学位申請論文

FOREIGN BANKING IN RUSSIA:

OUT-IN ENTRY AND IN-OUT EXPANSION CASES

AND THE ROLE OF INSTITUTIONAL CONTEXT

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To my beloved family

Victor Gorshkov
"Foreign banking in Russia: out-in entry and in-out expansion cases and the role of institutional context"
The dissertation submitted to Graduate School of Economics, Kyoto Institute of Economic Research, Kyoto University, Kyoto, Japan in November 2013. The extensive summary of the dissertation in Japanese is available upon request. The summary in Japanese is a separate pamphlet that is an integral part of the disseratation. The author bears full responsibility for the remaining errors and omissions in the text of both the present dissertation and the summary.

TABLE OF CONTENTS

AKNOWLEDGMENTS

Six years have passed since my arrival to Japan in April 2008, but I still have a feeling as if I arrived just yesterday. I would definitely agree with those saying that time is indeed flying. I clearly remember the day of my arrival to Kyoto and my first visit to Kyoto University. Starting from that exactly day my “japanese journey” both in academic and personal spheares of life literally began. And it all in the first place became possible thanks to the Ministry of Education, Culture, Science and Technology (MEXT) of Japan that provided me with the opportunity to organize my research activity first as a research student at Kyoto Institute of Economic Research, Kyoto University (2008-09), and later as the master course student (2009-11) and PhD course student (2011-14) at the Graduate School of Economics, Kyoto University. I am indebtedly grateful to all those hosting institutions and their professional staff members for making my stay indeed unforgettable and full of sweet and warm memories.

The result of my short academic journey is the present dissertation that selectively analizes issues of foreign banks in Russia. This dissertation is in a sense still a work in progress with many drawbacks and shortcomings, and for that I ask my readers for an apology. In either case, I would like to express my deepest appreciation to all those colleagues and friends who provided me with the possibility to compete this PhD project.

A special gratitude I give to my supervisor, Professor Satoshi Mizobata (Kyoto University), whose contribution in stimulating suggestions and encouragement for completing this dissertation is enormous. I express my warmest regards for his constant and throughout academic and personal support and guidance throughout my stay in Kyoto, Japan.

I would also like to express my deep gratitude to Professor Takekazu Iwamoto (Kyoto University), Professor Ryuhei Wakasugi (Kyoto University/Yokohama University), my research sub-supervisors, for their patient guidance, enthusiastic encouragement, useful critiques, and constructive suggestions during the planning and development of this research work. I would also like to thank Professor Byung-Yeon Kim (Seoul National University) for his advice and assistance.

My grateful thanks are also extended to members of the Japanese Association for Comparative Economic Studies (JACES), namely Professor Hiroaki Hayashi (Shimane University), Lecturer Yutaka Konishi (Gifu University), Associate Professor Kazuho Yokogawa (Kanagawa University), Assistant Professor Tsuyoshi Yanagihara (Matsuyama University), Associate Professor Katsumi Fujiwara (Osaka University), Associate Professor Ko Takada (Wakayama University), Professor-Emeritus Sadayoshi Ohtsu (Kobe University), Professor Dimiter Iyalnazov (Kyoto University), Research Fellow Hironori Fushita (The Japan Institute of International Affairs), and Graduate School Students of Professor Mizobata’s Seminar, namely Mihoko Satogami, Takuma Kobayashi and Dai Yamawaki.

I am also very grateful to Professor Shinichiro Tabata (Hokkaido University, Slavic Research Center) for his willingness to give his time so generously during my stay at the Slavic Research Center in July 2012.

Some other warmest regards are for Professor Joseph Brada (Arizona State University), Professor Boris Kuznetsov (National Research University "Higher School of Economics"), Professor Anna Luliyanova (National Research University "Higher School of Economics"), Professor Sergey Zakharov (National Research University "Higher School of Economics"), Professor Karoly Attila Soos (Hungarian Academy of Science), Professor Keiji Natsume (Ryuukoku University), Professor Hiroshi Tanaka (Ritsumeikan University), and others.

My special thanks go to Ms. Emiko Horibe for her technical support and constant help in offering me the resources in running this research project.

Furthermore, the success of this dissertation to a large extent is due to my beloved friends who have played an important role for a successful completion of this dissertation. My deepest acknowledgments go to Fara R., Alexander S., Tymur S., Mai I., Lena B., Alena V., Ilona A., Alex S., Theang O., Shino K., Rina K., Atsumi K., Hironori T., Takenori A., Sachiko Y., Akitsuyu O., Masuto F., Kengo T., Daiki H., Ryota S., Olga K., Anastasiya S., Olga S., Kristina I., Zoya P., Aya T., Kenji S., Megumi H., Akiko Y., Kiyoko T., Taka Y., Miki Y., Yoshiaki M., Reiko M., Taka M. and many others. I am grateful to all the friends I met during my stay in Kyoto and in Japan for the past 6 years.

And finally, I would also like to acknowledge with much appreciation the crucial role of my family. Without constant support of my mother Elena, my father Andreyan and brother Andrey, it would not have been possible to finish this dissertation. My dear beloved family, thank you for your patience, deep understanding and constant throughout support. All that I have achieved up until now is, without exaggeration, thanks to you and for that I am sincerely grateful.

Victor Gorshkov

PUBLICATION OF DISSERTATION RESULTS

Some parts of the present dissertation were publicly presented at scientific conferences, research seminars, young scientist workshops both domestically in Japan and abroad (South Korea, the United Kingdom, the United States). Moreover, major scientific findings have been published in the form of research articles and working papers. The author bears full responsibility for the remaining errors and omissions in such publications.

<u>Major publications:</u>

1. Victor Gorshkov, Foreign banks in Russia: motivation, entry modes and strategies, *KIER Discussion Paper*, No. 801, December 2011 (CHAPTER 3).
2. Victor Gorshkov, Foreign activity of Russian banks: reconsidering multinational banking theory, *KIER Discussion Paper*, No. 830, November 2012 (CHAPTER 5).
3. Victor Gorshkov, Foreign banking in Russia: an analysis of inward-outward expansion, *Journal of Comparative Economic Studies*, No. 8, pp. 77-107. March 2013 (CHAPTER 5, CHAPTER 1).
4. Victor Gorshkov, Inward entry of Japanese banks into the Russian market, *KIER Discussion Paper*, No. 864, May 2013 (CHAPTER 4).

<u>Major conferences participation:</u>

1. Victor Gorshkov, "Foreign banking in Russia," presentation at *International Workshop for Young Researches from Laos and Vietnam*, August 2010, Kyoto University, Kyoto, Japan (CHAPTER 1, CHAPTER 3).
2. Victor Gorshkov, "Recent trends in Russian banking," presentation at *Workshop on Macroeconomics*, 10 March 2011, KIER, Kyoto University, Kyoto, Japan (CHAPTER 2).
3. Victor Gorshkov, "Recent trends in Russian banking," presentation at *Workshop on Macroeconomics*, 10 March 2011, KIER, Kyoto University, Kyoto, Japan (CHAPTER 2).
4. Victor Gorshkov, "Russian banking system and transnational banks," presentation at *Young Researchers' Workshop on Economic Transition and Development*, May 2011, World Class University Project, Seoul National University, Seoul, South Korea (CHAPTER 1, CHAPTER2, CHAPTER 3).
5. Victor Gorshkov, "Russian banking system," presentation at *International Workshop for Young Researches from Laos and Vietnam*, August 2011, Kyoto University, Kyoto, Japan (CHAPTER 2).
6. Victor Gorshkov, "Recent trends in Russian banking," presentation at *Japan Association for the Comparative Studies of Management*, December 2012, Ryukoku University, Kyoto, Japan (CHAPTER 2, CHAPTER 3).
7. Victor Gorshkov, "Foreign banks' entry and the development of the Russian banking sector," presentation at *Pacific-Rim Conference on Economic and Financial Development*, May 2012, Honolulu, Hawaii, USA (CHAPTER 1, CHAPTER 2, CHAPTER 3).
8. Victor Gorshkov, "Foreign banking in Russia," presentation at *Workshop for Visiting Researches under Suzukawa-Nakamura Research Fund*, July 2012,

Slavic Research Center, Hokkaido University, Sapporo, Japan (CHAPTER 1, CHAPTER 2, CHAPTER 3, CHAPTER 5).

9. Victor Gorshkov, "Foreign activity of Russian banks: reconsidering multinational banking theory," presentation at *12th European Association for Comparative Economic Studies (EACES) Conference*, 6-8 September 2012, University of West Scotland, Paiseley, Scotland, UK (CHAPTER 5).
10. Victor Gorshkov, "Foreign banking in Russia: activity of foreign banks and Russian banks' foreign expansion," presentation at *Workshop of JACES*, September 2012, KIER, Kyoto University, Kyoto, Japan (CHAPTER 1-5).
11. Victor Gorshkov, "Inward entry of Japanese banks into the Russian market," presentation at *Pacific-Rim Conference on Economic and Financial Development*, April 2013, Seoul National University, Seoul, South Korea (CHAPTER 4).
12. Victor Gorshkov, Satoshi Mizobata, "Emerging Multinationals in Russia," presentation at 38th Conference of the *Japan Association for the Comparative Studies of Management*, May 2013, Kagoshima International University, Kagoshima, Japan (CHAPTER 5).

Major projects participation:

1. "Russian Transnational Corporations and Transnational Banks," Joint Usage and Joint Research Project "General research on Slavic and Eurasian Regions (ex-Soviet countries and Eastern Europe," organized by Slavic Research Center, Hokkaido University and The Japan Institute of International Affairs, February 2011.
2. Kyoto ERASMUS program (financial aid for the Pacific-Rim conference participation in USA), September 2012.
3. Nakamura-Suzukawa Research Grant, Slavic Research Center, Hokkaido University, 3-17 July 2012. Research topic: "Foreign expansion of Russian banks," "Foreign banking in Russia".
4. Kyoto ERASMUS program (financial aid for the 12th EACES conference participation in UK), May 2012.

LIST OF TABLES, FIGURES AND APPENDICIES

TABLES

FIGURES

APPENDICIES

EXPLANATORY NOTES

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INTRODUCTION

Increasing globalization and internationalization in the world economy is a major trigger for integration processes among national economies that contribute to further expansion of international relations. This process is self-perpetuating and has affected almost all spheres of human activity. The development of integration processes is particularly apparent in the financial sector. Facilitation and further sophistication of the financial (capital and banking) markets, the increase of currency flows among countries, growing liberalization and integration of international and domestic financial markets and ultramodern technologies are separate characteristics of what is indeed a unified process often described as financial globalization in academic literature. Financial globalization has no alternative but to further develop in the near future.

The primary actors facilitating the process of financial liberalization are transnational (multinational, foreign) banks [further in the text of the dissertation, we apply MNBs and TNBs accordingly]. The internationalization of national banking sectors emerged due to the activity of these financial actors characterized by possession of massive resources in terms of economic, financial and political power. Activities of TNBs have fostered debate regarding possible economic theories explaining why TNBs choose to internationalize and expand their businesses abroad. Versatile theories on foreign direct investment (FDI), multinational corporations theory (MNC theory) and its extension – multinational banking theory (MNB theory) [1] have been successfully applied by

[1] Multinational bank theory (MNB theory) emerged from the theory on multinational corporations (MNCs). Researchers in the sphere of foreign banking and multinational banking currently apply the term “theory of multinational banking” in their studies, although initially the United Nations Center on Transnational Corporations introduced the term “multinational bank” in 1981. According to this definition, a multinational bank is “a bank having more than five affiliates or subsidiaries abroad and one engaged in organizing commercial banking activity.” Grubel (1977) developed his theory of multinational banking based on the theory of FDI in manufacturing. According to it, MNBs have some comparative advantages. Banks go abroad to better serve their domestic clients (“follower strategy” or “gravitational pull effect”). Banks’ internationalization grows in parallel with FDI as banks try to meet the demand for banking services of MNCs abroad. However, due to the diversification and complication of

researchers in order to investigate issues regarding the foreign expansion of TNBs from developed countries, namely the United States, Japan and some European countries.

The continued spread of financial globalization in the 1980s raised the important issue of financial liberalization of markets. There is overwhelming evidence in the economic literature corroborating the notion that this question is important for both developed and developing economies, with transition economies being the most affected. This is due to the fact that financial liberalization plays an important role in establishing sound and stable financial systems.

Consequently, there has been an ongoing debate about whether the discussion on access of TNBs (foreign banks) to financial (banking) systems of developing and transition economies is new or not. For many developing and transition economies, the problem of foreign capital persists, even 20 years after beginning their transitions.

The 1990s marked the beginning of the transition period from a planned (command) to a market economy; many American economists highlight the importance of the establishment of a stable financial system based on efficiently functioning capital markets, while much European economics research argued for the development of an efficient banking sector. Both these initially controversial approaches were considerably influential on the financial systems of transition and developing economies and were applied as an institutional basis for its establishment. In particular, Central and Eastern European countries (CEEC) followed the approach of introducing solid national

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banking transactions at the present stage of development of banking activity in general, we argue that the definition of MNB (TNB) needs some revision. In essence, any foreign banks doing business abroad nowadays can be categorized as a multinational. For the simplicity of the analysis herewith we assume that Russian banks having foreign affiliates or subsidiaries can be regarded as MNBs (or TNBs), due to the fact that the main condition (expansion of business to other countries is fulfilled and the ownership structure of major banks going abroad, namely OAO "Sberbank," OAO" Vneshtorgbank," and OAO "Gazprombank") is represented by participation of foreigners (though only through minority shareholder participation). MNB theory is precisely discussed in Section 1.2.

banking systems. Gradual financial liberalization in these countries opened domestic banking markets to foreign investors and as a result foreign banks acquired control and dominance in regions, which in most cases, from the institutional point of view, resulted in the creation of a sound banking sector. In countries like Estonia, foreign banks' share participation in banking assets amounts to nearly 100% (Vernikov, 2002).

In Russia, the size of the banking sector is relatively small and for a long time it was dominated by the state (Kievskiy, 2008). It experienced malfunctions after the financial liberalization reforms implemented in the 1990s. Notwithstanding this setback, the foreign share in banking assets and capital is gradually increasing. The banking sector remains dominated by state-owned banks such as OAO[2] "Sberbank" and OAO "Vneshtorgbank," whose share of total banking assets and capital are extremely high. Nevertheless, increasing foreign competition holds promise in Russia.

How do these two issues overlap? What is the nature of relations between the activities of TNBs and financial liberalization processes in developing and transition economies? There seems to be no compelling reason to argue that foreign banks have executed significant influence on financial liberalization processes in the selected group of economies. The underlying argument in favor of their crucial role is based on the fact that a large amount of foreign capital participated in privatization schemes of national banking sectors of these countries.

Nevertheless, the far more important issue on the essence of relations between the two extends beyond simple practical expectations from the foreign capital participating in these countries. There is a theoretical component of the deal – one that is the primary focus of economists. As will be further discussed in Chapter 1 of this dissertation, traditional FDI, MNC and MNB theories have mostly concentrated on explaining the

[2] OAO stands for "Otkritoe Akcionernoe Obshestvo" (Open Joint-Stock Company). The term is applied by the Russian legislation on judicial companies.

motives of banking FDI from developed to developed economies, but recently there is a growing tendency for FDIs to flow from developed to developing, among developing, and among transition economies. The driving forces behind foreign expansion into these regions might be different from those generally investigated in the related literature. As discussed later in this dissertation, there is ample support for the idea that the behavior of foreign banks in developing and transition economies is difficult to explain within the frameworks of existing MNB theory.

Therefore, the present dissertation will focus on the *activity* and *behavioral patterns of foreign banks* entering into the Russian market. We focus on issues of *motivation*, *entry modes*, *organizational structure,* and *strategies* of foreign banks in the Russian market. Our main argument is that existing theories on FDI, MNC, and MNB do not comprehensively explain the motives and behavioral patterns of foreign capital entering the Russian market. We conditionally assume that *domestic environment*, comprising *macroeconomic*, *microeconomic* and *institutional* contexts, and *idiosyncratic features of the Russian banking sector* and *market specificity* of both home and host countries exert an influence on motivation, entry modes, organizational structure and strategy of foreign banks. As a working hypothesis, we presume that institutional context plays a significant role in shaping activities and behavioral patterns of foreign banks operating in the Russian market. Furthermore, both institutional environment and idiosyncratic features matter in cases of out-in entry (foreign banks entering the Russian market) and in-out expansion (Russian banks expanding their business abroad). However, as it will be shown in two case studies on European and Japanese banks as well as in cases of in-out expansion of Russian banks, the Russian domestic environment might have a significant role in shaping the activity of foreign banks.

The key concepts and definitions of the dissertation will be discussed in the next chapter. Major tasks required to empirically test our major assumptions and hypothesis are summarized as follows:

1. To provide the outline of theoretical approaches regarding the analysis of foreign banks' activities and validate the view that existing theories on FDI, MNC, and MNB have flaws in explaining the behavioral patterns of foreign banks entering developing and transition economies.
2. To develop a new combined methodological approach in order to empirically test our major working assumptions, namely the proposition that the analysis should be host country-focused (Russia) [we further refer to it as *a foreign banking theory approach*].
3. To analyze major trends and problems in the banking system of Russia and identify idiosyncratic features of the banking sector and stress the market specificity issues in Russian conditions.
4. To investigate and identify major trends in inward and outward banking FDI (macroeconomic analysis of the activity of foreign banks).
5. To empirically portray the activity and behavioral patterns of foreign banks in Russia, particularly concentrating on issues of motivation, entry modes, organizational representations and strategies of foreign banks in Russia. Application of existing theories of MNB in the analysis and implementation of empirical surveys of foreign banks with 100% foreign capital participation in order to fill the gap of such empirical studies in the present literature.
6. To evaluate the role of home countries by providing case studies on European and Japanese banks operating in Russia. Both home and host countries' environments matter.

7. In order to support the proposition in 6, to conduct an analysis of Russian banks' foreign expansion and underline the importance of the institutional context of Russia as the home country.
8. To summarize major findings and theoretically define the role of institutional context and its impact on the activity of foreign banks.

Major sources of statistical information applied in the process of writing this dissertation include the following: statistical data and analytical materials of the Central Bank of the Russian Federation (CBRF), the International Monetary Fund (IMF), the United Nations Conference on Trade and Development (UNCTAD), the World Bank (WB), online resources and working papers and materials presented at various symposiums, conferences, and workshops related to the topic of this dissertation. Furthermore, we apply data from financial reports of banks and other disclosed sources of information. Major sources of scientific literature compiled for this dissertation will be presented in Chapter 1.

A few words on the structure of the dissertation, which consists of 180 pages and includes the following sections: introduction, five chapters, conclusion, five appendices, an explanatory note and a bibliography[3]. There are 33 tables and 23 figures in the body of the dissertation, which are numbered consecutively and reference chapter numbers (e.g., Table 1-1 refers to Table 1 located in the body text of Chapter 1). Each Chapter in the dissertation is followed by an executive summary that highlights the major ideas and findings in each chapter. The overall structure of the dissertation is presented in Figure 1-1.

The Introduction explains the relevance of the present research topic and briefly states aims, tasks and methodology.

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[3] Appendices and explanatory notes are not included in the page count.

Due to the complexity of the research subject and its methodology, details regarding theoretical aspects of the dissertation are provided in Chapter 1, where we define the object, subject, and key definitions of the dissertation, shape the methodological framework of the “foreign banking theory” through review of existing methods of analysis of the foreign expansion of banks (namely, MNB theory) and academic literature on foreign banks in Russia.

Chapter 2 emphasizes idiosyncratic features and market specificity of the host country (Russia). We provide a general outline of contemporary banking legislation in Russia and analyze the banking sector from institutional and macroeconomic points of view and attempt to perform international comparisons.

Chapter 3 provides evidence regarding out-in entry cases in the Russian market. After an investigation of general trends regarding foreign inward investments into the Russian banking sector, we accentuate behavioral patterns of foreign banks, namely their motivation [three-tiered analysis on the basis of microeconomic, macroeconomic, and institutional frameworks], entry modes, organizational representations and strategies.

Chapter 4 introduces two out-in case studies of European and Japanese banks operating in the Russian market. European banks such as the Austrian Raiffeisen Group, are the most successful players in the Russian banking market, while locally incorporated banks with Japanese capital are relatively inactive and the scope of their activity is limited. However, Japanese banks, often regarded as typifying “followers,” are of great interest for investigating host country background (specificity).

In Chapter 5, we extend the theoretical framework of the “foreign banking theory,” by examining idiosyncratic features and market specificity of Russia as the “home country.” We summarize major trends in outward banking foreign investments by

Russia and extend our discussion to handling issues of foreign expansion of Russian banks. Chapter 5 empirically shows that institutional context in Russian conditions significantly influences the foreign expansion of Russian banks. We assume that in Russia's case, there is causality between out-in entry and in-out expansion.

In the Conclusion, we summarize major findings of each chapter, expound distinctive features of the present dissertation, and suggest directions for further research.

1. THEORETICAL FRAMEWORK OF THE DISSERTATION

1.1. Object, subject and key definitions of the dissertation

This dissertation aims to analyze the activity of foreign banks in Russia through the methodological approach of the *"foreign banking theory,"*[4] which is defined in Section 1.4 of Chapter 1. Applying the existing methods of analysis of the foreign expansion of banks, for instance MNB theory, we examine motivation, entry modes, organizational representation and strategies employed by foreign banks operating in the Russian market. We underline the importance of analysis from the viewpoint of "host country," investigating the behavioral patterns of foreign banks in the Russian market are through the prism of specific features of the Russian financial (banking) sector and idiosyncrasies of the host country (Russia). This is a distinctive feature of our study that differentiates it from similar studies within the framework of MNB theory, which largely analyzes the behavior of banks from the viewpoint of the "home country." However, whenever feasible, we attempted to include a discussion of home countries to supplement our analysis and broaden the notion of behavioral patterns of foreign banks operating in Russia.

Before shaping the methodology of the present study and introducing the coherence of our considerations, we briefly introduce the object, subject, and key definitions.

In the dissertation, we primarily investigate *out-in entry cases*, referring to the situation of foreign expansion of banks into the Russian market. As a supplement to our discussion on "*foreign banking theory*," we consider *in-out expansion cases* referring to

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[4] Some studies highlight the importance of analyzing the activity of foreign banks in national economies (Vernikov (2002, 2004a, 2004b, 2006) and Rozinskiy (2006, 2008a, 2009). The theory of foreign banking as a definite concept is not acknowledged in the literature. While acknowledging the importance of the MNB theory's approach, we argue MNB theory needs some revision.

Russian outward banking FDI and activities of Russian banks operating in foreign markets.

Home country in the present dissertation refers to a country that is the origin of financial investments into the banking sector (banking investments). Therefore, this category includes countries of origin where foreign banks locate their parent banking institutions.

Host country refers to the country that is the recipient of banking investments, namely Russia. Nevertheless, in Chapter 5 when in-out entry cases are considered as an extension of the "*foreign banking theory*," the definitions of home and host countries subsequently interchange. Russia is viewed as a "home," while countries from Europe and the Commonwealth of Independent States (CIS) that are the main recipients of Russian outward banking FDI are defined as "hosts."

We conditionally assume that both home and host countries have *idiosyncratic features* (specific features) and hold a sort of *market specificity,* referring to peculiarities of microeconomic, macroeconomic and institutional development of banking sectors in home and host countries as well as general market quality issues. These idiosyncratic features and market specificity play a crucial role in influencing, and in some cases pre-determining, motivation, entry modes, organizational representation, and strategies of foreign banks. Our main argument is that existing theories on the foreign expansion of banks, for instance MNB theory, are inclined toward the viewpoint of home country (parent bank), thereby market specificity of host countries, especially its institutional component, is often excluded from the scope of research.

The ***object of the dissertational research*** is foreign banks operating in the Russian banking market and their *on-shore activity* in the Russian market[5]. In the dissertation, we consider a bank to be a foreign one if it is registered as a banking institution in a foreign country. This definition is applied by CBRF and is legally applicable in some other countries (Japan). Therefore, organizational representations like representative offices are also considered to be foreign banks, though as a matter of fact they are not engaged in providing banking services in host countries. We apply the following basic indicators proposed by Vernikov (2005a, p. 10) in order to assess the presence and scope of activity of foreign banks in Russia, namely: the number of registered and factually operating banks with foreign participation; mass of foreign capital – the sum of registered shares in charter capital of operating credit organizations; share of non-residents in the total charter capital of the banking sector; share of banks controlled by non-residents in total assets and capital of the banking sector; share of assets and capital of banks with foreign participation in GDP; share of banks controlled by non-residents in distinct market segments (corporate and retail banking, deposits). The statistics on the banking sector developed by the CBRF mainly represent data on the above-mentioned indicators. The CBRF monitors the share of non-residents in the total charter capital of the banking sector. In order to evaluate the scope of activity of foreign banks, CBRF applies the following typology: *banks with foreign participation* are considered to be foreign banks with capital participation of non-residents and are divided into *banks controlled by non-residents* (more than 50% of charter capital is invested by foreign investors (non-residents)) and *banks with foreign participation of less than 50% of shares*. Among the group of banks controlled by non-residents, the CBRF distinguishes

[5] Therefore, cross-border lending transactions of foreign banks are beyond the object of the present study, though we mention some issues regarding cross-border investments when analyzing the general structure of inward and outward foreign direct investments (IDFI and OFDI) of the Russian banking sector.

banks with 100% foreign participation. This typology of foreign banks is developed by CBRF in order to assess the ownership structure of foreign banks and precisely calculate the limit of foreign banks' participation in the banking sector of Russia[6]. This is a sort of quantitative definition of foreign banks. In this dissertation we also apply a wider definition – the juridical one stipulated in Chapter 1 Clause 1 of Federal Law № 395-1 "On banks and banking activity" dated by 2 December 1990, whereby a "foreign bank is a bank recognized as such in accordance with the legislation of a foreign country in the territory which it is registered." Therefore, we employ a quantitative approach when analyzing the scope of activity of foreign banks, but apply a broader definition when dealing with the subject of the present study.

Some remarks should be made on terminology. In literature on foreign expansion, there is often a sort of confusion and ambiguity of terms referring to international expansion or foreign activity of banks. Some terms, namely *international bank*, *multinational bank*, *transnational bank*, *foreign bank* are often applied indiscriminately, despite the fact that in our view there are differences in their conceptual representation. For instance, *international banking* is a broad concept defined as "cross-border and cross-currency facets" by Lewis and Davis (1987, p. 219)[7]. The definition of a *multinational bank (MNB)* stems from the definition of multinational corporation (MNC), and it is generally accepted that MNBs "own and control branches and/or affiliates in more than one country" (Jones, 1992, p.xiiii[8]; Robinson, 1972, p.4[9]; Gray and Gray, 1981, p.37; Lewis and Davis, 1987, p. 219). An element of FDI is a

[6] In order to regulate FDI into the banking sector, the CBRF introduced the 12% upper limit on foreign participation in the total charter capital of the banking sector (1990s), though later during negotiations with the World Trade Organization (WTO) the limit was raised to 50%. The present share (January 2012) fluctuates between approximately 25% and 30%.

[7] The citation here is from Herrero and Simon (2006), official source for Lewis and Davis (1987) not obtained by author.

[8] See Footnote 6.

[9] See Footnote 6.

distinctive feature of multinational banking, i.e. the institutional presence in the host country matters. *Transnational banks (TNBs)* are similar in a way to MNBs; see the first definition introduced by the United Nations Center on Transnational Corporations (UNCTNC): "A transnational bank is a bank owning five or more affiliates or subsidiaries and implementing commercial banking activity abroad." A similar definition is applied by the OECD, "A foreign bank is a bank with its head office outside the country in which it is located[10]" We consider TNBs to be more complex structures that invest in foreign operations and provide banking services worldwide. While distinctions of any kind between these terms is very conditional, in order to avoid ambiguity in definitions for the purpose of the present dissertation we employ the term "foreign bank" defined by Russian Law, though we are grounded in the MNB theory and its approach when shaping our methodology of "*foreign banking theory.*"

The ***subject of the dissertation*** is behavioral patterns of foreign banks operating in Russia largely from the viewpoint of a host country. Behavioral patterns herewith include the choice of business strategy of banks in terms of *motivation*, *entry modes*, *organizational representation,* and *strategy*. We analyze these behavioral patterns using the common approach of MNB theory, but with a stronger emphasis on analysis through the prism of the "host country."

We aim to analyze the motivations of foreign banks operating in the Russian market and wherever possible to provide a three-tiered analysis: microeconomic (behavioral), macroeconomic, and institutional frameworks, with particular focus on the institutional context[11]. Both PUSH (home country-related factors) and PULL (host country-related

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[10] According to the OECD Glossary of Statistic Terms.

[11] We follow classification conventions of MNB theories and determinants of foreign expansion of MNBs in the empirical literature proposed by Herrero and Simon (2006), but reshape it in order to fit our methodological requirements (see details in Section 1.2 and Section 1.4).

factors)[12] reasons of entry are considered in this three-tiered approach. However, in the dissertation we highlight the significance of analyzing the motivation of foreign banks through the prism of host country.

In terms of entry mode, there are two types of entrances into a foreign market: *greenfield investments* and *brownfield investments*.

The former involves setting up a banking institution from scratch and in some cases requires a significant capital infusion (subsidiary, branch) when compared with less costly forms of entry such as representative offices or branch offices. In conditions of instability and fragile financial systems in emerging economies, greenfield investments allow banks to take advantage of their global image and reputation and in some cases to reach market segments that would be difficult to achieve through acquisition. *Representative office* of a foreign bank is the initial form of entry[13]. Representative offices negotiate correspondent relations with the local banks, evaluate market potential, provide consultation services and investigate economic conditions of the host country. A *Branch* is not an independent legal entity, but an integral part of the parent bank that can offer a complete range of diversified banking services. Branches are subject to supervision by both home and host countries. Branches are integral to the parent banks and are not separately capitalized; therefore, they have access to the full support, credit rating, and capital base of the parent. A *Subsidiary* is a locally incorporated institution of a foreign bank and it is legally independent from the parent bank in the home country, but controlled by a parent bank in another country. Hence, subsidiary represents a more expansive entry mode for banks. Subsidiaries are sometimes wholly owned, as this

[12] While not directly within the subject matter of this dissertation, we acknowledge the current economic theory of global PUSH and global PULL factors that stipulate the direction of capital flows in the world economy. For instance, refer to Fratzscher (N.D.).

[13] Though some researches claim that the establishment of correspondent banking is a prerequisite for the international expansion of banks, we consider correspondent banking to be a part of international banking.

reduces potential problems associated with dissenting minority shareholders. The host nation regulations imposed on foreign bank subsidiaries often determine whether this organizational structure is chosen[14].

Brownfield investments generally refer to penetration in the form of *mergers and acquisitions (M&A)*. Acquisition characteristics range from a *100% purchase of shares, 50/50 deals in the form of joint ventures (JV)* to a *minority stake*. In case of Russia, banks are therefore classified into those controlled by non-residents, banks with foreign participation, and banks with minor shareholders participation. M&A provides access to local knowledge and easily allows buyers to establish efficient retail networks.

Organizational representation of foreign banks refers to the type of juridical entity foreign companies tend to establish in the market of the host country (Russia). This includes OOO (Limited Liability Company), OAO (Open Joint Stock Company), ZAO (Closed Joint Stock Company), ODO (Additional Liability Company), and other juridical entities stipulated by the Civil Code of Russia for banking credit institutions.

Strategy of foreign banks is often applied indiscriminately in the academic literature and sometimes confused with entry modes. We conditionally define such strategies of foreign banks as "*organic growth,*"[15] "*cherry-picking*"[16] and *M&A*[17]. Organic growth is also regarded as *de novo* business in the literature (Hryckiewicz et al., 2008).

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[14] In the academic literature there are other entry modes, such as corresponding banking, agencies, consortium banks, merchant banks subsidiaries and edge act corporations (for details refer to Williams (1997)).

[15] The aims of organic growth strategy are the expansion of business by full dependence on internal resources of foreign banks. The strategy is costly and takes much time to be implemented (Vernikov, 2005a). Literature describing this approach warns against pursuing M&A as part of this strategic approach.

[16] A Cherry-picking strategy is a strategy employed by foreign banks and involves the short-term acquisition of profits without any intention of establishing long-term business in the host country (Vernikov, 2005a).

[17] Though M&A is sometimes regarded as an entry mode in international business literature.

1.2. Foreign expansion of banks: theoretical approaches

As stated in the Introduction, during the 1990s foreign participation in the financial sector of emerging economies rose substantially. Financial liberalization in developing and transition economies facilitated the influx of foreign banks into these countries. This expansion fueled interest in the causes and consequences of financial FDI, with CEE countries perhaps being the center of attention. Theoretical support for explaining the motives of FDI became a cornerstone problem for many economists in the field.

To our view, there are two different approaches in the theoretical investigation issues of financial FDI, namely approaches of FDI theories (includes both MNC theory and its extension MNB (or TNB) theory) and methods of analysis in the sphere of international business. The former focuses on determinants of FDI and originated in research on international and foreign trade of MNCs. With the growing extension of financial FDI, MNC theory was theoretically extended and adapted to address issues with foreign banks (MNBs). In short, FDI, MNC, MNB theories primarily tackle issues of FDI motives. The latter, however, mainly has fostered debate on the process of internalization of foreign banks with the investigation of issues regarding entry modes, organizational representations, and strategies of foreign banks (e.g., Slager, 2005). The distinction between the two is a conditional one, due to the fact that the two approaches often overlap in the literature.

A literature review by Herrero et al. (2003) explaining financial FDI and systematization of empirical literature on FDI determinants concludes that the "existing theoretical paradigms need to be adapted to explain the recent surge in international banks' local operations in emerging economies." Herrero et al. (2003) subdivides main theories into two major groups – micro-behavioral and macro. Herrero et al. (2003) divided explanatory factors from empirical literature into three groups – macro, micro-behavioral and institutional. His major finding is that "empirical literature on FDI has concentrated on bank-specific factors and much less so on macroeconomic determinants; the effects of financial FDI on the home country is virtually unknown" (see details in Appendix A).

In the present dissertation, we do not provide a comprehensive analysis of the existing theories on FDI, MNC, and MNB, but we summarize the major drawbacks of the current discussion below.

To begin with, there is significant *general criticism* regarding the outdated approaches of MNC and MNB, including ambiguity of definitions (FB, MNB, TNB, international bank) and a limited selection of targeted countries. Herrero et al. (2003) mentions in his work that the present stage of development of foreign banks is the so-called "third wave," while theoretical approaches now being applied had been formulated in the 1970s and 1980s, and mostly targeted investigations of cases of foreign entry among the United States, Japan and other developed European economies. Despite the fact that the geographies of research were later extended to emerging and transition economies, as it will be shown in Section 1.3, there are insufficient systematic empirical studies on Russia that apply the traditional theories of FDI, MNC and MNB, while there is ample research targeting similar issues in CEE (Hryckiewicz et al., 2008).

Furthermore, the foregoing discussion initiated by Herrero et al. (2003) implies that there is a lack of both theoretical elaborations and empirical studies on macroeconomic determinants of financial FDI. PUSH/PULL factor analysis is applied in order to define entry motivations without deep understanding of microeconomic, macroeconomic situations in both host and home countries. The issue of behavioral patterns of foreign banks is clouded by the fact that this behavior is analyzed without profound economic and institutional analyses of the banking sector of both home and host countries' economies.

In addition, the existing approaches often represent a one-sided analysis (either from the home or host country's perspective) generally dominated by home country-related studies (Uibopin and Sorg, n.d.)[18]. Analysis of foreign banks from the host country's perspective is still poorly elaborated (Appendix A).

Overall, much of the current debate on financial FDI in both developed and emerging economies revolves around micro-behavioral and macroeconomic theories. There is a lack of theoretical reasoning regarding institutional factors of both home and host countries that significantly impact the entry choice of foreign banks and the expansion of domestic banks. As Nacken et al. (2012, p. 4) show, there seems to be no compelling reason to argue that the "institutional-based view has great potential to increase our understanding of entry strategies used by MNBs and to generally advance international business research." Hrysckiewicz (2008) also states that entry modes and strategies of foreign banks in particular are not related to the choice of mission or a strategy of a foreign bank, as they depend on entry conditions. While it is generally acknowledged that foreign banks adapt and align their motivations, entry modes, organizational representation and strategies to the institutional characteristics in a particular host country, a closer look at the empirical studies indicates that there is no theoretical grounding for the effective application of the role of institutional framework in the existing MNB theory. Herrero et al. (2003) identified PUSH institutional factors, such as domestic restriction, and PULL institutional factors, such as level of openness of the host country, tax incentives, legal system, and per capita income. Nacken et al. (2012)[19]

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[18] See Footnote 6.
[19] See Footnote 6.

examine the activity of foreign banks in CEE in relation to institutional risk and uncertainty; however, they also fail to provide a comprehensive definition or explain the impact of institutions on behavioral patterns of foreign banks.

On the other side, the international business field likewise has not contributed much to the exploration of institutional factors. It does better tackle issues of internationalization of foreign banks, providing more exact frameworks regarding key definitions (international, multinational, transnational, foreign banking) and fosters discussion on preferable types of investment (green-field vs. brown-field) and efficient entry modes. We particularly highlight the works of Enatsu et al. (2008) that theoretically summarized the theory and evolution of international business and extend research to the service sector.

To sum up, there is ample support for the revision or further theoretical extension of the traditional FDI, MNC, and MNB theories and a need for synthesis of these theories within the field of international business. The core argument for this revision is based on the fact that emerging and transition economies have experienced one of the highest levels of banking intermediation into their national financial (banking) systems. Hryckiewicz et al. (2008) foster the debate based on the proposition that MNBs of the 1990s in CEE can hardly be found to be attracted to markets abroad in order to exploit favorable financial systems. Financial liberalization in this region should also be analyzed in relation to the activities of foreign banks. For this purpose, more complex research on the banking sectors of these countries is required.

1.3. From multinational banking theory to foreign banking theory: methodological framework of the present study

In order to address the drawbacks mentioned in Section 1.2, we humbly suggest a *foreign banking theory approach,* which is described in terms of theoretical methodology and the general structure of the dissertation is presented in Figure 1-1. Traditional MNB theory opts to analyze activities of banks from the viewpoint of the home country. Conversely, our approach, while acknowledging the scientific importance of the MNB theory, is based on the idea of examining motivations, entry modes, and organizational representation of banks via the prism of the host country's environment (Russia in our case). We conditionally assume that both home and host countries have *idiosyncratic features* in the banking sector and have their own *market specificity*. We refer to it as *specific environment* consisting of *microeconomic, macroeconomic, and institutional contexts*. We assume that this environment significantly exerts an influence on behavioral patterns of banks as they expand their businesses aboard. Within the framework of our *foreign banking theory*, parent foreign banks from home countries such as Europe, the United States, and Japan (FB1) operate in home country environments defined by specific microeconomic, macroeconomic, and institutional contexts and market specificity. In expanding their businesses abroad, these banks follow the business strategy of foreign expansion comprising *motivation*, *entry modes*, *organizational representation,* and *strategies* which are directly and indirectly influenced by the home country's environment. Up until this point, our viewpoint is similar to that of MNB theory. Our extension of the theory comes into play when banks enter the host country's market (Russia in our case), where there exists a similar *three-tiered environmental context* that might directly or indirectly pre-determine or stipulate the behavioral patterns of foreign banks. Therefore, when analyzing the activity and behavioral patterns of locally incorporated banking institutions established by parent foreign banks (FB1*d*), we should keep this in mind and shift our analysis toward a closer examination from the viewpoint of the host country. We argue that institutional context is of particular importance in the case of Russia.

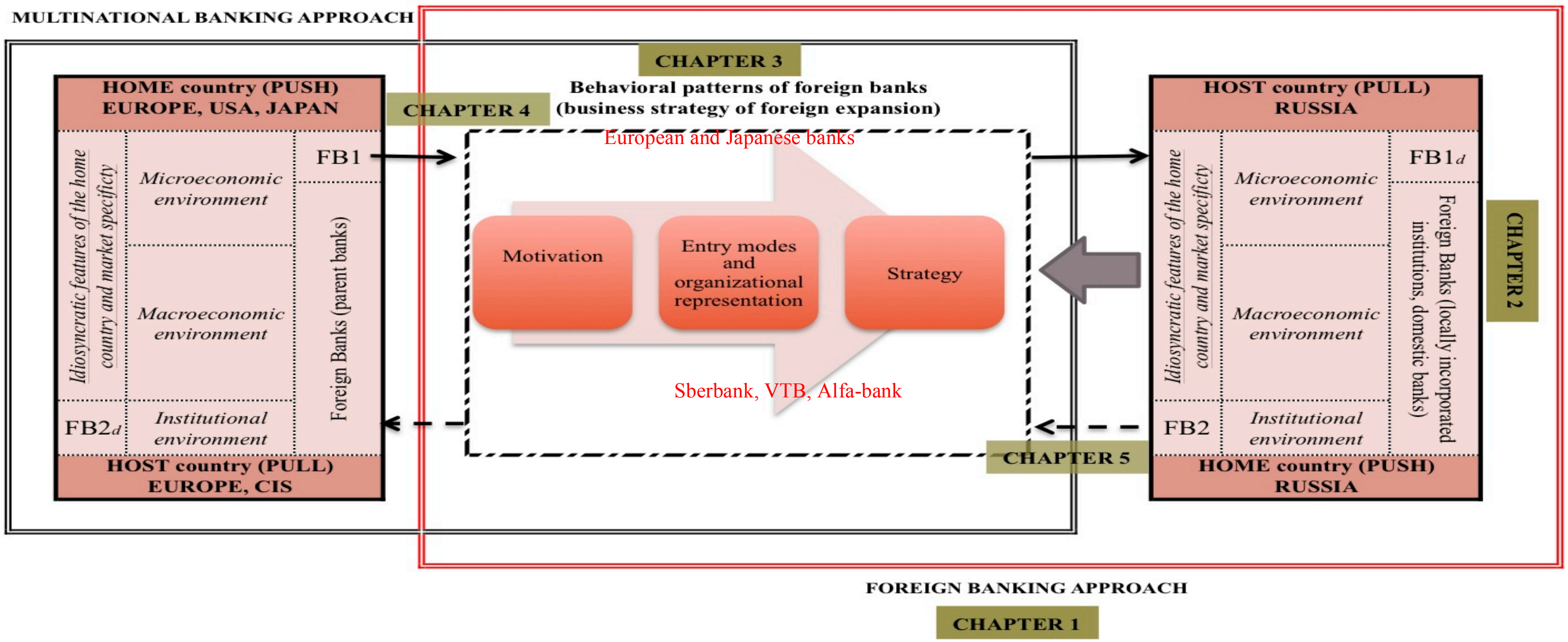
In addition, in emerging and transition economies like Russia, national governments tend to provide their own definition of foreign capital in the banking sector and summarize statistical data in accordance with such definitions. National governments set upper limits for foreign capital participation in the total charter capital of the banking system and measure the share of foreign bank capital in total banking assets and capital. MNB theory lacks these methodological issues in its analysis.

To sum up, the upper part of Figure 1-1 illustrates the *in-out entry cases*, namely inward foreign direct investments (IFDI) by parent foreign banks from home countries into the Russian banking sector. To support our argument that institutional context indeed significantly matters, we extend our analysis to *out-in expansion cases* and examine Russian outward foreign direct investments (OFDI), e.g., provide evidence of the role of the domestic environment of the home country. The lower part of Figure 1-1 demonstrates the case of parent banks located in Russia, such as OAO "Sberbank," OAO "Vneshtorgbank" and OAO "Gazprombank" (FB2) that expand their businesses by establishing locally incorporated institutions abroad (FB2*d*).

The advantages of our methodology can be summarized as follows: This approach is wider that traditional FDI, MNC, MNB theories, as it combines essential parts of all three and integrates approaches from international business when dealing with entry modes, organizational representation and the strategies of foreign banks. In addition, the suggested methodology provides a comprehensive three-tiered analysis of microeconomic, macroeconomic, and institutional contexts of both host and home countries[20]. Furthermore, it allows us to examine both out-in entry and in-out expansion cases and to determine the causality between each as the result of including institutional background.

[20] Though we focused primarily on host country domestic macroeconomic and institutional environment in the dissertation.

Figure 1-1 Conceptual representation of the foreign banking theory and chapter breakdown of the dissertation



Source: complied by author

1.4. Literature review

In this section, we summarize major source literature for the present dissertation. We paid particular attention to theoretical and empirical studies by Russian and foreign scholars published in scientific sources of information and available in three major languages: Japanese, English, and Russian. The literature applied can be classified as related to the following major topic groups:

(1) FDI, MNC, MNB theory

Major studies for this group were discussed in Section 1.2 and are divided into theoretical and empirical works in Appendix A. Other theoretical studies focusing on the essence of the MNC theory and its application to MNB include Bain et al. (2009), Dunning (1977, 2008), Duser (1990), Golberg et al. (1990), Golberg and Saunders (1981a, 1981b), Grubel (1977), Slager (2005), Kasheeva (2006), Hall (2009), Hurduc and Nitu (2011), Ball and Tschoegl (1982), Tschoegl (1983), Lehner (2009), Lihong and Delios (2008), Miva et al. (2005), Petrov et al. (2010), Vernikov (2005a), Yakovleva (2006), Hurduc et al. (2011), Tsai et al. (2011), Calzolari (2011) and others. The most detailed study regarding clarification of financial FDI, MNC, and MNB literature is that of Herrero et al. (2003). MNBs in emerging economies are analyzed in the works of Barisitz (2008), BIS (2004, 2009), Claessens et al. (2008a, 2008b), Clarke et al. (2003), Domanskiy (2005), Gorunov (2006), Shavshukov (2012), Sauvant (2005), Hryckiewicz and Kowalevski (2008); issues with transition economies, excluding Russia are investigated in scientific works by Bonin et al. (2003, 2005), Etokova (2006), Havrylchyk and Jurzyk (2011), Havrylchyk (2012), Manea and Pearce (2004) and Sugiura et al. (2008).

(2) Russian banking sector

General issues in the development of the Russian banking sector, its specific features, problems and development are under scrutiny in the works of Borisov (2004), Borovikov et al. (2012), Bogdanov (2008), Bulatov (2011), Fomenko and Subkhankulova (2009), Ivanov (2009), Khromov (2012), Kanaev (2011), Kosmachev (2006), Kozlova (2010), Lane (2002), Lavrushin (2010, 2011), Miroshnichenko (2012), Mizobata (2002), Moiseev (2006), Tulin (2011), Turbanov (2011), Vernikov (2007, 2009, 2012), Vinogradov (2008), Voronova (2006), Zrazhevskiy (2006), Zverev (2008), Sugiura (2011), Shtaihner (2005), Ono (2008), Rapport (2009), Gref and Udaeva (2009), Andrushin (2009), Vedev and Grigoryan (2011), Moiseev (2006), Tosunyan et al. (2008) and others. We rely on these works when analyzing institutional and macroeconomic structures of the banking sector of Russia, as well as when defining the idiosyncratic features of the Russian banking sector.

(3) Foreign banks in Russia

Literature solely targeting foreign banks' activities in Russia is quite diverse. However, in many cases, the analysis is made in terms of its strong correlation with general issues of the development of the banking sector. General issues of foreign banks' presence, scope of their activities, impact on the Russian banking sector and efficiency of domestic and foreign banks are scrutinized by such scholars as Bobkova (2007), Bogdanov (2008), Dorynin (2012), Cufari (2003), Elizavetin (2004), Jumponnen (2004), Khandruev (2008), Kievskiy (2008), Melikiyan (2006), Rozinskiy (2006, 2007, 2008a, 2009), Webber (2011), Wistinghansen (2006), Trofimov (2009), Vernikov (2004b, 2005a, 2006), Sukhov (2009) and Karas et al. (2010). Selected studies addressing issues of motivation, entry modes and strategies of foreign banks are presented in the works of Bochkarev (2006), Jumpponen (2004), Kulik (2006), Kievskiy (2008), Fungasova and

Pogosyan (2009), Mamonov and Solntsev (2008, 2009), Rybin (2007, 2008a, 2008b), Shmelev and Akopyan (2007), Vernikov (2002, 2004a, 2005a, 2006), Rykova (2007), Hattori (2004), Zhurova and Novikova (2007). We particularly stress the significant works of three Russian scholars: Vernikov, Rozinskiy and Rybin. However, even their studies contain no systematic analysis within the framework of traditional FDI, MNC, and MNB theoretical approaches. Foreign capital participation is often viewed in the context of general liberalization, modernization processes of the Russian banking sector, restrictions on financial FDI, perspectives of development of the banking sector, and other relevant issues. Behavioral patterns of foreign banks are insufficiently analyzed. While there are previous studies on entry modes and strategies of foreign banks in Russia (Rybin, 2007, 2008a, 2008b), in general institutional context and its impact on the activity of foreign banks has been scrutinized by Russian or foreign scholars.

(4) Russian banks' foreign expansion

We rely on the relevant scientific literature in order to explain in-out expansion cases of Russian banks. The investment boom in OFDI in Russia is mostly driven by the emerging transnational corporations (TNCs). The research on Russian TNCs is a prominent issue in the sphere of world economics and international economic relations. Kuznetsov (2007, 2008, 2009, 2010a, 2010b, 2011, 2012), Ivanov (2009), Bereznoy (2008), Filatotchev (2007), Kalotay (2008), Panibratov (2012) and many other researchers devote their efforts to the investigation of issues regarding how Russian TNCs emerge, why they expand their businesses abroad and their major business strategies in terms of foreign markets. Some studies focus on specific features of Russian MNCs and advocate the revision of the multinational corporations theory (Mizobata, 2012, 2013).

On the other side, research on transnational (multinational) banks (TNBs or MNBs) from emerging economies, including Russia are scarce in number in comparison to the research on non-financial TNCs. In the process of liberalization and globalization of financial systems both IFDI and OFDI should be considered. While the literature on foreign banks' activities in Russia is quite extensive and the topic is a heavily debated one, the activity of Russian banks is not fully covered in the existing literature. There are some detailed studies on the activity of Russian banks abroad from the point of view of international economics (Abakumova, 2012). Nevertheless, issues of MNBs from Russia are often addressed in relation to the general analysis of Russian TNCs (Panibratov, 2010) or in relation to the internationalization of the Russian banking sector (Panibratov et al., 2011), or investigated as the part of an FDI analyses (Abalkina, 2010), or as part of studies on Russian TNCs in the service sector (Kuznetsov, 2011).

In our opinion, the most closest comparable study to our own for in-out expansion cases was conducted by Panibratov (2010, 2011), who concludes that internationalization of the banking sector in Russia is mainly going to CIS and some select countries in Western Europe, the United Kingdom and the United States. Russian banks showed slow interest toward the countries of Africa, China, and Singapore. The author defined subsidiary banks and representative offices as the main organizational representation forms of Russian banks abroad and noted that the expansion approach is a conservative one based on organic growth and a series of strategic acquisitions (most active in countries that actively trade with Russia). Panibratov (2010) also highlighted the role of the state in foreign expansion of Russian banks, showing its great importance for the state-owned banks. However, the author has not fully explained reasons for the emergence of Russian MNBs within the framework of the existing literature on MNBs and limited his research to the largest banks, Sberbank, Alfa-Bank, Gazprom, and

Vneshtorgbank. In Panibratov (2011, 2012) key points of international expansion in the Russian banking sector are presented in more detail. The author argues, "while being significantly state-owned, Russian banks are most likely guided by economic motives (as opposed to political ones) and are leaning towards safer expansion destinations in conditions of suffering from home market immaturity."

Two more studies on Russian OFDI worth mentioning are those of Liuhto (2005) and Hanson (2010). Though both surveys do not fully target Russian banking OFDI, both authors consider the role of the Russian state as either a source of guidance for FDI or a source of reasons to "escape." Hanson (2010) provides empirical evidence and case studies showing that motivation of OFDI is "largely commercial" so far as the host-country pattern of OFDI is concerned. He also finds an element of "escape" by indicating tax-havens as major destinations of Russian OFDI.

To sum up, the literature applied in the dissertation can be subdivided into four major categories. We also refer to statistical data from official agencies and cite other relevant sources of information.

1.5. Summary

Chapter 1 introduces the theoretical framework of the present dissertation. By defining key concepts and providing a review of topic literature, we identify some drawbacks in exiting traditional theories explaining behavioral patterns of foreign banks for emerging and transition economies. We selected foreign banks operating on the Russian market as the object of the dissertation and developed the methodological approach of the foreign banking theory in order to comprehensively analyze activity and behavioral patterns of foreign banks in conditions in terms of a three-tiered domestic environment (microeconomic, macroeconomic, institutional) of both host and home countries. In the Introduction we constructed our hypothesis on the distinct role the institutional context plays in Russia and its impact on out-in entry and in-out expansion cases.

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2. GENERAL OUTLINE OF THE RUSSIAN BANKING SECTOR

2.1. System of the contemporary banking legislation in Russia

2.1.1. A brief outline of historical development of the banking sector

The creation of autonomous profit-motivated banks and stable banking system are the crucial part of the capitalism system. For Russia that experienced transition/transformation of its economic system from the planned to a market economy the transformation of the banking sector was a one of the most difficult tasks to implement.

For the purpose of a brief analysis, we conditionally classify the evolution of the banking sector in Russia into following several stages: emerging period from the late 1980s - beginning of 1990s (the so-called Soviet-style banking); reforms and privatization of the banking sector 1990 - 97; financial crisis in 1998; financial sector restructuring starting from 2000s; contemporary period of development 2006-12[21] characterized by intensification of financial activities and management improvement. In particular, in 2000s the scale, structure, banking activities, management strategies of many banks experienced considerable changes followed by the high economic growth rates in Russia.

In order to understand the structure, main elements and contemporary situation in the banking sector of Russia, it is important to consider the structure and process of banking in the Soviet period. The formation of the banking system in Russia started in the Soviet Union times with the emergence of Gosbank and cooperatives in perestroika years. In the late 1980s until the early 1990s five sectorial banks were established each being in charge of the most important industries for the Soviet economy. These included

[21] Detailed analysis of this stage is presented in Sections 2.2-2.5.

Sberbank, Industrial Construction Bank, Vneshtorgbank (foreign trade), Agricultural bank, Bank of social and economic public development (housing and social welfare). These five banks were controlled and managed by Gosbank (state bank).

The Russian state essentially renounced its monopoly in banking in 1988 with the adoption of Law on Cooperatives that resulted in emergence of “greenfield” private banks established by private individuals and small business associations (cooperatives) and local branches of state-owned “specialized banks”. The metamorphosis of state-owned banks took place almost entirely within the public sector (Vernikov, 2007).

Banks’ role in the appraisal of risk both in the production of commodities and with respect to enterprises was actually absent and replaced by the responsibility of the economic agents responsible for the implementation of state economic plans. In other words banks were channeling and allocating the finance whereby gosplans. And as the matter of fact the main function of banks was to exercise financial control over enterprises (Lane, 2002).

The Soviet style banking system changed with the adoption of the Federal Law No. 135-1 “On banks and banking activities in Russia” dated by 2 December 1990 that stipulated the basic principles for the development of the banking system. Gosbank was replaced by CBRF. In the process of privatization of state property many private banks emerged, together with the so-called “oligarchy” and pseudo-state financial institutions (Gazprombank, Alfabank, Rosbank, etc.). Simultaneously, many small regional banks emerged and developed very strong ties with the local governments and enterprises. Major banks (Sberbank, Vneshtorgbank) partially being privatized as the matter of fact were remained under the government control. This feature is omnipresent nowadays, meaning that state-owned banks hold dominant position on the banking market (Vernikov, 2009, 2012).

Unlike CEE countries, Russian banks were not involved in voucher privatization or other privatization schemes. State withdrawal was attained through dilution of state-owned stakes, assets-stripping, malicious bankruptcies and shady methods (Vernikov, 2007).

As Lane (2002, p. 23) posited, Russian banks in the first decade of transition from socialism to capitalism failed to mobilize the finance to facilitate the wealth and growth. Banks simply evaluated the risk potential of investments and their intermediary role is rather limited. "Major activities of banks before the financial crisis 1998 were to speculate in foreign exchange, to provide a conduit for the export of capital, to buy government bonds, and to facilitate the interest of client companies by the provision of funds and by facilitating non-monetary exchange of commodities."

The economic and financial crisis in 1998 triggered the necessity of reconsideration of the bank sector restructuring, the government had to reevaluate the role of the banking sector in the financial flows. Financial sector restructuring started under the Putin Government and included polices on simplifying permission procedures for investment projects, improvement of bank insolvency procedures, implementation of government audit and better law enforcement in securities markets. As a consequence, the state intervention intensified and the government strengthened its control through various channels such as CBRF, ARCO[22] and government financing (Mizobata, 2002).

Many researchers concur with the idea that Russian financial institutions developed through speculative activities rather than by playing the role of intermediaries. In the process of the post – crisis bank restructuring networks, political interests, bargaining

[22] ARCO was founded in March 1999 with the goal of creating an efficient banking system. ARCO was a non-profit public corporation owned by the Federal Property Fund and CBRF. Main tasks in accordance with the Law on Restructuring of Credit Organizations dated by July 1999 were supervision of troubled banks, acquisition of bank assets based on restructuring schemes and participation in the liquidation process.

among governments and other economic and political actors have played a much stronger role than market institutions. This fact has eventually become a kind of precondition or even “legacy”[23] stipulating contemporary specific features of the banking sector of Russia. Before identifying these features (market specificity of the host country), we shall briefly introduce major elements of the Russian banking system and legal framework of its activity.

2.1.2. Major elements of the Russian banking system and contemporary banking legislation

Banking system is an integrated establishment that stipulates its stable development. As an aggregate of elements it can be presented in the form of three blocks: fundamental, organizational and regulating ones. The fundamental block includes a bank as a credit institution and rules of banking activity. Organizational block comprises banks and non-banking credit organizations, fundamentals of the banking activity, organizational structure of the banking activity, and banking infrastructure. The third block is represented by state regulation of the banking activity, banking legislation, norms and instructions of the CBRF, instruction and manuals elaborated by commercial banks (Lavrushin I. O., 2010, p.196-197).

While there is no consensus among economists on whether the Russian banking system is a market banking one or a system of a transition period, generally it acts as a market model and has two tiers: CBRF and its institutions and the system of

[23] We apply the broad definition of the “Soviet legacy” in this dissertation, meaning the embeddedness of the old Soviet-style banking in the current banking system of Russia. Lane (2001) defined the “Soviet legacy” as “the impossibility of the banking sector to become an independent sub-system of the economy, due to inefficient and limited intermediary function and dominant position of the state in the banking sector and management of major banks”. In addition, Lane (2001) concludes that privatization reforms in the banking sector resulted in emergence of reciprocal ownership of assets by banks, non-financial companies and state institutions. These agents being clients of banks themselves are an obstacle for the investment activity and rather predetermine the “settlement operations” of banks rather than investment activities (which was also typical in the Soviet period). Moreover, the existence of Sberbank (largest saving sate-owned bank both in USSR and Russia) is another indicator of the vitality of the Soviet system.

commercial banks. These two tiers are regulated by the system of banking legislation that on its turn is comprised by three levels. The first level of banking legislation includes federal laws on the CBRF and activity of commercial banks. The second level is reperesented by specific laws on auctions, capital and debt markets, commercial papers, mortgage, trusts and financial indstrial groups, and investment funds. Constitution, Civil Code, Tax Code are related to the third level of the legislation. The second and third level indirectly regulate the activity of banks, while the legal acts of the first level define legal norms, licencing order, responsibility and control of the banking agents. The basis of the contemporary banking legislation was founded in 1995-96 with the promulgation of two laws: Federal Law “On the Central Bank of the Russian Federation” dated by 26 April 1995 and Federal Law “On banks and banking activity” dated by 3 February 1996. Consequently, these two laws were subject to numerous ammendments, but the main principles of the banking activity of market type remained immutable (Lavrushin, 2011). The banking legislation was further extended by Federal Laws “On insolvency (bankruptcy) of credit organizations” (1999), “On restructuring of credit organizations” (1999), “On currency regulation and currency control” (2004), “On deposit insurance of individuals in banks of the Russian Federation” (2004), “On credit history” (2004).

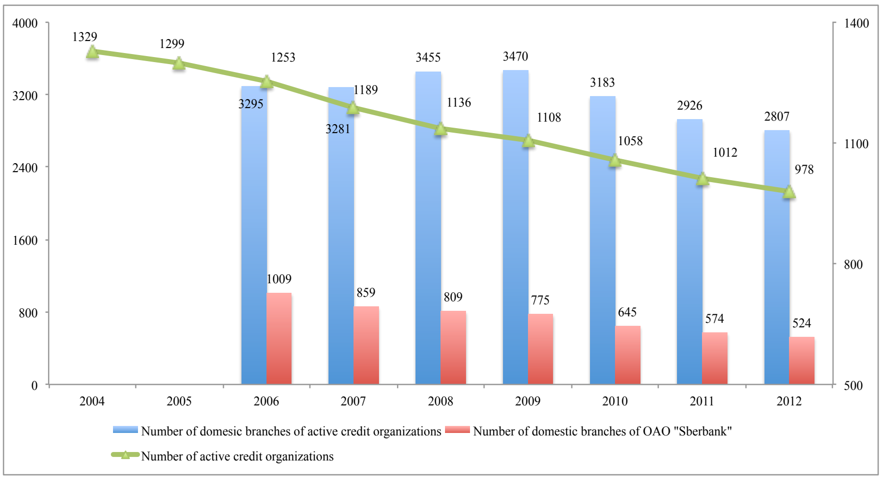
There are many documents prepared by the government of the Russian Federation related to the banking system. Among them “Strategy of development of the Russian banking sector until 2008” (2005), “Stategy of development of the Russian banking sector until 2015” (2011), “National banking system 2010-20” prepared by the Association of Russian bankers.

In general contemporary banking legislation of Russia corresponds to the international standards and allows the banking system to adapt to conditions of the market economy.

2.2. Institutional aspects of development of the Russian banking sector

Institutional aspects of development of the Russian banking sector characterize the fundamental and organizational blocks of the Russian banking system. In this section we particularly provide quantitative and qualitative analysis of the banking sector and demonstrate its institutional structure and concentration of banking activities.

Figure 2-1 Number of credit organizations and their domestic branches as of January 1st



Source: compiled by author on the base of the statistics of the CBRF

As of 1 January 2012 978 banks operated in Russia. The peak in terms of number of banks was in 1995 when there were 2273 that actually provided banking services on the market. The amount of domestic branches of Russian banks is also decreasing due to optimization of their activity and amounted to 2807 in 2011 with 524 branches belonging to OAO "Sberbank" (Russian Savings Bank). The number of credit institutions and domestic branches as shown in Figure 2-1 is gradually decreasing due to the continuing process of domestic M&A and recalls of licenses. According to the CBRF statistics, 22 licenses on implementation of banking activity were recalled in 2011. The recall of licenses and liquidation of credit organizations is partially pushed by the regulating instructions of CBRF on increase of the minimum charter capital[24]. Eighteen credit organizations were deprived of licenses as the result of reorganization in the form of acquisition, whereas five new credit organizations obtained general licenses. Thus, the tendency towards decreasing of the number of banks continued (CBRF, 2012c).

In terms of legal status majority of banks in 2011 (65.95%) are established in the form of Joint Stock Companies (JSC) of two types: closed (261 banks) and open (384 banks). Three hundred thirty three credit institutions were organized in the form of LLC comprising 34.05%. Civil Code of Russia allows organizing banks in the form of Additional Liability Company (ALC); nevertheless no banks possessed this legal status (Table 2-1). The choice of legal status is stipulated by problems with low transparency of property and ownership rights in Russia.

Table 2-1 Legal status of credit organizations as of January 1[st]

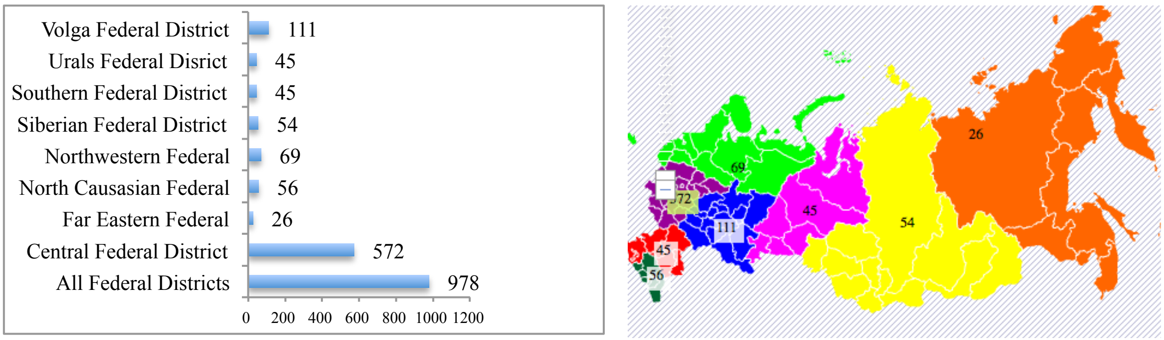
Legal status by number of credit organizations	2011		2012	
	Number	%	Number	%
Number of credit organizations holding licenses for banking activity, total	1012	100.00	978	100.00
Including:				
- Joint Stock Companies (JSC)	671	66.30	645	65.95
- ZAO (Closed Joint Stock Companies) (CJSC)	272	26.88	261	26.69
- OAO (Open Joint Stock Companies) (OJSC)	399	39.42	384	39.26
- ODO (Additional Liability Companies) (ALC)	0	0	0	0
- OOO (Limited Liability Companies) (LLC)	341	33.70	333	34.05

Source: compiled by author on the base of the statistics of the CBRF (2012a)

24 The minimum charter capital in 2010 amounted to RUB 90 million, 2012 – RUB 180 million. Following the Basel II regulations government adopted the bill to set the limit of the minimum charter capital in the amount of RUB 300 million.

The number of banks in Russia is excessive in comparison to other economies, whereas the domestic territorial distribution of credit institutions is heterogeneous. In 2011 around 58% of all credit organizations were located in Central Federal District with Moscow being the leading city in terms of number of banks operation on its territory – 502 credit organizations. Second place belongs Volga Federal District with 111 banks followed by Northwestern Federal district with 69 banks, including 39 operating in the second largest city St. Petersburg. The largest Federal District Far Eastern one that occupies 36% of the territory of Russia is a home place to only 26 credit organizations.

Figure 2-2 Territorial distribution of credit organizations in 2012



Source: compiled by author

Therefore, the territorial distribution is uneven and there are severe disparities among the regions. Similar trend is epitomized in terms of number of ATM per 1000 people and concentration of banking services per population[25].

For the purpose of stability analysis of the banking sector CBRF subsumes certain groups of banks in six clusters: banks controlled by state, banks controlled by foreign capital (non-residents), large private banks, small and medium banks of Moscow region,

[25] The number of domestic credit institutions (braches, offices, sub-offices, etc.) per 100 thousand people amounted to 28.4 in 2011 (27.1 in 2010).

regional small and medium banks, non-banking credit organizations. Some indicators of credit organizations divided by clusters are presented in Table 2-2. Majority of banks belong to the group of regional banks (both of Moscow region and other Federal Districts), whereas their shares in total assets and capital remain very low. This fact alludes to the idea that regional banks are mostly small in size and are undercapitalized. These small-scale regional banking institutions often operate only in specified federal districts and have no extensive branch networks besides the local companies and individuals. Banks controlled by the state accounted for 50.2% of assets and 50.8% of capital of the banking sector in 2011. Large private banks and banks controlled by non-residents are on second and third places in terms of share in total banking assets and capital.

Table 2-2 Basic indicators credit organizations divided by clusters as of January 1st

Classification of banks	Number of credit organizations		Share in total assets of the banking sector, %		Share in total capital of the banking sector, %	
	2011	2012	2011	2012	2011	2012
Banks controlled by the state	27	26	45.8	50.2	47.3	50.8
Banks controlled by foreign capital	108	108	18.0	16.9	19.1	17.6
Large private banks	131	132	30.5	27.5	26.9	24.9
Small and medium banks of the Moscow region	317	301	2.6	2.5	3.5	3.4
Regional small and medium banks	372	355	2.7	2.5	2.9	3.1
Non-banking credit organizations	57	56	0.4	0.4	0.3	0.2
Total	1012	978	100.0	100.0	100.0	100.0

Source: CBRF (2012b), p. 91

Classification of the CBRF is a conditional one and for the simplification we consider that from the institutional point of view in terms of ownership structure Russian banking sector is represented by four major banking actors: *banks with direct and indirect state participation*, *large private banks with the Russian capital*, *foreign banks* (*controlled by non-residents* and those *with foreign participation*), *small and medium-sized regional banks*. The structure of the banking market is very segmented.

The state remains to be major shareholder in many banks both *directly* and *indirectly* (through CBRF, Vneshekonombank and Agency on Deposit Insurance; banks that are integrated into banking groups established by these state institutions). Vernikov (2009, p.5) expounded his view on the essence of banks with state participation and shaped his original classification of them. He firstly divided banks into two groups – those controlled by the state and other banks under state influence. Banks controlled by the state are sub-divided into banks owned by the state (more than 50% shares) and banks managed by the state. State-owned banks in turn are classified into banks belonging to federal, regional and municipal authorities and CBRF and banks belonging to government banks and companies, Agency on Deposit Insurance, Vneshekonombank. This "national and cultural specifics" of the banking sector must be considered when dealing with the banking sector of Russia. Vernikov (2007, p.11) showed that "public sector banks often form pyramid-like vertical holding structures[26], whereby the state entity controls the bank at the top, which in its turn controls several (nominally independent and private banks". The good example of this is Gazprom that is the main shareholder of OAO "Gazprombank" with an extensive network of domestic subsidiaries. OAO "Vneshtorgbank" (VTB) is a government-owned bank with many subsidiaries in Europe and CIS that in turn have their affiliates in Russia (e.g. Eurofinance-Mosnarbank). Vernikov (2007) therefore proves that the ownership structures blur the boundaries of public and private in Russian conditions and reassess the market share of TOP 5 state banks, namely OAO "Sberbank", VTB Group, OAO "Gazprombank", Rosselhozbank (Russian Agricultural Bank) and Bank of Moscow up to 49.3% (Vernikov, 2009). His major finding is that despite the fact that Russian government is implementing an industrial policy of growing state-controlled national

[26] Russian banking holding groups tend to utilize the so-called "entrenchment strategy" of main shareholder against external factors.

champions leading to raising similarities between the Russian case and the evolution of the Chinese banking industry (Vernikov, 2012).

Table 2-3 Share of banking groups in the total banking assets as of January 1st

Classification of banks (rating top-down)	Share in banking assets, %		
	2010	2011	2012
1-5 (5 banks)	47.9	47.7	49.6
6-20 (15 banks)	20.4	20.9	20.6
21-50 (30 banks)	12.1	11.6	11.3
51-200 (150 banks)	13.3	13.7	12.8
201-500 (300 banks)	4.7	4.7	4.5
From 501	1.5	1.4	1.3
Total	100	100	100.0

Source: same as Table 2-1

Another issue worth mentioning from the institutional point of view is the level of concentration of the banking sector and consolidation of capital (Sukhov, 2009). In 2011 active operations of banks showed positive dynamics. Simultaneously, the general level of concentration of the banking sector increased. The share of TOP 200 in consolidated banking assets of the banking sector amounted to 94.3% in 2011 (Table 2-3).

Concentration was high in terms of capital as well, with TOP 200 banks sharing 92.5% of the consolidated banking capital of the banking sector. The number of credit organizations with charter capital of more than RUB 1 billion increased from 291 to 315 following the general trend of amalgamation of small banks and increasing capitalization. Table 2-3 shows that TOP 5 banks in 2011 accounted for 49.6% of the total banking assets, providing evidence that the institutional structure of the banking sector is highly segmented and concentrated. Major banking assets as of 1 January 2012 belonged to TOP 3 banks, namely OAO “Sberbank” (RUB 11 268 524 million), OAO “Vneshtorgbank” (RUB 4 327 974 million), OAO “Gazprombank” (RUB 2 499 943 million), all being under direct (Sberbank, Vneshtorgbank) and indirect (Gazprombank) state control.

Herfindahl-Hirschman Index (HHI)[27] of assets (0.092), capital (0,101) and corporate loans to residents (0,133) calculated by CBRF indicated moderate level of concentration of the banking sector, while HHI for deposits of individuals is extremely high (0.225 in 2011). Meanwhile, Vernikov (2012, p.13-14) claims for even higher level of concentration and points to a monopoly of state banks in the banking sector.

2.3. Macroeconomic indicators of development of the Russian banking sector

Major macroeconomic indicators of the banking sector are shown in Table 2-4 below. The share of consolidated assets in GDP is gradually increasing and amounted to 76.6% in 2011. In absolute figures the consolidated assets almost doubled within the period. In absolute figures the similar trend is identified for the consolidated capital, the share of which in 2011 amounted to 9.6%. The share of total capital is slightly decreasing from 2009.

Followed by the high economic growth of Russia in 2000s, banks expanded their credit activity and the share of credits and loans in GDP increased up to 42.8%. Growing trend is obvious for the deposits ratio in GDP, both for individual households (21.8%) and organizations (25.7%). Nevertheless, the problem of the so-called “long money”, which is a primary source for investments, remains.

[27] Herfindahl-Hirschman Index (HHI) is a measure of the size of banks (or indicators of their activity) in relation to the banking industry and an indicator of competition among them.

Table 2-4 Macroeconomic indicators of the banking sector as of January 1st

Indicators	2007	2008	2009	2010	2011	2012
Total assets of the Russian banking sector (share in GDP), %	51.9	60.5	67.9	75.9	75.2	76.6
Total capital of the Russian banking sector (share in GDP), %	6.3	8.0	9.2	11.9	10.5	9.6
Credit and loans to Russian companies and individual households (share in GDP), %	29.8	37.0	40.0	41.5	40.4	42.8
Deposits of the Russian households:						
share in GDP, %	14.2	15.5	14.3	19.3	21.8	21.8
share in total capital, %	27.3	25.6	21.1	25.4	29.0	28.5
Deposits of Russian organizations (companies, Ministry of Finance, entrepreneurs, etc.)						
share in GDP, %	17.8	21.2	21.3	24.6	24.8	25.7
share in total capital, %	34.3	35.0	31.3	32.5	32.9	33.6

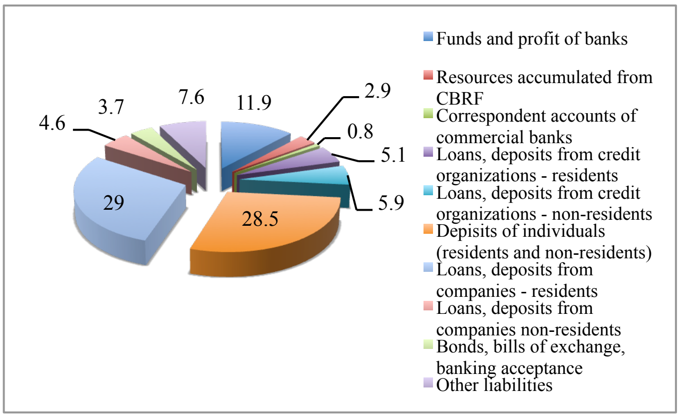
Source: same as Table 2-1

The structure of liabilities of the banking sector is presented in Figure 2-3. The primary source of capital are deposits of individuals both residents and non-residents – 28.5% and loans and deposits from companies-residents (29%). Loans from CBRF increased in 2011 by three times and reached RUB 1.2 trillion (2.9%).

Loans provided by banks-non-residents increased by 18.4% and their share in the total liabilities structures amounted to 5.9%. For banks with foreign capital participation this indicator amounted to 13.5% of consolidated liabilities of this group of banks exceeding the indicator of banks controlled by the state (4.3%) and large private banks (5.1%).

Majority of deposits from individuals and juridical entities were accumulated by banks controlled by the state, 58% and 48.8% accordingly. Large private banks hold the second place followed by banks controlled by foreign capital. Nevertheless, as it was mentioned before large private banks might be included in vertical holding groups with direct and indirect state influence, thus the actual share of deposits for the state-controlled banks might be even higher.

Figure 2-3 Structure of liabilities of the banking sector in 2011 (%)



Source: (CBRF, 2012b, p.23)

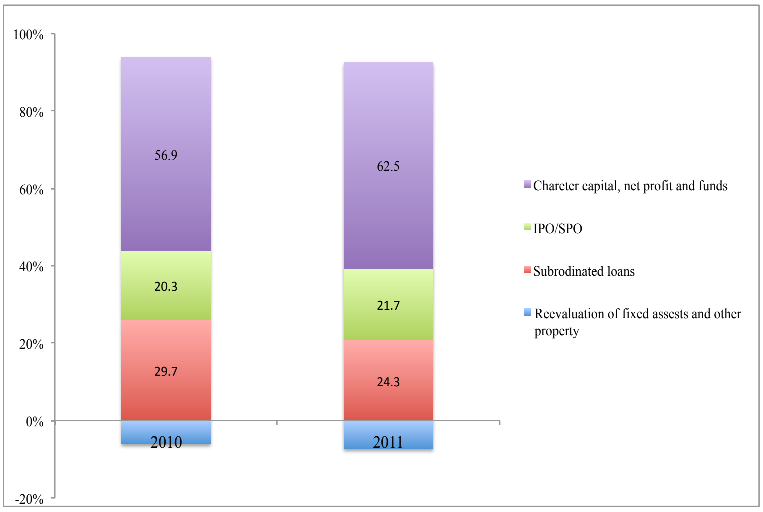
Table 2-5 Distribution of deposits of individuals and juridical entities (companies) by groups of banks (as of January 1st)

Classification of banks	Share of individual deposits in total deposits of the banking sector, (%)		Share of individual deposits in liabilities (capital) of the banking group, (%)		Share of company deposits in total deposits of the banking sector, (%)		Share of company deposits in liabilities (capital) of the banking group, (%)	
	2011	2012	2011	2012	2011	2012	2011	2012
Banks controlled by the state	57.4	58.0	36.4	33.0	40.1	48.8	15.6	19.5
Banks controlled by foreign capital	11.5	11.4	18.6	19.3	19.1	19.0	18.9	22.6
Large private banks	25.3	24.6	24.0	25.6	38.1	29.7	22.3	21.7
Small and medium banks of the Moscow region	2.1	2.4	23.8	26.8	2.7	2.5	9.1	10.0
Regional small and medium banks	3.7	3.6	40.1	40.6				

Source: (CBRF, 2012b, p.24-25)

Vedev and Grigoryan (2011) assert that increase of charter capital, net profit and funds will remain the primary sources of capital (liabilities) growth of the banking sector. The problem of "long-term" liabilities has been discussed in Russia for the past 20 years. Banks lack long-term liquidity that is a crucial element for the development of investments. External funds (borrowings on international markets) are available for Russian banks on conditions of stability in global marketes and positive trends of major macroeconomic indicators of Russia. Even though, only large banks have access to international capital and financial markets, and majority of domestic Russian banks still lack luquidity and long liabilities. Therefore, the problem of low capitalization or even undercapitalization of the banking system remains.

Figure 2-4 Factors of capital growth of the banking sector of Russia (as of January 1st)

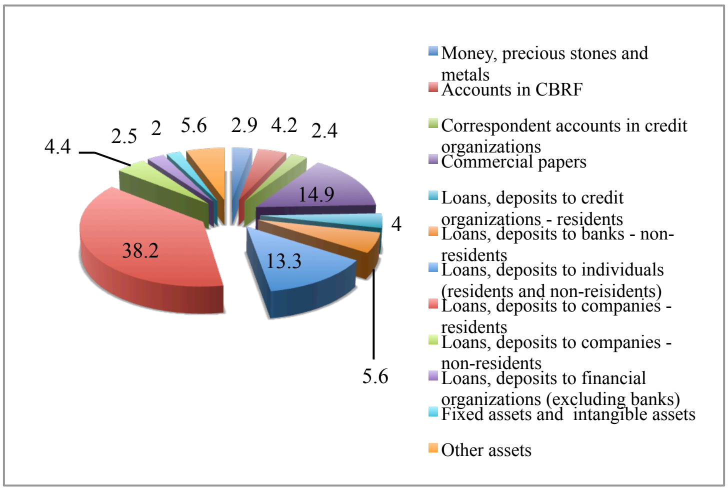


Source: (Vedev and Grigoryan, 2011, p.27)

IPO/SPO are also difficult to implement for majority of banks due to the high costs, complexity of procedures and necessity of maximum transparency toward the market. Relatively high share of subordinated loans (Figure 2-4) reflects the intention of the CBRF to introduce Basel III mechanisms that concentrate on development of the banking institutions through the capital of first tier and decrease of so-called "synthetic capital".

Structure of assets of the banking sector is presented in Figure 2-5. Thirty-eight point two per cent are loans to companies that are residents of the Russian Federation. In 2011 the increase of credit and loan portfolio was driven by expansion of credit activity for both retail and corporate sectors. Consolidated amount of credits in 2011 increased by 28.2% and in absolute terms amounted to RUB 23 266 billion (55.9% in consolidated banking assets).

Figure 2-5 Structure of assets of the banking sector in 2011 (%)



Source: (CBRF, 2012b, p.26)

In 2011 the share of banks controlled by the state increased on the corporate market (54.5%), while those of banks controlled by foreign capital (14%) and large private banks (27.2%) experienced a slight decrease. The tendecy towards long-term borrowings continued, despite the fact that in the corporate loan structure the share of loans (credits) with paying off period of more than one year decreased insignificantly, share of loans with paying off period of more than three years increased from 38.5% in 2010 to 39.7% in 2011.

Table 2-6 Distribution of loans to individuals and juridical entities (companies) by groups of banks (as of January 1st)

Classification of banks	Loans to individuals in total amount of loans of the banking sector, (%)		Loans to companies in total amount of loans of the banking sector, (%)	
	2011	2012	2011	2012
Banks controlled by the state	46.4	48.7	50.2	54.5
Banks controlled by foreign capital	25.7	22.0	15.1	14.0
Large private banks	23.0	24.5	30.4	27.2
Small and medium banks of the Moscow region	1.9	1.9	2.2	2.2
Regional small and medium banks	3.1	3.0	2.3	2.0

Source: (CBRF, 2012b, p.27-28)

State-controlled banks and large private banks are yet major creditors of the non-financial organizations in Russia. Their consolidated share is about 84%. Loan (credit) structure by major industry in 2011 is as follows: 20.9% - entreprises in the spehere of trade (both wholesale and retail), 20.3% - entreprises in manufacturing industries. Loans portfolios to companies- producers and distributors of electricity, real estate, transport and communications also increased.

Similtaneously, the competition on the retail market intensified. The share of loans (credits) to individuals in the total amount of assests of the banking sector increased to 13.3%, in the total amount of loans – to 19.3%. Major holders of credit portfolios to individulas in the total structure of credit portfolio of banks were regional and small banks – 27.1% and banks controlled by non-residents 23.8%. Banks controlled by the state accounted for 17.9%, small and medium banks of Moscow region – 18.3%, large private banks – 18.7% of credits in the retail banking. Majority of all credits (94.2%) are issued in Russian rubles. Meanwhile, as Table 2-6 specifies major creditors of individulas were banks controlled by the state (48.7%). State-controlled banks and large private banks are also the main holders of promissory notes (51.1% and 30.2% in 2011) (CBRF, 2012a).

The total profit of the banking sector in 2011 was a record-breaking one and reached RUB 848.2 billion, and including financial results of previous years it amounted to RUB 2243.1 billion. Proportion of profitable banks increased from 92% to 94.9%. In the total revenue structure state-controlled banks accounted for 58.4% of the financial result, large private banks – 20.2% and banks controlled by non-residents – 17.4%.

Financial leverage (multiplicator of capital) calculated as a ratio of consolidated assests to consolidated capital amounted to 7.4809 in 2011, while the total profotability of capital of the banking sector is 0.1764 (Table 2-7).

State-controlled banks and banks controlled by foreign capital proved to be the most profitable players on the market followed by large private banks.

Table 2-7 Profitability of different group of banks as of January 1st

Classification of banks	Profitability of assets, (%)		Profitability of capital, (%)	
	2010	2011	2010	2011
Banks controlled by the state	2.4	2.8	14.8	20.6
Banks controlled by foreign capital	2.1	2.4	14.5	17.4
Large private banks	1.1	1.7	8.4	14.2
Small and medium banks of the Moscow region	1.4	1.5	6.7	8.0
Regional small and medium banks	1.5	1.7	9.8	10.4
Whole banking sector of Russia	-	-	0.1251	0.1764

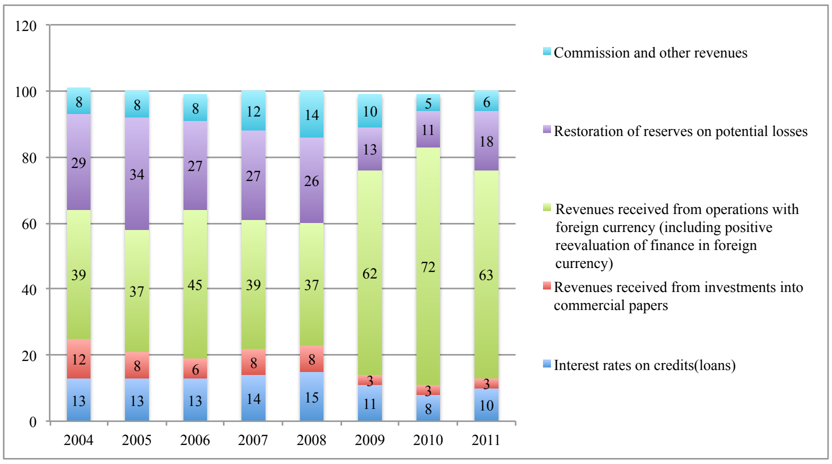
Source: same as Table 2-1

Revenue structure of credit organizations in Russia is presented in Figure 2-6. The structure is very disproportional with revenues received form operations with foreign currency (including positive reevaluation of finance in foreign currency) accounting for 63% in 2011. Other factors of revenue structure include restoration of reserves on potential losses (18%), interest rates on credits (10%), commission and other revenues (6%) and revenues from investments into commercial papers (CP) (3%).

The structure of net profit in 2011 is as follows: net interest rate profit – 68.6%, net commission revenue – 22.6%, net revenue from CP – 0.4%, net revenue from operations with foreign currency and currency valuables – 4.3%, reserves on losses – 4.1% (CBRF, 2012a).

From the dynamics of macroeconomic indicators, their quantitative and qualitative analysis, we conclude that starting from 2000s the Russian banking sector is dynamically growing. Next section analyzes the Russian banking system via prism of international comparison.

Figure 2-6 Revenue structure of credit organizations in Russia, %



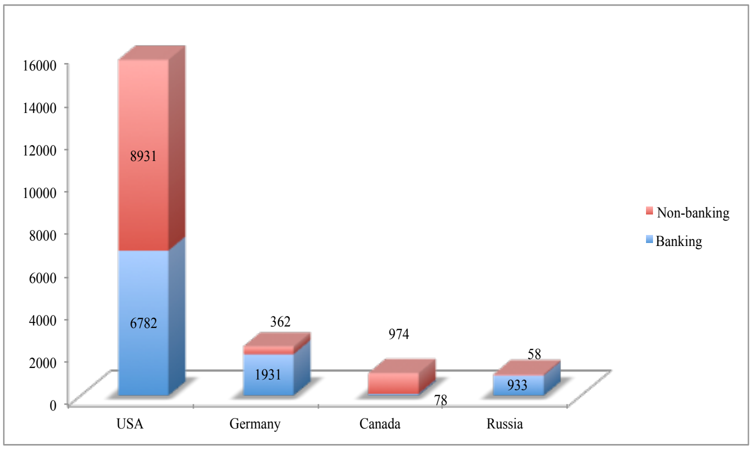
Source: Vedev and Grigoryan, 2011, p.33

2.4. Russian banking sector in the system of international comparison

Historical review of the development of the Russian banking sector, analysis from institutional and macroeconomic points of view allude us to the idea that Russian banking sector is dynamically developing. While there are some problems and specific features in the banking sector (that we will cover in detail in Section 2.5), from the international comparison point of view the Russian banking sector is still under development and inferior to efficiency of other countries.

Russia is the third country in the world in terms of number of banks after the United States (6782) and Germany (1931). In 2010 Russia had 933 banks and some researchers claim this number to be quite excessive due to the fact that the size of the economy of Russia is incomparable with that of United States or Germany.

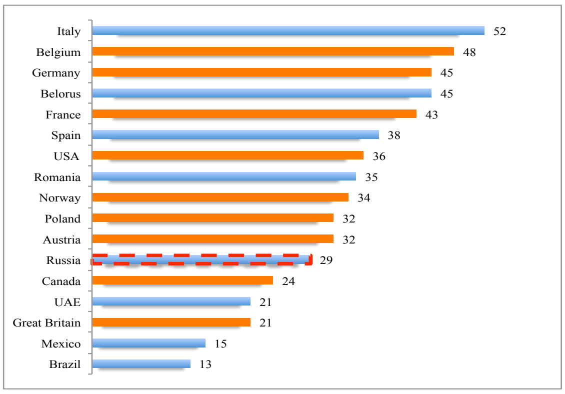
Figure 2-7 Countries with the largest amount of banking and non-banking credit institutions in 2010

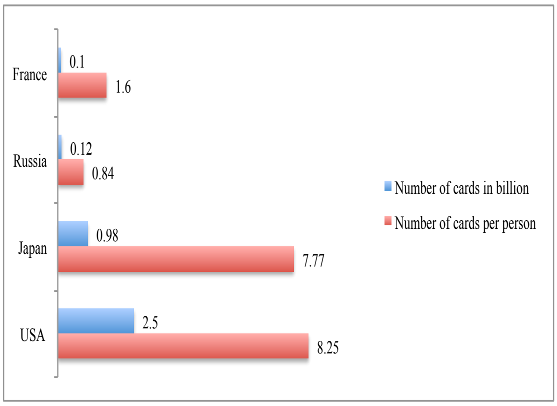


Source: (Vedev & Grigoryan, 2011)

Number of banking offices per 100 thousand populations is relatively high and comparable to the size of other developing economies (Figure 2-8). The number of credit cards in billion is also not very low, though banking cards per person ration remains very low when compared to the United States (8.25) or Japan (7.77).

Figure 2-8 Number of banking offices per 100 thousand population and number of credit cards in 2010

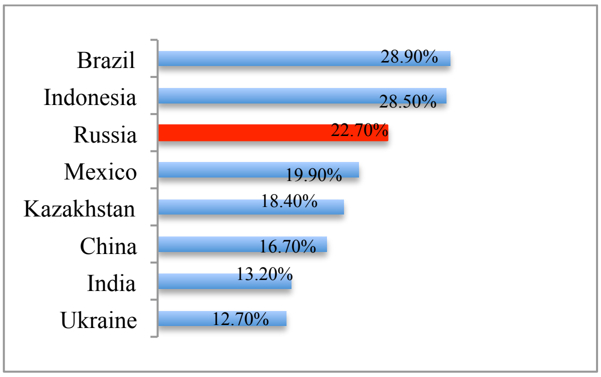




Note: Orange bars are for the countries with high penetration of electronic banking
Source: same to Figure 2-7

As Figure 2-9 shows, ROE of the Russian banking system is also relatively high. While the state-controlled banks still dominate in the institutional structure of the banking sector, ROE in 2007 was higher than that one in Mexico (19.9%), Kazakhstan (18.4%), China (16.7%) or India (13.2%).

Figure 2-9 ROE of banking systems of developing economies in 2007



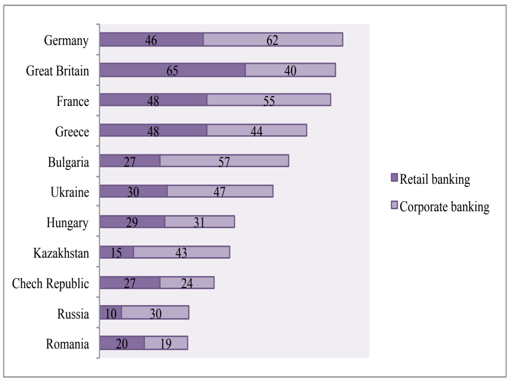
Source: same as Figure 2-7

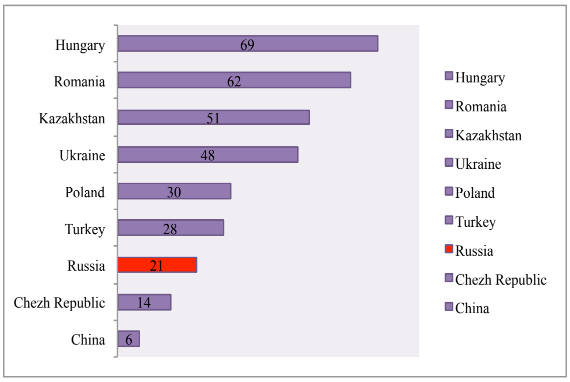
Despite the fact that ratio of credit portfolio in GDP for both retail and corporate sector showed positive dynamics in 2011, in terms of international comparison the ratio of credits to GDP remains very low. That is typical for both retail banking (10%) and corporate banking (30%). Majority of credits are provided in local currency (rubles) in contrast to high proportion of foreign currency in countries like Hungary (69%), Romania (62%), Kazakhstan (52%) and others.

The productivity of the Russian banking sector remains one of the lowest. Even in some other transition economies this indicator was higher. While on the domestic market there are not so many discrepancies in the efficiency of different group of banks.

Generally speaking, Russian banking sector at the present stage of development is growing very fast, but mostly under the dominance of "national champions" or the so-called state-controlled banks. Indicators presented for the international comparison indicate that banking system of Russia is inferior to most developed countries, but is competitive to banking systems of BRICs and some other transition economies. Nevertheless, in the report "Global competition 2010-11" (2011) Russia was on 125th place out of 139 ranked by the most important indicator of the financial system – financial market development index. Russia got 101st place on the level of business sophistication, 109th on availability of financial services and 129th on ease of access to loans. Consequently, Russian banking sector is often regarded as underdeveloped.

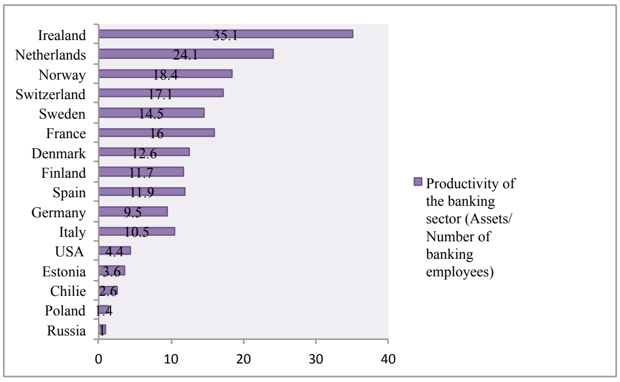
Figure 2-10 Ratio of credits to GDP (%) and share of credits in foreign currency in the total amount of credits in 2010





Source: same as Figure 2-7

Figure 2-11 Productivity of the banking sector in 2009, € million



Source: same as Figure 2-7

2.5. Specific features of the Russian banking sector: host country specificity

Outline of the evolution of the banking sector, analysis on current legislation on banking activity, institutional structure and macroeconomic indicators allows to identify problems and prospects of development of the Russian banking system. Within the framework of the foreign banking theory we consider these problems and prospects to be *host country's specific features* when we analyze the activity of foreign banks in the Russian banking market and refer to them as *home country's specificity* when issues of foreign expansion of Russian banks are investigated. In any case these specific features influence directly and indirectly on motivations, entry modes, organizational representation, and strategies of foreign banks (out-in entry cases) and Russian banks going abroad (in-out entry cases).

At first, Russian banking system is an example of bank-based financial system, meaning that majority of financial power severely depends on banks. While the capital market is rapidly developing, share of loans to GDP in 2011 was 42.1% in comparison with 11% of market capitalization[28] .

Second, despite the fact that the Russian banking system is categorized as a bank-based financial system, situation with converting deposits into investments is inefficient, therefore the intermediary function is not fully implemented by banks. The refinance rate as of 15 January 2013 is 8.25% and is relatively high that makes credit resources rise in price. The share of loans and credits in fixed assets of the Russian companies (excluding small enterprises) is only 7-8%, while the rest of financing comes from internal reserves of companies, private equity, issuance of corporate bonds, cheaper loans from foreign banks or international capital markets.

[28] Market capitalization of Russia in 2009 amounted to USD 256 billion. Share of market value of shares in GDP.

Third, from the institutional point of view Russian banking is over concentrated and oversaturated in terms of banks number. Majority of assets and capital belong to limited group of banks, therefore the segmentation of banking institutions is very strong. Conversely, there is a large number of small banks with very low level of capitalization and the gap between the TOP players and quantity of small banks is extremely high. In addition, there discrepancies in territorial distribution of banks among the territory of Russia with concentration of banks in the European part of Russia, namely in Moscow city and Moscow region.

Fourth, Russian banking sector is categorized by strong government participation or even dominance of state-controlled banks on the market. TOP 3 banks in the banking sector in terms of assets, capital, deposit and loan ratio to GDP are under direct (OAO “Sberbank”, OAO “Vneshtorgbank”) and indirect (OAO “Gazprombank”) state control. Some researches claim that the whole banking system is comprised of “national banking champions” (Vernikov, 2009, 2012).

Fifth, there is a generally recognized problem of undercapitalization of the banking sector (Fomenko and Subkhankulova, 2009; Sulhov, 2009). The growth rate of capital of the banking system is lower that the growth rate of assets. Consolidation of banking capital is an on-going process on the market followed by the initiative of the government to increase minimum requirements on charter capital under gradual introduction of Basel III principles. Some researches indicate the problem of “dyspepsia of capital” (Kanaev, 2011).

Sixth, the structure of liabilities of the banking sector shows that the banking system has a problem with providing “long-term financing”. Many banks depend on individual customers that prefer to avoid irrevocable deposits. Small and medium size banks have limited access to international capital markets and experience difficulties with attracting institutional investors. Consequently, banks lack finance to provide for the long-term financing.

Seventh, from the international comparison we found out that Russian banking system has low productivity, but ROE is comparably with some other developing and transition economies. The banking market is saturated from the point of view of market players, but the access to banking services is dispersed (Kanaev, 2011) and competition is very limited due to the dominance of main players on the market (Kosmachev, 2006).

Eighth, Russian financial (banking) system is fragmentary and heavily dependent on external international markets. Kanaev (2011) divides financial system into national financial system that accumulates short-term finance, serves current money flow and invests into working capital and foreign financial system that accumulates long-term finance and invests into fixed capital. Low interest rates at the international credit markets, disproportions in development of the banking system and financial sector, high credit ratings of Russia are among the reasons that stipulate this dual structure. The ratio of credits (loans) to non-financial sector provided by domestic and foreign banks in 2011 was 61 to 39 (USD 463.4 and 291.3 billion accordingly). The external debt of banks in the beginning of 2011 reached USD 144.8 billion. Among the external corporate debt about 30% (USD 134 billion) belonged to state-controlled banks and state corporations. Simultaneously, the dependence of domestic Russian banks on external finance on the intra-banking market increased from 70% in 2005 to 80% in 2008 (Kanaev, 2011, p.70).

Ninth, the revenue structure of the banking sector is unbalanced. Operations with foreign currency exchange and reevaluation of foreign commercial papers account for more than 50% of revenues of some banks while net interest income and net comission income are substantially lower in number.

Tenth, despite the strong governemnt participation and dependence on external capital markets, foreign banks' presence is increasing on the market. The growing foreign share in both assets and capital of the banking sector and institutional positioning of foreign banks as individual players on the market competitive to state-controlled, large private and regional banks[29].

Some researches also advocate for the "low level of trust among credit organizations" (Zverev, 2008) and lack of detailed and structured conception of development of the banking sector and call this situation "a strategic deadlock"((Kanaev, 2011).

Rozinskiy (2006) illustrates three possible scenarios of further development of the Russian banking system, namely enforcement of state participation, spasmodic development of domestic private banks and East-European scenario (growing presence of foreign banks). We generally support the idea of increasing presence of foreign banks in the banking system, but argue on the role of foreign banks in our later discussion.

As it was shown above, Russian banking sector has many specific features that distinguish it from banking sectors in some other developed and developing economies. In general, the development of the banking system has little response to needs of Russian economy and its current role, as a driver in modernization process in Russia, is rather limited.

2.6. Summary

In Chapter 2 we analyzed the development of the Russian banking sector and defined its specific features that play crucial role in determining motivation, entry modes, organizational representation of foreign banks entering the Russian market and significantly influence on the choices of international expansion by Russian banks. We

[29] Activity of foreign banks on the Russian market is investigated in Chapter 3.

conditionally divided the development of the Russian banking sector into several stages and analyzed the present structure, main elements and legal framework of the banking system. By implementation of institutional and macroeconomic analysis we outlined the general situation with the Russian financial system and stipulated the limited role of banks in it. We applied basic indicators for comparative analysis from the international point of view and concluded that Russian banking sector is inferior to the banking sectors of the developed countries and some other developing and transition economies. The growing liberalization process in the financial sector goes side by side together with the strong participation of state-controlled banks that are regarded as the legacy of the Soviet system. In the next Chapter we particularly analyze the activity of foreign banks operating in Russia and try to identify how specific features of the Russian banking sector (specificity of a host country, Russia as a recipient of FDI) predetermine their entry choice into the Russian banking market.

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3. ACTIVITY OF FOREIGN BANKS IN THE RUSSIAN MARKET: OUT-IN ENTRY CASES

3.1. Inward investments into the Russian banking sector: macro-level analysis

In Russia, the process of liberalization in the banking sector started in the 1990s. Many domestic banks were established, and some foreign banks obtained access to the Russian market. Initially, CBRF restricted the activities of foreign banks. In the 1990s, the upper limit for foreign capital participation in the banking sector was established at 12%; a licensing procedure was implemented, and some operations by foreign banks were prohibited (Presidential Act No. 1924 on “Temporary prohibition of foreign banks’ activities with Russian physical and juridical entities” dated 17 November 1993). At present, the activity of foreign banks is being regulated by the Federal Law “On banks and banking activity” (1996) and by regulative acts of the CBRF (e.g., Regulation No. 437 “About procedures of registration of financial institutions with non-residents capital” dated 23 April 1997). These documents generally stipulate three major conditions (regulations) for foreign banks’ activities in Russia: 1) a negative attitude toward establishment of branches (actual prohibition), 2) establishment of an upper limit for foreign capital participation in the capital of the banking system (12% during the 1990s; in the process of negotiations for WTO accession, Russia agreed to raise the limit to 50%), 3) a licensing and permission system for the establishment of locally incorporated foreign banks.

Before examining the activities of locally incorporated foreign banks in the Russian market, we present an overview of foreign investments into the Russian banking sector. Two ideas are expressed in many research studies of the role of foreign investments (foreign banks) in the Russian banking sector: overestimation and underestimation. We support the idea that, despite the fact of a gradual increase of non-residential shares in the market, the scope of foreign banks' actual activities remains relatively low[30]. Table 3.1 demonstrates international investment positions in the Russian banking sector, and the data shows that foreign investments are increasing (excluding years of crisis and recovery, the general trend is positive)[31].

Table 3-1 International investment position of the Russian banking sector (USD million)

Indicator	2005	2006	2007	2008	2009	2010	2011	2012
Assets	*25,989*	*39,182*	*65,351*	*96,843*	*167,825*	*165,965*	*170,212*	*215,359*
FDI from Russia	818	1,498	1,570	2,533	3,413	5,062	6,665	6,870
Portfolio investments	3,714	6,964	7,645	12,855	15,774	26,258	29,727	33,673
Other investments	21,304	30,669	55,914	80,032	143,336	132,423	132, 211	169,697
Financial derivatives	153	51	222	1,423	5,302	2,222	1,609	5,119
Liabilities	*37,337*	*60,009*	*123,927*	*214,771*	*206,259*	*179,123*	*204,621*	*216,017*
FDI to Russia	3,020	4,975	9,127	20,682	22,670	25,911	28,674	29,091
Portfolio investments	3,756	6,858	17,171	36,445	12,160	26,516	34,740	25,149
Other investments	30,372	48,124	97,451	156,769	161,033	121,614	138,392	156,198
Financial derivatives	189	52	178	875	10,396	5,082	2,814	5,579
Net investment position	*-11,348*	*-20,827*	*-58,576*	*-117,928*	*-38,434*	*-13,158*	*-34,409*	*-658*

Source: CBRF, www.cbr.ru

Consequently, the Russian banking sector is a net-debtor, due to the fact that international banking positions were negative at the beginning of 2012. Inward investment into the banking sector amounted to USD 216 million, with other investments[32] accounting for more than 72%. Inward FDI and portfolio investments were approximately the same in volume. However, in comparison to 2005, inward FDI

[30] Data supporting this argument will be presented below.
[31] The trend is similar for the whole volume of inward investments into Russia. As Figure-EXN 2 and Table EXN-2 (Explanatory Note 1) show, the amount of inward FDI increased from USD 32.3 billion in 2001 to USD 493.4 billion in 2011 (CBRF data). The majority of investments flow into the Russian economy from non-CIS regions.
[32] Other investments (both inward and outward) in CBRF statistics include lending.

into the banking sector increased by almost a factor of ten, underscoring further gradual expansion of foreign banks into Russia[33].

Table 3-2 Inward investments into the banking sector and non-banking corporations in 2007-11 (USD million), balance of operations

Years	2007	2008	2009	2010	2011	Main destinations in 2011 (share in total investments, %) TOP 5 destinations for both abroad and CIS
Foreign investments	55,073	75,002	36,500	43,288	52,878	Cyprus (23.8%), British Virgin Islands (13.8%), Netherlands (13.3%), Ireland (10%), Luxemburg (7.8%), Germany (4.1%), Bahamas (3.5%), France (3.42%), Sweden (3.4%), Austria (3%), St. Kitts and Nevis (2.5%), Azerbaijan (0.24%), Ukraine (0.21%), Belarus (0.2%)
Non-CIS	54,708	74,737	36,102	43,201	52, 521	
CIS	366	265	398	87	357	
Participation in capital	27,119	35,015	8,121	9,895	9,729	Netherlands (24%), Bahamas (18.8%), Germany (12.3%), St. Kitts and Nevis (11.3%), British Virgin Islands (10.1%), Switzerland (7.5%), Austria (4.4%), Azerbaijan (0.9%), Ukraine (0.6%), Belarus (0.5%)
Non-CIS	26,804	34,902	7,949	9,759	9,522	
CIS	315	113	172	136	208	
Reinvestment of earnings	23,389	33,449	15,434	18,644	20,077	Cyprus (47%), British Virgin Islands (18%), Sweden (6.2%), Gibraltar (5.8%), Bermuda (4.2%), Austria (3.35%), Ukraine (0.3%), Azerbaijan (0.06%), Belarus (0.04%)
Non-CIS	23,384	33,353	15,383	18,630	20,003	
CIS	4	97	51	14	75	
Other capital	4, 565	6,538	12,945	14,749	23,072	Ireland (22%), Cyprus (20%), Netherlands (19.5%), Luxemburg (15.2%), British Virgin Islands (11.4%), France (4.6%), Belarus (0.21%), Azerbaijan (0.12%)
Non-CIS	4,519	6,482	12,770	14,812	22, 997	
CIS	46	56	175	-63	75	

Source: compiled by author. Data retrieved in September 2012 from www.cbr.ru

[33] There were 230 banks with foreign capital participation as of 1 January 2012 (versus 130 in 2001) according to CBRF statistics. Their share of capital in the Russian banking sector was 27.7%. As of April 2013, 246 banks with foreign capital participation were registered (Retrieved on 22 June 2013 from www.cbr.ru).

Table 3-2 shows the dynamics and geographical distribution of inward foreign investments into Russian banking and non-banking corporations. The general trend is positive (excluding the crisis year 2008-09) and foreign investments amounted to USD 52,878 million in 2011. The majority of investments are in the form of reinvestments of earnings and other capital. This is an astonishing fact proving the hypothesis that the Russian banking and corporate sectors are financed by Russian capital, which is sometimes regarded as foreign investment by Rosstat and CBRF. Another interesting feature is the large share of tax haven and offshore regions[34] (Cyprus[35], British Virgin Islands, St. Kitts and Nevis, British Virgin Islands, Gibraltar) and pseudo-offshores (Netherlands, Luxemburg) that are major investors in the Russian banking sector. Foreign investments from non-CIS regions considerably exceed the foreign investments from CIS, proving the general assumptions of traditional theories that financial FDI follows foreign trade.

3.2. A brief macro-economic analysis of foreign banks' activities in Russia

To be more specific, below we focus on foreign banks as participants in the Russian banking sector. In Russia, the size of the banking sector is relatively small, and for a long time it was dominated by the state (Kievskiy, 2008). Even after the financial liberalization reforms of the 1990s, the Russian banking sector failed to reach

[34] Offshore regions are major destinations of Russian banking inward and outward foreign investments due to the existence of the so-called tax havens there. These investments are in fact Russian capital circulating through offshore regions (constant inflow and outflow from the Russian market). Table EXN-4 shows the TOP-10 countries in FDI for Russia and confirms that the role of offshores in FDI for both banking and non-banking sectors is enormous. Table EXN-5 also provides interesting data on the number of companies with foreign capital participation registered in Russia; the majority of them are financed directly from Cyprus.

[35] In November 2009, €10 billion in Russian deposits were placed in the banking sector of Cyprus (total volume of foreign deposits: €15 billion). The majority of these deposits return to Russia in the form of reinvestments; in 2010, Cyprus' investments in the Russian economy amounted to USD 52 billion, including USD 36 billion in the form of FDI. A low tax rate on dividends attracts Russian businesses to this offshore region (Kuznetsov, 2010b).

satisfactory efficiency levels, however, the foreign share in banking assets and capital remains invariably increasing (Table 3.4).

The current structure of the banking sector in Russia features state-owned banks such as OAO "Sberbank" and OAO "Vneshtorgbank" maintaining an extremely large share of total banking assets and capital, despite increasing competition from foreign market players.

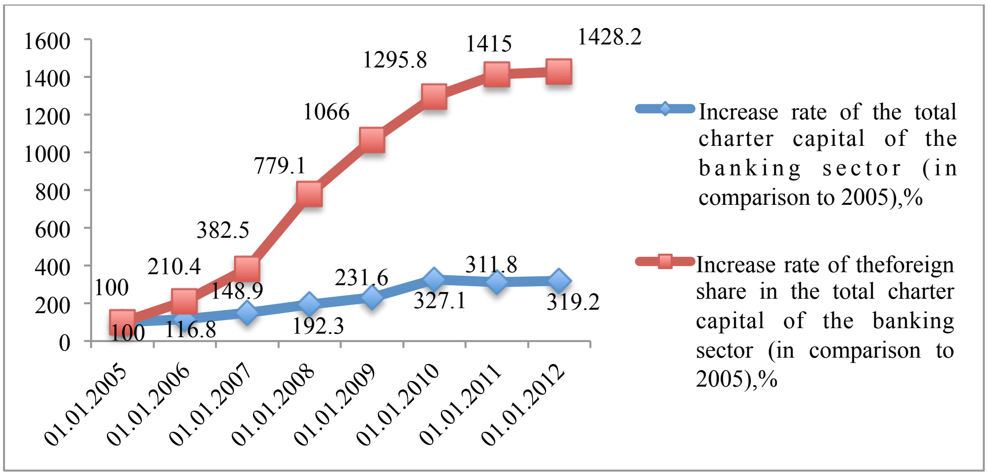
In the following section, we portray the role of foreign banks in terms of deposits, corporate lending, and retail banking. General trends regarding financial resources acquired and placed by non-residents are succinctly presented in Table 3.5.

Table 3-4 Some indicators of foreign banks' activites in Russia (as of January 1st)

Indicator	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012*
Number of banks with foreign participation,	123	128	131	136	153	202	221	226	220	230
Including share of more than 50%	-	-	-	-	13	23	26	26	31	36
100% foreign share	-	-	-	-	52	63	76	82	80	77
Commercial banks with foreign participation of more than 50%										
Assets	8.1	7.4	7.6	8.3	12.1	17.2	18.7	18.3	18.0	17.4
Equity (Capital)	7.1	6.6	7.8	9.3	12.7	15.7	17.3	17.0	19.1	17.9
Corporate loans	7.1	6.1	6.2	7.4	10.0	15.5	16.6	14.8	15.1	14.6
Deposits (households)	2.3	2.3	3.0	3.4	6.2	8.9	10.3	12.0	11.5	11.2
Commercial banks with100% foreign captital participation										
Assets	5.6	5.6	5.9	8.0	9.0	11.6	13.0	11.3	11.0	10.3
Equity (Capital)	5.4	5.4	6.3	9.0	10.1	11.1	12.2	11.0	12.1	11.3
Corporate loans	5.5	4.6	4.6	7.3	7.9	10.7	11.6	9.0	9.2	8.5
Deposits (households)	1.5	1.5	2.4	3.3	4.1	5.0	5.4	6.2	5.3	5.2

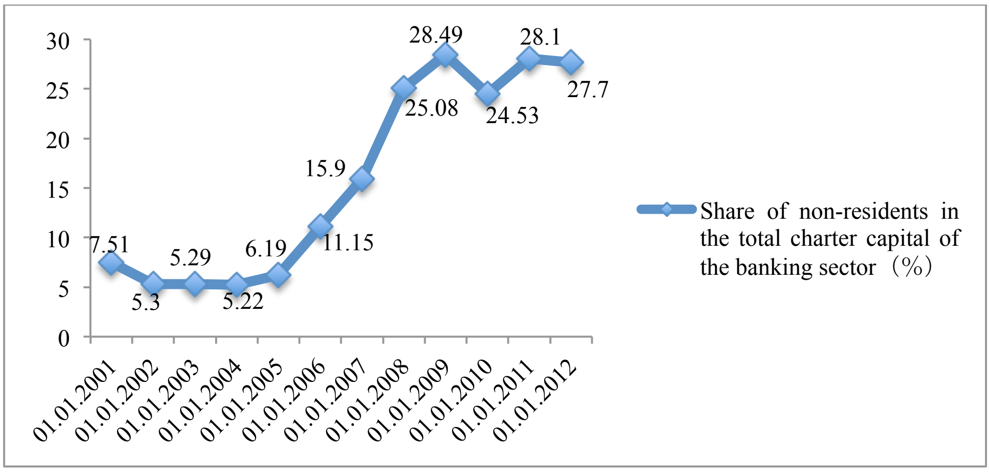
Note: data for 2012 as of 1 December 2011
Source: compiled by author on the base of statistic data of CBR, www.cbr.ru

Figure 3-1 Increase rate of foreign share in total charter capital of the Russian banking sector (%)



Source: compiled by author on the base of statistic data of CBRF, www.cbr.ru

Figure 3-2 Share of non-residents in the total charter capital of the banking sector (%)



Source: compiled by author on the base of statistic data of CBRF, www.cbr.ru

Financial resources acquired by non-residents in 2012 constitute a relatively low share in company accounts (5.1%), correspondent accounts in other banks (0.3%), and credit (deposits) of other banks (6%). Conversely, financial resources placed by non-residents constitute a higher share, with total deposits amounting to 10.4% and credit and loans to companies representing 4.5%.

Consequently, the role of foreign banks in deposits is insufficient. According to CBRF data, the foreign share of deposits in the banking system amounts to roughly

12%. As of March 2013, only a few foreign banks were included in the TOP-30 in deposits: ZAO "Raiffeisen" (Austria), in 5th place; ZAO "Home Credit and Finance Bank" (Czech Republic), 8th place; ZAO "Promsvyazbank" (Netherlands, dispersed ownership), 9th place; ZAO "Rosbank Societe Generale Group" (France, less than 100% shares), 13th place (*Profil*, No.12, 2013, p. 41). ZAO "Citibank" is in the TOP 40. The deposits of ZAO "Raiffeisen" (Austria) account for only 1/28th of that of OAO "Sberbank," proving that state-owned banks and Russian private banks remain predominant in deposit activities. As of April 2012, ZAO "Raiffeisen" stood in 5th place, again proving the high reliability of Russian individual clients[36].

Table 3-5 Financial resources acquired by and placed at non-residents

Indicator	2010	2011	2012*
Financial resources acquired by non-residents			
Companies' accounts	5.1	5.2	5.1
Correspondent accounts in other banks	0.4	0.3	0.3
Credits, deposits of other banks	6.4	6.1	6.0
Credits of foreign governments	0.0	0.0	0.0
Financial resources placed at non-residents			
Deposits, total	9.2	8.7	10.4
placed at other banks	6.5	5.1	5.9
credits, loans to companies	2.6	3.6	4.5
credits, loans to households	0	0	0
Correspondent accounts in other banks	2.3	2.0	2.0
Investmennts in securities and commercial papers	2.4	2.3	2.3
Participation in affiliated companies	0.3	0.4	0.3
Credits to foreign governments	0.0	0.0	0.0

Source: Central Bank of Russia (CBRF), www.cbr.ru
* data as of 12 January 2011

In contrast to deposit rates, the role of foreign banks in corporate lending is more significant. Corporate loans of foreign banks became a common business in the 1990s and maintained positive dynamics in the 2000s. In 2003, the total volume of corporate

[36] Deposit rating as of 1 March 2012 was as follows: OAO "Sberbank" – 1st place (RUB 6296 million), ZAO "VTB 24" – 2nd place (RUB1005 million), ZAO "Gazprombank" – 3rd place (RUB 298 million), Alfa-bank – 4th place (RUB 294 million), ZAO "Raiffeisen" – 5th place (RUB 222 million). Retrieved from www.banki.ru/banks/ratings in March 2013.

lending amounted to USD 38 billion but the role of foreign banks in project financing and syndicated loans is immense (for details refer to Gorshkov, 2011b). Some banks are trying to establish strong positions in retail banking (ZAO "Home Credit and Finance Bank" (Czech Republic) (4th place), ZAO "Rosbank Societe Generale Group" (France, less than 100% shares) (5th place), ZAO "Raiffeisen Bank" (Austria) (10th place), ZAO "UniCredit Bank" (Austria) (12th place), ZAO "Promsvyazbank" (Netherlands, dispersed ownership) (20th place), ZAO "Renaissance Capital" (France, less than 100% of shares) (22nd place), ZAO "Sovkombank" (Netherlands, dispersed ownership) (28th place), ZAO "Citibank" (22nd place). Some banks prioritized corporate lending to private companies as their core business in Russia: ZAO "UniCredit" (Austria) (7th place), ZAO "Promsvyzbank" (Netherlands, dispersed ownership) (9th place), ZAO "Raiffeisen Bank" (Austria) (10th place), ZAO "Rosbank Societe Generale Group" (France, less than 100% shares) (13th place)[37].

In short, common trends for foreign banks can be summarized as follows: 1) foreign banks are mostly engaged in traditional banking activities (deposit, lending, foreign exchange activity); 2) foreign exchange activity (foreign currency operations) accounts for around 60% of total profits (the fact that also reflects the general situation with revenue structure of the banking sector)[38]; 3) some foreign banks establish business providing non-traditional banking services[39]; 4) scales of cross-border financing, syndicated loans, project finance should also be considered when studying the role of foreign banks in the Russian market (Gorshkov, 2011b). More details regarding the

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[37] Bank rankings in terms of corporate loans as of 1 March 2013: OAO "Sberbank" – 1st place, OAO "VTB" – 2nd place, OAO "Gazprombank" – 3rd place, OAO "Rosselhozbank" – 4th place, OAO "Alfa-Bank" – 5th place, OAO "Moscow Bank" – 6th place, ZAO "UniCredit Bank" (Austria) – 7th place, ZAO "Nomos-Bank" – 8th place. Retrieved from www.banki.ru/banks/ratings in March 2013.

[38] Data supporting this argument is presented in Figure 2-6.

[39] For example, Internet banking (ZAO "Obibank" –a 50% share of the market belongs to SBI Holding (Japan)), consulting, investment banking (OOO "Deutschebank," ZAO "Citibank").

share of foreign banks in terms of total assets, capital, deposits and corporate loans are presented in Table 3-4.

ZAO "UniCreditBank" (Austria) and ZAO "Raiffeisen Bank" (Austria) have strong capital positions (6th and 7th place as of 1 April 2012), while leading positions are occupied by major state-owned banks (OAO "Sberbank," OAO "VTB," Rosselhozbank).

Bank financial results shed light on another interesting feature. Some studies (Vernikov, 2005a; Ono, 2008) already demonstrated that foreign banks sometimes prove to be more efficient in Russia than domestic ones. Foreign banks have strong representation among TOP 30 banks in terms of overall profits: (ZAO "Raiffeisen Bank" (Austria) (4th place); ZAO "Sovkombank" (Netherlands, dispersed ownership); ZAO "Home Credit and Finance Bank" (Czech Republic) (9th place); ZAO "UniCreditBank" (Austria)(11th place); ZAO "Citibank" (USA) (12th place); ZAO "Deutsche Bank" (Germany) (16th place); ZAO "RosEvrobank" (UK) (19th place); ZAO "Absolut Bank" (Belgium) (29th place). Thus, foreign banks constitute about 30% of the most profitable banks in the TOP 30 list.

To sum up, it is possible to conclude that the presence of foreign banks in Russia is gradually increasing, which is proved by their increasing share of assets, capital, loans, and deposits. Despite the fact that the overall scale of activities of foreign banks on the market in terms of absolute volume is limited, many foreign banks prove to be relatively successful in the market. Below, we focus on the motivation, organizational representation, entry modes, and strategies of the foreign banks in Russia examined by both PUSH and PULL factors.

3.3 Analysis of motivation of entry

In this section, we focus on the motivations of foreign banks. First, we apply traditional PUSH/PULL analysis and intend to identify major driving forces prompting foreign banks to enter the Russian market. Our analysis relies mainly on the existing literature and available case studies. We show the limit of these approaches and incompleteness of study results. Second, in Section 3.2.2, we conduct our own analysis of 73 banks with 100% foreign capital participation registered as of 1 January 2013 by CBRF. We structurally define six major groups of out-in entry motivation and show the institutional peculiarities and idiosyncratic features of foreign banks operating in Russia.

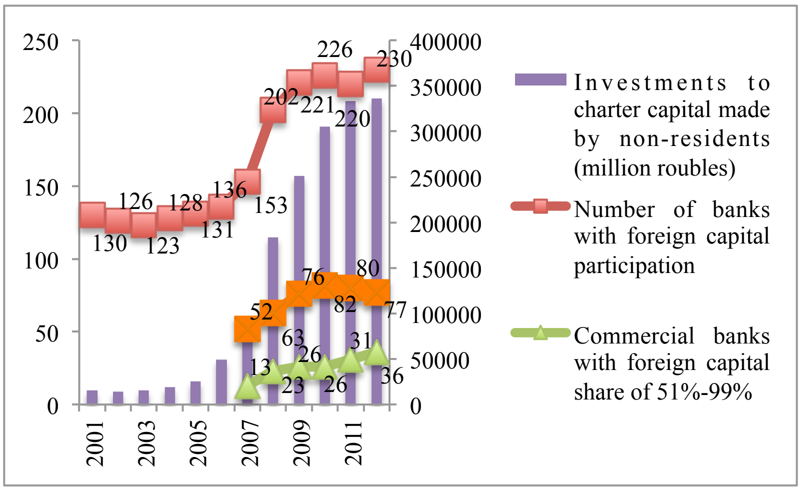
3.3.1. Motivations of entry of foreign banks entering the Russian market within the traditional MNB framework

As of 1 January 2012, 230 foreign banks operated in Russia. Figure 3-3 shows that the number of foreign banks increased when compared to the previous year, but not significantly. The number of foreign banks has been steadily growing since the 2000s[40].

Commercial banks with foreign bank participation are located in 37 regions of the Russian Federation, of which 148 credit institutions (63%) are located in the city of Moscow, with 12 in St. Petersburg, five in the Tatarstan and Samarskaya regions and four in the Sverdlovskaya region, proving that domestic segmentation and concentration of the banking sector exerts an influence on the location preferences of foreign banks. Some regions have two or three commercial banks with foreign capital participation, while 15 regions of the Russian Federation have only one such institution apiece. This shows that the branch network of foreign banks (27 with 100% foreign participation) extends mostly to the European part of Russia.

[40] As of 1 January 2013, 244 organizations with foreign capital participation had a banking license in the territory of Russia, therefore the growing presence of foreign banks has continued. Though the number of banks with 100% foreign capital participation decreased to 73 (a list of this group is presented in Appendix B).

Figure 3-3 Number of foreign banks and investments of non-residents into the banking sector



Source: compiled by author on the base of statistic data of CBRF, www.cbr.ru

Major indicators of foreign bank activities, as shown in Table 3-4 and Table 3-5, invariably exhibit a growth dynamic. Thus, we contend that the interest of foreign banks in the Russian market has increased in recent years. However, what lies behind this growth? On the institutional level, there were few changes during the 2000s but foreigners still showed a high level of interest in entering the Russian market.

During the Soviet period, the position of the state regarding foreign banks' entry was somewhat negative, and as a result foreigners experienced difficulties investing in the banking sector (Rozinskiy, 2007). However, this suspicious attitude changed with a Russian government initiative to promote FDI policy. Thus, foreign banks received more opportunities to enter the Russian market. FDI promotion policy overlaps with a period of high economic growth in the 2000s and as a result fostered out-in entry.

When analyzing the motivations of foreign bank entry from the perspective of home and host country, it is important to investigate so-called *PUSH* and *PULL factors*. While there is no systematic and coherent literature on this issue for Russia, below we compile major relevant findings from the existing studies.

After the transformation of the 1990s, many foreign banks came to operate in Russia: International Moscow Bank (1989, Germany and Finland), Home Credit Bank (1990, Czech Republic), Calyon Rus Bank (1991, France), Bank of China (1993, China), Credit Suisse Bank (1993, Switzerland), Absolut Bank (1993, Belarus) and Raiffeisen Bank (1996, France). These banks roughly constitute 40-50% of all foreign-owned banks currently. Despite the frangibility and instability of the financial system during this period, banks aimed to enter the market primarily motivated by so-called *PUSH reasons* (originating in the host country or in the management of banks). In this sense, the strategies of banks correspond to those pursued in other developing countries[41]. Nevertheless, *PUSH reasons* for entering the Russian market differ slightly from those of other developing economies, as motives for financial FDI, such as escape from domestic financial regulation, increased competition or a drastic drop in domestic profits in home countries were not common. *PUSH reasons* for entering the Russian market included such motives as *political interactions and historical ties* between Russia and the home countries of foreign banks. Some banks established operations in Russia as the result of bilateral and economic agreements between Russia and other countries (Bank of China, 1993). Moreover, the Russian government sometimes invited foreign banks into the market motivated by insufficient financial liquidity.

In many cases, foreign banks were attracted by high level of economic growth in host countries, and this was true of some foreign banks entering Russia in the 2000s (*PULL reasons*). High growth rates attracted both banks and other foreign companies. In order to provide financial services to Russian consumers, banks were motivated to enter the market as well. At the micro-behavioral level, the so-called *"follow the customer"* strategy was typical for many Japanese banks and German banks providing

[41] For details regarding other developing and transition economies see studies of Vernikov (2005a, 2005b).

automobile loans. In comparison to European banks, Japanese banks operating in the Russian market are less competitive and prefer to stick to "main bank" features when establishing relations with their clients[42]. Though some banks, such as SBI Holdings (2010), which bought a 50% stake in Russia's ZAO "Obibank" in order to launch an Internet banking business, provide another motivation for Japanese banks to enter the Russian market[43].

Needless to say, out-in entry motivation of foreign banks into the Russian market can only be partially explained by the *political* and *"follow the customer"* hypotheses. High economic growth before 2008 and a gradual recovery from crisis consequences stimulated conditions for growing consumption that were partially driven by retail banking loans. Some foreign banks such as American Express Bank (United States) (2005), Home Credit and Finance Bank (Czech Republic) (2002), Rabobank (2008), Swedbank (Sweden) (2005(1994)) and J&T (Czech Republic) (2007 (1994)) decided to expand their business to Russia. We can consider this group of banks to be motivated by so-called *PULL reasons* (originating in a host country). Market size, growth of GDP per capita and other macroeconomic indicators account for these entry motives.

Moreover, there are other institution-related factors (macroeconomic and structural imbalances of the economy, a lack of creditability regarding financial institutions, high country risk) that indicate high potential banking profits. Therefore, among *PULL reasons* there is also a so-called "*high risk/high return*" motivation of entry. This constitutes a group of foreign banks that entered before or during the 2000s for the purpose of domestic business expansion. For Raiffeisen Group (Austria), for example, the Russian market is its second-largest one after Austria. The Group first entered in

[42] Case studies on European and Japanese banks are presented in Chapter 4 of the dissertation.
[43] Such as exploring new business opportunities.

1996 but altered its motives toward the establishment of a massive network in Russia only in the 2000s.

Vernikov (2002) cites "support of global image" as the FDI motive for foreign banks. For banks operating globally, not having an office in new emerging economies like China, India, Brazil or Russia, is a significant oversight in corporate strategy.

Furthermore, the literature shows historical and political reasons for the final decision regarding out-in entry. For example, Societe Generale first operated entered Russia in the 19th century and officially established a representative office in 1973. Consequently, it is one of the most successful market players in Russia[44]. Similar arguments can be made for other European banks (see Chapter 4).

Entry motives often discussed in the existing literature on foreign banks in Russia are presented in Table 3-6.

From the data presented in Table 3-6 and the existing literature we underscore the following:

First, foreign banks entering Russia to a great extent are motivated by similar factors that attract banks to other developing countries, though escape from regulation or decreased domestic profits in home countries are not necessarily behind entry into Russia.

Second, both *PUSH* and *PULL reasons* were identified among the motivations of banks. *PULL reasons* include high economic growth that attracts foreign investment

[44] Societe Generale started operating in Russia in the 19th century and initially provided consulting services and financed Russian companies. In order to expand its business in 1901, Societe Generale opened a branch in St. Petersburg (Severniy Bank) and organized financing for the Russian economy. Ten years after Severniy Bank merged with Russian-Chinese Bank, and Russian-Asian Bank was formed. In 1914, this was the leading bank among all others operating in Russia. Its share of assets amounted to 84% of those of Societe Generale. In 1917 the bank interrupted its operations due to the Russian Revolution. In 1973, a representative office in Moscow was established, and during the 1990s following financial liberalization, Societe Generale opened a subsidiary in Russia (from the website of Societe Generale).

and stimulates conditions for foreign bank entry. At the same time, we highlight the significance of PUSH *reasons*.

Third, there are multiple reasons for bank entry. Banks tend to alter and modify their motivations simultaneously with the changing external environment (e.g., after the collapse of the Soviet Union some banks preferred to exit the market, while others decided to stay).

Fourth, we identified non-economic reasons for initial entry (political, global image of banks, historical ties) and have underlined their importance.

Fifth, it is difficult to categorize the behavior of foreign banks based on their particular home country. A relevant example is the out-in entry of Japanese banks, as market specificity (relationship banking, main bank system) of the home country (Japan) indeed plays an important role in their decision to expand their businesses abroad. Shares of Japanese banks in total banking assets, deposits, and lending rates remain low in Russia, but some Japanese banks tend to view the Russian market as having growth potential. The Japanese banking system is typical of "relationship banking."

To sum up, the existing literature on the motivations of foreign banks in the Russian market is rather vague and ambiguously analyzes the driving forces that stimulate market entry. This is due to several reasons: First, traditional macroeconomic PUSH/PULL factors and micro-behavioral theories (follow, leader, and escape strategies) only partially explain the motivations of foreign banks. Second, idiosyncratic features of the Russian banking sector and their impact are excluded from the analysis, but they are particularly important in explaining the institutional context that to a great extent shapes the motivations, entry modes, organizational representation, and strategies of foreign banks. Third, there are no detailed studies dealing with the motivations of foreign banks specific to Russia. The existing literature provides no clear distinctions within the three-tiered analysis of micro-behavioral, macroeconomic, and institutional contexts. While it is rather difficult to establish consistent theoretical frameworks that clearly distinguish all three-levels, we aim conduct our own analysis of motivations in in Section 3.2.2.

Table 3-6 Motivations of entry of foreign banks into the Russian market

Motivation	PUSH/PULL reasons	Example
High risk-high return, macroeconomic conditions in Russia	PULL	Raiffeisen (Austria), Societe Generale (France), BNP Pariba Group (France), ING Group (Holland), Deutsche Bank(Germany), Bank of Cyprus (Cyprus)
Development of retail banking, market potential	PULL	Toyota Bank (Japan), Mercedes Bentz (Germany), American Express Bank (United States)
Global image	PUSH	City Group（United States）, other American banks
Banks having strong relations with Russian companies and individual customers aiming to establish a profound network on the Russian market	PUSH	Raiffeisen (Austria), Societe Generale (France), ING Group (Holland)
Support of foreign companies operating in Russia (follow strategy)	PUSH	Eurasia Tokyo-Mitsubishi UFJ (Japan), Sumitomo-Mitsui Europe (Japan), Mizuho Bank(Moscow) (Japan), Toyota Bank (Japan)
Leadership	PUSH	n.d.
Escape of costs, rising competition, loss of profits in a home country	PUSH	Establishment of a subsidiary is very costly and risky in Russia. Examples of banks used this motivation are not common
Non-economic, historical reasons (path-dependence)	PUSH/PULL	These reasons are common for entry at early stages. There are some studies showing that banks like Sociate Generale or Gredit Lyonnais already operated in Russia in 19-20 th centuries.

Source: compiled by author with references to Vernikov (2002,2004a, 2004b, 2005a); web-sites of foreign banks; Rosia NIS Keizaikenkyujyo. *Rosia no ginkou, kinyuu bumon no saishinjijyo*, March 2007, Shadanhoujin Rosia NIS Boekikai Rosia NIS Keizaikenkyujyo, pp.96 (in Japanese)

3.3.2. Analysis of entry motivation of foreign banks with 100% foreign capital participation

As of 1 January 2013, 73 banks with 100% foreign capital participation were registered in the Russian banking market. This list of banks is presented in Appendix B.

In our analysis, we tried to pursue the following goals: 1) identify the ultimate owners of foreign banks with 100% foreign capital participation as this data is not disclosed by CBRF; 2) identify M&A or the date of investments into foreign banks, as the CBRF only provides data on the initial registration of foreign banks, and further changes in the shareholders' structure are not consequently followed; 3) collect relative information on activity/motivation, strategy, and shareholders structure of foreign banks; 4) develop an extension of the typology of motivation of entry discussed in 3.2.1 by clustering foreign banks with 100% participation into 6 groups that in our view better describe their motivations when compared to previous empirical studies.

The information to conduct our analysis was collected from publicly available sources such as Internet home pages of banks and scientific and periodical literature, including disclosed information on shareholder composition.

The results of our analysis are presented in Table 3-7 below with detailed information provided in Appendices C through F. Our final sample included 72 banks with foreign capital participation, since we failed to identify the ownership structure for ZAO "Settlement Board of the Samara currency and foreign exchange market." In terms of geographical distribution by home country, Europe is the main region from whence foreign banks penetrate the Russian market with a total share of 51.4%, followed by Asia and offshore regions[45] – 15.3% each, CIS – 9.7%, and North America – 8.3%. However, when so-called pseudo-offshores[46] are included, the share attributed to Europe decreases to 37.5%, while the share attributed to tax havens and offshore territories increases substantially to 29.2%. In general, the geographical distribution by home country corresponds to our main findings in the macro-analysis of inward FDI

[45] We apply UNCTAD's definition published in the World Investment Report (2012). According to UNCTAD and as defined by OECD, offshore regions and tax haven territories include the following countries: Andorra, Gibraltar, the Isle of Man, Liechtenstein, Monaco, Bahrain, Liberia, Seychelles, the Cook Islands, Maldives, the Marshall Islands, Nauru, Niue, Samoa, Tonga and Vanuatu, Anguilla, Antigua and Barbuda, Aruba, Barbados, Belize, the British Virgin Islands, the Cayman Islands, Dominica, Grenada, Montserrat, the Netherlands Antilles, Panama, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, the Turks and Caicos Islands and the United States Virgin Islands (*World Investment Report*, 2012, p. 8).

[46] Although many tax-haven economies are in developing countries, special-purpose entities (SPEs), including financial holding companies, are more prevalent in developed countries. Luxemburg and the Netherlands are a typical example of such countries. It is not known to what extent investment in SPEs is directed to activities in the host economy or in other countries (*World Investment Report*, 2012, p. 8). In the dissertation, we refer to SPEs as pseudo-offshores and consider banks from these regions to be pseudo-foreign ones.

into the banking sector of Russia, where we highlight the disproportionate share attributed to offshore regions. In the purest sense, foreign banks from home economies that are offshore or pseudo-offshore regions are not authentically "foreign," but rather represent cases of indirect FDI, such as round-tripping FDI, reinvestment of Russian capital and investment through SPEs, which makes it really difficult to discern the identity of ultimate owners. In other words, these are a kind of *pseudo-foreign bank* or *quasi-foreign bank* funded with round-tripping Russian capital[47].

Table 3-7 Geographical distribution of foreign banks with 100% foreign capital participation

Region	Sample of 72 foreign banks		Pseudo-offshores	
	Number of host banks registered in the region	Share, %	Number of host banks registered in the region	Share, %
Europe	37	51.4	27	37.5
North America	6	8.3	6	8.3
CIS	7	9.7	7	9.7
Asia	11	15.3	11	15.3
Offshore	11	15.3	21	29.2
Total	72	100	72	100

Source: compiled and calculated by author

Appendices E and F present our classifications of motivation of entry. We conditionally subdivided foreign banks into the following 6 groups:

1) first pioneers from Europe[48] and the United States (15-16 banks) driven by historical, cultural and geographical context and Soviet legacy that generally followed an "organic growth strategy" and entered in the form of green-field development;
2) foreign banks that entered the market in order to support bilateral economic and trade relations or banks that were established under government agreements. This group includes 18 banks, and the majority of them entered under the so-called

[47] The offshore issue, pseudo-foreign banks and related issues are discussed in the Conclusion of the dissertation.
[48] A case study on European banks is presented in Chapter 4. We argue that the success of European banks in the Russian market is not primarily explained by their relatively early entry into the market driven by PULL reasons, but rather by historical, cultural, and geographical proximity that in fact constitute the institutional context.

"gravity model" had geographical proximity to CIS in the form of green-field developments or M&A;

3) the "second wave" from Europe, the United States, and Asia driven by high market potential and high-risk/high-return "market-seeking" strategies. The group has 16 banks at present mostly driven by PULL factors;
4) followers of home countries' business – three megabanks from Japan[49];
5) those motivated by the establishment of the automobile lending business in Russia – five banks from Germany, France and Japan, also regarded as "followers";
6) pseudo-foreign and quasi-foreign banks from offshore regions[50] (both pure offshore and offshore banks with Russian citizens as the ultimate owners).

Overall, we identify two time periods of out-in entry: the 1990s and the 2000s. Group 1 and 2 entered the market principally during the 1990s, while groups 3–6 are late market participants that intensified their operations in the 2000s. Groups 4 and 5 relate chronologically to Group 3 and can be regarded as its sub-groups, but we define them separately for the purpose of motivation analysis. We presume that macroeconomic context played a significant role in determining motives for Groups 1, 2, and 3, while Groups 4 and 5 were more likely influenced by micro-behavioral factors. Offshore banks in Group 6 represent an expository example of the articulate impact of institutional context. Institution-related background is revealed in the existence of historical, cultural proximity, and political will of home and host countries. Notwithstanding our results, the differences among the environmental contexts are conditional.

[49] A case study on Japanese banks in Russia is presented in Chapter 4.
[50] Pseudo-foreign banks and offshore issue are viewed as part of the institutional context in the Conclusion of this dissertation.

3.4. Organizational representation and entry modes of foreign banks

Foreign banks entering the Russian market apply different organizational representation and entry modes. If we use the broad definition of a foreign bank (juridical one), it is possible to identify four types of entry modes at present: *subsidiary, JV with a Russian bank, minor shareholder participation, and representative office*.

Representative office is the most common entry mode for starting a business in Russia for many foreign banks. Although representative offices do not provide banking services, they enable parent banks in home countries to collect information about the Russian market and provide that relative information to their clients. After a few years, a representative office is usually converted into a subsidiary (Russian juridical entity). A majority of banks operating in Russia employ this approach because the establishment of a subsidiary requires a lot of preliminary work (such as licensing by CBRF and accreditation of documents). Typically, in Russia, foreign banks tend to establish a 100% foreign subsidiary, e.g., an entity owned by a parent bank. There remains in Russia high levels of mistrust and low transparency levels when it comes to property rights protections[51]. In 2013, the total number of 100% foreign shares banks in Russia amounted to 73[52].

The establishment of branches is uncommon. Only one foreign bank branch has been established in Russia, this happened in 1990 when Armenian bank "Anelik," opened a branch, but then converted it into a subsidiary in 2003. Until 15 March 2013, the

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[51] The data confirming a generally poor institutional environment and low competitiveness of the banking sector can be obtained from the Global Competitiveness Report 2013-2014. According to the report, the Global Competitiveness Index of Russia in 2013-2014 is 4.2 scores (64th place out of 148 countries). The lowest parameter is the quality of institutions (126th place), goods market efficiency (121st place), financial market development (121st) and business sophistication (107th place). Low scores for financial market development are largely explained by such factors as difficulty with availability and affordability of financial services, low levels of financing through local equity markets, difficulty with access to loans, low soundness of banks (124th place), ineffective regulation of securities exchanges, few protections of legal rights (3 scores out of 10) (World Economic Forum, Global Competitiveness Report, pp. 326-327).
[52] Official statistics from the CBRF. Retrieved on 24 April 2013 from www.cbr.ru.

Banking Law did not officially prohibit branches, but due to bureaucratic restrictions this was not a viable entry mode[53]. Shareholders control and management are key issues for many foreign banks. Participation as a minor shareholder or deciding to a controlling interest is a key dilemma for the management of many foreign banks. Statistical data show banks prefer to establish 100% foreign-owned subsidiaries due to low transparency into ownership structures and few ownership rights protections[54] in Russia. The large number of banks with dispersed ownership also supports this assumption.

Joint venture businesses among Russian and foreign banks is also rare, supporting the conclusion that entry modes of foreign banks are shaped by sensitivities to ownership and property rights issues.

As of January 2010, there were 118 banks participating as minority shareholders, more than half with foreign participation. Thirty-three banks had less than a 1% foreign share; in 60 of those banks foreign investments amounted to between 1% and 20% of ownership, and 25 banks had foreign share participation rates between 20% and 50%. On one hand, banks try to follow a strategy of "*ownership rights=dominance,*" but on the other hand they agree to be a minor shareholder in exchange for a market presence (Vernikov, 2002). Entry modes reflect this dual structure (100% control vs. minor participation).

Another interesting fact proving the increasing participation of foreign banks as minor shareholders is the degree of shares controlled by non-residents in state-owned banks. In OAO "Sberbank" 32% of shares are controlled by non-residents; in OAO

[53] According to the present legislation dated 15 March 2013, branches of foreign banks in the territory of Russia are prohibited. In general, the difference between branches and subsidiaries is that branches are not subject to Russian laws or regulation by domestic authorities and are not obliged to pay the minimum reserve funds to CBRF or disclose accounting information in accordance with Russian law.
[54] Global Competitiveness Report, pp. 326-327.

"Vnestorgbank," nominees of Bank of New York International control 16% of shares. Both of these figures are very compelling evidence and foreshadow the relatively liberal nature of the Russian banking system.

As of 1 January 2012, 191 credit organizations with foreign share participation (80%) were registered in the form of the JSC, including 67 (29.1%) in the form of closed JSC and 39 (17%) in the form of LLC. One hundred twenty-four credit institutions (53. 9%) have foreign share participation and general licenses for the banking activities; 104 (45.2%) have licenses for foreign exchange transactions and transactions in rubles; 197 (85.7%) have the right to attract deposits; 27 banks with 100% foreign share participation have a total of 155 branches across Russia. The number of branches decreased by 48 (ZAO "Prosvyazbank", ZAO "Absolut Bank", ZAO "Raiffeisen" and other foreign banks closed their branches).

The most typical organizational form for banks entering the Russian market is still the establishment of 100% foreign-owned banks, though some other types of foreign participation are also present. This fact is largely explained by the institutional context of the Russian banking sector. On an official level, the law prohibits the establishment of branches by foreign banks, but even before this law's application there had been only one foreign branch registered due to bureaucratic obstacles and an unwillingness on behalf of the government to issue official permission. Moreover, ownership rights in Russia are not sufficiently protected[55]. Some investors point to difficulties in the market environment such as language barriers, administrative barriers and bureaucracy, corruption, a lack of transparency, complicated juridical procedures, a complex

[55] Russia's world rankings in terms of various legal protections are as follows: property rights protections, 133rd, intellectual property rights, 113th, burden of governmental regulation, 120th, transparency of government policy making, 101st, protection of minority shareholders' interests, 132nd, strength of investor protections, 100th (Global Competitiveness Report, p. 327).

hierarchical structure, weak corporate governance, high business transaction costs, weak infrastructure, and generally weak legislation (*RBK*, April 2013, p. 99).

3.5. Strategies of foreign banks in the Russian market

In general, strategies of foreign banks in the Russian market are similar to those used by foreign banks in other developing and transition economies. These include asset-seeking, profit-seeking, and efficiency seeking approaches. In particular, banks try to capture a market niche, develop new market segments, and expand their businesses. All of these actions substantially define the behavior of foreign banks. In the case of entry into developing countries, foreign banks normally use one of two strategies: greenfield, known as *de novo operations* or *organic growth*[56]*,* and brownfield developments in the form of the *acquisition of rivals (M&A).*

M&A was a dominant strategy used by foreign banks in countries that implemented financial liberalization and the privatization of the banking sector (Rybin, 2007). In Russia, however, privatization of the banking sector by foreigners was a slow and complicated process. As a result, banks that entered the market in the 1990s such as ZAO "Raiffeisen" or ZAO "Citibank" mostly used an "*organic growth strategy*" and started their businesses from scratch. In our analysis on motivation, we also uncovered other examples of banks in this first group of pioneers from Europe and the United States. The second group, driven mostly by decisions of their home countries, also tended to apply an organic growth strategy (see Appendix F).

The organic growth strategy is a very moderate and limited one. On one hand, it allows banks to escape problems with management and avoid arguments in the process

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[56] Organic growth strategy is the expansion of business fueled by internal resources of a foreign bank. It is normally very costly and slow to implement.

of business integration between home and host countries, but it has the drawbacks of slow development and high transaction costs. With transaction costs being so high in Russia, foreign investors often have to pay an expensive “entrance fee” when entering the market. Moreover, factors such as over-segmentation of the market, regional diversity and the strong positions of domestic (both state and private) banks make it difficult for foreign banks to set up businesses by applying an organic growth strategy to achieve dominance or a competitive market position (Vernikov, 2002). It is interesting to note that the organic growth strategy was most common in the 1990s, when the banking sector was still developing, and foreign investors lacked information on the potential attractive features of M&A among domestic banks. In other words, clarity of the domestic market predetermined the entry strategy of foreign banks.

In contrast to the organic strategy approach, in the 2000s M&A became the primary entry strategy among banks in Russia. From M&A theory we know that the primary motives for this approach are market share expansion, increasing capital and intensification of competition. Some of these motives are applicable to Russia. M&A deals were soaring, reflecting the relatively fast progress of reforms in the banking sector during this time. Economic growth requires substantial money inflows, but the domestic Russian banking sector was unable to fulfill this demand. M&A deals were a possible solution for resolving the problem of obsolete banking technologies and the intense competition from foreign banks that would eventually fuel an acceleration of the process of development of the Russian banking sector (Rybin, 2008a, 2008b).

Below we analyze the dynamics of M&A in the Russian financial sector. Both increasing numbers of M&A deals and deal valuations show the positive dynamics of M&A strategy in the Russian banking sector (Figure 3-4). In 2006, M&A in the financial sector amounted to 7.1% of all M&A deals, and in 2008 this figure rose to 9%.

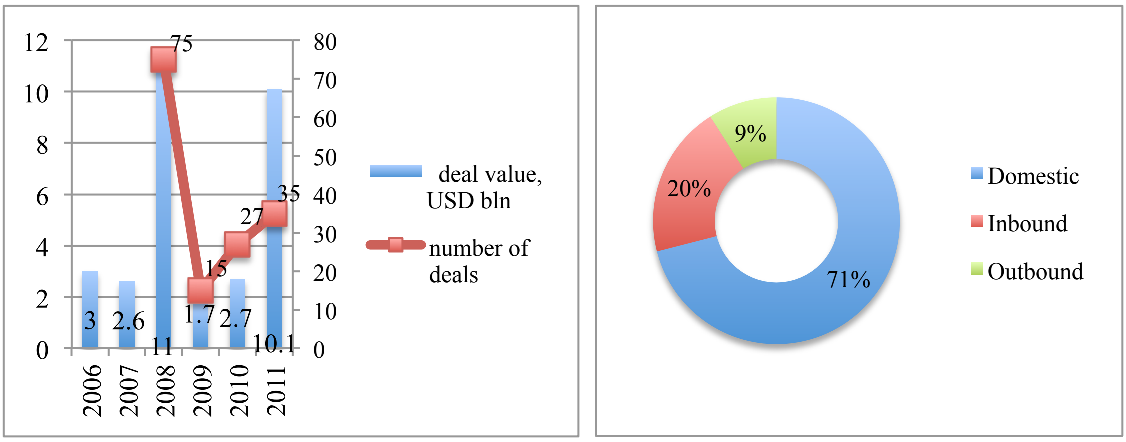
M&A trends follow the general dynamic of foreign capital participation in Russia's overall economy (most deals out-in) (Rybin, 2008a, 2008b).

As Rybin (2008a) shows, M&A processes in Russia can be divided into several steps. Before the introduction of market mechanisms and the financial crisis of 1998, participation of foreign capital in the banking sector was limited, unlike the situation in Latin America and CEEC. CBRF determined the upper limit of participation of foreign capital and aimed to control the banking sector. During this period, banks operating in Russia tended to use an organic growth strategy. Raiffeisen Bank (Austria) had plans to expand its business to CEEC and CIS. Banks such as Chase Manhattan and ABN Amro Bank used the "*follow the customer*" approach and supported foreign companies operating in Russia. During this period because of flaws in the institutional base and negative attitudes toward foreign investments, M&A was uncommon. Banks preferred to create 100% foreign owned subsidiaries (Kulik, 2006; Rybin, 2007, 2008a, 2008b).

In 2003-04, the Russian economy showed positive signs of growth; the investment climate improved; linkages among banks increased, resulting in higher levels of transparency regarding business regulations. As a result, many foreign banks pursued an out-in entry strategy in Russia. Despite these changes, there remained negative trends from the first wave, such as a lack of transparency in the banking sector, economic and institutional barriers, and problems with WTO accession.

Nevertheless, during 2003-04, M&A as the chosen method to achieve access to the market gradually increased. *Greenfield investment* was replaced by the *brownfield model*. The banks acquired at this stage were mostly the ones that already had a small share of foreign capital or were medium-sized and strong in a particular banking sector. In the literature, this period is called the "*potentially hidden period of M&A*" (Rybin, 2007).

Figure 3-4 M&A in the Russian financial sector 2006-11 (USD billion, %)



Source: Retrieved on 24 April 2012 from www.kpmg.de M&A in Russia

In 2005-06 the potential period of M&A growth in banking was replaced by an open stage. M&A cases and market deals skyrocketed; targets for M&A shifted to larger banks, banks with strong retail networks and a few small banks. For example, Societe Generale (France) bought 20+1% shares of ZAO "Rosbank" which had a strong retail customer network in 2006. Raiffeisen also acquired ZAO "Investbank," which had a very strong retail and regional presence. The reasons for acquiring banks with developed retail networks are obvious: escaping initial costs of developing a choice segment[57] and market entry into the potentially profitable segments[58]. Regional banks as a rule have a strong brand name and a good reputation among established customers, making their acquisition a profitable deal for foreign banks. The acquisition of small-sized banks can be explained by the desire of banks to avoid the transaction costs of establishing a direct subsidiary (licensing by the CBRF, other administrative and institutional procedures)[59].

In 2007-08, the Russian banking sector was showing positive dynamics. In 2007, 69 M&A cases were registered in the financial sector with a total market value of USD 2.6

[57] Buying a competitor with an established network is easier.
[58] A boom in retail banking in Russia was fueled by high levels of economic growth.
[59] Major M&A transaction are listed in Gorshkov (2011b) and Bogdanov (2008).

billion. Domestic transactions amounted to 53% in 2009, and out-in deals amounted to 28%, showing positive trends in foreign bank entry. Despite the existing deterrents (institutional factors), in addition to foreign banks, financial groups and investment funds started implementing M&A in the Russian market[60] (Rybin, 2007, 2008a, 2008b).

The financial and economic crisis in 2008 significantly influenced the dynamics of M&A transactions. In 2009, the number of M&A cases in the banking sector decreased; total market transactions value experienced a drop of 84.5% (from USD 11 billion to USD 2 billion). In 2010, the positive dynamics of M&A recovered, following the gradual recovery of financial liquidity of banks that suffered the consequences of the crisis.

M&A strategy was typical for Group 3 (the second wave from Europe, the United States, and Asia) and Group 6 (pseudo-foreign banks from offshore regions and quasi-foreign banks with Russian citizens as ultimate owners), as shown in Appendix F. In particular, 15 banks belonging to Group 6 employed M&A to acquire relatively strong domestic banks such as OAO “Promsvyazbank” (Netherlands), OOO “Sovkombank” (Netherlands), OAO “RosEvroBank” (UK), OAO “Fleksinvest Bank” (Cyprus), ZAO “RUNETBANK” (British Virgin Islands, Cyprus) and others.

On the other hand, a domestic wave of M&A is of some interest and can be explained by pointing to the enlargement of banks in order to meet restrictions on minimum capital requirements (Russia is gradually increasing the upper limit of the charter capital of banks in accordance with BASEL III). M&A cases involving large Moscow banks that acquire regional banks that have a strong market share in retail banking have become omnipresent. The majority of M&A deals are friendly ones and are driven by the necessity to resolve problems of low capitalization.

[60] For example, Merrill Lynch invested in TIB Holding, which had an affiliated financial institution in Russia.

As the audit firm KPMG shows in their report on M&A in Russia (2011), the general turmoil in the global economy and financial markets has affected players in the Russian financial services market. Foreign investments in the sector declined due to its high-risk status, the strong presence of state-controlled banks and pressure on margins as the result of intense competition. However, despite the difficulties experienced in the Russian financial sector, M&A deals bounced back in 2011. Thirty-five transactions were announced in 2011 (a 30% increase in comparison to 2010). The majority of these transactions were in the domestic market (71%). Inbound transactions amounted to 20%, outbound – 9%. Foreign banks with a presence in Russia are experiencing difficulties, as they frequently have to pay higher costs than their Russian competitors in order to achieve economies of scale and are affected by high levels of regulation. The current economic uncertainty may also be resulting in a lack of commitment from head offices to push their businesses forward due to a relatively low risk appetite, putting expansion strategies on hold[61].

Simultaneously, Russian banks show high levels of interest in expanding their businesses abroad. In-out expansion cases are a prominent feature the Russian banking market. Domestic banks belonging to large financial industrial groups (OAO "Gazprombank") have the potential to acquire assets of banks abroad. However, due to domestic restrictive factors, such as problems of undercapitalization, consolidation, and segmentation of the banking sector, only relatively large Russian banks "go global" and even they tend to acquire less capitalized banks from CIS countries. In 2005, the total market transaction value of outbound deals with the participation of Russian banks amounted to USD 113 million and further increased in 2006. In 2007, banks like

[61] M&A in Russia in 2011. Retrieved on 24 April 2012 from www.kmpg.de.

Slavneft (Belarus) and Areksimbank (Armenia) were acquired[62]. Russian banks used dual motivations for entering into the CIS markets: providing support and financial services to Russian companies operating in CIS countries (e.g., a "*follow the customer*" approach) and interest in potential development of the region (*PULL reasons*)[63].

Overall, *de novo* operations are being replaced by a growing number of M&A deals that show a different side of foreign banks' strategies. The total number of M&A deals is increasing, and this new strategy of development by foreign banks has some specific features: 1) targets of M&A shifted from medium-sized banks to regional (local) ones; 2) banks with sound and stable retail business networks are priority assets; 3) friendly character of M&A; 4) the dominance of domestic M&A driven by the problem of undercapitalization; 5) an increase in outbound M&A by Russian banks.

As a result, the concentration of capital in the banking sector is increasing, in terms of both foreign and domestic capital. Russia's large banks are acquiring small-sized domestic banks, while foreign banks are more interested in medium-sized banks that have wide and stable regional networks. M&A is pursued by foreign banks in order to escape transaction costs. In addition, M&A strategy is used to establish retail banking in Russia (Kulik, 2006), as it helps banks to become instantly competitive. Thus, we conclude that the strategy of foreign banks in the Russian market is gradually changing, with a shift toward M&A financed by parent banks from home countries becoming widespread.

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[62] In 2006, ZAO "Vneshtorgbank" (ZAO at the period of acquisition, OAO at present) acquired 98% of the shares of AKB "Armiya" (Ukraine); OAO "Sberbank" bought 100% of the shares of TechsakaBank (Kazakhstan).
[63] In-out expansion cases among Russian banks are analyzed in Chapter 5.

3.6. Summary

In Chapter 3, we analyzed activities of foreign banks in Russia at the macro-level (analysis of inward investments into the Russian banking sector) and further analyzed motivations, entry modes and strategies of foreign banks. We provided classifications of banks in terms of the motives of their financial FDI and showed the role of microeconomic, macroeconomic, and institutional contexts that predetermined the motives of out-in entry. We also presumed that the division of the three-tiered domestic environment into microeconomic, macroeconomic, and institutional contexts is a conditional one, as the limits among the three often overlap depending on the angle of analysis. The institutional context proved to be particularly important for entry modes, organizational representations and strategies of foreign banks. Idiosyncratic features of the Russian banking sector (consolidation, over-segmentation, geographical distribution, concentration, revenue structure) and market specificity (ownership rights, legal system transparency, etc.) directly and indirectly contribute to the fact that foreign banks entering Russia tend to establish traditional business types in the European part of Russia with relatively moderate domestic branch networks. Motives for out-in entry are diverse, and foreign banks alter them over time, but both PULL and PUSH reasons at the macroeconomic level and micro-behavioral context (follower, leader) together with institutional factors (historical, cultural ties, geographical and language proximity, path-dependency, and offshorization) can be justified.

Chronologically, we defined two periods of out-in entry: the 1990s and 2000s. First, pioneers from Europe and the United States with other foreign banks entered the market as a result of bilateral trade agreements or close economic ties between Russia and home countries (geographical, language, cultural, historical proximity). This group entered based on an organic growth model and established *de novo* operations, while a second wave from Europe, followers of home countries' clients and offshore banks (pseudo- and quasi-foreign) fostered their activity in the 2000s and primarily employed M&A as an entry mode. All groups of foreign banks with 100% of capital tend to establish CJSC or LLC, following the general trend in the market. Institutional contexts (legal system, regulations, law enforcement) are accountable for this organizational choice.

We also explained why banks might be influenced by their home country's domestic environment (Japan, for example) and underscored the increasing trend toward in-out expansion among Russian banks. The role of the home country will be discussed in Chapter 4, and expansion of Russian banks abroad will be subsequently investigated in Chapter 5.

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4. CASE STUDIES ON EUROPEAN AND JAPANESE BANKS IN THE RUSSIAN MARKET

4.1. Activity of European banks in the Russian market

4.1.1. Presence of European banks in the Russian market

In this section we analyze the activity of European banks in the Russian market. Historically European capital was the first one to enter the Russian market and its influx into the banking sector is supported by gravity models and geographical proximity of Russia and Europe, as well as the path-dependence issues.

As it was analyzed in Chapter 3, as of January 2013 73 banks with 100% foreign participation operated in the Russian banking market. Table 3-7 provided the analysis of ultimate ownership structure of this locally incorporated banking institutions (list of them is presented in Appendix B). We could not identify the ultimate shareholder for ZAO “Settlement Board of Samara currency inter-banking stock exchange” (Sample 73 in Appendix B). Therefore, the total number of locally incorporated institutions with 100% foreign capital participation in our sample is amounted to 72. We further analyzed geographical distribution by major home-country investor and obtained the following results. The share of Europe is amounted to 50% for all banking institutions with 100% foreign capital participation (36 foreign banks), followed by Asia (15.3%, 11 foreign banks), CIS (12.7%, nine foreign banks), offshore regions (12.7%, nine foreign banks), North America (8.5%, six foreign banks). Countries such as Belgium, the Netherlands, the UK and Switzerland are conditionally regarded as pseudo-offshore regions, the recalculation of their share is as much as 26.8%, which makes them the second largest geographical destination after Europe.

In either case, the share of European capital in the Russian banking sector is predominant; therefore we focus on investigating the history of European capital and provide an overview of cases studies on some European banks operating in Russia.

Europe by home-countries investing into the Russian banking sector is presented by Germany (four banks), France (four banks), Netherlands (four banks), the United Kingdom (three banks), Turkey (three banks), Switzerland and Austria (two banks each) and countries having only one locally incorporated institution in Russia, namely Belgium, Italy, Finland, Norway, Czech Republic, Slovakia, Serbia, Albania and Israel. TOP 2 countries in terms of number of locally incorporated banking institutions are Germany and France, though the most prominent player on the market is ZAO "Raiffeisen Bank" (subsidiary of Raiffeisen International (Austria)). German banks are represented by three banks specializing in automobile loans, namely OOO "BMW Bank", OOO "Mercedes-Benz Bank RUS", OOO "Volkswagen Bank RUS", and OOO "Deutsche Bank" providing services of investment banking, and ZAO "Kommerzbank (Eurasia)" and OAO "RosEvroBank". French banks are represented by ZAO "Societe Generale.Vostok"[64], ZAO "BNP Paribas", ZAO "Credit Agrikol' Corporate and Investment Bank", ZAO "Natiksis Bank".

4.1.2. History of foreign entry of European banks into the Russian market

As Rybin (2010, p. 32) shows the history of foreign expansion of the European banking capital into the Russian market goes back to 1989, when the first commercial bank of new Russia ZAO "International Moscow Bank"[65] was established by the

[64] Merged with OAO "Rosbank" and combined into a single legal entity. ZAO "Rusifinance Bank" and ZAO "DeltaCredit" transferred to the control of OAO "Rosbank". The bank is now called OAO "Rosbank. Societe Generale Group" and as of January 2013 was not classified as a bank with 100% foreign capital participation by Russian CBRF (the current share of Societe Generale Group is 82.3%). Data retrieved on 9 April 2013 from http://www.rosbank.ru/ru/about/disclosure/affiliates/).
[65] ZAO "UniCredit Bank" since 2007. 100% of shares belong to Austrian shareholders.

Decree of the Ministry Council of USSR. Sixty per cent of the charter capital was financed by foreign investors – German, French, Italian and Japanese capital. This was the first bank under control of foreign (primarily European) capital. This form of expansion – equal participation of shareholders was not typical for the European capital, and later on when restrictions were put on the establishment of branches, many banks altered their entry modes towards opening 100% subsidiaries.

Rybin (2010, p. 32) calls the period 1989-98 to be the first stage of development of European banking capital on the Russian market. There were no M&A deals, and largest Austrian, German, Deutch, French and Swiss banks registered their first locally incorporated institutions during this period. The range of financial services provided by these foreign banks was rather limited and included mostly investment banking and services to corporate sector (mainly to foreign companies from home countries). Therefore, we assume that initial motivation of entry was driven by PUSH (follow the customer) reasons. European banks reluctantly entered the market due to strong regulation from CBRF and generally bad investment climate in Russia. Thus, Russian banking system in contrast to the East European economies, maintained relative independence from foreign capital, but lost the potential of growth (Rybin, 2010, p. 33).

The success of Austrian banks (ZAO "Raiffeisen Bank", ZAO "UniCredit Bank") on the market is logical. Being a bridge between Western and Eastern Europe, and with small and medium Austrian banks hardly standing the competition in developed markets of Europe and United States, Austrian banking capital was predetermined to enter CEE markets. Russian authorities were enthusiastic about the expansion of Austrian capital and supported the decision of banks. From the beginning of entry into the Russian market, Raiffeisen Bankengrouppe started providing banking retail services. The interest of Austrian banks in the Russian market is proved by the fact that the

Group continued its operations even after the financial crisis of 1998, when some banks bore severe losses and exited the market.

Rybin (2010, p. 33) calls the European capital at the initial stage of entry “the landmark for growth”, meaning that it was not the primary source for the development of the Russian banking sector. However, sharp increase in M&A activity in 2000s (namely 2005-08) shows positive signs for growth. More and more European banks expressed increased interest (PULL reasons, macroeconomic context) and entered the market by brownfield entry mode and provided extensive banking services. Even though, activities of European banks are limited to 1) retail business (high profitability and growth potential) (ZAO “Raiffeisen Bank”, ZAO “Societe Generale. Vostok”, ZAO “Unicredit Bank) 2) investment banking (OOO “Deutsche Bank”, but major investing operations (loan syndication, consulting, underwriting) are provided by main offices in home countries, 3) loans and credits to small and medium business (ZAO “Kommertzbank”), 4) private banking (ZAO “Credit Swiss”, OOO “Deutsche Bank” 5) corporate financing (ZAO “Raiffeisen Bank”, ZAO “Societe Generale. Vostok”), loans and credits are distributed not through the locally incorporated institutions in Russia, but through syndication of loans by parent banks. Russian companies still prefer to provide financing from abroad, causing the increase of external debt of the corporate sector (Mizobata, 2011, 2012). As the result, interest rates from all transactions flow directly to Europe, leaving Russian banking system without additional profit sources and cutting the tax base. Rybin (2010, p.35) explains the reasons for relatively low interest in the corporate lending by lower profitability of these investments in Russia in comparison to investment banking; non-transparent shareholder structures of many Russian companies; and low protection of creditor’s rights. Retail business was traditionally and historically the first sphere of activity that foreign banks from Europe concentrated their efforts on. European banks brought completely new quality standards in servicing individual customers and introduced new banking products, such as automobile loans (German banks), credit and debit cards (ZAO "Raiffesen Bank", ZAO "International Moscow Bank", ZAO "Societe Generale. Vostok". Over the period from 1998-08 European banks altered their status from being a "landmark for growth" to "investors". The role of foreign banks from Europe is even higher, when we consider indirect presence of European capital in the form of cross-border lending and loans to the corporate sector (both companies and banks) by parent banks located in home countries. The paradoxical situation herewith is that European banks earn more interest rate profits by providing loans and credits to Russian banks and pseudo-state institutions, than by directly financing projects in the domestic market in Russia (Rybin, 2010, p.36).

The situation with flows of European capital after the economic crisis of 2008 has not drastically changed. As it was analyzed in Chapter 3, there was a temporary slowdown in M&A activity in 2009 and some banks reorganized their locally incorporated institutions in Russia, but general trends for major European players are rather positive. Below we briefly introduce short case studies on European banks on the Russian market.

4.1.3. Short case studies on European banks in Russia

4.1.3.1. ZAO "Raiffeisen Bank"[66]

ZAO "Raiffeisenbank" is a subsidiary of Raiffeisen Bank International AG (major shareholders are Raiffeisen CIS Region Holding GmbH – 99,97% shares and Raiffeisen-Invest-Gesellschaft m.b.H – 0.03% shares). Raiffeisenbank (Austria) had USD 190.2 billion of assets and was ranked 98th in the world, 47th in Europe and second

[66] The information is mostly retrieved from the bank's homepage http://www.raiffeisen.ru/en/about/inrussia/ in April 2013.

in Austria (*Vedomosti*, 21 February 2013, p. 9). The bank has been operating in Russia since 1996 and offers a full range of services to retail and corporate customers, both residents and non-residents, in rubles and foreign currencies. In 2006 Raiffeisen International Banking Group[67] purchased 100% shares in OAO "Impexbank". ZAO "Raiffeisenbank," aims to strengthen its position as one of the leading universal banks in the region and is regarded as one of the most reliable banks in Russia by rating agencies. Asset, liability, equity, net profit, and revenue structure of ZAO "Raiffeisen Bank" is presented in Table 4-1. ZAO "Raiffeisen Bank" is a leading foreign bank in ratings: in terms of assets – 11th place, capital – 10th place, corporate lending – 11th place, consumer lending – 10th place, deposits of individual customers – fifth place. High ratings of ZAO "Raiffeisenbank" prove that it is rather competitive on the Russian market, despite the domination of state-owned and pseudo-state-owned banks.

The regional network of ZAO "Raiffeisenbank" is very extensive. It currently operates in almost all major cities in Russia. As of 2012 ZAO "Raiffeisenbank" had 193 domestic intuitions in Russia and staff of around 8000 people that provided services to more than 2.2 million clients (*Vedomosti*, 21 February 2013, p. 8-9).

The bank applied diversified motivations of entry to enter the Russian market. Historical and geographical ties (institutional context) together with the bank's expansion strategy in Eastern Europe (microeconomic context) and growing potential on the market (PULL factors, macroeconomic context) are accountable for the motives of Raiffeisen Group in Russia. Entry mode has also altered toward M&A instead of *de novo* operations, while the strategy on expanding the retail business has been maintained. In our view, the highest ratings of ZAO "Raiffeisenbank" in Russia might

[67] Raiffeisen International and RZB before M&A.

be attributed to the fact that it was a "first mover" in retail business with a historically established relatively high reputation among Russian individual and corporate clients.

Table 4-1 Assets, liability, equity, net profit and revenue structure of Raiffeisen Bank (RUB, thousand)

Years	2007	2008	2009	2010	2011
Assets	419,738, 284	555,142,221	474,435,124	482,906,850	571,916,479
Liabilities	377,490,032	498,005,212	414,875,194	416,186,289	494,605,427
Equity (Charter capital)	21,828,968	36,711,260	36,711,260	36,711,260	
Net Profit	6,857,005	2,159,880	3,566,553	8,516,542	14,197,764
Revenue structure:					
Interest rate revenue	31,183,775	45,444,634	48,549,246	35,699,389	40,742,738
Comission revenue	8,414,638	6,272,721	6,762,002	7,489,028	8,952,077
Income from foreign exchange operations	1,714,745	3,177,102	7,969,079	6,515,142	157,961
Revenue from reevaluation of foreign curreny	2,337,485	-2,848,425	-4,545,782	-556,277	7,111,433
ROA, %	1.63	0.39	0.75	1.76	2.48
ROE, %	31.41	5.88	9.72	23.30	38.67

Source: Balance sheets of banks obtained from CBRF, various years
* ROA (return on assets) and ROE (return on equity) are calculated by author

Table 4-2 Raiffeisen Group in Russia

Year	Locally incorporated institutions in Russia
1989	Raiffeisen Zentralbank Austria Representative office in Moscow
1996	ZAO "Raiffeisenbank Austria", 100% Austrian subsidiary
2000	OOO "Raiffeisen Leasing"
2001	Northern Capital Branch in St. Petesburg
2003	OOO "Raiffeisen Capital Asset Management Company"
2004	Non-State Pension Fund "Raiffeisen"
2005	Uralsky Branch in Ekaterenburg, Samarsky Branch in Samara, Sibirskiy Branch in Novosibirsk
2006	Yuzhny Ural Branch in Chelyabinsk, Povolzhsky Branch in Nizhny Novgorod, Kubansky Branch in Krasnodar, Krasnoyarsky Branch in Krasnoyarsk, Permsky Branch in Perm
2007	Sochinsky Branch in Sochi, Credit-cash office "Kemerovsky" in Kemerovo, Tyumensky Branch inTyumen
2008	Bashkortastan Branch in Ufa
2009	Kurskiy Branch in Kursk, Credit-cash office "Pyatigorsky" in Pyatigorsk

Source: Retrieved from http://www.raiffeisen.ru/en/about/inrussia/ in April 2013

4.1.3.2. OOO “Deutsche Bank”[68]

Deutsche Bank was established in 1870. With 78 291 employees in 76 countries it offers advanced banking services throughout the world. The bank launched its operations in Russia in 1881 by underwriting a capital increase of the Russian Foreign Trade Bank based in St. Petersburg and placing the new shares in Germany. In the mid-1880s Deutsche Bank was the first to arrange railroad loans in Russia and in 1926 it was the leader in organizing the first German-USSR export finance consortium. In the 1970s, Deutsche Bank supervised fundraising to finance pipe supplies for the construction of a pipeline from Russia to Europe. Thus, Deutsche Bank has strong and long-lasting historical relations with the Russian market, and in order to improve these relations it was decided in April 1998 to establish OOO “Deutsche Bank Russia” as a wholly owned subsidiary of Deutsche Bank AG (100% shares). Since than Deutsche Bank became one of the largest foreign banks in Russia and survived the crisis of 1998. The subsidiary in Russia is a universal bank with a professional staff of 1000 people (Moscow city) providing local and international, corporate and private clients with a broad range of financial services, comprising corporate finance and advisory, sales, trading, transaction banking as well as wealth managing and asset management services. Large Russian MNCs are among the clients of Deutsche Bank. The subsidiary in Moscow is a leading bank in the Russian private banking market, advisory services on M&A and other major investment banking services. OOO “Deutsche Bank Russia” actively supports cultural initiatives in Russia and contributes to the development of the Russian-German historical and cultural relations. In 2008 OOO “Deutsche Bank” announced the opening of a representative office in St. Petersburg. In 2010 the second representative office in St. Petersburg was established.

[68] The information is mostly retrieved from the bank’s homepage https://www.db.com/russia/index_en.htm in April 2013.

OOO "Deutsche Bank" entered the market by establishing *de novo* operations in order to acquire strong positions in investment banking. However, institutional context (historical, cultural ties) also accounts for the motives of its entry.

4.1.3.3. OAO "Rosbank Societe Generale Group"[69]

Societe Generale was founded in France in 1864 and is one of the leading international financial groups. It started operating in Russia in the 19th century and provided consulting services and financing of Russian companies. In order to expand its business in 1901 Societe Generele opened a branch in St. Petesburg (Severny Bank) that later emerged with Russian-Chinese Bank and as the result Russo-Asiatique Bank was established. In 1914 Russia-Asia Bank was the leading foreign bank in Russia. In 1917 the bank stopped its operations in Russia, and re-entered on the market in 1973. The short history outline of Societe Generale in Russia is presented in Table 4-3.

At present Societe Generale operates in the Russian market under the brand name OAO "Rosbank. Societe Generale Group" and includes ZAO "Rusfinance Bank" and ZAO "DeltaCredit Bank" as subsidiaries. Key business lines are retail banking and specialized financial services, corporate and investment banking, global investment management, and private banking. OAO "Rosbank" is the largest asset of Societe Generale Group outside France and is on the first place among Russian privately-held banks in terms of Tier 1 capital. OAO "Rosbank" is also in TOP 3 retail banks in Russia and second largest private bank in Russia in terms of retail network.

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[69] The information is mostly retrieved from the bank's homepage https://careers.societegenerale.com/groupe/en/discovering/an-international-network/xxx-30/societe-generale-in-russia.html in April 2013.

Table 4-3 Societe Generale Group in Russia

Year	Locally incorporated institutions in Russia
1872	First investments into Russian enterprises: forge and metallurgical works in Donetsk, French-Russian metallurgical works in St. Petersburg, shipyard construction in Nikolaeev
1910	Foundation of Banque Russo-Asiatique with the largest network in Russia (175 outlets)
1917	Termination of business in Russia
1973	Return to Russia, opening of representative office in Moscow
1993	Foundation of Banque Societe Generale Vostok (BSGV) – the first foreign bank to acquire the General License from the Central Bank of Russia
2003	Creation of BSGV Leasing and launch of retail banking services; BSGV becomes a universal bank
2004	Introduction of specialized subsidiaries: Rusfinance Bank (consumer loans) and ALD Automotive (car fleet leasing and management)
2005	Acquisition od DeltaCreditBank, one of the leaders on the Russian mortgage lending market
2006	Introduction of SOGECAP (insurance services); acquisition of 20% minority stake in Rosbank, one of the leading players in the Russian banking sector
2008-11	Gradual increase of the share in Rosbank (up to 82.4%); finalization of assets consolidation in Russia: • January 2011 – Rusfinance and DeltaCredit become 100% Rosbank subsidiaries • June 2011 – BSGV is merged with Rosbank • July 2011 – New united Rosbank starts operating
2012	140 years of Societe Generale presence in Russia

Source: Retrieved from https://careers.societegenerale.com/groupe/en/discovering/an-international-network/xxx-30/societe-generale-in-russia.html in April 2013.

The motivation of entry for Societe Generale Group historically changed, but the ambitions to continue business in Russia never faded. The initial entry mode was the establishment of a representative office and later its conversion into a subsidiary. In parallel with this, Societe Generale implemented strategic M&A and acquired a considerable stake in OAO “Rosbank” and ZAO “DeltaCreditBank.” The further course of actions were re-branding and change of strategy, that resulted in a merger of ZAO “Societe Generale Vostok” and OAO “Rosbank” and re-emergence of the group under the brand name of “Rosbank. Societe Generale Group.”

While there is some evidence in favour for the institutional context (historical ties, cultural proximity) that explain the motives of Societe Generale in Russia, the active M&A transactions of the Group in Russia clearly indicate the interest in the growing market opportunities (macroeconomic context) and original strategy of the group to establish strong positions in retail banking and corporate banking (microeconomic context). Nevertheless, institutional factors are presumably more accountable, as they shaped the entry mode strategy of Societe Generale Group in Russia.

4.1.3.4. Followers of the automobile business

Case studies on ZAO “Raiffeisenbank”, OOO “Deutsche Bank”, OAO “Societe Generale. Vostok” mostly revealed the role of the institutional context of Russia as the host country, however the institutional context of home countries also exerts an influence on the behavioral patterns of banks. This is particularly justified on the example of banks following the automobile business. There are there German banks (OOO “Mercedez Benz Bank RUS”, OOO “BMW Bank”, OOO “Volkswagen Bank RUS” and one French bank (OOO “Bank PSA Finance RUS”) both establishing *de novo* operations in the form of LLC, following their domestic automobile producers and primarily focusing on automobile loans. In other words, these banks “import” domestic institutions of their home countries and their strategy is different from automobile manufactures such as Hyundai (South Korea), Honda (Japan), Suzuki (Japan), Nissan (Japan), Mitsubishi (Japan) that prefer to establish finance programs with participation of Russian domestic banks, such as OAO “Sberbank”, OAO “Gazprombank” or other locally incorporated banks with foreign capital participation, such as ZAO “Raiffeisenbank”, ZAO “UniCredit Bank” and OOO “Rusfinance Bank” (subsidiary of OAO “Rosbank” which is acquired by Societe Generale Group). For German and French banks, as well as for ZAO “Toyota bank” (Japan) it is extremely important to maintain the finance programs within the Group in their host countries, therefore they prefer to “import” financial institutions from their host countries.

4.2. Activity of Japanese banks in the Russian market

4.2.1. Specific features of the banking system in Japan: home country specificity

Japanese banks actively conduct international businesses such as foreign exchange operations, lending, securities, trusts, leasing businesses, foreign currency, derivatives operations (future, swaps and options), trade finance and others. In the mid-1990s Japanese banks were reducing their overseas businesses as a part of their restructuring programs that resulted in a decrease of foreign branches of Japanese banks from 437 to 130 as the end of March 2006. However, some signs of recovery have been appearing recently. At the end of March 2009 it was reported that the number of overseas branches was amounted to 144[70]. Interest of Japanese business in BRICs economies is also an on-going process facilitating the entry of Japanese banks into these countries.

Japanese investments into the Russian economy have increased in recent years, though Japan is yet far from being the major foreign investor for Russia. According to the data of the Federal State Statistics Service (Rosstat) in 2010 the total volume of foreign investments from Japan amounted to approximately USD 1.1 billion, which is nine times higher in comparison to 2004. Majority of investments are in the form of other investments and trade credits, FDI are on the second place and portfolio investments are insignificant in number. The volume of accumulated Japanese investments in Russian economy in the end of June 2009 rose to USD 6.09 billion, almost by half in comparison to 2008. Nearly 80% of this amount are investments in oil production and refining, 3.4% – in forest and wood, 1.6% – in automotive industry, 2.6% – in the sphere of information and communication technologies.

[70] Retrieved from http://www.zenginkyo.or.jp/en/banks/principal/index.html in November 2012.

As for the financial sector, the share of Japanese foreign investments here is relatively low and amounted only to 2.36% in the total volume of Japanese investments into Russia in 2010[71].

Problems of foreign expansions are extensively covered in the existing literature in studies of Yamori (1997, 1998), Duser (1990), Hall (2009), Slager (2005), Marc Von Der Hur (2005), Wan, Hoskisson, & Kim (2008), Orr (1990) and others. In MNB theory Japanese banks are often regarded as a typical example of "following the customer strategy", while recently there are studies concluding that Japanese banks "lead" international business. Traditionally for Japanese banks, FDI in the manufacturing sector are considered to be the determinant factor in location choice of their financial institutions. Below we summarized several stages of development of foreign expansion of Japanese banks: post-war period, "flourishing" period of rapid growth in 1980s- early 1990; slow-down caused by domestic problems on the Japanese banking market; slow signs of recovery and new wave of expansion in late 1990s-early 2000s; present stage of expansion.

Though Japanese banks had their institutions established abroad even after the WWII[72] we start our analysis with the 1980s which are considered to be the flourishing years of Japanese banks' foreign expansion. Rapid foreign expansion during this period shifted Japanese banks in the center of attention in MNB theory.

The 1980s were the period of active expansion of Japanese banks. Duser (1990) states that "japanese banks are the winners in the process of internationalization, emerging as the biggest financial institutions of their kind in the world in the second part of the 1980s". During this period Japanese banks constructed worldwide operations

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[71] Author's calculation based on Rosstat data. The average share of Japanese investments into the financial sector in the total volume of foreign investments from Japan for the period 2004-09 amounted to 0.4%.

[72] In 1950-55 there were 13 branches, 3 subsidiaries and 4 representative offices of Japanese banks abroad, 1970 the number of overseas offices increased to 54, 37 and 125 accordingly.

and became very important players in several countries as well as on international financial markets. The primary question of interest is what were the driving forces behind motivations of Japanese banks that allowed them to establish such an extensive international network?

Duser (1990) states that deregulation of the Japanese financial system in parallel with growing "securitization" trend in financial markets and slow-down in economic growth fully explain motivations of Japanese banks during this period. Duser (1990) generally concludes that both PUSH and PULL reasons accounted for motivations of Japanese banks. Yamori (1996) analyzed activity of Japanese banks in the United States from 1951-94 and his result is generally consistent with the hypothesis that demand in the manufacturing sector was a crucial factor for Japanese banking FDI in the United States, but the author also found some reasoning that location of Japanese FDI was partially determined by local banking opportunities. During the 1980s positions of Japanese banks on the United States market were rather strong. Orr (1990) states that Japanese banks were in TOP 10 leading banks during this period, while American City bank was ranked only in the TOP 20. Sixty per cent of business loans on United States domestic market were provided by Japanese banks, 2/3 of which with the direct participation of Japanese banks. Orr (1990) identifies the driving forces of this extensive foreign expansion of Japanese banks by increasing volume of United States trade, growing consumption rates in the United States and excessive saving rates in Japan, generally favourable national treatment of Japanese banks in the United States, "*keiretsu system*"[73] and preferences of Japanese managers to retrieve banking services from compatriot banks with whom they have extesive relations in Japan. In his later study

[73] Orr (1990) argues that *keiretsu* representing a cozy relationship between banks and Japanese enterprises let banks participate in the growth management of their clients and provide below-market loan rates. Banks accumulate huge amounts of hidden assets on the books' acounts.

Yamori (1997) also highlights the idea that Japanese banks had financial resources superior to their competitors and by analyzing motivations of banks druing 1977-84 concludes that Japanese banks proved to be “followers” in Asia and Oseania where they had competitive advantages, “leaders” in the Middle East and “escaped” domestic Japanese regulations in order to penetrate to the United States markets. Yamori (1997) advocates for the idea that internationalization of Japanese banks and their expasnion to the United States and Europe in the 1980s was also driven by the motivation to learn new banking technologies. Duser (1990) also supports the idea that expansion of Japanese banks to Europe was driven by the aspiration to learn new technologies and acquire cheaper financing.

The situation drastically changed in the 1990s after the collapse of the bubble economy. This was a slow-down period of the so-called “Japan premium”, namely the situation when interest rates of Japanese banks were extremely higher than that of foreign banks. It became more difficult for Japanese banks to withstand the competition. In addition, many Japanese banks experienced the problem of non-performing loans and some implemented restructuring programs. As the result, many Japanese banks withdrew their international businesses from abroad and oriented on the domestic franchise[74]. Introduction of Basel principles put new barriers for Japanese banks as many of them experienced a problem of capital adequacy (Nozaki, 2008). Hall (2009) analyzed financial condition of japanese banks from 1995-2002 and conluded that “the performance of japanese banks was dire due to collapse of Japan’s assets price bubble and stagnation in the real economy”. Hall (2009) identifies years of net losses of japanese banking sector: 1995, 1997, 1998, 2001, 2002. Conversely to the behavior of banks, foreign expansion of Japanese companies was relatively moderate.

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[74] In 1994 53 Japanese banks had 373 branches and 361 representative offices in 36 countries, but the number of overseas offices was decreasing in the latter 1990s and beginning of 2000s.

In the latter 1990s and in the beginning of 2000s many Japanese banks could restore their financial stability and retrieved the competitive spirit. Nevertheless, the domestic demand for financing has not improved as it had been expected. As the result, domestic competition intensified and lead to the emergence of large banks (city banks) that actively started implementing foreign expansion. We refer to this period as “slow signs of growth” and “new wave of expansion,” whereby Japanese banks were pushed to search for new market opportunities abroad.

The present period of expansion is characterized by the following trends: redistribution of management resources of major European and American banks; shift to Asian markets, China in particular; growing interest in BRICs.

The first trend revealed after the financial and economic crisis of 2008 when many American and European banks bore severe losses and there were cases of investments into charter capital by Japanese banks that less experienced consequences of the crisis.[75] General level of trust toward Japanese banks increased, share of financing in foreign currency decreased opening opportunities for Japanese yen.

The shift to Asian markets is explained by various factors. Yukimoto (2002) names high profit expectations, growing presence of Japanese business in the region, relatively high level of trust to Japanese banks as the main driving factors of foreign expansion. Yukimoto (2002) points out interesting fact that while the general trend with overseas offices of Japanese banks during late 1990s and beginning of 2000s was negative, in case of China the number of branches, representative offices was actually increasing.

As for the BRICs countries, the volume of economic transactions with this region increased, therefore larger amounts Japanese companies show interest in the growing emerging markets where they can get high profits. Profitability is also a motivation for

[75] Mizuho Bank invested in Merill Lynch (United States) and Sumitomo-Mitsui Bank participated in the charter capital of Barclays Capital (United Kingdom).

expansion for Japanese banks. According to the Bank of Japan, loan balance of Japanese banks to BRICs as of March 2005 amounted to JPY 1.5 billion, 2/3 was invested to China. Japanese banks show interest in small and medium enterprises and some European companies operating in China and not simply "following" Japanese business.

The presence of Japanese banks is abroad yet an on-going process, but some researches point out that foreign business of Japanese banks is not sufficient enough (Nozaki, 2008). Japanese banks are strong at project financing and scope of syndicated loans in the Middle East and Europe and have leading positions in the region (SMFG, Mizuho FG), but inferior to competitors in the total level of advisory services on M&A. Foreign expansion of Japanese banks developed in several stages and at present it is shifted towards Asian and BRICs countries. Previous studies have shown that Japanese banks applied the "follow the customer" approach in expanding their international business, due to the fact that domestic banking system of Japan is based on the so-called "*main bank*"[76] system and extensive system of "*keiretsu*". This system of relationship banking provided access to extensive financial resources and increased assets of many Japanese banks and was considered to be the crucial factor in foreign expansion in the 1980s. The new wave of expansion of Japanese megabanks in the beginning of 2000s partially might be explained by these "market specificity" of the Japanese banking industry and business relations. Meanwhile, as viewed above there are some studies advocating for the change in behavioral patterns of Japanese banks, showing a shift

[76] The present literature is overwhelmed with definitions of the main bank system, but generally it is understood as a system of intensive relationship between the banks and the firms in terms of reciprocal shareholding, monitoring, providing information, managerial and banking services. The main bank is the largest single lender to its corporate client and its larger shareholder among other banks. This system emerged in Japan in the early period of uncertainty and difficulty following the World War II and grew rapidly in the high growth era. Aoki et al. defines the main bank system as a nexus of relationship comprising a multitude of financial, informational and managerial ties between the firms and their partner banks, a unique reciprocal relationship between the regulatory authorities such as Ministry of Finance or Central Bank. In their analytical study Aoki and Patrick (1994) explain the main bank system as an informal set of regular practices, institutional arrangement and behavior that constitute a system of corporate finance and governance.

towards local business opportunities in foreign countries. In Section 4.2.2 we consider the history of foreign expansion of Japanese banks and later on try to evaluate motivations of Japanese banks in the Russian market.

4.2.2. History of foreign expansion of the Japanese banks into the Russian market

The amount of investments accumulated by the Russian banking sector in the form of FDI is difficult to evaluate in the Rosstat statistics, therefore below we analyze Japanese investments into the banking sector through the activity of locally incorporated banks (domestic juridical entities) with Japanese foreign capital participation.

Table 4-4 summarizes the chronology of foreign out-in entry of Japanese banks into the Russian market. While generally the expansion of foreign banks from Japan is somewhat restrained in character in comparison to foreign out-in entry of banks from Europe or the United States, it is possible to define a few stages in penetration of Japanese banks into the Russian market.

The first wave started right after the collapse of the Soviet Union and can be characterized as a sort of *temporizing period* (1992-98). This is the period of formation of the banking regulation and banking sector of Russia as the whole when many foreign banks even from other countries were reluctant to penetrate the market. Representative office in Moscow of Tokyo Bank (1992) and representative office of Michinoku Bank in Uzhno-Sakhalinsk (1995) were established during this period for the purpose of gathering information on the market, legal framework of the banking sector and social, economical and political situation as the whole. Financial crisis of the 1998 can be regarded as a deterrent factor for entry. Despite the growing liberalization of the financial sector, the entry of banks was somewhat slow.

Table 4-4 History of foreign entry of Japanese banks into the Russian market

Year	List of Japanese banks and their domestic institutions in Russia
1992	Representative office of Tokyo Bank in Moscow
1995	Representative office of Michinoku Bank in Uzhno-Sakhalinsk
1999	ZAO Michinoku Bank (Moscow)
2002	Domestic branch of ZAO Michinoku Bank (Moscow) in Khabarovsk
2003	Domestic branch of ZAO Michinoku Bank (Moscow) in Uzhno-Sakhalinsk
8.2005	Representative office of Mitsui-Sumitomo Bank (Europe) in Moscow
8.2006	ZAO Mitsubishi-Tokyo UFJ Bank (Eurasia) in Moscow *(officially started the banking activity from 11.2006)*
10.2006	ZAO Mizuho Corporate Bank in Moscow *(Mizuho Bank (Japan) acquired 100% of shares of ZAO Michinoku Bank (Moscow), domestic branches of ZAO Michinoku Bank (Moscow) in Khabarovsk and Uzhno-Sakhalinsk were closed)*
12.2006	Representative office of Mizuho Bank *(officially started the banking activity from 2.2007)*
6.2007	ZAO Toyota Bank (Moscow) *(5 domestic branches of ZAO Toyota-Bank in St. Petersburg at present)*
4.2008	Representative office of ZAO Mitsubishi-Tokyo UFJ Bank (Eurasia) in St. Petersburg
3.2009	Representative office of Hokkaido Bank in Uzhno-Sakhalinsk
4.2009	ZAO Sumitomo Mitsui Rus Bank in Moscow
2.2010	SBI Holdings (Japan) acquired 50% of shares of Obibank (Russia)
9. 2012	Domestic sub-branch of ZAO Mitsubishi-Tokyo UFJ Bank (Eurasia) in Vladivostok

Source: compiled by author

The second wave of activity of Japanese banks in the market from 1999 – 2003 can be definitely marked as the *pioneer period* actively driven by a regional Japanese bank Michinoku. Michinoku was the first Japanese bank to open a subsidiary (locally incorporated banking institution) in Russia. The subsidiary ZAO "Michinoku Bank (Moscow)" was opened in 1999 as the result of 10 years lasting strong, cultural and regional ties between the Far East of Russia and Aomori Prefecture.[77] The subsidiary was established in Moscow under the pressure of Russian authorities, though initially the Management Board of Michinoku planned to established a subsidiary in the Russian Far East. For that purpose a representative office was firstly opened in Uzhno-Sakhalinsk in 1995 and Michinoku company's office was opened in Khabarovsk. The representative office gathered information about the market. The financial crisis of 1998

[77] Two regions established cultural and international exchange between citizens of the Far East and Aomori Prefecture. Charter flights were organized for tourists in summer; student exchange among junior high schools of both regions. As of end of 2000 more than 1800 Russian junior high school students visited Aomori and about 450 Japanese junior high school students visited Russia (Imai, 2004).

had low impact on the decision of Michinoku to establish a subsidiary in Russia and therefore ZAO "Michnioku Bank (Moscow)" was established as a 100% subsidiary by Michinoku Bank (Japan). In 2002 a branch of ZAO "Michinoku Bank (Moscow)" was opened in Uzhno-Sakhalinsk and Khabarovsk (2003). Having a reputation of a "Family Bank" in Japan, Michinoku on acquiring the license permitting operations with Russian citizens in 2001, started consumer-lending business (retail banking). In particular, it provided mortgage loans to Russian citizens. From 2003 ZAO "Michinoku Bank (Russia)" acquired permission to issue letters of credit to the participants of the Japanese-Russian trade. The bank also participated in financing Gazprom (Blue Stream Pipeline Company) and provided loans to OAO "VTB" (export of equipment from Japan to Russia). As Imai (2004) shows the success of Michinoku in the Russian market[78] was due to excellent management and personal sympathy towards Russia of the former chairman of the board of directors Mr. Daidoji; strategic move to make a breakthrough on the niche market different from rivals and decisiveness and managerial skills of the board of directors. The behavioral pattern of Michinoku Bank is an outstanding example of the impact of the micro-behavioral context. Notwithstanding these success points, the subsidiary of Michnioku in Moscow was acquired by Michinoku Bank and domestic branches in Khabarovsk and Uzhno-Sakhalinsk were closed.

In 2000s the Russian economy finally moved toward a relative stability and showed signs of high economic growth. Many foreign investors including Japan showed their interest in natural resource and manufacturing sectors. This fact facilitated the decision of foreign banks to enter in the market. Japanese banks were still going behind the financial institutions from other countries, but even though 2003-05 were years of

[78] Ratings of ZAO "Michinoku Bank (Moscow)": in terms of capital – 185th place; charter capital – 23d place; consumer lending – 22nd place; deposits – 17th; corporate lending – 24th place.

reevaluation of market opportunities and growing interest in the Russian market by Japanese business. During this time a representative office of "Mitsui-Sumitomo Bank (Europe)" was established in Russia (2005), two Japanese megabanks stepped into the Russian banking market mostly driven by their domestic clients who started business operations in Russia. Among the three megabanks the first one to start-up the banking activity on the Russian market was Tokyo-Mitsubishi UFJ. In August 2006 it obtained the license of CBRF and officially started its activity from November 2006. 100% of shares of ZAO "Mitsubishi-Tokyo UFJ (Eurasia)" belong to Mitsubishi-Tokyo UFJ Bank (Japan). At present the bank is mostly involved in providing finance to the corporate sector. Mizuho Bank also entered on the market in 2006 through acquisition of 100% of shares of ZAO "Michinoku Bank (Moscow)." Simultaneously, for the purpose of investigation of the Russian market it obtained the permission (2006) and opened a representative office in Moscow in February 2007. The decision of Toyota Group to establish a plant in St. Petersburg, growing boom of Japanese food and culture in Russia stipulated to some extent the further entry of Japanese business into Russia. Japanese banks traditionally oriented on their customers. Thus, Toyota Financial Group opened a subsidiary in Moscow in 2007. As of end 2007 349 Japanese companies operated in Russia, 2007-09 many Japanese automotive companies entered the market: Toyota (2007), Trad (2007), Isuzu (2008), Nissan (2009), Mitsubishi, Suzuki and others. Therefore, foreign entry of Japanese banks happens simultaneously with the expansion of Japanese business.

Japanese banks stayed on the market despite the global financial and economic crisis. After crisis years (2009-12) may be regarded as the *fourth wave* of out-in entry. The third megabank Mitsui-Sumitomo Bank that historically had three attempts to enter the Russian market finally established a locally incorporated banking institution in order to provide assistance to Japanese companies and consultation to Russian and European companies and business. New players such as SBI Holdings showed interest in the development of on-line banking in Russia and entered in the form of JV in 2010. Further expansion of Japanese automotive industry to Russia and recent economic development of the Far East under the guidance of the Russian government stipulated the decision of ZAO "Mitsubishi-Tokyo UFJ (Eurasia)" to establish a domestic sub-branch in Vladivostok in 2012.

To sum up, we conditionally define several stages of foreign entry of Japanese banks into the Russian market: temporizing period (1992-98); sole pioneering (1999-04); reevaluation of market opportunities and growing interest of Japanese business towards Russia (2005 – 08); post-crisis stage and emergence of new players (2009-12). Meanwhile, the entry of banks on all stages (except perhaps the sole pioneering one) was implemented in parallel with the entry of Japanese companies in the market. In the next section we consider the issues of motivation, organizational representation of Japanese banks in the Russian market, their entry modes and strategies.

4.2.3. Motivation, entry modes and strategies of Japanese banks

In this Section using the approaches of MNB theory we examine issues of motivation, organizational representation, entry modes and strategies of the Japanese banks on the Russian market. At first, by examing motivations for foreign out-in entry, we aim to define the driving forces that stimulate Japanese banks to go abroad (PULL/PUSH reasons).

Notwithstanding the fact that in scientific literature on foreign expansion of banks Japanese banks are often regarded as the typical example of the "follow the customer" strategy, there are research studies demonstrating that this tendency is not the sole one employed by them (Marc Von Der Hur (2005), Slager (2005)). As Table 4-5 demonstrates, in case of Russia "the follow the customer" approach is common for many Japanese banks, especially for the there megabanks. Thus, the so-called PUSH reasons are the major triggers for penetration of Japanese banks into the Russian market. Foreign entry of many Japanese companies stipulated the foreign entry of Japanese banks. This is often explained by the fact that Japanese banking system is a typical representative of *"relationship banking"*, e.g. through the specific features of the home country. The system herewith mostly refers to the relationship finance. Traditionally every large Japanese firm had a strong and often long-term relationship with one bank that served as its *"main bank"*. That bank implemented functions of firm monitoring, intervened in its governance through board appointments, acted as a delegated monitor for other creditors, and agreed to rescue the firm if it falls into financial distress. Nevertheless, some researches argue the sustainability of the main bank system, due to the fact that Japan deregulated its financial markets in the 1980s and as the result many Japanese firms prioritized market finance over their relational lenders (Miwa et. al, 2005). We do not argue the sustainability of the main bank system, but we do stress that it yet has a very strong impact on the Japanese domestic market (home country market), which proves to be one of the specific features of the Japanese banking sector as a whole. Therefore, in case of foreign expansion into Russia, the relation between relationship banking and the follower the customer approach is somewhat difficult to be neglected.

Meanwhile, in case of Michinoku Bank PUSH factors were strongly dependent on historical and non-economic issues as it was shown in 4.2.2.

Some Japanese banks were attracted to the Russian market as the result of high economic growth of Russia in the beginning of 2000s and its market potential, explaining the motivation of Japanese banks by PULL factors (macroeconomic context). SBI Holdings entered the market in order to start online banking operations, while Hokkaido bank established a representative office in order to search for the market potential (PULL) and provide consulting services to the Japanese companies considering foreign expansion into the Russian market (PUSH). The out-in entry of ZAO "Sumitomo Mitsui Rus Bank" is also not solely driven by PUSH factors.

Thus, motivations of Japanese banks in the Russian market are mostly explained by PUSH reasons and many Japanese banks in the market are initially regarded as *"followers."* ZAO "Toyota bank" is a typical example of the "follower" strategy that provides evidence on export of home country's institutions to Russia. They prefer to provide financial banking services only to the corporate sector of their domestic Japanese clients operating in Russia. There are few exceptions from this rule – the motivation for entry of SBI Holdings (on-line baking both for the corporate sector and retail banking), ZAO "Sumitomo Mitsui Rus Bank" and Hokkaido Bank. Needless to say, that motivations of the Japanese banks are likely to change over time. Domestic expansion of ZAO "Mitsubishi Tokyo UFJ Bank" that opened a representative office in St. Petersburg in 2008 and sub-branch in Vladivostok in 2012 is a good example to demonstrate this fact. Representative office of "Mitsui Sumitomo (Eurasia)" in Moscow aims to provide support and consulting services to European companies having connections with Russian business and Russian companies planning to attract finance from the international markets.

Table 4-5 Motivations, entry modes and strategies of Japanese banks on the Russian market

Name of the locally incorporated institution (organizational representation)	Main Japanese shareholders	Motivation of entry	Entry mode	Strategy
ZAO “Michinoku Bank (Moscow)” (1999) (CJSC)	Michinoku Bank (Japan) - 100% of shares	PUSH (micro-behavioral, historical, non-economic reasons)	Representative office, subsidiary, domestic branches	Organic growth
ZAO “Mitsubishi Tokyo UFJ Bank (Eurasia)” (2006) (CJSC)	Mitsubishi Tokyo UFJ Bank (Japan) - 99,999% of shares	PUSH (follower)/PULL	Representative office, subsidiary, domestic sub-branch	Organic growth
ZAO “Mizuho Corporate Bank “(2006) (CJSC)	Mizuho Bank (Japan) - 100% of shares	PUSH (follower)	Representative office, subsidiary	M&A
ZAO “Toyota Bank” (2007) (CJSC)	Toyota Kreditbank GmbH (Germany) – 99.75% of shares, Toyota Leasing GmbH (Germany) – 0.25% of shares (Toyota Financial Group (Japan))	PUSH (follower)/	Subsidiary	Organic growth
Representative office of Hokkaido Bank in Uzhno-Sakhalinsk (2009)	Hokkaido Bank (Japan)	PULL (macroeconomic context: market potential)	Representative office	-
ZAO “Sumitomo Mitsui Rus Bank” (2009)(CJSC)	Mistui-Sumitomo Bank (Japan) – 99.0% of shares, Sumitomo Mitsui Banking Corporation Europe Ltd. (UK)– 1% of shares	PULL (macroeconomic context: market potential)/PUSH (follower)	Representative office, subsidiary	Organic growth
ZAO “Obibank “(CJSC)	SBI Holdings (Japan) – 50% of shares; LLC Investment Financial company “Metropol” (Russia) – 46.49% of shares , individual shareholder – 3.51% of shares	PULL (macroeconomic context: market potential, investment and internet banking)	Joint-Venture (JV)	M&A (JV business)

Source: compiled by author

In terms of organizational structure, all Japanese banks that established locally incorporated banking institutions in Russia preferred to choose the closed joint-stock company (CJSC) type and almost in all cases distribute the shares among the parent banks located in Japan (Table 4-5). The exception is ZAO “Toyota Bank” whose main shareholder is a subsidiary of Toyota Financial Services located in Germany[79]. The example of ZAO "Toyota Bank" is somewhat interesting, due to the fact that this domestic subsidiary was established by the indirect-FDI or *"expansion under the third country's flag"* which is a relatively new issue in the theory of TNB (MNB).

Representative offices and 100% subsidiaries (locally incorporated banking institutions) were chosen by Japanese banks as the entry modes into the Russian market. Non-transparency of legislation regarding the property rights, difficulties in finding local partners, views on business in Russia through the "ownership=dominance" prism might be the reasons stipulating this choice. We refer to these restrictive factors as peculiarities of the host country (Russia). In general, the behavior of Japanese banks corresponds to the so-called *"organic growth"* strategy, but SBI Holdings established a JV with the Russian ZAO "Obibank" and Mizuho used M&A strategy as an entry mode for their out-in entry. Entry modes and organizational structure are similar to the ones employed by other foreign banks operating on the market, but European and American banks recently enter the Russian market using M&A strategic approach (Gorshkov, 2011b).

In short, Japanese banks are mostly driven by PUSH factors when entering into the Russian market as "followers" of their domestic clients. They tend to apply green-field investment scheme and establish 100% subsidiaries in the form of CJSC. Their behavior is explained by the "organic growth" strategy. Some Japanese players are attracted by the conditions of Russia as the host country (PULL factors) and establish trial businesses (ZAO "Obibank") or simply explore the market potential by establishing representative offices, which are non-banking locally incorporated institutions of Japanese banks. The import of Japanese institutions (home country institutional

[79] In this sense foreign investments from Toyota should be regarded as the German ones, but we consider them as indirect FDI, as Toyota Financial Services (Japan) is the parent bank for Toyota Kreditbank GmbH (Germany).

environment) is explicitly shown on the example of ZAO "Toyota Bank" that preferred direct participation in the market instead of establishing relations with domestic Russian banks specialized in auto loans business.

4.2.4. Economic and financial analysis of locally incorporated banks with Japanese capital

In the present section we briefly introduce economic and financial position of locally incorporated banks with Japanese capital. Based on the CBRF statistics, balance sheets of banks and statements on profits and losses, we analyze the dynamics of assets, liability, equity and net profit structure. We also show the position of Japanese banks in the total ranking of Russian banks.

Figure 4-1 shows data on assets, liabilities and equity structure. The amount of assets and liabilities generally fluctuates around RUB 12-25 million. ZAO "Toyota Bank" has the highest indicators, though in terms of equity it is considerably inferior to other banks (except JV ZAO "Obibank"). The amount of equity exceeds the minimum stipulated by the CBRF[80]. Nevertheless, when compared with some other banking institutions in Russia, positions of banks with Japanese capital are not comforting. In terms of rating in assets, the best positions belong to ZAO "Toyota Bank" (103rd place) and ZAO "Mitsubishi Tokyo UFJ" (134th place). Situation with the capital ranking is somewhat better with ZAO "Mitsubishi Tokyo UFJ Bank" being on the 50th place and ZAO "Sumitomo Mitsui Rus Bank" on the 63rd place. In any case, Japanese banks are inferior to some European and American banks (ZAO "Raiffeisenbank" is on the 11th place in terms of assets and on the 10th place in capital)[81]. Nevertheless, with almost

[80] For details refer to CBRF data, balance sheets of particular banks. For all Japanese banks as of 1 January 2012 the capital sufficiency coefficient was higher than the level stipulated by CBRF.
[81] For details on ratings refer to Table 4-7.

1000 banks operating on the market, these ratings of Japanese banks look rather satisfactory.

Table 4-6 Assets, liability, equity and profit of locally incorporated banks with Japanese capital (RUB thousand)

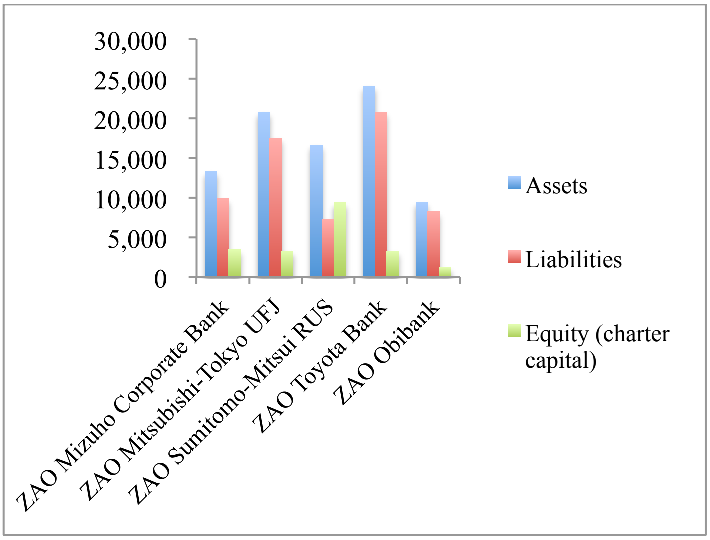
Banks	Years	Assets	Liabilities	Equity (charter capital)	Profit	ROA,%	ROE, %
ZAO “Mizuho Corporate Bank”	2011	13,312,032	9,864,640	3,430,829	16,564	0.12	0.48
	2010	7,509,100	4,078,271	3,430,829	27,275	0.36	0.79
	2009	3,420,102	2,016,547	1,403,555	35,942	1.05	2.56
	2008	2,849,159	1,526,546	1,367,613	35,284	1.24	2.58
	2007	2,574,587	1,242,680	1,331,907	65,241	2.53	4.90
ZAO “Michinoku Bank”	2006	2,479,193	1,218,360	1,260,833	60,425	2.44	4.79
	2005	2,451,873	1,254,818	1,197,055	39,800	1.62	3.32
ZAO “Mitubishi Tokyo UFJ Bank”	2011	20,788,228	17,520,835	3,267,393	170,875	0.82	5.23
	2010	15,480,731	12,384,212	3,096,519	38,705	0.25	1.25
	2009	14,236,516	11,178,703	3,057,813	396,512	2.79	12.97
	2008	13,676,653	11,015,351	2,661,302	32,992	0.24	1.24
	2007	2,582,135	2,129,629	452,506	-150,915	-5.84	-33.35
	2006	627,075	23,823	603,252	-138,688	-22.12	-22.99
ZAO “Sumitomo Mitsui RUS Bank”	2011	16,652,671	7,285,481	9,367,190	244,517	1.47	2.61
	2010	4,543,651	2,320,978	2,222,673	9,699	0.21	0.44
	2009	2,282,862	69,888	2,212,974	-87,026	-3.81	-3.93
ZAO “Toyota Bank”	2011	24,107,529	20,821,559	3,285,970	377,708	1.57	11.49
	2010	13,140,164	11,311,902	1,828,262	77,233	0.59	4.22
	2009	6,439,726	4,688,697	1,751,029	827,777	12.85	47.27
	2008	5,238,511	4,315,259	932,252	-370,435	-7.07	-40.12
	2007	1,372,419	107,903	1,264,516	-66,213	-4.82	-5.24
ZAO “Obibank”	2011	9,437,462	8,234,865	1,202,597	22,236	0.24	1.85
	2010	9,857,342	8,663,624	1,193,718	23,115	0.23	1.94
	2009	9,693,991	8,527,540	1,166,351	24,801	0.26	2.13
	2008	9,050,343	7,981,308	1,069,035	85,236	0.94	7.97
	2007	8,891,856	7,813,945	1,077,911	0	0.00	0.00

Source: Balance sheets of banks obtained from CBR, various years
* ROA (return on assets) and ROE (return on equity) are calculated by author

Net profit dynamics is shown on Figure 4-2. In general, the first operating year after the establishment of the banking institution in Russia was negative for almost all Japanese banks. For some banks, namely ZAO “Toyota Bank”, the negative trend continued even for 2 years fueled by the crisis in 2008. 2009 was rather positive year for many Japanese banks and they could maintain (ZAO “Obibank”, ZAO “Mizuho Corporate Bank”) and considerably increase (ZAO “Toyota Bank”, ZAO “Mitsubishi

Tokyo UFJ Bank") their net profits. In 2010 for almost all banks the negative trend continued due to the market fluctuations, but in 2011 the recovery trend was outlined. The structure of assets shows that Japanese banks provide loans to corporate sector and Russian banking institutions[82].

Figure 4-1 Assets, liabilities and equity of locally incorporated banks with Japanese capital (RUB, million) as of 1 January 2012

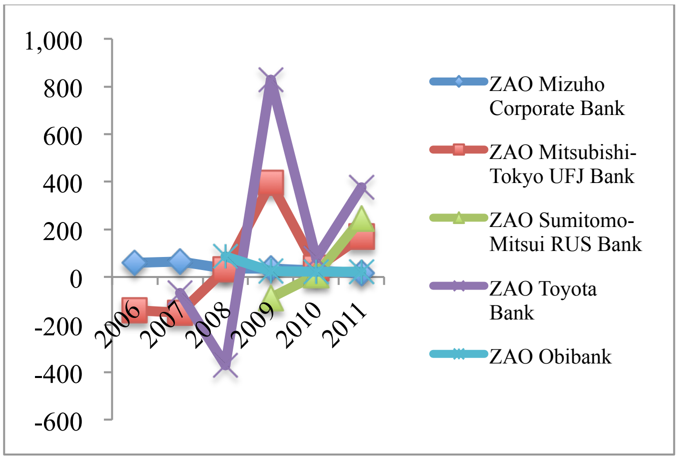


Source: compiled by author on the basis of CBRF statistics

Return on assets (ROA) and return on equity (ROE) for Japanese banks locally incorporated in Russia are calculated and presented on Figure 4-3 and Figure 4-4. ROA is generally reflecting the dynamics on assets and general trends more or less the same for all banks. Even when compared with ZAO "Raiffeisenbank" the ROA are on the same level and are in the range of 1-2.5% as of 1 January 2012 (for details refer to Table 4-1).

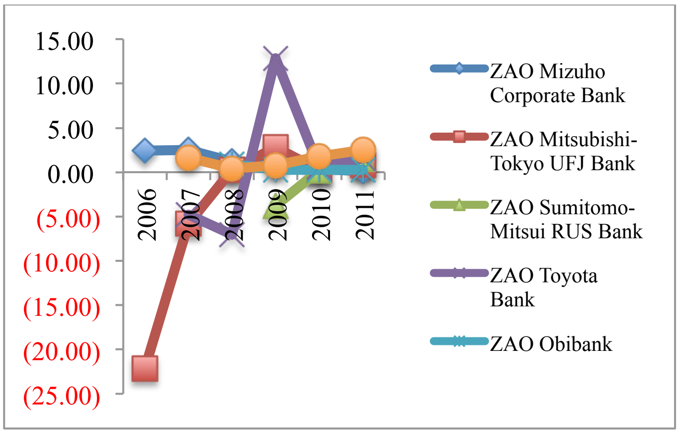
[82] For details see balance sheets of the specified banks.

Figure 4-2 Net profit of locally incorporated banks with Japanese capital (RUB, million) in 2006-11



Source: Same as Figure 4-1.

Figure 4-3 ROA of locally incorporated banks with Japanese capital and ZAO Raiffeisenbank (%) in 2006-11

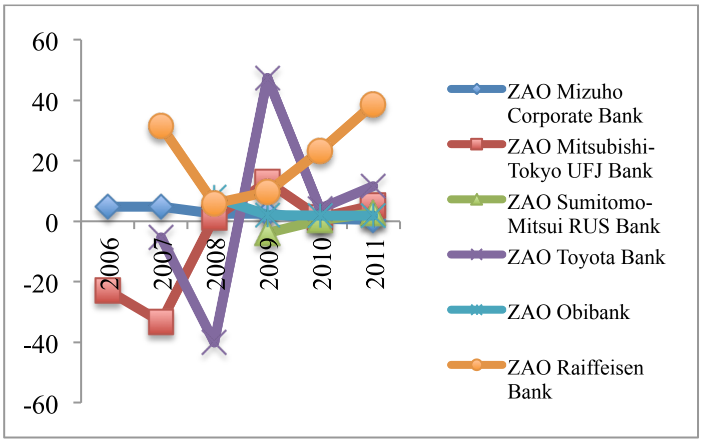


Source: Same as Figure 4-1.

The situation of ROE is slightly different. While it is yet possible to distuinguish similar trends in ROE dynamics, the gap with other foreign banks here is rather high - up to 30% (ROE of ZAO "Raiffeisennbank" is calculated for the purpose of a relative comparison).

Table 4-7 shows that Japanese banks are mostly engaged in corporate lending and do not prefer to work with the individual customers. Ratings in corporate lending for them are better than those for consumer lending or deposits. ZAO “Toyota Bank” is an exception here marking the 36th place out of almost 1000 in terms of consumer lending as of 1 October 2012. Retail business of ZAO “Toyota Bank” (providing automobile loans) stands behind this high-ranking results. Other Japanese banks obviously show no interest in retail business and deposit activity with their ranking positions fluctuating in the range of close to 900th place. This sounds extremely astonishing when compared with the leader on the Russian market among foreign banks – ZAO “Raiffeisenbank” that is marked 11th in terms of assets, 10th in capital, 11th in corporate lending, 10th in consumer lending and fifth in terms of deposits from individual households.

Figure 4-4 ROE of locally incorporated banks with Japanese capital (%) in 2006 – 11



Source: Same as Figure 4-1

Finally we look at the revenue structure of Japanese banks operating in the Russian market. Table 4-8 provides data on revenue structure in 2010-11. Majority of revenue origins from interest rates with only one exception - ZAO “Sumitomo Mitsui Rus Bank” which revenue structure is mostly based on commission. Income from foreign exchange operations and reevaluation of foreign currency is also significant in the total revenue structure, but with some negative outcomes for particular banks.

Table 4-7 Rating of locally incorporated banks with Japanese capital and ZAO "Raiffeisenbank" (place in the total rating) as of 1 October 2012

Bank	Rating (place) in				
	Assets	Capital	Corporate lending	Consumer lending	Deposits of individual households
ZAO "Mizuho Corporate Bank"	186	132	156	856	718
ZAO "Mitsubishi Tokyo UFJ Bank"	134	50	79	866	871
ZAO "Sumitomo Mitsui Rus Bank"	163	63	137	884	880
ZAO "Toyota Bank"	103	128	162	36	868
ZAO "Obibank"	242	227	298	307	N/A
ZAO "Raiffeisen Bank"	11	10	11	10	5

Source: Retrieved on 20 November 2012 from http://bankir.ru/rating

Table 4-8 Revenue structure of locally incorporated banks with Japanese capital (RUB, thousand)

Bank	Net Profit		Interest revenue		Comission revenue		Income from foreign exchange operations		Income from reavaluation of foreign currency	
Years	2010	2011	2010	2011	2010	2011	2010	2011	2010	2011
ZAO "Mizuho Corporate Bank"	27,725	16,564	158,174	290,410	24,334	59,191	42,002	50,777	3,219	-2,807
ZAO "Mitsubishi Tokyo UFJ Bank"	38,705	170,875	399,482	503,458	33,138	53,974	-110,051	-18,302	172,556	146,04 2
ZAO "Sumitomo-Mitsui RUS Bank"	9,699	244,517	87,307	304,146	371,636	609,534	3,780	-9,123	2,985	19,716
ZAO "Toyota Bank"	77,233	377,708	1,092,565	2,336,065	1,288	1,378	2,274	12,122	-1,457	-1,856
ZAO "Obibank"	23,115	22,236	677,779	628,390	22,042	28,086	-5,024	105,897	-10,394	- 36,768

Source: Compiled by author, P/L of banks retrieved from CBRF (2010, 2011)

To sum up, the scope of activity of locally incorporated Japanese banks in Russia is not that high. Japanese banks are inferior to some other foreign banks operating on the market. The analysis on revenue structure and dynamics of assets and liabilities showed that many Japanese banks are engaged in corporate lending mostly to the Japanese companies operating in Russia and crediting Russian banking institutions. Retail business and deposit activity are not priority vectors of development on the Russian market for the Japanese banks. Therefore, the scope of activity generally corresponds to the initial motives for entry.

4.3. Summary

Chapter 4 presented case studies on European and Japanese banks operating in the Russian market. The case studies on these two regions are of some interest due to the following reasons: 1. Europe is the largest region where parent banks are located; 2. European banks prove to be the most successful players on the market; 3. Japan has the largest number of banks from Asia that operate in the market; 4. Both Japan and Europe are a good sample to provide evidence on the role of the home country's environment.

In case of European banks, we identified main players from Austria, Germany and France and highlighted the fact that banks from these countries having physical presence in Russia are very successful players due to the early "first move". Analysis showed, that the key players on the Russian market have deep historical and cultural relations with Russia, with many banking activities dated to the 19th century. In a sense, there is a confirmation of the so-called institutional context (historical, cultural ties; geographical proximity) behind motives of these banks in Russia. However, some banks, such as ZAO "Raiffeisenbank" followed the Group strategy in the region of Eastern Europe and CIS, and therefore their behavior is influenced by the micro-behavioral context. In addition, we discussed the issue that motives for European banking FDI are subject to change with the general improvement of macroeconomic situation in Russia (macroeconomic context). The role of home country's context was justified on the example of German and French banks that "follow" automobile manufactures from their home countries and do not establish business relations on financial programs with local Russian banks specializing in auto loans business. The same is true for ZAO “Toyota Bank” that established its own financial services and not following strategy of Honda, Mitsubishi, Suzuki, Nissan and Hyundai that preferred to arrange automobile loans for their products with leading Russian domestic banks in the auto loan business – OAO “Sberbank”, ZAO “VTB24”, OAO “Gazprombank”. An interesting finding is also the fact that these automobile manufacturers arranged financial programs with the support of other locally incorporated banks with 100% foreign capital participation, namely ZAO “Raiffaisenbank” (Austria), ZAO “UniCredit Bank” and OOO “Rusfinansbank” (France).

As for the Japanese banks, we analyzed the history of foreign entry of Japanese banking capital into the Russian market and conditionally defined a few stages of foreign entry. We also raised issues with motivations, organizational representation, entry modes and strategies of Japanese banks. The shares of Japanese banks in total banking assets, deposits and lending rate of the Russian banking sector remain low, most Japanese banks in Russia are “followers” of the business of Japanese companies. Meanwhile, there are exceptions from this rule in the behavioral patterns of the Japanese banks. As it was shown in the paper, motivations of entry for Japanese banks are mostly explained both by PUSH factors. These include the “follow the customer” approach, historical and cultural reasons, and decisions on foreign strategy of particular banks. Nevertheless, motivations for entry like high profitability of the market, searching new market niches, consumer lending business, providing services to the domestic banking, and non-banking clients and others comprise the so-called PULL factors (macroeconomic context).

Our main argument is that in case of Japanese banks both the market specificity (relationship banking, main bank system) of the home country (Japan) and host country (Russia) to some extent plays an important role. Barriers existing in the banking sector of Russia and Russian economy as the whole stipulated the choice of organizational forms such as CJSC and form of entry as organic growth strategy rather than the M&A approach. Japanese market specificity to some extend predefined the limited scope of activity on the Russian market. As the matter of fact, these home and host country specificities are conditional ones. Nevertheless, they allow explaining the differences among the foreign entry of banks from other home countries.

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5. FOREIGN EXPANSION OF RUSSIAN BANKS: IN-OUT EXPANSION CASES

Chapter 5 will focus on activities of Russian banks abroad. We highlight the importance of MNBs theory in explaining the issues with Russian banks' foreign expansion; however, we are not advocating for its full acceptability. Therefore, we selectively, not comprehensibly, use the approaches of MNBs in exploring the activity of Russian banks abroad. In particular, we aim to summarize and re-assess the existing literature on motivation, entry modes, organizational representation, and strategies of Russian banks abroad. Using the approaches of MNB theory we aim to define the driving forces that motivate Russian banks to go abroad (PULL/PUSH reasons) and stress that behavioural activity of banks cannot be fully explained within the framework of the existing literature on MNBs. We highlight that the institutional context plays a crucial role in the foreign expansion of Russian banks and consider idiosyncratic features of Russia as the home country.

The chapter is divided into five sections. Section 5.1. analyzes the dynamics of OFDI of the Russian banking sector. Section 5.2. deals with motivation of the Russian banks in expanding their businesses abroad. In Section 5.3. we outline entry modes and strategies of Russian banks in foreign markets and provide short case studies on foreign expansion of OAO “Sberbank”, OAO “VneshTorgBank” (VTB), and Alfa-Bank. Section 5.4. summarizes the major problems in the foreign expansion of Russian banks and shows the idiosyncratic features of Russian MNBs. In Section 5.5. we summarize the major ideas of each section and conditionally propose some revisions to the existing MNBs theory.

5.1. Outward investments of the Russian banking sector

The role of emerging economies, especially the BRICs (Brazil, Russia, India, and China), in the export of capital has increased in recent years. This phenomenon is mostly explained by the growing liberalization process in these countries, especially in the financial sector. Generally speaking, this group of countries became more open, successfully implemented financial and capital markets reforms, and adopted measures for integrating their national economies into the global financial system. From simply being importers of capital, they have now become the sources of foreign direct investment (FDI) (Shishkina, 2011; Shavshukov, 2012). In accordance with UNCTAD statistics, with respect to overall global outward foreign direct investment (OFDI), Russia[83], following China, has the biggest share, which in 2009 was 4.1%[84].

The total share of BRICs in the export of capital is only 5%, but the absolute volume of outward FDI from these countries increased by 12 times over the last 15 years (Kuznetsov, 2012, p. 3). While the statistics on Russian FDI have their own peculiarities [due to methodological issues[85] there are considerable discrepancies in the volume of both inward foreign direct investment (IFDI) and OFDI in the data provided by the CBRF and the Russian Federal State Statistics Service (Rosstat)], we mostly rely on CBRF data[86] in this dissertation.

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[83] Majority of OFDI in CIS region come from Russia (USD 362.1 billion OFDI stock in 2011). Other countries exporting FDI include Kazakhstan (USD 19.9 billion), Ukraine (USD 0.5 billion), Azerbaijan (USD 3.7 billion). For details see Kvashnin and Kuznetsov (2013, p. 49). Generally, there is a neighboring effect among CIS countries in allocation of foreign investments.

[84] UNCTAD (2010), p. 6. For instance, Russian outward FDI in 2004 was USD 13.9 billion; USD 12.8 billion in 2005; USD 20 billion in 2006, USD 56 billion in 2008, and 46 billion in 2009. The general trend is positive.

[85] The amount of accumulated inward FDI in 2010 was USD 369.1 billion (15% less than preliminary calculations). So-called reinvestments (return of Russian capital in the form of FDI) are also calculated in CBRF statistics. Affiliated businesses of Russian companies are registered in offshore regions (Cyprus, British Virgin Islands, and Bermuda) and are the main sources of these so-called pseudo-FDI (for further details refer to Kuznetsov, 2012, 2012b; Kheyfets, 2008). Kalotay (2005) distinguishes legal FDI (including investments in oil tankers), pseudo-FDI (mainly round-tripping FDI via Cyprus, other offshore centres, and some other categories of investments), illegal FDI, and other forms of "capital flight". The general scheme of capital flow in Russia is presented in Figure EXN-1 (Explanatory Note 1).

[86] For the purpose of comparison some data from Rosstat and UNCTAD is also being used.

As of January 2012, total assets of the Russian banking sector abroad were USD 215 billion. The breakdown of the assets was as follows: other investment (78.9%), portfolio investment (15.6%), OFDI (3.2%), and financial FDI (2.3%). Therefore, the majority of Russian outward investments in the banking sector are in the form of trade credit and intra-banking loans. This is typical for the whole international investment position of Russia. The relatively low share of OFDI seems to be astonishing at first sight, in a sense indicating low-motivation of Russian banks to expand their business abroad. However, in comparison to 2005, FDI from Russia in the banking sector increased 8 times, which is a significant increase. Below we consider how the increase in banking OFDI is related to the activity of Russian banks abroad.

Table 5-1 below demonstrates the OFDI dynamics of both banking and non-banking corporations (balance of operations) from 2007– 11. In general all indicators (FDI from Russia, participation in capital, reinvestments of earnings, and other capital) show positive growth dynamics. The only exception is the crisis year 2008–09, when there was a slump in all types of outward investments of the banking sector. Outward investments abroad (non-CIS region) significantly exceed those to the CIS region. Major destinations of OFDI in 2011 are also presented in Table 5-1. The majority of all investments are directed to offshore zones[87] (Cyprus, British Virgin Islands, St. Kitts and Nevis, Bermuda, and Gibraltar), which reflects the general situation with Russian IFDI and OFDI[88]. The capital is circulated through offshore (tax haven) territories in order to avoid taxation and regulation in the domestic market (capital flight[89]) or simply to attract cheaper financing (Mizobata, 2011; Kheyfets, 2011).

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[87] Offshore regions are major destinations of Russian banking OFDI due to the existence of so-called tax havens there.
[88] General situation with Russian IFDI and OFDI is presented in Explanatory Note 1 of the dissertation.
[89] CBRF statistics classifies "dubious transactions" plus errors and omissions, which can be regarded as "capital flight". This presumably applies to funds moved abroad in order to launder criminal earnings or to evade (legally escape) taxation (for details see Hanson, 2010).

Table 5-1 Outward investments of the banking sector and non-banking corporations in 2007—11 (million USD), balance of operations

Years	2007	2008	2009	2010	2011	Main destinations in 2011 (share in total investments, %) TOP 5 destinations for both non-CIS and CIS
FDI	45,897	55,540	43,632	51,886	67,221	Cyprus (33.3%), Netherlands (14.7%), St. Kitts and Nevis (6.9%), British Virgin Islands (6.2%), Luxemburg (6.2%), Switzerland (5.8%), Belorussia (4.8%), Ukraine (1.2%), Kazakhstan (0.95%), Uzbekistan (0.14%), Armenia (0.09%)
Non-CIS	42,423	51,977	39,734	50,618	62,748	
CIS	3,473	3,563	3,898	1,268	4,473	
Participation in capital	17,770	29,355	26,823	19,620	23,255	Cyprus (19.4%), Belorussia (11.1%), Switzerland (10.3%), Luxemburg (6.7%), Turkey (4.9%), Australia (4.8%), Germany (3.8%), British Virgin Islands (3.6%), Spain (3.6%), Ukraine (1.8%), Kazakhstan (0.9%), Armenia (0.27%), Uzbekistan (0.12%)
Non-CIS	16,338	26,930	23,940	18,675	19,950	
CIS	1,382	2,425	2,883	945	3,305	
Reinvestment of earnings	16,667	24,654	7,571	14,049	15,831	Cyprus (55.8%), British Virgin Islands (14.8%), Gibraltar (7.4%), Bermuda (4%), Kazakhstan (2.4%), Germany (2.32%), Ukraine (1.3%), Belarus (1.03%), Uzbekistan (0.4%)
Non-CIS	15,775	23,780	7,103	13,462	15,008	
CIS	902	874	468	587	823	
Other capital	11,450	1,532	9,238	18,216	28,136	Netherlands (34.7%), Cyprus (34.6%), St. Kitts and Nevis (16.9%), Switzerland (5.4%), UK (4.6%), Ukraine (0.75%), Kazakhstan (0.22%), Belarus (0.21%), Tajikistan (0.17%)
Non-CIS	10,259	1,269	8,692	18,481	27,792	
CIS	1,190	263	546	-264	344	

Source: compiled by author. Retrieved in September 2012 from www.cbr.ru

Needless to say, the CBRF statistics include illegal investments and pseudo-investments, for example, one-day companies and illegal establishment of juridical entities. The weight of the CIS region in the distribution of both total FDI and OFDI is also significant, with Belorussia, Ukraine, and Kazakhstan being prominent[90]. As demonstrated below, for the banking OFDI, geographical, historical, cultural, and

[90] In general CIS and EU are main recipients of Russian FDI. The share of CIS is about 30%, but more than 80% of these investments are concentrated in three neighboring countries (Ukraine, Kazakhstan, and Belarus). The share of EU is almost 40%, with offshore regions dominating in this segment. Thus, Russian investments are distributed in accordance with the so-called “neighboring effect” (for details see Kuznetsov, 2008; Kvashnin and Kuznetsov, 2013).

institutional proximity plays an important role. In other words, banks prefer to invest in countries where they already have contacts and can easily form business networks.

The role of offshore business is astonishing. Instruments of other investments are mostly used as speculative mechanisms, methods of legal "capital flight" of Russian companies abroad or simply intra-banking loan and deposit activities. For the analyses of motivation and entry modes of Russian banks expanding their businesses abroad we focus on OFDI, that is, banking institutions established by Russian banks abroad.

5.2. Motivation of inward-outward expansion

To start our analysis we briefly consider market specificity of the home country (Russia). This will allow us to understand the conditions under which the expansion of Russian banks abroad is taking place. In the former USSR, banks were established by the state for implementing particular functions in the major industries of the economy. This has resulted in a very high concentration level of the current banking sector (Panibratov and Verba, 2011). The Russian banking sector has some idiosyncratic features[91] that exert an influence on the foreign expansion of its banks.

The Russian banking landscape was highly fragmented at the end of 2000. Some researchers show that there has been a rapid increase in banking and financial services in Russia during 2000–08 (Panibratov, 2010). The diversification of banking and financial products as well as further liberalization and integration of the banking sector continues. There were 982 banks operating in Russia as of 1 January 2012 and even the

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[91] We analyzed those in Chapter 2 and identified the following: 1. strong government participation; 2. strong linkages of some banks with financial industrial groups; 3. the function of converting deposits into investments is not working effectively (companies tend to issue bonds or attract capital from foreign markets; 4. concentration towards large banks with the existence of many small banks; 5. difficulties with attracting long-term borrowings; 6. low share of loans in GDP (Germany – 108%; United Kingdom – 105%; Ukraine – 76%; Russia – 40% (corporate loans – 30%, retail and consumer banking – 10%)); 7. the revenue structure of banks is unbalanced (revenues from foreign exchange operation are considerably high; 8. high interest rates; 9. low level of capitalization; 10. low productivity (assets/number of employees) of the banking sector (Ireland – 35.1%; Netherlands – 24.1%; Poland – 28.5%; Russia – 1%); 11. low level of return on equity (ROE) (Brazil – 28.9%; Indonesia – 28.5%; Russia – 22.7%); and 12. increasing presence of foreign banks. For details see our earlier work. For details on idiosyncratic features 6, 9, and 10 refer to Vedev&Grigoryan (2011).

largest private banks had less than 4–5% of the market. In turn, state-owned banks held about 50% of the market[92]. On the other hand, foreign banks had only about 10% in 2009 (Panibratov, 2010) but their share in total assets, capital, deposits, and lending shows stable growth.

"Technology in the Russian banking sector was somewhat simplistic, with corporate loans usually extended against collateral rather than against forecast cashflows. Fee-based products played a negligible role, rendering many Russian banks overly dependent on interest and trading income" (Panibratov, 2010). The distortion of the market represents opportunities for some foreign banks and simultaneously there are cases of Russian banks aiming to internationalize their business by opening subsidiaries in neighbouring countries.

The large number of Russian bank-like institutions and their special functions indicates that the Russian banking sector has not reached a high level of maturity in servicing its clients either domestically or abroad. Therefore, it is understandable that the foreign activities of Russian banks abroad are rather limited (Jumpponen et al., 2004).

However, by the time of the collapse of the former USSR, banks were in a leading position in outward investments. In 1991, OFDI from the banking sector was USD 2–10 billion, while total share in capital of foreign banks amounted to USD 540 million. Therefore, a few banks (namely OAO "Sberbank", OAO "VneshTorgBank", and VneshEkonomBank) in some cases simply inherited the banking assets of the Soviet

[92] Share in banking assets of Top-5 banks (including OAO "Sberbank", OAO "VTB", OAO "Gazprombank", OAO "VneshEkonomBank", and OAO "Rossselhozbank") was 49.6% as of 1 January 1 2012. They also account for the majority of deposits and lending. Retrieved in April 2013 from www.cbr.ru.

foreign banks (as the government transferred its credit institutions and shares in foreign banks to them).

Before analyzing the motivation of inward-outward foreign expansion of Russian banks we briefly introduce the geographical representation, entry modes, and strategies (where applicable) of Russian MNBs in Table 5-2.

The CIS region and Western Europe can be identified as the major destinations where Russian banks establish their affiliated credit and financial institutions. Top Russian banks, namely OAO "Sberbank", OAO "VTB", OAO "Gazprombank", and OAO "Alfa-bank" established their subsidiaries and representative offices there. In the CIS region, the most popular destinations are Ukraine, Belarus, Kazakhstan, and Armenia; while in Europe, Russian banks are mostly represented in the U.K., Luxemburg, Austria, Germany, and Cyprus. However, the presence of Russian banks is very limited, and in most cases, there are no extensive branch networks. Banks registered in offshore regions (Cyprus) or countries with simplified tax systems[93] (Netherlands, Luxemburg) are mostly geared to work with Russian capital going abroad. The astonishing fact herewith is that the major destinations of Russian banking OFDI are not identical. The category "other investments" tends to be concentrated in offshore regions, while direct representation of banks in the form of subsidiaries and representative offices is salient in the CIS and EU regions. However, banks like OAO "VTB", ZAO "Promzsvyazbank", ZAO "MDM Bank" have subsidiaries in Cyprus.

[93] So-called SPE (special purpose entities). *World Investment Report* (2012).

Table 5-2 Geographical representation of Russian banks abroad

Bank	Major destinations	Entry modes	Strategy
OAO "Sberbank" (state-owned)	CIS, Eastern Europe, China, India (branch), Germany	Subsidiaries	Expanding subsidiary network via green-field, brown-field investments, mostly major deals supported by the government
OAO "VneshTorgBank" (VTB) (state-owned)	Subsidiary banks in Ukraine, Armenia, Georgia, Belarus and Azerbaijan; banks in UK, France, Austria, Germany, Cyprus, Switzerland, Angola, Singapore, India; financial company in Namibia. Representative offices in Italy, Kazakhstan, Kyrgyz Republic, China, Vietnam; Shares in Donau-Bank (Austria), East-West United Bank (Luxemburg), Ost-West Handelsbank (Germany), Russian Commercial bank (Cyprus)	Subsidiaries, branches, representative offices	Widest network of foreign presence. Expansion strategy is driven by both bank's management and government as the main shareholder
OAO "Alfa-Bank" (private)	Subsidiaries in Kazakhstan, Netherlands (full European banking license), United States, Luxemburg, UK; branches in CIS (Ukraine)	Subsidiaries, purchase of major shares	Careful expansion via greenfield/brownfield investments into CIS or developed markets without state support, hence the affinity to maximizing control
OAO "Gazprombank" (indirect government control)	Branches in Armenia, Belarus, Switzerland; representative offices in China, Mongolia	Branches, representative offices	Clearly biased towards parent company interests in gas industry and portfolio investments
ZAO "Promsvyazbank"	Cyprus, Kyrgyzstan	Subsidiaries	
ZAO "Petrokommerz" (79.3903% of shares belong to Reserve Invest Holding (Cyprus)	Subsidiaries in Ukraine	Subsidiaries	Petrokommerz holds 96.48% of shares in Petrokommerz (Ukraine). Mainly engaged in corporate banking and serving employees of corporate companies
Bank of Moscow	Belarus, Latvia, Estonia, Serbia	Subsidiary	VTB is the main shareholder of Bank of Moscow (94.87%)
Moscow Industrial Bank	Austria	Representative office	N/A
Centrocredit	UK	Representative office	N/A
Krasbank	UK	Representative office	N/A
Rosbank (Russia, France)	Switzerland, CIS	Subsidiary	Rosbank is at present owned by Societe Generale (France)
MDM Bank	Cyprus	Subsidiary	

Source: compiled by author with references to Kuznetsov (2007, 2008, 2009, 2010a, 2010b, 2011, 2012), Jumpponen (2004), Ivanov (2009), Panibratov (2010, 2012), Panibratov and Verba (2011) official information of banks, homepages of banks, *Profil*, No.11, 2013, p. 10-11, Another interesting feature is that expansion abroad is mostly driven by the largest state-owned banks (or banks with a strong direct or indirect state influence like OAO "Sberbank", OAO "VTB", and OAO "Gazprombank", which underscores the view that only banks that possess significant financial resources (sometimes in the form of government assistance) can "go global". Among private banks, only Alfa-bank has the widest foreign network, with representation in the CIS, Europe, and the United States Asian and African regions are not major destinations for Russian banks as trade and investment relations with these countries are less developed. OAO "VTB" has the leading position here, as it has the most diversified foreign geographical network among Russian banks. Some other private banks (ZAO "Promsvyazbank", ZAO "Petrokommerz", and Centrocredit) also try to establish their businesses abroad driven via industrial financial groups that are closely connected to them.

The existing literature on the motivation of Russian banks (and MNCs) is rather extensive. Table 5-3 briefly summarizes the key motives that drive Russian banks to go abroad. We attempt a simple PUSH/PULL analysis here.

The motivations behind inward-outward foreign expansion are diverse. In general, many studies name geographical, historical, and economic proximity to the CIS as the major driving force behind Russian banks establishing their businesses there. We summarize these factors within the institutional context. Many Russian TNCs operate in the region; therefore, Russian banks are pushed to penetrate here in accordance with the "follow the customer" strategy applied in the theory of MNBs (microeconomic context). The same is partially true with respect to the European countries. Russian banks tend to establish their presence hereby in order to serve the interests of large Russian industrial financial corporations mainly in mining, metallurgy, crude oil, and gas sectors. Close trade relations with the CIS and Europe (both regions account for about 70% of total

Russian trade) also create favourable conditions for inward-outward expansion (the institutional and macroeconomic context).

Table 5-3 Motivation of foreign entry

Motivation	PUSH/PULL	Example of banks
Growing interest to CIS, similarities in transformation process of the banking sector, potential of growth. Expansion on already existing directions	PULL (macroeconomic, institutional context)	Sberbank, Vneshtorgbank (VTB Austria, VTB France, VTB Deutchland, Russian Commercial Bank Ltd).
Providing services to companies in post-Soviet region (“follow the customer”) and Europe	PUSH (microeconomic context)	Vneshtorgbank, Promsvyazbank, Gazprombank, International Bank of St. Petersburg
Acquisition of low-estimated assets in CIS	PULL (macroeconomic context)	Sberbank, Vneshtorgbank
Presence in international financial centres of EU and CIS	PUSH /PULL (microeconomic context)	Alfa-Bank, Vneshtorgbank
Expansion as the result of the domestic environment in Russia (state pressure, non-transparent legislation, political and economic instability, M&A as a way to keep distance from government intervention)	PUSH (institutional context)	N/A
Competitive advantages on the CIS market; cheap financial resources in CIS	PULL/PUSH (microeconomic, macroeconomic context)	Ukraine – Alfa-Bank, VTB, Sberbank; Belorussia – VTB, Gazprombank; Kazakhstan – Sberbank, Alfa-Bank; Georgia – VTB; Armenia – VTB, Gazprombank

Source: made by author with references to Kuznetsov (2007, 2008, 2009, 2010a, 2010b, 2011, 2012), Panibratov (2010, 2012), Panibratov and Verba (2011), Kalotay and Sulstratova (2008), Filippov (2008), Jumpponen J. et al. (2004); official information of banks; homepages of banks

Table 5-4 Dynamics of assets and capital in CIS region controlled by investors of the region, million dollars

Year	Intraregional investments into the banking capital of CIS	Assets of banks controlled by investors from CIS
2005	384.2	2,355.5
2006	1,034.4	7,949.8
2007	2,354.1	16,552.9
2008	4,035.5	26,771.2

Source: Abalkina, 2010, p. 30

At the end of 2005, there were 1,600 banks in the CIS region but their financial resources did not allow them to actively pursue economic integration. 77% of these banks were based in Russia (Murichev, 2006).

Foreign expansion of banks in the CIS region has intensified. At present, there are 30 credit institutions in the CIS with their home countries located in the CIS region. Needless to say, Russia is a prominent investor in the region. As of end-2008, there were 60 banks with capital from CIS countries (Abalkina, 2010).

At the initial stages of internationalization banks tended to use the so-called “follow the customer” expansion strategy (PUSH factor, microeconomic context). Banks provided services to their clients expanding their businesses in the CIS region. Today the situation has changed, and the motives of penetration into the CIS region have diversified. Banks have shown an interest in foreign stock markets; for example, Russian banks were attracted by the low level of capitalization of Ukrainian banks (macroeconomic context).

Expansion of Russian banks into CIS should also be considered from the viewpoint of host countries. Difficulties with expanding businesses to the developed countries (for example, institutional barriers of entry, regulations on charter capital, difficulties with competition) and competitive advantages in CIS motivate the penetration of Russian banks into this region.

Intra-regional investments into the banking sector within CIS increased 10 times (Table 5-4), with Russia having the most prominent position. Russian banks actively penetrate by M&A due to the abundance of undercapitalized banks in the region. The major investors into the CIS banking sector in 2008 were: Russia – 65% (29 affiliated banks, mostly Ukraine, Belarus, Kazakhstan); Kazakhstan – 30% (20 affiliated banks, mostly Russia); Ukraine – five affiliated banks; Georgia and Azerbaijan – two banks each; Uzbekistan and Armenia – 1 bank each (Abalkina, 2010). The biggest players in the market are undoubtedly Russian, as demonstrated in Table 5-5, with OAO "VTB" being the most active.

Table 5-5 Biggest Russian TNBs in CIS region in 2008

Bank	Total assets, million USD	Total capital, million USD	Number of subsidiary banks in CIS
VTB	4,887.9	520.1	5
Alfa-Bank	4,608.3	521.9	3
Vneshekonombank	4,283.1	621.3	2
Sberbank	1,436.0	422.6	2
Moscow Bank	945.7	110.2	2
Gazprombank	790.9	160.4	2
Rosbank	494.1	31.7	1

Source: Abalkina, 2010, p. 32

Thus, Russian banks view CIS as a potential emerging market (Panibratov, 2012), where there is a high demand for financial services (PULL, macroeconomic context). However, we argue that this motive does not fully explain the behaviour of Russian banks here. Market specificity of host countries does matter but the Russian banking system lacks capital; the total level of capitalization is rather low, and therefore, it is difficult for the banks to go abroad. Only large state-owned banks or large private banks (the only suitable example is OAO "Alfa-Bank") can expand their businesses in CIS. Despite the brand awareness of many Russian banks operating in CIS, the bulk of their operations is directed to support the Russian TNCs. Moreover, physical representation of Russian banks abroad is mostly limited to state-owned banks, where the motives for penetration might be significantly "politically-oriented". The oil and gas sector, which is strategically very important for Russia determines the overall strategy to a large extent and the role of Russian state-owned banks is undoubtedly relevant here. For example, the expansion of OAO "Gazprombank" to Belarus is difficult to explain by simply "economic motivations for entry". Here the expansion strategy is closely correlated to that of Gazprom and the Russian government (its main shareholder), thereby being somewhat "customer-oriented" and "state-oriented" (Panibratov, 2012). We do not claim that the political motives explain the expansion of all Russian state-owned banks but such factors should not be underestimated in a country like Russia where only large state-owned banks are successful in foreign markets (PUSH factor as the result of domestic institutional environment and idiosyncratic features in the strategy of banks). Some researchers also point to the fact that Russian banks tend to behave like typical natural-resource-based TNCs (Panibratov, 2012; Kuznetsov, 2011).

Thus, the behaviour of Russian banks might be explained to some extent within the framework of MNBs theory, namely Dunning's OLI paradigm[94]. Russian banks have a better structure of assets and capital in comparison to the banks from CIS, and as a result, they have a competitive advantage. In addition, the lower level of development of the banking sector in the region and extensive possibilities for location-specific advantages for foreign entry create opportunities for Russian banks. In Europe, the situation is quite different. Here it is difficult to imagine Russian banks having any competitive advantages (ownership, location, internalization), as they have to compete with the financial giants from Europe and the United States. Russian banks' entry into European banking markets is mostly driven by an aspiration to establish an image of "global presence" or to follow Russian companies operating in Europe. Participation of banks in syndicated loans, investment schemes, or corporate lending to European companies is not common.

[94] Proposed by Dunning (1977) in order to explain the behaviour of MNCs abroad. Subsequently, the OLI paradigm was applied in the theory of multinational banking. Ownership-specific advantages, location specific advantages, and internalization advantages were later extended to eclectic theories.

Some literature provides the rationale for foreign expansion of Russian banks being the result of the domestic environment in Russia (state pressure, non-transparent legislation, political and economic instability, M&A as a way to maintain distance from government intervention), which in MNBs theory is mostly explained by the "escape hypothesis" (PUSH, unfavourable conditions on the domestic market). However, we have not found any persuasive reasoning for this, nor could we find any examples of banks that actually implemented this approach of foreign expansion. In our view, the PUSH motives for foreign expansion are mostly explained by direct and indirect influence on Russian banks by the government, which makes it difficult to successfully distinguish the government's strategy from that of the banks. In addition, the behaviour of banks is strongly correlated with its major Russian clients and foreign expansion is therefore a sort of synergy of banks, Russian TNCs (Panibratov, 2012), and the Russian government to some extent.

In the existing theory on MNBs, issues of historical, non-economic, and political motivations of entry are not explicitly covered. However, we find that in the case of Russian banks' foreign expansion, such driving forces for building a global strategy are present. Some banks acquired credit institutions abroad in the form of the "Soviet legacy". This trend is typical for some Russian TNCs as well. Therefore, the institutional context is a crucial component of the domestic environment that exerts influence on inward-outward expansion cases.

5.3. Entry modes and strategies of inward-outward expansion

As for the entry modes of Russian banks, the most common are establishment of wholly-owned subsidiaries and representative offices. By contrast, in the Soviet times, banks tended to establish correspondent relations and actively participated in the capital of foreign banks, mainly in countries that were leading trade and investment partners of the USSR. After the collapse of the Soviet system, banks like OAO "Sberbank" and OAO "VTB" simply inherited capital shares abroad (we cover the details below in the analysis of foreign strategies of selected banks), so the preconditions for entry existed in the form of the "Soviet legacy" (Mizobata, 2011; Panibratov, 2012). Representative offices are mostly established for fulfilling the market-research function, evaluating the opportunities of growth in the market, as well as for providing consulting services about the Russian market and general trends in the Russian economy for foreign investors planning to enter the market. This motivation of business expansion is a salient feature of the Russian banks trying to attract investors to the Russian economy but without providing any particular banking services. According to various estimates, there were 44 representative offices abroad (13 in CIS) (Abalkina, 2010). Representative offices are normally established in countries where direct penetration in the form of a subsidiary is somehow bound by high institutional barriers, coordination by financial supervising authorities, and so on. The practice of conversion of representative offices into subsidiaries is not very common. Therefore, Russian banks tend to use the so-called "organic growth strategy" in expanding their foreign business. The subsidiary choice, as shown in the existing literature (Panibratov, 2011, 2012), is provided with the knowledge that Russian banks have no other entry modes and therefore have to make this "forced choice".

M&A has historically not been a common form of entry into the foreign market for Russian banks. However, in the CIS region this trend has been quite strong recently (for example, the entry of OAO "Gazprombank" into the Belorussian banking market). Some researchers report on the growth of M&A in the CIS region (Abalkina, 2010; Vinokurov, 2010) due to the low level of capitalization of banks and cheap financial resources. In Europe, on the contrary, Russian banks can hardly allow themselves to merge with or acquire domestic banks. Therefore, within the existing MNBs theory, we conclude that both brown-field and green-field strategies of expansion are being used by Russian banks.

However, there are some distinctive features in foreign expansion. At present, banks like OAO "Rosbank. Societe Generale" and ZAO "Petrokommertz" are owned by foreign capital. The share of Societe Generale (France) in Rosbank is 82.3%, while 94.87% of shares in ZAO "Petrokommertz" belong to Reserve Invest Holding (Cyprus). Therefore, further foreign expansion of these banks is not purely driven by the motivation of Russian capital. Foreign banks operating in the Russian market are also active; for them expansion through Russian subsidiaries to CIS might be a strategic move and the easiest way to expand their presence in the region. Further research on the motivation of such banks in the form of "hidden expansion under other countries' flags" will be somewhat difficult to explain within the framework of existing TNB/MNB theory[95].

In general, Russian banks are quite conservative and their direct presence abroad is limited. Nevertheless, as mentioned earlier their role in other investments is unquestionable. As the motivations for entry into the foreign markets differ, so do the strategies of specific banks. Internal linkages with the state and natural-resource-based TNCs that are major clients of Russian banks are significantly strong and clearly have an impact on strategies of some banks. Below we briefly consider the international

[95] Similar issues were found by the author for the Toyota Group that established ZAO "Toyota Bank" in Russia through Toyota Kreditbank GmbH (99.75% of shares) and Toyota Leasing GmbH (0.25%), both located in Germany. Therefore, from the Russian point of view and in accordance with the conservative approach to foreign banking, FDI in this case should be counted as German, although it is obvious that Japanese capital (namely Toyota Financial Group and Toyota Group as the whole) is behind it.

expansion strategy of three major banks: OAO "Sberbank", OAO "VneshTorgBank", and OAO "Alfa-Bank".

5.3.1. *OAO "Sberbank"*

Table 5-6 Affiliated foreign institutions of OAO "Sberbank"

Name	Sberbank share	Note
OJSC "BPS-Sberbank" (Belarus)	97.91%	One of the leading banks in Belarus. The share of corporate loans on the market is planned to be increased to 12% by 2015
JSC "Sberbank" (Kazakhstan)	100%	Acquired by Sberbank in 2006. Wide branch network (13 branches, 100 offices)
Volksbank international AG (Austria)	100%	First acquisition of Sberbank out of CIS region. 2012 – 100% shares acquired. The bank has 295 affiliated divisions and more than 600 000 clients. The bank is widely present in CEE
JSC "Sberbank" (Ukraine)	100%	Acquired in 2007. Regional network is about 80 divisions. Mainly serving Russian companies working on the Ukrainian market or Ukrainian companies with Russian investments
Representative office of JSC "Sberbank" (Germany)	-	Representation and protection of interests of Sberbank and its clients in Europe; consulting services; business relations with state and commercial institutions of the EU
Representative office of JSC "Sberbank" (China)	-	Expansion of opportunities in order to serve client doing business on the Chinese market; consulting services to both Russian and Chinese companies
JSC "Sberbank" branch office in New Deli (India)	100%	Strategic development on the market is declared as the major motivation

Source: compiled by author. Data retrieved on 10 July 2012 from www.cbr.ru

Sberbank is the largest bank in Russia[96] and Central and Eastern Europe (CEE) and considers international expansion to be an important part of its strategy. The bank acquired a considerable stake in foreign assets as part of the "Soviet legacy." At present OAO "Sberbank" aims to attract foreign capital in foreign markets on favourable conditions for the financing of the Russian economy, and to support its clients engaged in foreign trade and investments. The bank is expanding its international influence and, at present, has correspondent relations with 220 leading banks in the world. The

[96] As of 1 January 1 2012 OAO "Sberbank" is rated as the top bank in terms of assets, capital, deposits to both corporate and individual customers, and lending (see rating of Russian banks).

expansion of OAO “Sberbank” started in 2006 when it acquired a bank in Kazakhstan. In 2007, OAO “Sberbank” entered the Ukrainian market and launched its business in Belarus in 2009. At the next stage of its international expansion, OAO “Sberbank” opened representative offices in Germany and China, and a branch office in India. The bank aims to acquire new assets in these countries, establish subsidiaries, branches, and representative offices, as well as non-banking financial corporations. It plans to increase the share of its international activity to 5% by 2014 and is actively participating in IPOs[97]. Table 5-6 represents the list of affiliated foreign institutions of OAO “Sberbank” as of July 2012.

5.3.2. OAO “VneshTorgBank” (VTB)

OAO “Vneshtorgbank” is the largest transnational financial corporation in Russia. The bank was firstly established in October 1990 as a closed joint-stock company aimed at furthering foreign economic relations of the Russian Federation. It currently operates in 15 countries (the geographic distribution of destinations is presented in Figure 5-1).

The main motivation is supporting foreign operations of its clients in the EU and CIS markets. The foreign correspondents network of the bank is large and includes over 100 units (Jumpponen, 2004).

The VTB Group (comprised of OJSC VTB Bank and its subsidiaries) is a leading Russian financial group, offering a wide range of banking services and products in Russia, CIS, Europe, Asia, Africa, and the U.S. The government holds 75.5% of the shares and 10% belong to foreign investors. The group conducts its banking business in

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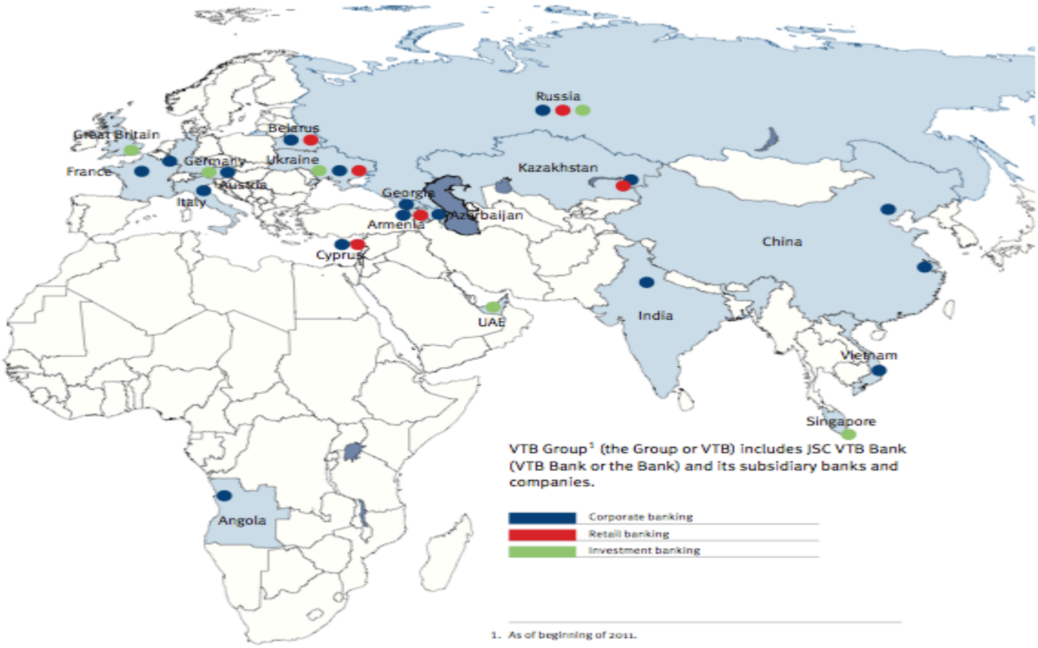
[97] Although we do not consider IPOs within the frameworks of the dissertation, we note that IPOs are very important for Russian banks. According to Bloomberg™, in November 2012, 46.3% of the turnover in OAO “Sberbank” shares was on the London Stock Exchange.

Russia through VTB bank as the parent company with five subsidiary banks. The group's largest subsidiary banks are VTB 24, Bank of Moscow (95% of shares), and TransCreditBank (78% of shares). The group operates outside Russia through 15 bank subsidiaries located in CIS (Armenia, Ukraine (two banks), Belarus (two banks), Kazakhstan, and Azerbaijan); Europe (Austria, Cyprus, Germany, France, U.K., and Serbia); Georgia; Africa (Angola); two representative offices in Italy and China; two branches in China and India; four branches of VTB Capital in Singapore, Dubai, Hong Kong, and New York. The CIS region is the secondary direction for the VTB group. The main goals here, in accordance with the company's strategy, are an increase in market share, improvement of the credit portfolio, client base and maintenance, and an increase in deposits. VTB aims to establish institutions with universal banking services for Russian companies operating in the region and local and international corporate clients, and develop retail banking. The group also entered Asia and Africa as there are many joint investment projects in this region. South-East Asia and the Middle East are important regions for the development of investment banking; therefore, VTB has institutions in Singapore and Dubai.

In the former Soviet Union, there existed a system of Soviet foreign banks that were controlled by Gosbank. At the beginning of 2000, these banks were bought by VTB in accordance with the strategy of the development of the Russian banking system. This is how VTB received shares in Soviet-controlled foreign credit institutions: Moscow Narodny Bank; BCEN-Eurobank (France); Donau Bank (Vienna); Ost-West Handelsbank (Austria); Russiche Kommerzial Bank (Switzerland); and East-West United Bank (Luxemburg). These banks were mostly oriented towards supporting international trade of the Soviet Union.

Figure 5-1 Affiliated foreign institutions of VTB



Source: VTB today, Retrieved on 11 July 2012 from www. vtb.com

Kuznetsov (2007) considers VTB to belong to the Russian TNC-type institutions, named "successors of the Soviet Union", as VTB inherited the oldest foreign assets under Russian control. For example, the main subsidiary of state-owned Vneshtorgbank is Moscow Narodny Bank (a part of VTB Europe), which was established in London in 1912. It was nationalized after the Bolshevik revolution and VTB controls 88.9% of its shares. Another VTB subsidiary is the former Banque Commerciale pour l'Europe du Nord – EUROBANK, which was acquired in Paris in 1925 (VTB controls 87% of the shares at present). Several VTB subsidiaries were established in other countries in the 1970s to support Soviet trade. Therefore, their status became unclear in the 1990s, but later the government gave them to VTB. In these market conditions VTB tried to transform itself into the "classic" bank and develop its business mainly within Russia; it also established subsidiaries in countries where Russian trade reputation is relatively high (Ukraine, Armenia, Vietnam, Angola, and China).

VTB reconstructed these banks considerably: banking institutions in Luxemburg and Switzerland were sold; the office in London was merged with VTB capital; and banks in Austria, Germany, and France were consolidated within the framework of European sub-holding. Currently, the share of the foreign network in the total amount of profits is about 10%, the number of employees in foreign subsidiaries is about 9,000 (*Profil*, June 2012, p. 56–57).

5.3.3. OAO "Alfa Bank"

Table 5-7 Affiliated foreign institutions of OAO "Alfa Bank"

Name	Alfa Bank share	Note
Alfa Capital Markets (UK)	100% owned by Alfa Capital Holdings (Cyprus) Ltd.	International investment banking, attracting international investors to the Russian equity markets, providing expertise and assistance to Russian and Ukrainian companies accessing London capital markets. Branch of Alfa Capital Holdings (Cyprus) Ltd.
Alfa Capital Holdings (Cyprus) Ltd.	N/A	Brokerage services to international clients in the Russian, Ukrainian and UK capital markets
Alforma Capital Markets, Inc. (US)	N/A	Brokerage and investment services to US institutional clients investing in Russia and CIS
Amsterdam Trade Bank N.V (Netherlands)	100%	Standard and tailor-made products in the field of Russian, CIS and East European related structured trade and commodity finance, corporate banking and international money transfers. Amsterdam Trade Bank has a representative office in Moscow.
Alfa-Bank (Ukraine)	Second largest shareholder	9^{th} largest bank in Ukraine in terms of assets. All types of traditional services, investment banking, online banking
Alfa-Bank (Belarus)		Established in 1999, one of the most reliable and dynamic banks. Head-office in Minsk and 17 branches across the country. Large companies in crude oil refining, wholesale of oil products, metallurgy, building material and food industries are major customers. Also engaged in business with government bonds, short-term bonds of the National Bank, corporate bonds and shares, auto lending and consumer financing, individual deposits, money transfers.
Alfa-Bank (Kazakhstan)		Established in 1994. Full package of banking services to corporate ad individual clients. 4 branches and 3 representative offices.

Source: compiled by author. Retrieved on 11 July 2012 from www.alfabank.com

The bank was founded in 1990 and is a member of the Alfa Group. Alfa Bank offers a wide range of services: corporate and retail lending, deposits, payment and account services, operations with foreign exchange, investment banking, and others. Alfa-Bank is the largest private bank in Russia, which is consistently among the Top-10 banks in terms of assets, capital, deposits, and lending. The bank's management team has both Western and European specialists who have a solid understanding of the needs of the Russian market. The bank consistently builds its strategy both in domestic and international spheres. Emerging markets were considered a great opportunity for business expansion; therefore, Alfa Bank established a subsidiary and three representative offices in Kazakhstan. By the end of the 2000s, the Alfa Group operated in Belarus and Ukraine, and entered several European markets. The banks affiliated with Alfa-Bank are presented in Table 5-7. The motivation of entry is to have a presence in the major international financial centers of EU and CIS.

5.4. Major obstacles in foreign expansion and specific features of Russian foreign banks: home country specificity

While there is no clear policy towards Russian outward investments, expansion of Russian banks abroad is an ongoing process. However, there are many boundaries or restrictive factors that influence the banks' strategy of foreign expansion and determine their behaviour. We categorize obstacles of foreign expansion of Russian banks into three major groups.

The first group of factors consists of home-country related issues. The specific structure of the Russian banking sector (which is highly concentrated and overly segmented), strong participation of the government in banks, the global image of Russia, the level of corruption and political instability, among others contribute to the image of Russian banks abroad (Kuznetsov, 2010b). Only large banks and mostly state-owned ones have access to foreign markets. Some Russian TNCs are viewed negatively abroad due to political issues, their profit-oriented and "cherry-picking behaviour". Some studies hardly consider Russian TNCs to be the "classic" ones (Kuznetsov, 2012). The same is true for the Russian foreign (transnational, multinational) banks. The majority of banks do not have sufficient resources or experience to expand beyond neighbouring countries with whom they have close historical economic and political ties. In other words, limited competitive advantages limit their choice of expansion to CIS. However, among CIS countries, Russian banks still enjoy ownership and location advantages.

The second group of factors is represented by host-country boundaries. These might include concerns existing abroad towards Russian investment expansion, peculiarities of banking systems of host countries accepting Russian banking investments, high standards of institutional barriers (regulation on minimum charter capital, successful history of business (€5 million and three years of successful history in many European countries as a precondition)), and "economic nationalism and protectionism of host countries" (Vernikov, 2005).

The third group of boundaries consists of the subjective limitations of the Russian banks themselves and their idiosyncratic features formulated by the domestic market specificity of the banking sector (interrelations with the state and large industrial groups). These might also include quality characteristics and the scale of banks, scarcity of banking capital (called the "objective restrictive factor" by Vernikov (2005)), as well as the distinct strategies of Russian foreign banks (historical, cultural ties predetermine motivation of entry in neighbouring countries; follow the customer approach; difficulties in understanding the real actors of management strategy).

In general, all three above-mentioned categories represent the domestic environment of both home and host country that consists of microeconomic, macroeconomic, and institutional factors that stipulate the form of foreign entry (IFDI) or expansion (OFDI). In case of Russia, we believe the institutional context is one of the critical factors.

A banking poll conducted in 2011 (Vedev and Grigoryan, 2011) defines the following obstacles regarding the limited expansion of Russian banks: (a) banking in Russia is more profitable than abroad; (b) no financial resources for expansion; (c) restrictions in the foreign target market to establish banking institutions; (d) no need to expand abroad; (e) no experience in operating abroad; and (f) the Russian government makes it difficult to expand abroad[98].

Thus, Russian banks can be regarded as rather conservative investors abroad. The share of OFDI is extremely low and existing obstacles minimize the number of banks operating abroad. However, the role of Russian banks in providing trade credits, loans to other banks, as well as attracting them is rather high.This explains the high proportion of other investments in the total structure of outward investments of the banking sector.

5.5. Summary

Recent trends in OFDI position BRIC countries as exporters of capital. In accordance with the theory of investment development, BRICs might be regarded as potentially strong suppliers of FDI in the near future. This view is partially corroborated by the emergence of TNCs (MNCs) from emerging economies.

Simultaneously with the expansion of TNCs, expansion of TNBs (MNBs) from emerging economies is of increasing interest. Contemporary national financial and banking systems are implementing important functions from the point of view of national economies. Within the context of globalization, liberalization of foreign markets, and integration of financial resources and capital, national banking systems get

[98] In the poll (2011) obstacles are presented in the ascending order from (a) the most frequently mentioned answer to (f) the least mentioned one.

more opportunities to access foreign capital markets in order to diversify their risks and to achieve additional speculative income. Some financial institutions are prone to increase their presence abroad as part of their overall international strategy.

We conditionally introduce the foreign banking theory approach and consider the foreign expansion of Russian foreign banks within the framework of existing MNB (TNB) theory. Soviet and Russian banks started foreign expansion in the late-1980s and actively expanded their businesses abroad, first as correspondent banks and later in the form of representative offices and subsidiaries. Needless to say, the internationalization of the banking sector stimulates competition, which places limits on concentration and centralization of capital, and spurs M&A.

The motivation behind foreign expansion of Russian banks is mostly driven by "follow the customer" strategy into CIS countries where there is cultural and historical proximity and where they are still relatively competitive. Both PUSH/PULL reasons can be identified as factors driving the expansion of Russian banks. We particularly stressed the historical factor (close ties with CIS and the "Soviet legacy") as having a key role in explaining reasons of foreign expansion. In other words, the institutional context of the domestic environment predetermines the behavioural patterns of inward-outward expansion cases. With references to the existing literature we confirmed that Russian banks generally penetrate foreign markets by establishing representative offices and subsidiary banks, and mostly use both green-field and brown-field expansion modes. The strategies of many banks are sometimes dependent on government policy since the majority of banks are directly or indirectly controlled by the state. Foreign expansion is limited to state banks and large private banks, although there are cases of expansion of banks that are members of large industrial corporations (for example, ZAO

"Promsvyazbank" and OAO "Gazprombank"); OAO "VTB" is the pioneer in international expansion.

Geographical destinations for expansion might be a result of business motives or environmental constraints. As other researchers show, affinity to CIS, Europe, and BRICs markets is likely to be caused by traditionally close ties, some brand awareness, other Russian companies' activities in those markets, and high demand for financial services in relatively developed or rapidly developing emerging economies (banks behave like typical natural-resource-based TNCs here). Non-transparency of the real actors of Russian banks' international expansion strategy, high involvement in offshore businesses (tax havens) in the form of other investments, and "hidden penetration under other countries' flags" are other distinct features that characterize Russian foreign banks (TNBs).

CONCLUSION

High economic growth in the 2000s and Russia's position as an emerging country with a stable, growing economy resulted in a foreign investment boom that extended into the banking sector. Foreign banks entering Russia stimulate the inflow of FDI into other sectors and indirectly contribute to the improvement of Russia's investment climate. Foreign banks bring new banking technologies and financial products into the Russian market. Therefore, their positive impact is significant.

Needless to say, with foreign banks entering the Russian market, the banking sector itself is subject to transformation and changes. Such changes include reduction or merging of small-sized banks, an increase in the minimum capital requirement rates and growing banking assets and capital. Despite the fact that the Russian banking sector was liberalized in the 1990s, its development is often considered as immature in comparison to other developed economies due to the fact that there are problems with market quality, weak banking infrastructure, and non-fulfillment of intermediary functions[99] by a majority of banks.

In the present dissertation, we targeted the issues facing foreign banks operating on the Russian market. We selectively, not comprehensively, analyzed activities of foreign banks in Russia and raised the issues of motivation, entry modes, organizational representation, and strategies. Our main argument is that existing theories on MNBs, international management and FDI tend to lack analysis on the so-called institutional environment of both home and host countries. This is particularly true in the case of Russia, with most research on foreign banks lacking any deep investigation and

[99] Intermediary function – one of the three traditional banking functions, means the role of banks in attracting financial resources in the form of deposits and their allocation among other industries in the form of investments. For Russia, both deposits and lending rates are quite low in comparison to other countries. Companies tend to attract financing directly from capital markets or use internal resources.

understanding of the role of institutions in a Russian context. We mainly focused on the host country approach and looked to prove our hypothesis that institutional context matters and its role in shaping the present activity of foreign banks is significant in Russia. We also stressed the fact that for transition countries like Russia, traditional MNB theory should be reconsidered, due to the fact that these groups of countries apply a unique definition of foreign capital and set upper limits on the participation of foreign capital.

Despite the fact that there are obviously some negative features for FDI participation in the banking sector, more and more banks are showing interest in the Russian market. As is shown in the present dissertation, the foreign share of total banking assets, capital, deposits and lending is increasing. Some foreign banks try to develop traditional banking services (deposit, lending, settlement of accounts) competing with state-owned and Russian private banks, others prefer entry into particular market segments. The share of foreign banks in traditional banking services is moderate and their role is rather limited, but foreign banks' participation in syndicated loans, project financing and cross-border lending is relatively high. Foreign banks are solidly represented in the TOP 10 or TOP 30 ratings of banks and compete with domestic state and private banks in terms of efficiency levels.

Using the existing literature, we have shown that the motivation for entry into the Russian market could be explained by both *PUSH* and *PULL theories (macroeconomic determinants)*. Non-economic motivations (political, historical, support of global image) comprising *PUSH reasons* together with high economic growth and improved investment climate (*PULL reasons*) comprehensively explain specific features of foreign bank entry into the Russian market in the 2000s. Existing literature presents vague conclusions on issues of motivation; therefore, we have extended the literature on motivation by conducting our own empirical survey of 73 banks with 100% foreign capital participation and subdivided them into six groups defined by their motivation, entry mode and strategy (where applicable). From the sample results, we found that there are multiple reasons for entry and that motivation for entry is subject to change in accordance with market structure or trends in economic growth. In other words, foreign banks significantly influence the Russian banking sector and, in turn, the economic development of host countries and specific features of their banking sectors influence the background of foreign banks' motivation. In short, market specificity and environmental context (macroeconomic, microeconomic, institutional) of both home and host countries matter and to a great extent shape the behavioral patterns of banks. In Russia's case, domestic environment might be predominant in both out-in entry and in-out expansion.

The mutual relationship and significant roles of institutional context, foreign banks' motivation and banking sector traits of a particular country can be fully expressed via analysis of entry modes and strategies employed by foreign banks. As for the entry modes, in accordance with Russian legislation, entry vehicles for foreign banks include representative offices, JSC, subsidiaries and participation as minor shareholders. Representative offices fulfill banking operations, and are therefore not counted as financial institutions in Russia. However, for the purpose of entry modes analysis, it is worth counting them as initial forms of entry[100]. Upon entering into the Russian market, a majority of banks established representative offices and later converted them into subsidiaries (*evolution of forms of entry).* Legislative and institutional restrictions, limitations of the Russian banking system, position of the government and some other

[100] This broadens the definition of a foreign bank. Representative offices, while not being financial institutions, are counted as initial forms of entry.

factors significantly affect decision-making processes regarding entry modes of foreign banks.

In addition, in terms of strategy, we show that foreign banks gradually substitute the "*organic growth*" approach with *M&A*. M&A is common not only in the form *out-in*, but also *in-out* and *in-in*, meaning that the activities of foreign banks considerably influence the internal structure of the Russian banking sector.

Some other idiosyncratic features of the Russian banking sector are its extra-segmentation, strong presence of the government, concentration of all operations toward large-sized banks, a large number of small-sized banks, undercapitalization of the banking sector, regional differences, unbalanced revenue structure of the banking sector (high proportion of revenue from foreign exchange operations), problems with long term financing, low productivity levels, restricted competition, fragmentation of the banking sector and strong dependence on external international markets, low levels of transparency of credit organizations, offshorization of the banking sector and the Russian economy as the whole.

In addition, specific features of the broader Russian market include: non-transparency of legal actors and ultimate shareholders, direct and indirect state participation in corporate sectors, weak protection of property rights, an "ownership=dominance" concept, administrative barriers, language barriers, high levels of bureaucracy, corruption, a lack of transparency and complicated juridical procedures, complex hierarchical structures, weak corporate governance, high transaction costs when doing business, weak banking and market infrastructure, little law enforcement[101].

[101] The Global Competitiveness Report 2013-14 (p. 326) also presents the following most problematic factors for doing business in Russia that might be regarded as general "market quality issues:" corruption, high tax rates, tax regulations, inefficient government bureaucracy, difficulties with access to financing, inflation, an inadequately educated workforce, inadequate infrastructure, crime and theft, insufficient capacity to innovate, a poor work ethic in the national labor force, restrictive labor regulations, policy instability, government instability, poor public health, foreign currency regulations.

Nevertheless, the financial and banking markets are functioning, and from the institutional and legal point of view, they are properly established. The regulation of foreign banks generally complies with WTO standards.

The important issue is how all these factors exert an influence on the behavioral patterns of foreign banks. The most evident answer is that the impact is both direct and indirect. Some examples of significant importance in terms of the domestic institutional environment are represented below:

1. Foreign banks' role in providing long-term investments is quite weak, which also reflects the general situation regarding a dearth of long-term borrowings in Russia. Foreign banks mostly provide short-term financing and domestic credit to financial institutions experiencing undercapitalization problems.

2. Concentration, over-segmentation, consolidation of the banking sector between state-owned and large privately held banks and territorial discrepancies (the majority of banks operate in the European part of Russia) lead to a situation in which foreign banks find it difficult to compete with the three "giant state banks" (OAO "Sberbank", OAO "Vneshtorgbank", OAO "Gazprombank" (a private bank with strong indirect government participation)) and find their niche in the market. However, there are exceptions to this rule, as shown in Chapter 3.

3. Low productivity of the banking sector results in higher efficiency of foreign banks when compared to their domestic rivals. However, even for locally incorporated banks with foreign capital participation, it is rather troublesome to reach the status of a TOP 3 bank, despite the fact that some foreign banks prove to be very efficient and have high ratings and credibility from Russian citizens.

4. Undercapitalization of the banking sector significantly impacts the activity choices of foreign banks in Russia, with many banks serving as intermediaries to

finance domestic financial institutions rather than participating in the corporate sector. Dependency of the banking sector on external financing is rather high.

5. Unbalanced revenue structures of the banking sector incline toward a high share of profits coming from foreign exchange operations; this is also found in the balance sheets of foreign banks (e.g., some Japanese banks referenced in Chapter 4).

6. A low level of business transparency and a low level of ownership rights protections prompt a majority of foreign banks to establish businesses from scratch and largely in the form of 100% subsidiaries or with minor shareholders participation with JSC as the most preferable organizational representation.

7. Credibility toward the banking system in Russia is generally low, but many foreign banks have comparatively high rankings and are often counted as among the more sound and credible financial institutions.

8. For many foreign banks, high transaction costs are not a hindrance to an organic growth strategy. Paying high entry costs is in a way easier than finding stable, credible business partners. M&A has been widespread since the 2000s, but a majority of banks with high credibility and sound accounts have already been acquired, and some M&A deals are directly related to the establishment of pseudo-foreign and quasi-foreign banks via offshore regions and tax havens.

In our view, institutional environment is not limited to the idiosyncratic features of the banking sector and market specificity of the host country. In our analysis of motivation, we found proof for the gravity model, geographical, cultural, historical proximity of Russian and European and CIS countries. Therefore, more than just microeconomic (follower, leadership, escape, efficiency strategies) and macroeconomic contexts (PUSH/PULL) determine the choices of foreign banks when it comes to entry into the Russian market. In our clustering analysis of foreign banks, we found proof of the political element that should not be underestimated (establishment of foreign banks in order to support bilateral ties between Russia and banks' home countries). Moreover, we raise the issue of the historical path-dependence and Soviet legacy. After the collapse of the USSR, initial foreign entry was, in a sense, predetermined and pursued by the governments of both home and host countries. In the 2000s after the gradual liberalization of the banking sector and Russian economy as the whole, the situation changed, but the indirect influence of the government should not be underestimated. Even for the most successful European players in the Russian market, we see evidence that there was initially a profound binding historical context that might have predetermined the entry choice of such banks.

Furthermore, we methodologically shape the idea that microeconomic environment (behavior of particular foreign banks, their business strategy) and home country's macroeconomic and institutional environment also exert an impact on motivation, entry modes and strategy of foreign banks. Raiffeisen Bank is an appropriate example of the original behavior among foreign banks with its unique and sophisticated business strategies in CEE and Russia. ZAO "Toyota Bank" and German banks related to automobile manufactures might also represent a typical case of parent company strategy.

As for the institutional environment of the host country, we introduce case studies of Japanese banks and European banks specializing in automobile loans that are often regarded as those of significant impact on the domestic environment. Relationship banking, main bank system, and keiretsu system do matter in cases of expansion in Japanese banks; however, idiosyncratic features of the Russian banking sector, market specificity, and macroeconomic environment of Russia as a host country presumably have a more significant impact.

In order to extend our idea of home country influence in predetermining conditions for foreign expansion of banks, in Chapter 5 we analyze the activity of Russian banks abroad. We focus on Russia as the home country, and reached similar findings. Most Russian bank expansion focuses on Europe and CIS, and their motives can only partially be explained by traditional PULL/PUSH factors of the macroeconomic environments of host countries. We found proof for the gravity model, cultural, historical and language proximity, as well as some examples of how the domestic institutional environment in Russia predetermines the location choice of Russian banks abroad. These examples lead us to the conclusion that the Soviet legacy is indeed important when we deal with both out-in entry and in-out expansion cases.

One more very important issue that is worth addressing is the offshorization of the banking sector in Russia. Though not initially the primary focus of our investigation, we identify the role of offshores and describe it proportionate share of the banking sector in both inward and outward FDI is significant. Offshores are normally not targeted by the MNBs theory. While avoiding a deeper analysis of this issue in the text of the dissertation, we mention that offshore regions are both major investors into the Russian economy and major destinations for Russian capital. This is true for both corporate and financial banking sectors. While corporate sector companies are not our primary concern, it became obvious in the process of our analysis that the offshore issue has two sides: it is present in both out-in entry and in-out expansion cases[102].

As for the out-in entry cases, we demonstrate in Table 3-2 that offshore regions and SPE (Netherlands, Luxemburg) are major investors into the banking and corporate sectors of the Russian economy, and their share in terms of foreign capital (participation in capital, reinvestment of earnings and other capital) is relatively high. In Chapter 3,

[102] General FDI trends in Russia are presented in Explanatory Note 1.

our detailed analysis of the motivation of 72 banks with 100% foreign capital participation, we calculate the share of offshore regions (15.3%) and recalculated the share of offshores and SPE (29.2%). Detailed methodology and development of our analysis and major results are presented in Table 3-7 and Appendix B. Consequently, we identify a group of 15 banks operating in the Russian market (Appendix E), parent banks that originate in offshore and SPE regions. We found evidence for both banks with direct foreign capital participation of offshores (quasi-foreign banks) and banks with Russian citizens as ultimate owners (pseudo-offshores, round-tripping banking FDI). Moreover, we identified banks with less than 100% foreign participation, such as OOO “Rosprombank” (50.04% of shares belong to Cyprus Popular Bank) and ZAO “Uniastrum Bank” (80% shares belong to Bank of Cyprus). We conditionally call both of these sub-groups pseudo-foreign banks, due to the fact that their motivation is hard to explain by the traditional theories regarding MNBs. We stress the fact that active offshorization of the Russian banking sector started in the 2000s with both Russian banks hiding their ultimate shareholders in offshore regions and offshore banks investing into relatively stable medium-sized banks with sound asset structures.

As for the in-out expansion cases, we show in Chapter 5 that many Russian MNCs[103] and MNBs have a direct presence in offshore territories with Cyprus being one of the most popular destinations for Russian capital (Table 5-1). We also provide factual evidence regarding the presence of Russian banks in offshore regions (Table 5-2) and

[103] Examples of Russian MNCs having affiliated institutions in offshores: Evraz, mine “Raspadnaya,” NLMK, Mechel, Metallinvest, Uralchim, Severstal, Norilskiy Nikel, SUEK (coal), Rusal, TMK, Lukoil, Novatek, Bashneft, Uralsib (financial company), Storyinvestbank, Bashprombank, Sberbank, VTB, Nomos Bank, Gazprombank. Russian banks by the end of 2012 provided USD 30 to40 billion to Cyprus companies (Kompaniya, 18 March 2013, p. 36-37). Offshore schemes are also popular among developed countries, such as the United States (83 out of the TOP 100 MNCs have a presence in offshore regions) and the United Kingdom (97 of the TOP 100) (Kompaniya, 18 March 2013, p. 36-37).

identify the following banks at present: OAO "Sberbank," OAO "VTB," ZAO "Nomos-Bank," OAO "Gasprombank," OOO "Stroyinvestbank," OAO "Bashprombank."

Since the share of offshores is relatively high, we should also address the problem of how the offshore issue influences our analysis and identify major reasons for high percentages of offshore capital in both out-in entry and in-out expansion cases. The motivation for banking FDI with offshore origins is unlikely to be fully explained by traditional theories regarding MNBs.

There are versatile factors that make offshore regions attractive to foreign capital[104] for both the corporate and financial sectors. In the case of Russia, Cyprus[105], though officially being excluded from the list of offshore regions, is still the major destination for channeling capital "in" and "out" of the Russian economy[106], and many Russian companies operate on the island by applying various schemes[107]. The role of banks in these round-tripping FDI and reinvestment of earnings is very significant.

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[104] Some of these include: 1. Differences in tax systems, tax optimization (tax rates on dividends in Cyprus is only 5% vs. 9% in Russia); the corporate income tax rate in Cyprus is 10% vs. 20% in Russia; banks registered in offshore regions are released from paying taxes on transactions in which commercial paper is issued by both foreign and domestic offshore companies; offshore companies can be used as nominal shareholders of valuable assets and are thus not subject to taxation in home countries; 2. The ability to apply Anglo-Saxon legal rules that provide strict standards of confidentiality on the disclosure of ultimate owners and beneficiaries; 3. Loose restrictions on the disclosure of the origins of money (e.g., Russian capital in Cyprus); 4. Cultural, historical proximity (no visa requirements for Russians in Cyprus, transparent management, the generally positive attitude of Cyprus businessmen toward Russian capital); 5. The presence of a sound financial system in offshore regions with strong protections for ultimate owners; 6. Low language barriers (English and Russian speakers in Cyprus are quite common); 7. Capital flight and protection of assets; 8. Illicit money flows: tax evasion, money laundering (Brada, 2011).

[105] The GDP of Cyprus is €18 billion and 70% to 80% is comprised of financial and juridical services; foreign debt of the country is estimated at 75% of GDP (€13.5 billion) (*Profil*, 2013, No.11, p. 8-11). The banking system of Cyprus (balances of banks) is estimated to be 706% of GDP with the majority of domestic banks operating in the market (7 times higher than the real GDP) (*Profil*, 2013, No. 12, p.30; *Profil*, 2013, No. 12, p. 38-41).

[106] Inward FDI from Cyprus into the Russian economy amounted to USD 128.8 billion in 2011, which is 5 times higher than the actual GDP of Cyprus. The annual amount of reinvestments is estimated at USD 200 billion, while the foreign trade share between the countries is about 1% (compared to 12% for Greece). (*Kompaniya*, 18 March 2013, p. 36-37). Russian deposits in Cyprus are estimated as €15 billion out of a total €64 billion (*Profil*, 2013, No.12, p.30). It is also estimated that Russian annually brings €2.1 billion in profits to Cyprus (12% of GDP) (*Kompaniya*, 25 March 2013, p. 2-3). The volume of loans and credits provided by the Russian corporate and financial sector to companies registered in Cyprus is estimated at about €30 billion (*Ekspert*, 2013, No. 12, p. 19-21).

[107] Some of the mechanisms include the followings: 1. Provision of loans (credits) to companies or banking institutions registered in Cyprus with further transfer of these financial resources to third countries; 2. Establishment of companies in Cyprus with major financial accounts allocated to Western Europe; 3. Loans (credits) to companies registered in Cyprus in return for 0% interest rates on bill of exchange (e.g., OAO "Rusgidro") and others (*Ekspert*, 2013, No.12, p. 19-21).

The leading role of Cyprus is not contingent, and the complex system of money flows in Russia often called “the parallel economy”[108] is applied by corporate, financial, and state sectors. In a sense, capital transfer via offshores with a high share of reinvestment of earnings of Russian banks might be regarded as the institutional context that characterizes the Russian market. Offshores have become an integral part of the banking sector and Russian economy as a whole. Presumably, even Russian businesses tend to avoid operations in the domestic environment due to various legal and illicit reasons. It is interesting to note that close relations with Cyprus were established in the 1990s, therefore the offshore issue is not a new phenomenon.

The author sees the following major points regarding the significance and originality of this dissertation:

1. It offers a complex application of MNC and MNB theory for the analysis of foreign banks operating on the Russian market and a systematization of literature on foreign banks in Russia and clarifies major problems. The dissertation provides empirical evidence for the limitation of MNC and MNB theory and theoretically extends the existing FDI approaches.

2. The dissertation develops a classification system for foreign banks with 100% foreign capital participation. The author provides an empirical analysis of the ultimate owners of 73 foreign banks operating in Russia and defines 6 cluster groups based on their motivation, entry modes, organizational representation and strategies.

3. The dissertation reveals the complex and profound causality between the idiosyncratic features of the Russian banking sector and activity of foreign banks. The singular role of the institutional context is stressed and some recommendations are suggested in order to include institutional context in the theoretical analysis of MNC

[108] Ninety-five percent of large Russian MNCs have affiliations with offshores (Kheyfets, 2008); 9 out 10 transactions take place via offshore regions (*Kompaniya*, 18 March 2013, p. 40).

and MNB.

4. Empirical case studies on European and Japanese banks in the Russian banking sector are presented. The analysis of Japanese banks in Russia is a sort of pioneering work, as there are no detailed studies available in the current literature. Both case studies were introduced in order to test the hypothesis regarding the impact of the home country's domestic environment in shaping activities of foreign banks; however, we obtained contradicting results. While there is a significant impact of the home country, in the case of Russia, the domestic environment comprising of microeconomic, macroeconomic, and institutional contexts has a predominant impact.

5. We develop a foreign banking theory approach as an alternative to the existing theoretical methodologies targeting the activity of foreign banks. This approach is wider that traditional FDI, MNC, MNB theories as it combines essential parts of all three and integrates approaches of international business when dealing with entry modes, organizational representation, and strategies of foreign banks. In addition, our suggested methodology provides a comprehensive three-tiered analysis of microeconomic, macroeconomic, and institutional contexts of both host and home countries[109]. Furthermore, it allows us to examine both out-in entry and in-out expansion cases and to determine the causality between the two, established as the result of institutional background. The foreign banking theory approach has also been introduced in order to deal with issues of definition of foreign banks in transition economies, upper limits on foreign capital participation and specific indicators applied by Central Banks in transition and emerging economies in order to evaluate the scope of activities of foreign banks.

6. A broader definition of the institutional context has been developed. Our

[109] Though we focused primarily on the host country's domestic macroeconomic and institutional environment in the dissertation.

empirical results allowed us to include idiosyncratic features of the banking sector, market specificity, offshorization of the banking sector and the existence of historical, cultural, geographical and language proximity, Soviet legacy and path-dependence as the major features constituting institutional context.

Overall, in this dissertation, we found that there are some limitations in the MNB theory approach. While it is possible to conduct a general analysis of motivation, entry modes, and strategies of foreign banks entering Russian market and Russian banks going abroad, MNB theory needs revision with respect to understanding the essence of foreign banks going abroad (ambiguity of definitions among TNBs and MNBs) and the role of host and home country approaches in investigating the activities of foreign banks. Needless to say, there is some research in this sphere targeting the salient features of the banking systems of both host and home countries, which should perhaps be summarized and theoretically extends the existing theory of MNB. We humbly attempted to suggest an eclectic approach in the form of a foreign banking theory that relies on the approaches of MNB theory and points out the necessity of investigating the expansion of foreign banks from the point of view of home and host countries, as well as from the viewpoint of bank strategy. As demonstrated in the Russian example, the distinctive features of banking sectors of host and home countries; offshore businesses of banks; hidden forms of expansion through third countries; the role of banks in other outward foreign investments; non-transparency of legal actors of foreign banks and their strong interrelation with the state and resource-based MNCs and large financial and industrial groups; and cultural and historical ties among the host and home countries are factors that do matter and should be considered when investigating the foreign expansion of banks. We humbly presume to identify those features as the institutional environment, comprising idiosyncratic features of the banking sector and market specificity in Russia.

The form of internationalization (multinational, transnational, or simply foreign) in fact is not a priority when we try to understand why banks go international and identify the driving forces behind it.

In addition, globalization itself is also a key factor affecting organizational and entry (expansion) strategies of foreign and Russian banks. Global rules gradually change the internal structure of the economy and modify state-business relations that are often considered to be providing competitive advantages to Russian TNBs. Sophisticated ownership structures are also at the center of regulation from the international community.

Finally, the results of our empirical study suggest that entry motivation of foreign banks into Russia cannot be solely explained by traditional ownership, internalization, and location factors, and it is strongly dependent on the internal structure of the whole Russian economy. If these peculiarities are to be found in other emerging economies, for instance China or India, MNB theory requires revision regarding these issues. Thus, in the medium-term run it is possible to assume that idiosyncratic features and market specificity, while criticized by the international community, will continue to exist, and as a result banks will aim to implement capital movement in both internal and international markets.

MNC and MNB theories have been developed focusing on behavioral patterns and strategies of companies primarily from developed economies. In the present dissertation, in addition to traditional approaches, we highlight the definitive role of the specific institutional context of the economic system that exerts an influence on in-out entry and out-in expansion cases. The theoretical implication suggests that analysis on motivation and behavioral patterns of MNBs should be organized in connection with a structural analysis of the economy of the relevant countries and should be viewed through the prism of diversity of both market economies and banking systems.

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Mitsubishi Tokyo UFJ Bank http://www.bk.mufg.jp/
SMBC http://www.smbc.co.jp
Mizuho Bank http://www.mizuhobank.co.jp/index.html
Hokkaido Bank http://www.hokkaidobank.co.jp/
SBI Holdings http://www.sbigroup.co.jp/english/
ZAO Obibank http://www.obibank.ru/index.wbp
ZAO Mizuho Corporate Bank http://www.mizuhocbk.com/russia/about/index.html
ZAO Toyota Bank http://www.toyota.ru/toyota-fs/

Other homepages of banks listed in Appendix B.

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APPENDECIES

APPENDIX A

Theories and empirical studies explaining financial FDI

Name	Theoretical approaches	Empirical literature
Microeconomic/ behavioral framework	Comparison of **benefits and costs** of investment design. Hymer (1969) FB face significant disadvantages when compared with local competition (cultural differences, control problems). FB need to find gains unavailable to local competitors: **(i) competitive advantage factors**, **(ii) efficiencies**, **(iii) geographical risk diversification**. **(i)** Dunning (1977) **eclectic theory of MNC** (location, ownership, internalization advantages). Gray and Gray (1981) **multinational banking.** Buckley and Casson (1991) **internalization theory**. Information as a competitive advantage: Brimmer and Dahl (1975), Gray and Gray (1981), Ball and Tschoegl (1982), Aliber (1984) **"follow the client"**: Grubel (1977) **defensive reaction** of banks in order not to lose customers at home. Swoboda (1990), Guillen and Tschoegl (1999) **Common origin:** (historical, linguistic). **(ii)** Efficiency theories – **size of the bank** (Terrell, 1979; Tschoegl (1983), Sabi (1988), its **degree of internationalization** (Ursacki and Vertinsky, 1992), **product and distribution channels**. **(iii) Risk diversification** Aggrawal and Durnford (1989), Berger and Young (2001), Errunza and Senbet (1981). *Other micro-behavioral theories:* **role of strategic behavior,** internationalization as the way of **following the oligopolistic behavior** (Knickerbocker, 1973), **leader theories**, **mutual forbearance**	Goldberg and Johnson (1990) Bilateral trade and financial FDI. Goldberg and Saunders (1981a, 1981b), Yamori (1998), Buch (2000), Focarelli and Pozzolo (2001) FDI and Financial FDI. Seth et al, (1998) follow the customer hypothesis. Galindo et al. (2003) common origin. Grosse and Golberg (1991), Ursaki and Vertinsky (1992), Williams (1996, 1998) bank size. Di Antonio et al. (2003) international experience. Guillen and Tschoegl (1999) common product and distribution channel. Amihud et al. (2003) risk sharing hypothesis Garcia Blandon (2003) first mover hypothesis. Choi et al. (1996) mutual forbearance.
Macroeconomic framework	**(i) General equilibrium models** that compare trade and FDI (Markusen and Makus, 2001; Helpman, 1987). **(ii) Financial conditions-related theories** – imperfection of capital markets (Froot and Stein, 1991; Klein et al., 2000), Goldberg and Saunders, 1981).	**PUSH factors:** Thomsen (2000), Barrell and Pain (1996) home country's economic cycle. Albuquerque et al. (2002) interest rates. Blonigen (1997) exchange rate Klein and Rosengren (1994) stock market value. Klein et al. (2000) relative access to credit. **PULL factors:** Focarelli and Pozzolo (2001) host country's expected economic growth; development of the financial system; economic integration. Gross and Goldberg (1991), Yamori (1998) macroeconomic volatility. Walter and Gray (1983) stable deposit base.

Institutional framework		**PUSH factors:** Buch and DeLong (2001) domestic restrictions; openness of the host country; Nigh et al. (1986), Goldberg and Johnson (1990) tax incentives. Legal system (protection of creditors rights and the quality of bankruptcy procedures); Brealey and Kaplanis (1996), Yamori (1998), Buch (2000) high per capita income in the host country

Source: complied by author from Herrero and Simon (2003).

APPENDIX B

List of credit organizations with 100% foreign capital participation as of 1 January 2013

N	Name of the bank	Date of registration	Charter capital, thousand rubles
1	ZAO “Absolut Bank”	22.04.1993	1 844 840, 0
2	ZAO “Asia Invest Bank”	30.08.1996	72 166, 9
3	OOO “ICICIC Bank”	27.05.1998	1 594 077, 5
4	ZAO “Alef Bank”	16.10.1992	1 125 817, 2
5	OOO “American Express Bank”	15.12.2005	377 244, 0
6	OOO “Anelik RU”	05.09.2003	19 000, 0
7	OOO “Atlas Bank”	17.10.2007	206 400, 0
8	OOO “Bank BTSK Moscow”	27.12.2007	1 293 680, 0
9	ZAO “Inteza”	31.12.1992	10 820 180, 8
10	ZAO “Chinese Bank ELOS”	23.04.1993	935 000, 0
11	ZAO “Bank Credit Swiss”	13.09.1993	460 000, 0
12	OOO “Bank PSA Finance RUS”	13.03.2008	1 900 000, 0
13	ZAO “Bank of Tokyo-Mitsubishi UFJ (Eurasia)”	29.05.2006	10 917 913, 0
14	ZAO “Troika Dialog”	31.12.2002	1 174 000, 0
15	OOO “BMW Bank”	17.03.2008	895 000, 0
16	ZAO “BNP Paribas Bank”	28.05.2002	5 798 193, 1
17	OOO “VESTA”	01.06.1993	375 700, 0
18	OOO “VRB Bank”	03.12.2009	210 000, 0
19	ZAO “Garanti Bank - Moscow”	10.11.1985	441 150, 0
20	OOO “Goldman Sachs”	30.10.2008	1 450 000, 0
21	ZAO “Danske Bank”	28.11.1996	1 048 000, 0
22	ZAO “Denizbank”	15.06.1998	1 128 608, 7
23	ZAO “J&T Bank”	21.09.1994	400 000, 0
24	OOO “JP Morgan International Bank”	26.10.1993	2 715 315, 0
25	OAO “DNB Bank”	24.12.1990	800 000, 0
26	OOO “Deutsche Bank”	17.04.1998	1 237 450, 0
27	OAO “Evrazijskij Bank”	27.11.1990 (1992?)	239 210, 0
28	ZAO “Ziraat bank”	01.11.1993	674 810, 5
29	ZAO “Investicionnij Bank Kubani”	12.04.1999	189 000, 0
30	ZAO “ING Bank (Eurasia)”	13.09.1993	10 000 010, 3
31	ZAO “Ishbank”	01.06.1994	1 723 048, 2
32	ZAO “CAPITAL-MOSCOW”	13.04.1994	62 000, 0
33	ZAO “KOMMERTZ BANK (EURASIA)”	10.12.1998	2 155 600, 0
34	OOO “Commercial bank of India”	05.11.2003	593 970, 0
35	ZAO “Royal Bank of Scotland”	26.10.1993	2 751 177, 3
36	ZAO “Credit Agrikol’ Corporate and Investment Bank”	24.12.1991	2 883 000, 0
37	OOO “MBA-MOSCOW”	24.01.2002	856 110, 0
38	OOO “Mercedes Benz Bank RUS”	19.07.2007	1 750 142, 0
39	ZAO “Mizuho Corporate Bank (Moscow)”	15.01.1999	2 620 482, 9

40	ZAO “Mir Business Bank”	30.01.2002	1 108 000, 0
41	OOO “Morgan Stanley Bank”	08.06.2005	2 000 000, 0
42	OAO “Moskommerzbank”	11.04.2001	1 443 600, 0
43	ZAO “Natiksis Bank”	17.01.2002	1 116 180, 0
44	OAO “NBK-Bank”	05.02.1996	1 088 820, 0
45	OAO “Promzsvyazbank”	12.05.1995	11 133 854, 7
46	ZAO “Raiffeisen Bank”	10.06.1996	36 711 260, 0
47	OAO “Renta-Bank”	22.09.1994	180 000, 0
48	OAO “RosEvroBank”	19.10.1994	288 353, 9
49	ZAO “RUNETBANK”	11.05.1994	91 360, 0
50	OAO “Svedbank”	01.09.1994	5 037 999, 8
51	ZAO “Citibank”	01.11.1993	1 000 000, 0
52	OOO “Investment Commercial Bank “Sovkombank”	27.11.1990	1 906 004, 1
53	ZAO “Sumitomo-Mitsui RUS Bank”	07.04.2009	6 400 000, 0
54	OAO “SEB” Bank	15.03.1995	2 392 000, 0
55	ZAO “Tinkoff Creditnie Systemi”	28.01.1994	1 427 000, 0
56	ZAO “Toyota Bank”	03.04.2007	2 439 999, 8
57	ZAO “Trade and Industrial Bank of China”	30.08.2007	1 000 000, 0
58	OOO “Transport Investment Bank”	22.03.1995	13 780, 5
59	ZAO “Uri Bank”	18.10.2007	500 000, 0
60	OOO “Financial Standard”	03.12.1990	245 000, 0
61	OAO “Fleksinvest Bank”	06.09.1994	200 000, 0
62	OOO “Volswagen Bank Rus”	02.07.2010	880 000, 0
63	ZAO “For a-Opportunity Russian Bank”	24.06.2005	340 253, 0
64	OOO “Khellenik Bank”	16.02.2009	1 365 000, 0
65	OOO “Home Credit and Finance Bank”	19.06.1990	4 173 000, 0
66	OOO “HSBC Bank”	23.04.1996	6 888 000, 0
67	OOO “UBS Bank”	09.03.2006	3 450 000, 0
68	OOO “UNIASTRUM BANK”	31.03.1994	5 099 865, 0
69	ZAO “UniCredit Bank”	20.10.1989	40 438 324, 4
70	ZAO “YAPI CREDIT BANK MOSCOW”	01.11.1993	478 272, 0
71	OOO “Non-banking credit organization “Western union DP Vostok”	01.03.1994	42 900, 0
72	OOO “Evroinvest”	05.11.2001	39 000,0
73	ZAO “Settlement Board of the Samara currency and foreign exchange market”	26.12.1997	130 000, 0

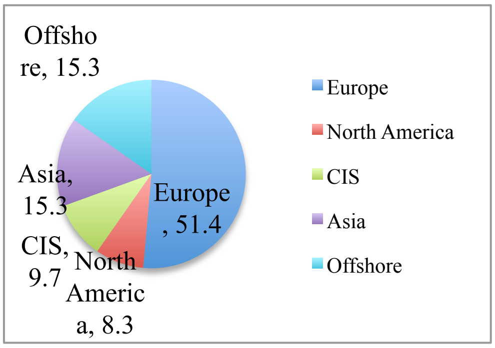
Source: Retrieved in February 2013 from www.cbr.ru

APPENDIX C

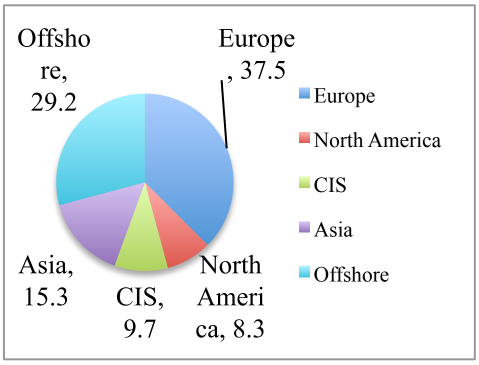
Geographical distribution of foreign banks with 100% foreign capital participation in Russia

73 banks with 100% foreign capital participation as of 1 January 2013
72 banks in sample of ownership property
Yellow color refers to pseudo-offshores

Europe	Belgium	1	
	Netherlands	4	
	UK	3	
	Switzerland	2	
	Pseudo-offshore regions Total		10
	Italy	1	
	Austria	2	
	France	4	
	Germany	6	
	Finland	1	
	Norway	1	
	Sweden	2	
	Czech Republic	2	
	Serbia	1	
	Albania	1	
	Turkey	4	
	Isrel	1	
	Europe Total		37
	Europe Total (excluding pseudo-offshores)		27
North America	USA	6	
	North America Total		6
CIS	Armenia	1	
	Kazakhstan	4	
	Azerbaijan	1	
	Uzbekistan	1	
	CIS Total		7
Asia	India	2	
	China	2	
	Japan	4	
	South Korea	1	
	Vietnam	1	
	Iran	1	
	Asia Total		11
Offshore	British Virgin Islands	1	
	Cyprus	9	
	Seychelles Islands	1	
	Offshore regions Total		11
Total	*Offshore regions plus pseudo-offshores Total*		21
	Total number in sample		72



	Number	%
Europe	37	51.4
North America	6	8.3
CIS	7	9.7
Asia	11	15.3
Offshore	11	15.3
Total	72	100.0



Recalculation of pseudo-offshores

	Number	%
Europe	27	37.5
North America	6	8.3
CIS	7	9.7
Asia	11	15.3
Offshore	21	29.2
Total	72	100.0

APPENDIX D

Motivations by groups, strategy and ownership of foreign banks with 100% foreign capital participation

No	Name of the bank	Date of registration	Charter capital, thousand rubles	Investor	Date of M&A or investment	Entry mode	Activity/ Motivation	Strategy	Remarks
6	OOO "Anelik RU"	2003	19 000, 0	Armenia	1990	Greenfield	Services to Armenian citizens residenting in Russia (money remittance)	Organic growth	The sole foreign branch established in Russia in 1990 and incorporated into a subsidiary in 2003
25	OAO "DNB Bank"	1990	800 000, 0	Norway	1990	Greenfield	Corporate and retail business; investment banking	Organic growth	Main shareholder - largest Norwegian Financial Group DNB
36	ZAO "Credit Agrikol' Corporate and Investment Bank"	2002	2 883 000, 0	France	1991(2002)	Greenfiled	Trade financing to French and Russian companies, deposits insurance	Organic growth	1991 – "Livonskiy Credit (Russia)" that later was renamed into "Credit Lyonnais Rus Bank" and 2002 got the name ZAO "Credit Agrikol'"
27	OAO "Evrazijskij Bank"	1992	239 210, 0	Kazakhstan	1992	Greenfield	Support of economic activity of companies of both countries	Organic growth	
10	ZAO "Chinese Bank ELOS"	1993	935 000, 0	China	1993	Greenfield	Support of economic relations among the	Organic growth	Subsidiary of Bank of China, Ltd.

							countries; retail and corporate business		
11	ZAO "Bank Credit Swiss"	1993	460 000, 0	Switzerland	1993	Greenfield	Investment banking; 2006 - traditional banking services to individuals	Organic growth	First representative office was established in 1976
24	OOO "JP Morgan International Bank"	1993	2 715 315, 0	United States	1993	Greenfield	Security market, conversion and other investment banking services to corporate clients	Organic growth	First representative office was established in 1973
28	ZAO "Ziraat bank"	1993	674 810, 5	Kazakhstan	1993	Greenfield	Support of economic activity of companies of both countries	Organic growth	
30	ZAO "ING Bank (Eurasia)"	1993	10 000 010, 3	Netherlands/ Belgium	1993	Greenfield	Banking services to large corporate clients in Russia		ING Group and Russia are connected with more than 200 years history
35	ZAO "Royal Bank of Scotland"	1993	2 751 177, 3	United Kingdom	1993	Greenfield	Securitization, foreign exchange, transaction banking services	Organic growth	
51	ZAO "Citibank"	1993	1 000 000, 0	United States	1993	Greenfield	Universal banking services	Organic growth	
70	ZAO "YAPI CREDIT BANK MOSCOW"	1993	478 272, 0	Turkey	1993	Greenfield	Trade and investment relations between the countries	Organic growth	
3	OOO "ICICIC Bank"	1994	1 594 077, 5	India	1994	Greenfield	Support of foreign trade b/w the countries	Organic growth	Subsidiary of the 2d largest bank "ICICIC" and 1st private bank in India
71	OOO "Non-banking credit organization "Western union DP Vostok"	1994	42 900, 0	United States	1994	Greenfield	Money remittance	Organic growth	

19	ZAO "Garanti Bank - Moscow"	1995	441 150, 0	Turkey	1995	Greenfield	Corporate sector of Russian business; support of Turkish companies in Russia		Main shareholder - Garanti Bank (Turkey), second largest private bank in Turkey
2	ZAO "Asia Invest Bank"	1996	72 166, 9	Uzbekistan	1996	Greenfield	Support of trade and economic relations	Organic growth	Established on the base of the Agreement b/w Russia and Uzbekistan
21	ZAO "Danske Bank"	1996	1 048 000, 0	Denmark	1996	Greenfield	Asset management, corporate sector	Organic growth	Subsidiary of Danske Bank A/S which is a part of Danske Bank Group, one of the largest group in North Europe
46	ZAO "Raiffeisen Bank"	1996	36 711 260, 0	Austria	1996	Greenfield/ M&A since 2000	Retail and corporate sector	Organic growth	
66	OOO "HSBC Bank"	1996	6 888 000, 0	United Kingdom	1996	Greenfield	Corporate and investment banking services for international and Russian companies and financial institutions	Organic growth	
67	OOO "UBS Bank"	2006	3 450 000, 0	Switzerland	1996	Greenfield	Investment banking	Organic growth	1996 - Representative office in Moscow, 1997 - JV JSC "Bransvik UBS Warburg" (investment company); 2004 - JV JSC "Bransvik UBS Warburg" was acquired by UBS (Switzerland) and reorganized into 100% subsidiary ZAO

									“UBS Securities”; 2006 - ZAO “UBS Bank”; old player on the market
26	OOO “Deutsche Bank”	1998	1 237 450, 0	Germany	1998	Greenfield	Investment banking	Organic growth	
33	ZAO “KOMMERTZ BANK (EURASIA)”	1998	2 155 600, 0	Germany	1998	Greenfield	Trade finance, commercial credits	Organic growth	
42	OAO “Moskommerzbank”	2001	1 443 600, 0	Kazakhstan	2001	Greenfield	Corporate sector (SMEs), retail business; trade support b/w the countries	Organic growth	Subsidiary of “Kazkommerzbank”, one of the largest banks in Kazakhstan and Central Asia
72	OOO “Evroinvest”	2001	39 000,0	Cyprus	2001	Greenfield	Retail and corporate sector	Organic growth	Offshore
14	ZAO “Troika Dialog”	2002	1 174 000, 0	Cyprus	2002	M&A 2002	Acquisition of large investment company in Russia; investment banking and operations on securities and debts markets		In the process of Integration with OAO “Sberbank” (100% shares acquired on 23 January 2012); offshore owning Russian business; 1991 - establishment of the investment company
16	ZAO “BNP Paribas Bank”	2002	5 798 193, 1	France	2002	Greenfield/ M&A (since 2000s)	Corporate and Investment banking, investment solutions, retail banking (consumer finance)	Organic growth	One of the first foreign banks to come to Russia. 1974 - Representative office of Banque Nationale de Paris and Banque de Paris. 2000 - significantly expanded

									the presense in Russia
37	OOO "MBA-MOSCOW"	2002	856 110, 0	Azerbaijan	2002	Greenfield	Trade and investment relations between the countires; expansion of capital from Azerbaijan; support of Azerbaijan citizens in Russia	Organic growth	100% subsidiary of the largest bank in Azerbaijan "International Bank of Azerbaijan" (established in 1992 by Azerbaijan Division of Vneshekonombank USSR
40	ZAO "Mir Business Bank"	2002	1 108 000, 0	Iran	2002	Organic growth 2002/ M&A (?) 2010	Trade support among the two countries	Organic growth	Contorlled by Bank Melli Iran (the largest bank in Iran with 100% shares belogning to Iran Government); former "Bank Melli Iran"
43	ZAO "Natiksis Bank"	2002	1 116 180, 0	France	2002	Greenfield	Corporate investment and financial services; private banking, asset management, insurance	Organic growth; investment banking	100% subsidiary of France's second largest banking group
65	OOO "Home Credit and Finance Bank"	1990	4 173 000, 0	Czech Republic	2002	M&A	Pure retail business; salary accounts		Former "Innovation Bank Technologies"; undisputed leader in POS finance
22	ZAO "Denizbank"	1998	1 128 608, 7	Turkey/Austria	2003	M&A	Account management; deposits; money transfer; foreign currency operations		Former CJSC "Iktisat Bank"; part of DenizBank Financial Services at present
34	OOO "Commercial bank of India"	2003	593 970, 0	India	2003	Greenfield	Support of economic and trade relations	Organic growth	

4	ZAO “Alef Bank”	1992	1 125 817, 2	UK	2004	M&A	Acquisition of the Russian network; corporate business		Offshore banks with Russian citizens as ultimate owners
44	OAO “NBK-Bank”	1996	1 088 820, 0	Kazakhstan	2004	M&A	Corporate and retail banking		Former OAO “Khlebniy”, 2004 - acquired by AO “Narodniy Bank Kazakhstana”
1	ZAO “Absolut Bank”	1993	1 844 840, 0	Belgium	2005	M&A	Corporate business of SMEs; retail business		Main shareholder - KBC Group (Belgium)
5	OOO “American Express Bank”	2005	377 244, 0	United States	2005	Greenfield	Credit cards, retail	Organic growth	
49	ZAO “RUNETBANK”	1994	91 360, 0	British Virgin Islands/Cyprus	2005	M&A	Universal commercial banking to corporate and retails sectors		Offshore bank with Ukrainian citizens as ultimate owners
50	OAO “Svedbank”	1994	5 037 999, 8	Sweden	2005	M&A	Financial services for corporate clients (Russian large companies and companies of North Europe and Baltic States operating in Russia)		Main shareholder - Swedbank AB
41	OOO “Morgan Stanley Bank”	2005	2 000 000, 0	United States	2005	Greenfield	Universal banking services; investment banking	Organic growth	
13	ZAO “Bank of Tokyo-Mitsubishi UFJ (Eurasia)”	2006	10 917 913, 0	Japan (via Germany)	2006	Greenfield	Corporate business to Japanese and Russian clients	Organic growth	
39	ZAO “Mizuho Corporate Bank (Moscow)”	1999	2 620 482, 9	Japan	2006	M&A	Corporate business; support of Japanese and Russian companies		
54	OAO “SEB” Bank	1995	2 392 000, 0	Sweden/Latvia	2006	M&A	Universal products of SEB Group in Russia; leasing; corporate business		Former OAO “Petroenergbank”
7	OOO “Atlas Bank”	2007	206 400, 0	Serbia	2007	Greenfield	Financial services on the Russian market	Organic growth	

8	OOO "Bank BTSK Moscow"	2007	1 293 680, 0	Kazakhstan	2007	Greenfield	Developing of business in corporate and retail sectors	Organic growth	Subsidiary of JSC "Bank Center Credit" (Kazakhstan)
23	ZAO "J&T Bank"	1994	400 000, 0	Czech Republic	2007	M&A	Corporate and retail business; credit cards		Former financial company "Tretiy Rim"
38	OOO "Mercedes Benz Bank RUS"	2007	1 750 142, 0	Germany	2007	Greenfield	Automobile loans	Organic growth	
55	ZAO "Tinkoff Creditnie Systemy"	1994	1 427 000, 0	Cyprus	2007	M&A	Acquisition of the Russian network; internet banking; credit card business		Offshore bank with Russian citizens as ultimate owners
56	ZAO "Toyota Bank"	2007	2 439 999, 8	Japan (via Germany)	2007	Greenfield	Automobile loans	Organic growth	
57	ZAO "Trade and Industrial Bank of China"	2007	1 000 000, 0	China	2007	Greenfield	Trade and investment relations between the countries	Organic growth	
59	ZAO "Woori Bank"	2007	500 000, 0	South Korea	2007	Greenfield	Support of Russian and S.Korean companies working in the foreign trade among the two countries	Organic growth	
69	ZAO "UniCredit Bank"	1989	40 438 324, 4	Austria	2007	M&A	Universal banking services		Former International Moscow Bank
15	OOO "BMW Bank"	2008	895 000, 0	Germany	2008	Greenfield	Automobile loans	Organic growth	
20	OOO "Goldman Sachs"	2008	1 450 000, 0	United States	2008	Greenfield	Security market operations of Russian and foreign companies; repo transactions; derivatives transactions (derivatives connected with natural resources); investment banking	Organic growth	
29	ZAO "Investicionnij	1999	189 000, 0	Cyprus	2008	M&A 2008/greenfiel	Banking services to Russian corporate clients;		Cyprus Bank of Development,

	Bank Kubani”					d 1999	retail, corporate sector, money remittance		agreement with Russia in 1999, offshore
45	OAO “Promzsvyazbank ”	1995	11 133 854, 7	Netherlands (dispersed ownership)	2008	M&A	Private banking, corporate lending, retail business (deposits, currency operations)		Offshore bank with Russian citizens as ultimate owners
61	OAO “Fleksinvest Bank”	1994	200 000, 0	Cyprus	2008	M&A	Acquisition of the Russian business network; Investment banking; credit card business, deposit activity; distance services to clients	Investment banking; credit card business, deposit activity; distance services to clients	Offshore bank owned by Investment Fund “Aurora Russia Ltd” (most probably with Russian shareholders as ultimate owners)
68	OOO “UNIASTRUM BANK”	1994	5 099 865, 0	Cyprus	2008	M&A	High potential of the Russian market; Universal banking services, retail business		Owned by the group of companies of the Bank of Cyprus (1899): offshore
9	ZAO “Inteza”	1992	10 820 180, 8	Italy	2009	M&A	Corporate business of SMEs in Russia; retail business - mortgage, credit cards, etc.		1992 – “KMB Bank” established by EBRD for promoting SMEs in Russia. The bank merged with Intesa Sanpaolo Group in 2005; ZAO “Bank Inteza” was established in 2003 and was the first bank with 100% of Italian capital; 2009 – “KMB Bank” and ZAO “Bank Inteza” emerged into ZAO

									“Bank Inteza”
17	OOO “VESTA”	1993	375 700, 0	Cyprus/Panama	2009	M&A	Investment banking to corporate clients		Offshore bank with Russian citizens as ultimate owners
18	OOO “VRB Bank”	2009	210 000, 0	Vietnam	2009	Greenfield	Economic relations and trade; support of Vietnamese companies in Russia	Organic growth	100% subsidiary of Vietnamese-Joint Venture Bank (Bank of Investments and Development of Vietnam and VTB)
53	ZAO “Sumitomo-Mitsui RUS Bank”	2009	6 400 000, 0	Japan	2009	Greenfield	Corporate business; support of Japanese and Russian companies (some international companies)	Organic growth	
64	OOO “Hellenik Bank”	2009	1 365 000, 0	Cyprus	2009	Greenfield	Corporate and retail banking	Organic growth	Established by Hellenic Bank Group; first operations on servicing Russian clients in 1990s; offshore
12	OOO “Bank PSA Finance RUS”	2008	1 900 000, 0	France	2010	M&A	Auto loans in the retail sector; acquisition of the established bank		Acquired OOO “AIG Bank (RUS)” in 2010. The strategy of the bank is determined by automobile companies “Peugeot” and “Citroen”.
47	OAO “Renta-Bank”	1994	180 000, 0	Israel	2010	M&A	Deposits; juridical accounts of companies; money transfer; foreign currency operations		

60	OOO "Financial Standard"	1990	245 000, 0	Cyprus	2010				Former "Djidaagrobank" and former OOO "Bank Buryatii", offshore bank with Russian citizens as ultimate owners
62	OOO "Volswagen Bank Rus"	2010	880 000, 0	Germany	2010	Greenfield	Automobile loans	Organic growth	
63	ZAO "FORA Opportunity Russian Bank"	2005	340 253, 0	Albania	2010	M&A 2010	Support of entrepreneurship		1993 Microfinance schemes by Opportunity International; 2002-2005 Investment Fund "FOR A" - entrepreneur projects; 2005 Investment Fund "FOR A" established ZAO "FORUS Bank" for a better financial services of SMEs; 2010 – "Opportunity Albania Sh.A." acquired ZAO "FORUS Bank"
31	ZAO "Ishbank"	1994	1 723 048, 2	Turkey	2011	M&A	Retail; support of economic and trade relations		Former bank "Sofiya" (1994); acquired by TIB (Turkey) in 2011; change of name to ZAO "Ishbank"
48	OAO "RosEvroBank"	1994	288 353, 9	United Kingdom	2011	M&A	Retail and corporate business		Offshore bank with Russian citizens as ultimate owners
52	OOO "Investment Commercial Bank	1990	1 906 004, 1	Netherlands (dispersed	2012	M&A	Acquisition of the Russian business network; retail		Former Bujkombank (1990), 1823 offices

	"Sovkombank"			ownership)			business		in Russia, offshore owning Russian business; extremely complicated scheme of affiliated companies
58	OOO "Transport Investment Bank"	2007	13 780, 5	Seychelles Islands	2012	M&A	Corporate and retail business		Offshore bank
32	ZAO "CAPITAL-MOSCOW"	1994	62 000, 0	Netherlands (dispersed ownership)	2013	M&A	Further expansion of the Russian business; specialized banking services for automobile business, corporate business		

APPENDIX E

Typology of banks by major motivations of entry

Offshore (both pure offshores and offshore banks with Russian citizens as ultimate owners) PUSH (institutional context, round-tripping of the Russian capital)
Support of economic and trade relations; foreign banks established under bilateral and other governmental agreements (PUSH/PULL)
Automobile loans (PUSH, followers)
Following of home country's business (PUSH, follow)
Second wave from Europe, the United States, Asia: market potential of Russia, high risk-high return (PULL)
First comers from old Europe and the United States (PULL, PUSH: historical, cultural and geographical context)

APPENDIX F

Typology of banks by major motivations of entry

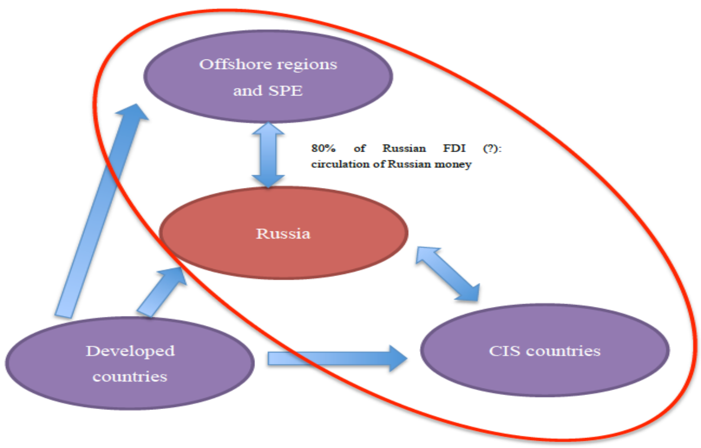
Category of banks by major activity on the market motivation	No in a group	Classification by PUSH/PULL factors; Entry mode; Strategy	Example of Banks
First pioneers from Europe and the United States	15 (16)	PULL/PUSH historical, cultural and geographical context Greenfield investment Organic growth	OAO “DNB Bank” (Norway, 1990); ZAO “Credit Agrikol’ Corporate and Investment Bank” (France, 1991 (2002)); ZAO “Bank Credit Swiss” (Switzerland, 1993); OOO “JP Morgan International Bank” (United States, 1993); ZAO “ING Bank (Eurasia)(Netherlands/Belgium, 1993)”; ZAO “Royal Bank of Scotland” (United Kingdom, 1993); ZAO “Citibank” (United States, 1993); OOO “Non-banking credit organization “Western Union DP Vostok” (United States, 1994); ZAO “Danske Bank” (Finland, 1996); ZAO “Raiffeisen Bank” (Austria, 1996); OOO “HSBC Bank” (United Kingdom, 1996); OOO “UBS Bank” (Switzerland, 1996); OOO “Deutsche Bank” (Germany, 1998); ZAO “Kommertz Bank (Eurasia) (Germany, 1998)”; ZAO “BNP Paribas Bank” (France, 2002); ZAO “UniCredit Austria” (Austria, 2007 (1989);
Support of economic and trade relations; foreign banks established under government agreements; geographical proximity to CIS and other countries	18	PUSH/PULL(?) Greenfield investment (very rare M&A) Organic growth	OOO “Anelik RU” (Armenia, 1990(2003)); OAO “Evrazijskij Bank” (Kazakhstan, 1992); ZAO “Chinese Bank ELOS” (China, 1993); ZAO “Ziraat bank” (Turkey, 1993); ZAO “YAPI CREDIT BANK MOSCOW” (Turkey, 1993); OOO “ICICIC bank” (India, 1994); ZAO “Garanti Bank-Moscow” (Turkey, 1995); ZAO “Asia Invest Bank” (Uzbekistan, 1996); OAO “Moskommerzbank” (Kazakhstan, 2001); OOO “MBA-MOSCOW” (Azerbaijan, 2002); ZAO “Mir Business Bank” (Iran, 2002); OAO “NBK-Bank” (Kazakhstan, 2004(1996)); OOO “Bank BTSK Moscow” (Kazakhstan, 2007); ZAO “Trade and Industrial Bank of China” (China, 2007); ZAO “Woori Bank” (South Korea, 2007); OOO “VRB Bank” (Vietnam, 2009); ZAO “Ishbank” (Turkey, 2011 (1994))

Second wave from Europe, the United States, Asia; market potential of Russia, high-risk high return; "market-seeking strategy"	16	PULL Greenfield investment/ M&A	ZAO "Natiksis Bank" (France, 2002 (1990)); OOO "Home Credit and Finance Bank" (Czech Republic, 2002); ZAO "Denizbank" (Turkey/Austria, 2003 (1998)); ZAO "Absolut Bank" (Belgium, 2005(1993)); OAO "Svedbank" (Sweden, 2005(1994)); OOO "Morgan Stanley Bank" (United States, 2005); ZAO "Bank of Tokyo-Mitsubishi UFJ (Eurasia)"(Japan, 2006); ZAO "Mizuho Corporate Bank (Moscow)" (Japan, 2006 (1999); ZAO "Sumitomo-Mitsui Rus Bank" (Japan, 2009); OAO "SEB" (Sweden/Latvia, 2006 (1995)); OOO "Atlas Bank" (Serbia, 2007); ZAO "J&T Bank" (Czech Republic, 2007 (1994)); OOO Goldman Sachs (United States, 2008); ZAO "Inteza" (Italy, 2009 (1992)); OAO "Renta-Bank" (Israel, 2010 (1994)); ZAO "FOR A Opportunity Russian Bank" (Albania, 2010 (2005)); ZAO "CAPITAL-MOSCOW" (Netherlands, 2013 (1994)
Following the home country's business	3	PUSH Greenfield/rare M&A Organic growth	ZAO "Bank of Tokyo-Mitsubishi UFJ (Eurasia)"(Japan, 2006); ZAO "Mizuho Corporate Bank (Moscow)" (Japan, 2006 (1999); ZAO "Sumitomo-Mitsui Rus Bank" (Japan, 2009)
Establishment of automobile loans business	5	PUSH (followers) Greenfield Organic growth	OOO "Mercedes Benz Bank RUS" (Germany, 2007); ZAO "Toyota Bank" (Japan, 2007); OOO "BMW Bank" (Germany, 2008); OOO "Bank PSA Finance RUS" (France, 2008); OOO "Voswagen Bank Rus"(Germany, 2010).
Offshore (both pure offshores and offshore banks with Russian citizens as ultimate owners; pseudo-offshores	15	PUSH (institutional context; round-tripping of the Russian capital)/PULL (?)	OOO "Evroinvest" (Cyprus, 2001); ZAO "Troika Dialog" (Cyprus, 2002 (1991)); ZAO "Alef Bank" (UK, 2004 (1992), Russian capital); ZAO "RUNETBANK" (British Virgin Islands/Cyprus, 2005 (1994, Russian (Ukrainian capital); ZAO "Tinkoff Creditnie Systemy" (Cyprus, 2007 (1994), Russian capital); ZAO "Investicionnij Bank Kubani" (Cyprus, 2008 (1999)); OAO "Promsvyazbank" (Netherlands, 2008 (1995), Russian capital); OAO "Fleksinvest Bank" (Cyprus, 2008 (1994), Russian capital); OOO "UNIASTRUM BANK" (Cyprus, 2008 (1994)); OOO "VESTA" (Cyprus/Panama, 2009 (1993)); OOO "Hellenik Bank" (Cyprus, 2009); OOO "Financial Standard" (Cyprus, 2010 (1990)), Russian capital); OAO "RosEvroBank" (UK, 2011 (1994)), Russian capital; OOO "Investment Commercial Bank "Sovkombank" (Netherlands, 2012 (1990)); OOO "Transport Invest Bank" (Seychelles Islands, 2012 (2007)).

EXPLANATORY NOTE 1

FDI in Russia: General statistic data

Figure EXN-1 Capital (FDI) flow mechanism in Russia



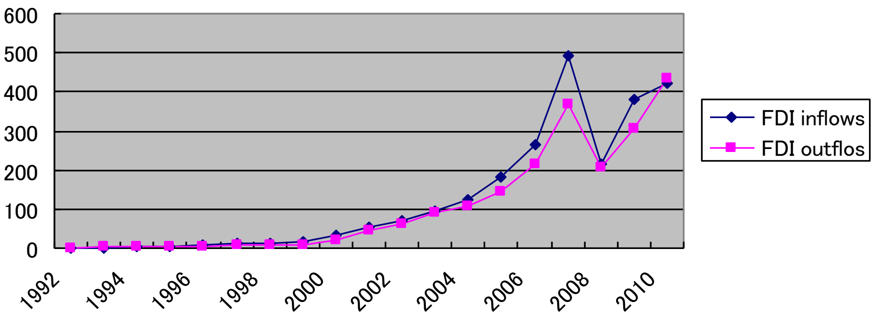
Source: Mizobata (2013), p. 13.

Table EXN- 1 Import and export of capital by major economies in 2002-08 (USD billion)

	Capital export	Capital import
World; total	40, 753	45, 030
Developed countries	35, 584	39, 115
Emerging market economies	4, 159	5, 484
BRIC	1, 409	2, 212
Russia	565	481
China	636	1,017
India	34	303
Brazil	132	305

Source: Mizobata (2012), p. 3-4. Primary source: Bulatov (2011a), p. 67.

Figure EXN-2 Inward and outward investments in Russia (USD billion)



Note: stock, nominal value, calculated by nominal exchange rate

Source: Mizobata (2012), p. 4. Primary source: UNCTAD, http://unctadstat.unctad.org/TableViewer/tableView.aspx, 14 February 2012.

Table EXN-2 Russian FDI (stock), (beginning of the year, USD billion)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Outward FDI											
CBR	20.1	44.2	62.4	90.9	107.3	146.7	216.5	370.2	205.5	302.5	369.1
Rosstat	na	na	na	na	na	3.5	6.1	13.9	32.1	44.6	56.8
Inward FDI											
CBR	32.2	52.9	70.9	96.7	122.3	180.2	265.9	491.1	215.8	378.8	493.4
Rosstat	na	na	na	na	na	49.8	67.9	103.1	122.4	109.0	116.2

Note: Rosstat regards more than 10% investments to stocks and statutory capital as FDI, while CBR includes the amount of reinvestments.

Source: Mizobata (2012), p. 6. Primary source: CBRF, http://www.cbr.ru, 22 January 2012; Rosstat, http://www.gks.ru/sbscripts/cbsd/dbinet.cgi, 14 February 2012

Table EXN-3 Russian foreign assets and outward FDI (stock) by regions, (beginning of the year, USD billion)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Total assets	248.8	259.5	288.5	336.8	406.6	516.3	731.3	1092.2	1010.7	1089.5	1173.2
Non-CIS	238.0	249.3	277.9	324.7	392.4	497.3	708.6	1057.5	976.9	1055.3	1133.7
CIS	10.8	10.2	10.6	12.1	14.2	18.9	22.7	34.7	33.8	34.2	39.6
FDI total	20.1	44.2	62.4	90.9	107.3	146.7	216.5	370.1	205.5	302.5	369.1
Non-CIS	18.6	42.2	60.0	87.8	103.0	141.4	209.4	355.1	193.6	287.5	353.3
CIS	1.5	2.0	2.3	3.1	4.3	5.3	7.0	15.0	12.0	15.0	15.8

Source: Mizobata (2012), p. 6. Primary source: CBRF, http://www.cbr.ru, 22 January 2012

Table EXN-4 TOP-10 countries in FDI (beginning of the year, USD billion, %)

	2010	2011
Cyprus	119.7 (39.6)	153.9 (41.7)
Netherlands	24.6 (8.1)	39.7 (10.8)
The British Virgin Islands	33.3 (11.0)	38.8 (10.5)
Bermuda	2.2 (0.7)	13.8 (3.7)
Luxemburg	14.8 (4.9)	12.0 (3.3)
U.K.	10.3 (3.4)	10.3 (2.8)
USA	10.5 (3.5)	9.8 (2.7)
Switzerland	7.7 (2.5)	9.3 (2.5)
Germany	7.4 (2.4)	6.7 (1.8)
Belarus	5.7 (1.9)	5.7 (1.5)
Gibraltar	11.6 (3.8)	5.7 (1.5)

Source: Mizobata (2012), p. 6. Primary source: CBRF, http://www.cbr.ru, 22 January 2012.

Table EXN-5 Dynamics of companies with foreign capital participation (number)

Countries	2001	2003	2005	2007	2008	2009
Cyprus	1051	1576	2043	3250	3915	4545
Germany	1322	1298	1332	1454	1505	1597
The British Virgin Islands	na	590	880	1123	1219	1312
China	966	1499	1403	1577	1352	1045
Ukraine	416	612	839	1170	1032	1104
Belarus	350	465	720	1212	1496	848
Kazakhstan	143	128	205	368	386	416
Uzbekistan	120	109	135	159	166	200

Note: Top four countries of both Non-CIS and CIS regions

Source: Mizobata (2012), p. 17. Primary source: Rosstat, *Russian statistical annuals*, 2002, 2004, 2006, 2008, 2009, 2010.