

DEVELOPMENT OF SERVICES ACTIVITIES IN CENTRAL AND EASTERN EUROPEAN COUNTRIES

Development of Bank Services in Bulgaria – from Transition to Sustainability. The Regulatory Perspective

Julia G. Dobreva

*VUZF University, Higher Institute for Insurance and Finance
1 Gusla str., Sofia, Bulgaria*

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Abstract

The aim of this paper is to review from a regulatory perspective the major trends in the development of the bank services sector in Bulgaria. The analysis covers the period from the first years of transition until present and stresses the importance of regulatory issues. The objective of the research is to prove that bank regulation was a key factor in sustaining the financial sector both during the transition from a centrally planned into the market economy and also today, when it is being confronted with the global financial crisis. The research methodology includes an overview of the research work on financial services development in transition economies and a case study with a retrospective analysis on the development of bank services in Bulgaria in the 90s as well as on current credit portfolio tendencies and their future prospects. The paper highlights the role of the Central Bank, the International Monetary Fund (IMF), the World Bank, and the European Bank for Reconstruction and Development (EBRD) and their contribution to the progress made in the financial services market in Bulgaria. The research results underline the importance of a solid regulatory base for sustaining the development of the financial market in the country and for sound financial management of the bank services sector in the region.

Keywords: sustainability, bank services, transition economies, regulation, financial crisis, development.

Introduction

The development of the financial services market in Central and Eastern Europe encompasses a broad scope of economic, political and social processes, which have shaped the regional profile since the beginning of the 90s. The problem has been subject to various studies with political (Fidrmuc, 2000; Grabbe, 2002; Fidrmuc, 2003; Schneider, 2004; Alam et al., 2009), economic (Svejnar,

1996; Peng, 2001; Dikova and Witteloostuijn, 2007), and socio-political (Deacon and Michelle, 1997; Pollert, 2003; Murray, 2005; Pascal, 2005) perspectives. However, the interrelation of all these factors has not been the sole contributor to the development of the banking sector throughout the transition and post-transition periods.

In this paper, the sound regulatory base is considered as the key element that supported the process of reviving the bank services sector after the first years of transition from a centrally planned to the market economy. Furthermore, the analysis suggests that it also played a vital role in the last five years by protecting the financial system from a severe crisis observed in the region (e.g., Greece). Although the system is currently stable, the risks for the banks in Bulgaria remain, which is evident from the downsizing of credit portfolios since 2008. The latest research (Wehinger, 2012) postulates that restoring investors' confidence may require new approaches to redesigning the incentives, rules, and regulations for the financial sector. As deleveraging in the sector goes on, it is not clear where this process stops and how far some temporary regulatory forbearance can help restore lending that has substantially declined. Other investigations (Rubini and Mihm, 2010; Wyman, 2011) signal the rising threat of the shadow banks, where assets grew rapidly in 2010 and 2011. According to the Cisco Survey Report (Farah et al., 2010) the current banking environment of low interest rates combined with high charge-offs and delinquencies is making it difficult for banks to generate revenue in traditional ways. The survey shows that the rise of younger generations will have a profound impact on retail banking, providing the next opportunity for revenue growth.

The aim of this paper is to review, applying a regulatory perspective, the major trends in the development of the bank services sector in Bulgaria. The analysis covers the period from the first years of transition until present and stresses the importance of regulatory issues. The objective of the research is to prove that bank regulation served a key factor in sustaining the financial

sector both during the transition from a centrally planned into the market economy and also today, when it is being confronted with the global financial crisis. The paper explores the development of the bank sector in the country in detail in order to illustrate the sequence of events that gradually shaped the system, starting from the appropriation of the old financial services model and its gradual reconstruction. The explicit formulation of these mainly political and regulatory flaws contributes to a better understanding of the conditions which formed the foundation of the system.

The analysis further explores the present development of the sector, after the accession of Bulgaria to the EU in 2007 and since the beginning of the global financial crisis. It provides an observation on major trends in the bank services sector, the tendencies of credit portfolios, and the perspectives for future development. The research methodology includes an overview of the research work on financial services development in transition economies and a case study with a retrospective analysis on the development of bank services in Bulgaria in the 90s as well as on current credit portfolio tendencies and their future prospects. The challenge to sustain the development of the financial market in the country is suggested, based on solid regulations and opportunities for sound financial management that might arise in the current regional and global environment.

The paper is structured in the following way: firstly, it provides a retrospective overview of the transition period in Bulgaria and reveals a reflection of the bank services sector, then it describes the processes which gradually led to economic downturns and inflation and, finally, it reveals the introduction of the currency board. The analysis comments on the role of the IMF, the World Bank, and the European Bank for Reconstruction and Development (EBRD), and their contribution to the progress made in the financial services market. In its second part, the paper identifies current tendencies of the bank services sector in the country under the conditions of financial and economic crisis and the prospects for its development. The final part of the paper summarizes the results from observations.

Financial market in Bulgaria during the transition period, from 1989 to 1999

A centrally planned Bulgarian economy has a history of approximately 44 years, starting from 1945 and going on until the fall of the communist government in the autumn of 1989. This is a period characterized by monopolization of the banking sector through the existence of only one state bank, the Bulgarian National Bank (BNB) with its network of branches. Until 1981 there were only two other banks in Bulgaria: the State Savings Bank, specifically operating for servicing the deposits of the entire population, and the Foreign Trade Bank, which was responsible for all international financial transactions. The application of this model was simple and easy to control by the communist party authorities.

Yonkova et al. (1999) observe that the first reforms in the Bulgarian banking sector commenced in 1981 when a small bank (called Mineralbank) was established to

provide credits only for newly set SMEs. Later on, in 1989 seven new banks were founded, which were meant to provide credits to various newly established businesses in the country. The system was entirely functioning to provide financial resource in the dawn of private production. This significantly eased the overall reform in the bank services sector. Immediately after the reforms, in early 1990, a well-constructed modern system was already functioning, with one Central Bank and several other commercial banks, built from the previous branches of the BNB. In the beginning of 1990, BNB licensed 61 banks and by the end of the year their number reached 70. Such reorganization that used an already functioning system and personnel was definitely time-saving, using a strong and reliable capital base with appropriated non-risky assets and liabilities.

Structure of the financial market

During the first years of transition, Bulgarian financial market consisted of basically three groups: state-owned banks, small and medium sized commercial banks, and private banks.

State-owned banks. During the period 1994–1995, eight out of nine large banks with assets for more than 30 bln leva were state-owned and specialized in financing bigger industrial branches which were also managed by the state at that time. By the end of 1995, these 9 banks held approximately 75 % of all financial assets in the system¹. Thus, in the early 90s the state played a commanding role in the bank services sector, not significantly different from the role it had in the late communist period. Hence, transition was still vague and cautious, going through an outward reform but keeping the ruling position of the party authorities behind the scene. The period we marked by a sequence of short-time cabinets, mainly ruled by the Socialist Party which inherited the Bulgarian Communist Party (BKP).

According to the archive data of the BNB, by the end of 1997, the banking services sector in Bulgaria had the following structure: 67 % state-owned banks, 15 % private banks, and 17 % foreign banks. Thus, it is obvious that in the late 90s, which is the phasing out of the officially recognized transition period, the Bulgarian banking services system was still dominated by state-owned banks. In effect, it was not considered as a disadvantage, primarily due to the fact that such a control function obliged the state to guarantee the solvency of state-owned banks to ensure a normal functioning of the system. However, this was also a sign that the potential for liquidity problems for each of the state-owned banks could become a source of systemic risk.

Small and medium sized commercial banks. Most of small and medium commercial banks were created out of former BNB branches. By the end of 1995, their assets were estimated to be below 30 bln leva and they held approximately 25 % from the total assets in the bank services sector.

Private banks. The establishment of private commercial banks began in early 1991 and took up a

¹ BNB official site: www.bnb.bg

period of approximately two years. In the beginning, a licensing regime for commercial banks was very liberal and the requirements for a start-up capital were significantly low, thus facilitating a free entry in the provision of financial services. Another trait of the period was that there were no legally binding requirements to prove the origin of the funds used as a start-up capital, thus, many of the newly established private banks commenced operating with borrowed capital, which originated from unidentifiable sources. In essence, private banks in the beginning of the transition period had one major goal – to provide credits, backed up by overestimated market value of their collaterals, to the shareholders or persons and businesses closely related to them. The scheme allowed for money to be siphoned through the refinancing of the BNB and the capital of the former State Savings Bank.

Nevertheless, the private banking sector expansion in Bulgaria had two major impacts on the banking services sector in the transition period:

Firstly, a growing number of private banks gradually provided for the rise in competitiveness on the financial market with regard to the provision of financial services, albeit the quality of the services was not substantially improved, compared to the one functioning during the time of the centrally planned economy. Due to low barriers to entry, the number of private banks grew up from 2 in 1990 to 26 by the end of 1995.

Yet, a negative effect was a dramatically increased number of loans which gradually started to become non-serviced as a result of being provided to shareholders or persons closely related to them. In 1995 the banking sector was intensely decapitalized as 19 banks reported negative financial results at the end of the year (excluding capital adequacy), amounting to 12 % of the country GDP. Therefore, in 1996 private bank assets in relation to total bank sector assets decreased to 9 % due to the loss of public confidence in private banks. The officially recognized bank decapitalization and non-observance of provision requirements indicated that the capital of the banks could not back up creditors' claims if private banks continued to report and accumulate losses due to non-serviced loans.

Meanwhile, in the late 1996, the number of foreign banks grew up substantially as the state actively encouraged the activity of foreign banks as a possible way to secure the liquidity of the bank services system.

Bank consolidation

In 1991, the number of state-owned banks were 70 (Table 1), primarily small ones with the capital of up to 10 million leva (approximately 5 million euro). An average amount of loans was up to 250 million leva (approximately 125 million euro). This was the time when the BNB began preparations to consolidate the bank services sector in order to prevent it from further fragmentation. In 1992 the Bank Consolidation Company was established with a capital amounting to 933 million leva (approximately 465 million euro). It was set up as a joint-stock company and its main function was to transfer the share of the state in the capital of the commercial banks. Also, it had to consolidate commercial banks with more than 50 % state-owned shares and to assist the privatization of certain banks. The process commenced with the consolidation of 22 banks into one bank – the United Bulgarian Bank. In 1995, the number of state-owned banks decreased from 70 (set up in 1991) to 11 (Dobrinsky, 1994).

As an outcome of an agreement with the IMF and the World Bank, by the end of the second quarter of 1997, the first deal of privatization was finalized and, as a result, 35 % of banks' shares were acquired by the European Bank for Reconstruction and Development (EBRD) and 30 % were acquired by the American company Oppenheimer & Co. The remaining 35 % of the shares were held by the biggest bank at the time, Bulbank (currently UniCredit Bank, owned by the Italian UniCredit Group).

Banking crisis and bank services sector development in 1996-1997

In 1996, Bulgaria entered into an economic and financial crisis which seemed impossible to resolve for many years to come. As deficits multiplied, being transferred from firms to banks through bad debts and eventually to the government budget through bailouts or monetization, in April 1996 the Bulgarian currency started falling and finally collapsed in February 1997. The year 1996 showed almost six-fold depreciation, with the currency dropping from some 70 Bulgarian leva per US dollar in January to almost 500 Bulgarian leva per dollar by the year's end.

Table 1

Bulgarian Banking Sector Structure, 1990 – 1996

Banks	1990	1991	1992	1993	1994	1995	1996
Total banks, end of year	70	78	59	41	45	47	35
Of which Foreign banks	0	0	0	1	3	5	7
Licensed during the year	61	8	2	7	10	4	2
Of which Foreign banks	0	0	0	1	2	1	2
Consolidated banks	0	0	22	29	9	3	0

Note. From Development of the Banking Sector in Bulgaria, Part One, by Yonkova, Aleksandrova and Bogdanov, 1999, in *The Banking Sector in the Conditions of Currency Board*, Sofia, Institute for Market Economy.

Moreover, at the beginning of 1997 the depreciation accelerated further, reaching unprecedented levels of about 3000 leva per dollar in February 1997, while foreign exchange reserves dried out (Andronova, 2001).

The commercial bank crisis which commenced in the beginning of 1996 and for a year swept through the entire sector, was primarily due to the lack of sound regulative base and practices (Yonkova et al., 1999). The first signals were sent out in 1993 when the net loss of the bank services sector amounted to 5 billion leva (approximately 2.5 billion euro), growing up to 7 billion leva (approximately 3,5 billion euro) in 1994 and reaching 30 billion leva (approximately 15 billion euro) in 1995.

In 1996, when the crisis was officially recognized, the net loss amounted to 100 billion leva (approximately 50 billion euro).

Among the main factors which BNB reports as major causes for the crisis there are a weakened private sector, poor bank management, oversupply of money on the financial market, concentration of credit risk, and a negative structure of credit portfolios, combined with an increasing number of non-performing loans. In effect, all of these factors led to the decapitalization of the bank system and the loss of confidence in it. Various governments tried to 'fix things' in the sector without actually undertaking a policy reform process to lay regulatory and institutional foundations that the banking industry needed for its independent intermediation of financial resources (Andronova, 2001).

However, the circumstances for this crisis in the Bulgarian bank service sector were present back in the early phase of the transition period, when in 1990 the banking system appeared to be fragmented due to a large number of small state-owned banks. All of them inherited a substantial amount of non-performing credits which were provided to the state enterprises during the period of a centrally planned economy. A catalyzing factor was also a rather slow process of bank consolidation and the non-performing loans granted after the beginning on the transition period in 1990.

Approximately 50 % of the loans provided by state-owned banks in the period prior to the bank consolidation were reported to be uncollectible. This was largely due to the influence of the government on the lending policy of the banks. Credits were provided to enterprises which were considered to be of strategic importance for the country but consequently turned out to be dysfunctional due to the use of outdated production technology and the lack of competitive markets for the products. In addition, a major drop in industrial output due to structural reforms carried with it the inability of the borrowers (state-owned enterprises) to meet their obligations to banks (Bristow, 1996). Companies were gradually accumulating losses which remained unobserved by the state and a proper use of the financial resource provided in the form of credits was also entirely out of governmental scrutiny. Thus, it is generally believed that a substantial amount of these credits was redirected by the top-management of the enterprises or by people closely related to them. Some small banks were set up for the sole purpose of providing credits from the deposits and also through refinancing from

the BNB and redirecting money to newly established companies that had no intention to repay the loans. As a result, in the beginning of 1996, nearly 41 % of all credits provided by both private and state-owned banks were reported to be irrecoverable.

A list of credit millionaires was published by the BNB, containing individuals and firms to which large credits had been given. Credit millionaires were individuals and companies related to banks, big state-owned enterprises, or organized private economic groups with extended political connections such as Multigroup, Orion, Euroenergy and others. Among the 'leading' bad debtors were firms owned by these private banks. Most often cited were the cases of Agrobusiness Bank, International Bank for Investment and Development, Elit Bank, and Mollov Bank. Banks themselves were in another group of 'credit millionaires'. Credits up to billions of leva were extended to private banks to provide some liquidity on their balance sheets (Andronova, 2001). Further on, difficulties in managing loans came from uncertainty and corruption on every level of the economy. The privileged access to credits harmed financial discipline and the development of new private businesses (World Development Report, 1996, p. 99).

Another major reason for the deterioration of the bank credit portfolio was the lack of an effective legal framework, regulating the process of collecting credits from bad debtors and realizing the collaterals. There were also no procedures for legal proceedings against state-owned enterprises which were declared bankrupt and/or insolvent. By the end of 1995, only four banks reported profit and the rest were officially recognized as decapitalized. The financial status of the banks led to a loss of confidence in the system among depositors and the result was a hectic withdrawal of deposits from banks. This was commonly referred to by the Bulgarian population as 'jar banking' due to the fact that money was literally kept in jars at home.

For a twelve-month period (from May 1995 to April 1996) eighteen banks were closed and put under special supervision by the BNB, out of which 14 were put under conservation. In May 1996, with the amendment to the Banking Law, a legal procedure for bank bankruptcy was introduced for the first time since the beginning of the transition period. Also, by mid-1998 the BNB issued Regulation Ordinance 8 on capital adequacy and the minimum requirement for bank founding capital, amounting to 10 billion leva (approximately 5 billion euro), and this was considered as a significant problem for many of the small banks which did not possess foreign capital. All banks in Bulgaria are now required to have capital adequacy ratio of not less than 6 % for first level capital and not less than 12 % total capital adequacy.

Since the end of 1997, the financial status of commercial banks has significantly improved as a result of depreciation of the Bulgarian lev and a brief hyperinflation which allowed banks to restructure their portfolios. Only after the first three months from the introduction of the currency board, they significantly improved their capital adequacy and their liquidity.

Following a recommendation of the International Monetary Fund (IMF), the Currency Board arrangement was introduced in July 1, 1997. The BNB was prohibited to refinance commercial banks or to set deposits in them under no other circumstances than a systematic risk for the banking sector. The IMF provided more than 1 billion USD in support of the board to basically distance the government from control of the monetary policy in the country and to terminate hyperinflation. The Bulgarian currency was fixed to the DMark, the volume of currency circulation was linked to the hard currency reserves, and the currency board undertook the monetary policy management (Andronova, 2001).

However, overall, until the late 90s the average profitability of banks' portfolios was considerably below the interest rate levels as a part of their assets (bad loans) did not generate income. As a consequence, the majority of banks became very conservative in their crediting policy, because there was no substantial improvement in the business environment and the impairment costs due to non-performing loans were rather high. In addition, as a measure to prevent limitless crediting of shareholders and related companies, the Bank Act stipulated that there should be no provision of loans exceeding 25 % of a bank's own capital.

Interest rates have significantly fallen since the beginning of 1997, reaching only 5 % annual base interest rate. The BNB reports every week the base interest rate on the basis of the average yield of government securities with 3 months maturity. Meanwhile, the inflation rate has remained high and therefore the real interest rates are negative, which is a hindrance for keeping a good level of deposits in the country. For that purpose, many companies continue to maintain savings deposits abroad through registering offshore companies.

The Currency Board

Specifically, the Bulgarian currency board attained the functions typical for a central bank in imposing minimum reserve requirements on commercial banks, and in operating as a lender of last resort. Also, an Issue Department was created within the BNB to manage the excess coverage of the currency board arrangement and

extend it to commercial banks only in the case of severe liquidity problems (Miller, 1999). The law postulated a maximum constraint on the possibilities of refinancing the bank services system with the funds at the Issue Department. There is one more deviation of the Bulgarian currency board from more conservative board arrangements. The government has a deposit at the Issue Department which can be used only for financing the budget deficit or negative differences in net financing by the BNB. These two possibilities give way to the government to cover its deficit. However, Andronova (2001) notes that considering the fact that the revenues from the privatization of state-owned enterprises would be exacerbated soon, the government has no other source of revenue to rely upon but the growth of the real economy. Using the Issue Department deposits for covering budget deficits may question financial discipline that the board implies and again create conditions for moral hazard. It all depends on the credibility of the commitment of politicians to respect the currency board arrangement for stabilizing Bulgaria's economy and for stimulating its growth. Early results signalled improvement, as the currency board arrangement managed to bring both inflation and interest rate levels to single-digit numbers (Table 2). The output growth and exchange rate for the period marked a significant improvement too. In addition, the interest rate spread drastically decreased after the introduction of the board, too, from 86,33 % as of December 1996 to 6,07 % in March 2000. Banks were operating with a very good capital-adequacy ratio, which came up from about 11 % in 1996 to 26,86 % at the end of 1997, about 23 % in 1998, and reached the level of 41,8 % at the end of 1999. However, positive expectations did not fully materialize, considering the level of deposits in the banking system, for example. It is worth pointing out that they had not restored their pre-crisis levels yet. Since the tightening of financial constraints, commercial banks tried to restore financial intermediation, however, with increased cautiousness. The amount of reserves increased two-fold in just a year, from approximately 10 % to 20 % of total assets. At the same time, liquidity in the banking sector was quite high, but credit activities had not been fully restored.

Table 2

Selected Economic and Banking Indicators 1995–1999

Economic indicators	1995	1996	1997	1998	1999
GDP growth	2,9	-10,1	-7,0	3,5	2,4
CPI cumulative (end of year)	33,8	310,4	578,6	1,0	6,2
Nominal Exchange Rate Level (end of year, USD)	67	178	1674	1760	1836
Basic Interest Rate, % (end of year)	38,59	435,03	6,95	5,17	4,54
Short-term credits	51,43	481,11	13,85	13,51	12,41
Time deposits	25,29	211,87	3,04	3,30	3,25
Marginal spread	20,86	86,33	10,49	9,89	8,87
Total Assets, % of GDP	113,6	207,6	43,3	34,8	36,4
Total loans, % of GDP	47,8	115,3	22,2	20,7	22,5
Private Sector Loans, % of GDP	21,6	37,0	13,1	12,8	7,2

Note. From the Bulgarian National Bank official website: BNB Statistics, www.bnb.bg

The ratio of total loans to GDP was at its lowest levels in 1998 (20,7 %), and in addition, loans to the private sector severely declined (Table 2). As a whole, however, the currency board arrangement conveyed a powerful message to commercial banks and the government. The Central Bank stopped pouring funds into politically-driven lending and put an end to the protection of problem borrowers. Insider financing became more difficult and government protection for such credits was terminated. The currency board made all necessary steps to provide a new regulatory and institutional environment for the functioning of the financial sector. Moreover, distancing the government from the micromanagement of the bank services sector restored overall public confidence in the reform policy process.

In essence, the Bulgarian financial market went through significant transformations during the transition period. The major challenge was to develop and implement a reliable regulatory base, primarily concerning the introduction of minimum capital requirements. Its successful implementation gradually revived a collapsing banking system and proved to be a solid ground for its future development.

Current tendencies and perspectives for sustainable development of the Bulgarian bank services sector

The accession of Bulgaria to the EU in 2007 had a major impact on the banking sector – the adoption of the new Basel capital agreement (Basel II), which was meant to facilitate the improvement and assure the stability of financial institutions in the changing global environment. Its methods and techniques aimed at achieving more effective risk management which on its turn had a positive influence on sustaining favorable capital levels. However, with the advancement of the global financial crisis and its aggravation, the financial system worldwide was characterized by extreme levels of leverage, insufficient capital levels, liquid buffers, and bad stimuli for risk taking. The weaknesses in the bank sector were transferred into a real economy, which resulted in a significant narrowing of liquidity and a general decrease in credit resources. If regulatory standards had been stricter and more prudent, the global crisis would not have been of this scale and the public sector would have been in a much more favorable situation (Milanova, 2012). Thus, in 2009 the Basel Committee on bank supervision adopted a new reform programme – Basel III – which was meant to strengthen the resilience of the banking sector as a new philosophy of capital accord. It targeted the improvement of the capital framework in 5 main aspects: strengthening the quality, consistency, and transparency of the capital base; risk coverage improvement; supplementing the risk-based capital requirement with the leverage ratio; reduction of procyclicality of the counter-cyclical buffers; solution to the issues with the system risk and interconnectedness.

The introduction of a global standard for liquidity is presented as another significant aspect in the Basel III package and the banking sector in Bulgaria is currently

preparing itself for the introduction of these more rigid capital requirements. Regardless of its late adoption and the prolonged discussion over it, the regulatory approach established through the adoption of Basel II in 2007 had a tremendous impact and managed to sustain the system through the most critical years of the crisis and preserve it from the financial collapse, observed elsewhere.

When considering the current status of the financial system in Bulgaria, it is important in the first place to observe the regional environment and common trends in the development of the bank services sector in the CEE countries. A recently published report by Deloitte (2012) indicates that the development of post-transition countries in Central and Eastern Europe is a proof that geographical proximity does not necessarily predicate similarities in terms of banking activity. In fact, a distinguishing pattern of the region is that the financial sector is at different stages of development even in bordering countries. For example, while Poland survived the crisis with a substantial growth in GDP of 3,3 % on average for the period 2009–2011, other countries like Bulgaria, Croatia, Hungary, the Czech Republic, Serbia, and Romania faced a recession. It is expected that such a significant discrepancy may impact the future revenues of banks in respective countries.

An overall profitability of banks in the region has decreased by approximately 40 % compared to the 2008 levels. The reason for this significant decline is primarily due to high levels of impairment costs, i.e. a large gap between the assets value and the recoverable amount. In 2011, the volume of writ-offs and other impairment costs equaled 24,4 % of the revenues generated by the banking industry as compared to 12,2 % in 2008.

The level of non-performing loans (NPL) has grown dramatically since 2008 but it is now gradually stabilizing. While in Poland, the Czech Republic, and Slovakia the NPL level is below 7,3 %, for the rest of the region it is well above, reaching 19 % in Serbia. The volume of loans has risen by 9,4 %, however, it is largely due to the 16,2 % growth in region's largest market – Poland, followed by 15,2 % growth in Hungary and 8,7 % in Slovakia.

Another problem is a lack of liquidity. Since 2008, the interbank market has been slowing down and many small banks find no other liquidity sources different from deposits.

In their report Deloitte (2012) highlight that Bulgarian banking assets stood at an impressive 102 % of GDP in 2011, which puts the country among the most advanced in the region. This is, however, a legacy of a rapid expansion that was seen in the years preceding the financial crisis.

Net interest income remains the chief source of revenue and its share of total income grew marginally to 74 % in 2011. However, this is not perceived as a positive trend. Considering a small demand and supply of new loans, an increasing share of interest income shows problems with fee-based business. Fees constitute the second most important source of income, with a 19–21 % share of total income over the period, and represent the largest potential for growth. Fees and commissions generate 24–26 % of total revenues in the most profitable markets in the region (Poland and the Czech Republic).

Financial operations remain the most volatile component and their share fluctuates in the range of 4 %–9 %. Deloitte (2012) further claim that revenues are the most important factor in improving the cost-to-income ratio for the sector.

The report conveys that physical presence is a strong feature of the banks operating in Bulgaria. This is evident not only in terms of the number of bank branches per 100 000 inhabitants (which exceeds 40, putting Bulgaria ahead of any other country in the region) but also in terms of its ATM statistics. The number of ATMs per 100 000 is similar only in Estonia and hence both countries form the most developed networks in the region. This significantly allows Bulgarian banks to be close to the customer, enabling good access to banking services.

Country's two biggest banks, UniCredit and DSK, demonstrate high efficiency as measured by their cost-to-income ratios. When observing the top 10 banks which hold 77 % of the banking assets, it is evident that the structure is very close to the average for the region. This highlights market consolidation as another general feature of the countries from the CEE block, including mergers and acquisitions, especially among smaller players which perform continuous economies of scale. Deloitte's bank-by-bank analysis (2012) shows two clear leaders in Bulgaria, Unicredit and DSK, which respectively hold 15,5 % and 11,1 % of the market. These players dominate the bank services market in all four major categories: loans, deposits, assets, and equity. The next four banks in the top 10 list, UBB, Raiffeisen, First Investment Bank and Postbank EFG, command a market share that is under the 10 % threshold but they are all firmly established with a market share of over 7 %. The rest of the market is fragmented, divided between a group of smaller players with little market strength.

Deloitte (2012) observe that private investors have a significant presence in the market. The top 10 largest banks belong to private capital groups. The majority of market players are either owned by a foreign strategic investor (for example Unicredit, OTP, National Bank of Greece, and Raiffeisen), or are a part of a local capital group. An interesting observation is that the banking services sectors of many CEE countries are dominated by banks with headquarters in Italy, Austria, and France. In Bulgaria, three top 10 banks have Greek owners and one Hungarian (DSK, owned by OTP). Considering that both countries have gone through serious political and economic problems which have affected significantly their local markets, this might seriously impact Bulgarian financial operations.

Another important factor is asset quality. It has deteriorated considerably since the beginning of the crisis. The ratio of overdue loans over 90 days has increased from 11,5 % in 2009 to 19,7 % in 2011, along with an increase in the amount of impairment charges. Nevertheless, the increase in provisions was not as high as in the case of non-performing loans. In Bulgaria, provisions for loans overdue for more than 90 days constitute 44,4 % of the stock, which is the second lowest result in the region.

Ever since the beginning of the transition, deposits have been a primary source of liquidity for Bulgarian banks. They represented 69 % of liabilities in 2011. Yet,

the significance of deposits has increased over recent years, as their effect on the expense of interbank lending has increased by 9 % since 2008 (Deloitte, 2012). A rapid withdrawal of interbank funding forced banks in the region to raise the rates they offered depositors, which resulted in a significantly higher cost of deposits. This is considered a key challenge due to the fact that it seriously impacts banks' profitability.

When observing the development of banks' loan-to-deposit ratios, it is important to note that, prior to 2007 (Bulgaria's accession to the EU), the sector was with high liquidity and parent companies were competing to provide credits. This resulted in an accelerated increase in the amount of loans growing faster than deposits. The financial crisis had a further contribution to the process and the ratio reached its peak in 2008, attaining a record level of 133 %. However, this situation was not sustainable in the long term, and recent data (Deloitte, 2012) shows that banks' dependence on non-deposit funding has experienced a gradual decrease, amounting to 8 % annually from 2009 to 2011.

During the last five years, Bulgarian banks have demonstrated an increasing tendency for being precautionary in their lending activity. This stands out as a major reason for a general slowdown in the crediting activity. The structure of bank assets is gradually changing as an outcome of the risk environment. In the years preceding the crisis, the lending activity was intensified whereas the investments in long-term debt instruments decreased. Since 2009 the tendency has been reversed with an insignificant increase in the crediting activity and a drastic increase in debt assets. The percentage of non-serviced and restructured credits is gradually increasing, though within reasonable margins.

The greatest share in the bank credit portfolio is taken up by business credits which contribute greatly to the investment activity in the country. As a result of numerous restrictions on the crediting activity, imposed by the Bulgarian National Bank, the surveys carried out among local companies show that bank standards have tightened. The Basel II requirements for the management of credit risk and capital adequacy have considerably influenced banks' crediting policies with regard to the amount of collaterals, risk premiums, interest rates, and credit maturity. The measures taken for the limitation of the credit expansion which have relied solely on the minimum reserve requirements, have led to the slowdown of crediting activity. Although these regulatory approaches have significantly reduced bank credit portfolios, the system is currently stable and the risks for the bank system have been temporarily overcome.

According to the data from the BNB Annual report, the total amount of loans in 2008 was gradually declining – up to 31,2 % for the enterprises and up to 33,7 % for the households, due to the decrease in economic activity. In 2009, the tendency in the slowdown of crediting activity was observed both in the demand and supply of credit resources. In order to respond to the changing conditions, Bulgarian banks introduced more restrictive crediting policies.

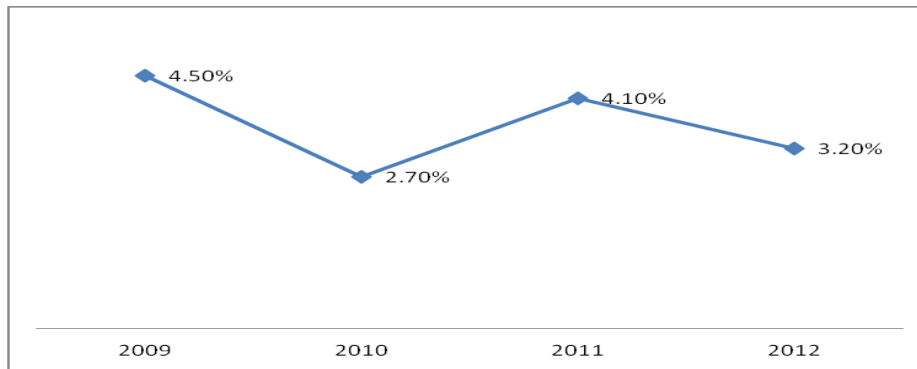


Figure 1. Dynamics of the changes in the credit portfolios of the Bulgarian banks for the period 2009–2012

Nevertheless, there was an annual increase in all the segments of portfolios, estimated at 4,5% (2,3 mln. leva). In 2010, credits increased nominally by 2,7 % (1,4 mln. leva). In 2011, the total amount of the credit portfolio increased by 4,1 % (2,2 mln. leva), mainly due to an increase in the amounts of corporate credits and in 2012 the increase was by 3,2 % (Figure 1).

The result from the slowdown in crediting activity and additional liquidity in the bank system is a cash outflow registered in the financial account of country's payment balance. It was expected that the bank sector would revive in 2011, but the results reported for 2012 demonstrate that the tendency is analogous to the one in 2010.

It is primarily due to the slowdown of investment activity, the decrease in consumer spending, and high commercial liabilities. Banks have become more cautious in the provision of credits also due to tightened national regulatory requirements. As a result, the Bulgarian bank system has enough liquidity and capital buffers in order to overcome additional shocks due to the increase of bad debts. However, in the case of any future aggravations of the crisis in the Euro zone, the Bulgarian economy will be seriously affected due to its dependence on outside factors.

Based on the above data, it can be inferred that the current status of the Bulgarian bank services sector is of a rather stable nature, characterized by high liquidity, moderate profitability, and satisfactory loan-to-deposit ratio. The sector has gone rather smoothly through the crisis and has overcome all the negative tendencies, inherited from the fragmented structure of the transition period. Bank consolidation has been successfully completed and foreign investment had a key contribution to the finalization of the process.

It is predictable that the sustainable development of the banks currently operating in the country will be assured through the strict adherence of current regulatory requirements. Preservation of the currency board is of primary importance as well as a further development of legislative regulations. The perspectives for sustaining the stability of the sector require both strict compliance with the normative basis and minimal political interference. However, the acceleration of the loan provision activity, commensurate with a stabilization of the market value of the collaterals still remain a key challenge. However, this mainly depends on the attainment of high levels of GDP and sustaining of long-term economic growth.

Conclusion

In this paper, the process of transition from a centrally planned to the market economy was subject to a detailed retrospective overview. The analysis has highlighted the major events that reshaped and restructured the bank services sector from the first years of transition until its final stages. The transition period in Bulgaria is marked by intensive political and economic changes which have significantly impacted the bank services sector. Regardless of the immense losses reported by the banks in the late 90s, the sector managed to revive as a result of the introduction of the currency board, the development of reliable legislative requirements, and the well-structured process of bank consolidation.

Furthermore, the paper has provided an observation on the current tendencies of the financial services market in Bulgaria and the problems the system is currently facing. After overcoming the deficiencies identified throughout the whole period of its development, the bank services sector, surviving the hardest years of the financial crisis, demonstrates favorable prospects for sustainable growth. It has been suggested that the sector is highly dependent both on economic growth and solid regulatory base, therefore, these two factors should be the primary concern in the elaboration of relevant governmental and non-governmental policies, requiring joint effort of both the public and the private sector of the economy.

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Julia G. Dobрева

Bankų paslaugų vystymasis Bulgarijoje pereinamuoju laikotarpiu ir po jo: reglamentavimo perspektyva

Santrauka

Centrinės ir Rytų Europos finansinių paslaugų rinkos vystymasis – tai mokslinių tyrimų objektas, analizuojamas politiniais (Fidrmuc, 2000; Grabbe, 2002; Fidrmuc, 2003; Schneider, 2004; Alam et al., 2009), ekonominiais (Svejnar, 1996; Peng, 2001; Dikova, Witteeloostuijn, 2007) ir sociopolitiniais (Deacon, Michelle, 1997; Pollert, 2003; Murray, 2005; Pascal, 2005) požiūriais. Nepaisant to, pasigendama visų šių požiūrių sintezės analizuojant bankų paslaugų sektoriaus vystymąsi pereinamuoju laikotarpiu ir po jo.

Reglamentavimo bazė straipsnyje laikoma vienu iš esminių elementų, palaikiusių bankų sektoriaus paslaugų atgaivinimą pirmaisiais pokyčių metais pereinant iš planinės į rinkos ekonomiką. Tyrimai rodo, kad būtent šis aspektas pastaruosius penkerius metus turėjo didelės įtakos apsaugojant finansinių paslaugų sektorių nuo krizės (pvz., Graikijoje). Nepaisant stabilios padėties Bulgarijos bankų paslaugų sistemoje, įvairius rizikos tebeegzistuoja ir tą atskleidžia nuo 2008 m. vis mažėjančios kreditų portfelių apimtys. Naujaisi moksliniai tyrimai (Wehinger, 2012) rodo, kad investuotojų pasitikėjimo stiprinimui reikia naujo požiūrio, kuris perkonstruotų finansinio sektoriaus taisyklės ir įstatymus. Šio sektoriaus įsiskolinimas didėja ir tampa neaišku, kur šis procesas baigsis ir kaip tam tikri laikini įstatymai sustabdys jo smukimą.

Be to, pabrėžiama (Rubini, Mihm, 2010; Wyman, 2011), kad 2010 ir 2011 metais sparčiai didėjo kai kurių bankų aktyvai ir tai leidžia daryti prielaidą, jog augs šešėlinių bankų grėsmė.

Remiantis Cisco tyrimo ataskaita (Farah et al., 2010) matyti, jog dėl žemo reitingo, didelių atskaitymų bei mokėjimo terminų praleidimų, bankams sunku generuoti pajamas tradiciniais būdais.

Straipsnio tikslas – išanalizuoti esmines bankų paslaugų sektoriaus Bulgarijoje vystymosi kryptis reglamentavimo požiūriu. Analizė atliekama laikotarpiu, kuris apima virsmą iš planinės į rinkos ekonomiką ir tęsiasi iki šių dienų. Analizuojant pabrėžiama aspektų, susijusių su reglamentavimu, svarba. Teigiama, kad būtent reglamentavimas – tai esminis veiksnys, kuris palaiko finansinių paslaugų sektoriaus stabilumą tiek pereinamuoju laikotarpiu, tiek vykstant šiandienos globalioms finansinėms krizėms. Straipsnyje analizuojamas bankų paslaugų sektoriaus šalyje vystymasis identifikuojant pagrindinius įvykius, turėjusius poveikio sistemos formavimuisi, pradedant senuoju ir baigiant laipsniškai perkonstruotu finansinių paslaugų sektoriaus modeliu. Visų šių įvykių išryškėjimas leidžia atskleisti ir geriau suprasti sąlygas, kurios formavo sistemos vystymosi pagrindą. Be to, straipsnyje pateikiama ir sektoriaus vystymosi analizė, kuri apima laikotarpį nuo Bulgarijos įstojimo į Europos Sąjungą (2007) iki globalios finansinės krizės. Joje atskleidžiamos pagrindinės vystymosi kryptys, kreditų portfelio tendencijos ir tolesnės sektoriaus vystymosi perspektyvos. Analizė atliekama remiantis atvejo tyrimo strategija taikant retrospektyvinę sektoriaus vystymosi analizę. Straipsnyje siūloma atkreipti dėmesį į tai, kad finansinių paslaugų sektoriaus stabilumui išlaikyti būtinos tvirtos teisinės normos ir galimybės, kurios leistų tinkamai valdyti sektorių, atsižvelgiant į regioninę bei globalią aplinką.

Straipsnio struktūrą sudaro trys dalys. Pirmojoje pateikiama retrospektyvinė Bulgarijos finansinių paslaugų sektoriaus analizė. Aptariamas IMF, Pasaulio banko, Europos rekonstrukcijos ir plėtros banko vaidmuo finansinių paslaugų rinkos progresui. Antrojoje straipsnio dalyje identifikuojamos šių dienų bankų paslaugų sektoriaus Bulgarijoje tendencijos finansų ir ekonomikos krizės kontekste bei pateikiamos šio sektoriaus vystymosi perspektyvos. Trečiojoje dalyje pateikiama pagrindinių tyrimo rezultatų reziumė.

Reikšminiai žodžiai: bankų paslaugos, pereinamojo laikotarpio ekonomikos, reglamentavimas, finansinė krizė, vystymasis.

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