ENTRY DECISION OF FOREIGN BANKS IN POST-COMMUNIST COUNTRIES: THE CASE OF UKRAINE AND BELARUS

by

Aliaksei Razanau

A thesis submitted in partial fulfillment of
the requirements for the degree of

Master of Arts in Economics

Economics Education and Research Consortium
at Kyiv-Mohyla Academy

2000

Approved by _____
Chairperson of Supervisory Committee

_____

_____

_____

Program Authorized
to Offer Degree _____

Date _____

Economics Education and Research Consortium
at Kyiv-Mohyla Academy

Abstract

ENTRY DECISION OF FOREIGN BANKS IN POST-COMMUNIST COUNTRIES: THE CASE OF UKRAINE AND BELARUS

by Aliaksei Razanau

Chairperson of the Supervisory Committee: Professor Anatoliy Voychak
Director of the Christian University

The entry of foreign banks into Eastern European markets has expanded since the fall of Communist regimes. However, the distribution of foreign banks' offices between the Former Soviet Union countries is conspicuously uneven both in terms of scale of presence and parent bank selection. This paper will examine the theoretical framework of bank expansion and illustrate its empirical application to the cases of Ukraine and Belarus. The study will reveal bank-prospective motives underlying the decision of a foreign bank to enter post-communist markets, as well as the country-specific determinants of the extent of foreign bank presence on a given national territory. The synergy of such a twofold analysis will provide immediate practical applications for both the management of Western banks and policymaking in transition economies.

TABLE OF CONTENTS

ACKNOWLEDGEMENTS

I would like to express my sincere gratitude to my research advisor, Dr. Laurel Adams, for all her kind guidance and enormous help.

I am indebted to Dr. Roy Gardner and Dr. Janusz Szyrmer for their valuable comments and criticism.

Thanks are also due to Mr. Valentin Gavrilov of the National Bank of Republic of Belarus and Mr. Vladimir Griniuk of Société Générale de Surveillance - Minsk, for providing a large portion of the statistical data.

I am also thankful to Mr. V'yacheslav Honchar of Citibank-Ukraine and Ms. Irina Krasovskaya of Belgazprombank for sharing their expert opinion on the topic-related issues.

All the errors remain the author's responsibility.

GLOSSARY

Agency - an organizational form of foreign bank's office, which allows making loans, but restricts access of funds to those transferred from the parent bank and borrowed on the foreign wholesale and money markets.

Branch - a direct expansion of the parent bank into an overseas market; it is still reliant on its parent bank for capital support, but also normally has access to both wholesale and retail domestic deposit and funding markets.

Country (Sovereign) Risk - the risk that repayments from foreign borrowers may be interrupted because of inference from foreign governments.

Degree of penetration - the ratio of the value of total assets of foreign banks present in a country to the value of total assets of this country's banking system.

Multinational Bank - a bank which has offices in other countries and is engaged in banking activities abroad.

Multinational Banking - the conduct of banking activities by overseas offices of Multinational Banks. This term is used interchangeably with the terms *International Banking* and *Cross-border Banking* throughout the text.

National Treatment - regulating foreign banks in the same fashion as domestic banks or creating a level playing field.

Representative Office - an organizational form of foreign bank's expansion, which books neither loans nor deposits, but rather acts as a loan production office, generating loan business for its parent bank at home.

Subsidiary - an organizational form of foreign bank's office, which implies incorporation to the host country banking system, i.e. a subsidiary has its own capital and charter, operates in the same way as any domestic bank, with access to both retail and wholesale domestic markets.

INTRODUCTION

The universal globalization processes coming about in the world today have hardly left any spheres of economic activity intact. In particular, multinational banking as a form of foreign direct investment by banking firms has been experiencing a vigorous upturn during the last decades. Foreign banks are now an indispensable part of domestic banking sectors in almost every country.

Despite having become a commonplace of our reality, international banking is still harboring numerous conundrums for professional economics and finance researchers. As Ingo Walter, the author of one of the volumes on international banking noted, "international banks [are] perhaps one of the least understood aspects of finance and one of the most diffuse as well". Indeed, up to now an integral theory of multinational banking has not been developed. Furthermore, the few existing approaches to constructing such a framework are largely disconcerted, which accentuates the heterogeneity of the topic's taxonomy.

International banking as a research topic can be divided into two aspects: international financial intermediation and industrial organization questions. [Goodman (1984)] The first group includes various microeconomic issues of bank financial management as well as several global macroeconomic topics such as international lender-of-last-resort facility and contagion phenomenon in international lending. This paper focuses on the second aspect of international banking - the industrial-organization issue, which intends to explain the economic forces that induce a bank to expand beyond the national boundaries. The industrial organization facet also addresses the sources of comparative advantage accruing to a bank's office in a foreign location and enables it to compete successfully with the indigenous competitors.

This research employs the Foreign Direct Investment approach to the study of driving forces of banks' expansion abroad. The aim of this research is to illustrate how the application of eclectic FDI paradigm facilitates the analysis of the pattern of foreign bank entry into the transition economies of Ukraine and Belarus.

Ñhapter 1 surveys the most notable extant pieces of empirical research on entry decision and location choice of foreign banks, portraying the path of the topic's elaboration and reviewing the definitive findings. Chapter 2 focuses on the discussion of one of the theoretical approaches to the study of the bank's expansion abroad - the Grays' modification of Dunning's eclectic paradigm. Chapter 3 overviews the extent of foreign banks' presence in Ukraine and Belarus and comments on the entry patterns from the Grays' concept viewpoint. Section 4 introduces a framework for the econometric analysis of determinants of a foreign bank's decision to enter the Ukrainian market. It also presents, interprets and discusses the obtained empirical results.

This paper might not only be of an interest to economic researchers working in the field of multinational banking, but also have practical implications for both the management of Western banks and policymaking in transition economies.

Chapter 1

TRADITIONAL APPROACHES TO THE EMPIRICAL STUDY OF ENTRY DECISION AND LOCATION CHOICE OF FOREIGN BANKS

As it has already been emphasized, the issues of multinational banking and foreign banks' entry decisions and location choice particularly, are a relatively new topic to the economic literature. Despite its recent introduction, this sphere of research has attracted a large number of prominent scholars, and, up to the present time over fifty published pieces of the research work have contributed to its exploration. Unfortunately, the large number of publications does not reflect a comprehensive elaboration of the topic. The following are the reasons.

First, a significant fraction of the studies (like *Transnational Banking*) do not go beyond offering analytical surveys of foreign banks' activity in various countries over different time spans. Those are valuable sources of systematized information, but they are not intended to add to the disclosure of the phenomenon's causal foundations.

Second, there is still limited formal treatment given to theoretical justification of the motives that are presumed to underlie the foreign banks' location-specific entry decisions. Up to now there were only two attempts – by Grubel (1977) and Gray and Gray (1981) - to develop theoretical underpinnings of cross-border banking.

Thus, the above overview of the drawbacks leads to a conclusion that there is ample room still left for the further research in the field. Nevertheless, this by no means suggests that the previous works be disregarded; on the contrary, they are to be closely and critically reviewed.

The earliest researches on the multinational banking are dated mid-seventies. They were descriptive in nature and hypothesized on the basic factors underlying the observed outburst of foreign direct investment by banks.

Brimmer and Dahl (1975) surveyed the growth of U.S. banks abroad and suggested two factors affecting the motivation of U.S. banks' expansion overseas. The first factor was the restrictions on foreign direct investment enacted in the United States in 1965 as part of a program to improve the nation's balance of payments. The second factor was alleged to be the "... banks' desire to finance their foreign customers (especially U.S. multinational corporations) in light of the imposition of U.S. capital controls."[Brimmer and Dahl.1975, p. 349]

Kelly (1977) has undertaken a political science study of the causes of U.S. banks' entry into Great Britain. She formulated some interesting hypotheses, distinguished between the political and regulatory factors, but made little attempt to test separate effects of those factors on bank expansion over time.

The reasons of U.S. bank expansion into different countries are also discussed in Fileke (1977). "In cross-sectional regression models for the years 1974 and 1975, employing data from ten and eight countries respectively, he found that U.S. direct investment had a major influence on the extent of branching activity, while the influence of local GNP, the volume of trade (exports plus imports), and the rate of return on branch assets were inconclusive as explanatory variables. He concluded that the major reason for bank expansion abroad was to finance the business activities of non-bank firms in the host country."[cited in Goldberg and Grosse.1980, p. 632]

Goldberg and Saunders (1980) empirically analyzed the short- and long-run motivation of U.S. banks' expansion into the Great Britain. It was found that the factors most conducive to growth were U.S. trade overseas and the expansion of domestic bank activity. Despite the author's hypothesis, there was no evidence that disintermediation in the home country was a significant determinant. The

Eurodollar rate and the dollar-pound exchange rate were significant factors in the early time period. The results also offered some tentative support for a constraining effect of the U.S. capital controls on branching, refuting at the same time the hypothesis on the constraining effect of British regulation.

In the eighties the shift in the focus of research to the growth of foreign banks in the U.S. has been marked by a definitive article by Goldberg and Saunders (1981b). Three major organizational forms of foreign banks in the U.S. - agencies, branches and subsidiaries - have been given an individual consideration. It was hypothesized that four factors could be expected to account for the foreign banks' entry: current profitability, expected future domestic business, expected future international business, and expected regulatory changes. According to the empirical results, these factors appeared to act on agencies in a different manner from branches and subsidiaries, with agencies more affected by international business considerations and short-run profitability.

Another revolutionary paper by Goldberg and Grosse (1994) discussing the penetration of foreign banks in the U.S. by state was the first attempt of the location choice analysis. The data on all fifty states has been used to explain both quantitative (in terms of the number of offices) and qualitative (in terms of the assets value) foreign banks' presence in each state. Three explanatory variables were suggested: the local financial market size, the volume of host-country's international trade and the foreign direct investment into the host country. All three factors proved to be highly significant. The model was also estimated separately for each organizational form. The size of market variable was significant in all cases, but the effects of other variables differed, suggesting the difference in motives for foreign banks' expansion through different organizational forms.

Hondroyannis and Papapetrou (1996) undertook a similar study. Having added the explanatory variables reflecting the political risk and geographical

distance between home and host countries to the Goldberg-Grosse framework, the authors applied it to investigating the factors affecting the foreign banks' presence in Greece. On the output all the determinants were statistically significant. An unexpected result was a strong evidence of the positive relationship between the geographical distance between countries and the presence of banks from that home country. The major merit of the research was in the disaggregation of foreign banks by country of origin, which undoubtedly added to the explanatory power of the Goldberg-Grosse model.

It should be noted that all the econometric models contained in the above works have linear specification form and are estimated by either OLS or GLS methods.

In this respect extremely interesting is an alternative approach to the foreign bank's expansion issue discussed in Ball and Tschoegl (1982). The authors applied binary classification procedures, such as discriminant analysis and maximum likelihood logit to the study of factors, that a foreign bank having branches in California and Japan considered when making a decision whether to expand its presence in these countries through establishing an additional office. The proposed explanatory variables in the model are the parent-bank's experience in banking abroad and in the given host country, the parent bank's size, and the geographical proximity of the host country and the parent bank's headquarters. Apparently, in contrast to the macroeconomic focus of the previously discussed empirical work, Ball and Tschoegl followed a more microeconomic approach. Besides, the linear specification has finally been abandoned in favor of logarithmic form of relationship between the bank's presence and some of the RHS-variables.

Ursacki and Vertinsky (1991) were the first to focus the research on the timing component of foreign banks' entry. They employed the survival time (duration) econometric modeling in order to explain the fact that some banks

enter a particular foreign market earlier that the others. The reported results of applying such a framework to the data sets on South Korea and Japan suggested that the most important variables in determining the timing of foreign bank's entry into a host market were the bank's size and its attained level of geographical diversification. Monitoring costs, trade and investment ties to a home country, as well as banking technology were not identified as important factors.

The recent researches by Blandon (1999) and Tschoegl (1999) on the pattern of foreign banks' entry in Spain and Norway respectively, provided further supporting evidence that parent bank's assets and capital-assets ratio, host country's international trade, and geographical proximity were the major determinants of the bank's entry decision.

Thus, the above works are the cornerstones of the extant economic knowledge in the area of multinational banking, modeling the multinational banks' location preferences and location-specific FDI decisions.

The next section elaborates on a one of the theoretical approaches to the study of multinational banking.

Chapter 2

ECONOMIC THEORY AND MULTINATIONAL BANKS

As it was mentioned in the previous chapter, Jean and Peter Gray (1981) were the first to explicitly adopt one of the central concepts of FDI framework - Dunning's eclectic paradigm - to financial firms. The traditional theories of Foreign Direct Investment were originally developed to explain the investment behavior of manufacturing firms, and therefore were not immediately applicable to the banking industry.

According to the original version of the Dunning's eclectic theory it was presumed that in order for a firm to turn into a multinational the sequence of three groups of factors was required. A core prerequisite for multinationality lies in the Ownership Specific Advantages (OSAs) – the features that make it possible for a firm of one nation to compete in foreign markets with indigenous firms. OSAs consist mainly of intangible assets that derive from the size and established position of a firm. The second set of factors - Internalization Incentives induces a firm to expand beyond the national boundaries and, consequently, internalize (or use up) its Ownership-Specific Advantages. Finally this structure is to be reinforced by the presence of Location-Specific Advantages – the cost structure that favors operation in the host country.

Gray and Gray reduced the concept to six single factors with no strict mutual complementarity and no sequential ordering. Below is a succinct presentation of this modified version of the Dunning's paradigm.

I. **Imperfections in Product Markets** -

- **entry deterrence**: an important element of the structure of the banking industry in a host country. A multinational bank may be willing to access an oligopolistic foreign market if the differential returns are substantial.
- **product differentiation and segmented markets**: can result from superior marketing techniques, research and development and the qualitative differences associated with experience in a particular product line. However, these advantages are short-lived in the banking industry, as the innovations cannot be protected by patent law and therefore competitors can quickly emulate them.

II. **Imperfections in Factor Markets** -

- **access to global funds**: by managing liabilities on a global basis, a multinational bank internalizes its costs of funds. At the same time non-MNBs access global funds indirectly (by means of the correspondent relations with MNBs) and, therefore, bear a higher cost.
- **cognitive imperfections**: banks acquire a considerable stock of commercial intelligence from long-standing corporate-client relationships. When servicing its old customer abroad, a MNB can supply more suitable or lower-cost financial services than can indigenous banks unfamiliar with the customer's needs.

III. **Economies of Internal Operation** -

- **efficiency in marketing and account management**: in contrast to manufacturing, banking is a service industry. Banks need to develop facilities for direct and personal contact with a potential

client, wherever she is located. Thus, the activities of bank's foreign offices parallel those of the home office, but they are location-specific: the home office cannot provide them as efficiently.

- **availability and cost of funds transfers**: MNBs can economize by substituting intrabank funds transfers for some of those made through the external market. Such a reduction of external transaction costs narrows marginally the spread between the cost of funds and their use, and provides a MNB with a greater flexibility in asset and liability management.
- **larger and improved networks of market information and commercial intelligence**: the sheer number of separate and geographically dispersed sources of commercial intelligence can provide a more efficient network of information with consequent increased profit opportunities.
- **potential for reduced earnings variability**: the MNBs additional stability derives from the broader asset diversification on the condition that credit market cycles are not perfectly correlated among nations. Furthermore, the practice of international asset and liability management enables shifting the funds from markets with lower loan demand to the ones where the demand is higher.

IV. **Preserving Established Customer Accounts** -

Information capital provides opportunities for MNBs to internalize an ownership-specific advantage so long as client relationships remain intact. If a bank wishes to maintain its market share, it must extend its operations and be able to provide on-the-spot services for its domestic customers abroad. Differently stated, if a bank does not become a multinational, its information capital and consequently its market share

will be eroded as more and more MNBs compete in specialized international markets.

V. **Entry into a Growing or High Growth Market -**

The desire to participate in the growing foreign markets may well be an important cause of banks' expansion abroad since MNBs and large non-MNBs can extend and adapt existing product lines in new markets at a relatively low marginal cost. When deciding on an entry, a bank is concerned how long the ownership-specific advantages can be retained in a foreign market and how uncertain the potential returns are.

The Grays' theory has proved to possess a large explanatory power. Its first merit was a successful generalization and systematization of the results of the earlier researches. Furthermore the subsequent country-specific studies in the field of foreign direct investment by banking firms have confirmed the correctness of the Grays' provisions: Hondroyannis and Papapetrou (1996) – for Greece; Blandon (1999) – for Spain; Ursacki and Vertinsky (1992) – for South Korea and Japan; Tschoegl (1999) – for Norway; Goldberg and Grosse (1994) – for the United States. In the next chapters I will attempt to explain the pattern of foreign banks entry into two Eastern European transition economies – Belarus and Ukraine – using the elements of the Grays' concept.

Chapter 3

FOREIGN BANKS IN UKRAINE AND BELARUS: AN OVERVIEW

After the fall of the Communist order in the USSR and Eastern Europe, many Western banks have entered those countries.

Ukraine has one of the most liberal policies towards foreign banks in the region, and the government is easing the restrictions on foreign banks even further. On this wave several have expanded into Ukrainian market recently, inluding Creditanstalt Austria, ING Barings, Raiffeisenbank and Citibank. Credit Lyonnais Ukraine, registered in 1993, is now listed as the country's 12th-largest bank. Among the largest banks with 100% foreign capital are also Société Générale Ukraine and Credit Suisse First Boston. In total at present Ukraine hosts nine full-operating branches and subsidiaries, and over twenty representative offices of foreign (mostly Western) banks.

As already mentioned, there are few market entry barriers in the banking sector. Foreign-owned banks are required to open a resident representative office one year before applying for a banking license. The minimum authorized statutory capital fund is Euro 10 million, a small sum by international standards, which apparently is not viewed as a disincentive to entry by foreign banks. Foreign capital has now exceeded 14% of the industry's assets.

Most foreign operations serve multinationals' subsidiaries and joint ventures by extending short- and medium-term credit and assisting in export transactions. Several foreign banks in Ukraine, as revealed by a direct survey, are currently pursuing a more aggressive strategy by displaying intentions to serve local corporate and individual clients.

Belarus has a very different pattern of foreign banks' presence. The country hosts only one subsidiary of a foreign bank ("Mosbiznesbank" which is a small Russian bank) and nine representaive offices. Only two of the latter are the offices of major world banks (Dresdner Bank and Commerzbank). Two of the offices represent Latvian banks, one – a Polish bank and four - Russian banks.

Such a meager picture is somewhat contradictory to the absence of direct entry bans, low indirect restrictions (mandatory statutory capital of 5 million Euro) and the declared national treatment regime towards foreign banks.

Let us try to analyze the causes of this phenomenon within the Gray and Gray's framework.

I allege that the first three factors that, according to the Grays' theory, induce bank's expansion into a foreign country - namely, imperfections in the product and factor markets, and economies of internal operation do not constitute a significant incentive for foreign (particularly the Western) banks to enter either Ukrainian or Belarusian markets. The financial sectors in both countries are currently on the early stages of institutional and technological development. Both nations are still making their ways out of economic and political disorders. Apparently such an environment is not conducive to the exploitation of the three enumerated potential advantages by new entrants.

Thus, it follows that the main motives that have brought the observed handful of foreign banks into Ukraine and Belarus are rooted into the other two factors – preservation of established customers' accounts and willingness to participate in a growing market.

First, it can be hypothesized that those banks were following their domestic customers, who are either engaged in trade relationships (most likely exports) with Ukrainian/Belarusian residents or have undertaken FDI and extended their production facilities into Ukraine/Belarus. This hypothesis evidently holds for the case of Belarus. Russia, Germany, Poland, and Latvia are the major trading

partners of Belarus. Furthermore, Germany and Poland are the main direct investors into the county each accounting for over twenty percent of foreign direct investment in Belarusian real sector. The correctness of the above hypothesis for Ukraine is not so apparent and needs a more formal treatment, given in the next chapter.

The second major driving force for foreign banks' entry is likely to be their willingness to take up a niche in the financial sector of Belarus or Ukraine in order to be the first among other banks to reap the benefits once the economies recover and start growing. An enormous difference in the number of foreign banks' presence between Ukraine and Belarus may reflect more optimistic prognoses of western investors toward the medium- and long-term prospects of Ukraine relative to those of Belarus.

Chapter 4

RESEARCH METHODOLOGY AND ANALYTICAL FRAMEWORK

The Model

The following linear in parameters econometric model is designed to reveal some of the factors that influence the foreign banks' decision to enter Ukraine:

$$Y_j = f(SIZE_j, RATIO_j, DISTANCE_j, IMPORTS, FDI) + u_j$$

where

j = bank.

Y_j is presence of a specific bank j in Ukraine:

- = 1 if the bank has an office in Ukraine;
- = 0 otherwise.

  Source: National Bank of Ukraine.

SIZE is the natural logarithm of parent bank's total assets in mln. USD:

- a proxy for bank-specific advantages;
- logarithm reflects my hypothesis that bank-specific advantages increase with the bank's size, but at a decreasing rate.

  Source: "Euromoney"

RATIO is the parent bank's capital-assets ratio:

- a proxy for bank-specific advantages;
- (Value of parent bank's own capital) / (Value of parent bank's assets).

Source: "Euromoney".

DISTANCE is the natural logarithm of geographical distance between Kyiv and the city where the parent bank's headquarters is located (in kilometers):

- a proxy for the costs associated with the bank's expansion abroad;
- logarithm reflects my hypothesis that the distance-associated costs increase with distance at a decreasing rate.

  Source: www.indo.com/distance

IMPORTS is the volume of the Ukraine's imports from the country of the bank's origin (mln.USD):

- reflects the hypothesis of "trade-induced" expansion, which suggests that financial services tend to be exported along with goods.

  Source: State Statistics Committee of Ukraine; International Monetary Fund database

FDI is the natural logarithm of the value of accumulated stock of Foreign Direct Investment into Ukraine from the country of the bank's origin (mln.USD):

- reflects the hypothesis of "FDI-induced" expansion, which suggests that financial services tend to be exported along with direct investment;
- logarithm reflects my hypothesis that the FDI has a positive marginally decreasing effect on the banks' entry decision

  Source: State Statistics Committee of Ukraine; Ministry of Economy of Ukraine.

For estimating this model I am using a cross-bank time-static (year 1998) data set drawn on the world's 100 banks with the largest assets according to Euromoney Top 200 Banks. Those Western multinational banks with established

presence in Ukraine / Belarus that are ranked below the Top-100 are simply added to the sample. The model suggests a non-linear relationship between the dichotomous regressand and some of the explanatory variables for the reasons specified.

The model is estimated using in parallel two binary classification procedures: linear multivariate discriminant analysis (DA) and maximum likelihood multivariate logit (it should be noted that the OLS estimation employed in this context is equivalent to multivariate discriminant analysis as proved by Ladd (1966)). Without going into much technical details, we should recall here that DA estimates are asymptotically more efficient compared to logit estimates. However, the DA depends strongly on the normality of data; if data violates the normality assumption the DA estimates become inconsistent. Alternatively, logit estimates are relatively robust to the use of non-normally distributed data. The use of both estimation techniques allows checking whether the regression results depend on the distributional assumptions made.

Analysis of Empirical Results

Table 1 presents the regression results of the entry decision model for Ukraine.

The OLS and logit produced very similar results in terms of the coefficients' signs and significance. OLS produced slightly more coefficients significant. Still, in both regressions all coefficients except the one for capital-assets ratio are significant at 5% for a one-tailed test. The coefficient for SIZE variable is significant with both techniques at 1% confidence level for a 2-tailed test. R^2 is somewhat lower for the OLS regression, but its value is quite reasonable for such a type of a model. All coefficients have the expected signs.

Explanatory variables are not significantly correlated, and, hence, multicollinearity does not seem to be a problem.

Thus, it can be concluded that empirical evidence suggests that bank's size in terms of assets is an advantage for an expansion into the Ukrainian market; whereas bank's soundness in terms of capital-asset ratio - is not. The latter result is quite surprising and differs from the results reported for many developed countries. The possible explanation might be that foreign banks do not expect Ukrainian client to be able to grasp the market signal of degree of bank's riskiness and interpret it to the entrant's advantage or disadvantage.

The hypothesis that geographical distance is an obstacle to multinational banking has received support from Ukraine. Also, the results unambiguously point to the strong positive correlation between the volume of Ukrainian imports from a foreign country with entry of banks from this country into Ukrainian markets.

The results of the regression analysis do not support the hypothesis of FDI-induced bank's expansion into Ukraine. Although this result is different from the ones of many previous empirical studies, it does not contradict the theoretical underpinnings. It is consistent with the earlier stated proposal that the weakness of the most of the traditional incentives for banks' expansion is compensated in Ukraine by the willingness of banks to participate in a new prospectively growing market.

Thus, the empirical results drawn on Ukraine generally support the validity and explanatory power of FDI-OLI approach to multinational banking and are largely consistent with the results reported for the industrialized nations.

Table 1. Regression Results - Entry Decision Model for Ukraine
(t-/z-statistic in parentheses)

	OLS	ML Logit
C	-1.595885 (-2.198664)††	-49.13927 (2.367855)††
Size	0.177769 (3.255366)†††	4.241093 (2.694319)†††
Ratio	1.860252 (0.967500)	27.61638 (0.506286)
Distance	-0.069397 (-1.812996)†	-1.652109 (-1.965512)†
Imports	2.44E-07 (2.131230)††	2.12E-06 (1.973091)†
FDI	-0.009313 (-0.227738)	2.427804 (1.184712)
R^2	0.33	0.52
F-statistic	6.81	n.a.

Note: † indicates significance at 10% level for two-tailed test;
†† indicates significance at 5% level for two-tailed test;
††† indicates significance at 1% level for two-tailed test.

SUMMARY AND CONCLUSIONS

The topic of cross-border banking and particularly the phenomenon of banks' expansion abroad is a relatively new, fairly contradictory and diffuse issue in the modern financial economics.

By providing a comprehensive analytic survey of the definitive pieces of research on the subject, this paper portrays the path of the elaboration of the topic and reveals its inherent conceptual discords.

It has been investigated whether the economic incentives that has been proved to drive the foreign banks' expansion in developed nations, can explain the pattern foreign banks' entry in transition economies.

The obtained results suggest that most of the provisions of the FDI-OLI approach to the study of banks' expansion abroad hold true for the representative transition countries of Ukraine and Belarus.

Bank's size as a main source of its ownership-specific advantage is shown to have an important bearing on the probability of entry into Ukraine.

Trade and direct investment ties between the home and host countries, which are proposed to be a primary determinant of foreign bank's expansion in Belarus, have a more ambiguous effect on bank's entry decision in the case of Ukraine. The results indicate that the volume of trade between Ukraine and the country of bank's origin positively correlates with the probability of entry, whereas the intensity of FDI flows between two countries is not an important determinant of the bank's entry. The latter finding contests the predominant "follow-your-customer" explanation of multinational banking; however it is not the first to do so, since the similar results have been reported for Japan and Korea by Ursacki and Vertinsky (1992).

Surprisingly, the bank's capital-to-asset ratio does not constitute an advantage for expansion into Ukrainian market, which is different from the

results reported for several developed countries. A suggested explanation rests on the failure of Ukrainian domestic customers to interpret this indicator of perceived bank's soundness adequately.

Finally, it is also demonstrated that geographical distance (which to a certain extent also incorporates the notion of cultural distance) between host and home countries constitutes a barrier to entry. This result is particularly important since there is no general agreement on the effect of distance on the cross-border expansion of banks.

Although the results obtained for Ukraine and Belarus are generally consistent with the results reported for the developed countries, the employed quantitative approach has failed to capture several more subtle determinants specific primarily to the transition economies.

First, the provided theoretical analysis of the pattern of banks' entry within the Gray and Gray's concept concluded that banks' willingness to participate in a newly opened market accounts for a significant portion of foreign bank entries into transition countries. There is evidence that many banks rushed to take up a market niche in Ukraine and Belarus in order to enjoy a competitive advantage relative to other MNBs once a transition economy recovers and takes off growing. Apparently, this specific type of entry largely depends on the direct investors' expectations as to the country's future performance.

Closely related to the above factor is the institutional structure of transition markets. In many instances such common features of transition economies as laxly defined and poorly enforced property rights, inconsistent financial market regulation policies, inferior financial market infrastructure etc. are a considerable drag on the foreign banks' entry.

The above points are a call for actions on the part of economic policymakers in transition nations. Attracting further foreign direct investment into the financial sector would have numerous positive externalities for the host

country, send very positive market signals to other potential investors and, thus, make a significant contribution to the economic development of a transition economy.

WORKS CITED

Aliber, Robert. 1984. International Banking: A Survey. *Journal of Money, Credit and Banking.* Volume 16, Issue 4, Part 2 (November): 661-678.

Ball, Clifford and Adrian Tschoegl. 1982. The Decision to Establish a Foreign Bank Branch or Subsidiary: An Application of Binary Classification Procedures. *Journal of Financial and Quantitative Analysis* 17 (September): 411-424.

Blandon, Josep Garcia. 1999. The Choice of the Form of Representation in Multinational Banking: Evidence from Spain. *Unpublished Working Paper*.

Brimmer, Andrew and Frederick Dahl. 1974. Growth of American International Banking: Implication for Public Policy. *Journal of Finance* 30 (May): 341-363.

Buch, Claudia. 1997. Opening up for Foreign Banks: How Central and Eastern Europe Can Benefit. *Economics of Transition* 5(2) (November): 339-366.

Dunning, J. and G. Norman. 1987. The Location Choice of Offices of International Companies. *Environment and Planning* 19(5) (May): 613-631.

Fileke, N.S. October 1977. The Growth of U.S. Banking Abroad: An Analytical Survey. Federal Reserve Bank of Boston Conference Series 18: 9-40.

Goldberg, Lawrence and Robert Grosse. 1994. Location Choice of Foreign Banks in The United States. *Journal of Economics and Business* 46: 367-369.

Goldberg, Lawrence and D. Johnson. 1990. The Determinants of U.S. Banking Abroad. *Journal of International Money and Finance* 9(2): 123-127.

Goldberg, Lawrence and Anthony Saunders. 1980. The Causes of U.S. Bank Expansion Overseas: The Case of Great Britain. *Journal of Money, Credit and Banking* 12 (November): 630-643.

Goldberg, Lawrence and Anthony Saunders. 1981a. The Determinants of Foreign Banking Activity in the United States. Journal of Banking and Finance 5(1): 17-32.

Goldberg, Lawrence and Anthony Saunders. 1981b. The Growth of Organizational Forms of Foreign Banks in the U.S.: Note. *Journal of Money, Credit and Banking* 13 (August): 365-374.

Goldschmidt, A. 1983. U.S. Banking Regulation and Foreign Banks' Entry into the United States: Comment. *Journal of Banking and Finance* 7(4) (December): 581-82.

Goodman, Laurie. 1984. International Banking: Coment. *Journal of Money, Credit and Banking.* Volume 16, Issue 4, Part 2 (November): 678-684.

Gray, J and P. Gray. 1981. The Multinational Bank: A Financial MNC. *Journal of Banking and Finance* 5(1): 33-63.

Grosse, Robert. 1988. *The Economic Impact of International Banking in Florida*. Discussion Paper 88-5, International Business and Banking, University of Miami.

Grosse, Robert and Lawrence Goldberg. 1991. Foreign Bank Activity in The United States: An Analysis by Country of Origin. Journal of Banking and Finance 15(6) (December): 1093-1112.

Guillen, Mauro and Adrian Tshoegl. 1999. At last the Internationalization of the Retail Banking? The Case of the Spanish Banks in Latin America. *The Wharton Financial Institutions Center Working Paper* 99-41.

Harrington, James. 1992. Determinants of Bilateral Operations of Canada and U.S. Commercial Banks. *Environment and Planning* 24(1) (January): 137-51.

Heinkel, R. and M. Levi. 1992. The Structure of International Banking. *Journal of International Banking and Finance* 11(3): 251-272.

Hondroyiannis, George and Evangelia Papapetrou. 1996. International Banking Activity in Greece: The Recent Experience. *Journal of Economics and Business* 48: 207-215.

Houthakker, Hendrik. 1984. International Banking: Coment. *Journal of Money, Credit and Banking.* Volume 16, Issue 4, Part 2 (November): 684-690.

Hultman, W. and L. McGee. 1989. Factors Affecting the Foreign Banking Presence in the U.S. *Journal of Banking and Finance* 13(3): 383-396.

Jacobsen, Siv Fagerland and Adrian Tschoegl. 1997. The International Expansion of the Norwegian Banks. *The Wharton Financial Institutions Center Working Paper* 97-38.

Kelly, Janet. 1977. *Bankers and Borders: The Case of Anerican Banks in Britain.* Cambridge, Mass.: Ballinger.

Murray, John. 1984. International Banking: Coment. *Journal of Money, Credit and Banking.* Volume 16, Issue 4, Part 2 (November): 690-695.

Nigh,D., K. Cho and S. Krishnan. 1986. The Role of Location-Related Factors in U.S. Banking Involvement Abroad: An Empirical Examination. *Journal of International Business Studies* Fall: 59-72.

Tschoegl, Adrian. 1997. Entry and Survival: The Case of Foreign Banks in Norway. *The Wharton Financial Institutions Center Working Paper* 97-40.

Tschoegl, A. 1988. Foreign Banks in Japan. *Monetary and Economic Studies* 6(1): 93-118.

Ursacki, Terry and Ilan Vertinsky. 1992. Choice of Entry Timing and Scale by Foreign Banks in Japan and Corea. *Journal of Banking and Finance* 16(2) (April): 405-421.

INDEX