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Bank Privatization in Post-Communist Russia: The Case of Zhilsotsbank

by Jeffery Abarbanell and Anna Meyendorff

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Jeffery S. Abarbanell
University of Michigan Business School, Ann Arbor, MI, 48109

and

Anna Meyendorff
Davidson Institute, University of Michigan Business School, Ann Arbor, MI, 48109

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Please address all correspondence to:

Jeffery Abarbanell
University of Michigan Business School
Ann Arbor, MI 48109-1234
tel. 313-764-4717; fax. 313-763-5688

Abstract

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This paper examines Russian bank privatization through the lens of the privatization of Zhilsotsbank, and the creation and subsequent performance of its most visible private successor, Mosbusinessbank. Several important features distinguish Russian bank privatization from that of other transitional economies. Much of the state banking sector was privatized in a rapid and decentralized manner that gave incumbent managers control rights over the new private banks. Over time, managers have increased their control over these banks relative to private shareholders. Bank strategy, operations and performance have been and continue to be influenced by the manner in which privatization was implemented. The effective removal of the state from direct ownership of these banks, in combination with the liberal licensing of *de novo* banks, has created a Russian banking sector which is more than 75% private. This highly competitive environment has led to innovation and increased efficiency in the banking sector. It has also exposed several of the shortcomings of privatized banks' operations. Moreover, liberal licensing contributed to serious instability in the system, as the development of regulatory and supervisory capabilities has not kept pace with the creation of new banks.

J. Comp. Econom. University of Michigan Business School, Ann Arbor, Michigan 48109.

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I. INTRODUCTION

In this paper we study the Russian experience with bank privatization through the transformation from state to private ownership of Zhilsotsbank, one of five specialized banks that functioned in the old Soviet system. We focus in particular on Mosbusinessbank, a large commercial bank created from 26 Zhilsotsbank branches.[1] Our objective is to highlight substantive differences between the Russian approach and those followed in Central Europe in order to provide new insights on how methods of privatization can influence subsequent bank organization, corporate governance, competitive position and performance. We also analyze the impact of the unparalleled opening of the Russian banking sector to domestic, *de novo* competition and assess how complementary reform policies interacted with privatization methods to influence the internal transformation of a state-owned bank.

Several important features distinguish Russian bank privatization from that of other countries in the region. Perhaps the most important is that, despite the widely-held belief that former state-banks would play a crucial role in banking sector reform, there was no formal scheme ever devised for converting state ownership of the banking system to private ownership. This situation stands in sharp contrast to the post-communist governments of Central Europe which proposed explicit plans for bank privatization and employed formal methods such as voucher privatization, initial public offerings, and sales to strategic investors to effect change.

The process of privatizing Russian branches of three of five Soviet specialized banks which began in 1991, was both motivated by and intended to promote the political and economic disintegration of the Soviet Union. Bank privatization, regardless of its form, served the interests of the Russian Republican government by ensuring that Soviet authorities would be permanently divested of ownership in the banks, and simultaneously served the interests of the Soviet government in transferring the financial obligation to subsidize the banks to republican and regional levels.

Given political exigencies and the absence of capital markets, expertise in valuing assets, and other institutional support for privatization, it was decided that primary responsibility for the process would fall to bank managers from the old state system. The new privatized banks' functions, corporate governance mechanisms, and ownership structures were determined by the managers of the old state banks in conjunction with local government officials, with clients of the old banks (primarily state-owned enterprises and government organizations) providing capital.[2]

One striking feature of the privatization of Zhilsotsbank is that many of the banks created from it were solvent or close to solvent at the time they were converted to joint stock companies. Privatizing at a later stage in the reform process and under different political and economic conditions, the market reform governments of Central Europe faced the choice of recapitalizing substantial amounts of classified loans in the state banks or writing them off. In contrast, the Russian government took no actions before or after the privatization of Zhilsotsbank to carve out bad loans or recapitalize the bank. Much of the bad asset problem was addressed directly through the method of privatization, which allowed managers of some of the old Zhilsotsbank branches to form new banks with reasonably healthy clients and clean loan portfolios.[3]

Another differentiating characteristic of Russian bank privatization has been the rapid and complete disengagement of the state from direct corporate governance of the newly privatized banks that emerged from Zhilsotsbank. Disengagement was facilitated by the rapid speed of privatization and laws requiring government divestiture of bank ownership. This result, however, did not come without costs. The corporate governance structure that emerged from the transition left inside management, rather than new ownership, in control of the bank. Over time, management entrenchment was deepened through the replacement of large client ownership with small individual shareholders - the bank's own employees in the case of Mosbusinessbank.

While many competent managers joined Mosbusinessbank at its inception, the introduction of new bank expertise across the many activities of the bank has been uneven. The impetus for change within the bank has often been provided by the presence of domestic competition in some of the bank's markets. Pervasive competition, perhaps the most interesting aspect of Russian bank privatization to date, was the result of liberal bank licensing policies that led to an explosion of new private banks.

Interestingly, the most important impact of policies that have promoted competition has been the moderation of the overall importance of successful bank privatization as a means of achieving an efficient banking sector. Over half of all Russian banks operating today originated in the private sector, with over 75% of banking assets under the control of private investors.[4] This is in sharp contrast to other countries in the region undergoing economic transition, where no more than 30% of banking assets are privately held. Moreover, while privatization enabled change in the banks created from Zhilsotsbank, the emergence of fierce competition from *de novo* banks has provided a powerful impetus for change.[5]

Mosbusinessbank, whose establishment as a private bank was led by the former chairman of Zhilsotsbank, Victor Bukato, is one of the most successful banks to come out of the old state banking system. The size of Mosbusinessbank's operations has more than doubled and its statutory capital has grown four-fold since 1991. These positive changes notwithstanding, the privatization of banks, including Mosbusinessbank, has not ensured that they can effectively perform the functions traditionally expected of banks in the West. For example, privatized banks have not reached their potential for performing the critical intermediary function of channeling capital from savers to the emerging private sector. Clearly, some of the reasons for this failure are unrelated to the method of privatization, as evidenced by the fact that most *de novo* banks have not performed considerably better than privatized banks in this regard.[6] However, additional obstacles to lending and overall bank efficiency can be linked to the method of privatization including, management adherence to bank strategies that may not adequately meet changing market conditions, carry-over of old employees, low levels of capital, and slowness to innovate and adapt bank organizational structure to client needs in activities where competition is not present. These problems have placed the privatized banks at a disadvantage relative to *de novo* banks, raising questions about their ability to remain competitive in the long run.

The next section of our study briefly summarizes government action both antecedent and contemporaneous to the privatization of Zhilsotsbank that significantly influenced the outcome of that process. Section III discusses how Zhilsotsbank was disbanded and Mosbusinessbank established from selected components. Section IV analyzes the results of this privatization transaction, including the creation of banks with positive franchise value, changes in Mosbusinessbank's corporate governance, bank strategy, operations and performance. It also describes how complementary policies have combined with the method of privatization to influence the privatization outcome. Section V concludes and summarizes some of the lessons learned from the privatization of Zhilsotsbank.

II. ACTIONS ANTECEDENT AND CONTEMPORANEOUS TO PRIVATIZATION

1. Reorganization of the State Banking System

In 1988, as a part of Perestroika, the Gorbachev government created a two-tiered banking system intended to promote an independent enterprise sector and financially independent specialized banks. The state-owned banking sector then consisted of Gosbank, the monobank, and five specialized banks which were supposed to conduct all commercial banking operations. The specialized banks included: Sberbank, the household savings bank, Promstroibank, the industry and construction bank, Agroprombank, the agricultural bank, Vnesheconombank, a foreign trade bank active in foreign currency operations and Zhilsotsbank, the housing and social development bank. Of the five banks, only Zhilsotsbank was an entirely new entity rather than in extension of a pre-existing administrative unit within Gosbank. It serviced many branches of light industry, e.g., textiles, construction, and retail trade and was also the collection agent for local government revenues.

The creation of the specialized banks along functional lines was to have important implications for their future privatization. Soviet production had always been organized by sector, with specialized ministries providing bureaucratic oversight for specific branches of industry. The creation of a banking structure which mirrored this sectoral division, with the assets and liabilities of the banks determined by the ministries and enterprises to which they were assigned, was a critical step in the configuration of the banking units which were to be privatized. As the decentralization of economic control which resulted from this restructuring increased, and the power of regional and local authorities grew, both the recentralization of control and the recombination of bank assets became virtually impossible.

The Law on the USSR State Bank and the Law on Banks and Banking Activity, both approved by the Supreme Soviet in December 1990, refined and extended the two-tier banking system. The laws called for the breaking up of the specialized banks, with the exception of Sberbank and Vnesheconombank, and for their transformation into joint stock, commercial, universal banks. As a part of this process, the chairmen of the specialized banks were solicited for ideas on how to carry out the commercialization of the banking sector, and the decentralized approach to privatization began to take shape.

Consistent with movement towards economic and political independence on the part of the republics of the Soviet Union, the Russian government, as early as 1989, had already required the transformation of banks on its territory into commercial banks. Thus several of the specialized banks were far along the process of commercialization before the USSR Banking Laws were passed.[7] The Banking Laws formalized this independence by creating republican central banks out of republican branches of Gosbank, and then giving them supervisory authority over banks on their territory. With the dissolution of the Soviet Union, the CBR took over the functions of Gosbank, including monetary policy and ruble emission. Table 1 provides summary statistics for the Soviet banking sector as of September 1990, shortly before it was dismantled.

2. Policies Affecting the Level of Domestic Competition

Just as restructuring of the banking system under Gorbachev began a process which led to both decentralization of control in the banking system and privatization of commercial banks, the early legalization of private banks set the stage for the introduction of competition in banking. The 1988 Law on Cooperatives allowed the establishment of cooperatives and private commercial banks, with the intent of servicing enterprises which had no access to the state banks. In fact, state-owned enterprises and ministries, as well as cooperative enterprises, took advantage of this law to move towards financial independence from central authorities. By September of 1990, there were already 400 registered commercial and cooperative banks, accounting for over 5% of total credit.[8] This rapid growth in the private banking sector increased pressure for privatization from state bank managers who faced the possible loss of clients and needed flexibility to respond to a changing environment.

Table 2 demonstrates the dramatic change in the structure of banking since reforms began. As of January 1, 1996, there were 2,598 banks in Russia. Of these, approximately 750 came out of the break up and privatization of the specialized banks, and several hundred were created by government ministries and large enterprises in the early reform process. *De novo* banks comprise the largest segment of the banking sector, with estimates ranging from one half to two thirds of total banking assets.[9] Of these, only 17 are foreign controlled banks.

As can be seen in Table 2, the top ten banks account for 52% of the total assets of the banking sector. In contrast to the banking structures of Central European economies, therefore, the level of concentration is relatively low (Meyendorff and Snyder, [1996]). While the two largest banks remain majority state-owned, six of the top ten are *de novo* banks, and they have tended to dominate the market for new services. For example, Inkombank has led the market for credit cards and Oneximbank and Rossiyskiy Kredit are actively involved in trading corporate securities. Agroprombank continues to play the role of channeling credit to the agricultural sector, and is in financial distress. Thus, of the former specialized banks, only Mosbusinessbank function as relatively healthy, large private bank, accounting for 2.7% of the total assets of the banking system.

3. Shock Therapy, Inflation and the Creation of New Markets

Yegor Gaidar's shock therapy program was introduced in Russia in January 1992, within a year of Mosbusinessbank's official opening. The impact of these reforms on both the economy as whole and the banking sector in particular was dramatic. The first important reform was price liberalization, leading to an annual rate of inflation of over 2300% in 1992 (see table 3 for basic macroeconomic indicators.) This high rate of inflation decimated the value of both bank loan portfolios and household savings, the former comprising only 12% of GDP by 1993 and latter only 2% of GDP. Inflation also led to lucrative new opportunities for banks, with the establishment of new hard currency exchanges, the Russian interbank market and the market for government bonds (GKO).[10]

III. THE METHOD OF PRIVATIZATION

A. The Commercialization of Zhilsotsbank

The privatization of Zhilsotsbank started informally in August, 1990. It was at this time that the newly formed CBR, under the direction of Georgi Matukhin, began to establish the independence of the Russian banking system from the Soviet government, seeking to ensure this outcome by pressing for the transformation of the Russian branches of the specialized banks into independent commercial banks. The director of Gosbank USSR, Victor Geraschenko, recognized the inevitable diminution of the role of Gosbank and, to ensure an orderly transfer of power, allowed decentralization to occur while he was still in a position to influence the final outcome.[11]

To initiate the commercialization process and to give individual branches a real option to be independent, the CBR declared that all assets and liabilities of three specialized banks, Zhilsotsbank, Promstroibank and Agroprombank, be transferred to the local branches of the CBR. It then allowed the managers of each branch of the specialized banks to decide whether they wanted to form their own small bank, or join together with other branches to form a larger bank. Transferring the assets and liabilities of the banks had the effect of depriving bank headquarters of much of the leverage it would have had over individual branch managers in this decision making process. Only after the new banks were formed and the ownership of the banks had changed hands did the CBR return complete control of the assets and liabilities to the new banks, on a branch by branch basis.

In implementing this process, the Central Bank of Russia (CBR) chose not to play a large role in determining the composition of the new commercial banks and not to implement an explicit recapitalization program for the banks prior to privatization.[12] In the case of Zhilsotbank there was significant variation in the quality of the loan portfolios of each branch, but the overall quality was higher than that of the banks that serviced heavy industry and agriculture. Ultimately, the problem of bad loans inherited from the state-owned banks was resolved by high levels of inflation in 1992 and 1993. This resolution was apparently anticipated by most of the players involved in the commercialization of the banks, since repressed inflation had been in evidence since the mid 1980s and price liberalization was fundamental to most reform proposals at the time.[13]

Unlike his peers at the other specialized banks, Victor Bukato, the Chairman of Zhilsotsbank, was in favor of privatization and acted quickly to create a new commercial bank. He assembled a committee consisting of he and several vice presidents of Zhilsotsbank to recruit from among the over 700 branches of Zhilsotsbank located within the Russian Republic. With the imprimatur of the CBR, Bukato called a meeting of the managers of the targeted regional branches and invited them to join with the Moscow city branches of Zhilsotsbank in the creation of a new joint-stock company. Fifteen branches from seven regions of Russia eventually joined the Moscow city branches to form Mosbusinessbank. These branches were required to meet two conditions. First, each branch was to seek agreement with representatives of its local government and CBR to ensure smooth assimilation into the new bank. Second, each branch was to discuss the merger with its branch clients to ensure retention of a viable asset base and, more important, to raise new capital. The impetus to meet these conditions likely emanated as much from the local governments and the clients of the branches, which were to have important stakes in the process, as it did from the proposed bank's management.

In all, 26 Zhilsotsbank branches agreed to form the newly christened Mosbusinessbank, the largest single entity (as measured by size of statutory capital) to emerge from the state-owned bank. Mosbusinessbank remains one of the ten largest banks in Russia today. Several other regional banks were formed from collections of branches and the balance of the branches became independent, one-branch banks.[14]

B. The Creation of Mosbusinessbank

On October 3, 1990, representatives of the 26 branches, a group of their most important clients (and soon to be investors), and Moscow city government officials were among the 299 representatives who attended a founders meeting to select the new bank's Board of Governors. Of the 299, 213 were representatives of enterprises or organizations.

The founder's meeting established the official corporate governance structure of the bank, electing the Council of Directors, the highest governing body of the bank, and the President. The Council of Directors, in addition to selecting the Management Board, was entrusted with numerous policy decisions concerning bank operations, including approving the financial plan, and determining management and employee compensation. The Management Board was charged with responsibility for day to day operations.[15]

The founders meeting elected Stanislav V. Sorokin, the general director of GUM, as Chairman of the Council of Directors and named Victor Bukato president of the bank. Within a month Mosbusinessbank was officially registered with Gosbank USSR which, at the time, still retained the responsibility for formulating the Union credit plan and supervising the new republican central banks. By this time, however, the republican central banks had taken direct control of the banks in their territories, a condition formalized by the 1990 Law on Banks and

Banking Activity. Mosbusinessbank registered with the CBR on the 12th of December and was granted a license to operate with foreign currency on December 20. The bank officially opened for operations on January 1, 1991 with over 32,000 clients comprising state-owned enterprises, local governments, individual depositors and a small number of private firms.

The amount of equity and the price of individual equity shares were determined in a founders meeting in January of 1991. Statutory capital was set at 800 million rubles ($ 7.3 million using the interbank exchange rate of 110 rubles to the dollar) and the price of a share was set at 1,000 rubles. Interestingly, the amount of capital to be raised was not determined on the basis of a valuation of the bank's assets and liabilities or by a competitive bidding process. The amount settled on was determined by a CBR regulation that required banks to maintain a minimum capital/asset ratio of 4%, where the denominator was based on book values. This rather haphazard approach to bank capitalization was typical of the entire privatization transaction, in which the urgency to get things done overrode any concern about choosing the correct process. As a result, the bank was undercapitalized (though within official regulatory standards) from the beginning of its operations, a legacy reflected in the fact that there have been new equity issues in each year of the bank's existence.

No detailed plan for determining the ownership structure of the privatized banks was ever articulated by the Soviet or Russian governments. However, according to Georgi Matukhin, the decision to transfer most of the shares to state-owned enterprises, ministries and public organizations, rather than selling shares to the population, was a deliberate one. The CBR was afraid that, in the absence of a functioning stock market and given a naive public, the new commercial banks could fall under the control of "pocket" banks. Thus, a decision was apparently reached to distribute 10% of the shares to employees and 90% to clients of the banks.

The founders of Mosbusinessbank complied with this implicit policy. The first prospectus states that shares would be sold to legal entities (enterprises and organizations) and to employees of both Mosbusinessbank and the new shareholding legal entities. Mosbusinessbank management, in particular Bukato, played a significant role in deciding which enterprises and organizations would be offered ownership and what their percentages would be. Details of the process are sketchy but it is clear that the ultimate outcome was the result of extensive bargaining and was not open to all of the bank's clients. It is unlikely that the whole story of how the shares were allocated will ever be known to people outside of the transaction.[16]

According to Mosbusinessbank's first prospectus, shares could be purchased with rubles, foreign currency or tangible assets. The new shareholders contributed 745 of the 800 million rubles in cash and another 55 million in buildings. One shareholder purchased shares with US dollars in the amount of US $1 million, or 1.7 million rubles at the official Gosbank commercial exchange rate.[17] The real ruble value of this contribution was closer to 22 million rubles, given an exchange rate of 22.88 rubles per dollar in the December 1990 foreign exchange auction organized by Vnesheconombank. Similarly, the estimated value of the buildings contributed, 55 million rubles in book value, vastly underestimated the market value of the capital received.[18] In addition to the initial equity capital the bank received very favorable lease terms on their headquarters building from the Moscow city government, a new owner in the bank.[19]

After the distribution of the 800,000 shares, Mosbusinessbank had 3,301 shareholders, of whom 2,607 were individuals and 694 were legal entities. The 213 enterprises and organizations which were founding members owned 37% of the shares. The single largest shareholder was Gostrakh USSR, the state insurance fund, with 9.4% of shares. The second largest was the Moscow city administration, with 6.9%. The third largest was the Board of Trade of the USSR Ministry of Defense, with 6.3%. The fifteen enterprises and organizations represented on the

Board of Directors held a total of 47.6% of shares. The ownership structure, based on information provided in Mosbusinessbank's 1991 and 1992 Prospectuses, is described in panel A, table 4.

C. Follow on Transactions

The ownership structure of Mosbusinessbank changed significantly in the five years following its founding. Technically, the formal conversion of banks from state to private ownership did not occur in Russia until 1993 or 1994. Several actions furthered this transfer. One was voucher privatization of the state owned enterprises which owned the majority of shares in the banks.[20] The second action was the divestiture, mandated by law in 1993, of the remaining portion of shares owned by central, regional and local government bodies. Government bodies during this time period were cash poor and facing large deficits, and were therefore willing to sell their shares in the banks. It is during this time period that the Moscow city administration sold its shares in Mosbusinessbank.[21]

The third and on-going action that formalized the transfer of ownership to private hands was a series of new equity issues to private shareholders. Mosbusinessbank has had three new issues of shares since 1991, with statutory capital increasing from 800 million rubles to 5 billion rubles.[22] The last prospectus places several restrictions on the purchase of shares. Commercial banks are allowed to purchase shares only with freely convertible foreign currency, and there is a 10% cap place on the number of shares that could be purchased with foreign currency. The purchase of more than 20,000 shares by one shareholder is subject to approval by bank management. This apparently overrides the *de jure* role of the general shareholders meeting, giving *de facto* power to incumbent management. Clearly, management has orchestrated share issues in a manner that reinforces its control over important decisions in the bank.

For all practical purposes, Mossbusinessbank has been a private entity since 1991. However, changes in Mosbusinessbank's ownership structure from 1991 to 1995 formally completed the privatization of the bank. In 1991, almost 90% of the bank's shares were held by state-owned enterprises and government organizations. By 1995, only 33% of shares were held by enterprises and organizations, and most of these were private. The remaining 67% of shares were held by individuals, the vast majority being bank employees. The evolution of Mosbusinessbank's ownership structure from 1991 to 1995 is summarized in panel B, table 4.

IV. RESULTS OF PRIVATIZATION

The management-led approach to privatizing Zhilsotsbank substantially influenced the subsequent configuration of assets, ownership structure, organization, activities, and financial performance of Mosbusinessbank. Among the most significant impacts are the disengagement of government from the corporate governance of the bank, the creation of a bank with significant franchise value from Zhilsotsbank assets, improvement of operational efficiency, and expansion of products and services offered. However, some of the problems present in Zhilsotsbank were not overcome by privatization and new ones were created for Mosbusinessbank. Among them are a severe agency problem between outside ownership and management, the potential continuation of non-arm's-length transactions between managers from the old state bank and various stakeholders of the bank, overstaffing, and slow, often localized introduction of new expertise.

We begin our discussion of the results of privatization below with a focus on the impact of management-led privatization on Mosbusinessbank's initial franchise value, corporate governance, stakeholder relations. We then discuss how the method of privatization and complementary government policies combined to influence Mosbusinessbank's strategy, operations and subsequent performance.

A. Direct impact of the Management-Led Privatization Approach

One of the main distinguishing characteristics of Russian bank privatization was the critical role played by incumbent managers in the process of establishing new private banks. This feature was essential to speedy privatization and bank reform, but there were negative as well as positive consequences for the long run situation of the privatized banks.

1. Creation of initial franchise value

A good deal of the potential franchise value of Zhilsotsbank was embodied in the incumbent managers. First, branch level managers contributed value through relationships with local stakeholders. The strength of management's relations with ministries and local government officials ensured the rights necessary to operate the old branches as a part of a new bank. Management relations with branch clients provided both a well-established revenue base and a source of new capital. Second, central and branch managers were allowed to take advantage of their knowledge of branch assets and clients to form solvent banks. Managers were given significant autonomy in deciding whether to join larger entities or create single branch banks, on the basis of this knowledge and their own risk preferences. This method of privatization thus significantly reduced the costs and time of aligning incentives within a large (by Russian standards) new private bank. As discussed in more detail below, however, the initial franchise value derived from incumbent managers may dissipate quickly after privatization with the introduction of product market competition.

Franchise value has been further increased through the retention of funds raised from selling shares in the bank. Granting managers total responsibility for the new ownership structure ensured that all funds raised from the sale of shares would be retained in the bank to bolster its financial position. The Russian government made no attempt to raise budget revenues from the privatization of banks. In fact, the specialized banks were viewed as a drain on resources by some officials, and encouraging their independence was seen as a means of eliminating a financial burden on the federal government.

Finally, the method of privatization allowed for a rapid and economically sound reallocation of management talent among the privatized banks. Victor Bukato was able to hand pick managers with extensive experience in the banking sector who also shared his vision and risk preferences. The rapid redeployment of managerial talent was not necessarily good news for many newly privatized banks. Many banks began operations with management teams unprepared for the challenges presented by the new banking environment and eventually closed or merged with other banks. In the case of Mosbusinessbank, the natural selection process was successful.

2. The evolution of internal corporate governance

Russian bank privatization effectively transferred control rights from the state to private parties. Management's ability to issue new equity and strategically select new owners gradually reduced the presence of the government in the ownership structure of Mosbusinessbank. By the time laws were passed that mandated full divestiture, government entities had already lost their ability to use voting rights to influence policies concerning dividend payouts, granting of credit, sales of new equity and levels of employment. This direct link between government and Mosbusinessbank was broken within a reasonably short period.

Initially, management control over the bank was derived from the (perhaps accurate) perception of new owner-clients that no substitute management expertise was available to serve their needs. However, management control was enhanced by its ability to select new owners whose interests were closely aligned with its own. In both 1992 and 1993, Mosbusinessbank imposed limits on the trading of its shares. Even after these limits were removed, the shares were traded only in several closed auction houses. Thus, the distribution of new shares seems to have been manipulated by the bank's management, rather than being governed by market principles.

Moreover, management was able to ensure low levels of ownership concentration through the governance structure it devised. Clauses in the Mosbusinessbank prospectuses, giving top management veto power over the purchase of large blocks of shares and limiting ownership by other banks, support this conclusion. With sufficient control over voting rights from the outset, management was subsequently able to tighten its grip on bank control rights by issuing dilutive new equity without meeting serious resistance from existing shareholders.[23] Over time, Mosbusinessbank's ownership structure has become extremely diffuse, with considerable concentrations of management and employee ownership (see panel B, table 4). While strong managerial control is not unusual in Western banks, it is unlikely to extend to this degree of latitude, especially on matters of who can own shares. Disaffected outside shareholders have no means to oppose management initiatives or dictate general policies such as dividend payouts, in the medium-term. Moreover, employee owners are subject to management determination of their job status without union protection or institutional support for concentrating their voting rights.

B. Mosbusinessbank Strategies, Operations and Performance

Mosbusinessbank did enjoy some advantages relative to *de novo* banks at its inception. Nevertheless, whatever implicit government support Mosbusinessbank had, its value was quickly diminished by political uncertainty, a contracting economy and rapidly growing government budget deficits (see table 3). More important, the bank was established without the benefit of implicitly or explicitly guaranteed monopoly rents that most newly privatized banks in Central Europe depended on for income. The former Zhilsotsbank branches were required to redefine themselves as organizations that could function in a dynamic environment where, apart from some local government support, there were no guarantees for success or survival in the short run.[24] In a shift towards profit maximization, Mosbusinessbank instituted many procedural and organizational changes designed initially to capture market share and, later, to respond to an increasingly competitive environment. It is clear, however, that the bank is not as aggressive as some *de novo* banks and appears to be adhering to familiar strategies that have not prevented losses in market share in many of their product segments.

1. Business Strategy

Early in its formative stage, Mosbusinessbank adopted a commercial business strategy based on universal banking. The core of its revenue generating capability remained tied to former Zhilsotsbank branch customers through relationship lending (in some cases with owner/creditors), corporate deposits and performance of services such as employee payroll and account settling. In the absence of hard budget constraints on enterprises in the early stages of the breakup, lending activities were profitable and posed small risks. It was apparent to management, however, enterprise liquidity was likely to dry up in the future and other revenue generating activities would be necessary. As a result Mosbusinessbank moved aggressively to take charge of and expand an extensive payment clearing system in Russia and the CIS countries, taking advantage of Zhilsotsbank's bank connections throughout the former Soviet Union.[25]

Benefiting from its status as a former state bank, Mosbusinessbank was one of the earliest banks to be issued a license to deal in foreign currency. Foreign currency operations were profitable from the beginning, and provided a foundation for a number of services that attracted new customers and extended relationships with existing ones. This included foreign currency exchange operations, international settlements, and checking and transfer accounts. Moreover, with the onset of hyperinflation following price reform, Mosbusinessbank, like other banks authorized to operate in foreign currencies, began to earn large profits speculating against the ruble. Exhibit 1 shows that foreign exchange trading income grew to as high as 18 % of operating revenue by 1993, tailing off to around 12% by 1995 as CBR monetary policies brought inflation down to single digit monthly levels. While profits from speculation are likely to dissipate substantially in the future, unlike hundreds of *de novo* banks that never developed standard foreign currency operations, Mosbusinessbank's conservative and competent management has laid a strong revenue foundation in traditional foreign currency activities for the future.

The combination of inflation and the establishment the Moscow interbank loan market offered another opportunity for several large banks like Mosbusinessbank to earn substantial profits on loans of short durations. Interbank operations account for over 20% of loan interest income or approximately 15% of total operating revenue.[26] Mosbusinessbank's expertise, liquidity and sound reputation have allowed the bank to emerge from a series of interbank liquidity crises with a larger role in the market over time.

The largest and increasingly important source of non-loan revenue is derived from trading in short-term government securities markets (GKO). High inflation and the need for deficit financing has lead to high yields, providing the bank with returns of over 200% in recent years. From exhibits 1 and 2 it can be seen that GKO operations have grown rapidly, accounting for 16% of total assets and 35% of net operating revenue by 1995.

Mosbusinessbank has widened its menu of financial products and services over the years in response to fierce competition in the commercial client segment. The bank now offers a range of retail services including VISA Card, deposit taking, and money market funds. It also engages in the provision of trust and guarantee services. Mosbusinessbank's management has been relatively slow in adapting to new retail markets, lagging behind *de novo* banks in the quality and range of service. There appears to be a recognition within the bank that because of the Zhilsotsbank legacy, management has been more inclined to focus on products and services that support its corporate clients (primarily small and middle market) than to aggressively pursue new market segments. For example, over 95% of deposits shown in exhibit 2 are commercial accounts, as Mosbusinessbank has not made significant strides in the household savings market to date.[27] Management has aggressively but unsuccessfully pursued new large corporate clients as demonstrated by the bank's shrinking share of the corporate market. The Zhilsotsbank tradition and mission in many ways still pervades Mosbusinessbank's organizational structure and culture, making it difficult to effect significant changes in strategy.

2. Changes in the Loan Portfolio

While the specific form of privatization had a significant impact on the evolution of Mosbusinessbank's loan portfolio, many factors affecting credit supply and demand in the entire banking sector have played a large role as well. On the supply side, the underdevelopment of commercial credit in Russia has been exacerbated by the relatively low risk and high profitability of deploying funds into interbank, government security, and foreign currency operations in an inflationary economy. Exhibits 1 and 2 show that a disproportionate share of Mosbusinessbank assets and revenues are linked to those activities of the bank that are not associated with traditional financial intermediation. Loans to non-bank clients represented a relatively small percentage, approximately 15% of bank assets in 1992. This reflected, in large part, the effect of hyperinflation on the loan portfolio after price reforms were instituted. Over time, the percentage of assets in non-bank loans has increased almost threefold but, even at a level of 43% at the end of 1995, that is well below the traditional percentage of 60-70% in Western banks.[28]

As is typical in transition economies banks also have low incentives to lend because of difficulties in identifying good credit risks. Unreliable accounting information, the absence of meaningful credit histories, and the lack of formal bankruptcy laws contribute to the problem. High rates of interest on loans of short duration and the vast amounts of inter-enterprise lending worked to reduce the level of credit extended to enterprises on the demand side. As a former state-owned bank whose establishment was the result of negotiations among the incumbent managers and old clients, Mosbusinessbank was able to overcome some of these obstacles through familiarity with client/owners.

From the outset of privatization there was also a move to reorient the Mosbusinessbank's commercial loan portfolio and scale back relationships with familiar troubled enterprises in light industry. These clients were systematically replaced by companies in industries that were relatively healthy and expected to grow. Many of these new clients took small ownership positions, seeing the benefits of an association with a former state bank able to procure a foreign currency license and well-connected to the Moscow city government. Thus, the natural alignment of incentives of clients owners and mangers that followed from the form of privatization contributed to changes in the loan portfolio.

It can be seen in panel A of table 5 that there is little overlap between selected top borrowers at the time of privatization in 1991 and those that remain in the portfolio as of the end of 1995.[29] Moreover, there is clear change in the industrial sectors represented by these loans that reflects the overall change in the character of the whole loan portfolio. For example, a check of the bank's annual reports since 1992 indicates that loan volumes that were once heavily concentrated in trading companies and restaurants, housing construction, medical care, and clothing and textiles were surpassed by sector loans to manufacturing and energy, agricultural machinery and pharmaceuticals by 1995.

Panel B of table 5 indicates another important characteristic of Mosbusinessbank's loan portfolio over time. In 1991 less than 20% of the bank's loans were issued to private entities. By 1995, state enterprises comprised less than 15% of the portfolio. Much of this change is attributable to voucher and management-led privatization in recent years.

It is clear from panel C of table 5 that conservative credit assessment and risk management techniques have led to a balance of irregular loans that are reasonably low for a former state bank in a transition economy. Moreover, ongoing provisioning for loans also appears to conservatively lead actual write-off experience. By all accounts, this treatment of bad loans is a strong indication of the philosophy of conservative president Victor Bukato, who has striven to promote Mosbusinessbank's reputation as a stable bank which avoids taking significant risks in unfamiliar activities. As can be seen in the table, it is also a reflection of the fact that the preponderance of loans have been of short duration, owing to inflation and pressures from duration mismatches created by the short-term corporate deposits and interbank liabilities.

C. Continuing Impact of Old Business Relationships and Organizational Structure

As described above, extensive control over privatization process afforded old Zhilsotsbank managers was initially a substantial source of franchise value. However, with an increase in competition and the introduction of other market reforms, the original benefits of their strong relations with various stakeholders of the bank have become less important and potentially detrimental in the long run. Some tendencies that are cause for concern are reflected in the strategy and operations of Mosbusinessbank and can be traced to the presence of old management and the method of privatization. These include the potential for non-arm's-length transactions with owners and creditors, overstaffing, difficulties in establishing strong internal controls throughout the semi-autonomous branch organizational structure, uneven introduction of new expertise, and informal ties to government entities that have implications for directed lending and the bank's reputation.

1. Moral hazard in client/owner relations

While the bank's loan portfolio has changed dramatically since privatization, some important pre-existing relationships with Zhilsotsbank clients were continued and augmented after the creation of Mosbusinessbank. Some old clients became owners of the bank and have been granted large loans. As a result, there is a potential for credit decisions to effect wealth transfers among the different owners. Moreover, because lending is typically a relationship-based activity, incumbent management might find it difficult for the bank to sever ties with clients that had been with the bank even prior to privatization. The problem is exacerbated the continued existence of several cross-holding and cross-governance relationships in both the bank's ownership structure and investment portfolio. Bank management claims connected lending is not a significant issue and audited financial reports indicate the volume of related party loans is not large. Nevertheless, an air of doubt circulates among banking sector observers about extent of the actual problem and more important, the potential for abuse in the future exists - especially if bank prospects change.

2. Overstaffing and organizational inefficiencies

The low priority given to bank privatization by government, the need to carry out reforms rapidly, and the lack of available budget resources, ensured that very little organizational restructuring could take place prior to privatization. While not a serious threat to the bank's survival immediately after privatization, the advent of competition in the banking sector and declining real profits from government securities, interbank and foreign currency operations, has revealed several structural problems.

As seen in exhibit 1, personnel expenses as a percentage of operating revenues have been rising steadily rising since privatization, reaching 30% of operating revenues for 1995. Nominal growth in wages was 580% and 920%, respectively for 1994 and 1995, well above average wage inflation. This is partly a reflection of the need to hire and retain new qualified personnel in a "sellers'" banking labor market. However, with an employee roll of over 5,000 for a 56 branch network, Mosbusinessbank is clearly overstaffed. Unlike their *de novo* competitors Mosbusinessbank will have to downsize substantially to reach an efficient size, a task management has been slow in addressing, perhaps a carryover from a paternalistic socialist system and their ongoing relationships with employees from Zhilsotsbank.

The effects of competition in the banking sector are also highlighted by the bifurcation of efficiency observed in the hard currency and ruble operations of the bank. Hard currency operations, where market competition is fierce, have been a significant source of profit for banks since 1992. To compete, Mosbusinessbank has had to make a significant investment in technology and expertise, upgrading lending, payments clearing, and foreign trade-related services conducted in hard currencies. In contrast, ruble operations where the bank faces little external competition, have not until recently, undergone significant restructuring. They remain a drag on bank efficiency.[30]

3. Branch autonomy

Within the first year of operation as a bank, there were significant improvements in inter-branch communication and information systems. Formal risk management procedures were devised and implemented, along with extensive budgeting and planning systems that did not impose edicts from central headquarters. The improvements in these areas were due in large part to the need to adjust to the new autonomy negotiated by branch managers as a condition for joining Mosbusinessbank. The original decentralized approach imposed some costs on the organization as some autonomous branch managers continued to lend to old clients without regard to creditworthiness, incurring large losses in the process. Central management has continually struggled to assert greater central control over the branches since privatization. More recently, the central credit department has begun to assemble credit histories for all clients, starting with those of the branches with the highest percentage of bad loans.[31]

4. Slow and uneven introduction of new expertise

Russia's method of privatization precluded the involvement of strategic foreign investors and several government policies restrict foreign ownership of Russian banks.[32] As a result, one of the most effective ways to modernize bank operations, the infusion of new expertise through a active foreign bank, was never a possibility for Mosbusinessbank.[33] Instead, the bank has attempted to introduce new banking expertise by sending managers to Western banks under contracted exchange programs. It has also contracted for Western banks to provide training to Mosbusinessbank employees at facilities located in Moscow. Furthermore, the bank has recently joined the World Bank FIDP program which will supply technical support and arrange for a Western twin bank to work closely on development of credit procedures and information systems. This patchwork of programs has the potential to improve banking expertise in certain areas of the bank, but it is clear that some gaps will remain and bureaucratic obstacles are likely to be present, slowing the transfer of expertise.

5. Real and perceived ties to the government

Zhilsotsbank managers established their careers in a system that required the sponsorship and approval of powerful individuals within the government. There was an established hierarchy and a common understanding of how to get things done. The mere fact that certain managers were given the ability to recruit branches of the bank to form their own banks suggests that some top management would be beholden to government officials. Because so many of the officials in the finance ministries and the CBR were part of the old "network", strong informal links between the managers of privatized banks and government were to be expected. One consequence of these links was the potential for non-arm's-length transactions between the banks and government. Indeed, up to 1995, the government was still engaged in funneling directed credits to troubled enterprises through the banks (including Mosbusinessbank), using central bank loans for leverage. For a time some government directed loans were profitable for the banks.[34] Eventually, government revenue shortfalls led to the imposition of hard budget constraints on many troubled enterprises and these loans turned into losses for the banks. Ultimately, the government devised a plan to recapitalize the loans with fixed income securities that will come due over the next eight years. Details of the plan and who will benefit from it have been difficult to uncover.

Another indication of informal link between the government and Mosbusinessbank can be found on in the bank's differential access to CBR credits. While discount window rates are substantially the same for all banks, the CBR is selective in granting credits. Mosbusinessbank continues to make loans sponsored by the government and it is likely that it's ability to gain credits from the CBR is related to cooperation in this sphere with the government. It is unclear how the recent change in CBR leadership has affected Mosbusinessbank's status. There are indications that powerful *de novo* banks have gained in influence relative privatized banks under the new administration.

D. Results of Privatization and Ongoing Changes the Banking Sector

1. Policies to combat inflation and increase the level of aggregate lending

From 1992 through most of 1994, there was little relevant distinction between monetary and fiscal policies. CBR credits to the government financed the deficit, and directed credits channeled through the central bank were the main instrument of "monetary" policy. Directed credits had three important consequences for the banking sector. First, they were inflationary, accounting for more than half of the expansion in the money supply in 1992.[35] Second, they delayed the restructuring of the banks, by alleviating the need to attract deposits and develop credit lending expertise. Third, many of the directed credits became non-performing loans in the banks' portfolios.

The channeling of directed credits through the banking sector was officially stopped as of 1995 (though some observers believe the practice is still being conducted through less transparent or alternative means). In addition, the successful maintenance of the currency corridor, along with a drop in the level of inflation, has diminished profit opportunities in the foreign exchange and interbank markets. Simultaneously, as the government began selling bonds (GKOs) in 1993 to finance the deficit, this market has increased in importance. Recent lowering of the interest rate on bonds is intended to diminish the crowding out of lending to the private sector. As of February 1996, the CBR has also begun lending to commercial banks using government bonds as collateral, with the intent of increasing liquidity and creating a mechanism for influencing interest rates. At the same time, direct foreign participation in the GKO markets has been allowed with the expectation of further declines in yields.

Finally, the CBR has developed a more sophisticated and somewhat more effective monetary policy. As a part of stabilization policy, the CBR committed to keeping its refinancing rate at the level of interest rates in the interbank market and has raised reserve requirements. The CBR has begun to use repo and Lombard rates more aggressively to inject liquidity into the system to encourage lending to enterprises by commercial banks.

2. Licensing, regulation and bank consolidation

Liberal licensing and regulatory policies have promoted competition in the banking sector. With competition has come a substantial increase in the number and quality of products and services offered to commercial and retail customers. As seen in the uneven development of Mosbusinessbank operations, the imposition of product market discipline on banks has acted as a complement to underdeveloped internal corporate governance mechanisms that resulted from Russia's method of privatization. In addition to innovation of new services, competition for prime lending clients has reduced spreads to bare minimums and is soon likely to have similar effects on middle market lending. Competition has also led to higher wages in labor markets and enhanced banks' human resources programs and raised living standards for banking employees. However, the explosive growth in numbers of banks has led to the creation of hundreds of poorly capitalized, inefficient and unstable institutions. In addition, corruption and crime, already latent in the underground economy for years before *Perestroika* naturally gravitated to the fast growing and profitable banking sector. Russian authorities were not prepared for the challenge.

Beginning with the August, 1995 interbank liquidity crisis, a period of consolidation has been unfolding in Russian banking. In 1996 alone the CBR suspended or revoked 161 bank licenses and is currently reviewing another 130 licenses for possible action. In the meantime, only 14 new bank licenses were issue by the CBR through November, 1996 (BISNIS Bulletin, November, 1996). Moreover, regulatory standards are rising with a scheduled increase required minimum capital for all banks from 1 mln to 5 mln ECU by 1999. Mandatory reserve levels are increasing and the CBR is working intensively on improving and expanding its monitoring and supervisory capabilities.

It appears that the CBR, lacking resources and time to clean up the banking sector has adopted a policy of allowing many banks to identify themselves through failure before taking action. Meanwhile, the CBR will carefully manage interbank liquidity and GKO market yield through state-owned Sberbank and Vneshtorgbank to enhance banking stability. Moreover, classification schemes such as OPERU33 which identifies 30 of Russia' most stable and reliable banks (Mosbusinessbank is a member of the group) are used to help customers identify banks safer banks.

V. SUMMARY AND LESSONS

Mosbusinessbank was created at a time when centrifugal forces were rapidly dismantling the Soviet Union. The economic and political turmoil accompanying the end of the Soviet regime allowed the commercialization and privatization of state-owned banks to be implemented without public debate and without regard to equity considerations. Since the commercialization of the three specialized banks occurred very early in the reform process, traditional market mechanisms for the privatization of state-owned assets did not exist. Instead, the Soviet and Russian governments turned the process over to the managers of the banks, allowing managers to carve up three large banks into hundreds of smaller banks, and to choose the ownership and governance structures of each of the new banks. As a result, bank privatization was rapid, decentralized and virtually irreversible.

The political and social conditions that characterized Russia at the time of bank privatization are not likely to be duplicated in other countries, however a number of lessons from the Russian experience have implications for bank privatization in the future. First, the transfer of assets was accomplished without compensation to the government and with little notoriety. While particular circumstances in Russia relegated bank privatization to a low position on government's list of priorities, it is nevertheless true that the absence of an attempt to extract revenues from selling banks and the low political visibility of bank privatization resulted in a rapid completion of the process. In contrast, unrealistic government revenue goals and highly visible politicization of plans to privatize have been stumbling blocks to selling banks in Poland and Hungary. Similarly, Russian government efforts to achieve a 'fair" allocation of Zhilsotbank ownership through, for example, a voucher scheme, would have prevented the self-interested behavior of management that swiftly sorted the assets of Zhilsotsbank into many entities. The rapid increases in efficiency in some of these viable privatized banks led to the creation of substantial consumer surplus and the early dissolution of bad banks unable to compete reduced the costs of government subsidies.[36]

The value of a rapid transfer of all of the ownership rights from state to private hands is an important lesson from the Russian experience. By way of comparison, most of the large commercial and specialty banks in Central Europe have not been privatized even though formal plans for doing so were being formulated at the same time Zhilsotbank was disbanded. The Polish and Hungarian experiences provide vivid examples of the problems engendered by delays in transferring ownership. Changes in political and economic conditions have continually altered government plans and objectives, adding to the cycle of increasing delays. There is a significant diminution of the bank's ongoing franchise value during these periods of delay. This occurs because the bank's ability to formulate strategies and effect restructuring is put on hold until the questions of ownership and control rights are settled. Delays also create opportunities for the emergence of conflicts among government agencies and agents over control rights in banks. Often the outcome is an ambiguous governance structure which makes it more difficult to find a buyer for the bank.[37] Privatized banks in Russia suffered no loss in franchise value from government delays in transferring ownership rights and it is clear that the subsequent explosion in competition in the Russian banking sector increased the importance of having avoided delays.

It is axiomatic that the objectives of government are not always confined to profit maximization and efficiency and, thus, are not always aligned with the objectives of private co-owners. In most of the transition economies of Central Europe, ministries responsible for managing the government's interests in the banks have, as a matter of policy, retained large blocks of shares in "privatized" banks and exercised influence on bank policies in contravention of private owner goals. The Zhilsotsbank example offers another lesson in that its method of privatization contributed to the elimination of government's role in the corporate governance of the bank. The combination of Russian laws promoting the divestiture of government holdings in "private" enterprises, management efforts to design an ownership structure to their liking and the rapid, decentralized management-led process of forming new banks were instrumental in ensuring the complete transfer of property rights to private entities. Achievement of this outcome is, arguably, the most important element of successful bank privatization, if not itself the ultimate objective.

The success of bank privatization, however, can also be judged by criteria in addition to that of complete government divestiture of its ownership claim. One such additional criterion is whether control of the privatized bank rests ultimately in the hands of its new private owners. In the case of Mosbusinessbank, it is important to acknowledge that as effective as the Russian approach was at accomplishing the transfer of property rights to private owners, it was equally ineffective in transferring effective control rights to these owners. In this respect, Mosbusinessbank serves as an example of agency problems that can result from inadequate attention paid to designing effective corporate governance, monitoring, and voting rights mechanisms prior to government withdrawal. The management-led creation of Mosbusinessbank gave rise to the creation of a passive, diffuse ownership structure that perpetuated managerial control. While legal property rights were transferred to a large group of shareholders, control rights remained vested in the management of the banks, with no institutional mechanisms available to ensure that managers are accountable to or will act in the best interests of the owners.

The failure to ensure that control rights are vested in the bank owners is a particularly acute problem in Mosbusinessbank because the entrenched management in this case is comprised of old state bank managers. The experience of Mosbusinessbank demonstrates that the presence of incumbent management is a double edge sword. On the one hand it is clear that incumbent management was instrumental in the creation of franchise value at the initial stages of privatization, primarily through the strength of their relations with prospective stakeholders of the bank. In addition, cautious policies and a conservative reputation as a "government bank" have benefited the bank during several sector crises. On the other hand, the tendency for these managers to engage in non-market driven transactions, to respond slowly to new opportunities, and to make restructuring decisions on the basis of criteria other than profit maximization, suggests that the franchise value of the bank will continue to decline in an increasingly competitive market. Thus, it appears that the value of incumbent management may be at its maximum in the period leading up to and immediately following privatization.[38] The declining potential for value added by incumbent management in the long term is of particular concern given the method of privatizing the bank preempted the attraction of a strategic investor.

Finally the success of bank privatization can be judged by the subsequent survival and performance of the bank. In this case, the creation of Mosbusinessbank should be viewed in light of other government policies that affected the bank subsequent to privatization. Perhaps the most important of these policies was the promotion of domestically-owned *de novo* banks which soon contributed to the emergence of intense competitive. The introduction of competition brought product market discipline to Mosbusinessbank and continues to be a motivating force behind improvements in the bank. The success of Mosbusinessbank and of the management-led and client-supported privatization that produced it, will ultimately be judged by its ability to survive in this competitive and volatile environment.

Remarkably, competition has also had the unanticipated effect of reducing the influence of government in the day to day affairs of banks still owned by the state.[39] Perhaps more important, promoting competition reduced the overall importance of bank privatization programs as a means of achieving an efficient banking sector. With over half of all Russian banks originating in the private sector, the issue of privatizing banks that remain the property of the state has taken on less importance over time. The fate of banking reform in Russia does not rest on the future success or failure of Mosbusinessbank or other former state-owned banks. This is in sharp contrast to other countries facing economic transition, where government policies have explicitly and implicitly made bank privatization a cornerstone of achieving efficiency and effective capital allocation.

We grant that there is a cost to promoting rapid growth in new banks in a transition environment. The absence of coordinated development of prudential regulation and supervision has increased the rate of bank failure and allowed organized crime and official corruption to infiltrate parts of the new banking sector. In addition, many banks failed to adequately match durations on liabilities and assets, a condition that could be avoided with better bank regulation and supervision. The consequence is occasional bank-wide liquidity crunches that undermine the stability of the banking system. While these problems may have been difficult to avoid in the Russian context, given the timing and magnitude of reforms, they may be avoidable in other countries through careful coordination of growth in the banking sector with the development of regulatory and supervisory capacity. The Russian example highlights the tradeoff that exists between banking system stability and competition.[40] The remarkable progress of bank reform in Russia in recent years suggests that some instability in the banking system in the early years of reform may be a price worth paying for the long-term benefits of having a large number of banks competing for a share of the banking market.

TABLE 1
USSR: OVERVIEW OF BANKING SYSTEM
SEPTEMBER 1, 1990

INSTITUTION	Loans Outstanding To Households & Enterprises					
	Short-term	Long-Term	Total	Capital	Number of Branches	Number of Employees
	In billions of US dollars[3]					*Thousands*
Specialized Banks	5.00	1.58	6.58	0.34	63,395	435.8
Promstroibank	1.90	0.45	2.35	0.05	1,466	68.6
Agroprombank	2.10	0.83	2.92	0.07	3,374	91.4
Zhilsotsbank	0.65	0.15	0.80	0.02		40.6
Sberbank	0.01	0.15	0.16	0.02	56,637[1]	231.2
Vnesheconombank	0.35	–	0.35	0.06	33	4
Commercial and Cooperative Banks	0.30	0.08	0.38	0.09	400[2]	...
Gosbank				0.03	169	10.6

[1] *Includes 52,347 agencies, i.e., offices that provide only savings deposit and withdrawal services.*
[2] *Number of banks.*
[3] *Conversion rate: 52.2 Rbl/USD. Numbers may not add due to rounding.*

Source: Gosbank

TABLE 2
STRUCTURE OF RUSSIAN BANKING
JANUARY 1, 1996

TOP 10 BANKS		Assets	as % of total
		In trillion of rubles	
Sberbank	state-owned	119.8	24.6%
Vneshtorgbank	state-owned	26.1	5.4
Agroprombank	former specialized	18.6	3.8
Uneximbank	de novo	17.7	3.6
Inkombank	de novo	14.7	3.0
Mosbusinessbank	former specialized	13.1	2.7
Rossiyskiy Kredit Bank	de novo	12.0	2.5
MezhFinKompania	de novo	11.3	2.3
Imperial	de novo	10.1	2.1
Mosindustrial Bank	de novo	10.0	2.1
Total of top 10		253.4	52.0%
Total banking sector	(2598 banks)	487.3	100.0%

US$ = 4,622 rubles (1/1/96)

Source: The Banker, Central Bank of Russia

TABLE 3
BASIC MACROECONOMIC DATA

	1991	1992	1993	1994	1995
Real GDP growth rate	-13%	-19%	-12%	-15%	-3%
Government deficit as % of GDP	31%	18.8%	7.6%	9.9%	5.7%
Inflation rate (end year)	144%	2,318%	841%	203%	140%
Private sector as % of GDP	na	14%	21%	25%	55%

Sources: EBRD, World Bank

TABLE 4
PANEL A: MOSBUSINESSBANK OWNERSHIP STRUCTURE
DECEMBER, 1991

Shareholder Type/Name	Number of shareholders	% of Total Shares
LEGAL ENTITIES	**694**	**90 %**
Founding entities	213	37
*Largest founding entities**	*12*	*17.74*
Largest shareholders	3	22.6
State Insurance Company (Gosstrakh USSR)		*9.4*
Moscow City Administration		*6.9*
*Board of Trade, Ministry of Defense, USSR**		*6.3*
Entities associated with bank's directors**	15	47.6
Banks	2	10
Entities of note		
GUM Department Store		*2.5*
TsUM		*0.31*
INDIVIDUALS	**2,607**	**10 %**
TOTAL	***3,301***	

* The Ministry of Defense is one of the 12 largest founding entities and one of 3 largest shareholders.
** Five entities associated with the bank's directors are also founding entities, comprising 26.4% of total shares; the remaining 10 own 21.2% of total shares.

PANEL B: MOSBUSINESSBANK OWNERSHIP STRUCTURE
1990 – 1995

	Number of Shareholders:		Percent of Total Shares:	
	Legal Entities	**Individuals**	**Legal Entities**	**Individuals**
Dec 1991	694	2,607	90%	10%
Mar 1992	707	2,614		
Dec 1993	966	6,534	70	30
Oct 1994	916	7,831	45	55
Aug 1995			33	67

Sources: Mosbusinessbank Prospectuses 1991, 1992, 1994, 1995; Mosbusinessbank Annual Report 1994, and an Interview with A. Ivashenko.

TABLE 5
PANEL A: LOANS TO LARGEST MOSBUSINESSBANK CLIENTS 1991 AND 1995*

	Enterprise	amount of loan	enterprise type	industry
1991		**mln rubles**		
	GUM	50	state	department store
	Rosinka	75	joint venture	construction
	Investpool	50	joint stock	construction
	Ulan Ude	70	state	textile
	Salut	unknown.	state	apparel
	Svoboda	unknown	state	perfume
	Vempel	unknown	state	apparel
1995		**bln rubles**		
	Farmimex	25	privatized	pharmaceutical
	Dal Moria Product	20	privatized	fishing
	Mostransneft-product	20	privatized	oil transport
	Central Pharmaceutical Warehouse	17	privatized	pharmaceutical
	Vladimir Tractor	39.4 (forex loan $8.5 million)	privatized	agricultural equipment

Source: Credit Department, Mosbusinessbank
* This is only a partial list of the top clients..

TABLE 5
PANEL B: PERCENTAGES OF TOTAL LOAN PORTFOLIO CREDITS BY BORROWER TYPE MOSBUSINESSBANK 1991-1995

BORROWERS	1991	1992	1993	1994	1995
state sector	60%	59.3%	47.1%	28.3%	10-15%
joint stock companies and partnerships	17%	16.9%	31.5%	53.6%	85-90% (all private enterprise)
cooperatives	8%	8.7%	3.7%	2.7%	
small business	9%	8.7%	7.2%	9.6%	
private businessmen	NA	0.3%	4.7%	5.8%	

Source: Mosbusinessbank Annual Reports for 1991 to 1994. Personal interviews with Mosbusinessbank credit department staff for 1995.

TABLE 5
PANEL C: LOAN PROVISIONS, WRITE-OFFS AND RESERVES
MOSBUSINESSBANK 1991-1995

	1991	1992	1993	1994	1995
Provision charge (percentage operating income)	not available	5%	15%	43%	82%
Provision charge (percentage of total loans)	not available	1%	7.4%	9.1%	8.1%
Net write-offs (percentage of Net loans)	not available	1%	1%	1%	3.4%
Loan Reserves (percentage of total loans)	not available	0%	6.6%	10%	10.6%
Related party loans (percentage of total loans)	not available	not available	3.4%	not available	7.2%

Source: Mosbusinessbank Annual Reports, November 1996 BankWatch Report.

TABLE 5
PANEL D: DEPOSITS AND LOANS BY DURATION
MOSBUSINESSBANK 1991-1995

	1991	1992	1993	1994	1995
DEPOSITS (% of total deposits)					
Demand	93%	88.8	78.4	68.7	72.1
Time	7	11.2	21.5	30.2	26.8
Other			0.1	0.7	1.0
Medium/long term				0.4	
LOANS (% of gross loans)					
short-term	100	97.5	93.6	83.1	91.2
medium-term			6.4	16.8	8.1
long-term		2.5		0.2	0.7

Source: Mosbusinessbank Annual Reports

Exhibit 1
MOSBUSINESSBANK INCOME TATEMENTS 1992-1995

($ in millions)

	1992*	% Total Op. Rev.	1993*	% Total Op. Rev.	1994*	% Total Op. Rev.	1995	
Interest income - deposits	4,361	22.1%	28,455	11.7%	109,345	14.1%	258,033	20.2%
Interest Income - securities	754	3.8%	673	0.3%	-		-	
Interest income - loans	14,514	73.5%	201,922	83.2%	561,702	72.7%	980,131	76.7%
TOTAL INTEREST INCOME	18,628	94.4%	232,054	95.6%	671,047	86.8%	1,238,164	96.9%
Interest expense	(4,545)	-23.0%	(62,993)	-26.0%	(325,071)	-42.1%	(841,017)	-65.8%
NET INTEREST	15,085	76.4%	168,061	69.3%	345,976	44.8%	397,147	31.1%
Fees & commissions	3,400	17.2%	-		-		172,861	13.5%
FX trading income	93	0.5%	43,648	18.0%	138,563	17.9%	148,964	11.7%
Securities trading income	-	-	14,303	5.9%	180,440	23.4%	445,881	34.9%
Other income	1,164	5.9%	15,646	6.4%	109,782	14.2%	113,463	8.9%
OPERATING REVENUE	19,742	100.0%	242,680	100.0%	772,761	100.0%	1,278,095	100.0%
Personnel expense	-		(22,838)	-9.4%	(77,075)	-10.0%	(393,324)	-30.8%
Depreciation	-		-		(14,768)	-1.9%		
Other administrative expense	(2,696)	-13.7%	(58,060)	-23.9%	(322,850)	-41.8%	(805,062)	-63.0%
OPERATING EXPENSES	(2,696)	-13.7%	(81,698)	-33.7%	(414,693)	-53.7%	(998,396)	-78.1%
OPERATING INCOME	17,045	86.3%	160,962	66.3%	358,068	46.3%	279,710	21.9%
Provisions - loans	(9)		(24,493)	-10.1%	(154,825)	-20.0%	(230,753)	-18.1%
Provisions - investments	-		-	0.0%	(779)	-0.1%		
GROSS INCOME	17,036	86.3%	135,458	55.8%	202,464	26.2%	48,957	3.8%
PRE-TAX INCOME	17,036	86.3%	135,469	55.8%	202,464	26.2%	48,957	3.8%
Tax	(5,151)	-26.1%	(57,031)	-23.5%	(661,660)	-85.6%	(33,598)	-2.6%
INCOME	**11,386**	57.7%	**79,438**	32.7%	**40,805**	5.3%	**15,361**	1.2%

* Income statements for 1991, 1992 and 1993 calculated using local Russian accounting standards.
The 1994 statement has been audited in accordance with international standards.

** Exchange rates for Income statement are averages for the year, as indicated by the August 1995 BREE re

Source: Mosbusinessbank Annual Reports

Exhibit 2

MOSBUSINESSBANK BALANCE SHEETS 1992-1995

($ in millions) *Assets*	1992*	% Total Assets	1993	% Total Assets	1994	% Total Assets	1995	% Total Assets
QUICK ASSETS								
Cash & bullion	3,818	0.8%	32,710	2.0%	330,769	7.7%	448,828	7.2%
Other Central Banks - Local	12,265	2.5%	233,665	14.2%	232,000	5.4%	241,233	3.8%
Banks to 7 Days	167,783	34.6%	75,602	4.6%	531,255	12.4%	807,365	12.9%
DECD T-Bills/Var Rate Gov			51,431	3.1%				
Other T-Bills - Local			25,696	1.6%	425,659	10.0%		
DECD Gov SECs - Fixed Rate							58,710	0.9%
Other Gove Sec Local							986,375	15.7%
Other Liquid Assets	551						259,189	4.1%
Total	184,408	38.0%	419,105	25.6%	1,519,583	35.5%	2,801,690	44.7%
Marketable securities								
Bonds/FRNs			30,946	1.9%				
Quoted Equities	84	0.0%						
TOTAL	84	0.0%	30,946	1.9%				
BANKS								
Banks to 1 Yr	188,072	38.8%	835,380	50.9%	865,120	20.2%	211,142	3.4%
Non-Local/DECD Banks >1 yr			10,000	0.6%				
TOTAL	189,072	39.0%	845,380	51.5%	865,120	20.2%	211,142	3.4%
LOANS								
Short-term (less than 3 mos.)	74,205	15.3%	309,425	18.9%	1,424,587	33.3%	2,682,959	42.8%
Medium-term (2-12mos.)			21,180	1.3%	287,447	6.7%	238,910	3.8%
Long-term (greater than 1 yr.)	1,898	0.4%			2,618	0.1%	19,265	0.3%
Loan loss reserves			21,701	1.3%	(171,013)	-4.0%	(311,869)	-5.0%
Total	76,103	15.7%	308,904	18.8%	1,543,638	36.1%	2,628,265	41.9%
Equity investments	29,243	6.0%	2,419	0.1%	5,595	0.1%	29,146	
Fixed assets	1,252	0.3%	18,573	1.1%	95,579	2.2%	346,325	5.5%
Other assets	4,731	1.0%	14,714	0.9%	150,572	3.5%	270,435	4.3%
Total Assets	**484,892**		**1,640,040**	100.0%	**4,277,390**	100.0%	**6,273,480**	100.0%

Liabilities

INTERBANK LIABILITIES								
Current to 7 days	113,633	23.4%	137,598	8.4%	506,845	11.8%	584,562	9.3%
Short	26,370	5.4%	70,645	4.3%	268,101	6.3%	325,749	5.2%
Other								
Total	140,003	28.9%	208,243	12.7%	774,947	18.1%	910,311	14.5%
				0.0%		0.0%		0.0%
DEPOSITS								
Demand	226,964	46.8%	968,915	59.1%	2,113,804	49.4%	2,933,599	46.8%
Savings								
Time	28,748	5.9%	265,084	16.2%	930,816	21.8%	1,289,382	20.6%
Other					21,851	0.5%		
Medium/long-term			1,276	0.1%	12,085	0.3%	49,388	0.8%
TOTAL	255,712	52.7%	1,235,275	75.3%	3,078,355	72.0%	4,803,052	76.6%
CENTRAL BANK								
Short-term			18,631	1.1%	8,783	0.2%		
Greater than one year								
Total			18,631	1.1%	8,783	0.2%		
Total Deposits	395,715	81.6%	1,462,149	89.2%	3,862,066	90.3%	5,713,363	91.1%
Medium/long-term debt	16,548	3.4%						
Bonds issued								
Other liabilities	43,106	8.9%	73,810	4.5%	242,835	5.7%	308,045	4.9%
Total Liabilities	455,768	94.0%	1,535,980	93.7%	4,104,900	96.0%	6,021,408	96.0%
				0.0%		0.0%		0.0%
SUPPLEMENTARY CAPITAL								
Revaluation of fixed assets			615	0.0%	12,613	0.3%	38,475	0.6%
TOTAL			615	0.0%	12,613	0.3%	38,475	0.6%
CORE CAPITAL								
Share capital-fully paid	1,800	0.4%	1,796	0.1%	2,762	0.1%	7,965	0.1%
Capital instruments - tier 1								
Reserves	27,324	5.6%	101,670	6.2%	157,115	3.7%	204,632	3.3%
Total	29,124	6.0%	103,465	6.3%	159,876	3.7%	212,597	3.4%
Total Capital	29,124	6.0%	104,080	6.3%	172,480	4.0%	252,072	4.0%
Total Capital & Liabilities	**484,892**	100.0%	**1,640,040**	100.0%	**4,277,390**	100.0%	**6,273,480**	100.0%

* Balance sheets for 1991 and 1992 calculated using local Russian accounting standards. Those for 1993 and 1994 have been audited in accordance with international standards.

Source: Mosbusinessbank Annual Reports

[1] Over 700 branches of Zhilsotsbank USSR were located in Russia. This paper limits its attention to privatization of the Russian branches of the bank only.

[2] This method of privatization anticipated the significant role which insiders played in Russia's enterprise privatization, a process described in detail in Boycko, Shleifer, and Vishny (1995).

[3] A significant part of the problem of bad assets was also addressed indirectly through continued subsidization of state-owned enterprises, which enabled them to continue servicing their loans. These enterprises did not face hard budget constraints until after the onset of severe inflation in 1992, which had the effect of erasing most of the debt in the banks' portfolios.

[4] BankWatch, Russian Federation Banking Infrastructure Report, August 1995, p.4. The 75% figure (from 1/1/95) assumes that all Russian banks excepting Vneshtorgbank and Sberbank are privately held. While several other banks have a small percentage of state ownership, often through state-owned enterprises, the state has virtually no role in the corporate governance of these banks and they are effectively controlled by private investors.

[5] Competition has also forced government, ill equipped to monitor bank strategies and day-to-day operations to maintain a more passive stance toward banks in which it retains a significant ownership stake, e.g., the savings bank, Sberbank.

[6] For example, all Russian banks have incentives to engage in less risky profit opportunities in the foreign exchange and government bond markets rather than lending, and face constraints stemming from the limited supply of qualified bank personnel and limits on loan sizes relative to equity capital imposed by prudential regulations. Abarbanell [1996] discusses reasons for the

failure of privatized banks to operate in socially optimal ways. Some reasons relate to while others are independent of approaches to privatization in Eastern and Central Europe.

[7] While the Soviet Union was formally one of the most centralized of the socialist economies, with more than 90 percent of production administratively directed by the state, the Soviet system actually functioned in an increasingly decentralized manner after the Stalinist era. Both the size of the economy and the inefficiency of the central planning mechanism contributed to this decentralization. This decentralization contributed to the ease and rapidity with which state-owned banks could be broken up into smaller private banks once the reforms began. Given that light industry was a relatively low priority for the Soviet government, Zhilsotsbank in particular benefited from this decentralization.

[8] The CBR issues ruble licenses and three types of foreign exchange licenses to commercial banks. Minimal paper work and fees were required to register a bank and receive a ruble license early in the process. In addition, very little scrutiny of bank capital adequacy claims was possible given the number of banks that registered. Foreign exchange licenses were issued through an informal process in which favoritism was shown to former state banks, like Mosbusinessbank and banks able to navigate adeptly "unofficial" protocol. Over the years minimum capital standards have increased. Today, commercial banks are required to have 6 bln rubles or approximately 1 mln ECU.

[9] FRBSF weekly letter, October 1995.

[10] The GKO market has grown rapidly, reaching a level of approximately 130 tln rubles by June, 1996 and serves an increasingly important role in funding fiscal deficits. It accounted for 96% of deficit financing in the beginning 1996 (see, *Transition*, October, 1996). In a highly inflationary environment, these markets provided a rate of return of up to 200% until the summer of 1995.

[11] The details of the commercialization of Zhilsotsbank and creation of Mosbusinessbank are derived from interviews with Victor Geraschenko, Georgi Matukhin, Aleksei Ivashenko (Mosbusinessbank) and Andrei Kozlov (CBR). The interviews were conducted from August to October, 1995.

[12] Previously, in a partial attempt to deal with troubled assets in the specialized banks, the Soviet government wrote off some of the non-performing loans of the specialized banks. For example, 73 billion rubles, approximately 48% of total loans outstanding, of Agroprombank loans were written off in 1990 and 10 billion rubles, approximately 8% of loans outstanding of Promstroibank loans were written off in 1991 (IMF/IBRD, A Study of the Soviet Economy, Vol. 2, p.111; IMF/IBRD, Economic Review: The Economy of the Former USSR in 1991, (April 1992), p. 68).

[13] From an interview with Aleksei Ivashenko, Vice President of Mosbusinessbank.

[14] The next largest bank formed from Zhilsotsbank in Russia was Unikombank, founded in December 1990 out of the Zhilsotsbank branches of the Moscow city region (oblast) and the Norilsk branch of Promstroibank. Unikombank, which inherited 70 branches of Zhilsotsbank, maintained the Norilsk Mining and Metallurgical Combined Works, one of the world's largest sources of copper, nickel and platinum, as a client and shareholder. The loss of this account in the summer of 1996 led quickly to financial distress and eventually government intervention.

[15] As stated in the first prospectus of the bank, the annual shareholders meeting is authorized to decide among other things, changes in bank statutes, equity issues and statutory capital, selection of Council of Directors and President, opening and closing of branches, and reorganization and liquidation of the bank. In between shareholders meetings, the Council of Directors is the highest governing body of the bank.

[16] The CBR was not officially compensated for its transfer of ownership of Zhilsotsbank. However, at the creation of Mosbusinessbank, there was an unofficial exchange of funds. According to Aleksei Ivashenko, 70-80 million rubles (held by Zhilsotsbank as development funds) were transferred to the CBR at that time. The money disappeared, never to appear on the books of the Central Bank.

[17] According to the first prospectus, one advantage to this method of purchase was that shareholders paying in foreign currency had the right, subject to approval by the Council of Directors, to receive dividends in foreign currency.

[18] Since there was no market for property at the time, it is impossible to estimate the actual ruble value of the buildings. Our opinion that book value underestimates market value is based on significant evidence that the state property monopoly was one of the main constraints to new business development, and is supported by subsequent increases in the market value of these properties after privatization.

[19] The CBR retained a significant amount of influence over the new commercial banks by retaining ownership of the buildings in which the banks were housed. In a February 1996 interview with Georgi Matukhin he described this as a deliberate policy, given the absence of other instruments of regulation and control.

[20] Voucher privatization also gave Russian banks the opportunity to purchase shares in enterprises, beginning a pattern of cross-ownership that continues to this day. For example, Mosbusinessbank owns shares in Gum Trading House, which, in turn, owns shares in Mosbusinessbank. The president of each company sits on the Council of Directors of the other, and GUM is a client of Mosbusinessbank's. Despite this example, relative to other banks, Mosbusinessbank has stayed away from significant cross-ownership. Its ownership structure is

very diffuse, and it has not participated significantly in the two bank consortiums negotiating for shares of important state-owned enterprises in exchange for government deficit financing.

[21] At this time, many banks were able to purchase their buildings from the state. State shares in the banks were also apparently sold to individuals in closed trading, giving high level bank management, well placed government officials and enterprise managers a greater ownership stake in the banks.

[22] 21.3% of shares from the first issue were purchased with US dollars, at an official exchange rate of 10 rubles per dollar. Using the December 1992 MICEX exchange rate of 414.6 rubles per dollar, the actual capital contribution of this purchase is valued at more that 8.8 billion rubles. Similarly, 5.5% were purchased with US dollars when the June 1994 MICEX exchange rate stood at 1,958 rubles per dollar, amounting to an actual capital contribution of almost 10.773 billion rubles. The last prospectus specifically limited to one million shares the number that could can be purchased with foreign currency, at a price of $100 per share. The official exchange rate of 50 rubles per dollar implied again severely overstated the value of the ruble as the January 1995 MICEX exchange rate was about 4000 rubles per dollar.

[23] For example, existing data from the over-the-counter market, for May through December 1995, indicate prices fluctuating between 15,000 rubles and 72,000 rubles, well above the 1995 issue price of 5000 rubles per share set by the bank. Given this differential, 1995 shares purchased for rubles were clearly dilutive.

[24] Agroprombank is a exception to this general rule. State subsidization of this bank continued after its nominal privatization, with up to 90% of the bank's funds in the form of directed credits.

[25] Much of the material in this section was compiled from interviews with Aleksei Ivashenko and other Mosbusinessbank staff.

[26] In aggregate 25% of banking assets are committed to intrabank loans. Sberbank, the large and extremely liquid savings bank is by a wide margin, the dominant player in this market.

[27] Even the most aggressive de novo banks have faced significant obstacles in luring household accounts from Sberbank. In addition to the public's familiarity with the institution, it is the only Russian bank with a federally supported deposit insurance scheme. Sberbank's share of the household savings market was eroded to around 50% as late as the summer of 1995, however, as a result of political uncertainty surrounding the 1996 presidential elections, a series of bank liquidity crises and a rash of bank closures have raised Sberbank's share of the market to over 70% again ("At your Service" CEER, October 1996).

[28] Mosbusinessbank 's ratio of non-bank loans to assets is roughly equivalent to the CBR's calculation of 45% for the aggregate of loans to assets of all Russian commercial banks. The ratio of banking assets to GDP is 17% in Russia, indicating weaker credit penetration than transition countries like Poland, Hungary, and the Czech Republic.

[29] From an interview with Mosbusinessbank Credit Department officials ?.

[30] It is no secret that the ruble side of the bank is inefficient, recalcitrant and overstaffed. One bank official disingenuously pointed to the fact that hard currency and ruble operations accounted for an equal amount of annual profit in 1995 but politely refused to comment on the issue of profitability per employee.

[31] Interview with Rafek A. Salekhov, Vice President, head of Credit Department, Mosbusinessbank. Moscow, July, 1996.

[32] Among these policies are a restrictive licensing policy for foreign owned banks and branches and an aggregate cap of 12% on foreign owned assets in the banking sector.

[33] See, e.g., Abarbanell and Bonin [1996], for a discussion of the impact of a strategic foreign investor in the case of Poland's Bank Slaski.

[34] Interestingly, an informal competition among banks developed around these loans. Some bankers familiar with the arrangements conjecture that some of the frequent assassinations of banking officials up to 1996 were related to how officials at newly privatized banks allocated large portions of directed credits intended by officials in the government to be spread among several banks.

[35] See, World Bank, Russia: The Banking Sector through Transition, 1993.

[36] Replicating the Russian approach would clearly be politically difficult for many reformist governments. However, these elements of the Russian model may be suitable and implementable in other settings. In fact, the Hungarian government, after many years of trying other methods, seems to have adopted feature the Russian approach in the recent privatization of Budapest Bank. Controlling interest in Budapest Bank was transferred to GE Capital, with no compensation to the government, with little public discussion of the terms until the deal was done, and in the expectation that self-interested behavior on the part GE Capital would maximize the franchise value from the introduction of modern, efficient banking practices and, in turn, generate substantial consumer surplus.

[37] Abarbanell (1996) argues the case for maximizing the speed of government disengagement from the banks, even at the expense some instability based on experiences in Hungary, Poland, the Czech Republic and Russia.

[38] Unikombank provides another example of how tenuous is the value created by management's relationship with clients. The main sources of franchise value at the time of its creation was its relationship with Norilsk Nickel. The recent transfer of much of Norilsk's business to

Oneximbank, accompanied by Unikom management's failure to adequately diversify the bank's loan portfolio when it had the opportunity, has put the bank's survival in jeopardy. In May of 1996, the CBR appointed a temporary administrator for the bank and is considering granting an emergency loan to prevent the bank's failure.

[39] For example, the Central Bank of Russia owns a 51% of the state savings bank, Sberbank, yet rarely interferes with the conduct of bank business. This policy allowed the Moscow branches of Sberbank to quickly adapt to customer-oriented practices and regain a significant share of the personal savings market lost originally to competition. Branches of Sberbank in other regions of the country where competition is less intense or non-existent, have not altered the way they conduct business.

[40] See Gordon and Witton (1996) for a analysis of this tradeoff.

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