MASTERARBEIT / MASTER’S THESIS

Titel der Masterarbeit / Title of the Master‘s Thesis

„Internationalization of UniCredit Bank within Bosnia and Herzegovina Market“

verfasst von / submitted by

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angestrebter akademischer Grad / in partial fulfilment of the requirements for the degree of

Master of Science (MSc)

Wien, 2018 / Vienna 2018

Studienkennzahl lt. Studienblatt / degree programme code as it appears on the student record sheet:	A 066 914
Studienrichtung lt. Studienblatt / degree programme as it appears on the student record sheet:	Masterstudium Internationale Betriebswirtschaft
Betreut von / Supervisor:	ao. Univ.-Prof. Mag. Dr. Josef Windsperger

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1. INTRODUCTION

Understanding the Internationalization of banking competitors is a critical component of developing a competitive business model. Many factors have influenced banks to move internationally. Generally, banks or firms become multinational to exploit firm-specific advantages. After carefully deciding upon Corporate Strategy of internationalization, the next step for banks is to develop a clear Business-level strategy in order to meet local demand and outperform competitors. As a result, they develop techniques and products or services that give them some competitive advantage, which then allows the innovating firm to perform well in the domestic market.

Particularly, it is important to understand how UniCredit Bank competes with major banks and what are the main drivers of UniCredit Bank's profitability in the market of Bosnia and Herzegovina. Namely, this paper analyzes why UniCredit is the most profitable bank on the B&H market and reveals its main sources of profitability.

The paper gives an overview about the globalization of the banking sector, the motives for bank consolidation and an insight in the most common market entry mode for banks – Mergers and Acquisitions.

This research can offer some illustrative benchmarks for other banking competitors that are intent on entering Central and Eastern European (CEE) markets. CEE has been characterized as the growing opportunity market for foreign investors, but still there is a need to clearly structure the strategy in order to compete and gain competitive advantage.

Although macroeconomic variables are considered as being uncontrollable by an industry or a bank, they are very important for successful global competitors, because they provide know-how, human resources, intense domestic rivalry and also demanding local buyers. As a result, these factors are significant determinants of the bank’s strategy that would lead to improved performance. The paper gives an overview of the transition markets and CEE countries to understand better the economic situation in the region and goes more detailed in the B&H market. The paper analyzes the macro environment of Bosnia and Herzegovina, which has been characterized as the market with high growth potential and low saturation of banking services, making it very attractive for foreign investors. This continued strong economic growth is being fuelled by favorable corporate profitability and rising household income and consumption.

It is crucial for foreign banks to consider all the forces of industry and institutional conditions, contemplate on its resources and capabilities clearly and decide and stay consistent with the chosen strategy. Specifically, in this research we find out how UniCredit Bank utilizes its competitive advantage.

Nowadays, clear and strong strategies are a necessity in order to compete and sustain the competitive advantage that will provide them with the chance to leverage their position in the market by adding value to company's service. However, the competition is fierce so the bank must be able to secure the long-term viability of its investments and this requires a healthy and transparent banking sector in the market.

In order to sustain the competitive advantage, a bank must also manage factors that influence its profitability, such as credit risk, liquidity risk, and expenses. The combination of the two can secure and sustain competitive advantage for a bank. For example, Raiffeisen Bank is the bank with the long tradition and presence in the market. It has been leader for many years, but UniCredit bank is developing strategies that will lead it to overtake Raiffeisen Bank.

2. GLOBALIZATION IN THE BANKING SECTOR

In the last two decades, the international financial system has experienced significant structural changes. Strong growth in international financial flows around the world was primarily driven by the liberalization and privatization of financial markets. This growth completely changed the environment and market legitimacy. The changes in financial systems are visible in the way how to apply the new financial instruments, technology, and financial techniques. The appearance of new financial institutions is also one of the differences, and the significant changes are evident in the regulation of financial institutions.

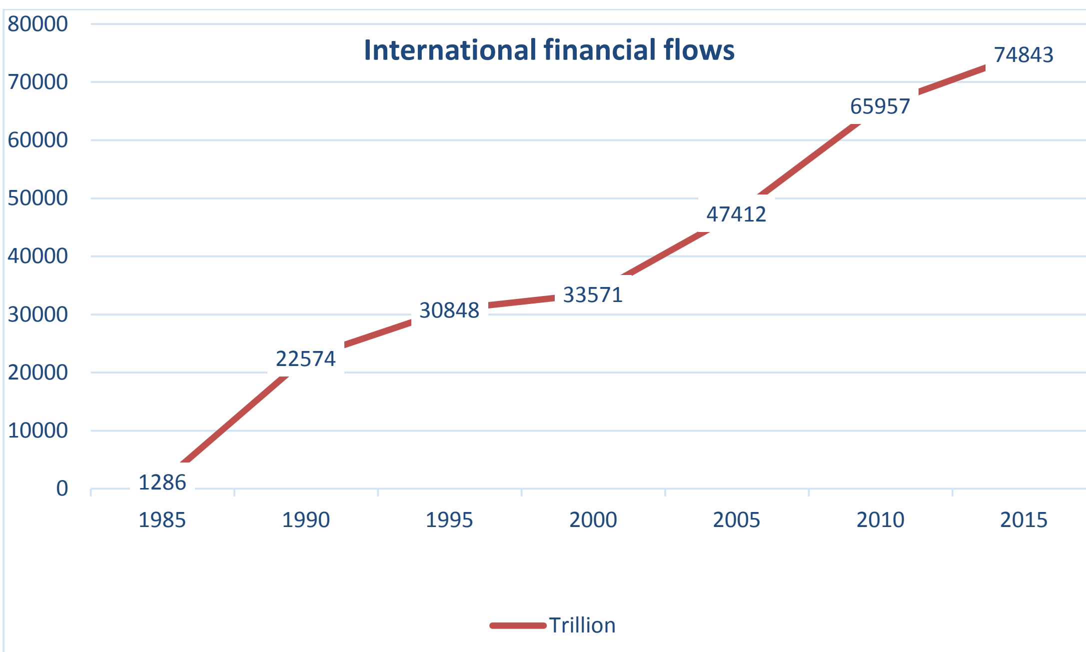
There are more and more international banks in the world. Between financial institutions, the benefits of global orientation are most recognized and used by banks that operate worldwide today. The concept of an international bank is most often represented by a bank that, with the help of subsidiaries is operating in other countries. In the international market, because of the lack of control or lighter control (e.g., non-compliance with mandatory reserves, more favorable tax treatment), these banks provide greater incomes compared to the home country. The liquidity and the value of individual shares increase as a result of the international market entrance.

Financial markets, as in the case of other markets, are blended into a single, global financial market. Developed countries are included in the process of financial globalization, as well as transition countries. The process looks unstoppable for the time being. By liberalization of financial markets, small monetary systems have to adjust to new conditions of market competition in the setting of increased financial instability. The advantages of financial globalization are a better quality of financial services, expanded volume of financial transactions because of access to the global financial market, modernized and raised performance level in institutions. In the uncertain global conditions, the goals of central banks are undoubtedly changing. The primary goal is to keep macroeconomic stability, especially the exchange rate. Under such circumstances, monetary policy stops being “leverage” in spurring the growth of employment and production. In these conditions of financial monopoly and capital risk, a dilemma arises in relations with and against the entry of foreign ownership into the banking sector.

2.1. Financial Globalization

Today, globalization is the opening point for almost all discussions, mostly with positive and sometimes with negative undertones. Figure 1 shows the acceleration of financial globalization in the last three decades. International courses of around 4% of world GDP after 1995 raised their share to over 14%. Today, these courses far exceed eight trillion US dollars. The increase of ten percent of world GDP share in just ten years means a qualitatively new appearance. The world is connecting to a centralized economic entity that brings a different functioning of the entire world economy, but also of every national economy inside the global economic system.

Figure 1: International financial flows



Data: www.worldbank.org Access: July 2018

Financial globalization is a notable segment, but only a segment of the globalization process. Due to the influence of monetary policy and money for each country, financial globalization is "most exposed", unlike other forms of globalization. Financial globalization is a basis for trade globalization. This slows down the dynamics of the globalization process as a whole because of the need to abandon monetary sovereignty under the conditions of financial globalization.

The development of technology, especially internet banking and brokerage services, has led to drastic changes in the bank's property structures and the development of new financial giants. The appearance of financial consolidation at the central bank raises the subject of monopolizing national banking systems and its possible consequences. In the period from 1985 to 1998, the volume of international credit transactions increased five times and today amounts to about $ 6 trillion.[1] The assets of the ten largest world banks point to the strength of the financial conglomeration process today. During 2000 the global financial market had an inevitable slowdown, because the banks were focused towards globalization, fusion, restructuring, and transition to Online Banking.

In the light of the financial globalization process, two issues impose. Does financial globalization create monopoly and inefficiency in the banking system? Also, can some sovereign monetary systems combat the processes of financial globalization? The current trends over the past ten years suggest that privatization of the banking system can build a monopoly not only in the banking but also in the real sector. The speed of entrance of foreign banks to Bosnia and Herzegovina's financial market shows the dynamics of the process of financial globalization and the possibility of its slowdown.

2.2. Banks Entering the International Financial Market

The extension of international banking and the share of large banks in the world market is mostly the result of their efforts to achieve the highest profits. The most successful banks in the most developed countries were the best in achieving this goal, so it is not surprising, that after the 1970s, the largest international banks were from the USA, Europe, and Japan. In that period banks are beginning to develop in the sense that we know them today.
In this period, most important international banks were from the United States. For example, in 1970, 79 US banks had branches abroad, and this number grew to 159 banks in 1980.[2] The

[1] Knight (1999), p.32
[2] Houpt (1999), p.603

principal reason for the US banks to expand for the world market is the strict regulatory system that in the USA ruled until 1994. Banks were forbidden to establish subsidiaries outside the Federal State, therefore many banks were searching for opportunities on the international market.[3] The paradoxical fact is that New York banks had branches in Taiwan and Hong Kong, but they could not have them in New Jersey.

The biggest regional representation of US banks is in the financial markets of European countries, due to the traditional economic and political bonds, but also due to the economic significance of some European centres, particularly London.

Of course, American banks are very much present in Asia and South America. The growing ubiquity of global banks in offshore centres is also there.

At the same time, the process of globalization goes in the opposite direction. The foreign banks enter the US market more and more. The size and traditional openness of the US economy, as well as the weight of the United States in the world economy, lure foreign investors, especially banks. For example, foreign currency assets in the United States had its peak in the last twenty years in 2013 and amounted to $ 11.68 trillion.[4]

The financial markets of Russia and China are the most impressive for investors from around the world. These markets are exciting for investors due to the large population, but also the expected sizeable economic growth projected for the economies of these countries in the coming period.

When looking at globalization in the banking sector, we usually consider takeovers in developing markets, and it is generally believed that they make up the majority of the merger transactions on the global financial markets. When looking at the data of the number on international mergers and acquisitions within developed countries in 2006, we see that it was even five times bigger.[5]

The leading cause of ever-increasing globalization in the banking sector is the desire to diminish costs in order to eventually increase the profit that would satisfy the owners (shareholders) of international banks. For the last twenty years in international finance, there have been many aspects that only favoured globalization in the banking sector. The most important of which are disintermediation, internationalization of finance, securitization, deregulation, re-regulation,

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[3] Madura (2001), p. 525

[4] Statistics on Development of global currency reserves, taken from: www.statista.com

[5] Recent Trends in Merger and Acquisition Activity in the Euro Area (2006), p. 36-39 www.ecb.europa.eu

technological revolutions and finances, the growing importance of the state on financial markets through public debt policy.

Disintermediation is the process of reducing the use of financial mediators, transferring money from indirect to direct market.[6] Deregulation is the process of removing regulations and barriers, namely, "lowering the traditional economic, physical and legislative barriers among European financial systems."[7] Another important phenomenon that marks international finance today is securitization.[8] Securitization has a narrower and broader meaning. The narrower meaning is the creation of bonds by some forms of assets. The broader significance of securitization is loaning on the open market by utilizing securities as credit instruments. Through securitization, banks can "release" some of the assets (claims) that are determined by high risks and interest rate changes.[9] Low liquid claims are converted into "liquid assets". In this way, banks come to the funds required for new business activities or to repay a debt to bank creditors.

2.3. Changes in the Structure of the Banking System around the World

Changes in banking systems in almost all countries of the world today are apparent, and they only vary in what economic systems they are. Financial globalization advocates are promoting, that through processes of merging we set up of a modern and stable banking system. That system will face any eventual stagnation and recession event and possible crises. The antagonists of financial globalization speak of the non-selective policy of large banks, where banks are mostly turning to finance the population, overlooking the regional character of banks and the multiplier impacts of lending to the economy. Monetary experts in the United States are not too concerned since their Megabanks still leave enough opportunity for banking competition to have a share of less than 50% in the total assets of the banking system.

Monetary experts like to speak about the good results of financial consolidation through the numbers and names of countries that have the most refined economic system and are most engaged in these processes. While large European, Japanese and US banks are grappling to dominate the global financial market, transition countries are still concerned about the outcomes

[6] Boscia, V., Carretta, A., Schwizer, P. (2009), p. 10
[7] Ibid., p.10
[8] Leko (2012), p. 48
[9] Ibid., p. 49

of the transition process and the issue of economic growth. All transition countries as "saviors" have adopted the model of joining the EU, hoping to obtain the needed economic growth rates and enjoy the benefits of markets. In correspondence with the reforms in the real sector, especially the public sector, the banking systems of transition countries are trying to adjust to an entirely new financial system in Europe in the best possible way.

The more successful ones between transition countries, such as the Czech Republic and Slovenia, are more easily adjusting to the new architecture of the European financial system. They supervise the processes of banking mergers between foreign and domestic, state or now privatized banks, attempting to adopt the "story" about the new financial system in Europe to its needs. Is it possible that two entirely separate economic motifs, such as banking profits and economic growth, are yet reconcilable categories that can provide fulfilment to everyone; a foreigner, domestic, and micro and macro levels.

The size of the necessary adjustments in a country's financial system to the demands of globalization processes reveals the nature of the process of banking mergers in the world.

3. ENTRY INTO NEW MARKETS

The market size limits all institutions, including banks, in their efforts to achieve more profit. Faced with the negativeness inherent in the establishment of monopoly and oligopolistic systems (banking and other), developed countries of the world have built such legal regulations aimed at preventing uncontrolled economic consolidation in order to protect the efficiency. Given the trend of larger banks to spread on the banking market, the same countries tried to reduce the network of subsidiaries of banks. They succeeded so that in the period from 1980 to 1991, there was a drop in the number of banks in developed banking systems. At the same time, banking corporations have argued that the problem of regulatory market expansion could be solved by expanding on foreign markets through the processes of merging with domestic banks or through acquisitions. In Europe, countries of transition have been particularly attractive for many reasons. The first reason is that until recently in these countries the state banking system performed in a way, that several state banks dominated the entire banking market. With the collapse of the planning system, state-owned banks had to adjust to new business conditions in addition to the severe problems of transition and privatization.

Today, Mergers and Acquisitions of banks in foreign countries are the most common form of bank issuance on the international market. An example of bond and dependence between those events on the global and local financial markets is when the Italian bank Unicredit bought the Austrian-German HVB Group in 2005 and formed the largest banking group in Europe. That act directly hit the Croatian financial market. Unicredit had to sell HVB Splitska bank because it previously owned the Zagrebačka bank. So the owner of these two banks became the owner of a significant stake in the Croatian banking market. In this way, the German purchase transaction led to the forced sale in the Republic of Croatia, but allowed the entry into B&H's market.

3.1. Forms of Bank Consolidation and Integration – Entry Modes

The dynamic development of entrepreneurial activity enables managers to use different instruments to keep the market competing and to sustain or strengthen their market position. Following various motives, entrepreneurs attempt to expand and consolidate their business on a temporary or permanent basis. The most common form of bank consolidation arises from mergers and acquisitions (M&A). Besides these two legal forms, banks and other entrepreneurs are allowed to use other methods to confirm their position in the market. It can be said that the most common form of consolidation are actually mergers between banks, where banks transfer all their assets to a new company or another society and desist to exist as an independent society.

Some authors generally use “corporate group” for all types of business connections that do not necessarily mean mergers and acquisitions but also other types of business arrangements.[10]

In competition law, they use the term “integration” for forms of consolidation such as mergers and acquisitions. After accepting the expression the first time in French law, the European Union legislation started using the same name. The concept of integration includes a form of bank merger, where they come under common control and create a sort of economic union. Such union did not exist until the time of the merger, because the banks acted, legally and economically, as independent entities.

The term "merger" derives from the US competition law and later it is included in the European Union Law. It means the procedure in which two or more banks establish a new bank to which they transfer all their assets. Then they stop existing, without the liquidation procedure, and the shareholders of the previous banks receive shares of the newly created bank. So, in the notion of a merger, there is the end of the existence of both founder societies and an establishment of third society.[11]

Another type of consolidation is where the entire assets of one or more banks are transferring to another bank. The related banks stop to exist without the liquidation process, and the shareholders of the bank, in exchange for their shares in the attached bank, receive the shares of the transferor bank. For such a form of merging, some authors use the term “fusion” in the narrow sense.[12] The fundamental difference between merger and fusion is that in the case of a merger a new society is formed and its founders stop to exist. In the case of fusion, one or more societies stop to exist, but the companies to which they fuse grow up.

Besides merger and fusion, integration is a process of gaining control or dominant influence with which the bank acquirer can make a decisive influence on the bank whose shares or a majority of voting rights it has. For such a form of corporate group, some authors use the term

[10] Orsag and Gulin (1996), p. 17
[11] Ibid., p.28
[12] Ibid., p.29

"acquisition".[13] When it comes to the character of the M&A we differentiate between friendly M&As, where the target company allows and agrees to be acquired, and hostile M&As or Takeovers, where the target company doesn't agree and rejects the acquisition offer.[14]

It is also possible for a bank to get control over another bank before merging and having influence on the bank's management policy. In this way, it is possible to create a group of banks in which one bank, as a parent company, has control over one or more other banks and financial institutions. Three basic types of integration differ from horizontal, vertical and conglomerate. In the case of mergers of banks or some other form of bank fusion, we have a horizontal integration (horizontal M&A), since the banks have the same activity and offer the same kind of services.[15]

Horizontal integrations represent a model of entrepreneurial integration involving groups of same or similar products and services within the same branch. Since it is the case for entrepreneurs from the same economic field, the implementation of horizontal integrations gives two significant consequences that normally do not occur in vertical or conglomerate integrations.

First, horizontal integrations in contrast to all non-horizontal integrations will reduce competition among market participants; there will be at least one participant in the market less. The other consequence is that the participants after the implementation of the integration together will have a higher market share. They can stimulate the creation of a dominant position on the market or in cooperation with other market participants, can create a common leadership position. The conclusion is that the horizontal integration is the most dangerous because it has the most significant adverse effects on competition in the relevant market.

Horizontal integrations represent forms of mergers among direct competitors in a particular market. The case of direct competitors is, if the products or services of the participants of the integration are mutually substitutable. Given the range of products and services of banks, their products are substitutable, and mergers among banks can only be a horizontal form of integration.

However, lately, there are forms of mergers between banks and non-banking financial institutions, which lead to the creation of a group of institutions or financial conglomerates.[16]

[13] Mlikotin Tomić et al., p. 148
[13] Peng (2014), p.330
[14] Ibid., p. 331
[15] Ibid., p.330
[16] Ibid., p.331

These groups apart from banking products offer a far more full range of products and services.
In the context of merging with other non-banking institutions, it would be necessary to consider the effects that will arise concerning the level of integration and the quality of relations between the institutions. Namely, the decision on the form of integration with other institutions should depend on the compatibility of the institutions that integrate. After the completion of the integration, the business processes should be optimized, without too much cost to accommodate integrated institutions.
In Central and Eastern Europe, bank M&A processes have been in dynamic growth for the last 13 years. The processes of financial conglomeration in Europe are characterized by M&As between financial institutions themselves and between sectors as well. Financial conglomerates within one country can be considered "domestic" while M&As of banks between EU member states and non-member countries are called international conglomeration. The forms of conglomeration in the EU determine matrices of sector and country size.
The trend of banking conglomeration in the EU has shifted from domestic to international conglomerations, whose dynamic expansion is particularly evident in 1999. That brings us to the conclusion that the process of financial conglomeration between the EU members is rapidly moving to areas of non-EU member states.

Table 1. The Forms of Financial Conglomeration

Between credit Institutions	**Domestic bank M&As** M&A of credit institutions located in the same country	**International bank M&As** M&A between credit institutions located in different countries, one of them is an EU country
Between sectors	**Domestic conglomeration** M&A between credit institution and insurance companies or other financial institutions in the same country	**International conglomeration** M&A between credit institutions in the EU and insurance companies or other financial institutions located in another country

Source: ECB, Mergers and acquisitions involving the EU banking industry, Dec 2000, p.10
Taken from: www.ecb.europa.eu

3.2. Motives for Mergers and Acquisitions of Banks

Regardless of what form of consolidation it is, entrepreneurs have some motives that encourage them to enter such a form of integration. The most common reasons for M&As are improved efficiency and benefits that result from using economies of scale and economies of scope.

The existence of economies of scale decreases the cost of production per unit with the number of units produced.[17] Economies of scope are actually the real reason for increased product and service offerings due to the implementation of M&A. It is considered that for entrepreneurs dealing with various, but complementary activities, it is cheaper for one entrepreneur to perform the affairs of both companies than to make two entrepreneurs perform separately for

[17] Camesasca (2000), p. 136

themselves.[18] For example, banks which before consolidation focused only on a specific segment of products and services will expand its range of offerings and compete in the universal banking market after consolidation.

However, according to Camesasca (2000), apart from the preceding reasons, there are also other reasons for consolidation: to achieve a dominant or even monopoly position, then to penetrate new non-banking markets. Motivation to enter the new market is obvious when creating new conglomerate integration. Entrepreneurs can realize their wishes for extra profit, but they are also protected from oscillations by allocating risk.

Diversification refers not only to the dispersion of risk but also to the dispersion of products and services, production processes and human resources. Consolidation can establish effective leadership through the implementation of the integration that will leave old obsolete technologies and start applying the most up-to-date management methods. Consequently, consolidation can be an opportunity for capable executives to demonstrate their knowledge. After merging, it is a chance to expel incompetent owners from the ownership structure.

Due to the specificity of the banking business and the system that builds its survival on the trust of customers, the reasons for bank M&As may be compelling. On the one hand, the pursuit of additional earnings and increased competition between banks. On the other hand, the strict regulation of the banking system encourages banks to find ways to increase their assets and market share, and one of the most effective ways is to merge with other banks.

[18] Ibid., p. 141

Table 2. Reasons and Motives of Financial Conglomeration

	Within one country	Among different countries
Between credit institutions	**Domestic bank M&A** Economies of scale related to cost expenditure, reduction of distribution and administration channels with information technology and risk management	**International bank M&A** Market size and strength, monitoring customer needs according to their market power, possible rationalization of operating costs
Between sectors	**Domestic conglomeration** Economies of scale through "cross-selling", diversification of risk and revenues, optimal use of complementary distribution channels, possible rationalization of operating costs	**International conglomeration** Economies of scale through "cross-selling", market size, diversification of risk and revenues, a bit smaller rationalization of operating costs since banks are subject to different legal provisions and practices

Source: ECB, Mergers and acquisitions involving the EU banking industry, Dec 2000, p. 30
Taken from**:** www.ecb.europa.eu

According to research, four motivational groups encourage banks to M&A: cost benefits, profit benefits, economic conditions, and other reasons[19]. Cost Benefits imply the above-mentioned economics of scale, then organizational efficiency, financing costs, diversification of risk and efficient capital use. Profit benefits include economies of scope, realising significant contracts and promoting economic rents. Under economic conditions, the authors consider the motives for merger that arise after the crisis or during the upswing in the business cycle. Other motives include managerial motives for consolidation, then defence from takeover and others. Entry of foreign banks into the domestic banking market can cause the problem of asymmetric

[19] Hawkins and Mihaljek (2001), p. 34

information as a motif that would encourage foreign banks to approach M&A as a model for entering an unknown market. Another issue is the existence of unequal distribution of information on the market. Namely, a bank already present in the market which has information about the market and its participants already has a better position in front of a foreign bank that is approaching an unknown market. The paradigm of asymmetric information is defined as the assumption that different economic participants have a different amount of information on relevant economic variables and use this information to realize their profits.

Therefore, a foreign bank’s strategy of entering a new market is choosing an already existing bank. The reason is to avoid the problem of asymmetric information as consequence of entering the market without some form of integration with other entrepreneurs. Based on the above, the conclusion is that the motives of consolidation are diverse and numerous and their participants have a wide range of explanations that can confirm the pro-competitive effects of consolidation.

4. CHARACTERISTICS OF BANKING MARKETS IN TRANSITION COUNTRIES

The countries of Central and Eastern Europe, including the Balkan countries are called transitional countries. The common characteristic of these countries is that they have all gone through the process of transformation from central-planning and socialist, to market economic structures and institutions. Although the transition process in these countries, regarding the legislative and institutional change, is mostly completed, the process of real convergence with developed Western European countries, concerning economic behaviour and results, will take several more years. Even when the transition process to the market legal and institutional framework is completed, it will take time for the financial systems to be fully developed, including credit markets. The transitional process also implies a significant transformation of the role of commercial banks in the financial and economic system.

In most cases, banking systems have gone through three phrases.[20] The first phase is consolidation - the write-off of a significant portion of bank's claims on loans granted to large state-owned enterprises and the transfer of losses related to those loans to the state. The second phase is privatization - sale of banks, primarily to foreign investors. And the third phase is the beginning of standard banking operations, including the increase in the approval of loans to genuinely private companies.

The timing of this process was different for each country, in line with the pace of banking sector transformation. However, this order of phases was common to all countries. Financial systems in transition countries are banking-oriented - on average, 85% of total assets of the financial sector goes to banking assets[21] - where capital markets (especially corporate bond markets and stock markets) are generally underdeveloped. The banking sector is the most critical channel for financial intermediation to meet the demand for financial resources. Therefore, the primary sources of external financing of corporate entities are bank loans, but in some of these countries foreign direct investments are also significant.

[20] Cottarelli et al. (2003), p. 5
[21] Ibid., p. 6

4.1. Credit Growth

Credit growth in transition countries is the result of the combination of microeconomic and macroeconomic factors. They have had a significant impact on the supply as well as the demand for loans to the private sector. The macroeconomic stabilization attracted expansion of loans. It helped also growing confidence in the economic policy framework that provided moderate or low inflation, which allowed a fall in real interest rates. The conditions for financing companies and households have improved significantly.

By improving the institutional framework of the financial sector in the countries of the region, the credit risk of banks has decreased, which has prompted the growth of credit supply. The institutional framework of the financial sector is reinforced through[22]:

1. The expansion of regulatory competencies of central banks and regulatory agencies
2. Strengthening prudential regulation and supervision, including an increase in banks' minimum capital requirements
3. Strengthening the creditor's rights
4. The use of International Accounting Standards in the banking sector.

The legislative, regulatory and supervisory frameworks of the banking sector have improved significantly in all transition countries as part of the convergence process. The Financial Sector Assessment Programs (FSAP), carried out by the World Bank and the IMF in the observed countries, generally concluded that the respect for basic Basil principles is high. Supervisory structures were stable. They had enough staff that operated independently, supervisors had adequate legal protection, and supervisory methods were mostly based on risk. Regulatory redundancy was not a common incident, and the conductibility of the rules was consistent.

In all countries, the financial sector infrastructure was significantly strengthened (credit bureaus, payment systems, corporate and collateral registers), so the application of International Financial Reporting Standards (IFRS) is widely used. The revision was conducted following the International Standards on Auditing (ISA), which allowed banks and market participants to make credit decisions based on complete information.

Significant legal system reforms were particularly important, which allowed a high degree of

[22] Prga and Sverko (2004), p. 81-87

guarantee for contract implementation and collateral development. Strong growth in production and income increased the demand for loans.

4.1.1. Credit Growth as Part of the Financial Deepening Process

Most transition countries have experienced a deep macroeconomic and financial crisis in the early and mid-1990s, which led to a slowdown in the financial intermediation process for some time. The successfully made macroeconomic stabilization process and prudent macroeconomic policies resulted in a decline in inflation, strong economic growth and rising profits and economic agents' incomes. That increased appetites for bank loans and made positive changes in banks' perception of loan applicants.[23] The entry of reputable foreign banks into the domestic banking market caused the strengthening of the regulatory and supervisory framework of the banking sector, leadig to the re-establishment of public confidence in the domestic banking sector and the sharp rise in deposits. The banks felt pressure to find profitable ways of allocating their growing assets. Large banking sector transformation has resulted in an improvement in the management process of banks, enhancing business operations and financial stability of the entire sector.[24]

Reducing budget deficits and establishing fiscal balances resulted in gradual deleveraging of the public sector from the credit market. Finally, the drop in premium risk in the transition countries and improved operating conditions triggered a rise in capital inflows, mainly through the mostly foreign-owned banking sector, which boosted pressure to loan growth.[25]

A significant role in increasing the pace of bank credit growth has increased confidence in the long-term viability of transition economies in the context of entering the European Union. Private sector loans recorded a dramatic rise, reflecting the process of financial deepening in those countries.[26]

Financial deepening in the transition countries had two primary dimensions. In the medium term, it was possible to see the shift to the equilibrium level of financial deepening.

Some sectors were neglected in terms of the degree of financial services provided to these

[23] Enoch and Ötker-Robe (2007), p. 28-29
[24] Ibid., p. 33
[25] Ibid., p. 7
[26] Ibid., p. 15-20

sectors. The depth of the financial system and the degree of provision of financial services to particular sectors were appropriate according to the changed structural characteristics of the economy and the degree of their economic development. At the same time, there was a rise in the level of financial deepening. That implied a rapid growth of credits given to the private sector because the transition economies became more economically, more prosperous. Also, cyclical movements have contributed to the acceleration of growth rates in certain periods.[27]

4.1.2. The Basic Characteristics of Credit Growth

The essential facts about the private sector credit developments in transitional countries in the observed period can be summarized in four basic conclusions.

Firstly, in most countries, it is possible to notice the dynamic growth of loans to private sector, even higher than in the euro area. Although the growth varied from country to country, the most dynamic growth was in household loans.

At the beginning of the transition process banks were restrained to credit activity, reflecting a risk aversion. That resulted from a lack of information on loan applicants, doubts about contract security and the rights of creditors and loss of client base, which in the past were mostly state-owned enterprises. Insufficient mature banking systems are often overwhelmed by inadequate regulation, corruption, and insufficient experience of agents involved in the banking market.[28] Low bank profitability was primarily due to the initial small amount of loans in total bank assets.

Banks in these countries, in their initial stages of transition, invested a significant part of the available cash assets in liquid assets such as deposits abroad. In particular, this was the case in countries where the central bank intervenes in the money market through sterilization operations of cash inflows into central bank bonds. By reducing the risk in credit markets, banks have gradually increased their profitability by giving credit to the private sector.

The economic recovery, re-establishing confidence in the banking sector, strengthening financial positions of banks and privatizing state-owned banks, decrease of bank risk aversion brought strong growth in bank loans.[29]

[27] Ibid., p. 21-22
[28] Ibid., p. 22-23
[29] Ibid., p. 29

The initial level of bank lending to the private sector concerning a gross domestic product in transition countries was generally significantly below the level in Western Europe. That was due to the underdevelopment of domestic financial (banking) systems at the beginning of the transition process. Many transition countries have liberalized their financial systems and eliminated distortions while strengthening regulation and supervision of the banking sector.[30]

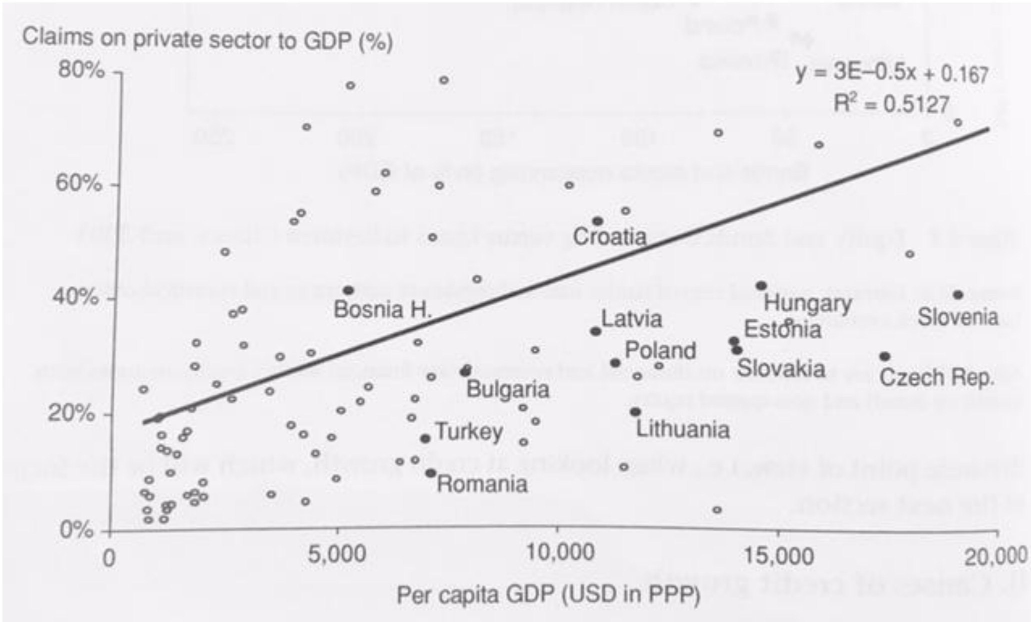
The expansion of bank lending has started with a low level of financial intermediation, in the efforts of these countries to "take a step" regarding the level of financial deepening with developed Western Europe countries. That is why it was expected that the relationship between loans to gross domestic product is growing faster in transition countries than in industrialized countries. Differences between individual countries in initial credit coefficient levels can be attributed to different approaches to external financing of companies in the central planning system.[31]

As we see in Figure 2, there is a positive relationship between the level of economic development (GDP per capita) and financial sector depth (credit to the private sector to GDP ratio). The regression analysis based on 124 countries, implies that only Bosnia and Herzegovina and Croatia (among the countries in the region) have a credit to GDP ratio higher than we would be expected on their levels of economic development.

[30] Ibid., p. 22

[31] Ibid., p. 91-93

Figure 2. Credit to the Private Sector to GDP Ratio and Per Capita GDP (2003)



Source: IMF, Rapid Credit Growth in Central and Eastern Europe, p. 22

Third, domestic as well as foreign sources financed credit expansion. Domestic savings primarily financed the growth of bank lending to the private sector. Strong growth in bank deposits was the result of growing confidence in the banking sector, an inflow of foreign currency, and relatively high interest rates on deposits.[32] Although resident deposits represented the main source of financing for credit growth, the inflow of money from abroad, whether from mother-banks or lending on international financial markets, became more and more important. The opportunity to make significant profits in the growing credit markets in transition countries made capital inflows. The process of convergence towards the European Union brought capital inflows into the countries of the region as a result of significant differences in the capital / labour coefficient compared to the countries of Western Europe.[33] It has led to falling risk premiums in these countries due to the expectation of soon entering the European Union, as well as significant differentials in interest rates between the two groups of countries.

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[32] Ibid., p. 24-25
[33] There is a significant supply of labour force in the transition countries. For their employment are unusually large capital investments needed.

The increase of banking markets was a factor of attracting capital from abroad. In the initial stages of the transition process, banks financed credit expansion by lowering foreign assets in the portfolio. That could potentially bring higher profit on granting credits on the domestic credit market. However, by gradually increasing the share of loans in the portfolio, the holding of foreign assets is reduced to the level corresponding to the banks' liquidity management need.[34] Although, that move is a good indicator of healthy competition in the banking sector, the pace of change was so fast that macroeconomic risks and financial stability risks were noticeable. The lack of alternative sources of corporate financing (e.g. corporate bonds, the initial public offering of stock) led banks to compete with each other.[35] Providing a range of services and lowering fees, but not by lowering interest rates was one of the ways of action. On the other hand, the growth of required reserves and the reduction of fees on compulsory reserves have often contributed to the maintenance of high interest rates. Banks have approved loans at relatively high rates, but with falling real interest rates and intermediation margins in local currencies.

In all Central, Eastern and South-eastern European countries was a trend of convergence of interest rates to the level in the Euro zone countries.[36] The active interest rate in commercial banks diminished from 26.1% at the end of 2000 to 9.6% at the end of 2006. In the same period, average passive interest rates fell from 11.6% to 4.4%, presented in Table 3.

[34] Enoch and Ötker-Robe (2007), p. 35
[35] Ibid., p. 36
[36] Ibid., p. 37

Table 3: Interest Rates of Commercial Banks in Transition Countries

County	Active interest rates		Passive interest rates	
	2000.	2006.	2000.	2006.
Albania	22,10	12,94	8,30	5,23
Belarus	67,67	8,84	37,55	7,68
BH	30,50	8,01	14,67	3,69
Bulgaria	11.34	8,89	3,10	3,17
Czech Rep	7,16	5,59	3,42	1,19
Estonia	7,43	5,03	3,76	2,84
Croatia	12,07	9,93	3,74	1,71
Latvia	11,87	7,29	4,38	3,53
Lithuania	12,14	5,77	3,86	1,31
Hungary	12,60	8,07	9,49	7,45
Macedonia	18,93	10,22	11,18	2,79
Moldova	33,78	18,13	24,87	11,88
Poland	20,01	6,10	14,17	2,51
Russia	24,43	10,46	6,51	4,05
Romania	53,20	10,20	32,40	5,16
Slovakia	14,89	7,67	8,45	3,57
Slovenia	15,77	7,41	10,05	2,80
Serbia	78,70	16,56	6,31	5,06
Ukraine	41,53	15,17	13,72	7,57
Average:	**26,11**	**9,61**	**11,58**	**4,43**

Source: IFS,National data, Access: March 2013, Taken from: www.cbbh.ba

4.2. Foreign Banks on the Banking Market in Transition Countries

Privatization of the banking sector and increased participation of foreign banks in the domestic banking market are some of the most important contributing factors to the expansion of loans in transition countries. The poor privatization process of the state-owned banks happened because of weak financial markets and the poor conditions, in the initial stages of transition. However, the further privatization of the remaining part of state-owned banking capital was a powerful boost to the rise in bank loans. Foreign investors acquired banks, with expectations of high profits as one of the main motives. Reformed banks' business strategies aimed at increasing market share and profitability.

With increasing capital adequacy requirements and changing asset structure to private sector credit, banks have been able to increase profitability. The reform of the banking sector has increased competition in the credit market and brought new banking products (e.g. mortgage loans). Banks began to focus on neglected market segments, primarily small and medium-sized enterprises, as well as the population.[37]

Banks with majority foreign ownership have often run the policy of aggressive lending to the private sector. That often led to lower interest rates and stimulated the growth in demand for bank loans. Most foreign banks, owners of banking institutions in transition countries, have their headquarters and the centre of their business in less profitable markets of Western Europe.[38] The Mother-banks have pushed their daughter-banks (branches and subsidiaries in transition countries) to lead aggressive credit portfolios policies to win as much of the local credit market as possible. That resulted in improved consolidated business results and accelerating credit growth rates. Commercial banks were privatized in the countries with the largest growth in bank loans.

The lousy perception is that the significant share of foreign banks is characteristic of the underdeveloped markets and countries. Foreign-owned banks make up a significant part of banking systems not only in less developed and transitional countries but also in developed countries. Approximately 43% of total banking assets across all European countries are from foreign owned banks.[39] In 2013, the largest share of foreign ownership among developed countries had Luxembourg (93%) and it was very notable in Finland (85%).

In the transition countries like Poland 76% of the banking sector was privatized, in Hungary 59%, and in Slovenia only 26%. In Bosnia and Herzegovina, the degree of privatization of the banking sector is 86%, while the share of foreign owners of all the transition countries is the largest in Croatia with 90%.[40]

[37] Ibid., p. 23
[38] Ibid., p. 39
[39] Cull, R. et al. (2017), p.6
[40] Ibid., p. 47-48

Table 4. Privatization and Foreign Ownership of Banks in Transition Countries

Country	State-owned banks[41]			Foreign banks[42]		
	1999.	**2002.**	**2005.**	**1999.**	**2002.**	**2005.**
Albania	81,1	54,1	7,7	18,9	45,9	92,3
Belarus	66,6	61,9	75,2	2,9	8,1	16,2
BIH	75,9	6,2	3,6	3,8	76,7	90,9
Bulgaria	50,5	14,1	1,7	42,8	75,2	74,5
Montenegro	-	23,8	5,1	-	16,9	87,7
Czech Republic	41,2	4,6	2,5	38,4	85,4	84,4
Estonia	7,9	0,0	0,0	89,8	97,5	99,4
Croatia	39,8	4,0	3,4	40,3	90,2	91,2
Latvia	2,6	4,0	4,3	74,0	42,8	57,9
Lithuania	41,9	0,0	0,0	37,1	96,1	91,7
Hungary	7,8	10,7	7,0	61,5	85,0	82,6
Macedonia	2,5	2,0	1,6	11,5	44,0	51,3
Moldova	7,9	13,4	19,3	34,4	36,7	19,6
Poland	24,9	26,6	21,5	49,3	70,7	74,2
Romania	50,3	43,6	6,5	43,6	52,9	59,2
Russia	-	-	-	10,6	8,1	-
Slovakia	50,7	1,9	1,1	24,1	84,1	97,3
Slovenia	42,2	13,3	12	4,9	16,9	22,6
Serbia	89,0	35,6	23,9	0,4	27,0	66,0
Ukraine	12,5	12,0	9,4	10,5	12,3	21,3
Average:	**38,6**	**17,1**	**11,2**	**31,5**	**53,6**	**67,4**

*(share in banking sector assets, data at year-end, in percent

Source: IFS,National data, Access: March 2013**,** Taken from: www.cbbh.ba

[41] State-owned banks are defined as domestic banks where state capital exceeds 50 percent of total bank capital.
[42] Foreign banks are defined as domestic banks in which foreign-owned capital exceeds 50 percent of the total capital of the bank.

5. FOREIGN OWNERSHIP IN THE BANKING SECTOR IN CEE REGION

5.1. Consolidation of Banks in the Region – Important Mergers

The trend of merging banking institutions to each other, as well as merging banks to other financial institutions, is also present in the CEE economic environment. The existence of a common market, which has enabled the smooth circulation of capital, additionally exacerbates the entry of foreign capital into domestic banks. No country in the region has resisted the effects of globalization. Regarding the economic situation in the countries of Central and Eastern Europe, all of them are under the influence of foreign capital and because of their development potential they are attractive investment of developed countries. The financial systems of the observed countries are mostly bank-centric, meaning that the most important role among the financial intermediaries have banks. Other financial intermediaries such as insurance companies, leasing companies, investment and pension funds and others are on a second place. There has been a slight drop in the share of banks, and the increasing importance of other financial intermediaries because of development of the financial system. Investments of foreign financial institutions in domestic banking systems mostly happen through the acquisition of shares in already established banks and less by the establishment of new banking institutions.

Since property buyers are usually the largest European banks of the European Union, there are some standard features regarding the origin of the foreigner capital. Looking at foreign banks' investments in countries of Central and Eastern Europe, the most significant investors were the Austrian Erste Bank and the Belgian KBC, which primarily focus to Central European countries such as the Czech Republic, Slovakia, Hungary and Poland. In the case of Bosnia and Herzegovina and neighbouring countries that are part of the region of Central and South-Eastern Europe, the Italian bank UniCredit, then the Austrian Raiffeisenbank and the French bank Société Générale are the most spread, according to investments.[43]

There is a specific connection between the same foreign investors, who choose the countries of former Yugoslavia and their neighbour countries of Hungary, Romania and Bulgaria as their target markets. Not all banks are present in nine countries and their markets, but three of them

[43] Fritsch, Gleisner, Holzhäuser (2007), p. 21

(UniCredit, Raiffeisenbank and Société Générale) expressed their interest by investing capital in the banks of the seven analysed countries. The jurisdiction over the operations within UniCredit Group in the area of Central and South Eastern Europe was granted to Bank Austria Creditanstalt so that UniCredit's ownership shares in domestic banks also transferred to the Austrian bank.

Its most significant investment, UniCredit acquired by purchasing Zagrebačka Banka d.d. in Croatia. A leading position UniCredit also holds in Bulgaria through UniCredit Bulbank. The fourth largest bank in Croatia Raiffeisenbank Austria d.d., is connected to the other six countries by the same foreign owners. Raiffeisenbank holds the leading position among the banks in Bosnia and Herzegovina, until the entering of UniCredit Bank on the market. The third largest investor in this area, the French company Société Générale, among domestic banks, does not hold a leading position in any country, but by investing capital, has a vital role in the development of banking in this area.[44]

5.2. Bosnian and Herzegovinian Market - General Overview

During the first five years of the 1990s, Bosnia and Herzegovina (B&H) was a region severely affected by the war in what was the former Yugoslavia. Including the serious humanitarian and social consequences due to the war, destruction, loss of financial and other economic activities and relationships, and the forced dispersal of B&H's entire labor force, these developments led to almost a complete breakdown of B&H's entire economic system.[45] The massive population displacement, both within the region as well as the surrounding areas, where refugees made up almost 50% of the total pre-war population, resulted in a difficult and logistically unstable social predicament and a reduced internal economy.[46] The collapse of BiH traditional markets and the degree of physical damage to the existing internal infrastructure led to a dramatic fall in gross domestic product or GDP on a per capita basis to an estimated 30 to 35% of pre-war levels. Therefore, because of the response to the ethnic and territorial conflicts that arose during the war, the agents that participated in the peace negotiations of Dayton during 1995 aimed at formulating a compromise that ensured not only political stability and a balance of power in the country but

[44] Kraft (2003), p. 10-12
[45] Friedman (2004), p. 49
[46] Ibid., p.78

also was intended to result in a restored economic environment and stable banking sector.[47]

The outcome of these Peace Accords and according to the Dayton Peace Agreement or DPA as it is commonly known, BiH consists of a central authority, an autonomous district and two autonomous entities which are known as the Federation of Bosnia and Herzegovina (the Federation) and the Republika Srpska (the Republic) which were formed as international protectorates under the supervision of the United Nations.[48] Both of these semi-autonomous entities and the district have established and operate their own individual and separate legislation and administration authorities and institutions, which are founded upon the defined conditions of the DPA.

From an economic and financial perspective with an emphasis on the banking sector, these entities are autonomous. This semi-autonomous state of the sub-components of the BiH market do cause some difficulty in terms of introducing uniformity in the banking sector, although the BiH market seems to have overcome such difficulties with its single currency and uniform monetary policy. Thus, foreign investors feel fairly certain that, while some political and regulatory differences do exist from area to area in the B&H market, the financial infrastructure is consistent and allows them to move funds across the region and in and out of the market itself. The official state of B&H is the central authority, but has only limited and very defined powers such as monetary policy in the areas of a common currency and a common central bank, external trade and customer relationships, regulatory authority on telecommunications, the internal transportation system and traffic control, foreign relations, as well as a variety of criminal laws and immigration policies.[49] These various semi-autonomous political entities, with each having their own constitutions, all have functions that are not expressly assigned to the central state within B&H officially adopted Constitution. In the background of this politically oriented formal separation, the various entities attempt to create conditions for social and economic unification in order to support a sustainable political and economic apparatus that can support a fully internationalized banking sector.

Additionally, there were some efforts in progress that are designed to enhance economic cooperation not only between the entities within the B&H state, but also with B&H neighboring

[47] Ibid., p.92
[48] Ibid., p.58
[49] Ibid., p.100

states. For example, during the first part of 2003, the governments of both entities agreed on the basic principles for a common economic strategy where the primary objectives set in this agreement were designed to strengthen the private sector, reduce dependence on external imports, increase exports, and join the World Trade Organization (WTO) as well as the EU by 2010.[50] In the course of these trade discussions and efforts related to the Stability Pact for South Eastern Europe, all relevant markets in the region have been setting up their own bilateral trade agreements.[51] As all the countries in this region continue to form a geographic and strategic unit from the perception of foreign investors, the ongoing liberalization of trade should continue to attract more in the way of foreign direct investment. Thus, the need for fully internationalized banking infrastructure, which banks such as UniCredit can provide, developing the country-specific competitiveness that UniCredit brings with it, will provide an important role in B&H's overall economic advancement.

5.3. Economic Environment in Bosnia and Herzegovina

The Bosnian and Herzegovinian market represents a growth opportunity for multinationals in general, and many foreign banks pursue this opportunity in order to exploit their competitive advantage and ultimately sustain that advantage.

Regarding its main economic developments, the B&H region experienced high GDP growth rates following the post-war years during the latter half of the 1990s, although these advances were established on an extremely low base-line. The outcome is that the region suffered a slowdown in GDP growth from 10% during 1999 to an approximate 5.4 to 5.6% in 2000, and real GDP growth in B&H finally attained a sustained level of 5.2% during the period from 2002 to 2006.[52]

It is important to point out the introduction of Value Added Tax (VAT) in 2006, which definitely contributed to the state strengthening, improved the settlement of tax obligations, stimulated the exports growth and reduced a "gray market" thus providing an incentive for the development of economy. VAT presents tax on final consumption (17%), i.e. its amount is included in the price paid by the final customer. It is obvious that VAT involves an increase in levying final consumption tax.

[50] Dyson (2002), p.114-118
[51] Ibid., p.82-94
[52] Statistics made by the Central bank of Bosnia and Herzegovina, taken from: www.cbbh.ba

Such macroeconomic stability is further enhanced by an inflation rate of 6.2% in 2006, which is managed by the Central Bank of B&H through the currency board regime. The extension of the tax base and increase of retail prices in 2006 had impact on slowdown of consumption growth.[53] This had a direct effect on decrease of import in B&H. Namely, the growth of public consumption was not sufficient to compensate for the decrease in individual consumption. Through more successful tax system and expansion of tax base, VAT had an impact on increase in income in comparison with sales tax revenues. Higher tax on final consumption brought a decrease of individual consumption and import which, through reduction of trade deficit, had positive impact on retaining macroeconomic stability. The one-time increase in prices caused by the introduction of VAT should not be interpreted as a sign of continued inflation, but as a usual "statistical effect" that will disappear after a certain period.[54]

However, the unemployment rate of 44.6 % in 2006 is a reflection of the insufficient degree of economic development.[55] The unemployment rate had its peak in 2008, and since than it is constantly decreasing (see table 5).[56]

As a result, in a very few short years, B&H has established a requisite stability and infrastructure to support an internationalized banking presence.

It should also be stressed, that Bosnia and Herzegovina has some undeniable advantages for foreign investors. The country's central location in the Balkans makes it an ideal base for accessing the entire South-Eastern European region, following the signed CEFTA agreement that would certainly ease the trading conditions in the region. On the other hand, this promising environment brings ever-greater number of entrants, hence competitors. CEE market has been characterized as the market with prolonged period of infrastructural, economic, institutional and political weakness, especially Bosnia and Herzegovina. Therefore, banks must consider weak physical infrastructure, such as communications that is way outdated, energy and transportation.[57]

More importantly, the institutional infrastructure, which includes the banking system, has a significant bearing on the ability of firms to raise money for their activities and enforce contracts. Thus, banks operating in these markets must be able to fix these institutional deficiencies.

[53] Bosnia and Herzegovina: Economic trends January - March 2006, p.18
[54] Ibid., p.18
[55] Ibid., p.32
[56] Data from trading economics, access: august 2018, www.tradingeconomics.com
[57] Inkpen and Ramaswamy (2006), p.153-155

Moreover, there is a poor degree of legal protection and enforceability of investors and stakeholders' interests. This was particularly problem in Republika Srpska, where some bank suffered losses because of low legal enforceability. Therefore, the market in which banks compete, its size, and its rate of growth are important in the formulation of strategy and this strategy must be customized to meet local market requirements.[58] Banks have different competing strategies when entering the new market. However, they must be cautious of the local demand and already established competitors. Bosnia's infrastructure is still in need for improvement, and some intensive efforts are underway to remedy this issue.

Table 5. General Economic and Political Conditions in B&H

	2004	2005	2006	2015	2016	2017
Nominal GDP (EUR bn)	8.1	8.7	9.8	14.7	15.3	16
GDP (per capita, EUR)	2.100	2.252	2.541	4.155	4.354	4.565
Real GDP annual growth, (%)	6,3	4,3	6,2	3,1	3,1	2,7
Inflation (CPI) (%)	0,5	4,3	6	1,9	1,8	0,9
Unemployment rate (%, average)	43,1	44,1	44,5	43,9	42,8	40,3

Sources: Statistics made by Central Bank of Bosnia and Herzegovina
Taken from: www.cbbh.ba

5.4. Characteristics of the Banking Sector in Bosnia Herzegovina

Following the implementation of its new monetary policy by the Central Bank during 1997 and the market entry of foreign banks, the market's financial sector, which is dominated by the banking industry, experienced an extremely positive consolidation process. It has become common in Bosnia and Herzegovina that the financial sector is a leader in achieving positive results in reforms and standardization of business and this is achieved largely by the banking sector. Additionally, the banking sector's results in the Federation area have been notably better than in the Republic area. Of particular importance, B&H has managed to effectively implement the privatization process of the banking system as being almost fully completed and the

[58] Ibid., p.156-160

regulatory framework as having successfully been put in place allowing the entrance of even more international banking competitors. The market has even reduced the number of banks which has the effect of making the market more stable. Foreign banks are present in the market and interest rates are falling, making the region more competitive.[59] Additionally, consumer confidence in banks has increased and a deposit insurance system has been established leading to an increase in the level of savings. It is well known in Bosnia and Herzegovina that there were many local banks that went bankrupt and caused thousands of people to loose their investments. This happened also due to poor subsidies from government to local banks, and that eventually sorted local banks out of competition. Furthermore, in legal entities of B&H, the area's bank privatization has been conducted in accordance with the necessary laws and therefore the banks could not be privatized against certificates or vouchers, but only against a positive cash investment that was selected via international sources, which internally strengthend the region's banks.

In the Republic portion of BiH, the capital of approximately 11 banks that were primarily state-owned was sold during the privatization period. By the close of 2003, approximately nine banks had been sold or merged with other banks and two had been closed, which further strengthened the market.[60] The outcome is that, most state-owned banks have been successfully privatized and the remaining ones are being offered for sale. According to the data from entities' banking agencies at the end of 2006 there were 32 banks in B&H: 22 in the Federation and 10 in the Republic. Due to the positive trends in the banking sector, which contributed to further stabilisation and strengthening of total system, banks continued the expansion. Basic characteristics of banks' financial activities in 2006 are moderate growth and development, financed mostly from deposits and loans funds. Other factors are the increase of banks in foreign ownership and concetration of the most significant bank categories (market share, loans, deposits and savings, capital and profit) in four large banks.

Currently, 24 banks are operating on the territory of Bosnia and Herzegovina (end of 2016).[61] In ten years time new banks entered the market and some mergerd with other banks, where others droped out due to strong competition of the large banks already well established on the market. These are mostly small local banks.

[59] Collignon and Schwarzer (2003), p.63
[60] Friedman (2004), p.99-100
[61] Annual report of the Central Bank of Bosnia and Herzegovina for 2016

The most notable differences in the pre-war and post-war banking sector in BiH were the change in ownership structures. By the end of 2006, private banking institutions were responsible for about 86% of total banking capital in B&H, with the share of international private capital in total capital coming to approximately 67%.[62] Thus, the overall share of international capital in private capital in the market amounted to the majority of total capital. The share of national capital in total banking capital increased since that time as a result of the recapitalization of the Investment Bank of the Federation instituted by the central government apparatus.
The banking investments of the two largest banking institutions, which were Raiffeisen and the UniCredit Zagrebacka banka together comprised as much as 35% of the region's total banking investment funds. These figures point to an increased degree of concentration in the banking sector accomplished through consolidation.[63] Furthermore, according to the same type of interpretation, concentration in the banking sector in BiH was even slightly stronger than the mean banking concentration in some other portions of the European Union, where the five largest banking institutions may account for less than 60% of total investments at the end. Although more than a half of the assets of the banking system is concentrated within five largest banks (see Table 6), the competition among banks is still strong. The share of foreign ownership has a slight growth trend, and the share of state ownership is the opposite.
The banking sector in Bosnia and Herzegovina become even more concentrated and would be classified as a sector of the perfect competition.[64] Foreign banks play a major role in developing the financial sector in Bosnia and Herzegovina, they increase their share of equity in domestic banks, which needs to be restructured and they offer global services to domestic customers and eventually bring expertise to the B&H market.

At the end of 2006, the banking sector of BiH consisted of 32 commercial banks, of which ten banks operated within five foreign groups[65]. Table 6 gives an overview of the largest banks' total banking system assets and the share of banks with the largest foreign capital, majority domestic private capital and majority state capital in the total assets of the banking system.
At the end of 2017, the banking sector consisted of 23 banks, of which only one is completely

[62] Statistics made by the Central bank of Bosnia and Herzegovina, taken from: www.cbbh.ba
[63] Ohanyan (2004), p.73
[64] Statistics made by the Central bank of Bosnia and Herzegovina, taken from: www.cbbh.ba
[65] UniCredit Group, Hypo Alpe Adria Group, NLB Group, Volksbank International AG, Poteza Adriatic Fund Amsterdam

domestic bank.

Table 6. Assets Division of Banking System in Bosnia and Herzegovina

	2005		2006		2017	
	in k of KM	Total*	In k of KM	Total*	In k of KM	Total*
Total Assets	12.789.923	100.0%	15.687.027	100.0%	28.595.000	100%
By size						
Top3	5.573.503	43.6%	6.826.734	43.5%	125.065.395	44,1%
Top 5	7.583.860	59.3%	9.308.839	59.3%	154.559.275	54,5%
Top 10	9.978.005	78.0%	12.504.867	79.7%	231.697.115	81,7%
By ownership						
Foreign	11,012,705	86.1%	14.165.856	90.3%	243.891.700	86,0%
Domestic	678.718	5.3%	399.155	2.5%	12.336.382	4,35%
State	1.098.500	8.6%	1.122.016	7.2%	27.366.917	9,65%

Data: Central bank of Bosnia and Herzegovina

5.4.1. Monetary Aggregates

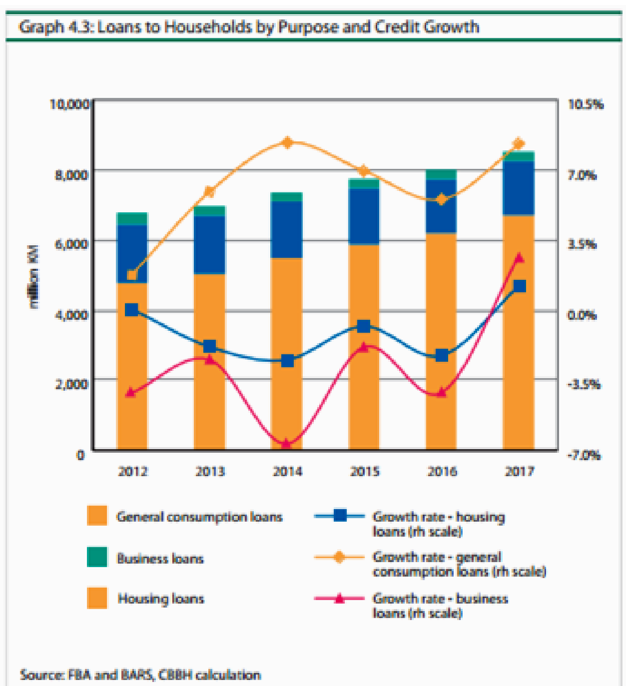
In B&H's economy, as in other CEE countries, there is a process of intense financial expansion, as increasing the volume of financial services to businesses and households. Economic growth and financial development are interdependent and influence each other positively. With economic development and increased transactions, there is need to increase the existing financial services and introduce new, innovative services, in accordance with modern financial trends around the world. On the other hand, development of the financial sector, primarily the banking sector, stimulates intensive economic growth. Development of the financial sector and strong financial expansion, manifested by dynamic growth of banking loans and monetary aggregates compared with the GDP movements, represents a natural consequence of comprehensive reforms in the country and of the "catching up" or converging with developed Western European countries.

5.4.2. Loans

Accelerated credit growth was the main characteristic of the financial sector in Bosnia and Herzegovina in the past years, similar to other countries in the region. Financial expansion through accelerated credit expansion was a result of a combination of factors affecting supply and demand.

Restructured and capitalized banks have great potential and try quickly to take a major market share. Development of new bank products continues in order to better satisfy the needs of clients. On the other hand, their clients need to finance investments and current expenditures and they mainly rely on bank loans for that purpose.

Figure 3. Loans to Households by Purpose and Credit Growth



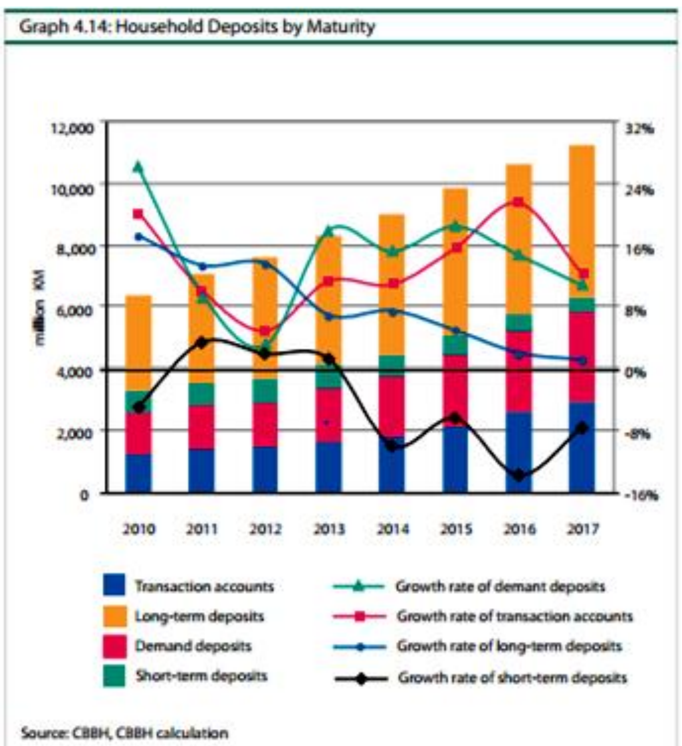
Source: Financial Stability Report 2017 from Central Bank of Bosnia and Herzegovina, p. 35

Taken from: www.cbbh.ba

5.4.3. Deposits

As already mentioned, deposits are low in comparison with loans in all transition countries at the early stage of transition. They are far below the Euro Zone. In Bosnia and Hezegovina, the most significant increase in absolute numbers, from the beginning of transition process was recorded in 2006. From total deposits of the banking sector, 46.4% were deposits of households. Therefore, the saving trends in BiH are primarily conditioned by the savings of households. Since then we have a continued progress in deposits. As we see in figure 4, deposits to households are continuously increasing year by year.

Figure 4. Household Deposits by Maturity



Source: Financial Stability Report 2017 from Central Bank of Bosnia and Herzegovina, p. 35
Taken from: www.cbbh.ba

6. UNICREDIT BANK ENTERING THE BOSNIA AND HERZEGOVINA MARKET

Internationalization is an important term to consider with respect to the banking industry. In this case study, UniCredit Bank of Europe, moved into the Bosnian and Herzegovinian market. Internationalization in the banking sector of a given market is typically characterized by certain criteria such as the degree of transparency in the receiving market, the number of existing competitors, and the number of foreign banks already in the market.[66] These are the types of criteria that UniCredit Bank must consider when moving into the Bosnian and Herzegovinian market since these factors directly impact the bank's ability to compete effectively in the market.

Internationalization is important to both markets and individual banking sector competitors for a number of reasons. By developing the requisite financial infrastructure to integrate with other markets, foreign direct investment (FDI) is easier to attract because foreign investors feel substantially more secure in making such investments. Additionally, industry competitors in all sectors are able to achieve economies of scale relative to their operations that ensure profitability by capitalizing on a market's comparative advantages in trade and commerce.

For example, Bosnia and Herzegovina's chief advantage in terms of trade with foreign markets relates to its relatively inexpensive labor pool, in which foreign manufacturers across the European continent are inclined to move into the market and invest in manufacturing facilities in order to capitalize on this advantage.

However, in order to do so, the market must also ensure the security and long-term health of these competitors' investments otherwise the risk cannot be mitigated and other markets may be considered despite their higher price-points. UniCredit Bank approached Bosnian and Herzegovinian market with high quality of service, organization and standardization of business in line with the market-oriented economies, and this enabled a worthy partnership relations between the bank and clients.

[66] Montgomery and Porter (1993), p. 301-305

6.1. UniCredit Bank: History and Internationalization Strategies

The UniCredit Bank is part of a larger financial group that spans the European continent. The banking group itself dates back to approximately 1870 when what was then known as Banca die Genova in Italy was established. Later this bank was renamed in Credito Italiano.[67] While the character and business model of UniCredit Bank has changed dramatically from this early formative period, there is no discounting its long and storied history on the European continent which translates into an excess of market experience. UniCredit Bank has undertaken a series of mergers that have truly internationalized the bank such as its integration with the German HVB Group, Italian Capitalia and the Bank Pekao in Poland.[68] Additionally, the bank has also merged with several other banks that have made the bank's current market value or market capitalization in excess of $ 47.8 billion and a presence in 32 countries with more than 26 million unique clients. The UniCredit Group maintains more than 103 thousand employees across approximately 8 thousand individual branches, and made a great expansion across the Central and Eastern Europe region on the European continent. The bank's mid and long-term growth strategy is focused on these CEE markets because of its growing stability and promising growth outlook.

UniCredit bank has acquired, restructured, and consolidated a variety of banks across CEE region and it should support increased demand for international banking services. Modest income levels and low consumption of banking services characterize the CEE region, but there is still great opportunity for expansion. The motivation to grow is fueled by top management's desire to provide better services and products to customers and to more geographical markets. Bank Austria Creditanstalt as a part of the UniCredit Group is responsible for the markets in CEE. UniCredit Group operates the largest international banking network in CEE with more than 2,200 branches and outlets, with 46 thousand employees and approximately 25 million customers.[69] CEE remains a highly dynamic banking environment.

[67] Annual report of UniCredit Bank for 2006
[68] Ibid.
[69] Annual report of UniCredit Bank for 2017

6.2. UniCredit Group's Strategy in Bosnia and Herzegovina

In Bosnia and Herzegovina, UniCredit bank has 3 subsidiaries which are legally separated; UniCredit Zagrebacka Banka, HVB Central Profit Banka and Nova Banjalucka Banka. For the sake of this research, I consider these three banks as the UniCredit Group. They are clearly the Number One on the B&H market[70], and are among the first banks to issue banking cards, first ATMs, first with Internet banking and SMS banking on retail and corporate clients. As of the year end 2006, the three banks have combined total assets around €2 billion, and are operating on a country wide network of 170 branches and serve over 1 million retail and corporate customers. In 2006, the integration process has been started between UniCredit Zagrebacka Banka and HVB Central Profit Banka, thus creating the largest bank in this market by any operating criteria. The aim of this acquisition process was the implementation of new service model that is unique on the B&H market, usage of synergies of the Group it belongs to, which contains more efficient, faster, and thus cheaper products and services. Further, the acquisition process intends to equalize and position business networks in the whole country and focus on the long-term growth. The characteristic of the new service model is based on the segmentation of the existing and potential clients in order to satisfy their needs and was fully introduced in 2006. UniCredit Bank is the leading bank in Bosnia and Herzegovina for quality of its products and services, technology innovation and the number of clients. This is driven by the highest economic growth in Europe mainly supported by dynamic local demand and lively foreign direct investment.

6.3. Strategy to Gaining Competitive Advantage in Emerging Markets

After having chosen the Corporate Strategy, such as acquiring, restructuring, merging, or internationalizing, a firm must decide upon a strategy in order to gain its competitive advantage.

The competitive advantage is essential, its development and exploitation is at the center of every brand or product success. Without a competitive advantage there is unlikely to be any real success.[71]

This is also supported by the theory of Inkpen and Ramaswamy (2006). They warn multinationals that "there are gaps in the prevailing wisdom about the competitors, the obstacles

[70] They have been market leaders since entering the BiH market.
[71] Hardy (1994), p.45

to profitability and growth, and the viability of developed-country strategies in such settings."[72] According to this theory, there are several misconceptions of the emerging market competition that can cause multinational banks to fail, such the following misconceptions.

Firstly, many multinationals see emerging markets as just incremental opportunity. However, those banks should see emerging market as market for big potential and growth. This growth is supported by the rising aspirations of customers who are becoming more sophisticated and demanding.

Secondly, sometimes the power of global brands in emerging markets is often overstated. Many multinationals believe that customers will automatically intend to buy global brands. However, local brands might be better positioned, supported by perception of greater value, given its local roots. For example, UniCredit Group's new master-brand strategy aims at creating a unique brand in Europe, which will be widely recognized. However, that might carry some risks with it, because in Bosnia and Herzegovina's market, Zagrebacka Banka is a well-established brand and renaming it might mean that it would loose its local flavor.

Some of the already established multinationals in emerging markets, such as Raiffeisen bank in Bosnia and Herzegovina, have a significant proportion of their revenues and profits exactly from these markets. Many of them have managed to increase the potential of their subsidiaries to generate innovations that have been taken to another level. According to Inkpen and Ramaswamy (2006), these multinationals have succeeded in emerging markets by three factors:

1. "Targeting a broad market instead of fortunate few
2. Building distribution systems that reach large segments of the population not easily reachable otherwise
3. Building brands and sustaining image and reputations that deftly blend the local with the global"[73]

In order to do so, a bank must set a clear business-level strategy that will help it utilize its competitive advantage in emerging markets. Moreover, a bank must be able to transfer proprietary skills or share important activities across business units.[74]

[72] Inkpen and Ramaswamy (2006), p. 165
[73] Ibid., p.164
[74] Montgomery and Porter (1993), p.238-249

Entrance of the foreign capital to the banking sector in Bosnia and Herzegovina has brought many changes. First, transfer of knowledge and skills (know-how) was implemented through education of employees and introduction of new products.

Second, globalization involves the integration of corporate activities across borders. Globalization also carries some risks with it. For example, American Subprime Mortgage crisis[75] impacts the market in the whole world, causing the European market to bear the consequences, and also Bosnia and Herzegovina, where the major impact was the increase in prices of long-term deposits. As a result, banks "must be internally differentiated to respond to the environmental differences that exist in different businesses and markets."[76] Namely, they need to consider both global and local factors.

6.3.1. Business-Level Strategy

Business level strategy is an "integrated and coordinated set of commitments and actions that a firm uses to gain a competitive advantage by exploiting core competencies in specific product (or service) markets."[77] When deciding on the business strategy selection, banks begin with exploration of who they are and what they offer. This is followed by making a decision of who the customers are and what their needs are. Most of the banks in a particular market are dangerous to their competitors because they offer similar services, but differences between them are the basis of their advantage.[78] Therefore, the process of development of competitive advantage starts with the people of business, and particularly management. This requires people with high skills, effort and resources. And, most of it lays in the attitude of the management.

The basic elements of strategic competition are:

1. "Ability to understand competitive behavior as a system in which competitors, customers, money, people and resources continually interact
2. Ability to use this understanding to predict how a given strategic move will rebalance the competitive equilibrium
3. Resources that can be used permanently for other uses even though the benefits will be

[75] Worldwide financial crises from 2007-2009
[76] Inkpen and Ramaswamy (2006), p.5
[77] Hitt et al. (2009), p.98
[78] Montgomery and Porter (1993), p.5

deferred

4. Ability to predict risk and return with enough accuracy and confidence to justify that commitment
5. Willingness to act"[79]

6.3.2. Customer Satisfaction as a Driver for Competitive Advantage

There are some premises discussed in a book by Collier (1994) which are essential for a service firm to gain its competitive advantage. These premises also define and characterize the banking industry.

For example, one of the premises says, "The best way to build quality and competitive advantage and to grow profits is by providing services that are tailored to local demand and even individual customers."[80]

This premise implies that an excellent service is the best way to differentiate from competitors, and this would assume the intangible attributes that the customer recognizes as the benefit. Therefore, the aim is to focus on the quality of service provided for the customer and not just on the cost cutting. However, one important reality about emerging markets is that consumers are much more price-sensitive than the population in developed countries; therefore, this could have a reverse effect.

Another premise points out that "Service/Quality performance is more difficult to manage than product/quality performance."[81]

This means that services are more difficult to define measure and execute than products. They involve human behavior, and each service is unique implying that it cannot be repeated exactly.

According to the same logic, services have also other characteristics, which make management of service providing, different from that of goods producing.

1. Services are **intangible**. They are very difficult to describe to the buying public and demonstrate to the buying public. There is a great need of understanding the customers' need in this kind of setting. Managers must be able to make this implicit service explicit. Moreover, there are different methods of supplying services, and customers have an

[79] Ibid., p.7
[80] Collier (1994), p.24
[81] Ibid., p.26

integrative way of accepting the service.[82] Thus, providing a particular service often involves simultaneous performance of marketing, operations, and human resource management. This determines the reputation of the firm, as well makes service managers much more essential, thus they need to have great skills and motivation.

2. Services are **perishable**. They cannot be stored, so the output is delivered as produced. Therefore, there must be a way to be at disposal for 24 hours, which would include more automated services.
3. Services provide **heterogeneous output**. There is a great deal of variability in the output of a single firm and single service employee. This means that it is very difficult to establish standards of the service provided and it is difficult to make sure that these standards are met.
4. Services require **simultaneous production and consumption**. This only further complicates the problem caused by intangibility, perishability, and heterogeneity. This implies that the customer participates in the service delivery system. Customer participation implies that customer is constantly involved in the activity. For example, if a customer calls a banking manager to resolve some issue regarding his credit card, he is participating in the process.

This active participation in the service delivery process makes the service uncertain in terms of service time, service quality, and operating costs.[83] Also, the nature of demand for services puts an enormous pressure on managers and service providers.

Furthermore, there are some other attributes that are unique for service firms. For example, a service firm needs to be accessible to the customer at any point in time. A firm needs to standardize facility and its operations and centralize total service delivery system. This is referred to as the multi-site management and that further complicates the task of managing business. Further, there are no patents on services, so managers cannot use the legal means of protecting package. They need to be able to capture market share rapidly.[84] For competitors, it is much easier to copy your service process.

Also, services need to be internationally movable. A firm or a bank that provides services must be able to support direct and protect the benefit that is provided for the customer. These are the

[82] Ibid., p.31
[83] Ibid., p.43
[84] Ibid., p.45

sources on which to formulate the strategy that will lead to competitive advantage.[85] It is essential for a bank to segment customers and markets, and to provide services accordingly. This strategy sets organizational values, performance objectives, and future goals of meeting customer needs with the ultimate goal of increasing profits.

Balling, Lierman and Mullineux (2006) indicate that the customer satisfaction should be considered when evaluating the competitive standing relative to other banks. They also stress that marketing plays important role in gaining competitive advantage, because banking is considered to be "people business". Especially in the small and concentrated markets, banks try to differentiate by creating their own images.[86] Same authors point out that because of changing pace of competition among banks, marketing plays an important role. If a bank puts an emphasis on its value, such as "fairness" or "trust", it must justify it by actual behavior. Once the customers are satisfied and feel attached to a bank, price plays minor role.[87]

6.3.3. Competitive Criterion for Foundations of Strategy

Managers must set a clear criterion when competing for markets. Competitive criterions are the way of providing a service to customers and they are the focus of management. Therefore, a well-established bank is able to find a way to satisfy customers' needs and also increase profits. Competitive priorities such as price, flexibility, service quality, and time identify firm's competencies that are hard to replicate.[88] As a result, of all the priorities above mentioned, service/quality is the best differentiator. It is said to be most difficult to execute daily and most challenging to copy.

In today's global business, all these priorities and strategy formulations become more complex and more difficult to execute. Therefore, as already stressed, it is essential to understand the market as a whole; economic, political and legal system, company systems and needs of customers in order to meet those needs.

According to Collier (1994), markets are now consumer driven, not company driven, and technology is also providing the capability to customize goods and services to individuals, the so-

[85] Ibid., p.85
[86] Balling et al. (2006), p.197
[87] Ibid., p.199
[88] Collier (1994), p.88

called, mass customized market.

This theory is supported by Michael Porter's generic strategies of Cost Leadership and Differentiation.

According to Michael E. Porter[89], and following his work of the competitive forces in an industry (competitors, suppliers, new entrants, buyers, and customers), he suggested three "generic" business strategies that could lead a firm to gain competitive advantage. These strategies relate to the extent to which the range of businesses' actions are narrowing versus broad and the extent to which a business seeks to differentiate its products and services. Specifically, these three generic strategies are: Cost Leadership, Differentiation, and Focus.[90]

1. Cost Leadership strategy implies that firms compete for greater number of customers, targeting mass-market at a lower price and little differentiation.
2. Differentiation strategy is usually associated with charging a premium price for products or services, reflecting higher costs and additional value provided for the customer. This strategy gives the customer the reason to prefer this product to others, which are less differentiated.
3. Focus strategy serves the needs of a particular segment or niche of an industry.

The implications of these three strategies are the option to perform activities differently or to perform different activities relative to competitors. It is crucial to choose one of the strategic dimensions and focus on it consistently.

In the Banking sector, the most important quality service factor is reliability, or producing what was promised accurately and dependably.[91] But in order to achieve competitive advantage, banks must excel in areas requiring immediate attention or improvement.

6.4. Determinants of Profitability for Banks

One of the theories regarding profitability of banks, which concentrates on the relationship between competition and profitability, is explained in the book by Balling, Lierman, and Mullineux (2000).

The Netherlands is one of the highly concentrated banking sectors. It has though the similar

[89] Porter (1985), p.11-25
[90] Peng (2014), p.45-48
[91] Brown (1993), p.32

situation as Bosnia and Herzegovina, where three main banks, namely UniCredit Bank, Raiffeisen Bank, and Hypo-Alpe Adria Bank, hold the market.[92]

It has been known, by same authors, that banks especially in the highly concentrated markets can earn greater profits than firms operating in less concentrated market. This results in increasing market share and concentration ratio. There is far less competition in markets which are highly concentrated.

The emergence, as well, of many intermediaries and non banks is clear reflection of the breakdown of the entry barriers, over the last periods, that could be applied also to the Bosnian and Herzegovinian market.

As the same authors state, banks, especially the retail ones, try to maintain or create a different image and therefore to distinguish themselves from their competitors. On the other hand, in the absence of competitors, especially the fierce ones, there would be no need to work and employ effort to define strategic positioning. In the aspect of concentrated markets, there is a need first to protect customers, and then later to alert policymakers of the possible problems that can come across, namely those rigid measures of concentration and competition which could undermine rather than improve financial stability.

Furthermore, literature proves the link between the market structure, behavior of the banks and profitability. A highly concentrated market is thought to lead to collusive behavior among larger banks, resulting in superior market performance.[93] The reason behind, is the tendency of large banks to abuse their market power to increase profits; in other words, concentration fosters collusion and anti-competitive practices.

There are two theories that explain the issue with profitability. The efficiency hypotheses state that efficient banks are able to increase their market share due to their profitability. Consequently, the degree of concentration increases “automatically”.

According to Goldberg and Rai,[94] a firm either maximizes profits by maintaining the present levels of prices and company size, or by reducing prices and expanding the size of the company. If the second choice is chosen, the bank will gain the market share and bank efficiency will be driving force behind the process of market concentration, without necessarily reducing the competitiveness. The contestability theory stresses that concentrated banking industry can behave

[92] Balling et al. (2006), p.183-200
[93] Goldberg and Rai (1996), p.752-755
[94] Ibid., p.755-758

competitively if the number of new entrants is low.[95] Only the threat of potential entry, forces banks with large market shares to price their product competitively under certain conditions.

To measure the profitability of banks, we use the ROA and ROE approach. ROA and ROE are defined as follows:

Return on assets (ROA) = Net Income/ Avarage Total Assets

Return on equity before tax (ROE) = Net Income/Average Total Equity

There are internal and external factors that influence the profitability of banks. Internal factors are subject to bank's management decisions and policy objectives. Such factors are respectively the level of liquidity, credit risk, capital adequacy and bank size. External factors are subject of the macroeconomic environment and industry-related. Such factors are represented by the bank's economic and legal environment.

Internal factors that influence profitability:

According to Athanasoglou, Delis and Straikouras (2006) "Liquidity risk, arising from the possible inability of a bank to accommodate with decreases in liabilities or to fund increases on the asset's side of the balace sheet, is considered an important determinant of bank profitability."[96] Loans to households and firms are risky, but they have higher returns copared to other bank assets. This implies a positive relationship between liquidity and profitability.

There is a link between increased credit risk and decreased bank profitability. Oscillations in credit risk cause changes in the credit portfolio, which on the other hand has impact on the bank's performance. If the bank operates with risky loans, it will be less profitable.[97]

"Bank size is generally used to capture potencial economies or diseconomies of scale in the banking sector. This variable controls for cost differences and product and risk diversification according to the size of the credit institution. The first factor could lead to a positive relationship between size and bank profitability, if there are significant economies of scale, while the second to a negative one, if increased diversification leads to lower credit risk and thus lower returns."[98]

[95] Baumol (1982), p.2-8
[96] Athanasoglou et al. (2006), p.6
[97] Balling et al. (2006), p.37-38
[98] Athanasoglou et al. (2006), p.6

External factors that influence profitability:

In the case of external factors, the literature points out that due to the new regulatory approach in Balkan part of Europe, Bosnia and Herzegovina, Serbia and Croatia became an interesting target for foreign investors. These countries didn't have a developed and modern banking system yet. Foreign banks tried to find acquisition parters to enter the banking sector and take advantage of the new attractive market.

According to Athanasoglou, Delis and Straikouras (2006), there are numerous reasons for foreign ownership effecting bank profitability:

1. Foreign capital is useful to strengthen the banking system and to minimize fiscal costs[99]
2. Private ownership (privatized through foreign capital) is more efficient than government ownership
3. Better performance and higher profitability through foreign capital due to the newest technology and human resources they bring into domestic banks
4. The entry of foreign banks enhances domestic bank's efficieny and reduces their expenses
5. Foreign capital has a positive effect on real credit growth
6. Lower costs in countries with foreign ownership banks

Source: Bonin et al. (2005), p.32-35

Athanasoglou et al. (2006) point out the importance of macroeconomic factors on bank's profitability. The banking sector is improving in the way it utilizes financial engineering techniques and global changes to avoid risk in future business operations.

Enhancing economic growth leads banks to give out more loans and on return to stipulate higher margins, which on the other hand, enhances the bank's asstes, increasing its profitability.

The profitability of banks is positively influenced by the financial reform and the banking reform is crucial for developing and improving the banking sector.

Moreover, entry barriers have a positive effect on bank's profitability. Namely, "entry restrictions are supported as being necessary for the prevention of ruinous competition, unsafe and unsound banking practices, and bank failures."[100]

[99] Tang et al. (2000), p.49

[100] Athanasoglou et al. (2006), p.9

7. CASE ANALYSIS

7.1. Methodology

The methodology I used for this analysis was based on investigative and qualitative research. I chose Bosnia and Herzegovina's market, beside the fact that this is my homecountry, specifically because of the credibility of results, since I was able to perform a research by interviewing managers from UniCredit Zagrebacka Banka and obtain more convenient documentation and presentations. Most of the data I collected is about year 2006, because this is the year when UniCredit, as we know it today, after several mergers started existing on the B&H market. The bank took the biggest portion of the market share and continued expansion on this market as well as in other CEE countries.

This study can be applied to the rest of the Central and Eastern Europe countries because most of them are characterized in the same way (see chapter 4&5), and are a target market of UniCredit Group. For the first research question, in order to analyze how UniCredit bank competes in the Bosnian and Herzegovinian market, the results are based on the answers from interviews and relevant documentation such as presentations from bank representatives, both from UniCredit holding as well as UniCredit Zagrebacka Banka. The Paper also compares UniCredit's profitability with those of their main two competitors within this market; Raiffeisen Bank and Hypo-Alpe Adria Group, and briefly discusses their strategies.

For the profitability research, I compared income statements of these three banks, focusing on the Net Operating Profit, because it gives us a more precise picture of the performance of banks.

The Profitability research is mostly based on the conversations with the Executive Officer of UniCredit Zagrebacka Banka.

In the Net Operating Profit analysis, there was no consolidated annual report available for the UniCredit Group in Bosnia and Herzegovina market because the three subsidiaries of UniCredit Bank are still operating as separate entities, each having its own report. Therefore, I consolidated financial findings of all three banks and named it UniCredit Group.

7.2. UniCredit Bank and its Competitive Advantage Strategy

From the interview with the Executive Director of UniCredit Zagrebacka Banka in Mostar, and revision of documents and presentations of the Bank representatives, this paper reveals how UniCredit Group competes on the Bosnian and Herzegovinian market.

7.2.1. The New Service Model

A Service model is the way by which the bank treats clients and the way of clients' perception of bank's services. In comparison to the "NEW" Model, the "OLD" Model is characterized as follows:

1. All clients have been provided with the same products and same level of service.
2. Branch was the sole contact with clients, and clients were the ones that asked to for service.

Most of the banks in Bosnia and Herzegovina represent this model.

The Main difference from the "OLD" Model is that the "NEW" model aims at maximizing customer satisfaction by the new approach to the client. It provides quality service for retail customers and unique integrated service for corporate customers with cross border business, which would eventually lead to the increase in revenues and profits.

The application of this model requires changes in the organization of Commercial Support Sales Department. This department monitors market trends, and tries to develop new products for retail and corporate clients in order to increase market share of the bank. It evaluates the market in detail by analyzing competition and market segments with the aim at identifying customers' needs. Moreover, this department initiates marketing research and helps in promoting bank's services.

Another important thing is measurement of customer satisfaction. UniCredit Bank measures customer satisfaction by appointing an outsourcing agency that performs surveys with clients. Also, the bank appoints a different agency to monitor dress code of the employees in the bank, friendliness of the staff, and overall atmosphere within the bank.

7.2.2. Segment Approach to Clients

Second finding is that UniCredit Group is the only bank on the Bosnian and Herzegovinian market that approaches its clients by segmentation. The bank appoints relationship managers for every business segment, through which clients generate business relations with the bank. This segment depends on the financial potential of clients. For example, 100 high valued clients have one relationship manager appointed, while 200 less valued clients have one relationship manager appointed. Moreover, each relationship manager has at least one assistant who provides intensive business relation and high service quality for client.

7.2.3. Expanding Branch Networks

In 2006, UniCredit Bank has 171 branches in Bosnia and Herzegovina, compared to 74 branches of Raiffeisen Bank, and 46 of Hypo-Alpe Adria Group, which are its main competitors.
UniCredit Bank expands business networks through expansion of physical distribution channels. Increase in ATM’s and POS’s is stimulated by more intensive card usage. UniCredit Bank is also a pioneer in Internet banking on the BiH market, enabling customers easier access to their accounts and managing transactions. Table 8 gives an overview of the actual data for 2017.

Table 7. Retail Products in 2006

	B&H	UniCredit	Market Share UniCredit
ISSUING			
Total number of issued cards	1.121.483	274.662	24%
Total number of transactions in card business	16.800.000	5.373.221	32%
ACQUIRING			
Total Transaction value	345.000.000	126.106.930	37%
Number of ATM's	538	100	19%
Number of POS	11.448	2.806	25%
E-BANKING			
Number of e-banking users (individuals)	5.308	3.247	62%
Number of e-banking users (legal entities)	6.813	772	12%

Figure 8. Retail Products in 2017

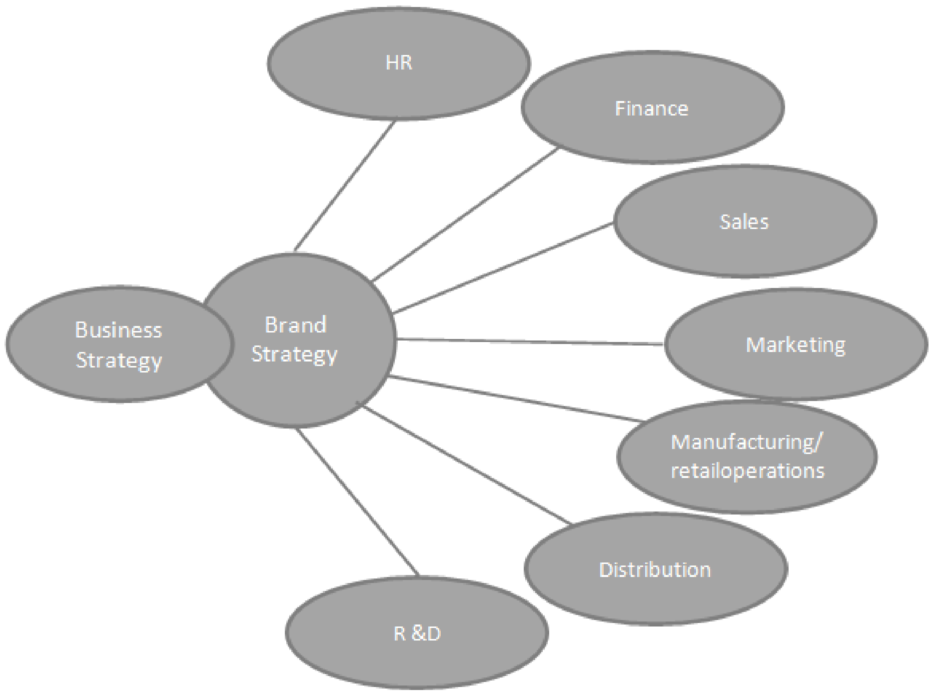
	B&H	UniCredit	Market Share UniCredit
ISSUING			
Total number of issued cards	2.005.213	382.557	19%
Total number of transactions in card business	78.902.847	17.463.751	22%
ACQUIRING			
Total Transaction value in EUR	4.863.070.000	1.367.000.000	28%
Number of ATM's	1.539	350	22%
Number of POS	27.458	5200	18%
E-BANKING			
Number of e-banking users (individuals)	425.898	103.920	24%
Number of e-banking users (legal entities)	64.961	6430	9%

7.2.4. Implementing the New-Master-Brand-Strategy

Another important aspect of the integration process is that UniCredit launched re-branding of all banks in CEE region by naming them “UniCredit Bank”.

Aim of this strategy is to leverage “The UniCredit Group” master-brand and its distinctive brand across and within countries. Since this strategy is a part of UniCredit Business strategy, it needs to fit and serve business needs and realities of each market. Therefore, UniCredit is constantly evaluating this strategy and in which markets it would be beneficial. As a result, the new master-brand strategy will leverage bank’s local heritage where it is valuable.

Figure 5. Brand as a centre of actions



7.3. Key Determinants of UniCredit Bank's Profitability within Bosnia and Herzegovina

7.3.1. Return on Equity

Return on Equity (ROE), by itself is one of the key measures of profitability of banks. As mentioned in the theory part, ROE is influenced by internal and external determinants of profitability. Internal factors include determinants such as level of liquidity, credit risk, capital adequacy and bank size.

ROE for UniCredit bank at year-end 2006 was 21.9% compared to last years ROE of 12.1%.

For the purpose of this project, I also used Net Operating Profit to depict UniCredit Bank operating efficiency on B&H market relative to other competitors.

In 2006, consolidated Net Operating Profit for UniCredit Bank was €32.454.000, compared to 2017 where it amounts €457.606.000.

7.3.2. Level of Liquidity

Liquidity risk arises in the funding of the bank's activities and in management of these activities. UniCredit Bank acts by the idea of lessening the connection and the dependence of debt and liquidity potentials. The bank has access to various funding sources, such as deposits from citizens and legal entities. This increases the flexibility of funding sources, lowers dependence on one source and generally ensures better management of financing costs.

7.3.3. Credit Risk

The bank possesses the conservative approach to credit risk; it monitors the creditworthiness of its clients on an ongoing basis and it tries to keep the expenses low in general. The bank has established a function of control over credit portfolio, which focuses on monitoring of credit risk. Credit risk monitoring lowers costs and improves the quality of the performance of the bank.

The bank analyses the outstanding debts that are negative and chooses the corresponding strategy to recover and activate new value with respect of critical deadlines. Moreover, the bank collects relevant information on possible negative or positive influences on value of the outstanding debt and duration of recover, provisioning of strategic revision, as well as monitoring of chosen recovery strategy.

7.3.4. Bank Size and Foreign Ownership

UniCredit Bank uses branches to exploit economies of scale. Moreover, UniCredit Bank can rely on the expertise of global business lines and apply it to the Bosnian and Herzegovinian market.

UniCredit Bank uses international know-how and deep local roots to offer the best service to the customers, thus leveraging bank's performance. Generally, international banks operate better in Bosnia and Herzegovina' market than domestic banks. This is also due to superior risk management development based on the standards of developed economies.

External Factors that determine profitability are industry related. Namely, they reflect legal and economic environment where the bank operates.

It was a very dynamic period for UniCredit Bank in Bosnian and Herzegovinian market, which tends to catch up progressively with modern economic trends. Structural economic reforms are creating a sound economic environment targeted at standardizing the market. A positive effect of such standardization is that the bank expanded the assortment of products, and penetrated other segments of financial operations in accordance with domestic legislation, therefore improving bank's overall performance. However, these economic improvements have contributed to the increase in competition, so this can also have a negative effect on the profitability.

This brings us to the final determinant of profitability, which is competition. As theory points out, in highly concentrated markets, there is a notion of contestability theory, which states that in concentrated bank industry; banks will behave competitively if the level of entrants is low. Therefore, with application to the B&H market, with three major competitors, and low level of entrants, the competitive behavior of UniCredit Bank is high.

Moreover, collusive behavior is possible in the concentrated B&H market, as there are only three major players, with tendency to increase profits and anticompetitive behavior, but such possibility is relatively insignificant. The reason behind this fact is that there are still significant competitors in the market and smaller banks who serve as a buffer on the market. As well, the notion of contestability that is characteristic of this market, most probably, is a prevailing factor and its positive effect wins over collusive behavior. The fact of increased attention given to customer satisfaction and innovation of products by UniCredit Bank in B&H, as well as attention given to credit risk and efficiency in cost, prove the competitive behavior of UniCredit group. These actions are significant means to excel in the performance, and to capture profitability on the B&H market.

Zagrebacka Banka, which was bought by UniCredit Group, was a domestic stable bank. Through acquisition to UniCredit Group it benefited technology spillovers that improved its services and product offering. Another benefit is the satisfaction of employees who were motivated to work more. They brought a know how typical for UniCredit Group and gave a different direction to a perspective but relatively small Zagrebacka Bank d.d. Mostar. However, in emerging markets such as the Bosnian and Herzegovinian, though significantly more open and stabilized, it is still affected by different political and economical instability. Moreover, a bank such as UniCredit has to protect itself from possible losses and negative effects of the macroeconomic situation. Protection is mainly concentrated in the area of protection of risky loans and risky investments, by charging higher interest rates. Moreover, it has to maneuver different regulations imposed by the relatively instable government and satisfy plural interests of different ethnic groups in B&H.

As already mentioned in the “Characteristics of the Banking Sector in B&H” part, credit needs of customers have increased so customers take loans from banks in order to finance their personal expenditures or investments. Deposits also increased because people in B&H feel more secure with foreign banks. This results in an overall increase of profitability in the B&H market, especially for UniCredit Bank. In the Table 9 below, we can see what the main sources of UniCredit Bank profitability are.

Table 9. Comparison of Main Competitors Profitability in 2006

Main competitors	Hypo-Alpe-Adria Bank		Raiffeisen Bank		UniCredit Group	
	2006		2006		2006	
Net Interest Income:	EUR (000)	%	EUR (000)	%	EUR (000)	%
Retail loans - Net	16612	44%	28256	37%	43033	42%
Corporate loans - Net	21614	57%	23789	31%	17367	17%
Loans to banks & Others Net	-12928	-34%	-2228	-3%	6768	7%
Total Net interst income	25297	67%	49817	65%	67085	66%
Net Fees & Commission income	5028	13%	20190	26%	28558	28%
Other Income	7349	20%	6686	9%	6743	7%
Total Income - Net	37674		76693		102386	
Other oprating expenses	22129		49542		69932	
Net Operating Profit	**15545**		**27151**		**32454**	

*UniCredit Group net operating profit comprises of consolidated net operating profits of three subsidiaries: UniCredit Zagrebacka Banka, HVB Central Profit Banka, and Nova Banjalucka Banka.
Source: Annual reports of the three banks for 2006

UniCredit Bank in B&H earns most of its interest income from retail loans to individuals. As shown in Table 9, 42% of net interest income relates to retail loans, 17 % to corporate loans, and 7% loans to banks and others. Therefore, net interest income represents 66%, net fee commission income 28%, and other income 7% of the total income.

If we compare UniCredit Bank to its main competitors in terms of net operating income, we can see that UniCredit Bank is the most profitable bank in the country. Moreover, the profitability has increased for €11.126.000 from 2005 to 2006 (see Appendix 3)

In 2016, UniCredit further strenghtend its position on the B&H market and remained the Number 1 bank in the country. UniCredit's total assets reached €2,243 billion with market share of 21,3%. Raiffeisen was the second ranked bank with total assets of €1,892 billion, and on the third place Nova Banka with €832,6 million total assets. Hypo-Alpe-Adria Bank doesn't exist anymore on the B&H market since 2015.

8. DISCUSSION and CONCLUSION

UniCredit Bank has a clear mission and vision of providing the first class innovative services. At the same time, UniCredit Bank strives to become the most desired bank on every market, taking into account local market demands, cultural differences and relies on the expertise of local management.

To gain market share, grow and prosper, the UniCredit Bank goal is to become excellent provider of services in order to increase customer satisfaction. Specifically, the bank focuses on the quality of service, and not particularly on price, therefore giving its client a reason why to prefer its products compared to its competitors. As already pointed out, quality of service is the hardest to replicate, making it the best differentiator.

On the other hand, UniCredit Bank's main competitors within BiH market, Raiffeisen Bank and Hypo-Alpe Adria Group have different strategies. The biggest rival Raiffeisen relies on marketing, while Hypo-Alpe Adria Group[101] has an appetite for high- risk credits.

Proximity of banks to customers is an important factor when considering customer satisfaction. UniCredit Bank offers clients the largest networks in terms of branches, thus enabling clients to have a constant access to the bank wherever they are located. As mentioned in theory, this is considered to be a multi-site management. Centralized offices are filled with relationship managers, each working to provide an excellent service to customers. This way, UniCredit also tries to acquire highly valued clients from smaller banks.

The New master-brand strategy helps UniCredit Bank to build a powerful and internationally recognized brand, and deliver a clearer picture of who the bank is and what it offers. As a part of the same strategy, UniCredit Bank retains local/global balance by carefully evaluating to which markets the bank can leverage on the name UniCredit. This reminds us of the old saying "Think globally, but act locally".

According to some researches, brands are increasingly becoming important and they determine why people buy products and services (see Appendix 1). Therefore, the brand is considered to be an element of the communication strategy. As a result, the master-brand approach advances efficiency of marketing activity, campaign development, production and sponsorship. New

[101] Hypo-Alpe-Adria Bank was sold in 2015 and doesn't exist on the B&H market. The new bank instead is Addiko Bank from Austria

master-brand strategy makes UniCredit Bank more competitive, secure and sustainable and improves the bank's reputation.

As already pointed out, Bosnia and Herzegovina is a growing market and contains a lot of prospective foreign investors. The relationship with subsidiary Bank Austria Creditanstalt, which has long history and focus on the CEE, enables UniCredit Bank to exploit its competencies within this market. Therefore, the combination of UniCredit Bank and Bank Austria Creditanstalt provides the group with competitive advantage in the region.

As a result, from the theory presented and results examined, we can argue that the UniCredit Bank strategy is based on differentiation factor.

Let us discuss differentiation strategy more in detail. Many managers and particularly banking managers disregard the quality of service issue, because they claim that the banking industry is purely price-driven.[102] They also claim that once they meet the industry standards, customers just choose from who to buy based on the lowest price. This is true to a certain extent in the banking industry. Specifically, in Bosnia and Herzegovina, where people have lower income than people in developed countries, it is very common to be price-sensitive. When a client wants to borrow funds from the bank, he will select the bank with the lowest interest rate. This brings the price wars between the banks, lowering interest rates, and thus fiercer competition. But as already said, this industry is concentrated with few competitors, and they cannot compete on price forever because there is some mutual interdependence. Therefore, there must be something that one bank can do differently than others. Banks must compete on price, but also consider quality of service. This part is considered as the "extra" of what the bank provides for the customer and by increasing quality, the bank increases the value of its service in customer's eyes, thereby gaining the competitive advantage.[103] For a bank it is also crucial to keep customers for as long as possible, because ultimately they are the ones that contribute to the banks for their long-run revenue.

This brings us back to Porter's statement that the differentiator cannot ignore its cost position, because inferior cost position will aggravate its higher prices, so the differentiator must find a way to keep its prices close to its competitors. For example, UniCredit Bank's market share in terms of assets is very close to its main competitor Raiffeisen, so UniCredit bank cannot compete independently from the actual competitors, because the market share of the competitors shows

[102] Brown (1993), p.11
[103] Ibid., p.13

stiff competition.

UniCredit has certainly pursued the approach to B&H market that Inkpen and Ramaswamy pointed out; to target a broad market instead of fortunate few, expanding distribution channels that reach greater segment of clients, and recently creating a brand that will blend local with global.

It was not until 2003 that the banking sector in B&H registered positive profitability ratios in a manner that would fully encourage international banks to invest in this market. Until then, banks such as UniCredit were adopting substantial risk by entering the market.

Then, in 2004, return on equity (ROE) came to about 6% in nominal terms. At the end of 2006, ROE of UniCredit Bank was 21.9%, which implies that the company generates substantial amount of profit from shareholders' investments. In 2017, UniCredit's return on investment is 12,1%, which is above the average od European banks.

Because of the conservative approach to clients, risk aversiveness and various sources of funds, UniCredit bank decreases costs thereby contributing positively to the profitability. This further contributes to the banking lending potential which affects the performance of the institution. For example, one of the UniCredit Bank main competitiors, Hypo-Alpe Adria Bank has been exposed to high-risk loans, therefore having the greater accumulation of unpaid loans and reverse effect on profitability.

Regarding the current environmental situation, banking sector has become generally stable, transparent and more profitable because of the consolidation and integration that had taken effect. Additionally, B&H has improved commercial banking sector; meaning that the confidence of clients has returned and depositors in the market are ready to put their funds in the banking institutions rather than keeping them at home. These developments created a basis for strong lending growth in the market. The ensuing increasing lending policy was directed primarily to households, with households lending growth exceeding household deposit growth. Foreign banks such as UniCredit play a crucial role in these financial markets development.

Customers now feel more attached to the bank and an increasing number of them are borrowing funds from the bank. However, interest expenses increased as well due to increase in deposits volume.

The main sources of non-interest revenues were service fees, and the increase was driven by fees on currency conversion, fees on current accounts and fees on performed bank's domestic payments.

Furthermore, income from business cards is constantly growing as a result of an increase in number of issued cards and performed transactions, which reflects on bank's leading position in business and operations in B&H. This all is encouraged by more stable macroeconomic environment where banks are inclined to lend more.

Apart from these, technological developments have altered the distribution of products and services, by introducing chanells such as ATMs, POSs, and Internet banking. As a result of these technological advancements, the importance of branches decreased, so it is very likely that some branches will be considered as less important in the future and UniCredit might need to reduce the number of branches.

We can now argue that in order to gain competitive advantage a firm must be able to differentiate itself from competitors in a highly concentrated market such as the B&H market. While some competitors collude, others such as UniCredit excel at providing different services to customers that will lead it to competitive advantage. When carefully reviewing all the results from above, we can argue that there is a close relationship between the competitive advantage strategy and profitability determinants. Namely, in order to perform all the activities related to customer satisfaction, a bank must demonstrate superiority in offering services that require skills and management of developed countries and global platforms.

UniCredit bank manages its processes selectively, trying to increase the number of clients and decrease costs by skillful risk management, thereby retaining sufficient level of liquidity in the market. As a result, these all factors contribute to its profitability. While other competitors such as Raiffeisen Bank have lower interest rates, UniCredit offers products that will satisfy existing customers and acquire new ones. All these combined makes UniCredit Bank the most profitable bank in the country.

On the other hand, however, there is a difficult period ahead for competitors in terms of harmonization of legislation, social and political norms, and standards on the road to EU integration. The Bosnian market is still in a recovery phase and needs clear and transparent banking.

Competition is becoming even stronger, which is evident from the decrease in the interest income for some banks because the strongest competition is present in this segment. This is a result of constant price cuts due to a relatively small market and concentrated banking sector.

8.1. Conclusion and Recommendations

In this paper, I have analyzed how UniCredit Bank competes within Bosnia and Herzegovina market and what the main determinants of the bank's profitability are. This analysis involved several steps: description of globalization in banking; theory on Market Entry Modes for banks; analyzing the banking market in Central and Eastern Europe countries; analysis of the economic environment in Bosnia and Herzegovina as well as characteristics of the banking sector; description of UniCredit Bank and its internationalization strategies; some theory review about how to gain competitive advantage and what the main determinants of the bank's profitability are; empirical results drawn from interviews with bank managers and discussion of these results.

Economic developments of Bosnia and Herzegovina market have inclined many banks to invest in this country. Some of them resist because of the limited potential, political instability and other macroeconomic factors. However, this paper reveals that although this is true to some extent, there is a great potential in this market for foreign investors.

Service firms are unique in themselves, and understanding how they work is an important aspect for the foundation of competitive strategy. This paper argues that the best driver for attaining competitive advantage is by providing superior service to customers. Firms must use all the resources available to deliver the service better than their competitors in order to form a good impression in customer's eyes.

This can only be accomplished by truly understanding how service management works, requiring high skilled managers that are able to excel at different tasks because ultimately, standards of performance in services include more human factor than in producing a product. It requires firms to cope with all aspects of the market where it operates, such as political conditions, legal, economic in order to understand the needs of the market. By satisfying customers, these firms can charge higher prices, and increase market share.

The Paper also reveals that profitability of the bank depends on many different factors such as internal and external factors. Internal factors cope with firm specific determinants such as credit risk, liquidity risk, bank size, and foreign ownership, while external factors deal with industry based and macroeconomic variables.

Moreover, as the last result, the paper shows that UniCredit Bank is the most profitable bank among the three leading competitors because it utilizes its resources and directs it in the manner that will suit its profitability.

We can conclude that there is a strong connection between choosing to provide superior service and profitability. Specifically, if a bank contemplates all the internal and external factors that influence its profitability and chooses the differentiation strategy for competitive advantage that is harder to replicate, then a bank is more likely to sustain that advantage. Raiffeisen Bank has been a well-established bank and a leader for many years in the Bosnian and Herzegovinian market, but UniCredit Bank has overtaken the position of being the leader in B&H in most of the segments (see Appendix 2).

Regarding the economic environment in Bosnia and Herzegovina, some additionally research could be directed to an in-depth assessment on the role of internationally active banking institutions with regard to the stability of B&H's financial network. One particular issue in this respect is whether internationally active banking institutions act only as stabilizers in times of severe financial distress, as experienced in Bosnia and Herzegovina in the previous decade, or whether they also form an additional risk of market difficulties.

For example, there is not much known about how UniCredit contributes to the international transmission of business cycles with respect to the B&H market. The current structure of the financial markets in B&H has contributed to the generally slow pace of the market transition, and some important challenges lie ahead. These include recommendations towards restoring momentum to the wide-scale privatization process and especially in the Federation, introducing an increased commercial approach to financial infrastructure services, redesigning the judiciary as well as enforcing policies related to competition and bankruptcy. Without added progress in these areas, the encouraging economic growth of the recent past is likely to halt which would leave most of the country experiencing greater levels of poverty and unemployment.

Finally, UniCredit has achieved the operational objectives that were part of its country or market strategy. UniCredit also developed a good pipeline of private sector projects, reflecting the increased interest of private investors in B&H economy. In light of the transition challenges and government priorities, UniCredit's focus over the next three years should be on the following operational priorities related to infrastructure, financial sector and the enterprise sector or at least the strategies related to them.

The focus of UniCredit activities should be on financially assisting the country in upgrading its infrastructure by supporting public works through financing and funding initiatives. UniCredit should build on its previous success in the sector and continue its support to the local B&H economy through local banking sector activities and assisting non-bank micro-finance institutions. UniCredit should also seek to support the development of the remaining locally owned banking institutions.

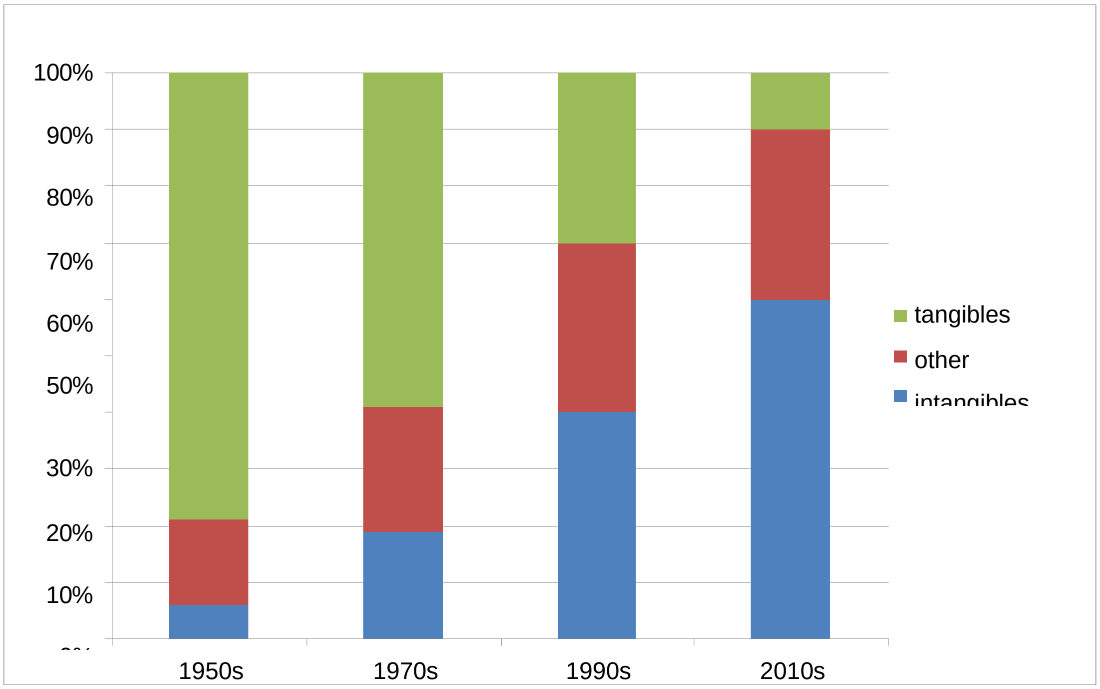
To conclude the paper, another fact should be mentioned: UniCredit Bank is an award winner of the magazine The Banker[104], as the best bank in B&H in 2006. It was the first prize in the B&H market, followed by further awards every year since than.

UniCredit Bank has been recognized as the leading force of modern banking system in Bosnia and Herzegovina and other CEE countries. This international recognition of the bank adds more value to high reputation that UniCredit Bank enjoys already as exceptional bank.

[104] The Banker is a magazine issued by most prestigious publishing house Financial Times, and due to its expertise, analyticality and independence in the tracing of financial and banking systems, for 90 years it is enjoying exceptional reputation from its readers.

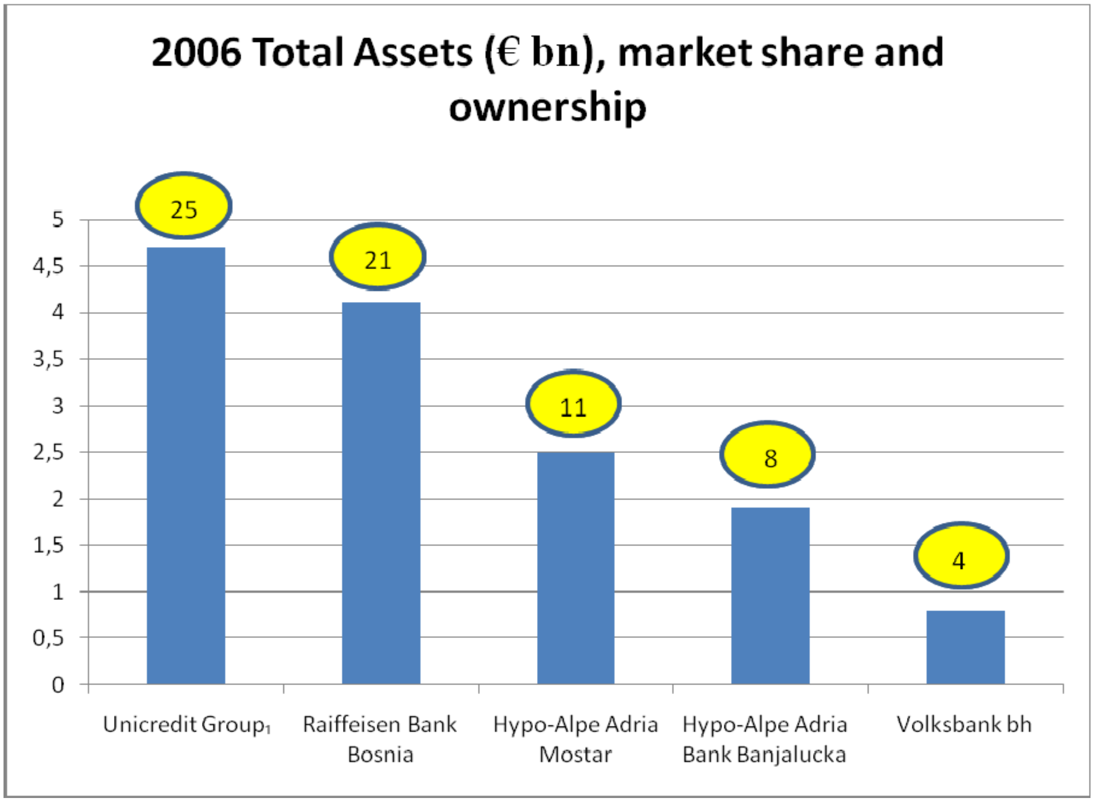
9. APPENDIX

Appendix 1: Brands are becoming the reason why people buy products and services



Source: Presentation "UniCredit Group New Brand Strategy"

Appendix 2: Top Banks in Bosnia and Herzegovina



Market shares (%) in terms of total assets

Note1: UniCredit Zagrebacka Banka, HVB Central Profit Banka and NBB

Source: Presentation “Benchmark Analysis of B&H Banking Sector”

Appendix 3: Consolidated income statement UniCredit Group for financial year 2006

	Zagrebacka Banka			HVB Central Profit Banka			Nova Banjalucka Banka			*Unicredit Group		
	2006		2005	2006		2005	2006		2005	2006		2005
Net Interest Income:	EUR (000)			EUR (000)			EUR (000)			EUR (000)		
Retail loans - Net	22557	43%		16970	48%		3506	25%		43033	42%	
Corporate loans - Net	10750	20%		3861	11%		2755	19%		17367	17%	
Loans to banks & Others Net	1468	3%		4808	13%		491	3%		6768	7%	
Total Net interst income	34692	66%		25640	72%		6753	48%		67085	66%	
Net Fees and Commission income	13941	27%		7757	22%		6860	48%		28558	28%	
Other Income	3931	8%		2232	6%		579	4%		6743	7%	
Total Income	52564			35629			14192			102386		
Other oprating expenses	31471			24349			14112			69932		
Net Operating Profit	21093		18945	11281		6343	80		-3960	32454		21328

* UniCredit Group: Consolidated statements of all three subsidiaries

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ABSTRACT

This paper describes one of the leading European banks, UniCredit Bank, its internationalization within the Central and Eastern Europe (CEE) with focus on Bosnian and Herzegovinian (BiH) market.

The aim of this qualitative research is to analyze how the bank competes and what the main determinants of the bank's profitability are within the Bosnia and Herzegovina market. UniCredit Bank is internationalizing in order to exploit its competitive advantages. However, the competition is becoming fierce, so it must be able to secure the long-term viability of its investments and this requires a healthy and transparent banking sector in the market. While there is significant potential in the Bosnia and Herzegovina market, it has not been so easy for multinational companies to meet the local demand. Nowadays, clear and powerful strategies are a necessity. We can see in this paper how UniCredit utilizes its competitive advantage, which strategy it applies and how it has been the market leader in Bosnia and Herzegovina for over ten years.

The Paper claims, that the most important source in developing competitive advantage is the quality of service provision that aims at improving customer satisfaction.

Moreover, the profitability of banks depends on internal factors such as liquidity risk, credit risk, bank size, foreign ownership, and external factors such as macroeconomic and political conditions.

UniCredit Bank combines its internal competences with strategy, carefully managing profitability determinants, and this combination makes the UniCredit Bank the most profitable bank in the region.

ZUSAMMENFASSUNG

Diese Masterarbeit beschreibt eine der führenden europäischen Banken, die UniCredit Bank, ihre Internationalisierung in Zentral- und Osteuropa (CEE) mit Fokus auf den Markt in Bosnien und Herzegowina (BiH).

Das Ziel dieser qualitativen Forschung ist es zu analysieren, mit welchen Hauptfaktoren der Profitabilität die Bank auf dem bosnisch-herzegowinischen Markt konkurriert. Die UniCredit Bank internationalisiert sich, um ihre Wettbewerbsvorteile zu nutzen. Der Wettbewerb wird jedoch immer härter und das Unternehmen muss die langfristige Rentabilität seiner Investitionen sicherstellen. Dies erfordert einen gesunden und transparenten Bankensektor auf dem Markt. Während auf dem Markt in Bosnien und Herzegowina ein erhebliches Potenzial besteht, war es für multinationale Unternehmen nicht einfach, die lokale Nachfrage zu decken. Heutzutage sind klare und leistungsstarke Strategien eine Notwendigkeit. Wir können in dieser Arbeit sehen, wie UniCredit seinen Wettbewerbsvorteil nutzt, welche Strategie es anwendet und wie es über zehn Jahre als Marktführer in Bosnien und Herzegowina besteht.

Das Ergebnis der Forschung ist, dass die wichtigste Quelle zur Entwicklung eines Wettbewerbsvorteils die Qualität der Dienstleistung ist, die auf die Verbesserung der Kundenzufriedenheit abzielt.

Darüber hinaus hängt die Rentabilität der Banken von internen Faktoren wie Liquiditätsrisiko, Kreditrisiko, Bankengröße, Ausländisches Eigentum und externen Faktoren wie makroökonomischen und politischen Rahmenbedingungen ab.

Die UniCredit Bank kombiniert ihre internen Kompetenzen mit der Strategie, wobei sie die Rentabilitätsfaktoren sorgfältig regelt. Diese Kombination macht die UniCredit Bank zur profitabelsten Bank in der Region.