Tatiana Kalinchuk

Institute of International Relations, Kyiv National Taras Schevchenko University, Ukraine

KEY FACTORS OF SURVIVAL OF SMALL AND MIDDLE BANKS IN POST-CRISIS TERMS

Huge amounts of government assistance have been poured into the global economy during the recent crisis. But even unsophisticated observer would note that all that assistance goes to the largest corporations and banks, while the majority of smaller market players are left alone with their problems.

Leaving behind the issue of ethics in curing the results of unbounded financial appetites of world's largest companies, I would like to focus on the problems of small and medium-sized banks, which prove to be the capillaries of national financial systems of almost all countries, compared to the large systematic banks, which we used to associating with backbone or heart.

It has been traditionally stated that micro, small and medium-sized enterprises are important ingredients for stable and equitable growth in any national economy, since they are more labor-intensive, more socially responsible, more innovative and flexible etc. Support of micro, small and medium-sized enterprises has become cornerstone of many national policies in both developed and developing countries. Still in many cases those companies would lack good access to financial resources if not small and medium-sized banks.

In a general case, modern bank is a set of mathematical formulas that earn revenues from spreads of dual pricing such as borrowing and lending rates, wholesale and retail rates, as well as from commissions. At the same time, bank costs are very similar to other servicing companies, being directly proportional to the complexity of products and adversely proportional to their standardization. The latter factor forced many banks to offer a variety of standardized products, which are customized only for the largest clients.

Dealing with small and medium customers are often perfunctory, via call-centers or internet sites, while they are the very group of clients that require personalized services and customized solutions to keep risks under control. That brings to the scene small and medium-sized banks, which have the same business philosophy and approach and are willing to deal in persons with much smaller customers.

In addition, smaller banks are often more specialized in servicing its customers and are able to react faster to changes in business environment and customer demands. Therefore, despite providing more expensive services, they in fact can lower total costs of banking for small and medium-sized companies.

Unfortunately, in Ukraine the situation is largely different. According to the National Bank of Ukraine, there are 120 small and 24 middle-sized banks in Ukraine as for 1st January 2009. Altogether they constitute 79 % of total number of banks in Ukraine, but operate only 20 % of its capital.

Small and medium-sized banks are mostly captive banks, used by large enterprises to gain access to cheaper interbank and foreign funds, as well as for servicing only corporate transactions. The examples of such banks are Kredit-Dnipro (associated with EastOne corporation of Viktor Pinchuk), Megabank (Energy Standard of Konstantin Grigorishin), Accent-Bank (Privat Group of Igor Kolomoyskiy and Gennadiy Bogolyubov).

Second large group of small and medium banks consists of regional banks. They are mostly universal banks with activities focused on one or several regions. Such banks are Poltava Bank, Marine Transport Bank (Odessa), Familniy (Donetsk), Bazis (Kharkiv).

The third group consists of specialized banks, focused on niche services. Most of them appeared during the flourishing of real estate and were active in real estate financing and mortgages, which was stimulated by specialized legislation. Examples are International Mortgage Bank, Arkada etc.

The fourth group includes banks that were created for sale or conduct market testing activities for foreign banking institutions prior to full market entrance.

As one might see, Ukrainian small and medium sized banks just entered their path towards performing their most appropriate functions. Still, current crisis made them face several very serious dangers, which are sometimes even higher compared to their large competitors.

Collapse of one of the most profitable business lines of Ukrainian small and middle-sized banks (namely mortgage financing and real estate project financing) forced some of them to close down or move operations to other sectors. That is not easy under crisis conditions but still provides chances for survival. Thus for example, International Mortgage Bank was renamed to Platinum Bank and enlarged its operations in consumer loans at the cost of mortgage financing.

The second problem, in order of appearance not in importance, is the absence of available financial resources. Interest on overnight loans, used as a proxy indicator of the health of financial system, has increased to 60 % and sometimes to 100 %, making them very expensive for most banks, while lenders became very careful concerning giving money to smaller banks.

National Bank of Ukraine provides long-term refinancing (above 1 year) only to the banks with more than 500 million UAH in statutory capital, which is not the case of small and medium-sized banks. Moreover, largest banks can count on support from international organizations and their own head offices, while smaller banks can not.

The third danger lies in the global trend to increase supervision and regulation of global banking system. Regulatory measures aimed at increasing capital and liquidity requirements will hit independent small and medium-sized banks with all their destructive power.

We should admit that small and medium-sized banks were lucky to avoid one danger that moves the current crisis in Ukraine. Due to their nature and inability to use complex financing instruments, small and medium-sized banks avoided accumulating large amounts of foreign debt, denominated in foreign currencies.

That fact that was a disadvantage in the era of unlimited growth becomes a survival factor nowadays.

Still, small and medium-sized banks will have to look for active strategies to fight the current crisis successfully. One is to follow the global trend of renaissance of classic banking and the movement towards universal banks. That will require them to enlarge the assortment of services to the maximum possible extent. Of course, they will not be able to become truly universal banks, but partial diversification of services is highly possible.

At one hand, following that trend will put them in competition with the majority of other market participants, but at the other hand it will allow diversifying their activities and manage specific risks of being focused on limited product line, economic sector or customer group. Such approach will also allow increasing deposit base, which is becoming the major source of capital for small and middle-sized banks. But in order to become successful, they will have to improve existing banking model, introduce strict control over expenses and invent unique and distinctive features that can become competitive advantages.

Another possible strategy is to follow the example of airlines by creating strategic alliances of specialized non-competing banking institutions to cover various sectors of banking services. Such form of cooperation is not common in the banking industry, but it will enable small and medium-sized banks to conduct cross-sales of products, minimize customer attraction costs, improve efficiency of operations and generate revenues from operations of other partners. Ideal banking alliance would cover the majority of specialized banking services and products, while individual partners will:

- provide basic banking services to its own customers under agreed pricing policy to avoid competition;
- concentrate on specific advanced services and products where it has competitive advantage over other market participants;
- generate profits on commissions from client forwarding to its strategic partners.

Mergers of small and medium-sized banks can become an implementation form of such alliances, when individual banks that participate in the merger will keep their specialization but will be managed from a single center of authority. Although mergers bring issues of proper evaluation of merging banks, which is not possible under crisis, and will create multiple grounds for conflicts between shareholders, which are not the case of strategic alliances.

And of course, traditional acquisitions of banks will take place in Ukraine, as in other developing countries, with small and medium sized banks being purchased by enterprises and investors from other industries with still positive cash flows, such as mining and resources, metallurgy, retail etc. Analysts tend to estimate that in the absence of other form of consolidation of Ukrainian small and medium-sized banks, 30-50 % of them will not survive the current crisis, being either closed or acquired by more healthy competitors or investors from other industries. In any case, all those sales of banks will not be beneficial for current owners, since the value of banks decreased significantly and in many cases is not even above 1 dollar of symbolic payment.

Kalinchuk, T. Key factors of survival of small and middle banks in post-crisis terms [Text] / T. Kalinchuk // Global Financial Crises and its national specific features: the International Scientific-Practical Conference papers (23-25 April, 2009). – Sumy: UAB NBU, 2009. – P. 56-59.