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Andrei Vernikov

Russian banking: The state makes  
a comeback?



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All opinions expressed are those of the author and do not necessarily reflect the views of the Bank of Finland.

Andrei Vernikov<sup>1</sup>

## Russian banking: The state makes a comeback? <sup>2</sup>

### Abstract

The purpose of this paper is to carefully assess the size of public sector within the Russian banking industry. We identify and classify at least 78 state-influenced banks. For the state-owned banks, we distinguish between those that are majority-owned by federal executive authorities or Central Bank of Russia, by sub-federal (regional and municipal) authorities, by state-owned enterprises and banks, and by ‘state corporations’. We estimate their combined market share to have reached 56% of total assets by July 1, 2009. Banks indirectly owned by public capital are the fastest-growing group. Concentration is increasing within the public sector of the industry, with the top five state-controlled banking groups in possession of over 49% of assets. We observe a crowding out and erosion of domestic private capital, whose market share is shrinking from year to year. Several of the largest state-owned banks now constitute a *de facto* intermediate tier at the core of the banking system. We argue that the direction of ownership change in Russian banking is different from that in CEE countries.

Key words: Russian banks; transition; banking; state; government; public sector; state-owned banks; state-controlled banks; state-influenced banks

JEL codes: G21, G28, P31, P43.

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Andrei Vernikov

## Russian banking: The state makes a comeback?

### Tiivistelmä

Tässä tutkimuksessa arvioidaan julkisen sektorin osuutta Venäjän pankkisektorista. Työssä identifioidaan ja luokitellaan ainakin 78 pankkia, joiden toimintaan julkinen sektori pystyy vaikuttamaan. Tutkimuksessa myös erotellaan pankit, joissa enemmistön omistus on liittovaltiolla tai keskuspankeilla, alue- tai kuntaviranomaisilla, valtion omistamilla yrityksillä tai pankeilla sekä valtiokorporaatioilla. Arvion mukaan näiden pankkien markkinaosuus suureni 56 prosenttiin koko pankkisektorin varoista kesäkuun 2009 lopussa. Kaikkein nopeimmin ovat kasvaneet pankit, joissa julkisen sektorin kontrolli on epäsuoraa. Keskittyminen on lisääntynyt julkisen sektorin omistamissa pankeissa, ja viiden suurimman tällaisen pankin osuus koko pankkisektorista on jo 40 %. Yksityisen pääoman osuus pankkisektorilla on vähentynyt. Suuret valtion hallitsemat pankit de facto muodostavat pankkisektorin ytimen. Muutokset pankkien omistuksessa ovat olleet hyvin erilaisia muihin siirtymätalouksiin verrattuna.

Asiasanat: venäläiset pankit, transitio, pankkitoiminta, julkinen valta, julkinen sektori, julkisen sektorin omistamat pankit, julkisen sektorin hallitsemat pankit, julkisen sektorin vaikutuspiirissä olevat pankit

# 1 Introduction

The primary motivation for this paper is to contribute to the study of the phenomenon of state-influenced banking in the Russian context. While the pervasiveness of the public sector in Russia is widely recognized, it is not a simple task to document it carefully. We collect empirical data to check whether the ownership structure of the banking industry has indeed shifted in favor of state-controlled players, which explains our interest in a more refined classification of state-influenced and state-controlled banks and in the techniques of state control over nominally private institutions. These issues are relevant for studies of comparative efficiency and performance of institutions of different ownership types. Karas *et al.* [2008] found – surprisingly – that in Russia domestic private banks are not more efficient than domestic public banks. Their study relies on public bank lists contained in two different Russian sources, dated 2002 and 2005. Since then, numerous private banks have changed hands. Moreover, we identify fairly many state-influenced banks for which the government is not a shareholder of record. For comparative purposes, the accuracy of data sample is critical, so we try to update the sample for future research.

Our second motivation was to follow up on a question posed in a BOFIT discussion paper in the early 2007: In what direction is the Russian banking industry moving? [Vernikov, 2007]. By the middle of the 2000 decade, we found parity between public sector and private sector and a suboptimal institutional equilibrium. Just three years later the situation appears substantially different, as the public sector has taken over. The direction of ownership change in Russia has clearly diverged from the path that all European transition countries (except Belarus) have followed. Banking industry structure is becoming similar to those in China and Vietnam. The domestic private sector is being eroded. It remains unclear to what extent such phenomena as quantitative lending targets, price controls over bank loans and deposits, administrative interference, and weakening of the rule of law reflect the global financial crisis or are due to public sector expansion.

A few papers on state-influenced banks in Russia have emerged since 2007. Babayev [2007] discusses key definitions related to state banking and offers a classification of public banks. Glushkova and Vernikov [2009] and Glushkova [2009] suggest a more elaborate classification distinguishing between control via state ownership, via the governance mechanism, and via other mechanisms. They also make an assessment of public sector size in terms of combined market share

of public banks by the beginning of 2009. Vernikov [2009a; 2009b] offers yet another version of public bank classifications and updates market shares with July 1, 2009 data.

The rest of this paper is organized as follows. *Section 2* gives key definitions and conventions and presents the author's classifications of state-influenced banks. *Section 3* assesses the share of the public sector in Russian banking. *Section 4* describes the changes in the ownership structure of the banking industry. *Section 5* places the evolution of Russian banking in an international context. *Section 6* summarizes our findings and offers some suggestions for future research.

## 2 Government banking: Scope, definitions and classifications

There is no universally recognized methodology for classifying bank shares and participations as public or private, especially with regard to downstream holdings. Absence of the state (understood as federal-level authorities) among bank shareholders of record provides a formal basis for treating such a bank as private property. The legal status of bank equity belonging to state-owned enterprises (hereinafter SOEs) and state-owned commercial banks (SOCBs) remains partially unregulated. The law does not clearly distinguish between property on the federal level versus the sub-sovereign level. For the above reasons, we could not fully rely on official publications; their scope and coverage of state-influenced banks does not suit our purpose of substantive analysis of the public sector that penetrates the surface of legal formalities. Attribution of a bank to one or another category was therefore judgmental, albeit based on all available information and signals. Here we unfortunately see no alternative.

The main criterion of classifying a bank as state-influenced is the degree of *control* over its decision-making and lending policy by state authorities and managers in charge of public capital. Control can be exercised via equity ownership, via governance, or otherwise. As far as 'grandson' entities are concerned<sup>3</sup>, their classifications depend on whether entities substantially influenced by the state can exert substantial influence on decisions made by owners and top-managers whose combined share of the given bank's equity exceeds 50%. In order to identify state-influenced banks, we searched for state authorities and all kinds of public sector institutions among listed shareholders at individual banks. First we found Russia's 200 largest institutions in terms of asset total. Then the sample was supplemented with smaller banks found to be affiliated with the government. Informa-

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<sup>3</sup> We call 'grandson' entities those banks for which over 50% of the equity belongs to companies and banks that are fully public property or with mixed public/private capital.

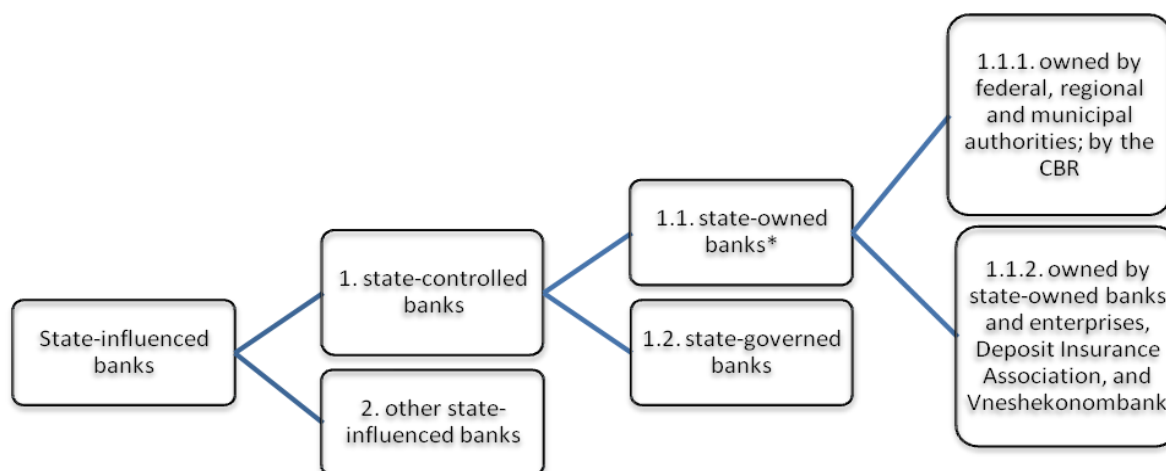


tion sources included statutory disclosure by banks and their parent companies, annual and quarterly reports, CBR publications and websites, RBC rankings, and other publicly available sources.

We tried to organize the diverse forms of interaction between banks and the authorities into a classification scheme (see **Fig.1**).

*State-owned banks*, or *government-owned banks*, or *public banks*, represent the centerpiece of the suggested classification (Group 1.1). These are banks directly or indirectly majority-owned<sup>4</sup> by the state and/or public funds. Banks in subgroup 1.1.1 are *directly state-owned* in the sense that their major or sole shareholder is an executive body at the federal, regional or municipal level, or a CBR. Banks in subgroup 1.1.2 are *indirectly state-owned*, because they are mostly capitalized by funds of public origin but do not belong directly to state authorities. Public funds can be invested in bank equity by state-owned companies<sup>5</sup> and SOCBs, by the Deposit Insurance Agency (ASV, in Russian), Bank for Development and Foreign Economic Affairs (*Vneshekonombank*), or by any other institution established with public funds.

Figure 1 Classification of state-influenced banks



\* At least 50% of equity originates from public funds

Our next category is *state-governed banks* (subgroup 1.2). Here we include banks whose key decisions the state can influence via corporate governance mechanisms, even without a controlling government equity stake. Influence may come, e.g., from ASV acting as bank liquidator or rehabilita-

<sup>4</sup> Majority ownership implies that at least 50% of equity has its primary origin in public funds. In the literature one comes across more liberal criteria: La Porta *et al.* would recognize a bank as ‘government-owned’ if government holds at least 20% of equity but acts as the single largest shareholder [La Porta *et al.*, 2002].

<sup>5</sup> State-owned companies *Gazprom*, *Rosneft*, Russian Railways, and *Alrosa* have equity participation in banks.

tor; from a government official actively participating in a bank's board of directors, etc. A local government would in some cases agree to a dilution of its controlling stake in a bank via new private owners in exchange for keeping a majority of seats on the board of directors.

State-owned banks plus state-governed banks make up our next category of *state-controlled banks* or *government-controlled banks*<sup>6</sup>. We believe that this sample corresponds to what is often called the public sector in the banking industry.

Finally, our broadest category is *state-influenced banks* or *government-influenced banks*<sup>7</sup>. Apart from state-controlled banks, this category includes *other state-influenced banks*. State influence can be identified in a variety of situations including, but not limited to, the following:

- A bank receives a large share of interest income from government bodies<sup>8</sup>;
- Government or a SOE appears among the bank's minority shareholders;
- ASV coordinates the process of bank rehabilitation after yielding shareholder control and operational powers to a new strategic investor;
- Delegates from a government body or a public sector entity sit on the bank's board of directors and can influence strategic decisions, but such influence is far from decisive and does not enable them to take key decisions single-handedly;
- So-called '*oporniy banki*' (base, supporting, pivotal banks) of ministries, public sector entities, regional or local authorities. Nominally these banks are privately-owned and run;
- A CBR delegate is present in the bank to oversee the use of financial assistance provided by CBR and other public authorities.

Our classification displayed in Fig. 1 is quite similar to that of Babayev [2007], except for some details. Firstly, in our investigation of state control and influence over commercial banks we did not limit the scope of analysis to equity stake ownership. We obtained sufficient empirical evidence of a strong government role in banks whose controlling equity stake remains nominally in private hands (group 1.2). We assume that when looking at a society with blurred and poorly defined ownership rights, one should avoid a purely legalistic approach, which is likely to artificially limit the scope of analysis. A qualitative approach can be used instead to identify various non-evident forms of state presence and assess its true magnitude.

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<sup>6</sup> CBR experts have started using the term 'state-controlled banks' in their analytical reports without specifying which exactly banks are meant [CBR, 2009, pp.18, 20, 24]. As far as we can judge by the nature of statistical indicators provided, CBR experts stick to a rather narrow definition of 'state' and basically cover only banks that belong to federal and regional executive authorities. We choose to define this category as 'state-owned banks' and place them in subgroup 1.1.1 in Fig. 1, while our interpretation of 'state-controlled banks' is broader.

<sup>7</sup> Russian-speakers would probably use the expression '*banki s gosudarstvennym uchastiem*', or literally 'banks with state participation', to describe the same phenomenon.

<sup>8</sup> Even a bank receiving a large share of interest income from government bodies can be defined as a public bank [Karas *et al.*, 2008].

*Secondly*, Babayev covers banks for which for over 50% of the equity is held by ‘state corporations’ and flagship banks of state-controlled groups [Babayev, 2007, p.60]. We broaden the scope by including in the sample other indirectly state-owned banks, i.e. ‘grandson’, ‘grand-grandson’, etc. downstream structures controlled by ‘state corporations’ and SOEs. We presume that the state can ultimately enforce its will on such nominally private banks via a chain of intermediate owners.

*Thirdly*, Babayev [2007, p.60] qualifies as ‘state-owned’ only fully (100%) state-owned banks, regardless of whether ownership is exercised directly or indirectly. We find this to be too restrictive. *Rosselkhozbank* would meet the criterion of 100% state ownership, but neither *Sberbank* nor *VTB* would, due to their minority holdings of equity. The broad public and the professional community always refer to both of these institutions as *gosudarstvennie banki*, or *gosbanki* (state-owned banks). The law does not specifically deal with SOCBs. We prefer to use the term ‘SOB’ in a broader meaning that includes *all* state-owned banks (subgroup 1.1).

Table 1 State-controlled banks in Russia

	<i>Number of banks</i>	
	<i>01.01.2001</i>	<i>01.07.2009</i>
Banks predominantly owned by public capital, <i>out of which, majority owned by</i>	33	50
Federal executive authorities and the CBR	6	4
Regional and municipal authorities	11	13
State-owned companies, state-owned banks and ‘state corporations’	16	33
Banks governed by the state without a majority stake in equity	9	11
<b>State-controlled banks, total</b>	<b>42</b>	<b>61</b>
Other state-influenced banks	...	17
<b>Total, state-influenced banks</b>	<b>...</b>	<b>78</b>

Source: Author’s estimate based on CBR and ASV data and formal disclosure of respective commercial banks.

Our broad sample of state-influenced banks includes 77 institutions, of which 60 are state-controlled banks and 17 are other state-influenced banks (**Table 1**). We report that by mid-2009, 6 commercial banks were owned by federal level authorities, 13 by regional and municipal authorities, and 31 by SOEs and SOCBs; another 11 institutions were governed by the state without major equity participation. The full sample is displayed in Appendix **Table A2**.

### 3 The size of public sector

We define market share as the percentage of total banking assets<sup>9</sup> held by state-controlled banks. Market shares of other state-influenced banks are disregarded for the sake of keeping our estimates conservative. When state participation exceeded 50%, the bank's assets were counted fully. Banks with minority state participation and not governed by the state were not included.

One can calculate “controlled assets” as a sum of multiples of each bank's assets by the equity share:

$$G = \sum A_i \times S_i,$$

where  $G$  is total assets controlled by the government,  $A_i$  is a bank's asset total, and  $S_i$  is share of equity belonging to the state. In the Russian situation, this method may be inappropriate because we think that it would distort substance. In an economy with legal institutions and governance traditions like Russia's only a controlling stake enables the owner to defend his interests. A blockholder can project his control over the entire assets of a bank. For instance, CBR owns no more than 57.6% of Sberbank ordinary shares and yet government representatives enjoy full control over Sberbank and its lending policies. There is no such thing as control of assets proportional to equity stake. Unrelated minority shareholders essentially control 0% of a company<sup>10</sup> ..

Combined market share of predominantly state-owned banks in Russia grew from 35.9% in January 2001 to 56% of total assets in July 2009, or by 1.6 times (Table 2). Adding state-governed banks without majority state ownership raises the combined market share of the public sector to 57.1% of all banking assets.

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<sup>9</sup> In our opinion, the asset-total indicator is a superior proxy for the magnitude of a bank's activity than the amount of charter capital or shareholders' equity. Better yet would be to calculate market share as share of loans and credits outstanding, total and per each type of lending (corporate loans, loans to households, mortgage loans, etc.). But data deficiencies did not presently enable this, and it remains on the research agenda for the future.

<sup>10</sup> While unpractical for calculating total banking *assets* influenced by the state, the method of proportional accounting can nevertheless be successfully employed to assess all state *equity* participations in commercial banks, including minority stakes and indirectly owned stakes. That is quite essential for analysing efficiency of direct state involvement in the banking sector, or the return from privatization.

Table 2 Market share of state-controlled banks, % of total banking assets\* at start of period

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>07.2009</u>
Banks predominantly owned by public capital**	35.9	37.2	39.0	39.4	40.7	43.5	44.3	45.3	53.5	56.0
Banks governed by the state, without majority equity stake	0.4	0.4	0.4	0.4	0.6	1.1	1.2	1.2	1.2	1.1
<b>Total</b>	<b>36.3</b>	<b>37.6</b>	<b>39.4</b>	<b>39.8</b>	<b>41.2</b>	<b>44.7</b>	<b>45.5</b>	<b>46.5</b>	<b>54.6</b>	<b>57.1</b>

\* including corporate lending by VEB; \*\* including VEB

Source: author's calculations based on CBR data [CBR, 2009], VEB, and RBC.

Bank for Development and Foreign Economic Affairs (*Vneshekonombank*, or VEB) is a financial institution that has the word ‘bank’ in its official name but formally is not a bank but rather a ‘state corporation’ governed by a special individual law. It is not chartered nor licensed as a bank; CBR has no regulatory power over VEB, and it is not covered in the national banking statistics. Foreign parties, however, do consider VEB to be a bank for all practical purposes, and do not hesitate to include VEB’s external assets and liabilities in statistical aggregates of the Russian banking sector. Apart from several specific functions where VEB acts as governmental agent, VEB also performs operations that in essence do not differ from the activity of regular commercial banks. VEB lends to Russian non-financial companies, and the bank’s IFRS reporting discloses in sufficient detail the size of its commercial-loan portfolio comprising corporate loans, pre-export financing, and project finance. We assume that in this area of its activity VEB is a lending institution that appeals to the same class of borrowers, making it a *de facto* competitor of other large corporate banks<sup>11</sup>. We estimate the commercial loan portfolio of VEB to have reached RUB577bn by mid-2009, or 2% of total assets of the official banking system. This amount is sufficient to dismiss the formal objection that VEB is not a bank. We do add VEB’s commercial loan figures to the Russian banks’ totals when assessing the overall amount of bank assets under the influence of the state. We believe that this results in a fuller coverage.

Our calculations and estimates might entail upward or downward bias. Potential *upward bias* stems from the fact that control does not automatically follow from equity ownership. There is ample empirical evidence of the state not fully exercising its rights as shareholder of banks, and of

<sup>11</sup> “We include development banks because their function is precisely to provide long term finance to development projects where private finance may fail (Myrdal 1968), and hence they constitute a prominent form of government entry into bank lending” [La Porta *et al.*, 2002].

state-owned banks not acting in the public interest. If pursuit of government policy or defense of public interest were strict criteria, then the public sector would be deemed to comprise only a handful of institutions. Recognizing that our use of the term ‘control’ may be too broad in some cases, we still draw the limits of public sector where the state could theoretically reach, whether it actually does or not. The potential upward bias may be caused by a misinterpretation of relations between state and banking business. Feature such as membership of a high-ranking government official in the bank’s board of directors can reflect two different phenomena, either business capture by the state or state capture by private business. Attribution is unavoidably judgmental in cases when there is no equity participation of the state but only control via corporate governance. The margin of error equals the market share of this category of banks, i.e. 1.1 percentage points. However we feel confident about most of the entries, so that upward bias is highly unlikely to inflate the bottom line in Table 2 by more than 0.3 percentage points.

Although our sample is representative enough<sup>12</sup>, we may have missed state-influenced banks as a result of poor disclosure of ownership structures and related parties, but those would be fairly small banks. The first 100 banks were screened carefully, and in Russia an institution below the top-100 cannot have a market share exceeding 0.07% and below the top-200 only 0.03%. The cumulative error should not exceed 2 percentage points of market share.

The outcome of our calculation appears to be on the high side if compared to most other sources using the same or similar indicator (**Table 3**). Central Bank of Russia experts put the share of total assets held by state-controlled banks at just 40.6%<sup>13</sup> [CBR, 2009a]. The Raiffeisenbank research department suggests that the market share of state-controlled banks is 45.7% of total assets [Raiffeisen, 2009], which is halfway between CBR figure and our estimate.

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<sup>12</sup> Identification of state-influenced banks is a continuous process. After the release of the previous version of this working paper in October 2009 [Vernikov, 2009a], we identified 5 subsidiary banks of TransKreditBank; a bank owned by Alrosa, the state-controlled diamond mining company; a bank owned by Odintsovo municipality in the Moscow region and a bank governed by the administration of the Leningrad region. All these banks were added to the sample.

<sup>13</sup> Central Bank of Russia has published more detailed information on market shares of ‘state-controlled banks’ in specific segments such as corporate loans, loans to households, corporate deposits, household deposits, securities portfolios, and total profit/loss of the banking sector (see **Table A1** in Appendix).

Table 3 Market share of public banks in Russia, January 1, 2009

<i>Author / source</i>	<i>Indicator</i>	<i>Market share, % of total assets</i>
CBR, 2009	‘state-controlled banks’	40.6
Raiffeisenbank, 2009	‘state-owned banks’	45.7
Glushkova, Vernikov, 2009	‘state-owned banks’	56.0
Glushkova, Vernikov, 2009	‘state-controlled banks’	59.0
<i>author’s calculation</i>	‘state-owned banks’	53.4
<i>author’s calculation</i>	‘state-controlled banks’	54.6

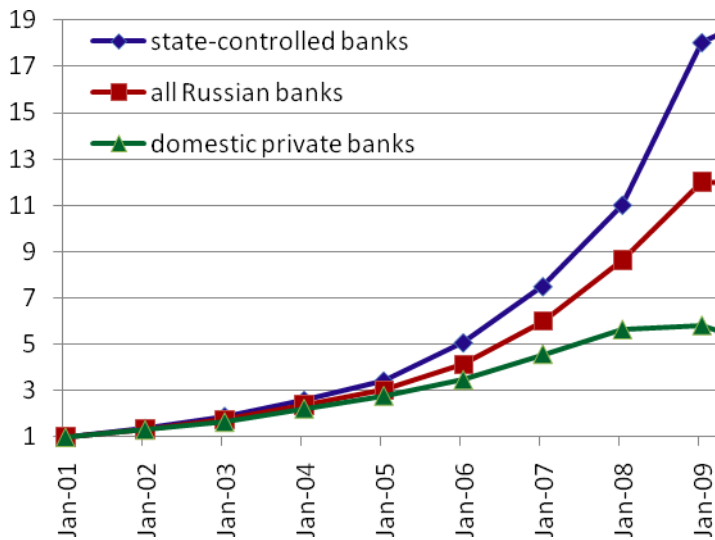
The gap of 12.8 percentage points between the CBR figure and our estimate is material enough to require some comment. The most likely explanation is the difference in the scope of coverage and definitions. The CBR definition of a state-controlled bank is narrow; it excludes numerous banking offspring of public companies. Moreover, our most recent estimate suggests a slightly lower number than in [Glushkova, Vernikov, 2009] as a result of reclassification of several private banks where we fail identify a critical impact of state authorities on strategic decisions. Those banks were moved from the ‘state-governed’ to ‘other state-influenced’ category and were dropped from the core sample.

## 4 Changes in industry structure

State withdrawal from the commercial banking sector in the 1990s was inconsistent. Core banks never became subject to genuine privatization. Instead, there was tacit appropriation of substantial banking assets in the public sector by bank insiders. Combined with very rapid growth of green-field private banks, that drove the market share of public sector to a low of 30% or so in 1998. After the 1998 crisis, however, the trend was definitely reversed. Public sector assets grew organically due to the greater dynamism of state-owned banks, and via takeovers of failed private banks, especially after September 2008<sup>14</sup>. The recent financial crisis of 2008-9 only catalyzed the process (Fig.2).

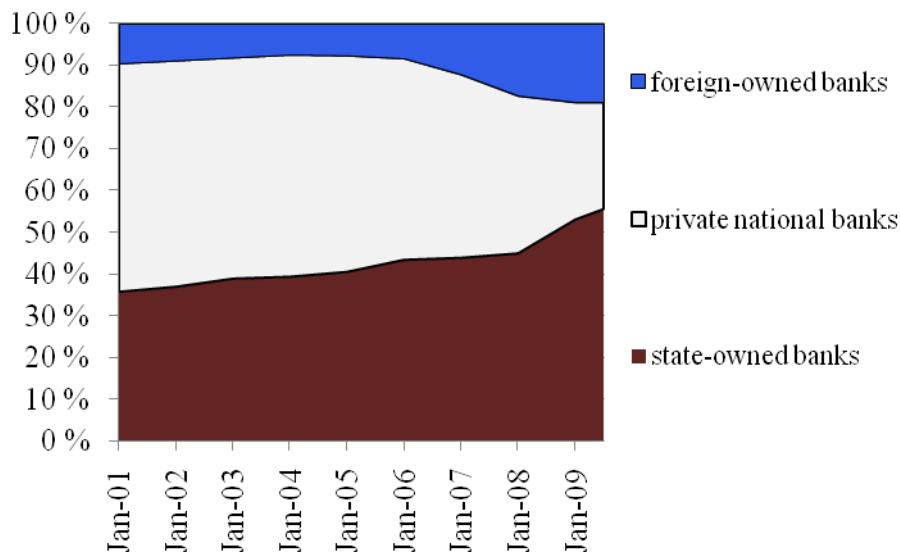
<sup>14</sup> First takeovers were unrelated to the 2008 crisis: *Vneshtorgbank* (now VTB) used public funds to take over the failed *Guta-Bank* in 2004 and the viable *Promstroybank* in 2005.

Figure 2 Growth of Russian bank assets (1 Jan 2001 =1)



Source: Author's calculations based on CBR data

Figure 3 Ownership structure in the Russian banking system (% of total assets)



Sources: Author's calculations and estimates based on CBR data

In 2006 we noted a parity between market strength of domestic private banks and public institutions and predicted that the standoff would not be sustainable [Vernikov, 2007]. It was not.

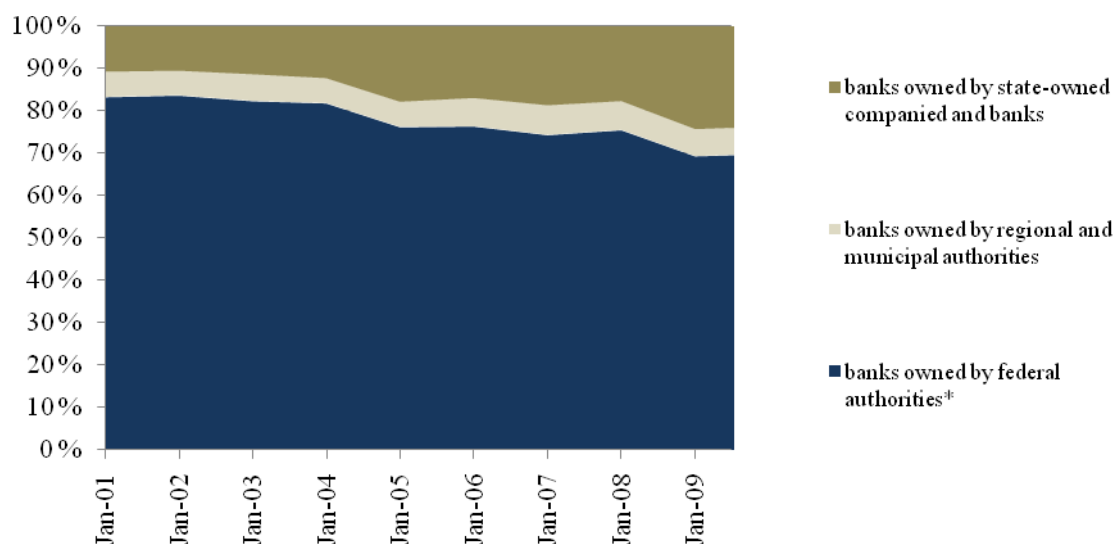


By 2009 the public sector has convincingly overtaken both the domestic private sector and foreign-controlled banks in terms of share of total assets. A breakdown of the Russian banking sector by form of ownership is displayed in **Fig.3**.

The estimate of combined market share of private actors (slightly below 45%) might be too optimistic. In Fig.3 state-governed banks are treated as nominally private, for formal reasons. Moreover, we simplistically tend to assume that all foreign-controlled banks in Russia are private<sup>15</sup>. In any case, domestic private capital stopped being the leading force in the industry. Its gradual erosion and crowding-out from the core of banking into regional and product niches continues. Natural attrition by bankruptcy and voluntary exit is complemented by business capture resulting from growing dependence of private banks on CBR and other authorities for funding and capital.

Restructuring takes place within the public sector. The number of banks majority-owned by state authorities at federal, regional or municipal levels has remained unchanged (17) in the 2000 decade. Meanwhile, the number of institutions controlled by SOEs and SOCBs has doubled from 16 to 33, and their share of all state-controlled banks' assets more than doubled from 10.7% to 23.7% (Fig.4).

Figure 4 Restructuring among state-controlled banks (% of total assets)

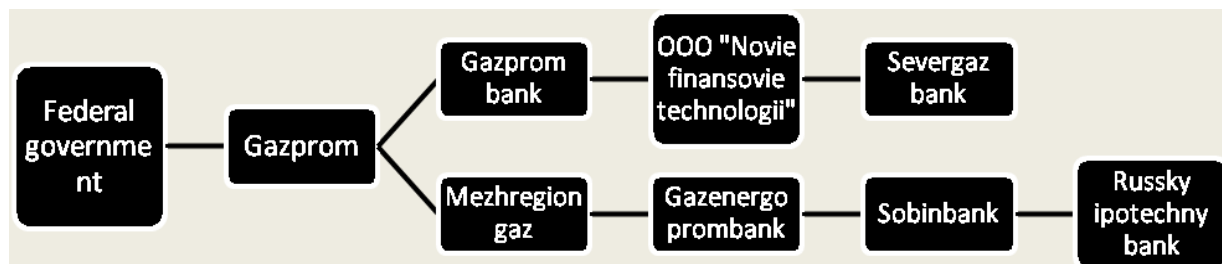


\* Including commercial loan portfolio held by Bank for Development and Foreign Economic Affairs – Vneshekonombank  
Source: Author's own calculations based on data from CBR, RBC and VEB.

<sup>15</sup> A few foreign subsidiaries are actually owned by public institutions, and apart from banks representing Azerbaijan, China, India, Iran or Uzbekistan there are as well banks from Germany (West LB) and UK (Royal Bank of Scotland).

Direct public ownership of banks is thus giving way to indirect ownership and control. Executive authorities delegate owner rights to related companies. We find growing evidence of multi-level holding structures with a large state-owned company or SOCB at the top of the pyramid. Each superior entity holds a controlling stake at the lower-level entity. An example of this type of control is shown in Fig.5. The Russian state controls *Gazprom*, which via one of its divisions (*Mezhregiongaz*) owns *Gazenergoprombank*, which took over *Sobinbank*, which in turn is used to control *Russky ipotechny bank*. Likewise, *Gazprom* controls *Gazprombank*, which uses an intermediate nominal owner (OOO “*Novie finansovie technologii*”) to own 68.8% of *Severgazbank*. We find three or four intermediate ownership levels between officially public funds in *Gazprom* and the equity stake in a downstream commercial bank. There are similar cases in addition to the *Gazprom* group. The state-run monopoly Russian Railways JSC owns TransKreditBank, which in turn owns five subsidiary banks.

Figure 5 Example of control structure in Gazprom group



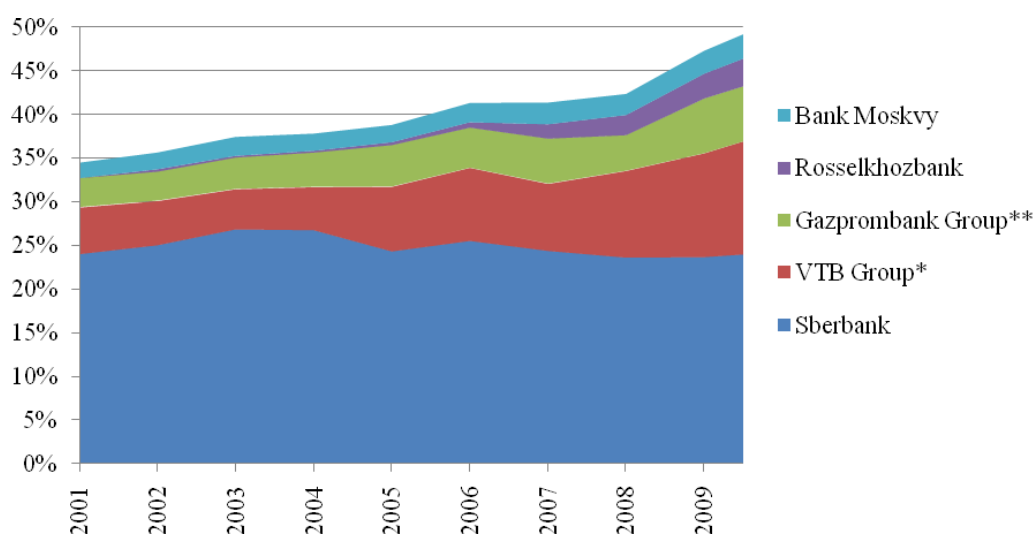
Source: Bank data.

The use of multi-level holding structures often signals *entrenchment* of the blockholder against outside shareholders<sup>16</sup>. In our case, the blockholder is not necessarily the government; it might also be the top management of SOEs. Public property invested in a subsidiary company or bank stops being public and becomes quasi-private. Public control and scrutiny over the use of public funds gets weaker with each additional tier. The bank at the end of the chain should still be regarded as public property in view of the predominantly public origin of funds at the top-level company. For all practical purposes, however, influential insiders (bank top managers, board members and the public officials who represent the authorities) treat such property and dispose of it as if it were their own private property. Use of the diluted public property by insiders is often followed by appropriation.

<sup>16</sup> On entrenchment of the blockholder against outside shareholders see: [Morck, Steier, 2005]. Entrenchment is a way to leave without leaving, i.e. to maintain leverage over the company after formally divesting from it.

Concentration is increasing within the public sector. In 2001-9, the market share of the five largest state-related banking groups (Sberbank, VTB group, Gazprombank group, Rosselkhozbank, and Bank Moskvyy) jumped from 34.5% to 49% of Russia's total bank assets (**Fig.6**). Another important banking group is being shaped under *Vneshekononbank*, which has four banking subsidiaries in Russia, one in Ukraine and one in Belarus. Of the ten largest banks by total assets, six are now public entities and only one is domestic private.

Figure 6 Share of leading state-controlled banking groups (% of total bank assets)



\* VTB Bank, Bank VTB24 and Bank VTB-Severo-Zapad; \*\*Gazprombank, Bank GPB-Ipoteka, Kredit-Ural, Severgazbank, Sibirgazbank and Noyabrskneftekombank.

Source: Author's own calculations based on data from CBR and RBC

The phenomenon of domestic champions from the public sector fits the pattern of dismantlement of a monobank and establishment of large SOBs each specialized in its own field such as foreign trade, agriculture, construction, etc. A similar system emerged in USSR in 1988 when 'specialist banks' (*spetsbanki*) *Sberbank*, *Vneshtorgbank*, *Promstroybank*, *Zhilsotsbank* and *Agroprombank* were spun-off from the state bank *Gosbank*. We observe a return to a modernized version of essentially the same system of '*spetsbanki*' based on a few core banks with a focus on a particular sphere of the economy or region - e.g., *Rosselkhozbank* (agriculture), *Gazprombank* (gas industry), *Bank Moskvyy* (city of Moscow), *Sberbank* and *VTB24* (retail), *VTB* (large corporate business and export financing) or *TransKreditBank* (railways).

Public banks now constitute a *third tier* of the Russian banking system, not explicitly observed in national law. What makes them a separate tier is not only access to privileges or being

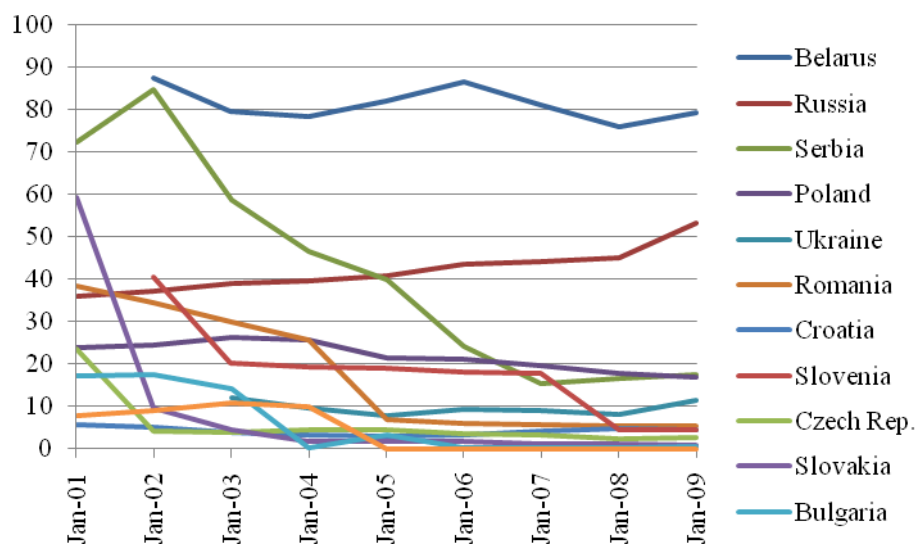
‘too big to fail’, but performance of special functions. In addition to the functions generally performed by all commercial banks, we see public banks also acting as:

- providers of liquidity to banks in the lower tier, the liquidity mostly originating from public funds;
- vehicles designed to acquire and hold non-core industrial assets deemed as strategic by state authorities. These assets range from construction companies in Russia to a carmaker in Germany;
- long-term investment providers to ‘systemically-important’ enterprises and ‘strategic projects’, including those with a social or political dimension like sport or congress facilities;
- corporate raiders and vehicles of property redistribution, especially with regard to assets pledged to banks by owners against loans received;
- first-aid provider of funds to socially or politically sensitive ventures.

## 5 International context

We earlier suggested that reassertion of government presence in the Russian banking industry differs markedly from the general pattern in transition countries [Vernikov, 2007]. European transition countries have moved away from government banking<sup>17</sup> towards an internationally-open model of banking dominated by private capital, foreign or national (**Fig.7**). In Russia and Belarus the share of public banks exceeds 50%, and is on the rise. These two countries now appear to be pursuing similar strategies, albeit Belarus has done it more consistently throughout the past years.

Figure 7 Market shares of state-controlled banks (% of total assets)



Sources: Author's calculations for Russia; [Raiffeisen, 2006; 2009] for other transition economies.

<sup>17</sup> Serbia and Slovenia were among the last to join the general trend of having the market share of public banks under 20%.

Industrial policy with regard to banking aims at modernization and increase of efficiency, under strict government control and guidance. The difference between Russia and Central and Eastern European economies is not in the *pace* of transition, as reform-thinkers often claim, but in the *direction*. Russian banking is evolving towards a quite different system that may well be the system existing in China and Vietnam. China, Russia and Vietnam all try to grow ‘national champions’ within the public sector. The number of such core banks varies from four in China and Vietnam to five in Russia<sup>18</sup> with combined market shares of 49% in Russia, 65% in China and 70% in Vietnam. True privatization of leading financial institutions has been carefully avoided and remains off the agenda, although private minority shareholding was made possible.

## 6 Concluding remarks

Our empirical study helped to identify at least 78 state-influenced banks, including 61 state-controlled banks. By the end of the 2000 decade, state-controlled banks commanded 54.6% of total assets, thus constituting the core of the Russian banking industry. Concentration is growing within the public sector, and the main players controlled by the state (*Sberbank*, VTB group, *Rosselkhozbank* and *Bank Moskvyy*) hold 81.7% of the group’s assets.

The main direction of ownership change in the industry can be described as renationalization, sometimes creeping and sometimes rampant. In terms of industry structure Russia might emulate the banking model of China or Vietnam, rather than Czech Republic or Poland. Major public banks became an intermediate tier of the system between the CBR and the rest of commercial banks. The domestic private sector is being diluted, eroded and crowded out. After 20 years of experimenting with private financial intermediation, Russia appears to be backtracking towards a state-run credit system.

We detected two new trends: (a) delegation of owner’s rights vis-à-vis banks from government authorities to state-owned companies and banks and ‘state corporations’; and (b) multi-

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<sup>18</sup> Big-5 in Russia (*Sberbank*, VTB, *Gazprombank*, *Rosselkhozbank* and *Bank Moskvyy*); Big-4 in China (Industrial and Commercial Bank of China, Bank of China, Agricultural Bank of China and China Construction Bank); and Big-4 in Vietnam (Bank for Investment and Development, Industrial Commercial Bank, Vietnamese Bank for Agriculture and Rural Development, and Bank of Foreign Trade). One might find some similarity in the above-mentioned banks’ names.

level structures of corporate ownership over banks, as part of the ‘entrenchment’ of the state and/or other insiders against external shareholders.

The number of state-owned banks has reached the level of 50. This calls for a ‘rationalization’ of the holdings. If our hypothesis about return to the system of ‘*spetsbanki*’ (state-owned specialist banks) is correct, one will soon be seeing mergers between public banks and even disposals of redundant entities. The federal budget is in deficit and needs non-oil revenues, hence divestment from banks is an option. Insiders are eager to ‘privatize’ (read: appropriate at submarket prices) the resources that authorities have pumped into their banks in 2008-9 before bank-share prices resume growth.

The *baseline* scenario for the immediate future rests on current trends of strengthening of market positions held by state-controlled banks. Public funds remain the main, if not the only, source of investment and liquidity, and public banks will keep their grip on the flow of these funds. *Upside ‘risk’* depends on a more favorable external environment (oil price). It would give breathing space to private banks and postpone the need for severe forms of resource mobilization. *Downside risk* is linked to adverse market environment as well as some form of social, political or ethnic unrest that will briskly increase centralization of all resources and enhance redistributive elements in the economy and society.

We see several *directions for future research*:

- further testing of the hypothesis that public banks are more efficient than private ones [Karas *et al.*, 2008], based on an upgraded definition of public banks and a broader sample;
- comparing growth patterns of banks representing different forms of ownership;
- impacts of state-controlled banks on competition in specific segments of the market for banking services (lending to medium-sized businesses; lending to small business and micro financing; mortgage lending; consumer loans; household deposits; etc.);
- patterns of opportunistic behavior of public bank insiders and the channel of rent extraction;
- causality between expansion of public property in the banking industry and revival of institutions inherent to redistributive economies, e.g. price controls and administrative resource allocation (directed lending).

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## Appendix

Table A1 Market share of state-controlled banks, % (CBR data)

<i>Share of:</i>	<b>01.01.2008</b>	<b>01.01.2009</b>
Total assets	39.2	40.6
Loans to non-financial companies and households	44.0	45.8
Loans to households	41.0	41.3
Corporate deposits	32.4	32.8
Household deposits	57.0	59.0
Fixed-income securities portfolios held by banks	40.8	37.6
Equity securities portfolios held by banks	45.7	19.1
Financial result of the banking sector	40.3	48.4

Source: [CBR, 2009; 2008].

Table A2 Russia: list of state-influenced banks<sup>19</sup>, July 1, 2009

reg.#	bank name	city	note
<b><i>Banks owned by federal executive authorities and CBR</i></b>			
3349	Rosselkhozbank	Moscow	Federal Government
3099	Rossiyskaya finansovaya korporaciya	Moscow	Federal Government
1481	Sberbank	Moscow	CBR
1000	VTB	St.Petersburg	Federal Government
<b><i>Banks owned by regional and municipal authorities</i></b>			
2602	Almazergienbank	Yakutsk	Yakutia regional administration - 54%
708	Bank Kazani	Kazan	Kazan municipality - 100%
2748	Bank Moskvyy	Moscow	Moscow municipality
1280	Chuvashkreditprombank	Cheboksary	Chuvashia regional administration -60% (?)
1399	Elita	Kaluga	Kaluga regional administration
1971	Khanty-Mansiyskiy	Khanty-Mansiysk	Khanty-Mansiysk regional administration
3360	Krayinvestbank	Krasnodar	Krasnodar regional administration - 97%
3344	Moskovskoe ipotechnoe agentstvo	Moscow	Moscow municipality - 100%
3197	Odinbank	Odintsovo, Moscow region	Odintsovo municipality – 56.7%
3269	Orenburg	Orenburg	Orenburg regional administration - 99%
2015	Sibsotsbank	Barnaul	Altay regional administration - 99.9%
2802	Yoshkar-Ola	Yoshkar-Ola	Mariy El regional administration - 71%
918	Zapsibkombank	Tyumen	Tyumen region - 25.1%, Yamalo-Nenets region -25.1%
<b><i>Banks majority-owned by state-owned companies, state-owned banks and ‘state corporations’</i></b>			
1339	Chitapromstroybank	Chita	TransKreditBank - 75%
843	Dalnevostochniy	Vladivostok	Vserossiysky bank razvitiya regionov
3284	Gazenergoprombank	Gazoprovod, Moscow region	Gazprom via Mezhrefiongaz
354	Gazprombank	Moscow	Gazprom, directly and via Gazfond

<sup>19</sup> Classification of banks into one or another category is done for analytical purposes and reflects the author’s judgment only; no official status or statement is implied. The author is liable for possible misallocations due to data deficiency.



1942	Globex	Moscow	VEB
2403	GPB-Ipoteka	Moscow	Gazprombank
1911	KIT Finance	St.Petersburg	Russian Railways
2584	Kredit Ural Bank	Magnitogorsk, Chelyabinsk region	Gazprombank
1088	MAK-Bank	Moscow	Alrosa - 84.7%
2003	MeTraKomBank	Rostov/Don	TransKreditBank - 76.4%
2863	Mosvodokanalbank	Moscow	Bank Moskvyy 50.1%
3466	Nacionalny kliringoviy centr	Moscow	MICEX
2786	Novosibirskiy municipalny	Novosibirsk	Khanty-Mansiyskiy bank
2274	Noyabrskneftekombank	Noyabrsk, Tyumen region	Gazprombank
729	Petrovskiy	St.Petersburg	ASV - 50%
2790	Roseximbank	Moscow	VEB
3340	Rossiyskiy bank razvitiya	Moscow	VEB - 100%
2312	Rossiyskiy kapital	Moscow	ASV - 100%
1968	Russkiy ipotechniy bank	Moscow	Gazenergoprombank via Sobinbank
2816	Severgazbank	Vologda	Gazprombank
3042	Sibirgazbank	Surgut, Tyumen region	Gazprombank
1317	Sobinbank	Moscow	Gazenergoprombank
2307	Soyuz	Moscow	Gazprom via Gazfinans - 75%
1338	Superbank	Blagoveschensk	TransKreditBank - 51.1%
1470	Svyaz-Bank	Moscow	VEB
459	Tarkhany	Penza	ASV
3238	Transinvestbank	Moscow	Gazprom via Mosenergo
2142	TransKreditBank	Moscow	Russian Railways - 55%
1342	Vostokbiznesbank	Vladivostok	TransKreditBank - 99.9%
3287	Vserossiyskiy bank razvitiya regionov	Moscow	Rosneft
439	VTB Severo-Zapad	St.Petersburg	VTB
1623	VTB-24	Moscow	VTB
414	Yugo-Vostok	Voronezh	TransKreditBank - 78.5%
<b><i>Banks governed by the state without a majority stake in equity</i></b>			
2590	Ak Bars	Kazan	Tatarstan Republic
3334	Bank Khakassii	Abakan	Khakassia regional administration
1049	Khakasskiy muniucipalny	Abakan	Abakan municipality - 40%
912	Moskovskiy industrialny	Moscow	Moscow municipality
948	Mosstroyekonombank	Moscow	Moscow municipality
2103	Municipalny Kamchatprofitbank	Petropavlovsk-Kamchatskiy	Kamchatka regional administration
1309	Narodny bank Respubliki Tyva	Kyzyl	Tyva Republic - 42.5%
410	Nomos-bank-Sibir	Novosibirsk	ASV
2865	Novokuznetskiy municipalny	Novokuznetsk, Kemerovo region	Novokuznetsk municipality
2484	Onego	Petrozavodsk	Karelia regional administration
138	Ruskobank	Vsevolozhsk, Leningrad region	Leningrad region administration

*Other state-influenced banks*


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2227	Bank24.ru	Yekaterinburg	ASV
2189	Bashinvest	Ufa	ASV
3388	Finservice	Moscow	Gazenergoprombank via Sobinbank - 49%
3252	Gazenergobank	Kaluga	ASV
2888	Kazansky	Kazan	KMPO (?), Kazan municipality (?)
2179	KB Otkrytie	Moscow	ASV
3087	Nacionalny trgovy	Togliatti, Samara region	VEB - 16.7%
1902	Naratbank	Saratov	Ak Bars
1851	Nizhegorodpromstroybank	Nizhny Novgorod	ASV
926	Nizhny Novgorod	Nizhny Novgorod	ASV
2546	Novikombank	Moscow	Rosoboronexport (?)
2786	Novosibirsky municipalny	Novosibirsk	Novosibirsk municipality
1019	Potensial	Zhigulevsk, Samara region	ASV
3262	Rinvestbank	Ryazan	Ryazan regional administration
2083	Severnaya kazna	Yekaterinburg	ASV
2975	Sverdlovsky gubernsky	Yekaterinburg	ASV
2523	Uralsky trastoviy	Izhevsk	ASV via Bank Petrovsky

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Source: bank data

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