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Competition within a Fast-Growing Market: the Ukrainian Case

Competition in the banking sector remains weak. This has allowed financial institutions to thrive by using a diverse set of strategies in their struggle to secure market share

Practically everyone is talking about the recent intensification of competition in the Ukrainian banking market. Several major foreign banking groups with centuries of experience and broad access to long-term and fairly inexpensive credit have entered the Ukrainian market. Just five years ago, analysts forecasted two scenarios for the development of Ukraine's banking sector: due to intensified competition, they predicted, small domestic banks would either merge or move into foreign ownership.

Yet, this prediction did not materialise. Between 2001 and 2004, the number of banks in Ukraine did tumble, but so did the share of foreign capital in the Ukrainian banking sector: in early 2005, it had fallen to 9.6%. Following the Orange Revolution, foreign investors awoke to Ukraine's potential. Interestingly, fashion on Ukraine led to the setting up of new banks, rather than the acquisition of already existing ones. In 2006 alone, the National Bank of Ukraine (NBU) registered 13 new banks, most of which were established in order to be re-sold. More specifically, what would be sold on are the banking licenses, client base, and sometimes even the management team.

The rapid improvement in the performance of the banking sector indicators (in 2006, assets soared by 59%) points to the fact that many of the novices successfully found niches, in which established market players are also being pushed. The Ukrainian banking sector is far from being consolidated: its top-ten banks control 51% of the assets, whereas in many Central and Eastern European countries, the top-five banks control 60% to 80% of the sector's assets. Therefore, the level of competition within the Ukrainian banking system remains weak, while asset consolidation has been decreasing (Fig. 1). Interest rates are too gradually decreasing — another symptom of low competition.

A sudden escalation of competition can take place only if banking sector growth slows down and the market comes close to saturation. This is not, however, expected to happen for at least three years, and the banks are therefore painstakingly trying to increase their current market share, bearing in mind that it is much easier to do so while the market is growing fast. Once the market reaches saturation, they will have to fight fiercely in order to secure even the tiniest share of it.

In search for assets

To establish the market shares of Ukraine's top 20 banks, we look at the changes in market shares by assets and household deposits over the past seven years. The market shares of PrivatBank, Raiffeisen Bank Aval, and UkrSibBank, Ukraine's largest financial institutions, showed the highest growth (Table 3). In the past seven years, the Dnipropetrovsk-based PrivatBank increased its market share by 1.86 percentage points (p.p.). As of January 2007, one in ten hryvnias of the sector's assets belonged to the bank. PrivatBank also controls 14.18% of the household savings (an increase of 2.05 p.p. over the past seven years).

PrivatBank's position as Ukraine's largest financial institution is unlikely to be challenged in the next few years. Its assets exceed those of its closest competitor, Raiffeisen Bank Aval, by an impressive UAH 6bn ($1.1bn), or 22%. We placed both banks in Group A, but assigned them different forecast: PrivatBank has been given an A++ rating (a positive outlook), while Raiffeisen Bank Aval has been assigned an A+ rating (a neutral outlook). We at *Expert-Rating* think that Raiffeisenbank's growth rate in Central and Eastern Europe is too high, to the extent that it is outstripping the parent group's resource capabilities. Thus, at the start of 2007, Aval still could not conduct its own big issuance of Euro-loans. At the same time, PrivatBank — having no foreign investors — has successfully established a debt issuance pipeline via UBS to secure financing at low rates.

Almost two percentage points separate the shares of assets of each of the three largest banks, while the gaps between the shares of the following three banks — UkrEximBank, PromInvestBank, and UkrSotsBank — are narrower. Out of the top 20 banks, PromInvestBank lost the biggest share of the sector's aggregate assets (-4.47 p.p.). OshchadBank, on the other hand, experienced the biggest drop in household savings: over the past seven years, its share plummeted by 14.6 p.p.

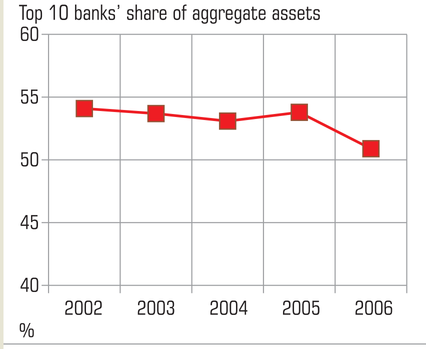
A confusing banking sector

In early 2006, the mid-level management of some of the top five banks complained about the inflexible policies of their smaller competitors. The situation has become paradoxical: in UkrSibBank (A++), a dollar-denominated mortgage loan could be obtained at a 10.8% (and with a 2% issuance fee), while in UkrPromBank (B++), a dollar-denominated time deposit yielded an 11%. Moreover, some of Group C banks offered 14% dollar deposit rate. This inconsistency has to do with the fact that the Ukrainian banking sector is divided between two categories of banks. The first category comprises foreign-

Figure 1

The Ukrainian banking sector is moderately consolidated

Top 10 banks' share of aggregate assets



Source: National Bank of Ukraine; calculations by Expert Ukraine

PrivatBank, Raiffeisen Bank Aval, and UkrSibBank will remain the market's key asset seekers

The top three banks take the lead

Table 3

The market share of top 20 Ukrainian banks (by assets and household savings)

Banks	Market share by assets			Market share by household savings		
	01.01.2007	01.01.2000	Change	01.01.2007	01.01.2000	Change
PrivatBank	9.93%	8.07%	1.86%	14.18%	12.13%	2.05%
Raiffeisen Bank Aval	8.16%	5.74%	2.42%	10.82%	4.60%	6.22%
UkrSibBank	6.58%	1.07%	5.50%	3.44%	0.43%	3.01%
UkrEximBank	5.48%	7.33%	–1.84%	2.81%	3.64%	–0.82%
PromInvestBank	5.17%	9.64%	–4.47%	7.09%	12.71%	–5.62%
UkrSotsBank	5.15%	4.81%	0.35%	4.78%	4.26%	0.52%
OshchadBank	3.41%	5.21%	–1.80%	6.98%	21.57%	–14.59%
OTP Bank (Raiffeisenbank Ukraine)	3.29%	0.89%	2.39%	1.78%	0.02%	1.75%
Nadra	3.03%	1.56%	1.46%	3.52%	0.67%	2.84%
Forum	2.17%	0.48%	1.69%	1.96%	0.27%	1.70%
Finance & Credit	2.16%	1.50%	0.66%	2.88%	0.64%	2.25%
Kreditprombank (Inkombank Ukraine)	2.09%	1.30%	0.79%	1.35%	1.14%	0.21%
UkrPromBank (ARC-Bank)	1.93%	0.14%	1.79%	3.38%	0.00%	3.38%
BrokBusinessBank	1.92%	2.47%	–0.55%	1.61%	0.69%	0.92%
First Ukrainian International Bank	1.79%	3.68%	–1.89%	0.94%	1.77%	–0.83%
UkrGazBank	1.31%	0.38%	0.93%	1.61%	0.18%	1.43%
VABank	1.30%	1.00%	0.30%	0.98%	0.81%	0.17%
TAS-Kommerzbank (Kiev-Privat)	1.21%	0.42%	0.79%	1.20%	0.17%	1.04%
Pivdenniy Bank	1.19%	0.54%	0.65%	1.27%	0.12%	1.15%
Rodovid Bank (Perkombank)	1.08%	0.25%	0.83%	1.03%	0.53%	0.50%

Source: National Bank of Ukraine; calculations by Expert-Rating

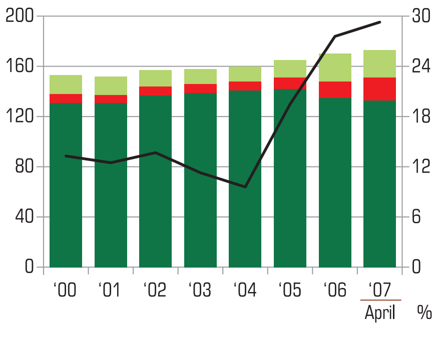
owned banks and those with unlimited access to global capital markets; the second category consists of banks which focus exclusively on the domestic market and service financial-industrial groups.

With the banking sector constantly evolving, it is impossible to place any bank firmly in either category. Only a year ago, it seemed like Ukrainian bankers had lined up, hoping to sell their banks to foreign buyers at a premium. However, high market growth and the growth of multipliers — whereby the price of a well-established bank with an extensive branch network is at least four times its book value — make it fairly unlikely that prospective foreign buyers will arrive en masse any time soon. The NBU is not planning to introduce restrictions on foreign ownership — unsurprising, given that for half of Ukrainian banks, the prospect of foreign ownership is very distant (Fig. 2).

Figure 2

Foreigners own less than a third part of the Ukrainian banking system

The number of banks operating in Ukraine, and the share of foreign ownership at year-end



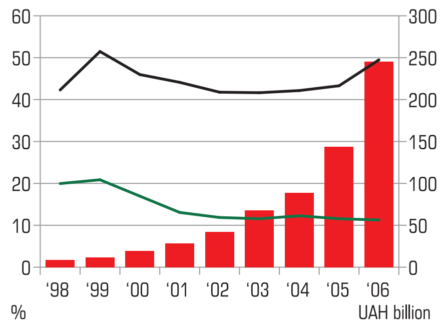
- Fully Ukrainian-owned
- Fully foreign-owned
- Partly foreign-owned
- Share of foreign capital (right scale)

Source: National Bank of Ukraine; calculations by Expert Ukraine

Figure 3

The share of forex-denominated loans is growing, while interest rates are no longer decreasing

Average interest rate and share of forex-denominated loans issued by Ukrainian banks



- Share of loans in foreign currency
- Average interest rate of loans in foreign currency
- Loans issued by Ukrainian banks (right scale)

Source: National Bank of Ukraine

The main reason behind the perpetuation of the two-category system is the strengthening of foreign lenders' confidence in the Ukrainian banking system. In the past 15 months, Ukraine's top 15 banks have borrowed around $4.7bn (excluding conventional trade finance, lead managers' loans, and interbank loans). Other banks have limited access to international financial markets.

Thus, PrivatBank's partnership with UBS helped the former to obtain two loans: $150m at 8.75% in early 2006, and $500m at 8% a year later. In December 2006, UkrSibBank secured an impressive $500m loan at a mere 7.75%. State-owned UkrEximBank, in turn, has attracted $1bn from foreign investors in the last 15 months.

This situation, in which a number of Ukrainian banks have managed to obtain cheap, large loans on international financial markets, has disturbed the domestic market profoundly. For instance, the loan that UkrSibBank obtained at 7.75% could have been used to issue domestic mortgage loans at 10.8%. At the same time, Forum Bank — which in October 2006 borrowed $100m at 10% — was itself issuing loans at interest rates of 12% or more. As it turns out, foreign lenders have a differential approach to Ukrainian loan seekers — not excluding the country's largest banks. A bank's rating is not a decisive factor here: in early 2007, PrivatBank and the First Ukrainian International Bank (FUIB), which had identical ratings (both assigned by Fitch), borrowed at 8% and 9.75% respectively. A bank's ability to secure a low interest rate on its loans is determined not only by the loan size, but also by the bank's credit history and its liaisons with prospective lenders.

Provided that no major mergers or acquisitions occur in the Ukrainian banking sector within the next five years, PrivatBank, Raiffeisen Bank Aval, and UkrSibBank will remain the market's key asset seekers. Their success will largely depend on sustaining their ability to borrow on global capital markets, as well as on the country's macroeconomic stability. Their principal competitors for leadership are fully foreign-owned banks, such as ING, Citibank, and OTP. Changes in their operational strategy in Ukraine will lead to crucial changes within the banking sector, and to a reshuffling of market shares.