GREEK BANKING SECTOR
Expanding into the South Eastern European region

by **Christos Staikouras**

Assistant Professor, Athens University of Economics and Business

The Greek Banking Sector

The banking sector constitutes the backbone of the Greek financial system, while continuing to be the main financier of the national economy, despite the fact that the depth of the capital and money markets has gradually increased over the last decades. Undeniably, the Greek banking sector currently represents one of the most sophisticated and modern sectors of the Greek economy.

Until the mid-1980s, the Greek banking system operated in an environment characterized by selective credit controls and regulations, which gradually led to allocative inefficiencies and serious distortions in the functioning of the financial system. Since then, the Greek banking landscape has altered significantly. During the last two decades, it has undergone substantial developments, mainly rooted in the modifications that occurred in the external environment, as a consequence of the increasing monetary and financial integration in the European Union, in particular in the context of the progress towards the Economic and Monetary Union (EMU) and the introduction of the Euro, as well as in the deregulation of the domestic financial system and in the gradual and extensive liberalization of capital flows.

Indeed, the significant economic growth, the continuous improvements in macroeconomic fundamentals, the liberalization of interest rate determination, the annulment of various regulatory credit ceilings, the introduction of advanced information and communication technologies, the internationalization of banking activities, the product and service innovation in financial markets, and the phenomenon of disintermediation have triggered major structural changes in the Greek banking environment.

These developments enhanced competition in both price and quality levels of the products and services offered by the banking sector, resulted in robust credit expansion to the private sector, especially households (consumer credit and mortgage lending), caused significant modifications in the balance sheets and profit and loss accounts of banks, gave impetus to the establishment and operation of new credit institutions, led to domestic mergers and acquisitions, and forced Greek banks to expand their presence throughout the South Eastern European region.

In fact, in an attempt to diversify their sources of income and profitability, Greek banks have invested a significant amount of their capital in acquiring financial institutions in the countries of the South Eastern European region.

THE BANKING SECTOR IN THE REGION

Banks play a dominant role in the financial system and economy of the South Eastern European countries; capital markets are practically limited to the equity markets and are, in general, quite fragile and underdeveloped. During the last decade or so, there have been rigorous and progressively accelerating improvements in the South Eastern European banking systems, aiming at enhancing the sectors' solvency, sustainability and credibility, and improving their performance. At the beginning of the transition process these nascent economies faced the difficult task of embarking on prudent macroeconomic stabilization efforts and transforming their financial systems, which, at that point in time, were merely something of a book-keeping mechanism for recording the authorities' decisions regarding the allocation of resources among various sectors and enterprises. Building viable

and healthy banking systems has proved to be a challenging task. Indeed, during the second half of the 1990s banking reform efforts were impeded either by internal setbacks or by external shocks.

Nevertheless, after a long period of economic restructuring, these countries have achieved significant rates of economic growth, adopted sound macroeconomic policies, and implemented structural reforms. Subsequently, they have managed to attract a substantial flow of portfolio and foreign direct investments, in order to build up their production capacity and modernize their infrastructure. The role of Greece in this process should not be overlooked. Greek firms are among the top three foreign investors in most of the South Eastern European countries. Greek banks in particular provided significant resources and, through their subsidiaries, supported the economic stabilization and reforms. Also, Greek banks facilitate the flow of remittances from the hundreds of thousands of immigrants in Greece; in some cases these remittances are the main source of foreign receipts (most notably in Albania).

Moreover, during the last decade or so, significant efforts were directed towards improving the legislation related to the banking sector, while there have been continuous amendments to the banking supervision regulatory system, aiming at its harmonization with the European Union regulatory regime and the international standards of effective supervision. These laws have increased the attractiveness of the banking industry to foreign investment, strengthened prudential standards and practices in the banks' operations, enhanced corporate governance, and improved efficiency in the banking operations and supervision. The European Bank for Reconstruction and Development (EBRD) index on banking sector reform identifies this progress (Table 1).

Thus, the macroeconomic stability and the "opening up" of the South Eastern European countries' financial systems have enhanced banking intermediation. Domestic credit to the private sector, although at unequal pace among the South Eastern European countries, increased significantly in the period 1995-2005 (Table 1). Bank credit to households contributed the most to credit expansion. Indeed, rising disposable income and the desire to improve the standards of living have given a boost to household consumption. However, despite this growth, the degree of financial penetration through banking products and services is lagging behind that of both other emerging markets and the European Union.

The noticeable increase of credit expansion in the region coincides with significant progress in the privatization process. This process was so extensive and foreign investors' demand so high that in most countries foreign banks already control the largest proportion of the banking system. The asset share of state-owned banks has been reduced significantly, falling at levels below 8 per cent in all South Eastern European banking sectors, except that of Serbia, where the privatization process has advanced but is not yet completed.

Foreign banks, and among them, in a pivotal role, Greek banks, have played an important role in the development of the South Eastern European banking markets. This is not only due to the capital investment from abroad - which lowered the fiscal costs of bank restructuring and provided a vote of confidence of the international financial system for the ongoing transformation of these economies - but often because privatization to reputable foreign owners was the only way to decrease moral hazard problems induced by previous repetitive bailouts. The motivation for this policy is that foreign banks can immediately import financial management, organizational skills, and general banking experience, which are likely to be in short supply among domestic entrepreneurs. Also, foreign banks are considered as "safer" by local depositors, who recognize that foreign banks are not manipulated by the political authorities, and also realize that these banks are supervised by experienced directors at home. Thus, allowing foreign entry, in the form of both greenfield and takeover investments, has been widely regarded as a springboard for increasing the efficiency and competitiveness of the banking sectors in the region.

GREEK BANKS IN THE REGION

Greek banks viewed the South Eastern European region as a natural extension of their home market. With their wide network, Greek banks are a significant integrating element in the region and, along with their corporate clients, are becoming important pillars for the rapid development of these countries. They expanded their activities to take advantage both of the significant rates of economic growth experienced in the South Eastern European economies and of the credit expansion potential, as well as to follow the more general expansion and operation of Greek industrial and commercial enterprises in the region. Furthermore, this penetration provides Greek banks with the opportunity to increase their size and differentiate the sources of their operating income, which have both hit a ceiling within the relatively small-sized Greek financial market.

Greek banks offer a wide range of products and services closely linked to the evolution of the host economies. They are already well established in Bulgaria, Romania, Albania, FYROM, and Serbia, representing at least 20 per cent of the entire banking system according to balance sheet aggregates [total assets], while in some of these countries their share is between one-third and two-thirds (Bank of Greece, 2006). Actually, the fact that Greek banks have been able to retain a very high share of these markets is an indication of some sort of comparative advantage in the provision of financial services, which allows them to thrive within an internationally competitive environment. Undoubtedly, Greek banks are better capitalized than their competitors, a fact that explains their access to more diversified source of funds. According to a recent report published by the Bank of Greece *"their better capitalization allows them to take somewhat higher risks, as shown by the fact that their loans to the private sector are generally a higher share of their assets than for the average bank. Although they take somewhat more risk, they are profitable overall, more than their average competitors. This signifies that Greek banks in the region have some competitive advantages."* Among these are the direct geographic adjacency, the cultural proximity, the increasing degree of economic ties and unification with these countries, and the superior organization structure and know-how.

According to figures obtained from the Bank of Greece, as of end 2005, Greek credit institutions controlled 18 affiliated banks and 6 networks of subsidiary companies in these countries, with roughly 1,000 official units [branches] and 15,000 employees. Indeed, all these figures have tripled since 2000. It should be pointed out that direct investments of the Greek banking sector in the region approached €400 million in 2005. Moreover, these investments positively contributed to the financial results of Greek banks; gross income from the operations in the South Eastern European economies approached 10 per cent of their total operating income.

The degree of penetration of Greek banks varies from country to country. Particular emphasis has been given on the banking market of Bulgaria (361 official units as of 2005) and Romania (263 official units). Infiltration is also marked in Serbia, where the number of official units has reached that of 286, compared with a tally of fewer than 30 operating during the previous year. The recent acquisition of Finansbank, the 5th largest private bank in Turkey, by the National Bank of Greece, and of 70 per cent of a smaller Turkish bank, namely Tekfenbank, by Eurobank (these two Greek banks acquiring a combined capital of roughly €2.5 billion), as well as the purchase of an Egyptian bank (Egyptian Commercial Bank) by the Bank of Piraeus, is transforming even more the landscape of the Greek banking sector, which is becoming more extrovert and, one could even dare say, international.

This expansion in the South Eastern region mainly represents a future investment of the Greek credit institutions that will counter the slack bound to occur if the pace of credit expansion in Greece starts to cool down. Benefiting from a more competitive domestic market, and one that is increasingly subject to international practice, Greek banks can be expected to continue to strengthen their presence in the wider region over the next decade, through the exporting of their successful local business model.

Table 1 Banking sector indicators

	Number of banks			Number of foreign banks			Asset share of state-owned banks (percentage)			Domestic credit to the private sector (percentage of GDP)			EBRD index of banking sector reform		
Country / Year	**1995**	**2000**	**2005**	**1995**	**2000**	**2005**	**1995**	**2000**	**2005**	**1995**	**2000**	**2005**	**1995**	**2000**	**2005**
Albania	6	13	16	3	12	14	94.5	64.8	7.7	3.6	3.0	10.3	2.0	2.3	2.7
Bosnia & Herzegovina	41*	56	33	5*	14	20	86.2*	55.4	3.6	na	7.0	22.6	1.0	2.3	2.7
Bulgaria	41	35	34	3	25	23	82.2*	19.8	1.7	21.1	11.7	26.0	2.0	3.0	3.7
FYROM	6	22	20	3	7	8	0.0	1.1	1.6	23.1	10.5	21.7	2.7	2.7	2.7
Romania	24	33	33	8	21	24	84.3	50.0	6.5	7.8	7.2	10.2	3.0	2.7	3.0
Serbia	112	81	40	3	3	17	94.7	90.9	23.9	9.2*	8.2	na	1.0	1.0	2.7

Source: European Bank for Reconstruction and Development (2006).

Note: The EBRD index of banking sector reform provides a ranking of progress for liberalization and institutional reform of the banking sector, on a scale of 1 to 4+. A score of 1 represents little change from a socialist banking system apart from the separation of the central bank and commercial banks, while a score of 4+ represents a level of reform that approximates the institutional standards and norms of an industrialized market economy.

* Figures are for year 1996.