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# Current trends in the banking system of Russia

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## Abstract

The paper provides an analysis of core issues that appear when Russian commercial banks generate and use their financial resources in terms of sanctions. Authors discuss whether commercial banks are able to meet their needs of investments in the national real economy if they use various forms of recapitalization. The today's banking system in Russia has a number of features that mainly relate to a structure of the banking sector. Systemic weaknesses, assets concentrated in hands of a few federal banks, and well-marked territorial inequality in distribution of banking institutions are serious challenges in the existing organizational system of banking services. Researchers have revealed that commercial banks in Russia mainly have to make financial resources for account of less urgent liabilities and liquidity risks.

## key words

banking system, financial resources, recapitalization forms, government control.

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## 1. Introduction

Commercial banks play an active part in the development of any national economy. They are those that contribute to redistribution of financial resources between economic entities, material and non-material sectors of economy, separate industries and areas. The today's banking system in Russia is a market-oriented sector of economy. In its design and general economic principles, it is identical to models valid in European countries (Jurevičienė, 2016, p. 159-173). At the same time, it is relatively vague, weak and describable as a system with no sustainable interrelations required between its elements.

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In current geopolitical conditions, Russian banks have found themselves in a rather difficult position because of the pressure that sanctions make on economy, mainly directed at the financial sector. A limited access of Russian banks to international financial markets forces them to use expensive and *short-term money* from the national financial market. This influences their ability to finance investment needs in the real economy that require long and cheap investments. This has kept significance of the questions raised in the paper.

The totality of national commercial banks, considered in their interconnection and interdependence, integrity and unity, looks like a relatively isolated system that keeps mandatory features inherent to the financial system. This initial methodological principle makes a basis for the analysis.

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## 2. Review of literature

The concept of *financial resources* in the Russian practice is not conventional. It refers to understanding of financial resources of a commercial bank because authors mainly use several interpretations of the same order (Ostapenko, 2016, p. 101-104). There are views that financial resources are bank resources (Ermakov & Yudenkov, 2011; Zhukov, 2012; and Chernetsov, 2014), resources of a bank (Korobova, 2009), resource base, resource fund, and bank liabilities. These terms reflect funds mobilized in a bank for active banking transactions and are associated with concepts of the credit fund, lending capacity, lending resources, and loan portfolio. Lending resources, although being a bulk of bank resources, are not identical to them.

We consider it more legitimate to use the term of financial resources to refer to banking resources as to the term that corresponds to a wider interpretation of finance. We believe that as an economic concept, financial resources describe specific economic relations between partner groups (stakeholders). As far as there are many types of financial resources that a commercial bank has, it is necessary to classify them according to certain characteristics (Table 1).

Table 1. Classification of kinds of financial resources at a commercial bank

Classification criterion	Types	Meaning
By origin	Internal	Generated from ongoing entrepreneurship
	External	Generated from external sources owing to mobilization in the financial market
By placement (use)	Cash	Mobile resources of high liquidity that make lending resources
	Fixed assets	Non-mobilized resources of low liquidity

Classification criterion	Types	Meaning
By ownership (sources of generation)	Own funds (bank's capital)	At a disposal of a bank without an obligation of their return
	Bank's liabilities	At a limited-term disposal of a bank with an obligation of their return
By deadlines for mobilization of resources	Short-term	At the bank's disposal within next 12 months
	Long-term	The bank is able to use these financial resources for more than 12 months

Sources mostly classify them by resource generation source. Meanwhile, each type of financial resources has its functional purpose if seen in aspect of different classification criteria. In this way, we need to divide financial resources into internal and external groups in order to justify a government policy towards banks and, in particular, support measures. A qualitative allocation or use of financial resources, defined with the ratio between cash and tangible assets, is a solution to the issue of bank liquidity. Note that this classification criterion is almost absent in the Russian practice, evidently because people usually associate resources with liabilities only instead of the assets side of banks' balance sheets.

The classification of financial resources by generation source provides characteristics of a degree of independence and sustainability. It is often in the literature to distinguish own and borrowed funds as generation sources for financial resources. We believe that it is more correct to regard own funds and bank liabilities as sources of resources, dividing them into attracted and borrowed funds. The division of financial resources by attraction time describes a potential liquidity risk. The ratio between various types of financial resources reflects a structure of financial resources that characterize a state of the banking system.

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### 3. Analysis of trends

#### 3.1. Concentration of bank assets

Imposed anti-Russian sanctions and the incompliance with needs of the national economy assume an involvement of new techniques to generate financial resources in commercial banks. Banks recapitalization is one among such techniques. Recapitalization in commercial banks might have a form of a governmental support, concentration of a bank capital and search for possible other external sources of capitalization.

As for the governmental support, only systemically important large-scale federal-level banks might count on the support under the anti-crisis plan of the Russian Government to ensure the sustainable development of economy and social stability. In 2015, banks received funds to increase capitalization under the governmental program (National

Welfare Fund via the Deposit Insurance Agency (DIA)) as a subordinated loan (deposit). The introduced program for bank recapitalization assumes that the Deposit Insurance Agency will obtain preferred shares and subordinated liabilities of banks with a maturity of at least 50 years.

For other regional banks, the support program was not available because of two reasons. Some of them did not join the program due to an insignificant size of their capital. As for the others, restrictions (for joining the program) proved to be beyond their strength in terms of recapitalization at the expense of shareholders themselves. Because of the introduced program of support to large banks, the Russian system of financial intermediation has chosen a path of targeting at government-controlled banks, a share of which has been getting higher in the financial market. On the one hand, this led to high growth rates (almost 8% in terms of assets) in the banking sector in 2017 (Mau, 2018), in spite of sanctions. On the other hand, this situation breaks the universal market principle of competition.

Ongoing concentration of bank assets (Table 2) is the second direction in bank recapitalization.

Table 2. Asset concentration in the banking sector of Russian

Bank distribution by asset value (rank)	January 1, 2016		January 1, 2017		December 1, 2017	
	Bln, Rub	Total %-ratio	Bln, Rub	Total %-ratio	Bln, Rub	Total %-ratio
The first 5	44,883,973	54.1	44,232,891	55.3	46,559,703	55.5
6-20	17,925,387	21.6	18,257,646	22.8	19,982,696	23.8
21-50	9,391,355	11.3	8,444,718	10.6	8,980,879	10.7
51-200	8,484,303	10.2	7,520,065	9.4	7,130,613	8.5
201-500	2,060,315	2.5	1,528,737	1.9	1,283,949	1.5
From 501	254,375	0.3	79,197	0.1	23,588	0.0
Total	82,999,708	100.0	80,063,255	100.0	83,961,428	100.0

Source: (Central Bank of Russia, 2018)

Table 2 implies that in the dynamics, assets of large banks and their share are increasing, while assets of small credit institutions are decreasing. Bank recapitalization also depends on an unequal development in the banking sector of national economy and a decreased number of operating credit institutions (Table 3).

Table 3. Distribution of operating credit institutions (CI) across federal districts of Russia

Region	January 1, 2013	January 1, 2014	January 1, 2015	January 1, 2016	December 1, 2017
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	Quantity	%	Quantity	%	Quantity	%	Quantity	%	Quantity	%
Central Federal District	564	59.0	547	59.3	504	60.4	434	59.2	322	56.8
North-West Federal District	70	7.3	70	7.6	64	7.7	60	8.2	44	7.8
Southern Federal District	46	4.8	46	5.0	43	5.2	42	5.7	36	6.3
North-Caucasian Federal District	50	5.2	43	4.7	28	3.4	22	3.0	17	3.0
Volga Federal District	106	11.1	102	11.1	92	11.0	85	11.6	71	12.5
Ural Federal district	44	4.6	42	4.6	35	4.2	32	4.4	26	4.6
Siberian Federal District	53	5.5	51	5.5	44	5.3	41	5.6	33	5.8
Far Eastern Federal District	23	2.4	22	2.4	22	2.6	17	2.3	18	3.2
Russian Federation	956	100.0	923	100.0	832	100.0	733	100.0	567	100.0

Source: (Central Bank of Russia, 2016; Central Bank of Russia, 2018)

It is clear that in 2013-2017, a number of credit institutions declined from 956 to 567, this process was especially active in the Central Federal District, Moscow, and the Moscow Region. This was due to licenses for banking operations recalled by the Central Bank. The revocation covered financially unstable banks and banks with questionable transactions. Funding needs of the real sector, banks also mostly face significant constraints, as they themselves have no long-term and cheap financial resources. Besides, there are expensive rationing and high investment risks (Włodarczyk *et al.*, 2018, p. 565-580; Kunitsyna *et al.*, 2018, p. 943-955). Banks have to focus on loans from the Central Bank of the Russian Federation and deposits from legal entities as a source of short-term funding and deposits from individuals for medium-term funds. As a result, commercial banks mostly have to generate financial resources at the expense of less urgent liabilities and potential liquidity risks.

### 3.2. Structural changes in the banking system

The Russian banking system has been acquiring certain features that disadvantageously distinguish it from the banking sector in the developed countries of the world (Danilov & Pivovarov, 2018, p. 30-47; Xu *et al.*, 2018, p. 929-942; Kaźmierczyk & Aptacy, 2016, p. 146-158).

First. In the sector, commercial banks dominate, while in the world (judging from a total value of assets), non-banking financial institutions prevail. They are distinctive in lower systemic risks and higher resistance to external shocks.

Second. The banking system will focus on banks controlled by the government, a share of which in the financial market has a clear trend towards its growth.

Third. There will be first a potentially high demand for loans from those companies that deal with or are going to deal with national investments. This is especially true in case of large-scale and medium-sized businesses (Basko & Dombaeva, 2009, p. 56-58; Kosmacheva, 2012, p. 19-33).

Fourth. There is a trend towards the development of the cash and liquidity management (so-called transactional business) new for banks, which exists as an operating activity. This kind of business has associations with the changed ratio between interest and non-interest income. Today's Russian commercial banks have interest income as a dominating one. On average, the ratio between non-interest and interest income is 20% to 80% unchanged for many years (Bezgacheva & Samotuga, 2017). Meanwhile, US banks receive today up to 40% of profits from fees. There is the same trend in Europe. German banks receive up to 65% of their proceeds from commission transactions (Lavrushina, 2008). This shows the development of cash and liquidity management in the banking sector of Western countries. This type of business is a sustainable source for income generation (at the sake of commission fees). It makes it possible for a bank to diversify revenues and a resource base, reducing a share of interest income in the revenue structure, and thereby reducing bank risks and increasing sustainability of the banks themselves.

As for leaders in the market of banking services, their incomes from this type of business are comparable with their income from lending. But this applies to large-scale federal banks, while it is difficult for regional banks to develop such business direction. Opportunities of regional banks are usually limited due to a lack of a developed branch network and bank product diversification.

Fifth. There will be changes in the system structure. There will be a progressive concentration of the most of assets in banks partially owned by the government. Consolidation of the bank capital also depends on the regulator's requirement for a minimum size of an authorized capital of a bank depending on a type of a bank license. The banks that have basic licenses might only work with small, medium-sized enterprises and individuals. First, these banks will mainly keep making their resource base at the expense of *expensive* money, i.e. deposits and interbank loans. Secondly, they can only work in the national market, while the development of small and medium-sized enterprises involves

their entrance to overseas markets. Hence, small and medium-sized enterprises will choose services provided by banks with a universal license.

Stricter requirements for a minimum size of the capital, on the one hand, make the banking sector more stable. On the other hand, they facilitate the displacement and absorption of small and medium-sized banks, which, due to a low volume of available funds, are not able to develop properly their risk management procedures and innovative technologies.

As a result, there will be a further distortion in the structure of the banking sector in favour of federal-level banks. In regions, the business development will rely on structural subdivisions of federal banks instead of their regional banks (Table 4). At the same time, regional banks have a significant advantage at a local level compared to branches (subsidiaries) of other banks. They can afford a more flexible approach to the customer. The customer might contact professionals with higher powers, count on custom-tailored services and quick solutions to his/her questions.

Table 4. Distribution of subsidiaries of credit institutions (CI) by federal districts of Russia

Region	Credit institutions in the region		Spec. gravity of subsidiaries in other regions, %	
	January 1, 2016	December 1, 2017	January 1, 2016	December 1, 2017
Central Federal District, including city of Moscow and the Moscow Region	434	322	47.0	44.1
	392	287	21.4	21.9
North-West Federal District	60	44	313.9	297.9
Southern Federal District *	42	36	296.4	252.6
North-Caucasian Federal District	22	17	213.3	227.8
Volga Federal District	85	71	199.1	163.1
Ural Federal district	32	26	137.7	113.0
Siberian Federal District	41	33	292.3	258.5
Far Eastern Federal District	17	18	336.4	294.7
Russian Federation	733	567	134.4	122.0

Source: (Central Bank of Russia, 2018).

In general, today's small regional banks are head-to-head competing with subsidiaries of federal-level banks for transactions made by individuals. A share of deposits in liabilities of regional banks is constantly growing. This is a matter of trust in local financial institutions. In terms of active business operations, it is not always sufficient to have a standard package of banking products offered by banks with universal licenses. Subsidiaries of large banks, represented at a regional level, as a rule, do not have such powers, have limited opportunities and, in many aspects, coordinate their actions with a parent bank, extending time for decision-making.



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## 4. Conclusions

Systemic weaknesses, the assets concentrated in hands of a few federal banks, and well-marked territorial inequality in distribution of banking institutions make a serious challenge in the existing organizational system of Russian banking services. The banking system in Russia has some features that in many aspects relate to the structure of the banking sector. In today's conditions, there are features in generation of financial resources related to the introduction of anti-Russian sanctions and incompliance with needs of the real economy. This involves a use of new techniques in a search for sources of funding in the national market, in particular, bank recapitalization technique. At the same time, one should refer to financial resources as bank resources exactly as corresponding to the wider interpretation of finance. We believe that, as an economic concept, financial resources describe specific economic relations between partner groups (stakeholders).

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