



MAGYAR NEMZETI BANK



Impact of Foreign Ownership on the Banking Sector: the Hungarian Experience

Balázs Zsámboki
National Bank of Hungary

Kiev, 13 June 2006

Historical background



- Development of the Hungarian banking sector
 - 1987-1991 establishment and crisis
 - 1992-1994 consolidation, recapitalisation
 - 1995-1997 privatisation, stabilisation
 - 1998-2004 towards the EU
 - 2004- towards the EMU
- Consolidation is only a temporary solution: a precondition for privatisation
- Privatisation was necessary to stabilise the sector and to provide future development
- Main motives behind promoting foreign investment
 - lack of domestic capital
 - lack of know-how

Bank privatisation 1995-2003



- Timing of privatisation
 - Most of the large banks privatised during 1995-1997
 - One remaining large bank sold in 2003
 - Methods of privatisation:
 - selling to strategic investors, by tender
 - new owners were also required to inject capital
 - largest retail bank privatised through public offerings
 - Privatisation price was well above nominal value
 - Banks were privatised by financially sound strategic investors
 - Structure of foreign investors is diversified by country
-

Impact of foreign ownership: performance and stability



- Impact on bank performance
 - positive impact on bank efficiency
 - increasing profitability
- Stability gains in the banking sectors
 - improved asset quality, partly due to more developed risk management methods
 - capital position strengthened by foreign owners
 - better corporate governance

Impact of foreign ownership: competition and quality



- Competition: uneven impact across market segments
 - enhancing competition in the corporate market
 - less, but growing penetration in retail markets by foreign controlled banks, still relatively high concentration
- Positive impact on service quality
 - technological development
 - improved risk assessment methods (e.g. credit scoring)
 - product innovation

Impact on financial deepening



- Lending to specific sectors (SMEs and households)
 - a potential disadvantages
 - cherry picking
 - lack of local knowledge
- Hungarian experience:
 - early periods of transition: focus on large foreign-owned enterprises, retail segments (households, SMEs) underserviced
 - recently: increasing focus on household lending
 - time was needed for penetration into retail markets

High foreign ownership: challenges



- Macroeconomic effects
 - Responsiveness of foreign banks to economic cycles in the home country
 - Hungary: no negative experience (German banks)
- Supervisory challenges
 - home – host issues, single European licence
 - Hungary: strengthened supervisory cooperation
- Regulatory issues
 - Basel II. implementation
 - Hungary: mother institutions provide technical assistance and know-how to their subsidiaries

Conclusions



- Foreign ownership may substantially improve banks' risk management techniques and performance
- Positive impact on competition and the quality of services
 - However materialisation of potential benefits may take time in certain market segments
- Enhanced corporate governance
- Integration into international financial markets
- A precondition for success: sound legal framework
 - Up to date legislation on bankruptcy, accounting, capital adequacy, provisioning, risk concentration, connected lending etc. is needed
- All of this promote financial stability which contributes to higher GDP growth and increases the well-being of customers