

# **The Globalisation of the Banking Sector – Evolutions and Predictions**

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## **Abstract**

*The present paper aims to describe the defining coordinates of the notion “globalisation” taking into consideration the different approaches of the phenomenon. On this basis and in relation with the positive and negative effects of globalisation, there is a continuous development of the evolutions generated by globalization in the financial subsystem of the global economy - its most dynamic subsystem. In this paper special importance is attached to the banking sector, an important component of the financial system. There are shown some evolutions noticed at international and national level, the concerns of international organizations to promote a stronger banking sector as well as the tendency that may allow the accomplishment of this desideratum.*

**Key words:** *globalisation, financial system, risk administration*

**JEL Classification:** *G21*

## **Introduction**

Throughout its history, mankind has experienced profound changes in the structure and functioning of the economy. They have generated outstanding performances in the technical and technological production, trade, services and information system.

These achievements were also accompanied by negative effects, consisting in the appearance of gaps and failures in the distribution of goods and income, in the management of conflicts and crisis etc.

To materialize these changes, two notions were proposed about a century ago, namely internationalisation and globalisation. Then grasping that the main beneficiaries of these changes are enterprises, multinational or transnational manufacturing companies, most analysts have adopted the notion of “globalisation”.

This Anglo-Saxon term was launched in the 60s of the last century. Irrespective of its origin, English and French dictionaries consider that the terms “global” and “world” have the same meaning, if they refer to planet earth and to its inhabitants.

This interpretation has determined many analysts to use the terms „globalisation” and “mondialisation” with the same major significance.

The same way of interpretation has suggested to some analysts the existence of the same meanings concerning the notions “globalisation” and “internationalisation”. They believe that

the two terms are both suitable for the same kind of facts or acts that are performed in the transnational space, beyond the political boundaries of states, with the participation of economic operators which have locations in different countries.<sup>1</sup>

At present, in the economic literature numerous definitions attributed to the concept of globalization can be identified, but none of them is fully accepted.

Among these definitions, we should mention the one formulated by Professor Joseph Stiglitz who considers that “the phenomenon of globalisation consists of the stronger integration of countries and their populations due to significant reduction of costs of transportation and communication and due to the elimination of the artificial barriers concerning goods, capital and people circulation between countries”<sup>2</sup>.

Other analysts present in their definitions the main elements that will identify the basic characteristics of globalisation:

- globalisation refers to those processes by which peoples of the world are incorporated into one global society (Martin Albrow);
- globalisation can be defined by the intensification of the social relations worldwide, which link locations situated at long distance in such a way that events that occur locally are seen through the eyes of others similar to them, occurring at many miles away and vice versa (Anthony Giddens);
- globalisation is a global network which gathered together communities on this planet, another time spread and isolated in a mutual dependence and a unit of “a single world”.

Adverse effects that globalisation generates were also the basis of some definitions elaborated by the opponents of this phenomenon. They consider globalisation as a “modern colonialism”, which generates unemployment, leading to reduced living standards.

These opponents of globalisation overlook the fact that it offers real opportunities for a real global development, but the degree of recovery of these opportunities depends on the speed with which different countries work to fructify the opportunities.

To support their conception of globalisation, the same analysts claim that, although it has beneficial effects, the process involves risks caused by volatile capital flows, associated with social and economic risks, as well as risks of environmental degradation caused by the possible widening of poverty.

Speaking about definitions attributed to globalisation, we cannot omit the Romanian authors' important contribution to a better clarification of this notion. We should mention Professor Ioan Bari's definition, who considers globalisation as “a very dynamic process of increasing the interdependence of national states, as a consequence of the enlargement and deepening of transnational connections in spheres of economic, political, social and cultural life increasingly large and diverse, with direct implication on globalisation activities, and also asking for a global solution”<sup>3</sup>.

The brief overview of some of the definitions of globalisation allows us to conclude that although they are not fully accepted, the term is widely used to characterize the current state of world economy. Although these definitions show the different meanings of the phenomenon of globalisation as analysts understand it, they point out the agreement of all that the world markets need to act taking into account the developments that occur on most of these markets.

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<sup>1</sup> Ghiță R., „Fenomenul mondializării și piețele”, in *Economia României și Uniunea Europeană*, Bucharest, ASE Publishing House, 2005

<sup>2</sup> Stiglitz, J., *Globalizarea. Speranțe și deziluzii*, Bucharest, Economic Publishing House, 2003

<sup>3</sup> Bari, I., *Tratat de economie politică globală*. Bucharest, Economic Publishing House, 2010

## **The Global Financial System - an Essential Component of the Globalisation of Economic Activity**

Nowadays, in the context of globalization, the world economy recorded significant changes in the structure and function of its main subsystems, especially in the financial subsystem.

Under globalization conditions, this subsystem, which includes capital flows (loans and bonds) and investment (foreign direct investment, shares and money), recorded the highest rate of increase of the volume business. This rate was quickened by the postwar monetary commitments from Breton Woods (U.S., 1944), and the creation of an international organism - the International Monetary Fund and World Bank – meant the steps of forming an integrated financial system.

More recently, as a consequence of financial globalization, the European Monetary Union was created and the euro was introduced. Its main purpose is the attempt to completely liberalize the capital movements within the EU by limiting foreign exchange fluctuations.

To achieve this goal, EU countries agreed that each Member State's monetary policy should be coordinated by the European System of Central Banks, formed by the European Central Bank and the national central banks of the member states.

The spread of capital circuits, plus a strong institutionalized infrastructure, have created a global financial market the developments of which are felt very quickly on domestic markets.

These evolutions, which involve significant systemic risk, have led many analysts' restraint concerning financial and capital market globalisation. This restraint is caused by the opinion resulted from the analysis of crises consequences which have occurred after 1990. So, these crises are believed to be a direct consequence of the effects of globalisation.

Sustaining this point of view, these analysts invoke the financial crises in Latin America (1994), East Asia and Russia (1997) and Argentina. The global financial crisis triggered in 2008 can be added to this list, which followed the American financial market crisis of the risk mortgages (2007).

Besides the positive effects of the euro, the same analysts have noticed in the European Monetary Union the negative consequences induced in the system by the impact of external shocks on the economic and social environment of the member countries. They consider, however, that the high rates of development of some countries would not have been possible if it had not been for the financial flows specific to the globalisation.

Today, despite the risks that accompany the development of the global financial area, including the globalisation of banks, capital and financial markets, it has become a vital part of the business globalisation.

## **Globalized Banking Sector - Evolutions and Predictions**

The banking area, a part of the financial and economic system is under the influence of changes caused by the current economic situation in which it is evolving- the instability of interest rates, the increase of the competition, the concentration of the capital, etc.

Initially created as financial institutions with a high degree of specialization, banks tried to diversify their activities. Such trend was required by the international competitive environment in which banks evolved and aimed to cover the financing needs in different geographical areas and industries. It materialized itself in the diversification of the services portfolio including more and more complex operations that require very high risk.

From this category of operations we can mention derivatives (futures, swaps, options) as well as new types of bonds used for speculative purposes or as hedges of currency risk.

At the same time, increased competition has led banks to create complex products in terms of the involved economic sectors. There appeared, in our country as well, a mixture between the banking sector and that of insurance, between commercial banks and investment banking sector, between the banking sector and the real estate and real estate securities markets, using financial and operational leasing operations. Another consequence of globalisation due to international trade is represented by the growth of the multinational banking sector, reflected in the opening of branches and subsidiaries in countries other than the country of origin of the bank.

These effects of globalisation have generated the need to harmonize banking regulations, to facilitate the extension of regional and global spread of banking services.

The starting point in harmonizing banking regulations was at Geneva in 1987, where an agreement was signed and to which countries that joined at that time were the "Group of 10 industrialized countries." The agreement aimed to establish the optimal size of the capital of a bank, the minimum level of the capital that a bank must have take into account the size of the risks associated with its assets and the level of capital adequacy. This agreement is known as the "Basel Convention".

Subsequently, concerns about the harmonization continued when in 1988 the Bank for International Settlements proposed a minimum standard for capital adequacy. The proposed standard aimed to eliminate unfair competition and improved the protection of depositors.

As for the Basel Capital Accord, through its content, it meant to ensure the convergence of the prudential regulations concerning the credit risk and the market risk. It sets the international standards of bank capital proportionality establishing a method of linking between bank capital and assets, using a risk assessment system and a minimum capital proportion of 8%.

Further developments of banking globalisation, the amplification of risks associated with this activity, have shown that the Basel Capital Accord does not allow taking into consideration all the risks associated with the activity of credit institutions.

Therefore, in 1996, the Basel Committee proceeded to an evaluation of the market risk, and the Capital Accord was signed in 1988. The provisions of the Accord tried to approach more closely the banks' capital to the risks. Several reviewed acts followed these provisions that culminated with the adoption of a new Capital Accord called Basel II in June 2004. The provisions of this Accord were included in the European legislation in 2007, as a consequence of the change of some existing EU directives.

The accord contains precise criteria for capital adequacy, it proposes a method to prevent the credit risk and it introduces specific approaches about different types of loans, taking into account the typology of risks and the possibilities to prevent them.

In 2010 new Basel III standards were elaborated. They have wider applicability, including both individual bank risk measures and measures concerning the risks of the entire banking system.

Through their content, Basel III standards aim at creating a strong banking sector, able to absorb the shocks from the economic and financial sector. They also seek a better risk management and attempt to strengthen the transparency requirements of the banks.

The "Banking Coordination Directive in Europe" had a very important role in standardizing bank regulations across Europe. In those two documents there is defined the notion of "credit institution" there are established the granting conditions for the authorization in the bank domain and there are created conditions for mutual recognition of authorization and banking supervision systems. There are also established other major aspects of the banking activity, such as setting the minimum capital level for a bank.

Currently, the evolution of the banking systems is oriented towards the meet of the needs of an environment where the competition is deepening, the exigencies of domestic and international regulatory bodies, given that, both on the national and supranational markets, there appear phenomena the impact of which affects their activity.

One of these phenomena is the worldwide recession in the early 2000s and amplified by the U.S. real crisis (2007). Its effects on the banking systems were many, some of which having been already listed. Overall, the entire activity of the banking systems has been focused on maximizing the profit, under the conditions of an increasingly severe competition.

In such an orientation the depersonalization of banking took place, some of the specific bank services (lending, payment transactions, transactions with financial derivatives instruments) being taken over by non-bank financial institutions.

Moreover, in order to increase profit by reducing labor costs and other costs there have been relocated some activities or banking units by transferring them to countries where costs wages are low.

In recent years, the increasing competition has led the banks to shift to a policy of fusions and acquisitions.

To start, such policies were noticed on the U.S. market in the '90s, with the fusion of Chase Manhattan and Commercial Banking. Subsequently, the same market was a real wave of fusions, resulted among others, by creating Citigroup.

In Europe, fusions materialized itself, among other things, in the acquisition of Sanpaolo bank by Intesa, or in the first big fusion in the European Union, one between UniCredit and HVB. This fusion had consequences on the Romanian banking market, resulting in the unification of HVB Romania banks, "Ion Tiriac" Commercial Bank and UniCredit Romania.

However it should be noted that although banking fusions and acquisitions have as main purpose the reduction costs, the dispersion of banking risks and the more efficiently use of the resources, they can generate dominant market positions.

The major banking companies resulted from fusions may impose their own policies even by using anticompetitive means.

Concerning Romania, the evolution of the financial system and its main components - the credit institutions - was influenced by the developments occurred in the global economy imposed by the globalisation.

Before the globalisation of the economic crisis, the banking system in Romania was offering standardized products, carrier of controllable risk categories from a prudential perspective.

Emphasizing the competition demonstrated however that these products could not cover the market requirements. Under these conditions banks have turned towards the diversification of products and towards the expanding of the market share of the traditional products.

With the deepening crisis, the products management offered by Romania's banking system has been subjected to the evolutions resulting from the banks' globalisation. In these conditions, the main concern of the banks was focused towards the loss reduction that could be caused by the mismanagement of services. They were not interested in the portfolio diversification, focusing on refinancing loans and mortgage loans in the "First Home" programme.

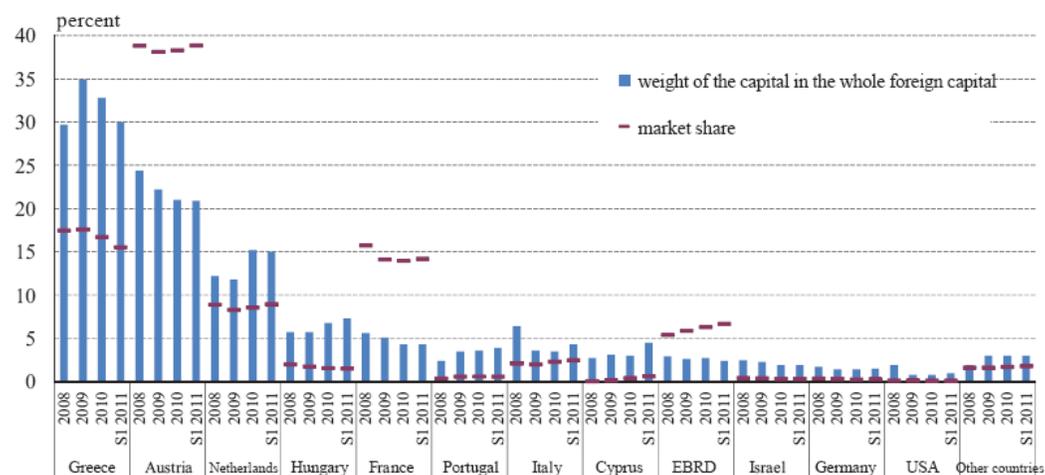
Joining the European Union has boosted the penetration of capital coming from EU countries, capital that currently occupies a significant weight in the capital structure of the Romanian banking (Table 1).

**Table 1.** Structural indicators of the Romanian banking system

	2003	2004	2005	2006	2007	2008	2009	2010	S1 2011
Number of credit institutions	39	40	40	39	42	43	42	42	42
Number of banks with majority private capital	36	38	38	37	40	41	40	40	40
Number of banks with majority foreign capital from which:									
branches of foreign banks	29	30	30	33	36	37	35	35	35
	8	7	6	7	10	10	10	9	9
Share in total assets of the banks with majority private capital (%)	62.5	93.1	94	94.5	94.7	94.6	92.5	92.4	93.1
Share in total assets of the banks with majority foreign capital (%)	58.2	62.1	62.2	88.6	88	88.2	85.3	85.0	85.4
Share of top five banks in total assets (%)	63.9	59.2	58.8	60.3	56.3	54.3	52.4	52.7	53.6
Herfindahl – Hirschmann indicator (points)	1,264	1,120	1,124	1,171	1,046	926	857	871	895

Source: NBR, Report on financial stability, 2011

Important conclusions can be formulated, if we follow the evolution of the social capital weight of credit institutions in whole foreign capital (Figure 1).



**Fig. 1.** The weight of social capital of the credit institutions in the whole foreign capital and the share market according to the origin country

Source: NBR, Report on financial stability, 2011

We can notice that the Austrian capital banks held in 2010 and in the first half of 2011 the largest weight- 38.8% - followed by the Greek capital - 15.5%. It should be noticed the substantial growth in 2010 of the weight of Netherlands capital in the whole foreign capital - 15% - due to additions caused by the establishment of the Garanti Bank branch in that year.

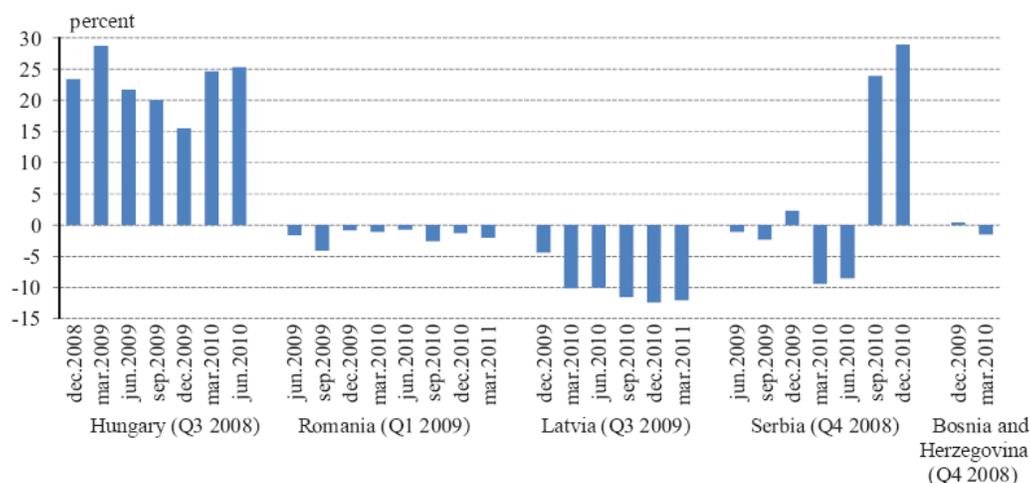
The succession of financial crises in recent decades has forced many countries, including Romania, to resort to external financing to support the development. The same phenomenon has prompted the concern of the international authorities (IMF, European Commission, European

Bank for Reconstruction and Development, European Investment Bank, World Bank) and of the national authorities too for the identification of coordinated actions to maintain the financial stability.

In Europe these concerns resulted in the “European Initiative of Banking Coordination”, composed at Vienna in 2009 (Vienna Initiative). Its main objective was to keep at a group level the bank exposures in the participating countries, as a consequence of some measures, involving the cooperation of authorities from the residence countries of the European banking groups active on the markets of the emerging Europe with those international authorities, bank groups representatives and authorities from the European emerging countries.

Credit institutions in Romania which participated in the initiative were Alpha Bank, Romanian Commercial Bank, Bancpost, BRD - Groupe Societe Generale, Romanian Bank - Member of the National Bank of Greece Group, Piraeus Bank, Raiffeisen Bank, Unicredit Tiriac Bank and Volksbank.

The subscriber banks to the initiative pledged to prevent the massive withdrawals of the bank exposures maintaining the exposure and recapitalizing their subsidiaries from the countries where funding programs were implemented by the European Union and the International Monetary Fund (Figure 2).



\* The data in parenthesis represent important moments concerning the exposures maintenance.

**Fig. 2.** The evolution of European banks exposure towards the emerging European countries, according to the reference time to maintain exposures

Source: BNR, Report on the financial stability, 2011

In Romania, the bank groups were committed to respect the obligations assumed during the first financing agreement concluded by Romania with the European Union and the IMF (2009-2011). Subsequently, they were committed on a long term to maintain the capitalization of subsidiaries of our country above the 11% threshold established in March 2011 for all the credit institutions in Romania.

For the banking sector of our country the initiative provisions have had an important role in ensuring the financial stability. They had as a result the exposures maintenance and the assurance of a capitalization of over 10%, while the banking sector has been subjected to international developments, being obliged to take measures of adequacy corresponding to them.

The effects of fusions and acquisitions policy notified internationally were also felt in the banking market in Romania. They resulted in the unification of HVB banks in Romania, “Ion

Tiriac” Commercial Bank and “Unicredit” Romania, after which the Italian banking group became, through the resulting asset size, market leader in Central and Eastern Europe.

At the same time, to reduce potential losses, the Romanian banks that are part of large international groups have outsourced currency loans, thus transferring their balance sheet exposures to parent banks balance sheets. In doing so, there have been valued the benefits of globalisation to avoid a potential restriction of the foreign currency balance and the increase of the minimum obligatory reserves constituted at NBR.

The same banks turned to the use of subordinated loans from parent banks to provide financing in foreign currencies at competitive costs.

In the next period there is expected to take new measures to strengthen the financial stability, including the activities of credit institutions. They are contained in the “National Reform Programme 2011-2013”, a document that contains measures in agreement with the requirements of the new European economic governance framework.

These measures aim to:

- restructure the domain of the credit institutions;
- extend the area of instruments accepted as guaranties in refinancing operations, action realized by NBR;
- establish a prudential treatment of the temporary holding of shares;
- monitor loans in foreign currency and adopt the measures in order that their price reflect with accuracy the transparent risk encountered when they are given to the borrowers exposed to the exchange rate;
- adopt measures to prevent the manifestation of the systemic risk in the banking sector.

We believe that a detailed presentation of these general measures, by identifying and implementing in a vigorous way some concrete actions is likely to achieve the objective for which they were established.

## Conclusion

In the current economic juncture, globalisation is a phenomenon that can not be avoided. It may lead to economic growth, if the advantages of this process are capitalized adequately and in close connection with the best internal policies and with the financial, fiscal and monetary appropriate leverage.

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## Globalizarea sectorului bancar – evoluții și predicții

### Rezumat

*În articol se prezintă coordonatele definiției ale noțiunii de „globalizare”, luând în considerație diferite modalități de abordare a fenomenului. Pe această bază și în relație cu efectele pozitive și negative ale globalizării, în continuare se dezvoltă evoluțiile generate de globalizare în cadrul subsistemului financiar al economiei globale – cel mai dinamic subsistem al acesteia. În economia lucrării, o importanță deosebită se acordă sectorului bancar, o componentă importantă a sistemului financiar. Sunt prezentate evoluțiile sesizate pe plan internațional și național, preocupările organismelor internaționale pentru promovarea unui sector bancar mai puternic, precum și tendințele care în viitor pot permite realizarea acestui deziderat.*