CHAPTER 28

MERGERS AND ACQUISITIONS IN BANKING SECTOR: THE CASE OF WESTERN BALKAN COUNTRIES[1]

Dragan FILIMONOVIĆ[2], Bojana RADOVANOVIĆ[3]

Abstract

The reform process that took place in the Western Balkan countries attracted the penetration of the international banks. European banks entered the markets predominately through acquisitions of the local state-owned and private banks. The M&A activities triggered by the European banks played an important part in changing of the banking sectors in the Balkan countries in terms of consolidation, market concentration and competition in banking sector, financial intermediation development and landing allocation. As a result of international banks penetration, banking sectors of the Western Balkan countries encountered with significant changes. In particular, M&A transactions have been the direct cause for the overall decrease in the number of financial institutions and for the substantial growth in foreign banks proportion in the total assets. Although the decline in interest rate spreads, as an indication of increase of competition in all observed countries, is noticeable during the past decade, the interest rate spreads are still much higher than on the European markets. The expansion of lending activity in three western Balkan countries was mainly due to an increase in credits to private households rather than to the companies, which is unproductive use of the financial sources.

Key words: *mergers and acquisition, banking sector, Western Balkans.*

---

[1] This paper is a part of research projects numbers 47009 (European integrations and social and economic changes in Serbian economy on the way to the EU) and 179015 (Challenges and prospects of structural changes in Serbia: Strategic directions for economic development and harmonization with EU requirements), financed by the Ministry of Science and Technological Development of the Republic of Serbia.

[2] Dragan Filimonovic, BA, Junior Researcher, Institute of Economic Sciences, Belgrade, Serbia

[3] Bojana Radovanovic, MPhil, Research Associate, Institute of Economic Sciences, Belgrade, Serbia

INTRODUCTION

The reform process that took place in the Western Balkan countries during the '90s has led to relatively consolidated banking systems with significant presence of foreign banks. European banks entered the opened markets of the ex socialists countries predominately through acquisitions of the local state-owned and private banks. As a result of international banks penetration into their markets during the past decade, banking sectors of the Western Balkan countries encountered with significant changes.

In this paper we will analyze mergers and acquisitions in banking sector and the implications on the market structures in three Western Balkan Countries: Bosnia and Herzegovina, Croatia and Serbia in comparison to Romania and Bulgaria (countries from the Balkan region, already EU member states) and the EU best practices. To begin with, we will briefly present the main motivation that led EU banks to penetrate Western Balkan markets and discuss the benefits for the host country in the first section. Then, in the second section, we will give an overview of the banking sector reforms in selected countries and analyze banking M&A transactions in selected Balkan countries. Finally, in the third section, we will examine the changes in banking systems of the selected countries in terms of consolidation, market concentration and competition in banking sector, financial intermediation development and landing allocation.

OVER BOARDER M&AS IN BANKING SECTOR – INTERNATIONAL BANKERS' AND HOST COUNTRY'S PERSPECTIVE

In this section, firstly we will briefly present the main motivation for mergers and acquisitions in banking sector, paying closer attention to the international M&As. Then, we will outline the main trends in the banking sector in the EU counties and their expansion towards the Balkan countries' markets. Finally, the M&A transactions will be discussed from the host country's perspective.

Although, there may many reasons why banks undertake M&A transactions, according to European Central Bank (ECB) research[4], pursuit for profit prevails as a dominant motive. It is pointed out in this research that cost savings are much more attainable than revenue benefits, which are more elusive. The cost benefits of economics of scale is the dominant motive for domestic banking mergers and acquisitions, while the anticipated revenue benefits from economies of scope is

[4] ECB, Mergers and Acquisitions Involving the EU Banking Industry – Facts and Implications, December 2000, p. 20.

the reason for creation of international conglomerates.[5] Particularly, the need to be big enough in the global market is the main motive for penetration into the international markets through M&A transactions. Not only does the size of the institution matter, the number of clients served is also one of the essentials for international transactions. The goal is to secure an access on new markets in order to gain new range of clients. International orientation offers a larger customer base, larger markets, thus it gives a possibility for achieving the economy of scale linked to the increasing revenues. Especially important are acquisitions in emerging and developing markets (such as the case is with Balkan countries). Although sometimes cross-border mergers and acquisitions could possibly encounter with political obstruction in host countries, there is small empirical recording on such behaviour.

European countries have faced with banking system re-structuring during the 1980s and 1990s. In this period, M&A transactions in Europe vary depending on the sectors (mutual banks, publicly owned banks, savings banks) and the size of domestic markets.[6] With the achievement of a certain level of consolidation in the national banking markets, financial institutions were encouraged to expend outside EU borders. In addition, after the creation of single market and introduction of euro, circumstances were made for cross-border expansion.[7] European banks were mostly investing in geographically and historically close regions, particularly toward European regions in transition (SEE and CEE countries) during '90s and 2000s. The implementation of the privatization programme conducted by transition countries' governments during '90s, enabled Western European banks to enter their markets, acquiring state-owned banks. However, recent financial crisis have made a huge impact on financial institutions strategic priorities of the European banks, which have shifted away from emerging and developing markets towards domestic priorities[8].

Nevertheless, M&A activities triggered by Western European banks played an important part in changing of the banking sectors in the Balkan countries. During the transition period, governments have put many efforts into restructuring the banking sectors. Eligible domestic buyers, "who were not the banks' main

[5] ECB, Mergers and Acquisitions Involving the EU banking industry – Facts and Implications, December 2000, p. 20.
[6] ECB, Mergers and acquisitions involving the EU banking industry, December 2000, p. 9.
[7] Salgado Santilian J. R., Banking Concentration in the European Union during the Last Fifteen Years, Panoeconomicus, 2011, 2, p. 250.
[8] PricewaterhouseCoopers, Back to the Domestic Future, March 2009, p. 9

customers, and who possessed any experience and know-how in banking"[9], were hard to find. In addition, because of fragile fiscal policy at the time, recapitalizing the collapsed banks by governments was unachievable for the most of transitional countries. Therefore, the authorities in these countries advocated the privatization of state-owned banks to foreign partners. The question that rises is whether host countries' banking systems have benefited from the acquisitions that foreign banks undertook.

The most important positive sides of the foreign banks entry into transitional countries market, according to T. Galac and E. Kraft[10], and Kraft[11], are: innovations of products and services and rapid improvement in banking business, economies of scale and scope, making a competitive environment, attracting FDIs, providing stability of host countries' financial systems and bringing a fresh capital.

First of all, since foreign banks are already offering a broad range of different products and services on their domestic markets, it is expected that they will implement such new products much easier in the markets of host countries. Domestic banks operating in countries in transition were occupied with inherited problems, like bad assets, outdated organizational structure and non-developed information systems, with no chance to deal with development of new services and products. In addition, expertise in marketing and risk management is significantly higher compared to domicile banks. Investments in information technology have also been evident. Moreover, development of information technology requires a lot of investment, therefore unreachable for domicile banks, having in mind their limited resources. Furthermore, acquiring small and local banks, foreign banks catalyze consolidation process, thus providing a base for reaching the effects of economy of scale. In addition, foreign financial institutions are encouraging the effects of economy of scope, using their expertise and experience in conducting different services such as: insurance, asset management and brokerage. Further, presence of foreign banks introduces a more competitive environment in the host markets. Newcomers are the most often a strong competition for domicile banks. Nonetheless, presence of foreign banks may have a positive influence on attracting non-financial institutions to invest as well. International companies' perception of foreign banks presence on the emerging and transitional markets can be interpreted as a signal to penetrate those markets. Also, foreign companies often are doing business exclusively with foreign banks.

[9] Kraft E, Banking Reform in Southeast Europe: Accomplishments and Challenges, November 2004

[10] Galac T and Kraft, E Sto znaci ulazak stranih banaka za Hrvatsku?, 2001, p. 1.

[11] Kraft E, Banking reform in Southeast Europe: accomplishments and challenges, 2004, p.4.

Additionally, the stability of domestic financial systems has been dramatically increased, due to the foreign banks entry. Finally, presence of foreign banks provides a fresh capital in transition economies, both in the form of equity investment and lending.

On the other hand, there are certain arguments against foreign banks' entry[12] such as: provision of small range products, fear of foreign control, banking as an infant industry argument, regulatory differences. Foreign banks sometimes tend to concentrate on specific market niche (top and selected segment), thus not providing broad-range services. Such orientation may lead to a lower level of competition in the market as a whole and reduced access to finance for large number of domestic companies. In additional, foreign control over loan allocation implies substantial economic power in any economy. Also, due to their crucial role in economy, banking industry is perceived as very important and thus deserving to have a special protection. Regulatory differences could also affect the results of foreign banks presence. Supervisors from the home countries lose regulatory control of banks as soon as they enter foreign market. Under the condition that a host country has a weak banking supervision system, this may lead to unsound banking in the host country.

To conclude, the financial institutions from developed markets are highly motivated to penetrate into the developing and emerging markets, such as Western Balkans'. The profits they gain mostly through the cost efficiency are their main driving force. The beneficence of international banks' penetration through domestic banks' acquisitions is not that straight forward from the host country's perspective. Although there are numerous advantages of the foreign backs presence, there are also certain concerns and potential threats for the host country's economy. In the sections that follow we will focus on the banking sectors of selected Balkan Countries examining the implications that the international banks' penetration through M&A with local banks have had on the development of the industry and the economy as whole.

BRIEF HISTORY OF THE BANKING SECTOR REFORMS IN SELECTED BALKAN COUNTRIES AND M&A TRENDS TOWARDS THE REGION

During the past two decades, governments of the Balkan countries, with the assistance of international financial institutions, conducted certain measures in order to rebuild their banking sectors and markets. This long and demanding process involved the restructuring, rehabilitation and privatization of state-owned

[12]Uiboupin J, Effects of Foreign Banks Entry on Bank performance in the CEE Countries, 2004, p. 10.

banks, the liquidation of insolvent institutions and an improvement in the administrative efficiency and capability of the banking sector.[13] Changes which have been introduced are the establishment and harmonization of new legislation, implementation of the accounting standards, adoption of a better risk management. In this section, firstly we will present brief history of banking reforms in Bosnia and Herzegovina, Serbia and Croatia as Western Balkan countries on which we focus our analyses, and we will also have a look on Romania and Bulgaria as benchmark countries, given according to Stubos G., Tsikripis I.[14] and Reininger T[15]. Then, we will analyze banking M&A transactions in selected countries in the period of Jan-2000 to Jan-2011.

In Bosnia and Herzegovina, after the civil war in 1995, banking sector was consisted of large number of institutions, which were undeveloped and under-capitalized. The reform at a faster pace started with the establishment of the Central Bank of B&H in 1997, operating as Currency Board. The key tasks were to enhance the cooperation between banking agencies of a two entity and to implement and harmonize the legal framework. With the introduction of the Law on Banks in 1998, conditions were met to build more uniform, properly monitored and functional banking sector.

In Serbia, reforms have begun in 2001. Political changes in 2000 were the breakthrough toward process of restructuring and privatization of financial institutions. Earlier, banks were under governmental control. With unrealistic fixed foreign exchange regime and low official reserves, financial conditions remained difficult until 2000. In addition, banks were supporting money-losing enterprises. Inherited banking system was insolvent with the liabilities high above the value of the assets. The National Bank adopted restructuring policy in May 2001. Reform objectives predicted included liquidation process for insolvent institutions and finalizing the privatization of state-owned banks, which were mostly undercapitalized.

Unlike in other transition economies, there has already been a two-tier banking system in Croatia. The main obligation of authorities was to set up a market base

---

[13] Athanasoglou P, Delis M, Staikouras C, Determinants of Bank Profitability in the SEE Region, 2006, p. 12.

[14] Stubos G., Tsikripis I., Regional Integration Challenges in SEE: Banking Sector Trands, Working paper No. 24, Bank of Greece, **Stubos G., Tsikripis I.** (2005) Regional Integration Challenges in SEE: Banking Sector Trands, Working paper No. 24, Bank of Greece, p. 12

[15] Ribnikar I., Kosak M, Development prospects of the banking industry in the new EU member countries and forthcoming member countries, Zbornik radova Ekonomski fakultet Rijeka, vol. 24, sv.1, UDC 339.923:061.1 EU 336.71, 2006, p. 2.

banking practice. With the existence of low minimum equity capital requirements and liberal supervision legislation, the number of financial institutions grew significantly during 90's and reached 60 by 1997, but the level of concentration was high. In 1995, four largest banks had share in total assets of almost 70%. Transition of banking system consisted of three stages: financial restructuring in which debts were written off and bad loans transferred to workout agency, changes in operational management and privatization to a strategic foreign investor.

In Romania, the process of banking sector restructuring took place more slowly than in other countries. During '90s, the level of financial intermediation was quite low, the concentration in banking market was very high (four banks had above 65% share in total assets) and the problem of non-performing loans in state-owned banks stayed unresolved. Banking sector reform was launched after 1999, with a liquidation of large state bank, Bancorex, privatization of the Banka Agricola and the clearance of significant part of non-performing loans. In the following years, the certain measures were taken in order to strengthen banking legislation and supervision. Regardless of the slower process of reforms at the beginning, Romania quickly caught up with progress made in other transition economies.

Finally, in Bulgaria, first reform law was introduced in 1991, which created the possibility for establishing financial institutions with foreign and domestic ownership. Two years from introduction of new legislation, eighty banks performed operations as joined-stock companies. However, it was promptly discovered that the new institutions had bad activities and lending practices. In the beginning of 1997, one-fourth of banks were in receivership. With help of international financial institutions, structural reforms were undertaken and Currency Board was introduced. Package of reforms included stricter supervision and control over financial services, liberalization of trade and more rigorous privatization policy. After the period of six years of structural reforms, the confidence in banking sector and its institutions was restored, and a number of mergers and acquisitions improved the banks viability.

All countries emerging from socialism era faced more or less the same inherited problems, such as an insufficient resource mobilization, weak intermediation role, unhealthy portfolio structure and insolvency of banking sector. In order to overcome outlined issues, national governments have put a lot of efforts in reforming legislation, privatization and attracting the foreign banks into domestic markets. At this point, it will be examined whether Balkan countries have become an attractive market for the European banks. Particularly, we will analyze banking M&A transactions in Bosnia and Herzegovina, Serbia, Croatia, Bulgaria and

Rumania in the period of Jan-2000 to Jan-2011. During the last decade, in the selected countries, there have been 92 M&A transactions in sum, which total value was 10.03 billion euro and an average transaction was worth 185.76 euro. Table 1 summarises data on banking M&A transactions.

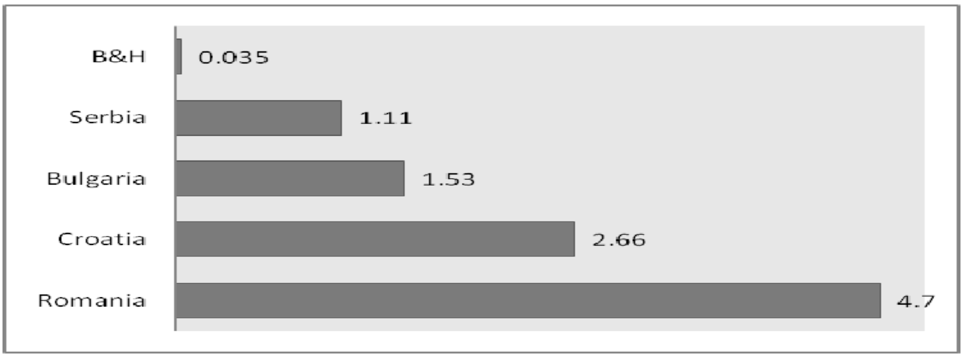
Table 1. Banking M&A transactions in selected Balkan countries from 2000 to 2011

Number of transactions	92
Total value	€10.03 B
Average transaction value	€185.76 M

Source: Bloomberg

Among the Balkan countries, Romania has managed to attract the largest investments in banking sector, and the value of transaction in Rumania is far greater than in other countries observed (4.7 billion euro). However, Romania is the biggest country in the region and its attractiveness does not surprise. It is interesting that Croatia attracted more acquirers than Bulgaria, which quicker become an EU member state. The total value of the transactions in Croatia was 2.66, while in Bulgaria it was 1.53 billion euro. Serbia falls behind Romania, Croatia and Bulgaria with 1.11 billion worth acquisitions. The transactions in B&H worth 0.035 billion euro are significantly smaller than in the other observed countries. In the Graph 1 there are presented total values of transactions by target countries.

Graph 1. Total values of transactions by target countries, 2000-2011(in bill. €)

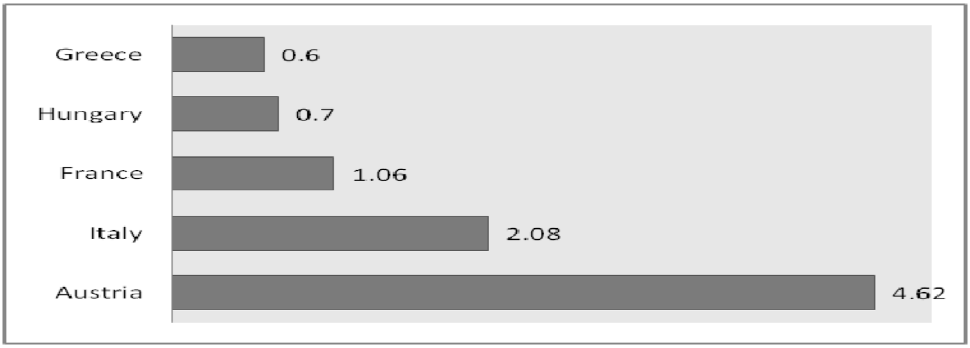


Source: Bloomberg

The largest single transaction in Romania was the acquisition of Banca Comercial (Romania) by Erste Group (Austria), amounted to €3.75 billion[16]. The biggest transaction in Serbia was the acquisition of Delta Bank by Intesa Sanpaolo SPA worth €333 million, in B&H it was the acquisition of UPI bank by Intesa Sanpaolo SPA with value of €16 million. The acquisition of Zagrebacka banka AD by UniCredit SPA valued at €552 million, was the largest in Croatia, and the acquisition of Bulbank AD by UniCredit SPA of €360 million was top transaction closed in Bulgaria.

The most significant acquirers (by country of origin) in selected banking markets have been: Austria, Italy, France, Hungary and Greece. Austrian banks, with 4.62 billion invested in acquisitions in the Balkan countries, were the most important acquirers. The value of acquisitions made by Italian banks, the second biggest acquirers in the region, was 2.08 billion euro. French banks invested 1.06, while Hungarian and Greek invested 0.7 and 0.6 respectively. A single acquirer with the most transactions in analyzed region is UniCredit SPA (Italy). Italian bank group closed six transactions, with total volume of €1.44 billion. The average value of their acquisitions was €240.21 million.[17] The Graph 2 presents top acquirers by value of transactions.

Graph 2. Top acquirers in selected countries, 2000-2011 (in billions of €)



Source: Bloomberg

The presented data show that, during the last decade, Balkan countries were attractive for the EU banks, and especially for Austrian, Italian, French, Hungarian and Greek financial institutions. Among western Balkan countries, Croatia was the most attractive and even more successful in attracting acquirers from EU that Bulgaria – the EU member state. The performance of Bosnia and

[16] Bloomberg
[17] Bloomberg

Herzegovina in attracting EU acquirers was far behind Croatia's and Serbia's. What was the impact of these acquisitions on the host countries' banking sectors is the issue that will be analyzed in the next section.

CHANGES IN BANKING MARKET STRUCTURE OF WESTERN BALKAN COUNTRIES

There has been an increasing foreign bank presence in Bosnia and Herzegovina, Serbia, Croatia, Romania and Bulgaria since 1990s and especially 2000s. In this section, there will be closer analyzed the impacts on the banking systems of the host countries in terms of consolidation, market concentration and competition in banking sector, financial intermediation development and landing allocation.

To begin with, M&A transactions have been the direct cause for the overall decrease in number of financial institutions[18], although closures of some existing institutions also affected the pattern. Serbia faced a sharp decline of operating banks in the past decade - from 81 banks operating in 2000 to 33 in 2011. The number of banks in Bosnia and Herzegovina also recorded a significant decrease – from 55 to 29 banks. The number of banks in Croatia varied until 2005, and from that point remained stable – about 33 banks. Since they commenced reforms earlier, much less oscillations can be noticed in Romania and Bulgaria in the last decade.

Table 2. The number of operating banks, in period of 2000-2011

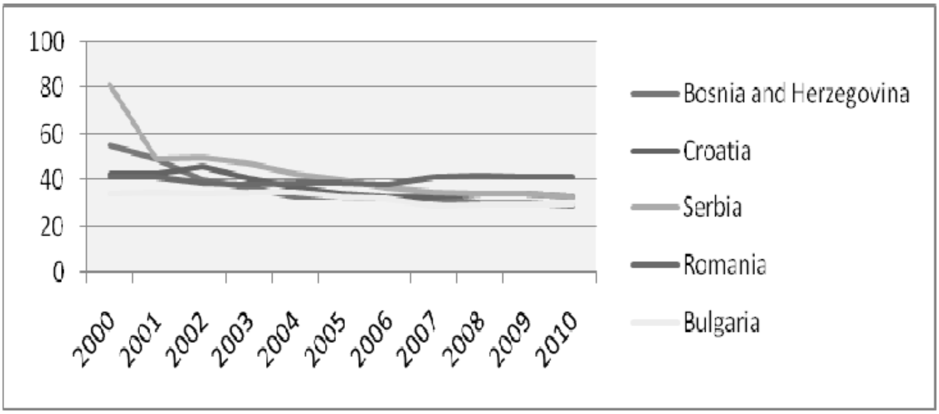
Country	Number of banks										
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Bosnia and Herzegovina	55	49	40	37	33	33	32	32	30	30	29
Croatia	43	43	46	41	37	34	33	33	34	34	33
Serbia	81	49	50	47	43	40	37	35	34	34	33
Romania	41	41	39	38	39	39	38	41	42	41	41
Bulgaria	34	35	34	35	35	33	32	29	30	30	30

Source: National banks reports and bulletins

[18] Ribnikar I., Kosak M, Development prospects of the banking industry in the new EU member countries and forthcoming member countries, Zb. rad. Ekon. fak. Rij, 2006, p 2.

To illustrate that, in 1991, there were 78 banks on Bulgarian market[19], while there were 34 in 2000 and 30 in 2011. Romania had an increase in number of banks from 1994-1998, from 27 to 45, and afterwards the number of banks remain stable around this figure. There was an overall convergence in pattern for Bosnia, Croatia and Serbia in terms of decrease in number of banks. Convergence is met in case of Bulgaria and Romania also, the number of banks in these countries remained more/less unchanged through the period. An overall trend in number of banks from 2000 to 2010 can be clearly seen on the Table 2 and Graph 3.

Graph 3. Trends of number of banks in selected countries, in the period of2000-2011



Source: National banks reports and bulletins

Furthermore, another important implication of banking M&A transactions is the high levels of market share of foreign banks, measured by the share of foreign banks' assets in total market assets. During the period 2000-2010, all countries faced with the substantial growth in foreign banks proportion in total assets. The shares of foreign banks in banking assets in all observed Western Balkan countries are well above European Union's New Member States' average of 69%.[20] Particularly, there has been a dramatic increase of foreign banks' share in total assets in Serbia - from 1% in 2000 to 79% in 2006. The market share of foreign banks' assets was 74% in Serbia in 2011 and it is the lowest share of all observed countries. The highest market share is in Bosnia and Herzegovina and Croatia – 90% in 2011. However, the market share of foreign banks operating in Croatia remains more or less stable during the observed period. Unlike Bulgaria, Romania encountered with significant increase in foreign banks share in total

[19] Yonkova A., Alexandrova S., Bogdanov L., Development of Banking Sector in Bulgaria, part one, p. 12.

[20] European Central Bank

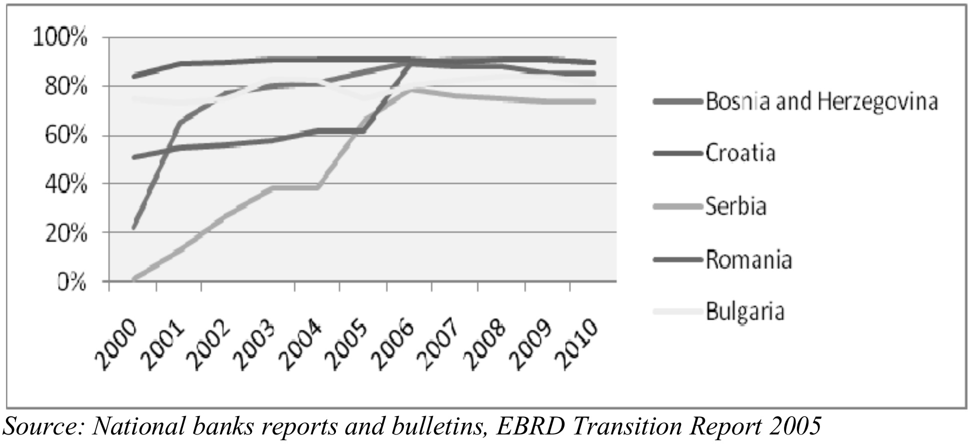
assets in its EU pre-accession year of 2006. The trends of foreign banks market share for selected countries over the period is presented in Table 3 and Graph 4.

Table 3. Foreign banks market share in selected countries in selected countries, in period of 2000-2011

Country	**Foreign Banks % in Total Assets**										
	2000	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Bosnia and Herzegovina	22%	65%	77%	80%	81%	86%	90%	91%	91%	91%	90%
Croatia	84%	89%	90%	91%	91%	91%	91%	90%	91%	91%	90%
Serbia	1%	13%	27%	38%	38%	66%	79%	76%	75%	74%	74%
Romania	51%	55%	56%	58%	62%	62%	89%	88%	88%	85%	85%
Bulgaria	75%	73%	75%	83%	82%	75%	80%	82%	84%	84%	81%

Source: National banks reports and bulletins, EBRD Transition Report 2005

Graph 4. Trend of foreign banks market share in selected countries, in period of 2000-2011



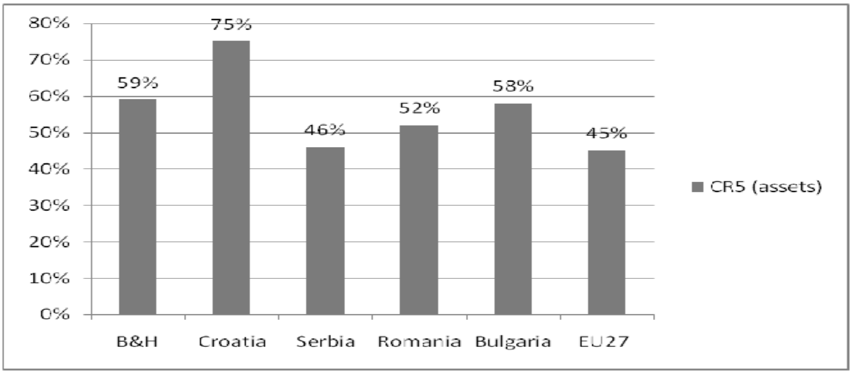
Source: National banks reports and bulletins, EBRD Transition Report 2005

Moreover, important implication of foreign banks' entry is the increase of concentration in host banking markets. According to Kraft, it may lead to more effective competition, as a small number of strong and developed banks are able to contest effectively, as opposed to a large number of small banks present at the beginning of the reforms.[21] The concentration in banking markets can be measured by *k* banks Concentration ratio index (CR_k). It is one of the most frequently used measures of concentration in literature. CR_k index is summing over the market shares of the *k* largest bank in the market, it takes the form:[22]

$$CR_k = \sum_{i=1}^{k} S_i$$

The most commonly in use for the CR_k assets index is the sum of the five largest banks' share in total assets. The graph below indicates the value of CR_5 index for assets in selected countries banking markets and the EU27 average – 45% in 2009. The market share of the five largest banks was lowest in Serbia - 46%, which is less than in Bulgaria (58%) and Romania (52%) and close to the EU27 average – 46%. The highest market power of the five largest banks was in Croatia of 75%. All the countries had the index value above the EU average. Yet, the value of CR_5 extensively differs among the EU member countries. For example, in Germany the value of CR_5 index was 25% and in Netherlands it was 85% in 2009.

Graph 5. CR5 (assets) index in 2009



Sources: National banks reports and Schoenmaker D., The European Bank Landscape After the Crisis[23]

[21] Kraft E. Banking Reform in Southeast Europe: Accomplishments and Challenges, Oesterreichische Nationalbank conference: South European Challenges and Prospects, 2004.
[22] Bikker J.A., Haaf K., Measures of Competition and Concentration in the Banking Industry: a Review of the Literature, De Nederlandsche Bank, 2000, p. 6.
[23] Schoenmaker D. (2011) The European Bank Landscape After the Crisis, DSF policy paper , No. 12, p.14

Although presence of foreign banks caused high concentration in all Western Balkan markets, high concentration ratios have not prevented competition from developing in host markets.[24] An indicator of competition in banking sector may be interest rate spread, where the spreads represent difference between lending rates and deposit rates.[25] As an overall pattern, the decline in interest rate spreads in all observed countries is noticeable. The decline is the most significant in Serbia – from 73% to 7 %. However, the spreads are still much higher than in more developed European markets. For example, in Slovenia, the interest rate spread is under 5% since 2002.[26] It is interesting that even with high concentration on the market, the level of interest rate spreads, in Netherlands is constantly under 1%, since 2003.[27] The interest rate spreads' trend in selected countries is presented in the Table 4.

Table 4. Interest rate spreads in the selected countries, in the period 2000 -2010

Country	**Interest rate spreads (%)***										
	2000	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Bosnia and Herzegovina	-	-	-	7%	7%	6%	4%	7%	4%	8%	-
Croatia	7%	7%	9%	10%	10%	8%	7%	7%	7%	8%	-
Serbia	73%	28%	16%	13%	11%	11%	11%	7%	11%	7%	-
Romania	21%	20%	16%	14%	14%	13%	9%	7%	5%	8%	-
Bulgaria	8%	8%	8%	6%	6%	6%	6%	6%	6%	5%	-

Source: EBRD Transition Reports, Central Bank of Bosnia and Herzegovina

Finally, the development of financial intermediation is an important indicator of the development of an financial system. It is important to stress that the financial systems in selected Balkan countries are pre-dominantly banking oriented. Therefore, the level of financial intermediation is presented as a ratio between domestic credit provided by banking sector and GDP. Domestic credit provided by banking sector includes all credit to various sectors on a gross basis, with the

---

[24] Bonin J., Hasan I., Wachtel P., Banking in Transition Countries, Oxford Handbook of Banking, 2008, p. 16.
[25] Ibid, p. 30.
[26] World Bank indicators
[27] Ibid.

exception of credit to the central government. The level of domestic credit as % of GDP has been growing in all observed countries during the past decade. The highest index was in Croatia – 82%, and the lowest in Romania – 55%. However, it is still very low in Western Balkan countries compared to EU average, which was 160% in 2010.[28] Still, positive fact is that the credit volume is in constant increase since 2000. Financial crisis has slowed down the lending activities of Balkan banks, but the expansion of lending activities is expected in years to come. The domestic credit as percent of GDP is presented in the Table 5.

Table 5. Domestic credit as percent of GDP in the selected countries, in the period 2000 -2010

Country	**Domestic credit (% of GDP)**										
	2000	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Bosnia and Herzegovina	37%	26%	30%	35%	37%	44%	48%	54%	59%	58%	58%
Croatia	41%	46%	54%	55%	58%	64%	69%	72%	75%	76%	82%
Serbia	63%	36%	17%	20%	25%	29%	26%	31%	39%	46%	57%
Romania	14%	13%	14%	16%	17%	21%	24%	35%	47%	53%	55%
Bulgaria	17%	20%	23%	29%	35%	40%	41%	56%	64%	70%	71%

Source: World Bank data

However, the expansion of lending activity in three western Balkan countries was mainly due to an increase in credits to private households non-financial business sectors. The household loans growth is the result of increase mortgage and credit card lending by foreign banks, which produced a great indebtedness of household sectors.[29] The beginning of financial crisis has caused a sharp decline in household loans growth in 2009. The annual loan growth rates are presented in the Table 6.

[28] World Bank data

[29] Cetkovic P., Credit Growth and Instability in Balkan Countries: The Role of Foreign Banks, Research on Money and Finance, 2011, p. 14.

Table 6. Real growth rates of lending activity and GDP

Country	2002	2003	2004	2005	2006	2007	2008	2009
B&H								
Total	28%	19%	15%	23%	16%	26%	13%	-3%
Non-financial business	26%	28%	33%	26%	18%	27%	19%	-1%
Households	113%	34%	33%	27%	19%	28%	10%	-5%
GDP	5%	4%	6%	4%	6%	6%	6%	-3%
Croatia								
Total	31%	15%	11%	16%	19%	10%	8%	-1%
Non-financial business	21%	3%	6%	13%	22%	7%	6%	-1%
Households	41%	25%	16%	17%	18%	15%	6%	-5%
GDP	5%	5%	4%	4%	5%	6%	2%	-6%
Serbia								
Total	-40%	23%	30%	29%	9%	25%	25%	9%
Non-financial business	-35%	19%	19%	20%	-4%	21%	30%	9%
Households	168%	70%	99%	69%	45%	35%	15%	3%
GDP	4%	2%	8%	6%	5%	7%	6%	-3%

Source: Credit Growth and Instability in Balkan Countries: The Role of Foreign Banks, Research on Money and Finance[30]

To conclude, M&A transactions have been the direct cause for the overall decrease in number of financial institutions, although closures of some existing institutions also affected the pattern. Another important implication of banking M&A transactions, and overall banking reforms in observed countries, are the high levels of market share of foreign banks, measured by the share of foreign banks' assets in total market assets. During the period 2000-2010, all countries faced with the substantial growth in foreign banks proportion in total assets. The shares of foreign banks in banking assets in all observed Western Balkan countries are well above European Union's New Member States' average, where the shares of top five foreign banks measured by CR index are above the EU average. Although the decline in interest rate spreads, as an indication of increase of competition in all observed countries, is noticeable during the past decade, the interest rate spreads are still much higher than in more developed European markets. Despite the expansion in landing, the domestic credit to GDP ratio is low in Western Balkan countries compared to European Union average. More importantly, the expansion of lending activity in three western Balkan countries was mainly due to an increase in credits to private households rather than to the companies, which is unproductive use of the financial sources.

[30] Ibid.

CONCLUSION

The financial institutions from developed markets are highly motivated to penetrate into the developing and emerging markets, such as Western Balkans'. The profits they gain mostly through the cost efficiency are their main driving force. The beneficence of international banks' penetration through domestic banks' acquisitions is not that straight forward from the host country's perspective. Although there are numerous advantages of the foreign backs presence, there are also certain concerns and potential threats for the host country's economy. However, during the past two decades, governments of the Balkan countries, with the assistance of international financial institutions, conducted certain measures in order to rebuild their banking sectors and markets.

This paper analysed merger and acquisition transactions in Western Balkan countries during the period 2000 – 2011 with the aim to examine whether the observed countries were attractive for EU banks and also what are the implications of the undertaken M&As in terms of consolidation, market concentration and competition in banking sector, financial intermediation development and landing allocation in the host countries. The data presented in the paper clearly show that the Balkan countries have been attractive for the EU banks, and especially for Austrian, Italian, French, Hungarian and Greek financial institutions. Among western Balkan countries, Croatia was the most attractive and even more successful in attracting acquirers from EU that Bulgaria – the EU member state. The performance of Bosnia and Herzegovina in attracting EU acquirers was far behind Croatia's and Serbia's.

As it is presented in this paper, M&A transactions have been the direct cause for the overall decrease in number of financial institutions, although closures of some existing institutions also affected the pattern. During the period 2000-2010, all countries faced with the substantial growth in foreign banks proportion in total assets. The shares of foreign banks in banking assets in all observed Western Balkan countries are well above European Union's New Member States' average, where the shares of top five foreign banks measured by CR index are above the EU average. Although the decline in interest rate spreads, as an indication of increase of competition in all observed countries, is noticeable during the past decade, the interest rate spreads are still much higher than in more developed European markets. Despite the expansion in landing, the domestic credit to GDP ratio is low in Western Balkan countries compared to European Union average. More importantly, the expansion of lending activity in three western Balkan countries was mainly due to an increase in credits to private households rather than to the companies, which is unproductive use of the financial sources.

References

1. Athanasoglou P., Delis M., Staikouras C. (2006) Determinants of Bank Profitability in the SEE Region, MPRA Paper No. 10274.
2. Bikker J.A., Haaf K. (2000) Measures of Competition and Concentration in the Banking Industry: a Review of the Literature, De Nederlandsche Bank.
3. Bonin J., Hasan I., Wachtel P. (2008) Banking in Transition Countries, Oxford Handbook of Banking.
4. Cetkovic P. (2001) Credit Growth and Instability in Balkan Countries: The Role of Foreign Banks, Research on Money and Finance, Discussion Paper no. 27.
5. EBRD Transition Reports (2000-2010)
6. ECB (2010), EU Banking Structures
7. ECB, (2000) Mergers and Acquisitions Involving the EU banking industry – Facts and Implications.
8. Galac T., Kraft E. (2001) Sto znaci ulazak stranih banaka za Hrvatsku?, Hrvatska narodna banka.
9. Kraft E. (2004) Banking Reform in Southeast Europe: Accomplishments and Challenges, Oesterreichische Nationalbank conference: South European Challenges and Prospects, Vienna.
10. National Banks Annual Reports and Bulletins (2000-2010)
11. PricewaterhouseCoopers, Back to the Domestic Future, March 2009.
12. PricewaterhouseCoopers, European Banking Consolidation, April 2006.Ribnikar I., Kosak M. (2006) Development prospects of the banking industry in the new EU member countries and forthcoming member countries, Zbornik radova Ekonomski fakultet Rijeka, vol. 24, sv.1, UDC 339.923:061.1 EU 336.71.
13. Salgado Santilian J. R. (2011) Banking Concentration in the European Union during the Last Fifteen Years, Panoeconomicus, 2011, 2, 336.71(4-672EU).
14. Schoenmaker D. (2011) The European Bank Landscape After the Crisis, DSF policy paper , No. 12.
15. Siegelbaum P., Sherif K., Borish M., Clarke G. (2002) Structural Adjustments in the Transition, Case study from Albania, Azerbaijan, Kyrgyz Republic and Moldova, World Bank discussion paper no. 429, Washington D.C.
16. Stubos G., Tsikripis I. (2005) Regional Integration Challenges in SEE: Banking Sector Trands, Working paper No. 24, Bank of Greece.
17. Uiboupin J. (2004) Effects of Foreign Banks Entry on Bank performance in the CEE Countries, Tartu University Press, Order No. 569, Tartu.
18. World Bank data indicators
19. Yonkova A., Alexandrova S., Bogdanov L., Development of Banking Sector in Bulgaria, part one.