

## **RESULTS OF BANK SURVEYS IN 2004**

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2004 has been one of the most successful years for Russian banks. This well-being was based mostly on development of retail services and on further expansion and strengthening of the market for corporate lending.

Even though we could conclude from the evidence of 2003 that the banks began to better fulfill their function of inter-sectoral redistribution of funds, the evidence of 2004 gives still more grounds for this conclusion.

Among other favorable trends, we have to pay attention to intensifying competition between the banks while the Sberbank continued to gradually lose its positions. The policies of the Central Bank were accepted much more positively in 2004. What is more, the respondent banks practically never complained about high taxes as a factor limiting their activities.

All this allows us to hope that positive development of the banking sector will go on in 2005 as well.

### **Sources of External Funds**

In 2004, there were no significant changes in the methods used by commercial banks for procurement of new financial resources. Ranking of main items of liabilities has remained more or less the same as in 2003. However, here we can point out at two interconnected structural changes that have become evident during last year. Firstly, in 2004 three leading items looked rather blurred. For instance, while in 2002-2003 the gap between the first and the third ratings was 23-24 percentage points, in 2004 it has reached 44 points. Consequently, in 2004 deposits of individuals, the leading item among the sources of liabilities in our list, has become almost twice as popular as deposits of juridical persons, which rank third in the list. Secondly, the variety of methods used to procure the funds has been getting narrower in three recent years. In

this respect, 2004 has become similar to 2001 (see the lowest line in Table 1).

Interbank credits experienced the most significant decline in 2004. Among main sources of external funds, rating of this liability item has declined by 9 percentage points (see Table 1). Deposits of juridical persons have demonstrated a comparable decrease (by 8 points).

Meanwhile, deposits of individuals have become a much stronger source of external funds: +10 points on the year. Therefore, this liability item, which stayed a leader for already three years, has become an absolute leader in four years of our observation: in 2004, deposits of physical persons were the main source of external funds for 91% of the surveyed banks.

**Table 1**  
**Rating of Sources of External Funds**  
(Shares of banks having mentioned each item as one of three major ones, %)\*

	1997	1998	1999	2000	2001	2002	2003	2004	(9)=(8)-(7)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
Personal deposits	80	76	61	81	75	90	81	91	+10
Settlement accounts of juridical persons	82	86	79	94	84	87	81	81	0
Deposits of juridical persons	32	34	36	51	49	66	55	47	-8
Interbank lending	28	15	7	12	15	9	16	7	-9
Other	7	8	15	17	13	7	6	10	+4
Targeted Central Bank lending	2	0	3	0	0	0	0	0	0
The sum of shares	231	219	201	255	236	259	239	236	-3

\* Respondents were asked to point out no more than three items

### Factors Limiting Inflow of Personal Savings

For already two years, more than a quarter of the surveyed banks (27%) have been pointing out that nothing could limit their drawing of personal deposits (see Table 2). However, this problem has become much less serious also for the rest of the banks that have pointed at limitations on procurement of funds from physical persons: the combined

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rating of all limiting factors has declined by 16 points on the year, from 150 to 134 points. All these trends demonstrate that the situation in this segment of banking activities is getting better.

A positive trend can also be seen in the changing balance of limiting factors as such. For instance, competition with other banks has become a leading factor for the first time in eight years of our observation. 38% of the surveyed banks have pointed at its restraining role (in procurement of personal deposits). Meanwhile, this factor has remained secondary (staying in the 4-7 places in our ranking list) in all previous years. In the post-crisis 1999, it scored as few as 6% voices of all the respondents', in the relatively happy 2002, 10%; in 2003, its score was 23%, but still lower than the rating of the leading Sberbank. Only in 2004 the balance of their power has changed to the opposite.

Competition between banks is becoming more intense as the Sberbank is gradually losing its position in this segment of the market. For example, while in 2002 more than a half of the surveyed banks (54%) reported that competition from the Sberbank was hampering their efforts to procure personal funds, in 2003 the share of such banks was 41%, and in 2004, only 28%. Nevertheless, although position of the Sberbank has become so much weaker, this bank still presents one of three most acute problems for the banks in their competition for personal savings. In 2004, this factor was in the second place.

A sharp decline in the number of complaints about the standards established by the Central Bank is another positive change. For instance, while in 1997-2003 from 28% to 48% of all banks believed that the requirements set by the Central Banks were a barrier to the inflow of personal funds, in 2004 their share number was 6% - an absolute minimum in all years of our observation.

Other shifts were related to high costs of serving small depositors (an increase by 9 points from 13% in 2003 to 22%) and to lack of necessary conditions to serve them (a decline by 7 points from 24% to 17%). Lack of offering of funds for deposition is gradually losing acuteness. In 2004, 17% of the respondent banks mentioned this factor (which was one point less than in 2003 and 16 points less than in 2002).

**Table 2**  
**Factors Limiting Inflow of Personal Savings**  
 (Shares of banks having mentioned each item, %)\*

	1997	1998	1999	2000	2001	2002	2003	2004	(9)=(8)-(7)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
Competition with other banks	12	10	6	12	8	10	23	38	+15
Competition with Sberbank	24	23	35	33	38	54	41	28	-13
High cost of retail banking	4	13	16	30	21	7	13	22	+9
Lack of adequate conditions for retail banking	8	3	6	4	10	10	24	17	-7
Lack of supply of personal savings	28	33	24	20	23	33	18	17	-1
Regulations set by Central Bank	48	35	28	38	44	30	28	6	-22
Other	13	10	10	12	4	2	3	6	+3
<i>Sums by column</i>	<i>137</i>	<i>127</i>	<i>125</i>	<i>149</i>	<i>148</i>	<i>146</i>	<i>150</i>	<i>134</i>	<i>-16</i>
No limitations	25	25	19	11	21	24	27	27	0

\* Respondents were asked to point out no more than three items.

### Composition of Assets

Rating of various items of assets remains relatively stable over recent years, in spite of some fluctuations.

Lending to trade intermediaries is the top item for the seventh year in a row. In 2004, the ranking of this item has increased by 9 points and reached its former maximum of 2002: 76% of all surveyed banks named this type of operations one of the two main items in their assets (see Table 3).

Lending to industrial enterprises was always the second item in our ranking for seven years. There was no change in 2004 - the same second line in the rating and 50% of the respondent banks, which named this asset item among the two major ones. However, its ranking showed great instability over several recent years. It declined in 2001 (-16 points), then rose in 2002 (+23) and declined once more in 2003 (-20 points). Nevertheless, the situation has probably stabilized in 2004: just +3 points from 2003.

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However, such item as lending to individuals showed the highest rate of growth: +12 percentage points on the year. While in 1997-2000 this item was reported as an important one by 5-12% of all banks, this share was 27-29% in 2001-2003 and as high as 41% in 2004.

The role of leasing (granting a credit for purchase of equipment on the security of the equipment) has risen in importance in recent years. In 2004, 13% of the surveyed banks pointed at this item as one of the two (!) main items of their assets. There were no such banks in our sample as lately as in 1997-2000. In general, we can state that in spite of a dramatic increase in lending to individuals, lending to juridical persons is still the main part of assets in the majority of the banks, and the gap between them keeps enlarging. The combined rating of lending to juridical persons has increased by 18 percentage points in 2004 (the sum of the 1<sup>st</sup>, the 2<sup>nd</sup>, and the 5<sup>th</sup> lines in Table 3), and rating of lending to individuals, by 12 points.

Lending to other banks remained in the same position in 2004 (22%), and foreign currency assets have practically lost their importance by this year.

**Table 3**  
**Rating of Main Asset Items**

(Shares of banks having mentioned each item among the two major ones, %)\*

	1997	1998	1999	2000	2001	2002	2003	2004	(9)=(8)-(7)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
Lending to trade intermediaries	60	54	56	71	71	76	67	76	+9
Lending to industrial enterprises	70	52	56	60	44	67	47	50	+3
Lending to individuals	10	5	7	12	29	27	29	41	+12
Lending to other banks	10	8	10	9	15	13	22	22	0
Leasing	0	0	0	0	0	2	7	13	+6
Investing in real estate	0	5	2	0	2	0	4	4	0
Foreign currency assets	7	15	25	17	15	9	6	0	-6
Other	18	22	14	19	11	7	2	7	+5

\* Respondents were asked to point out no more than two items out of nine offered in the questionnaire.

### Efficiency of Operations

In the REB surveys, respondent banks are offered to evaluate efficiency of various operations on a scale of "profitable - neutral - unprofitable".

In 2004, there was little change in the ranking of major types of operations by the rate of profitability for the banks. "Lending to trade intermediaries" has been the leading item for the last eight years. Although in 2004, the share of the respondents, which assessed these operations as profitable has declined by 5 percentage points, these operations remained profitable for the vast majority - 93% of all banks (see Table 4).

**Table 4**

#### Rating of Various Banking Operations

(Shares of banks considering the relevant operation profitable, %)

	1997	1998	1999	2000	2001	2002	2003	2004	(9)=(8)-(7)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
Lending to trade intermediaries	70	97	92	95	95	100	98	93	-5
Lending to individuals	31	49	45	60	60	72	72	83	+11
Lending to industrial enterprises	39	50	64	77	86	82	81	75	-6
Keeping of settlement accounts	52	66	78	51	66	79	77	66	-11
Foreign exchange operations	67	67	91	75	64	69	66	62	-4
Lending to other banks	60	67	48	67	71	66	55	47	-8
Equity investments	48	0	3	23	11	6	16	29	+13
Placement of securities issued by other juridical persons	17	5	3	0	10	14	24	23	-1
Trading in government bonds	63	23	12	36	20	7	23	16	-7

The share of respondent banks, which mentioned lending to individuals as a lucrative business has significantly increased (+11 percentage points on the year). As a result, their share in the total number of surveyed banks was 83%, so that this type of operations has shifted from the fourth to the second line of our rating, to push back lending to industrial enterprises (-6 points), keeping settlement accounts (-11), foreign exchange operations (-4), lending to other banks (-8),

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placement of securities issued by other juridical persons (-1) and trading in government bonds (-7). Interestingly, the ranking of the above mentioned operations remains almost the same. The only remarkable exception in this list is investing in equities. The share of banks that believe this operation is profitable has drastically increased from 16% in 2003 to 29% in 2004.

### **Indicators of Credit Activity**

After the credit market achieved certain stability in 2002-2003, we have witnessed its further development and strengthening in 2004. As a result, the past year happened to be the best in eight years of our observation by a number of indicators.

The share of credits in assets of the surveyed banks in 2004 was 59%, which was the absolute record in the period of 1997-2004. However, the share of lending to industrial enterprises has increased only by one percentage point - to 17%. Nevertheless, this is also the highest record in the last six years (see Table 5).

Average term of loans granted in 2004 (in the entire loan portfolio) has surpassed the half-year mark for the first time to reach 6.5 months. This is almost a month longer than in 2003. The term of lending to industrial enterprises has also got longer-from 6.1 to 6.3 months.

The share of outstanding long-term loans (given for one year or more) has increased. In 2004, it was 17% - 6 points more than in 2003, and 15(!) points more than in 1997. In 2004, only one out of ten banks was not engaged in long-term lending. This is only a third (!) of the figure of the same pre-crisis 1997.

The volume of overdue debt has been declining for the last eight years. It accounted for 19% of total credit outstanding in 1997, 8-9% in 1998-1999; 3-5% on 2000-2003, and just 1% in 2004. To all appearances, its "quality" has not been getting worse. In 2004, expectations of bankers about their chance to recover their debts have become the brightest in the whole period under review: on the average, the banks were looking forward to have *more* than a half (52%) of all overdue debts recovered (within six months). The frequency of cases, which the banks took to courts of arbitrage against their persistent

defaulters in 1999-2004, was roughly stable: one or two applications in a half-year.

**Table 5**  
**Indicators of Credit Activity of Commercial Banks**

	1997	1998	1999	2000	2001	2002	2003	2004
Share of credits in assets of banks, %	38	42	40	43	50	49	54	59
Share of credits to industrial enterprises in assets of banks, %	15	17	14	13	15	16	16	17
Share of long-term (over 1 year) credits in total credits, %	2	9	13	10	10	11	11	17
Share of banks granting no long-term loans, % of all banks	34	31	21	21	16	12	16	10
Average term of lending, months.	3,1	4,2	4,6	5,0	5,4	4,8	5,6	6,5
Average term of lending to industrial enterprises, months	3,5	4,9	4,7	5,3	5,4	5,1	6,1	6,3
Share of overdue debt in total debt, %	19	9	8	5	4	4	3	1
Share of banks having no overdue debts in their loan portfolios, %	5	8	5	13	15	10	8	10
Share of overdue debt repayable within a half-year in total overdue debt, %	32	32	38	30	40	45	45	52
Number of recourses to arbitration on overdue debt in a half-year	3,6	2,3	1,6	1,0	1,5	1,3	1,7	1,7

### **Financial Condition of Borrowers**

Banks are fairly optimistic in their assessments of financial condition of their borrowers. While in 1997-1998, financial condition of (industrial) enterprise borrowers was assessed as normal by only a half of all respondent banks, the share of such respondents was 70% in 1999, as high as 95% in 2001-2003, and 99% in 2004.

These assessments are probably not unfounded, because just about 12% of the total outstanding loans accounted for new borrowers, in other words, for those the banks had been dealing with over less than a year (see Table 6). And 56% of all loans were taken by the enterprises, which had been dealing with relevant banks for more than three years.

Notice that entry of new borrowers into the loan market, however slow it was so far, accelerated a little in 2003-2004. Those enterprises

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that the banks had been dealing with for less than a year accounted for as much as 12-13% of the total outstanding loans (against 7% in 2001-2002). And only 30-32% was granted to those that the banks had been dealing with for over five years (against 38-50% in 2001-2002).

**Table 6**  
**Distribution of Outstanding Loans by Term of Dealing**  
**with an Industrial Enterprise, % of total lending**

Term of dealing with an enterprise	1997	1998	1999	2000	2001	2002	2003	2004
Less than 1 year	8	3	8	9	7	7	13	12
1-3 years	4	4	15	19	20	28	31	33
3-5 years	13	10	24	20	23	27	26	24
More than 5 years	75	83	53	52	50	38	30	32

Assessment of changes in the number of enterprise borrowers shows the same trend: in 2003-2004, the range of borrowers widened at 40% of the surveyed banks. This is the maximum indicator in the period since 1997 (see Table 7).

**Table 7**  
**Changes in the Range of Enterprise Borrowers**  
 (Shares of banks whose range of borrowers expanded -  
 remained unchanged - narrowed in two months before survey, %)

	1997	1998	1999	2000	2001	2002	2003	2004
Expanded	15	12	29	32	39	29	40	40
Remained unchanged	79	82	64	64	56	67	56	57
Narrowed	6	6	7	4	5	4	4	3

### **Factors to Limit Lending Activities of Banks**

Facing rapid expansion of credit market, the bankers tend to overstate the role of factors that are limiting their activity in this segment of financial services. On the one hand, the number of banks that had no limitations to their credit activity has increased in 2004 by 2 percentage points from 2003: 16% against 14% (see Table 8). On the other hand,

according to our survey data, the situation has deteriorated for the remaining 84% of the banks.

For instance, the problem of shortage of credit resources as a barrier to expansion of credit activity was pointed out by 7 points more respondents than a year ago: in 2003, 40%, and in 2004, 47%. The condition of insolvency of borrowers has changed even more. The number of banks that singled out this factor has grown by 16 percentage points on the year: from 18% in 2003 to 34% in 2004.

Shortage of demand for funds and toughness of the Central Bank policy have retained their positions: 26% and 16% of the surveyed banks have named these factors among those that limited their lending activity.

Other factors were mentioned by no more than 3% of the respondent banks.

**Table 8**  
**Main Factors to Limit Lending Activities of Banks**  
(Shares of banks considering the relevant factors, %)

	1997	1998	1999	2000	2001	2002	2003	2004	(9)=(8)-(7)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
No limiting factors	9	8	10	12	13	20	14	16	+2
Shortage of credit resources	52	32	25	37	52	51	40	47	+7
Insolvency of borrowers	85	73	56	51	40	42	18	34	+16
Shortage of demand for credit (from sound and promising borrowers)	25	32	33	32	19	27	26	26	0
Tough policy of Central Bank	42	42	35	37	39	29	16	16	0
Lack of offices, equipment etc	0	0	0	2	4	0	4	0	-4
Price surge	0	7	0	2	4	2	2	0	-2
Taxes	7	8	7	7	7	3	0	0	0
Shift of the bank to other types of operation	10	0	5	7	0	0	0	0	0
Inadequate skills of personnel	0	0	0	2	2	0	0	0	0
Other	0	3	3	3	4	0	6	3	-3

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In recent years, industrial sectors have got a relatively clear ranking by credit attractiveness. Food is the undeniable leader in the list. In 2004, 49% of the surveyed banks believed it to be the most preferable object for long-term financing (see Table 9). Although the number of respondents that mentioned this industry among the three most interesting ones for long-term lending has declined by 5 percentage points on the year (and by 12% in two years), food remains the leader in the rating of industry-wise attractiveness.

**Table 9****Rating of Industries**

(Shares of banks considering the relevant industry attractive for long-term lending, %)\*

	1997	1998	1999	2000	2001	2002	2003	2004	(9)=(8)-(7)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
Food	32	45	50	56	57	61	54	49	-5
Fuel	34	25	25	26	25	33	26	44	+18
Electric power	33	29	25	22	30	24	27	33	+6
Machinery and metalworking	13	11	13	8	14	15	22	32	+10
Building materials	12	16	14	21	21	23	20	26	+6
Chemicals and petrochemicals	17	11	17	22	29	24	17	23	+6
Iron and steel and non-ferrous metals	14	8	9	13	19	12	17	11	-6
Light industry	4	6	5	8	9	19	12	8	-4
Agriculture	5	2	7	7	13	12	8	6	-2
Logging, woodworking, pulp-and-paper	8	6	10	7	9	7	8	5	-3
<i>All industries are bad</i>	19	25	16	13	7	5	7	2	-5

\* Respondents were asked to point out three industries.

Fuel sector has come close to the leader; in 2004, 44% of the surveyed banks mentioned it as a priority for lending. Let us point out that fuel, along with machinery, have become leaders in terms of rate of growth in their ratings. The number of banks that were willing to lend to enterprises in these sectors has increased by 18 and 10 percentage points on the year, respectively.

The second echelon is the industries, which 1/5 to 1/3 of all banks are ready to lend money to. They are electric power, machinery, building materials, chemicals and petrochemicals. Let us point out that all the industries listed above (not only the already mentioned machinery) have improved their positions in the credit market during the last year.

The third echelon is the industries, which 1/20 to 1/9 of the banks reported to be ready to lend money to. They are iron and steel, non-ferrous metals, light industry, agriculture and logging, woodworking and pulp-and-paper. These sectors stay in the lower ranks of the list for a long time, and their positions in the credit market have become still weaker in the last year.

Finally, only 2% of the banks have found that all industries are bad for lending. This is the lowest share in all eight years of our observation.

### **Financial Condition of Banks**

Financial condition of the surveyed banks was getting steadily better over the last eight years. The fastest pace of improvement was typical of the post-crisis years (1999 and 2000). Since 2001, none of the banks in our sample any longer assessed its financial condition as poor. In 2004, as many as 40% of the surveyed banks assessed their financial condition as good, and 60% believed it was normal (see Table 10). The improved situation was even better reflected in distribution of the banks by performance: in 2004, for the first time all the banks in our sample, without exception, made profit (see Table 11).

**Table 10**  
**Financial Condition of Banks**  
(Shares of surveyed banks, %)

	1997	1998	1999	2000	2001	2002	2003	2004
<b>Good</b>	12	17	34	42	32	32	39	40
<b>Normal</b>	72	78	65	57	68	68	61	60
<b>Poor</b>	16	5	1	1	0	0	0	0

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**Table 11**  
**Performance of Banks**  
 (Share of surveyed banks, %)

	1997	1998	1999	2000	2001	2002	2003	2004
Profits	74	80	83	91	92	90	89	100
Break-even	7	16	12	9	4	10	9	0
Losses	19	4	5	0	4	0	2	0

### Prospects for Bankruptcy of Banks

In the assessments made by the bankers, the threat of bankruptcy has substantially declined in recent five years. While in 1997-1999, 38-43% of all banks were out of this danger, in 2000-2003 the share of such banks was 61-70%. In 2004, 65% of the banks believed that this prospect was unlikely for them (see Table 12).

**Table 12**  
**Factors of Bankruptcies**  
 (Share of banks, %)\*

	1997	1998	1999	2000	2001	2002	2003	2004
<i>No danger</i>	38	43	43	70	61	61	70	65
Tough policy of the Central Bank	38	40	20	17	21	12	22	19
Insolvency of borrowers	57	33	24	17	15	13	5	11
Lack of external funds	29	13	10	8	15	23	11	6
Tax burden	28	18	13	10	14	6	4	0
Managerial errors	7	8	2	2	0	2	2	3
Other	2	18	9	4	4	5	3	3

\* Respondents were asked to point out no more than three factors to make the danger of bankruptcy close.

Nevertheless, even in the face of this bright picture, almost every fifth bank (19%) has mentioned tough policy of the Central Bank of Russia as a factor for potential bankruptcy, one out of ten (11%) has pointed at insolvency of their borrowers, and one out of seventeen (6%) has

referred to lack of external funds. Not more than 3% of all banks have mentioned other factors.

### **Competition in Banking Sector**

Pressure of competition remains tough in the banking sector. In 2004, 50% of the surveyed banks pointed at strong competition, and another 50% believed it was insignificant (Table 13). None of the respondents reported about absence of competition in their markets.

**Table 13**  
**Level of Competition**  
(Share of banks, %)

	1997	1998	1999	2000	2001	2002	2003	2004
Strong	24	28	26	36	26	38	62	50
Insignificant	61	51	65	62	74	60	37	50
Absent	15	21	9	2	0	2	2	0

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Substantial positive shifts in the banking sector in 2004, along with better relations of the banks with other sectors of the economy, better financial position of the banks as such against the background of keen interbank competition, and gradual loss of monopolistic position in the market by the Sberbank give grounds for hope that positive development will continue in several years to come.

### **REB Sample**

Surveys of banks are conducted by REB bimonthly. As a rule, they cover from 20 to 40 banks. The sample is based on medium-scale regional banks with average workforce of about 180 employees and average salary about 9200 rubles (2004). About 29% of all banks in the sample are the former special banks, and about 65% are new commercial banks.