



THE SERBIAN BANKING SECTOR: HOW FAR IS IT AWAY FROM SLOVENIA?

Healthy competition as the basis for a stable market

At the moment there are 33 banks in Serbia fighting for customers in a market with 7,6 million citizens (except Kosovo). The 3 largest banks in Serbia, compared to their total assets as of September 30th 2007, are all foreign owned: Banca Intesa, Raiffeisen and Hypo Alpe-Adria together share 30% of the Serbian banking market.

Among those 33 banks you can find a number of banks that are still (or at least partially) owned by the Republic of Serbia. Therefore the next round of privatizations in Serbia is already in preparation:

From the market's perspective irrelevant banks like Privredna Banka Pančevo or Kredi Banka Kragujevac should already have been sold years ago, but no potential buyer has been found so far. So, one of the scenarios will be that the Government will first take care of its restructuring and will then try to sell them again. Poštanska Štedionica and Srpska Banka will most likely try once again to merge, since they had failed already in 2006 because of how it was whispered in the banking community: "...there were allegedly no identical numbers on the active and passive side of their balance sheets".

Privredna Banka Beograd, where the Republic of Serbia has a stake of nearly 20%, is preparing its privatization. As it is already visible in many cities outside Belgrade the bank invested heavily in 2007 in the expansion of its branch network – and this is usually a very clear signal.

And finally there are 2 banks where EBRD is a strategic partner, with 25% and 24% respectively, besides the Republic of Serbia, who is the majority shareholder with each 39%: Čačanska banka and Komercijalna banka.

As a result of those privatizations I do not expect so many new international banking groups to enter the Serbian market, since almost all of them are already present. I see more of a concentration of the existing ones, which means that one or the other international banking groups can use the opportunity to expand its existing network by taking over one of the before-mentioned banks **and the total number of banks will drop below 30.**

In Slovenia the situation is totally different: although the concentration of banks on the Slovenian market is already relatively high – 24 banks are competing for 2 million citizens – the first direct bank will start very soon and there are rumors that a Slovenian private equity fund is going to establish its own new bank, which means banks number 25 and 26 will be in such a small market.

But what's more impressive is the fact that:

- a. the 3 largest banks on the Slovenian banking market together reach a market share of nearly 50% and
- b. the majority stake in all three banks is still held by Slovenian shareholders!

I am sure that every international investor would see Slovenia today more as a close, monopolistic system than an open banking market.



Loans are no longer the “one and only” product for Serbs

When following researchers and economists from Raiffeisen International, Unikredit or Deutsche Bank, then we will see even more focus on retail business than during the last few years. The reasons are that demographic structures in markets like Serbia are becoming more and more similar to the Western ones: young families no longer want to live together with one or two other generations in the same household, pensioners already have some money available for the grandkids' savings books, etc.

On the other side there are tremendous restrictions from the National Bank of Serbia to keep the loan growth rates on a very low level. One of these measurements is for instance a 45% obligatory reserve, which means that banks have to deposit 45 cents at the National Bank for every EURO they receive. Or in other words: if a bank pays 5% to its depositors, it has to lend the money to its borrowers for a minimum of 9%, just to cover the costs of the National Bank's restrictions.

In my opinion this was also necessary, because the banks in Serbia were fighting so much about market share and everyone tried to get ahead of the others by being more attractive towards customers: maturities of up to 35 years, grace periods of 2-3 years and loans in foreign currency (I don't mean the EURO as a foreign currency) **should make it easy for everyone to receive a loan, regardless of if the income matched the installments.**

Therefore, banks had to look for other sources of income. In 2006 they had already started to deal with securities; they even established their own mutual funds and the distribution of insurance policies through bank networks also suddenly became very attractive.

This is different in Slovenia, because an obligatory reserve is no longer necessary “to keep the fight for the best customer” on a reasonable level. This means that this difference of for instance 400 bps (like in the simple example before) could be transferred to customers and loans, and would be much cheaper for Serbian customers.

Besides that, you can already find advanced services like financial security and insurance or wealth and asset management in Slovenian banks' product portfolios.



Risk management systems and business growth are not developing parallel

There are huge expectations in developing markets like Serbia, and many shareholders, both institutional and private, want to see new records each quarter. **Banks with “just a sustainable growth” are not really sexy**, those with the highest numbers of customers, the largest branch networks, the highest increases in business volumes, in short the ultimate banks, are attracted by investors’ capital.

But what will the banks’ managers do if the market is one day no longer offering such extraordinary numbers, figures and developments? They can’t convince their shareholders, because they wouldn’t believe that “their developing market” is not delivering high yields anymore. So, either the managers are going to be fired or they tell the shareholders the stories they want to hear.

In such a situation, some managers might think “Banking business is so simple”, because there are not so many different alternatives to increase short-term profit: either a bank increases its risk or its management starts “changing the shape of the reports”. Both alternatives are not recommended, and we just recently saw a lot of examples in the international banking community that in the long run didn’t go well.

Yes, this is a magic circle, and I would recommend every investor not to expect solely and everlasting hypes in developing markets like Serbia. If investors keep their expectations on a reasonable level then this won’t put bank managers under pressure and tempt them to do the wrong things.

In that respect I must admit that Slovenia has managed its banking landscape quite well, and – in relation to the size of the appropriate banks – nothing really serious has been reported so far except for minor losses. And this is necessary, because **as long as customers trust in their banks and in their entire banking system, they will also carry their money to their bank deposits.**