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TO EXPAND A NETWORK, OR NEITHER – THIS HERE THE QUESTION

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ABSTRACT

In the past six years banks in Hungary had branch opening fever. Due to this fever and the series of bank fusions remedial process started at Hungary's "under-banked" territories and the current structure of the country's banking market has been developed (5-6 strong universal banks, 10-12 medium-sized banks). Fierce competition has been taken place among the banks to get customers and to conquer the market. The competition implies a serious struggle that banks try to overcome on one hand by branch expansion and by efficiency improvement on the other. Competition constitutes considerable challenges for financial institutions even in normal cases, not to mention a global financial and economic crisis that has been lasting for almost 3 years.
Keywords: bank, crisis, bank branch, branch opening

INTRODUCTION

Basically, the primary goal of a bank is to satisfy customers' needs as widely as possible, that inspires banks to constantly grow their organizations which manifests mainly in branch openings in the best available places and to get their products to the customers through other easily accessible sales channels. However, the current global financial and economic crisis makes banks even more cautious and uncertain. For us outsiders it might seem that so far the crisis had a minor effect on banks in Hungary as we daily encounter advertisements of banking products that confirm banks' organizational growth. But this is not reality. The branch opening process is preceded by prolonged planning and preparatory works. It is understandable that since the processes have already been at implementation phase when the crisis reached Hungary and because of only temporary turnover reduction banks would give up their network expansion conceptions only after serious consideration.

MATERIALS AND METHOD

The first and the second part of the paper are based mainly on literary works. In the third part it shows how the number of the main banks' branches changed with the method of comparative analysis and exact numbers.

Formation of the Bank Definition – Hungarian Versus English Example

If we wanted to determine the definition of the bank we should search for it extensively in the works of the last period. A nearly 50 year-old book titled

Banküzemtan written by *Szász* gives an interesting starting point. In this work the author defines the notion of the bank as follows: "We think a bank is a plant who professionally use and provide loans on its own account and whose special economic organization makes it able to make money" (*Szász*, 1947, 3. p.). The definition is not accurate enough anymore to describe the roles of today's banks but the fact is that in the last years Hungarian economists did not really bother with determining the definition of the bank, most of them used the expressions of bank and financial institution or banking and financial institutional activities as synonyms. If they still separated them economists followed that general principle that says bank is that which is able to money creation, financial institution is that which is not. Namely, banks keep current accounts for customers, from whom prompt transfer can be accomplished; financial institutions in contrast do not keep this kind of accounts. The unambiguous definition for the activity of banks and financial institutions was created only when the Financial Institutions Act of 1991 entered into force. This Act was the first to define financial institutional activity on the basis of which different financial institutions were defined. Understanding financial institutional activities (deposit collection, lending, keeping of accounts, borrowing, etc.) we can see that the banks' activity of dealing with money intermediation has an impact on every level of the society as there is no such company or household that would not have a connection to any bank.

Similarly that of England where there was no unified bank definition until the approval of the Banking Law of 1979 practically those financial institutions were considered as banks that were under the control of the Bank of England. However, the English Banking Law of 1979 neither defined banks exactly, but it rather drafted criteria of working capital cost and that the Bank of England should recognize financial institutions (whatever was written in the course books, a bank was considered a bank if it was recognized by the Bank of England).

In 1987 another Banking Law was entered into force according to which banks had to acquire the permission of the Bank of England to pursue its activities. This Law laid down the exact definition of the banks as those were considered banks that provided banking functions (e.g. payment transactions, deposit collection, granting overdrafts and other credits, currency and foreign exchange operations).

As the financial system developed, banks started to provide additional and more diverse functions. The above-mentioned traditional banking functions, in addition to the modern banking has become increasingly more widespread, and now there are other non-banking services provided to their customers (such as leasing, factoring, asset management, investment funds, etc.) (*Ligeti*, 2003).

Efficiency Measurement of Banks as Financial Institution

Definitions above do not mention organizations by chance as banks are established consciously by people where colleagues work to achieve a common aim (profit, gains). This certain aim is intended to be achieved together thus all the work in the organization is regulated for this purpose and tasks are shared in accordance with it. In these tracking systems efficiency and effectiveness are very important i.e. how efficient the organization is in reaching its aim and how effectively it is able to mobilize its recourses for this purpose (*Jávor*, 1993).

We have to decide what efficiency definition is to be used in connection with measuring efficiency. Basically, we can use three economic efficiency notions: cost efficiency, profit efficiency and the so-called alternative profit efficiency.

Cost efficiency

Cost efficiency qualifies the use of the available resources, i.e. it shows how near the costs of a given bank are to the optimum cost level in the course of producing output under certain conditions.

Profit efficiency

The standard or in other words the profit efficiency measures how near the gains of a given bank are to the profit maximum available under given input and output prices.

Alternative profit efficiency

Alternative profit efficiency shows how near the profit of a given bank is to the maximum if instead of the price the level of the output is given.

Reasons for different efficiencies

The banks' varying efficiencies can have many reasons. It can arise from the difference in their sizes, their variant scope of business, management defaults or we can mention many other factors independent of the management. However, efficiency can be improved by the development of information technology or by branch expansion for instance.

Changes in the banking sector by the development of information technology can significantly alter the structure of the retail banking market. One of such technologies is the ATM (*Automatic Teller Machine*) – commonly known as the bank machine, that gradually replace the traditional bank branches regarding money withdrawal, payment and account balance checking. About one third of the ATM's are installed outside branches. Besides ATMs the number of *EFTPOS* (*Electronic Funds Transfers at the Point of Sale*) terminals has been rapidly increasing, the use of credit and debit cards is more and more common and Home banking i.e. internet and computer based banking services has also started to develop significantly. These new sales channels result in cost reduction for the banks as customers use the bank system for the banking services with their own previously purchased devices. Through applying information technologies banks' turnover has undergone remarkable changes (*Kondrát*, 1998).

Structure of the Domestic Bank Market

Presumably this also contributed to the changes in the activities of our financial institutions which took place prior to Hungary's accession to the European Union on 1st May 2004. Foreign-owned banks entering the market after the EU accession gradually take control of the existing banks and as a result the structure of the market is rearranged and the exposure as well as the dependence to international competition intensifies. In the last few years similarly to Western Europe a number of bank fusions took place (ABN-Amro and K&H; BACA and Hypobank; Postabank and Erste Bank; MKB and Konzumbank; CIB and Inter-Európa Bank) which resulted in the commencement of Hungary's "under-banked" territories' remediation. The market structure change calls forth *5-6 strong universal*[1] *banks leading the Hungarian market, while the number of middle-sized banks stabilise at 10-12*. Large commercial banks are in constant competition for getting new customers and to conquer the market though the fight for possessing the places behind the market leader in domestic retail banking (OTP Bank Plc.) is also considerable.

Rivalry among banks can in point of fact be considered as a sort of competitive environment which is quite similar to the method delineated in Michael Porter's book titled Competitive Strategy (*Faulkner and Bowman*, 1999). Although Porter put forth his method to analyse the structure of an industry or a market segment but in a wider sense banks also operate in such competitive environment. Advertisements, special lending actions, advertising campaigns – just to mention a few – are all factors that indicate the intensity of competitive behaviour.

Trends in the number of branches 2004-2010

Due to this fact, the majority of the financial institutions of Hungary have been in branch opening fever over the last six years. In the gradation of branch number (based on the actual data of 2008) OTP bank is the leader, K&H bank operates the second largest network, Erste bank is the third, Raiffeisen is the fourth and CIB is the fifth. This sequence is expected to remain unchanged in the next few years as OTP bank owning the largest branch network is still going to possess at least twice as much branch than K&H bank. However, banks running behind OTP intend to catch up on the retail banking market by dynamic branch expansion (*Table 1*).

Commercial banks' branch opening fever was not typical only to Hungary or in countries of Eastern Europe; for instance, the number of branches in the United Sates of America has increased in spite of the widespread internet usage as half of the transactions and about three-quarters of sales still take place in branches which indicates that people prefer going to branches to advanced technologies.

Grouping of banks by their branch networks

Hungarian financial institutions can be divided into three groups according to their branch networks – earlier said by *Király*, vice-president of National Bank of Hungary. In her opinion the first group involves the largest branch network operator OTP bank that inherited a remarkable nationwide network from the

[1] Universal banks provide diverse financial services for customers; they operate more economically than other financial institutions due to their diversified activities, extent and diversification of their operations. Some authors say their activities beyond the traditional trade activities, the brokerage, the (short term) lending, the transaction of payments traffic. While others engage in operations as securities, and securities guaranteed issue. And in addition, there are those that consider non-financial companies holding shares in, or trading with derivatives and insurance, also includes the concept of universality (*Ligeti*, 2003). Simply that means investment bankings.

period before the change of regime. The second group involves those financial institutions that were formed by the merger of several financial institutions and their branch networks, e.g. Erste and K&H bank. All other banks belong to the third group. The expert says that the sequence will not change for long but any rearrangement might happen within the groups.

Table 1

Branch number of major banks at year ends

Bank	**Years**						
	2004	2005	2006	2007	2008	2009	2010
	actual	actual	actual	actual	actual	actual*	actual*
Allianz Bank***	0	0	5	17	41	60	80
Budapest Bank***	58	75	92	110	106	115	115
CIB Bank	58	77	98	105	150	165	180
Citibank***	23	23	23	23	26	23	23
Erste Bank	139	160	182	196	204	211	216
Inter-Európa Bank**	30	32	36	35	0	0	0
K&H Bank****	153	158	168	203	260	318	318
MKB Bank	50	52	67	74	81	97	107
OTP Bank****	427	408	408	409	403	420	420
Raiffeisen Bank	72	98	120	135	162	181	200
UniCredit Bank	38	51	74	81	127	122	122
Volksbank	27	30	39	46	70	76	91
Total:	1075	1164	1312	1434	1630	1788	1872

Source: *Financial institutions*

** As data of 2009 have not been published yet these are forecasts of the banks' unofficial perspectives; ** Inter-Európa Bank merged with CIB bank in 2007; *** Bank did not provide forecast for 2009 and 2010; **** Bank did not provide forecast for 2010*

Network developments, changes

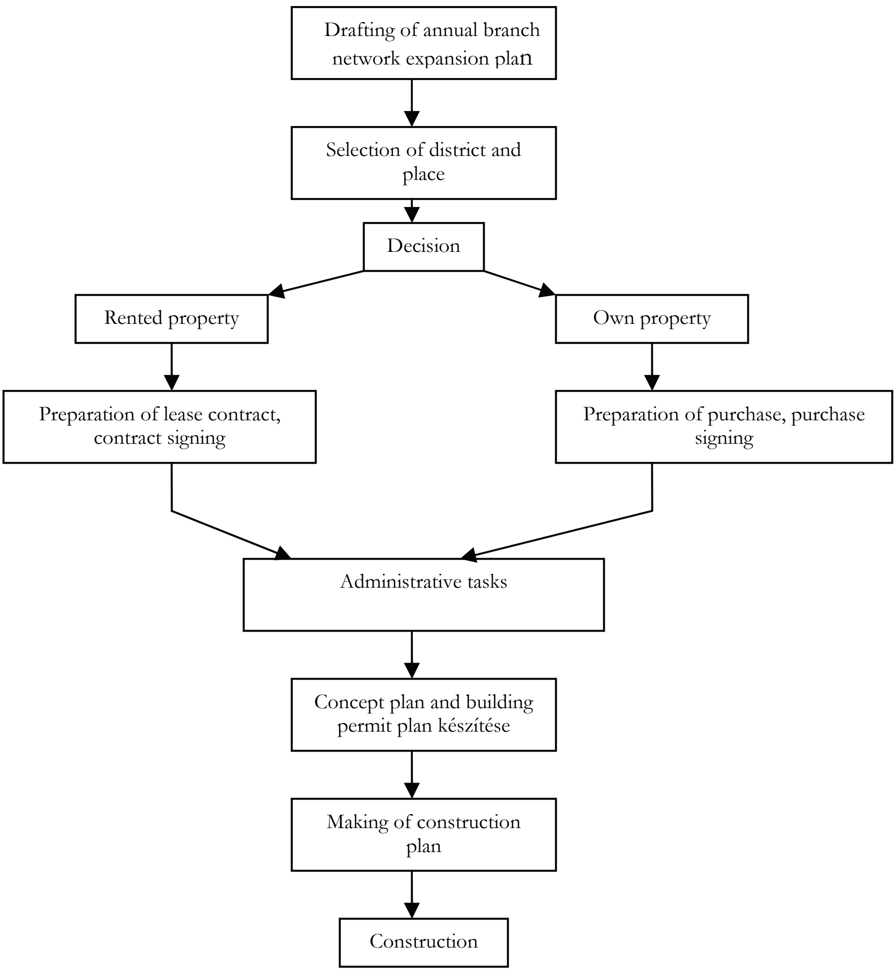
More frequently can we hear news about branch openings / branch expansions / branch refurbishments and increasing number of branches and bank machines (ATM) are set up in the cities in the vicinity of our homes. This all suggest the end of the branch opening processes which were preceded by a prolonged planning and implementation phase.

The process of branch opening

Opening a branch takes almost one year and it is usually implemented through a project work and it starts with the drafting of the annual branch network expansion plan. This is followed by the selection of the district or place where the branch is to be established. Then the commercial bank should decide whether it would like to rent or perhaps own the place. If it is rented the bank and the owner of the place have to enter into a lease contract, otherwise the bank needs to manage the preparation of the purchase and the related procedures. After the contract signing concept plans and a building permit plan should be prepared. When these are approved construction plans are drafted then the construction works begin. In the last phase of the construction work (but before the handover of the branch) the branch's devices, equipments and cash supply have to be ensured. After the handover date the related marketing activity starts and the necessary notifications for the authorities proceed (*Figure 1*).

Figure 1

The process of branch opening



(*Note*: "Construction" likely indicates new building, buying or leasing there is not need for this.)

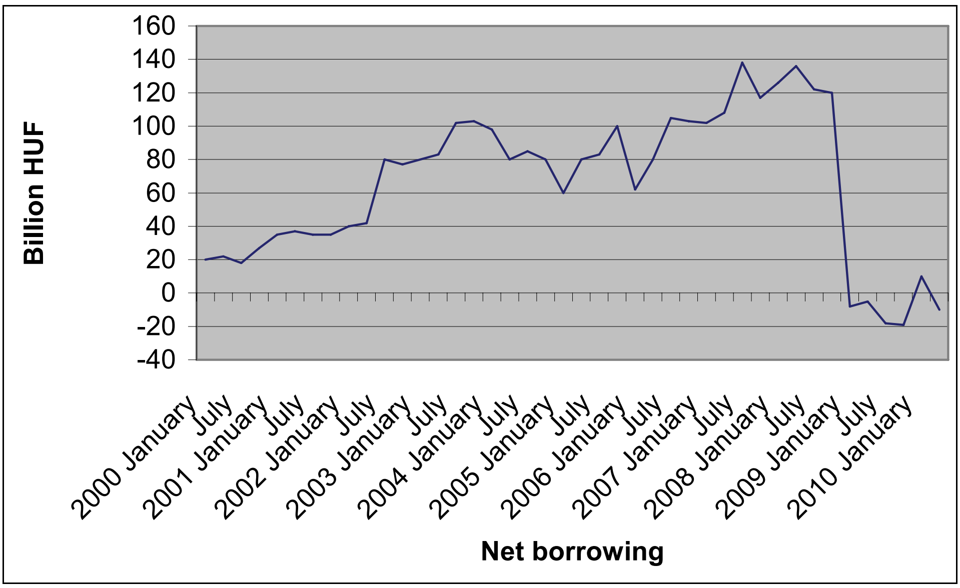
Perhaps the most difficult point of the process is to select the appropriate district, zone and the exact place. It matters heavily whether the selected area is settled by competitors or it is a so-called "virgin" territory that the bank would like to introduce to the public. A good decision based selection can help the bank to satisfy the customers' needs the widest possible and at the same time the bank might reduce its arrears in the retail sector too.

CONCLUSIONS

Branch opening fever seemed unstoppable until the burst of the crisis. From July 2008 the borrowing capacity of the retail segment significantly reduced (*Figure 2*); however, until then customer needs of the retail sector and the sharp increase in demand for housing loan inspired financial institutions to open branches.

Figure 2

Net borrowing of household sector



Source: Based on *MNB* data, 2010

As a consequence the majority of the financial institutions supported qualitative expansion so that they planned their branch openings at the busiest points of the city or its region. For this reason new branch openings were preferred primarily in Budapest and in the richer surroundings as well as in the county seats. Bank experts say the Hungarian market was not that saturated as the Western European ones or the American was that is why there were places for establishing new branches.

However, the international financial and economic crisis made banks even more cautious and uncertain. Some of them have already modified their conceptions concerning branch opening, others probably reconsider their expansion strategy nowadays.

But how can more and more branches open while employees are dismissed because of the crisis? Well, banks lay out their branch opening plans and timings years in advance that might be slowed down by the crisis but it does not stop completely. Even in the time of the crisis banks continuously search for potentials where such a bank can be opened that returns the invested capital in a longer term. Series of negotiations that began months before could by now result in the commencement of the opening process, thus none of the banks will retreat due to the temporarily decreased turnover caused by the crisis and they will give up their conception of network expansion only after serious consideration.

Overall, mass branch closing is not typical, moreover the number of branches in 2009 somewhat even increased despite the fact that almost 2000 jobs were terminated due to the crisis. It is rather the transformation and the appreciation of branches that can be felt as customers use electronic channels for routine banking transactions more often and branches specialize at financial advisory and/or selling new types of products. Although the number of clients who complete transactions in the branches decrease due to the users of electronic channels they are replaced by those who are interested in new products thus a more complete and national coverage of branch network is essential to be able to serve interested customers at an appropriate level. Regarding the desirable network size the number of "hundred" is considered the magic border on the basis of information supplied by banks.

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