



SS CYRIL AND METHODIUS UNIVERSITY IN SKOPJE
FACULTY OF ECONOMICS – SKOPJE



ECONOMIC RECOVERY IN THE POST-CRISIS PERIOD

Proceedings from International Conference

Edited by Vladimir Filipovski





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FACULTY OF ECONOMICS – SKOPJE**



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*Proceedings from the International Conference
held at the Faculty of Economics – Skopje
29 – 30 May 2015*

Edited by Vladimir Filipovski

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FOREWORD

The adverse effects of the latest global financial crisis and the accompanying Great Recession (2007–2009) have not only prevented a strong and fast recovery, but have also seriously questioned the ability of the major world economies to return to their pre-crisis long-term growth path. All this has created serious challenges facing economic and business theories and their policy prescriptions. Those challenges range from how to redesign economic policy and regulatory reforms to how to reinvent the business models so that markets, firms and governments can lay down the foundations for a future sustainable economic growth and job creation.

Aiming at creating a forum for exchange of ideas and empirical research that try to search for answers to these intellectual and practical challenges, the *Faculty of Economics* within the *Ss. Cyril and Methodius University* in Skopje organized an international scientific conference under the title: *Economic Recovery in the Post Crisis Period*. The Conference took place on 29. – 30. May 2015 at the Faculty of Economics in Skopje and it covered several topics grouped into three broad areas as follows:

- I. Macroeconomic Issues in the Post-Crisis Environment
- II. Finance in the Post-Crisis Environment
- III. Enterprise Restructuring in the Post-Crisis Environment

The *Scientific Board* of the *International Conference on Economic Recovery in the Post-Crisis Period* consisted of the following members:

1. Vladimir Filipovski, Ss. Cyril and Methodius University in Skopje, Faculty of Economics-Skopje, Republic of Macedonia (Chair)
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The *International Conference on Economic Recovery in the Post-Crisis Period* set itself an objective to attract theoretical and empirical research which will offer scientific insights into the following issues:

- the issue of main drivers of the long-term economic growth and how to improve the productive potential of the economies, while also taking into consideration the income distribution effects;
- the new context for the conduct of the monetary policy and new modes and instruments for its implementation;
- the issue of providing for fiscal discipline in the age of the crisis-related fiscal expansionism;
- how to build a truly stable and efficient financial system;
- how can enterprises restructure their business models to optimally adapt to the post-crisis changes in the business environment, and
- how to invigorate entrepreneurship, SME sector development and job creation, particularly for the unemployed youth, and etc.

During the three Conference sessions, 35 presentations were realized involving scientific papers prepared by authors from 12 countries: Republic of Macedonia, USA, Australia, Russia, France, Czech Republic, Slovenia, Belgium, India, Mexico, Serbia, Albania and Italy. It may be said that the Conference have created an exchange of ideas and discussions on wide range of issues, starting from the challenges to macroeconomic theory and policies, moving on to the issues related to financial markets and labor markets, then discussing issues that are of fundamental importance not only for the development of the enterprise sector but also for the overall process of economic development the core of which being innovations, their generation and policies for their promotion and stimulation.

The *Faculty of Economics* within the *Ss Cyril and Methodius University* in Skopje has subsequently organized the publication of the *Proceedings of the International Conference on Economic Recovery in the Post Crisis Period*. These *Proceedings* include not only the papers which were presented at the Conference but also several other papers that were submitted for the Conference and accepted by the *Editorial Board* of the *Proceedings*. The members of the *Editorial Board* are the following:

1. Vladimir Filipovski, Ss. Cyril and Methodius University in Skopje, Faculty of Economics-Skopje, Republic of Macedonia (Chair)
2. Daniela Mamucevska, Ss. Cyril and Methodius University in Skopje, Faculty of Economics-Skopje, Republic of Macedonia

3. Stojan Debarliev, Ss. Cyril and Methodius University in Skopje, Faculty of Economics-Skopje, Republic of Macedonia
4. Borce Trenovski, Ss. Cyril and Methodius University in Skopje, Faculty of Economics-Skopje, Republic of Macedonia
5. Kiril Jovanovski, Ss. Cyril and Methodius University in Skopje, Faculty of Economics-Skopje, Republic of Macedonia

This publication, the *Proceedings of the International Conference on Economic Recovery in the Post Crisis Period*, follows the same classification of the papers as in the one followed at the *Conference*. The first section contains papers related to the topics in macroeconomic theory and policies and the issues in economic growth and development. The second section contains papers that deal with banking and finance aspects of the macroeconomic issues. The third section is devoted to the various issues of the business sector restructuring in the post crisis context.

The *Proceedings of the International Conference on Economic Recovery in the Post Crisis Period* includes 35 papers from 62 authors/coauthors coming from 15 countries (Republic of Macedonia, USA, Russia, Australia, Canada, Honk Kong, France, Italy, UK, Czech Republic, Poland, Belgium, Slovenia, Serbia, Albania).

We would like to express our utmost appreciation and gratitude to all the authors of the papers included in these *Proceedings* and we believe that the readers will find many interesting thoughts and analyses related to some challenging economic issues.

Skopje, November 2015

Prof. Vladimir Filipovski

Editor in Chief

ACKNOWLEDGEMENTS

In organizing the *International Conference on Economic Recovery in the Post-Crisis Period*, the Faculty of Economics within the Ss Cyril and Methodius University in Skopje has been helped with the precious support from several institutions and individuals.

First of all, we would like to express our appreciation and acknowledgements for the esteemed Rector of the Ss Cyril and Methodius University in Skopje, Prof. Velimir Stojkovski, Ph.D., who has decisively contributed to make the financial support of the University to be timely and efficiently available to the organizer of the Conference, the Faculty of Economics Skopje.

We would also like to acknowledge the support of the American Embassy in the Republic of Macedonia, through its staff for economic affairs, has also provided logistical and financial support for bringing an American scholar to participate at the Conference.

In the similar vein, the Macedonia 2025 Foundation has also provided logistical support in organizing the Conference and we would like to thank its staff.

We would like to thank our young colleague, an MBA graduate Filip Fidanoski, for his time and efforts to help the Conference through successfully communicating with the Conference participants from various foreign countries.

Acknowledgements also go to *Vitaminka Joint Stock Company* from Prilep which has financially supported the Conference.

Skopje, November 2015

Editorial Board

CONFERENCE TOPIC

I.

**MACROECONOMIC ISSUES
IN THE POST-CRISIS PERIOD**

CONSOLIDATION OF THE BANKING SECTOR IN MACEDONIA: EFFECTS AND BENEFITS

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ABSTRACT

Modern-day banking is characterized by constant change and development, as a result of the globalisation in the world economy. It is currently passing through its most turbulent period ever since its inception, considering the ever-growing and fierce competition, the constant changes of technologies, the financial innovations, the entrance and domination of foreign banks on the market, the decrease of the prices of bank services and decrease of interest rates as well as the slow recovery from the Global financial crisis.

Ever since the global financial crisis occurred, banks all over the globe are struggling and facing decreased efficiency and profitability, especially small banks that are limited in many ways - they cannot diversify their portfolios nor use economies of scale, not to mention their limited access to new customers, new technologies and financial innovations. The case in the transition countries is even more dramatic, due to the fact that the financial system itself has not been developed enough and the entrance of foreign fierce competitors is more noticeable.

This paper revolves around the group of small banks in the Macedonian banking market, who have been facing negative financial results ever since the Macedonian economy has noticed the effects of the global financial crisis, due to the limited bank assortment, the small participation in overall loans and deposits and the limitations of being small in a globalized market.

The main objective of this paper is to emphasize the benefits of the consolidation in the banking sector in the Republic of Macedonia and to stress its inevitability. Consolidation will bring strong competition among quality competitors, higher quality of bank services, diversification of the assortment of bank services, lower cost of capital, branch optimization, change of the business models, implementation of up-to-date methods for risk management and most importantly, higher profitability and higher efficiency of the banks and the banking system as a whole. Furthermore, M&A influence the concentration in the banking sector; they bring higher competitive advantages and transfer of technologies, know-how, knowledge and innovative thinking. The synergy created by M&A's should not be underestimated.

Our research and the results of the valuation methods used strongly encourage banks' managements to consider the proposed consolidation, in order to gain higher efficiency, competitive advantage and opportunity to grow.

Thus, we suggest that consolidation of the banking sector is an inevitable process which Macedonian banks must implement, the sooner the better. However, it does require structural change of the banking sector and organizational transformation of the banks, but that is a small price to pay for the benefits the banks will enjoy.

Keywords: banks, consolidation, banking sector, efficiency, mergers, Republic of Macedonia

JEL classification codes: G21, G20, G34

INTRODUCTION

Considering the Macedonian bankocentric financial system, banks represent by far the most important institutions in the financial system. This is expected to change with the development of the financial system and financial markets. However, until then, banks hold a very important role in the growth of the financial system as well as the growth of the economy. These past 15 years have been characterized with many structural changes in the banking sector, most of them as a result of the globalization and its side effects.

Bank consolidation has been gathering pace in many transition countries as part of a global concentration trend following bank deregulation processes.¹²⁴ The reform process that took place in the Western Balkan countries attracted the penetration of international banks.¹²⁵ Many European banks have penetrated the Western Balkan's banking sectors, acquiring the local state-owned or private banks. Thus, many changes in the banking sectors have happened.

Foreign banks prefer entering transition countries' markets by M&A, since it is the best way to secure a significant part of the market in a very short notice, as well as to use the domestic base of clients and the current distribution channels.¹²⁶ However, the processes of M&A have led to significant development in the target countries as well. For instance, the banking sectors have consolidated, the market concentration got higher and the financial intermediation has developed further more.

This study is an attempt to address the issue of the benefits of the consolidation in the banking sector in the Republic of Macedonia and to stress its inevitability. Consolidation usually brings strong competition among quality competitors, higher quality of bank services, diversification of the assortment of bank services, lower cost of capital, branch optimization, change of the business models, implementation of up-to-date methods for risk management and most importantly, higher profitability and higher efficiency of the banks and the banking system as a whole. Furthermore, M&A influence the concentration in the banking sector; they bring higher competitive advantages and transfer of technologies, know-how, knowledge and innovative thinking. The synergy created by M&A's should not be underestimated. These facts have been proven in this study, i.e. the effects and benefits of the consolidation have been validated. This is why this process in the banking sector is more than welcome.

RELATED LITERATURE

Researches in the area of mergers and acquisitions show mixed evidence on the relationship between M&As, profitability and performance. The area of M&A in general is a very specific business and academic area. Furthermore, the M&A in the banking is very tempting for researchers and investment bankers, due to the many aspects it involves.

Beck, Demirgüç-Kunt and Levin (2006) find no argument that the bank concentration increases the fragility of banks, rather, the banking system concentration is associated with a lower probability that the country suffers a systemic banking crisis. Their findings support the theory that greater bank concentration is associated with a lower likelihood of suffering a crisis.

According to Almeida and Jayme (2008), the consolidation of the banking sector reduces the number of loans granted. Their explanation and research showed that the presence of bank branches and head offices in the regions is positively related to lending. Accordingly, the relocation of branches

¹²⁴ Almeida Castro d.B.D., Jayme Jr. F.G., (2008), "Bank consolidation and credit concentration in Brazil (1995-2004)", *Cepal Review* 95, August 2008, iss. 95, pp. 155-71

¹²⁵ Filimonović D., Radovanović B. (2011), "Mergers and acquisitions in banking sector: the case of Western Balkan countries", Chapter 28- Contemporary issues in the integration processes of the Western Balkan countries in the European Union, pp.460-477, Institute of Economic Studies, Belgrade

¹²⁶ Mašić S. (2010), "Mergers and acquisitions as cross-border growth strategy for European banks", XII international symposium "SymOrg 2010", Zlatibor, Srbija, 2010

in the country's most developed regions, together with the regional concentration of bank head offices, reduces the per capita credit stock in the other regions.

Dolar and Burak (2014) have stated that in the last two decades, the extensive consolidation of the banking industry, and its likely consequences of increased presence of large banking institution as well as concentration in local banking markets, have raised concerns about the ability of small businesses to obtain funds. The effects of consolidation on small business lending may be more pronounced during a credit squeeze when the supply of loans becomes increasingly scarce. Their findings suggest that small business lending growth declined in California's moderately concentrated and highly concentrated urban banking markets relative to unconcentrated ones after the financial crisis of 2008. They also found that the effect of market share structure on small business lending growth is moderated by market concentration in the post-crisis era.¹²⁷

Most of the economic literature has justified banking M&A on the ground that it enhances shareholder value (Ayadi, Arnaboldi, 2008). Prior studies show that the stock prices of the target bank significantly increase at and around the announcement of a takeover. The research of Figuera C. and Nellis A. (2007) implies that banks involved in M&A activity are more efficient after the M&A when compared with other large banks, which have chosen alternative routes of development. They suggest that country-specific characteristics appear to play an important role in explaining the results.

Andrade, Mitchell and Stafford (2001) study the stock market reaction in bank mergers, and the creation of shareholders' value, with most of the gains accruing to the target company. They found that the target firm shareholders are clearly winners in merger transactions.

Antić (2007) argues that the M&A operations in banking have potential to create value through benefits, which can be seen as either in the sense of market power or in the sense of higher efficiency. Regarding the efficiency, it can be achieved through reduction of the costs (cost synergy), increase of the revenues (revenue synergy), exchange of best practice and diversification of the risks.

Kraft (2004) points out that foreign bank entry has often been accompanied by a consolidation process that has increased concentration in banking markets. This may actually increase effective competition, as a small number of strong banks are able to contest markets effectively, as opposed to a large number of very small banks competing against one or a small number of large banks held over from socialism. Consolidation may also enhance financial stability.

Block (2006), on the other hand, states that the overall literature on mergers is not encouraging. He has sublimated many prior studies regarding the impact of the merger on the stock value of the acquiring and the target bank, and has found out that the target banks have experienced positive and substantial, whereas the bidder returns are mostly negative.

Our study is consistent with the findings of Filipović (2012), who claims that the company's size has a great impact on the takeover's success. Furthermore, he documents that the smaller the relative size ratio of the target company compared to the acquirer, the more successful is target company's performance after the takeover. This fact is an additional argument for the consolidation of the small group banks in the Republic of Macedonia.

Our research has been driven by several factors. First, number of studies have examined the effects of consolidation on competition and market structure of banking industry; however, these studies have concentrated on developed markets and transition markets, but very few findings regarding the Macedonian banking sector. Our study contributes to the literature by comparing the market structure of Macedonian banking industry pre- and post-consolidation periods.

¹²⁷ Dolar, Burak, (2014), „Bank consolidation and small business lending in the aftermath of the US financial crisis: evidence from California's banking markets“, *Journal of International Business Disciplines*, May 2014, Vol. 9 Issue 1, pp.1-26

BANKING IN THE 21ST CENTURY

Modern-day banking is characterized by constant change and development, as a result of the globalization in the world economy. It is currently passing through its most turbulent period ever since its inception, considering the ever-growing and fierce competition, the constant changes of technologies, the financial innovations, the entrance and domination of foreign banks on the market, the decrease of the prices of bank services and decrease of interest rates as well as the slow recovery from the Global financial crisis.

Speaking of changes, there are two tendencies that can be determined in the international banking: 1) increased competition that influence on the banking products and prices, and 2) technology improvements that affect the distribution channels of selling and the operating cost of the banking activities.¹²⁸ These two factors affect simultaneously and are interrelated.

The ever-growing competition in the banking sector (especially by nondepository institutions), the deregulation in the industry, the inevitable effects of the globalization and the constant changes in the technology, market approach and clients' preferences are strongly influencing the nature of commercial banking whereas the ability of banks to adapt to the changes and the new trends in the industry dictates their market position and therefore their performance.

The globalization of the world economy has been supported and initially stimulated by the growth and development of technology, in particular in three important domains: the computerization of the trading networks (enabling the supply and demand to meet without physical), the satellite communication (which enables very quick data transfer) and the Internet, who has changed the way businesses operate. As an indirect consequence of the globalization, many new players have appeared in the banking sectors throughout the world. There are pension, hedge and private equity funds that slowly take over many traditional functions of the commercial banks. Financial and banking innovations have increased over the past decade due to the growth and development of technology, i.e. banking software, applications and channels.

The idea of a 'global market' has given companies and banks from throughout the world an opportunity to embrace the changes and open themselves up to the new information era, where they all could benefit. However, some businesses (especially small businesses in transition countries) are reluctant to change and are therefore staying behind. The new economic order, the time when globalization has an impact on the growth of all businesses and countries, offers many advantages for those interested to stay in the game, i.e. for the companies ready to embrace the changes in the market and keep the pace.

The banking industry is a very specific industry that is by default very conservative and usually, if not always, banks are very big systems, with a lot of administration, processes and operations, which does not leave them with much space for adaptation to the new time. The fast growth and implementation of IT solutions in banking, however, affects their financial transactions' costs, by dramatically decreasing them. In recent years, technology has become increasingly important to the bank's growth and development of new electronic products.

The modern economic theories have selected a few main reasons for growth of banks through the processes of M&A: technological development, deregulation, globalization of the market and better financial services in a bigger financial sector.

¹²⁸ Nenovski T., Jolevska Delova E., Andovski I., (2012) "Banking services in terms of changing environment: the case of Macedonia", *Procedia-Social and Behavioral Sciences* 44, 2012, pp.347

THE BANKING SECTOR IN THE REPUBLIC OF MACEDONIA: STRUCTURE AND CONDUCTED CONSOLIDATION

The banking sector in general is a quite specific field for research, this is why we found it so tempting. However, the banking sector in the Republic of Macedonia has an additional value for researchers, since it differs from other countries' banking sectors.

The Macedonian banking system has not yet been affected by the increasing competition from new players and non-depository institutions¹²⁹, as other banking sectors in the region. As a matter of fact, the banks in the country have made their position stronger, dominating in the financial system (as showed in table 1).

Even though the non-depository institutions have been gaining part of the market, it is still insignificant and still not a remarkable change. This only confirms the crucial role of commercial banks in the bankocentric Macedonian financial system.

Table 1: The structure of the total assets of the financial system in Macedonia (in %)

Structure of the total assets of the financial system in the Republic of Macedonia (in %)								
	2006	2007	2008	2009	2010	2011	2012	2013
Depository financial institutions	90,1	91,67	90,5	89,7	90,1	89,5	89,2	88,3
Banks	88,9	90,5	89,2	88,6	89,2	88,6	88,5	87,6
Saving houses	1,19	1,17	1,2	1,1	0,9	0,8	0,7	0,7
Non-depository financial institutions	9,9	8,33	9,5	10,3	9,9	10,5	10,8	11,7
TOTAL	100	100	100	100	100	100	100	100

Source: National Bank of the Republic of Macedonia, Financial Stability Reports (2006-2013)

When analyzing table 2, it seems that the percentage of foreign capital is relatively the same in all three groups of banks. However, the fact that the small banks are limited in the number of clients and assets, it might be a better solution to merge among themselves, in order to gain the benefits, such as better access to new technology, financial innovations and bigger opportunity to credit approvals.

Table 2: Participation of the foreign capital in the total capital* (in %)

Group	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Big banks	37,1%	68,4%	74,2%	82,8%	80,7%	79,5%	79,7%	79,4%	78,1%	77,6%	76,3%
Middle-sized banks	25,3%	33,6%	41,9%	60,2%	69,0%	66,8%	68,6%	61,5%	69,0%	74,0%	76,3%
Small banks	48,8%	46,4%	46,2%	61,5%	72,5%	57,5%	70,0%	89,4%	87,0%	74,7%	75,7%
Banking sector	47,5%	52,5%	56,1%	69,1%	74,3%	68,6%	72,9%	74,7%	75,2%	75,2%	76,2%

*It is calculated as a ratio between the nominal value of the issued common and priority stock in foreign ownership and the total nominal value of all the issued common and priority stocks.

Source: National Bank of the Republic of Macedonia

¹²⁹ Nenovski T., Jolevska Delova E., Andovski I., (2012), "Banking services in terms of changing environment: the case of Macedonia", *Procedia-Social and Behavioral Sciences* 44, 2012, pp.348

In table 3, we have sublimated the number of banks in each group, so that it would be easier to notice the structural changes and the time frames of these changes. However, it should be emphasized that the criteria used for classifying the banks has been changing over time, as the financial and banking system has developed and grown. For example, the total assets used in classifying the small banks' group in 2004 has been less than 2 billion MKD. This criteria has risen since 2005 (and it has stayed so until 2010) onto total assets less than 4,5 billion MKD. In the years 2013 and 2014, the criteria has been- total assets of less than 7,1 billion MKD.

Table 3: The number of banks by groups in the period of 2004-2014

	Group of big banks	Group of middle-sized banks	Group of small banks
2004	3	8	10
2005	3	3	14
2006	3	7	9
2007	3	8	7
2008	3	8	7
2009	3	8	7
2010	3	9	6
2011	3	8	6
2012	4	8	4
2013	3	8	5
2014	4	8	3

Source: National Bank of the Republic of Macedonia

Table 4 gives us a very clear picture of the consolidations, M&As in the banking sector in the period of 1998-2014. In the period of the *first wave of mergers and acquisitions (1998-2001)*, the most crucial M&As have happened, leading from 24 banks in 1998 to 21 bank in 2001. In the period of 2001-2005 no changes in the structure have been made. However, *the second wave of mergers* in the banking sector has happened in the period of 2005/2006. *The third wave of M&As* in this sector have been in 2008, when Steiermärkische Sparkasse has acquired Invest banka AD Skopje and CKB AD Sofija has acquired CKB Banka AD Skopje. *The fourth wave* of M&As in the banking sector took place in the period from 2011-2014.

Table 4: Tabular overview of the structural changes in the Macedonian market 1998-2014

<i>Number of banks in the Republic of Macedonia</i>		
<i>Year</i>	<i>Banks</i>	<i>Additional remarks</i>
1998	22+2	The license of „Aka Banka,, AD Skopje has been withdrawn. Two new institutions appear in the banking markets: MBDP- Macedonian Bank for Development Promotion and an affiliation of "Ziraat Bankasi".
1999	22+1	22 banks + 1 affiliation of a foreign bank
2000	22	Issued license for the International Commercial Bank of the People's Republic of China-Taiwan. Tutunska banka AD Skopje has become a part of the Slovenian NLB Group. Greek NBG has acquired Stopanska banka AD Skopje, whereas Alpha bank AE Athens has acquired Alpha bank AD Skopje.
2001	21	In 2001, NBRM has issued license to Eurosviss banka AD Skopje. Furthermore, NBRM has issued 3 licenses for status changes: merging of Zemjodelska banka AD Skopje to Sileks banka AD Skopje, merging of Pelagoniska banka AD Prilep to Komercijalna banka a.d. Skopje, as well as merging of Teteks banka AD Skopje to Kreditna banka AD Bitola.
2002	21	No changes in the structure.
2003	21	No changes in the structure.
2004	21	No changes in the structure.
2005	20	The license of "Radobank" AD Skopje is withdrawn and the saving house „Maleshevka,, AD Berovo has been acquired by „Invest Banka,, AD Skopje.
2006	19	Merging of „Tetovska Banka,, AD Tetovo and „Teteks-Kreditna Banka,, AD Skopje, thus creating "TTK banka" AD Skopje. The saving house „Makedonska stedilnica,, AD Skopje has been acquired by "Invest Banka,, AD Skopje
2007	18	The license of „Makedonska Banka,, AD Skopje is withdrawn. This year, Ohridska banka AD Skopje has become a part of the Societe Generale Group. Bulgarian Alfa Finance Holding takes over Capital bank AD Skopje.
2008	18	(previously Invest banka AD Skopje), and CKB AD Sofija takes over CKB Banka AD Skopje.
2009	18	No changes in the structure.
2010	18	No changes in the structure.
2011	17	In January 2011, "Stater Bank" AD Kumanovo has merged into "Centralna Kooperativna Banka" AD Skopje. Halk Bank AD Skopje has bought the control package in IK Banka AD Skopje.
2012	16	Merging of „Ziraat Banka" AD Skopje and „Halk Bank,, AD Skopje.
2013	16	No changes in the structure.
2014	15	Postenska Banka AD Skopje has merged with Eurostandard Banka AD Skopje at 01.07.2014.

Source: NBRM annual publications (1998-2014)

THE GLOBAL FINANCIAL CRISIS AND ITS IMPACT ON MACEDONIAN BANKING SECTOR

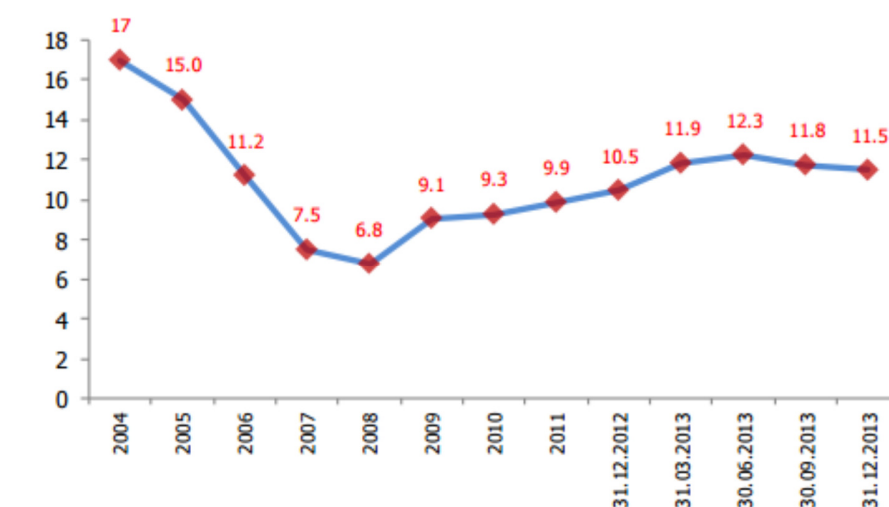
The Global financial crisis that occurred 2008 has inevitably left its mark on the Macedonian economy, thus the banking sector. Even though the effects of the crisis have occurred with a time lag, and were probably not as severe as the economies with developed financial markets, still, it has showed its impact. Even though the Macedonian financial markets are not well-developed, the crisis has had deep impact on the economy and the bank's performances. What was recognized was slower growth of the financial system of the country, slowing of the process of entry of new foreign capital

in the financial institutions as well as slower growth of the assets of the banking sector.¹³⁰

The banking system in Macedonia has remained stable, liquid and well capitalized. While NPLs continued to increase somewhat, they remained more than fully covered by provisions. The Macedonian banks (including subsidiaries of parent banks from the euro zone) are mostly financed by domestic resident deposits, do not depend on external wholesale funding, and have very limited credit exposure to countries or clients from the euro zone.¹³¹

The processes of M&A have been stopped in the period of the crisis, there were no changes in the banking system from 2008 until 2010, as showed in table 3, in this period, no changes in the structure have been made. We assume that the Global crisis has led investors into reconsideration of their future plans- this is why M&As in this period were left out.

Graph 1: NPLs (Non-Performing Loans) in the banking sector in the period of 2004-2013



Source: National Bank of Republic of Macedonia, Annual report for 2013

The impact of the crisis in the banking sector is best to be analyzed through the percentage of the non-performing loans in the total loans of Macedonian banks. A closer look at the NPL data from graph 1 indicates that 2008 has been the year with the lowest NPLs in the banking sector and ever since 2004 banks have decreased their NPLs. We believe it is important to emphasize the fact that there is a significant improvement before the M&As, before the internationalisation of the banking sector, before the domestic banks merged with foreign banks have started implementation of up-to-date methods for risk management, started assessing risk and managing it. However, due to the crisis and its impact on the economy and businesses (thus, on banks as well), it has showed an increase ever since 2008.

¹³⁰ Fotova K. (2014), "The Global financial crisis and its impact on the profitability of the banking sector in the Republic of Macedonia", Annual conference for Doctoral School, Skopje

¹³¹ Hafizi D., Bushi I. (2014), „Global Crisis Impact in Banking System for Western Balkan Countries“, Economic Questions, Issues and Problems, pp.117

BENEFITS AND EFFECTS OF THE CONSOLIDATION OF THE MACEDONIAN BANKING SECTOR

There are many different theories regarding the effects and benefits that banks get when merging and consolidating. Many of the conducted researches claim that the short term measures of success are not relevant (when the announcement of the merger is made, the value of the target company shares will increase, while the value of the acquiring company shares will remain static or fall¹³²). The long term measures of the success of the M&A and the benefits from it are what matters.

However, in the case of the banking sector of the Republic of Macedonia, the effects were relatively positive rather than negative. First of all, the consolidation of the banking sector has brought many foreign players in the banking market- about 71.8% coming from stockholders from the EU.¹³³ Thus, it was inevitable to modernize the market approach, the technology used and to offer diversified products and services to the Macedonian clients.

As shown in table 5, we have conducted a research on the technologies currently used in Macedonian commercial banks. What we found out is that there is a positive correlation between the advanced technologies used by the banks (i.e. the more options for clients, the more software options and channels used) and their affiliation in a foreign group of banks, who are interested in the market and therefore investing in it. This review would actually confirm the fact that the Macedonian banks have benefited the merging by implementing new and modern technologies. This table shows the channels and types of software/technologies used by the banks. For instance, it can be concluded that NLB Tutunska Banka AD Skopje, Stopanska banka AD Skopje, Sparkasse Banka AD Skopje, Komercijalna banka AD Skopje and Halk Bank AD Skopje have been investing heavily in new channels and adjusting their offers to the market's needs. This only led us to the ultimate conclusion: the banks belonging to the group of big and middle-sized banks in the Republic of Macedonia can afford to offer modern technologies, software and gadgets to their customers, following the trends in the industry and the region, but that is not the case with the banks belonging to the group of small banks.

Innovation has become an increasingly important source of value creation in many industries.¹³⁴ Innovation and technology are the most important factors when negotiating mergers and acquisitions. The importance of innovation has been heightened by rapid technological change and growing knowledge intensity in industries.

This way, the Macedonian banks have gained access to innovation in banking, new assortment of banking products and services, different distribution channels, therefore higher growth of profits and customer base, by being a part of a bigger group of banks and having access to bigger funds, know-how and already applied software solutions.

¹³² Roberts A., Wallace W., Moles P. (2010), „Mergers and acquisitions“, Edinburgh Business School, pp.1/14

¹³³ NBRM (2014), Report on the risks in the banking system of the Republic of Macedonia in 2013, Skopje, pp.60

¹³⁴ Hitt M., King D., Krishnan H., Makri M., Schijven M., (2009) „Mergers and acquisitions: Overcoming Pitfalls, Building Synergy, and Creating Value“, Business Horizons, Vol. 52, No. 6, November-December 2009, pp. 523-529

Table 5: Technology offered by the Macedonian banks

List of Banks	Technologies offered
Komercijalna Banka A.D. Skopje	Internet Bank, SMS Banking (for individuals and legal entities), m-Banka mobile application
Stopanska Banka A.D. Skopje	i-Bank (for individuals) with digital certificate, m-banking mobile application, e-banking (for legal entities), Phone banking
NLB Tutunska Banka A.D. Skopje	NLB klik using token, NLB Mobipay, NLB SMS Notification, NLB Proklik using token, NLB mKlik-mobile application
Halk Bank A.D Skopje	PayPass contactless cards, SMS notification, mobile banking, E-Banking
Sparkasse Banka A.D. Skopje	IndividualNet, NidividualNet Plus, IndividualNet Plus- sToken
TTK Banka a.d. Skopje	e Banking; Web, e-mail & SMS notification
Ohridska Banka A.D.	<u>OBSGN@t-</u> E-Banking
Uni Banka A.D. Skopje	E- UNIBank (virtual bank)
Eurostandard Banka A.D. Skopje	E- Banking
Centralna Kooperativna Banka A.D. Skopje	E-Banking by using digital certificate for electronic signature
Alpha Banka A.D. Skopje	Alpha Web Banking
Stopanska Banka A.D. Bitola	E-Banking
Capital Bank A.D. Skopje	Microsoft CAPICOM- E- Banking
ProCredit Banka A.D. Skopje	E-Banking, Phone Banking and SMS Notifications

Source: Websites and official announcements of the commercial banks in the Republic of Macedonia, sublimated by the authors

The consolidation and the entry of foreign capital in the Macedonian banking sector have created a very competitive market, and thus they have further developed the financial markets.

It is worthwhile mentioning that even though being part of a greater financial group has its own perks, it can also cause some damage in the sense of reputation risks. Namely, this effect has occurred in the case of NLB Tutunska banka AD Skopje and Stopanska banka AD Skopje. In the case of NLB Tutunska banka AD Skopje (which is a part of the Slovenian NLB Group), the bank has experienced reputation and security issues on more occasions. The first impact was in September 2012, when the media had published that the NLB d.d. Ljubljana's management has been under investigation, and the fact that the mother company is facing major losses due to the NPLs.¹³⁵ The second impact the bank experienced was a larger-scale impact which had made deponents insecure and questioning the bank's ability to operate. This time, not only the NLB Tutunska banka's CEO made a statement, but also the Governor of the National Bank of the Republic of Macedonia and the minister of foreign affairs of Slovenia, all reassuring the public that the bank is very solid and does not depend on the NLB d.d. Ljubljana, who is facing troubles.¹³⁶¹³⁷ It had been a very challenging period of time

¹³⁵ <http://24vesti.mk/nlb-ljubljanska-pod-istraga-depozitite-na-makedonskite-gragjani-i-kompanii-sigurni> (12.01.2015)

¹³⁶ <http://republika.mk/?p=52777> (15.01.2015)

¹³⁷ <http://kurir.mk/makedonija/ekonomija/111808-Makedonskite-gragani-da-ne-stravuvaat-depozitite-vo-Tutunska-banka-se-sigurni> (15.01.2015)

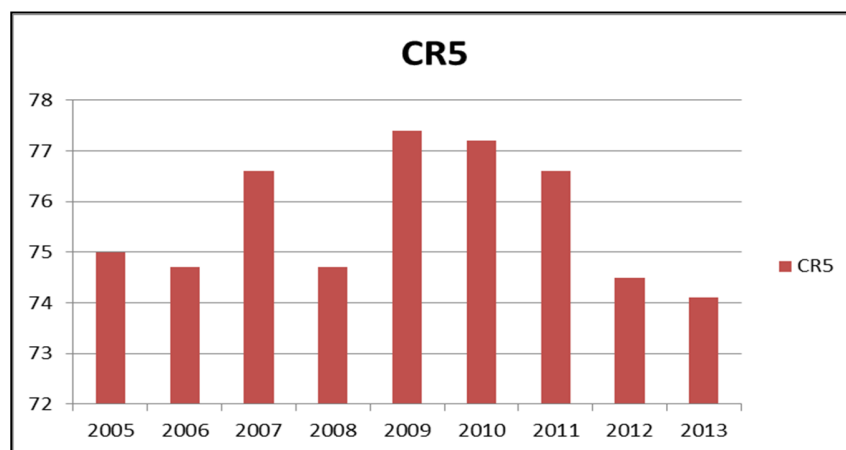
for NLB Tutunska banka AD Skopje, always being a target in the media. However, even though this could have destabilized the bank, this was not the case. Furthermore, the profitability of the bank in 2013 has improved since 2012 (ROA 1,06 as opposed to 2012- 0,85, and ROE 11,2 as opposed to 10,1 in 2012).¹³⁸

In June 2011, due to the crisis in the Greek economy, the Governor of the National Bank of the Republic of Macedonia had felt it was necessary to reassure the deponents in Stopanska banka AD Skopje (member of the Greek NBG Group) and Alpha bank AD Skopje (member of the Greek Alpha bank AE, Athens) that despite the crisis in Greece, the liquidity and capital adequacy of the two banks are high and there is no need to worry.¹³⁹ The Governor did highlight that both banks are independent of their Greek mother-banks. The second impact was also due to the situation in the Greek economy in May 2012. This time, the CEO of Stopanska banka AD Skopje has stated that the deposits are absolutely secure and that there is a growth of deposits in the bank. According to the results (Stopanska banka has had ROA fall from 1,4% in 2010 to 0,94% in 2011, but only to rise again on to 1,1% and 1,3% in 2012 and 2013 respectively), it seems that this had only short-term impact on the stability and the efficiency of the Macedonian banks with Greek capital.

When considering the concentration of the banking sector, no analysis is complete without the use of CR5 and the Herfindahl index. The Concentration ratio index (CR_k, and in our case the CR5) is one of the most frequently used measures of concentration in literature. CR5 is actually the sum of the five largest banks' share in total assets. Graph 1 shows data that the banking sector has been very concentrated in 2007, and from 2009 till 2011. However, the assets of the five largest banks seem to be decreasing, which shows that the medium sized banks (who have been acquired in the period before 2012) have been increasing their banking activities and offers, thus increasing their assets.

The HI graph shows moderate concentration in the banking industry in the Republic of Macedonia. What is interesting is that HI index has been declining, same as in the most of the EU member countries.¹⁴⁰ This could be elaborated as a higher percentage of competition on the market, due to the entry of new foreign investors in the middle-sized banks.

Graph 2: CR5 indicator for the Macedonian banking sector



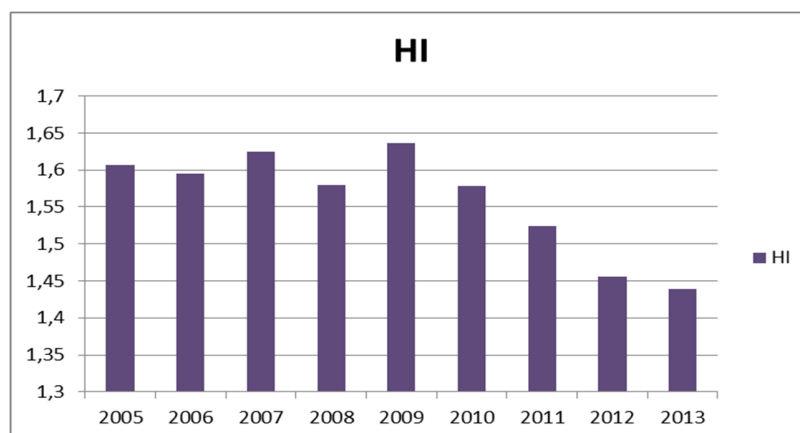
Source: NBRM

¹³⁸ Annual reports issued by NLB Tutunska Banka AD Skopje (www.nlbtc.com.mk)

¹³⁹ <http://vecer.mk/makedonija/grchkite-banki-vo-makedonija-se-sigurni> (15.01.2015)

¹⁴⁰ Lukić L., (2010), "Structural changes and consolidation management in Serbian banking", *International Scientific Conference MANAGEMENT*, Kruševac, pp.187

Graph 3: HI (Herfindahl index) for the Macedonian banking industry (total assets) in the period of 2005-2013



Source: NBRM

However, as seen in table 6, there is still place for improvement, especially in the small banks' group. Even though they have experienced significant decrease of losses ever since 2013, the losses are still present. Furthermore, when conducting the data in tables 7 and 8, it could be concluded that the participation of the small banks in the structure of the deposits and loans is unacceptably low in all categories (sectors, maturity and currency), when compared to the other groups of banks.

Table 6: The net profit/ net loss of the banking sector as a whole as well as the groups of banks separately (in millions of MKD)

Current net profit/net loss	Group of big banks	Group of middle-sized banks	Group of small banks	Total
2004	1032	306	-90	1247
2005	943	421	228	1592
2006	1907	819	74	2800
2007	2672	963	15	3650
2008	3389	104	-82	3410
2009	2.195	-355	-164	1.676
2010	2.688	-354	-27	2.307
2011	2.386	-998	-205	1.183
2012	1.985	211	-735	1.461
2013	1.694	665	-48	2.311
2014	2513	731	-94	3149

Source: NBRM's publications (2004-2014)

Table 7: Structure of the deposits in the groups of banks

Structure of the deposits		31.12.2011			31.12.2012			31.12.2013		
		Big banks' group	Middle-sized group	Small banks' group	Big banks' group	Middle-sized group	Small banks' group	Big banks' group	Middle-sized group	Small banks' group
Sectors	Business	57,5%	37,6%	5,0%	76,4%	20,6%	3,0%	58,5%	36,0%	5,5%
	Household	75,0%	20,3%	4,7%	76,9%	19,0%	4,1%	72,4%	21,5%	6,2%
	Other clients	70,0%	20,0%	10,1%	69,7%	23,7%	6,6%	63,2%	27,6%	9,2%
Maturity	On demand	71,9%	23,3%	4,8%	76,9%	20,4%	2,8%	67,6%	27,4%	4,9%
	Short-term	70,7%	25,6%	3,7%	80,3%	17,7%	2,0%	72,8%	22,9%	4,3%
	Long-term	66,2%	24,9%	8,9%	67,6%	22,4%	10,0%	63,6%	25,7%	10,7%
Currency	Denars	72,6%	20,5%	6,9%	74,8%	19,8%	5,4%	69,0%	23,3%	7,7%
	Denars with a clause	17,1%	80,5%	2,4%	78,2%	19,1%	2,7%	11,3%	75,5%	13,2%
	Foreign currency	70,1%	26,5%	3,3%	78,5%	19,2%	2,3%	69,3%	26,6%	4,1%

Source: National Bank of the Republic of Macedonia

Table 8: Structure of the loans in the groups of banks

Structure of the loans		31.12.2011			31.12.2012			31.12.2013		
		Big banks' group	Middle-sized group	Small banks' group	Big banks' group	Middle-sized group	Small banks' group	Big banks' group	Middle-sized group	Small banks' group
Sectors	Business	67,4%	28,8%	3,7%	73,9%	22,0%	4,1%	63,3%	30,1%	6,6%
	Household	67,7%	26,3%	5,9%	73,5%	22,3%	4,1%	66,2%	28,7%	5,1%
	Other clients	77,5%	20,9%	1,6%	75,2%	23,1%	1,7%	69,7%	28,6%	1,7%
Maturity	Short-term	65,6%	29,7%	4,6%	77,2%	17,8%	5,0%	62,2%	30,4%	7,4%
	Long-term	68,5%	27,7%	3,8%	72,9%	23,8%	3,2%	64,3%	30,5%	5,2%
	Past due	66,2%	31,7%	2,0%	78,4%	19,2%	2,4%	64,8%	27,8%	7,4%
	NPLs	65,5%	24,6%	9,9%	72,3%	19,8%	7,9%	69,9%	22,2%	7,8%
Currency	Denars	78,4%	15,8%	5,8%	79,5%	15,3%	5,2%	74,7%	19,4%	5,8%
	Denars with a clause	59,1%	38,1%	2,7%	75,5%	22,7%	1,9%	57,3%	35,8%	6,9%
	Foreign currency	61,3%	33,9%	4,7%	61,8%	33,6%	4,6%	53,1%	41,9%	5,0%

Source: National Bank of the Republic of Macedonia

CONCLUSION

The change of the banking industry as a result of the fast-growing technology is inevitable and banks all over the globe are embracing this change, implementing new IT solutions, market approaches, new strategies etc. The Macedonian banking system has been affected by the globalization and M&As were an integral part of the process.

At this moment, Macedonian banks are not facing competition from other (non-depository)

institutions, but that should not discourage them from large investments in IT software, training and education of their human capital and re-approaching the market. Our research has showed that the target banks of mergers and banks that are part of a bigger group are most active with implementing technology and inventing custom-made products, there is strong evidence that they are experiencing benefits from consolidating. These operations have given them a stronger position on the market, higher concentration on the Macedonian banking market and higher competitiveness. This has inevitably resulted in higher quality of the services for the clients.

What we are pointing at, is the assumption that the consolidation in the Macedonian banking sector has left many benefits for the target banks as well as the whole sector and the financial system. However, it is still impossible to clearly state whether M&As have led to improved financial efficiency or the sector itself is still undergoing reforms as a result of global economic meltdown¹⁴¹ and a transition into a new system in this case of the Republic of Macedonia.

More importantly, our research has showed that the group of small banks has been staying behind when new technology is considered. Furthermore, they have been still facing negative financial results. Even though the percentage of foreign capital in the small banks' group is relative high, the banks itself are not big enough to experience the benefits of the economies of scales. In their case, a reasonable solution would be a merger between them (as the least painful solution) or an acquisition in order to become bigger and keep track of where the industry goes. This would inevitably bring benefits to the banks themselves as well as the whole Macedonian economy.

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¹⁴¹ Okpanachi J., (2011) „Comparative analysis of the impact of mergers and acquisitions on financial efficiency of banks in Nigeria“, *Journal of Accounting and Taxation* Vol. 3 (1), pp.1-7

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