EFEKTI M&A NA KVALITET USLUGA BANKARSKOG SEKTORA U BOSNI I HERCEGOVINI

EFFECTS OF M&A ON BANKING SERVICE QUALITY IN BOSNIA AND HERZEGOVINA

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ABSTRACT
The main goal of the paper is analyses of level, structure and efects of foreign direct investments (FDI), specifically in the form of mergers and acquisitions (M&A), in banking sector of Bosnia and Herzegovina. We analysed quality of services bosnian banks offer to the clients too, in order to evaulate positive effects of growing level of M&A and to stress problems bosnian banks face with in the quality services area.
We used total banking assets, interest rates, structure of deposits and loans and profitability in order to evaluate banking sector itself and research among banking clients and SERVQUAL model in order to evaluate clients' expectations and perceptions.
Based on the results we obtained, it is possible to conclude that the FDI inflow has brought about the growing competition among banks on B&H market. Banks compete for each client, but mostly using conventional marketing instruments.
On the other hand, we found that there is a significant gap between clients' expectations and perception, even regarding foreign banks. We found that the main reason is a very high level of expectations created by advertising and other promotional activities by foreign banks (traditional marketing instruments), used in order to attract new clients.
Key words: FDI, M&A, SERVQUAL, service quality

1. INTRODUCTION

Foreign direct investments (FDI) are a crucial element for development of modern economies. FDI role in globalization is unquestionable; the countries, which receive the most FDI, develop faster. Evaluating development of specific sectors in transitional countries is important in understanding the effects of FDI both theoretically and practically. This is particularly important considering that the further economic development of transitional economies significantly depends on foreign capital inflows.
Two basic FDI forms are: green-field investments and mergers and acquisitions (brown-field investment). Main difference between the two of them is the fact the M&A change ownership of *existing* business entities, while the overall number of entities remains unchanged. That means that, at least in the first stage, M&A do not contribute to growth of business or production capacities in the host country. Therefore it is possible to conclude that M&A are less beneficial for the overall development of the country, in comparison with the green-field

ones. At the same time, looking at the forms of FDI, we can conclude that prevailing form of FDI are the M&A.
This paper looks at the level, structure and effects of FDI in the banking sector in Bosnia and Herzegovina (B&H). The focus is on the mergers and acquisitions as the prevailing form of FDI in B&H banking sector. The goal of the paper is to show the positive effects of the growing level of M&A in banking (as prevailing form of FDI), but at the same time identifies the gaps and problems B&H still faces. The paper incorporates comparison of B&H with other countries in the region, to determine whether there are significant differences, lessons or consequences of the large share of foreign owned banks for BiH.

2. THEORETICAL BACKGROUND

M& A, as the one of two basic forms of FDI, can be implemented in the form of an in-market or a cross-market transaction. In-market transactions have been most intense in the commercial banking sector, notably retail banking. Extensive banking overcapacity in some countries has led to substantial consolidation that has often involved M&A activity. Many of banking M&A are cross-border activities. During 1985-2002, most of M&A transactions in financial services sector were in-market (that is, within banking, insurance, securities, and so forth), with firms acquiring or merging with similar firms, rather than cross-market (between generic activities).
The value of taking over an existing entity for the acquirer could be expressed as the present value of the target's earnings and the discounted growth opportunities the target offers. (Walter, 2004; 62-79) As long as the expected rate of return on those growth opportunities is greater than the cost of capital, the merged entity creates value and the merger should be considered. From the perspective of the shareholders, M&A transaction must contribute to maximizing the franchise value of the combined firm. This means maximizing the risk-adjusted present value of expected net future returns. Consequently, the main motives for M&A are (Walter, 2004; 62-79): market extension Walter, 2004; 62), economies of scale (Walter, 2004; 64), cost economies of scope (Walter, 2004; 66), operating efficiencies (Walter, 2004; 67), revenue economies of scope (Walter, 2004; 69), seeking for markets domination in order to extract economic returns (Walter, 2004; 76).
Those motives lead to the growing trend of the M&A, as form of FDI, together with the growing trend of the FDI. Both of them demonstrate positive and negative effects on the economy and banking sector in host countries.
There are advantages and disadvantages stemming from M&A (FDI inflows) in (into) banking in transitional economies. Advantages can include the de-monopolization of the banking sector (Papi, Revoltella,1999; 9) and increasing the supply structure and quality of services. One of the crucial threats of FDI is to highlight the inferior position of domestic banks (Babić-Hodović, 2003; 169). Citizens often have a higher level of trust in foreign banks, given the recent history of economic crises. This is more common in TE economies and there is a possibility that domestic banks could become completely dominated by foreign ones (Stiglitz, 1993; 19-52).
Investment results in B&H, as well as those for Croatia and others, show that foreign banks increased the supply of retail banking very quickly after their entry into the market, thanks to the high level of technological development on the one hand, and mature financial markets in developed economies on the other. Data on deposit concentration in B&H confirm this increase in supply (FBA, 2003).

3. BANKING SECTOR DEVELOPMENT IN BOSNIA AND HERZEGOVINA

In order to analyze the real effects and consequences of FDI on the banking sector of B&H and comparing to the countries in the region we use several indicators: total assets of the banking sector as a per cent of GDP, interest rates, the structure of deposits and loans and profitability.

3.1. Total Banking Assets, concentration of banking sector and Foreign Participation

At the end of the December 2004, total bank assets in B&H were KM 1.6 billion, or 81% of GDP (Table 6). This represents growth from 33% of GDP at the end of 2000. The banking assets of the biggest bank, the Austrian Raiffeisen bank d.d. BH, accounted for nearly 20% of total banking assets. The five largest banks accounted for more 64% of total banking assets at the end of 2004. Three of these five banks were direct subsidiaries of Austrian banks (Reininger and Walko, 2005; 110-120). These ratios point to a high degree of concentration in the banking sector. It may be expected that consolidation will continue in the next few years.

Increased concentration in the banking sector can lead to the monopolization of the sector. However, with the large number of small banks in B&H in the 1990s, the level of concentration is not yet high enough to be of concern. In general though, it is important for emerging markets to ensure anti-monopolistic laws and regulations that would prevent closing of the circle of efficiency and structure supply, which was previously broken with the foreign banks entry.

3.2. Interest rates

Since 2000, interest rates on deposits in B&H, both in KM and euro, have decreased dramatically (Table 7). Greater competition among banks, especially those which are foreign-owned, reform and consolidation of the banking sector, along with large increases in savings deposits, have contributed to a decline in KM deposit rates to an average of around 3.7% in 2004. Despite the declining trend, these rates are still higher than those in the countries using the euro, to which the KM is pegged under the Currency Board arrangement. KM interest rates on deposits and loans are also higher than those in other countries that have currency boards pegged to the euro, but the differences are decreasing. In 2004, average lending rates in B&H came down to around 12%, which is comparable to, or slightly lower than, similar rates in neighboring SEE countries that do not have currency boards (Croatia 11.7%, Serbia 14.6%).

3.3. Structure of Deposits & Loans

Rapid credit expansion was particularly obvious in case of households. In 2002, banks' net lending increased by 55% (CBBH, 2004), followed by 35% growth in 2003 and 34% in 2004. Some believe that the market for consumer loans is beginning to be saturated. Other transition countries, especially those having made the most progress in reforming their economies, have also experienced rapid credit growth. However, rapid credit growth can be a leading indicator of future losses and difficulties for a banking system. Credit growth in B&H has been funded mainly from an increase in deposits as well as increased funding from abroad.

The main constraint on investment by the state-owned enterprise sector is its high level of indebtedness, along with illiquidity. Having written off their old loans to the state sector during the past few years, commercial banks, which are now mostly private and predominantly foreign-owned, have opted to lend selectively to privately owned companies. They have also expanded their lending to households, for the purchase of consumer durables, for house repair or purchase. This is a logical portfolio shifts by banks, but it has led to complaints from the enterprise sector whose access to bank credit is difficult, and has also fuelled imports of consumer goods. The advantages of improved access to bank credit by corporate borrowers who have credible business plans and cash flow that is demonstrably sufficient to repay their debts are obvious. Commercial banks will be well advised to maintain strict credit standards, in order to avoid incurring new bad debts.

3.4. Profitability (ROA and ROE)

The data on profitability show an improving trend in the Federation of B&H, with the RS moving the other way until 2004 (Table 9). Both showed losses until 2002. The poor profitability of many banks may be explained by a low level of efficiency, specifically an excessive number of employees for the scale of their operations and substantial provisions for loan losses, accompanied by the costs of expanding their branch networks (FBA, 2004).

Table 9: Profitability of Banks

<table>
<tr><th></th><th colspan="5">ROA</th><th colspan="5">ROE</th></tr>
<tr><td></td><td>2000</td><td>2001</td><td>2002</td><td>2003</td><td>2004</td><td>2000</td><td>2001</td><td>2002</td><td>2003</td><td>2004</td></tr>
<tr><td>B&H Federation</td><td>-1.29</td><td>- .48</td><td>0.43</td><td>1.09</td><td rowspan="2">0,8</td><td>-8.95</td><td>-5.14</td><td>2.57</td><td>8.33</td><td rowspan="2">6.5</td></tr>
<tr><td>B&H RS</td><td>- 0.4</td><td>- 0.4</td><td>- 0.1</td><td>- 3.6</td><td>- 1.4</td><td>- 1.5</td><td>- 15.1</td><td>- 15.6</td></tr>
</table>

Sources: Country Central Bank and Banking Agency Reports.

4. EFFECTS OF FDI ON BANKING SERVICES QUALITY

4.1. Measuring service quality level by SERVQUAL

For measuring the level of banking services quality of the B&H banks and for analyzing effects of FDI on the level of expectations and perceptions of domestic clients, we used SERVQUAL model. The model was developed 1988. by Parasuraman, Zeithaml and Berry. Originally, this model measures 10 dimensions. Later, they refined and condensed the ten dimensions to five: Tangibles, Reliability, Responsiveness, Assurance and Empathy. The 22 expectation/perception items which form the main questions of the SERVQUAL instrument were derived from the five service dimensions.

4.2. Methodology of research

We used the originally created lists of 22 statements for our research, because they are completely acceptable for analyzing different dimensions of supply and service of the banks.
During this part of research we created four focus groups formed of the: business people working with the some of foreign banks (E8)[1], MBA students using services of both foreign (E11) and domestic banks (E10), and finally a mixed group of clients (E12) using retail banking services of domestic banks. Each group expressed their expectations about what the excellent bank should have and evaluated the level of services of the bank they deal with. Only the group of MBA students evaluated both foreign and domestic banks in two separate processes.

4.3. Findings and discussion

According to the methodology of SERVQUAL model participants were asked to identify the level of expectations they have about the service by a hypothetical excellent bank and after that to evaluate relative importance of service dimensions to them. (Respondents were requested to divide 100 points among the five service dimensions. These results we used for further analyses.)
We found there were no significant differences between the relative importance of service dimensions the participants perceived. The exception is the result of evaluation we got from the retail banking clients group. They thought that the most important (relatively) is the Assurance dimension of service quality.

[1] We used the acronym of the E-expectations and number of participants of each focus group to identify them.

Other three (two) groups perceive the Reliability dimension with a mean score 31.00/22.36/28.10 as the most important dimension followed by the Responsiveness dimension with a mean score 23.00/20.27/24.50. The least important dimensions were Tangible and Empathy at a mean score of 12.25/12.70 and 18.63/16.42 respectively. During the discussion after evaluation participants stressed that Empathy is a "condition sine qua non" of the service business (MBA students) and that tangibility is the most often used way to "tangibles" services, even in the circumstances that are not so important for core service.
On the other hand, "retail banking clients" (specific words we used to explain "ordinary" clients if they exist at all) do not expect individualized attention and service and they are not influenced by "modern equipment syndrome" That is the reason why they did not rank these two dimensions on a higher level of the scale.

4.4. Servqual score

As shown in tables 8, 9 and 10 the overall SERVQUAL score for foreign banks and domestic bank evaluated by MBA students was negative.

Table 8. Business people evaluation of foreign banks

SD	E	P	SQ (P-E)	R	W %	SQW	SQWR
Tangible	6.00	5.88	-0.12	5	12.25	-0.07	5
Reliability	6.02	5.65	-0,37	3	31.00	-0.52	1
Responsiveness	5.91	5.56	-0.35	4	23.00	-0.36	4
Assurance	5.84	5.25	-0.59	2	17.88	-0.48	2
Empathy	5.78	5.15	-0.63	1	15.88	-0.45	3
			-0.41			-0.38	

Table 9. MBA students evaluation of foreign bank (E11)

SD	E	P	SQ (P-E)	R	W %	SQW	SQWR
Tangible	5.82	5.65	-0.17	5	12.70	-0.1	5
Reliability	6.02	5.38	-0.64	1	28.10	-0.82	1
Responsiveness	5.75	5.38	-0.37	4	24.50	-0.41	3
Assurance	5.62	4.98	-0.64	1	20.60	-0.6	2
Empathy	5.76	5.24	-0.52	3	14.10	-0.33	4
			-0.47			-0.45	

Table10. MBA students evaluation of domestic bank (E10)

SD	E	P	SQ (P-E)	R	W %	SQW	SQWR
Tangible	5.40	4.52	-0.88	4	18.81	-0.75	4
Reliability	5.89	4.96	-0.93	3	22.36	-0.94	2
Responsiveness	5.11	4.11	-1.00	2	20.27	-0.92	3
Assurance	5.33	4.23	-1.16	1	19.00	-1.00	1
Empathy	5.47	5.47	0.00	5	18.63	0.00	-
			-0.79			-0.72	

Table 11. "Retail banking clients" evaluation of foreign bank (E12)

SD	E	P	SQ (P-E)	R	W %	SQW	SQWR
Tangible	3.94	4.44	0.5	3	16.58	0.37	1
Reliability	4.16	4.18	0.02	5	26.42	0.15	4
Responsiveness	3.75	4.06	0.31	2	22.67	0.32	3
Assurance	3.67	4.12	0.45	1	17.92	0.37	1
Empathy	3.83	3.88	0.05	3	16.42	0.04	5
			0.27			0.25	

The tables indicate that there is a difference between the gaps we found before and after multiplying the SERVQUAL scores of the service dimensions by the weights assigned (and dividing the sum by 22 – i.e. 22 items in the questionnaires). The weighted SERVQUAL scores are less negative than the unweighted ones. It is very important because it shows that

the level of gap between expectations and perception is lower. It also means that banks created smaller discrepancies for the most important dimensions than for the others.
The other very important conclusion is the one about the level of perception (satisfaction) of the "retail banking clients". As one can see, there are no gaps between the expectations and perceptions of all service dimensions in this focus group. Additional discussion shows that the main reason for this was the lower level of expectations those clients had. Namely, they are the ones that used the banking service in the previous system, their requests are not high and they have no problems with the service encounter made by domestic banks and people. It is for these reasons that they did not even try to change the bank after the foreign banks branch opened on B&H market.
Speaking about the expectations of domestic banks, even the group of MBA students has the lower level of expectation of domestic banks services, compared to foreign ones. The explanation was that they precisely know that domestic banks cannot compete with foreign ones, at least not on the level of Reliability, Responsiveness and Assurance. The tangible dimension is the one that MBA students did not expect to be on a high level in domestic banks, but they did not consider it so important.
Obviously the Empathy dimension has the greatest service gap of -0.63 in the E8-business people focus group, followed by Assurance and Reliability, although Reliability has the greatest service gap after the level of gaps multiplied by the weights assigned. It is normal because of its relative importance for this group of participants, and the fact that they themselves were not so interested in the individualized service. From their point of view, "it is normal" to be VIP clients for banks and other companies.

5. COMMENTS AND CONCLUSIONS

Reform and privatization of the banking sector have brought reputable foreign banks to Bosnia and Herzegovina and the region. Early arrivals were Raiffeisen Bank and Volksbank (Austrian banks), Unicredito bank (Italy), Ziraat Bank (Turkey) and Zagrebačka Banka* (Croatia). More recently, substantial investments in B&H's banking system have been made by Hypo Vereinsbank [HVB] (Germany), Hypo Alpe-Adria-Bank (Austria) and Nova Ljubljanska Banka (Slovenia). This has happened largely through acquisition of local banks under the Entity governments' bank privatisation programs. However, several foreign banks (Turkish Ziraat bank, Volksbank, Zepter, Balkan Investment bank…) have set up new fully owned operations. Further consolidation by foreign banks of their respective interests in B&H and the region, to consolidate their holdings and enhance their competitive position is likely.
However, this presents a risk to financial stability in the region, with the possibility of problems in one country spreading to others. This risk is accentuated by the large and growing concentration of ownership in the banking sector, particularly from the domination by the Italian bank, Unicredito. This bank has businesses throughout the region, but in four countries (Croatia, Bulgaria, B&H, and Poland) it has a significant market share.
Whereas for the general population, the arrival of foreign banks has undoubtedly boosted their confidence in the banking system, the full effects of this development on the banking and enterprise sector still remain to be seen. Initially, several of the foreign banks that bought existing banks simply adapted to the local operating environment, rather than requiring that their bank operations be run in accordance with the stringent corporate guidelines enforced in their home countries. This was especially case in B&H. However, as competition intensified, foreign banks are introducing expertise from their headquarters, with a view of implanting their own corporate culture. They are undertaking significant staff training, including language training. Several banks have brought foreign account executives into the local

market, as well as training relatively senior local staff members to be managers within the wider bank system. Interest in the banking sector in the region is still high. Investment is profitable for the simple reason that, in spite of the high growth in lending, the share of banking sector assets to GDP in the region is still relatively low, compared to the European Union. This share is the highest in Croatia, at 110,8%, which is still low compared to an average of 209% in the European Union. This indicates that there is more space for expansion of the banking sector in the region.

Overall, the effects of increasing M&A (FDI) in the banking sector in B&H and the region has been positive. These include increased confidence in the banking system, increased banking deposits and assets as the foreign share has increased a decline in lending rates and a change in the structure of lending towards households, a previously underserved market. The price for this has been increased concentration, leading to a regional dependence on a decreasing number of foreign banks, with a possible increase in systemic risk and monopolistic behavior. Still, the lessons are clear, reform and the opening up of domestic markets has spurred growth and development of the banking sector. However, there is a need for countries to insist on good corporate behavior, as well as careful monitoring of potential anti-competitive behavior.

Based on the results we obtained, it is possible to conclude that the FDI inflow has brought about the growing competition among banks on B&H market. Banks compete for each client, but mostly using conventional marketing instruments. Very rarely do they start from serious analyses of the potential, even actual clients' requests. This is the reason why none of them has a formal or an efficient informal mechanism to follow up on clients' complaints and suggestions.

On the other hand, we found that there is a significant gap between clients' expectations and perception, even regarding foreign banks. We found that the main reason is a very high level of expectations created by advertising and other promotional activities by foreign banks (traditional marketing instruments), used in order to attract new clients. In the same time participants show a very high level of understanding of the domestic banks' position and strength compared to foreign ones. That was the reason why the level of expectations of these banks was not so high. It was especially visible among the "retail banking clients". Obviously there is the need to continue working on the analyses of specific interests and differences between the different groups we included in the research. But it was not the primary topic of our discussion here and this was the reason why we did not devote more attention to it.

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