing more and more from the financial market.

**Great Britain** had always been the most open one to the implantation of foreign banks, which tried to open subsidiaries in this country, especially in London, which knew a permanent prosperity even in the periods in which the country confronted itself with economical difficulties. More, they were also attracted by the stimulating policy of England's Central Bank, regarding the authorization and regulation of the banks' functioning. Later, the central bank's control hardened, but the already present foreign banks did not withdraw their subsidiaries. The first foreign bank that opened itself a subsidiary in England was a French one (The Discount National House/Bank from Paris), in 1865, so that, subsequently, the foreign banks number increase, due to both the existent facilities on the British market and to some favourable circumstances such as the stock exchange deregulation which stimulated mostly the foreign merchant banks. It can also be underlined the fact that, although the number of the banks authorized as British banks decreased in the last decade at approximately 200, the number of the authorized banks increased, due to the more and more powerful presence of the foreign banks, this fact reflecting the role of Great Britain and London as an international financial-banking system.

The foreign banks access **in Spain** was accomplished much later. At the beginning, because the economical development was insufficient for attracting the foreign banks, there existed only three subsidiaries implanted in Spain: Credit Lyonnais (from 1875); The London and South American Bank (from 1916) and Societe Generale (from 1919). A very restrictive legislation (from 1940) was practically blocking all the implantations of new foreign banks, a single derogation of these regulations being given in 1914, for the Banca Nazionale de Lavoro. Later, the restrictions regarding the extension of foreign banks in Spain diminished, so that, in 1987, a decree stipulate that the regulations be identical, both for the national banks

and for the foreign ones, a fact that led to the setting up of many new foreign banks, both through opening subsidiaries and by taking over in share at the Spanish national banks. The foreign banks centered mainly on offering long term loans to the enterprises, due to the Spanish banks' lack of interest for this type of clients, and also on operations specific to the merchant banks, which were practically unknown to the Spanish banking field.

Although the *United States of America* banking legislation had always been restrictive towards the foreign banks implantations, these couldn't resist to the need of being present in one of the most prosperous world countries and whose financial centre had become as important as the one in London. Still, the foreign banks, in comparison with the American banks, benefited of some competitive advantages. Thus, the foreign banks, although subjected to a double regulation (the ones of the respective state and the ones of the federal government) like the American banks, unlike these ones, they could open subsidiaries in various states, having at the same time the possibility to unroll activities specific both to the investment banks and to the commercial banks, without being subjected to the obligatory supplies system. Due to this fact, there has been voted, at the initiative of the Supply Federal System, an international banking document, by which the foreign banks were obliged to set up the obligatory supplies, to draw deposits superior to the amount of 100.000 USD and to comply with the same limitations in the banking activity as the American banks did. The implantation of the foreign banks in the United States continued to increase, so that, in 1981, by setting up „The international banking facilities”, the foreign banks be receiving some advantages: they were no longer subjected to the obligatory supplies system and the interest were not taxable. Yet, they had to comply with some regulations, like the drawing of deposits bigger than 100.000 USD and on term longer than two days. The only way by which the successful American banks could develop their activities, in the context in which the internal market had reached saturation point, was by opening subsidiaries overseas. This process was considerably sustained by the consolidation of the American dollar's role as a world-wide supply currency. All these facts contributed to the creation of a strong tradition in the multinational banking activity of the big American banks.

*The Japanese banking system* is very dynamic, the banks extending themselves a lot, especially on the east coast, mainly towards the Asian clients. On the international level, these hold 50% of the activity of all foreign banks, the banks from continental Europe holding only 30% and the British banks 10%. Japan was very restrictive when it came to implanting foreign banks, their authorization being made in a very small number. Because the national clients were devoted enough to the Japanese banks, the process implanting of the foreign banks was more difficult. Later, the Japanese government, as well as other countries too, ( the beginning of the 20th century in England, in the years 1970-1980 in the United States), had to prove a wider opening regarding the international banking activity, which led to the increasing of the foreign banks' number in Japan. The most numerous foreign banks in Japan are the ones of American, British and French origin.

At present, the cultural and social differences between the countries make that the strategy based on acquisitions in which the local brand is kept, be, at least for a long period of time, the most appropriate one.

#### **4. The foreign banks' role in the Central and East Europe banking system consolidation**

The banking scenery in Central Europe changed considerably, as long as the governments continued to encourage the foreign banks to acquire important institutions. In the last years, this tendency strengthened by: taking over the Ceska Sporitelna bank, from the Czeck Republic, by the Erste Bank from Austria; by taking over the biggest retail bank from Czech, Investicni a Postovi Banka by the Nomura International, and Citibank bought Bank Handlowy from Polland; on the other side, the Ceskslovensk Obchodni Banka and the Bank Pekao from Polland were sold to the KBC Belgian bank, respective Unicredito; the Polish bank Zachodni was sold to Allied Irish Bank, as for Hungarian Foreign Trade Bank, this one had already been under foreign property for many years.

More than in any other region on the map, the foreign banks considerably took over the control over the banking system in Central and East Europe and, taking into consideration the massive takings over and thepassings to private possession that are on the point of being finalized, it is doubtless that the foreign banks govern this field.

According to the declarations of the Reconstruction and Development Bank, the share of the total banking actives owned by the banks with a majority foreign share holding was in 1994 of only 5% but in 1998

increased to 32% and due to the big number of transactions in the following years, especially on the biggest banking markets from Poland, Czech Republic, Hungary and Romania, the experts believe that this share increased to 53% in the year 2000, so that in the following years there be registered shares of approximately 57%. The increase does not stop here, the Romanian example being self-evident – over 90% of the banking system is governed by the foreign banks.

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