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1 Introduction

Recent developments in the Russian banking sector, notably the restrictions on the activities of foreign-owned banks in Russia, are readily visible in the city of St. Petersburg, where the first foreign-owned banks started operations already in 1993. The city has also attracted Russian banks from Moscow and other cities by means of the mayor's plan to develop the city into a major financial center. This overview of the banking situation in the city should provide a window on the Russian banking scene prior to the parliamentary elections of December 1993.

The separation of cash money from non-cash account money is a salient peculiarity of Russian banking practices, which has recently caused special problems for foreign investors. In July 1993 Finnish newspapers reported that considerable fines, had been levied on a number of Finnish-Russian joint ventures in St. Petersburg because the companies had made payments in cash which should have been made through the banking system. The companies in question claimed that cash payments were the only way to settle payments quickly enough to stay in business, as the banking system is very inefficient.

Similar claims have been made elsewhere in Russia. According to recent criticism directed at the Russian banking system, payment transfers between banks take weeks to effect, banking supervision is ineffective, and mistakes, lost documents and even fraud are commonplace. The Central Bank of Russia has faced its heaviest criticism in connection with its inflationary monetary policies and especially for the withdrawal of old banknotes on very short notice in July 1993.

In this climate, banking legislation in general, the role of the central bank and the foreign-owned banks in particular have also been at the center of a politically oriented discussion in the Russian press. The government has tried to gain tighter control over the central bank, which was subordinate to the conservative Supreme Soviet until the latters's dissolution, and the domestic banks have lobbied against the admission of foreign-owned banks into Russia.

The following account of banking in St. Petersburg describes the banking situation in the city on the basis of recent discussion in the Russian press as well as interviews of Russian bankers and Finnish businessmen carried out in St. Petersburg in August 1993.

We start with a description of the banking structure and the competition between various groups of banks in the city. Secondly, the activities of the banks are described, based on interviews of bankers. Finally, the banking activities are analyzed in light of the experiences of their customers, particularly Finnish enterprises operating in St. Petersburg. Readers interested in a longer-term perspective of developments in the Russian banking system, since the beginning of perestroika, are referred to Kivilahti et al. (1992), Fuchita et al., and Hirvensalo (1993).

2 Banking structure and competition

According to a catalogue of St. Petersburg banks published in 1992 there were 24 commercial banks in St. Petersburg and 7 branches of Russian commercial banks, with head offices in Moscow or elsewhere in Russia. In the first half of 1993 the number of commercial banks has grown somewhat, to 37, the number of bank branches is about 90 and the number of Sberbank (Savings bank) branches is about 300. For a city of 5 million people, these are not large figures if we look at Finland, which has the same population but more than 10 times the number of branch bank. However, the number of commercial banks is much smaller in Finland than in St. Petersburg. But in comparison to Moscow, which has more than 600 banks, in St. Petersburg does not have a large number of banks.

2.1 Large banks rooted in the Soviet system of specialized banks

Judging by the size of the balance sheet, two big banks are dominant in St. Petersburg, Promstroibank and St. Peterburg Bank. Both are registered as independent limited liability banks as from 1990, but both have their roots in the Soviet system of specialized banks, which was created by the restructuring of the Russian banking system in 1987. The Promstroibank in St. Petersburg is now, however, independent of the Moscow based Promstroibank, despite their use of the same name. For example, the special status of the Promstroibank in Moscow, as a state agent financing state investment programs, is not shared by the Promstroibank in St. Petersburg. The Moscow bank finances mainly large industrial companies in the region. Twenty per cent of the bank's shares are owned by such (mostly state-owned) companies. Seventy per cent of the shares are held by private persons. In 1993 the bank floated several new share issues, including one denominated in foreign currencies.

The St. Peterburg Bank, in turn, continues the work of the former Zhilsotsbank branch of Leningrad and finances a large share of the housing and construction work in St. Petersburg. The bank has 4 000 shareholders, 3 500 of which are private persons. The remaining shareholders are companies, which hold the majority of voting shares. In 1993 the bank floated its fourth share issue. Shares could also be bought with privatization vouchers.

Two other former specialized banks, the Savings Bank and the Foreign Trade Bank, are represented in St. Petersburg by branches offices.

The Savings Bank of Russia is organized as a limited liability bank as of 1991, and this legal status has enabled it to pursue a relatively independent course, even to the extent of opposing the efforts of the Central Bank (its main shareholder) to incorporate the bank and its network of 40 000 branches into the Central Bank organization, as was the case before 1987. However, in November 1993 the Central Bank acquired more than 50 per cent of the voting shares of the

Savings Bank thus securing full control of the bank (Kommersant-Daily, November 23, 1993). The Central Bank has a strong interest in the large deposit base of the Savings Bank, which has traditionally been used in funding the state budget deficit. The Savings Bank has been practically the only bank that offers banking services to private persons. The St. Petersburg branch also serves small companies. Recently also the commercial banks have started offering services to private persons.

The Vneshtorgbank in St. Petersburg continues the work of the St. Petersburg branch of Vneshekonombank (VEB), whose customers it has inherited. The sole function of the VEB in Moscow is to service of the foreign debt of the former USSR. This includes the freeing of customer accounts that were frozen at the end of 1991. Private persons will be paid in cash by the end of 1993; corporate customers will receive bonds denominated in foreign currencies.

Measured by total assets, the new Vneshtorgbank became Russia's largest bank in 1993, when the Central Bank transferred its gold reserves to the bank. Having formerly served mainly specialized foreign trade organizations and companies with foreign ownership and foreign trade rights, they now have added small locally operating companies to their clientele. The bank apparently suffered from the loss of confidence that resulted from the freeze its predecessor had imposed on customer accounts. On the other hand, the bank has benefited from the correspondent relations of its predecessor. For instance, the St. Peterburg branch of the bank normally has to channel international payments through the Moscow head office, but payments to Finland can be made directly through the old correspondent accounts of the branch.

All the other commercial banks in St. Petersburg are new banks, created after 1989, and much smaller than the above-mentioned banks, which are rooted in the former system of specialized banks. Competition among the banks in St. Petersburg has thus far been fairly subdued because the demand for banking services has greatly exceeded the existing banks' ability to provide such services. Moreover, the new small banks have not been able to challenge the large established banks. However, two groups of potential competitors have recently entered the market, and they will likely change the picture somewhat in the near future. The groups comprise the Moscow-based Russian banks, and the foreign-owned banks.

The Moscow-based competition is represented in St. Petersburg, among others, by branches of Inkombank and Mosbusinessbank. Avtovazbank, headquartered in Togliatti, has also opened a branch in St. Petersburg. Of these banks, Inkombank seems to have the most aggressive strategy. As one of the largest Russian banks, Inkombank plans to become a major player also in St. Petersburg. The aggressive strategy was not affected by the murder of the 26-year old manager of the St Petersburg branch in summer 1993. Inkombank also seems to be actively seeking foreign capital. The bank announced in August 1993 that 40 per cent of its shares had recently been acquired by American shareholders, but voting rights and management remain tightly in Russian hands. The American investors did not confirm this, however (Izvestija, August 8, 1993, Euromoney, September 1993, p. 136).

2.2 Foreign-owned banks and new banking legislation

Newcomers on the St. Petersburg banking scene are the foreign-owned banks. Three foreign banks had received full banking licenses and started operations before new restrictions were imposed on foreign banks in November 1993.

The French Credit Lyonnais Russie was the first foreign bank to obtain a banking license in the former USSR, already in 1991. The bank's presence in St. Petersburg is largely based on old traditions; it was operating in the city already before the Russian revolution. The bank, however, has not been in a hurry to start operations, as it has been waiting for a clearing of the political, legal and economic environment. Credit Lyonnais has renovated an old building on the main shopping street, Nevski Prospekt. The bank has started its activities by opening currency accounts mainly for French companies operating in the city. In the initial stage the bank plans to serve only corporate customers.

The second foreign-owned bank, a joint venture between the German Dresdner Bank and the French Banque Nationale de Paris, contrast also started operating in St. Petersburg in 1993. In contrast to Credit Lyonnais, their target customers also include private persons. At the time of the opening of the St. Petersburg branch in September, the bank was already aware of the threat of new restrictions on foreign-owned banks. This was not considered to be a very serious matter, however, as the necessary political support for further restrictions still seemed to be lacking in September.

Another major German bank, Deutsche Bank, has opened a representative office in St. Petersburg. Dresdner Bank, in fact, had a representative Office in the city for two years before its joint-venture bank with BNP began operations.

The third foreign-owned bank in St. Petersburg is the branch of International Moscow Bank (IMB). Four western shareholder banks together own 60 per cent of the shares of IMB, and three Russian shareholders together hold the remaining 40 per cent. Credit Lyonnais was the fifth western shareholder in IMB until 1993, when the bank sold its shares (12.5 per cent) to the other western partners in order to avoid any conflict of interest that might arise concerning its subsidiary in St. Petersburg and IMB.

International Moscow Bank was founded in Moscow in 1989 and developed rapidly in the area of foreign payments, filling the hole that was left in the market when VEB froze the foreign currency accounts at the end of 1991. The resulting loss of confidence in all Russian banks helped IMB to acquire a significant market share in foreign payments. The bank is also likely to remain the only joint-venture bank in Russia with majority ownership in western hands, because the new legislation restricts foreign ownership of joint-venture banks to 50 per cent of share capital.

There was a heated political battle concerning the rights of foreign-owned banks in summer and fall 1993. The parliament passed the new banking law already in July 1993. In the preamble to this law, which was written by the conservative Supreme Soviet, the activities of foreign-owned banks were limited to off-shore banking. This would exclude ruble operations and would also prevent Russian residents from enlisting the services of foreign-owned banks. President Yeltsin vetoed the law twice before dissolving the parliament in September. It was generally expected that the final fate of the law would be decided by the new parliament to be elected in December. However, Yeltsin decided to sign the law already in November and thereby surprised, among others, the foreign banks that had already been issued licenses.

The restrictions were imposed for two years on all foreign-owned banks that had not started operations by November 15 and were to be lifted in January 1996 (Izvestija, November 20, Ekonomika i Zhizn 48/93 and Financial Times, November 21,1993). The above mentioned three foreign-owned banks in St. Petersburg were already operative and can thus continue their activities as planned. For others, the gate is closed for two years unless they restrict their activities, serving only foreign residents and dealing only in foreign currencies. Ruble business is not highly attractive to foreign banks due to the country's high rate of inflation and high credit risks. However, the Russian resident clientele is important to these banks because the number of foreign companies is very modest. Credit Lyonnais Russie, the joint venture of Dresdner Bank and BNP and International Moscow Bank can now benefit from their early start, develop their activities and pursue new Soviet client relations without having to fear increasing competition from other foreign banks in the city.

The powerful lobby of Russian banks has staunchly opposed the entry of foreign-owned banks into the Russian market. They claim that the foreign-owned banks will gain the best foreign-exchange-earning companies as customers, with the help of their modern and efficient technology. The Russian banks are then left with the less lucrative business of providing long-term ruble financing for the same customers. An additional fear is that the foreign-owned banks will distort the wage level in the whole banking sector by paying their Russian personnel higher wages than the Russian banks can afford. Already in August 1993 the wage level in the financial services sector was almost twice as high as the average level of wages in Russia.

Only a couple of weeks before the restrictions were imposed on foreign banks the Central Bank of Russia had issued licenses to 5 additional foreign banks, thus bringing the number of licensed foreign-owned banks to 12 (Financial Times, November 11, 1993). Among these banks was the American Citibank, which planned to open a subsidiary in Moscow in the beginning of 1994 and a branch of the subsidiary in St. Petersburg in May 1994 (Kommersant-Daily, November 3, 1993). However, the plans of Citibank as well as other foreign banks, that had not started operations in Russia, were greatly affected, if not actually frozen, by the presidential decree in December. The unexpected move has also created confusion in the European Community, where it is claimed that the new law is in open conflict with Russia's law on foreign investments (Financial Times, November 28, 1993).

One Finnish bank, Postipankki, applied for a license to set up a branch in St. Petersburg but the license was not issued before the restrictions were imposed on foreign banks. There are no other branches of foreign-owned banks operating in St. Petersburg, but the Bank of Austria has opened an off-shore branch in Moscow. Banking branches differ from subsidiaries from the point of view of banking supervision. Whereas subsidiaries are subject to local legislation and supervision by the Russian central bank, foreign branches are under the supervision of the authorities of the parent bank. Therefore, the supervision of foreign branches requires cooperation between the corresponding authorities in each country.

In St. Petersburg the supervising body is the local branch of the Russian central bank. The branch also issues licenses to foreign-owned banks in the city. The inspection the Central Bank is in the process of organizing bank inspection in the city. So far, the banks have not felt that their activities are very tightly controlled by the Central Bank. It seems that the local tax inspectors visit the banks more often than the Central Bank inspectors. However, the banks were disturbed by the rapidly changing, unclear and sometimes contradictory instructions of the Central Bank. In this respect the banks in St. Petersburg are somewhat worse off than the banks in Moscow, because permission to carry out certain operations is granted only by the Central Bank's home office in Moscow. This takes time and slows down the commeneement of operations. It is also indicative of the fact that the degree of independence in carrying out banking and monetary policy in St. Petersburg is very limited.

The local banks in St. Petersburg did not expect the new banking law to substantially change their activities. The new minimum capital requirement, 100 million rubles (about USD 80 000), was not considered problematic by the St. Petersburg banks. Accordingly, they did not expect any major bank mergers in the near future. This contradicts the general expectation voiced in the Russian press that a wave of bank mergers would be likely, especially among small banks facing difficulties in raising the required minimum capital. Apparently, high inflation has rendered the 100 million rubles more easily attainable than was originally expected. Therefore, plans already exist for a further increase in the minimum capital requirement (Kommersant-Daily, November 10, 1993). The first large bank merger has also seen the light of day in Moscow, where three strong banks have announced their plans to merge their operations and create one of the largest banks in the whole of Russia (Financial Times, October 12, 1993).

3 Activities of the banks

3.1 Payment transfers in rubles

The role of the Central Bank is significant in the clearing of interbank payments in the city. Payments within St. Peterburg are cleared through the Central Bank within 1–2 days or a week at most. Large payments take longer to clear than small ones because they undergo extra checking procedures. However, payments to other cities take weeks, even months, to clear because they have to go through Moscow and the documents are sent through the mail. Even though most banks in St. Petersburg seemed to be satisfied with the speed of payment transfers in the city, some, most prominently Promstroibank, expressed dissatisfaction with the Central Bank's efficiency. Promstroibank had also started (with the permission of the Central Bank) to establish direct correspondent accounts with other banks and was working for the establishment of a clearing center, which would eventually compete with the central bank clearing system. Inkombank, in turn, has developed its own payment transfer network covering most cities in Russia, and it offers clearing services to other banks. At the same time, the Central Bank is investing in new data processing technology and aims to start up a new clearing center within the next few months. This will improve the efficiency of payment transfers within the city but it will not have an effect on payments between Moscow and St. Petersburg until the telecommunication networks between the two cities are improved.

The Central Bank also issued new instructions to commercial banks at the end of October stating that the Bank will attempt to speed up payments and, more importantly, to deal with the problem of accumulating interenterprise arrears. According to the new instructions, Russian commercial banks will have to record their receivables from enterprises in the form of promissory notes by February 1994. Further, all new commercial payments are to be documented accordingly. The new procedure will define a payment term from 45 to 90 days and a definite due date for each transaction. In case of nonpayment, collection procedures will have a legal basis, which can lead to bankruptcy proceedings, if necessary (Moskovskie Novosti, October 31, Delovoi Mir, November 3, 1993).

In 1992 the payment arrears accumulated between enterprises were cleared with the help of cheap funding provided by the Central Bank. Earlier, the commercial banks also played an important role in registering interenterprise arrears and were empowered to automatically debit companies' accounts as soon as there was sufficient cover to effect payment. In 1993 central bank financing was less readily available for clearing arrears. The banks were also freed from registering the payables of the companies, and they lost control of their customers' liquidity position. The new payment procedure, based on promissory notes, can be seen as an attempt at a further hardening of companies' budget constraints, up until now, expanding interenterprise arrears have provided companies with a relatively easy means of adapting.

According to an estimate of the State Property Committee released in July 1993, one-quarter of the state-owned companies were making heavy losses and most of the companies losing money were insolvent. In addition, whole industries, such as the transportation industry, the powerful military-industrial complex, the metallurgical industry and coal mining, were close to bankruptcy (Izvestija, July 2, 1993). Therefore, it is not surprising that the Central Bank expects that a great number of commercial banks will also face severe financial difficulties (Rossijskaja Gazeta, October 15, Financial Times, October 22, 1993).

However, none of the banks interviewed in St. Petersburg expected bad debts to become a major problem for them. In the present environment of near hyperinflation, they are apparently counting on their customers' ability to service their debts, which carry a lower interest rate than the inflation rate. What the banks have difficulties in judging, however, is how the non-transparent network of interenterprise arrears will affect their customers.

3.2 Transactions in foreign currencies

The ability of Russian banks to carry out payment transfers in foreign currencies depends on the type of license they have received from the Central Bank. There are three types of licenses. The first is a general license, which gives its holder the right to conduct foreign exchange operations both within and outside Russia. In order to do this, the bank can open correspondent accounts in foreign banks.

The holder of the second type of license, the so-called ordinary license, can undertake foreign currency operations only in Russia. In order to carry out foreign currency payments outside Russia, such a bank needs the help of banks with general license. The third type of license, a special license, is issued only for individual transactions of a non-recurrent nature (Kivilahti et alia, 1992, p. 60).

According to the catalogue of St. Petersburg banks published in 1992, only five of the banks have a general license enabling them to establish direct correspondent banking accounts in foreign banks. Most of the other banks have ordinary licenses. All the foreign banks that started operations in 1993 have received general licenses.

The banks in St. Petersburg have not needed to engage in active marketing in order to attract customers, because the supply of banking services in the city has not been sufficiently large to satisfy the growing demand. Therefore, the commissions which St. Petersburg banks charge for opening accounts and making payment transfers are generally very high in comparison to normal banking commissions in western European countries, and they vary greatly from bank to bank. Table 1 lists commissions and banking fees charged for opening a foreign currency account by the major banks in the city. The large differences are also indicative of weak competition between the banks. Normally, the banks require that a new customer signs an agreement with the bank covering commissions and fees.

Table 1 **Commissions charged by banks in St. Petersburg in 1993 for opening accounts in convertible currencies**

Bank	Commission	Other conditions
ABI-Bank		Only for ruble accountholders
Astrobank	USD 100	
Baltijskij Bank	USD 300	
St.Peterburg Bank	USD 2 000	
Lenregionbank		Only for holders of export-import agreements
Severnij Torgovij Bank	USD 45	
Petrovski Bank	USD 50	
Promstroibank	USD 1 500	Only for ruble accountholders
Rossija	USD 500	
Ruskobank	USD 10	Presupposes an investment of 100 000 rubles in the shares of the bank
St.Peterburg Innovation Bank	USD 100	
Leso-Promyshlennij Bank	-	The account will be active in three days
Vitabank	USD 450	
	USD 300	For old customers
Branches of banks headquartered in other cities		
Aeroflot	USD 50	
Avtovazbank	USD 70	
Kredobank	USD 20	Minimum deposit USD 30
Inkombank	USD 200	Export-import agreement
Konversbank	SUR 15 000	Russian organizations foreigners are charged USD 50 for the first payment
Ladabank	USD 100	
Mosbusinessbank	-	first payment minimum USD 15 000
Sberbank	USD 50	

Source: Russian Trade Express No: 5, 1993, p. 38.

The banks are required to inform the tax authorities of each new bank account. In case of well-grounded evidence of misconduct, for instance, not channelling payments through bank accounts, tax inspectors can require more detailed information on the related account entries. Apparently based on such information, tax authorities in St. Petersburg have published information according to which 80–85 per cent of the retail sales in the city in 1993 were settled outside the banking accounts (East-West Report 2/92). According to the instructions of the Central Bank of Russia issued in summer 1993, all sums above 500 000 rubles (USD 500) had to be channelled through bank accounts. In October the Central Bank issued new payment instructions whereby the companies are required to keep all cash reserves exceeding their current needs for wage and social security payments in their bank accounts (Ekonomika i Zhizn, October 4, 1993). Companies and banks are to agree on limits for the cash reserves and the banks are responsible for monitoring the reserves.

It is clear from the above that there are significant inconsistencies between instructions and practice. Moreover, the level of understanding of the instructions varied greatly from bank to bank in August when the banks were interviewed. However, the tax authorities have not hesitated to issue fines to foreign-owned companies that use cash payments instead of going through the banks. These measures are no doubt influenced by a peculiar feature of tax inspection: inspectors are paid commissions of 10 per cent of the amount of fines levied on companies. As no local companies were treated in this way, tax inspection was clearly aimed at companies, that earn foreign currencies.

The restrictions are also tighter on cash payments made in foreign currencies rather than rubles. Additional limits are imposed on payments originally made in foreign currencies even after they have been converted into rubles. For example, such rubles could not in some cases not be used to pay local wages. According to the banks, the regulations and instructions concerning foreign currencies are incomplete and often controversial, which creates misunderstandings and long delays in transfers, because the Central Bank in Moscow has to be consulted on many of these transactions. In 1994 the rules will be somewhat more clear, because then the use of all foreign bank-notes will be forbidden. Foreign currency payments can be made, however, by using credit cards (Delovoi Mir, October 7 and 19, 1993).

In October 1993 the Central Bank announced a new foreign exchange control system, which also comes into effect in January 1994. The system aims at better control of the repatriation of export earnings and entails the extensive participation of Russian commercial banks. In case export earnings are not repatriated by the time payment is expected, the banks will be obliged to alert customs authorities (Kommersant-Daily, October 16, Financial Times, October 16–17, 1993). The system is designed to cope with capital flight, which grew significantly in 1993. In November the Russian banks had USD 15 billion in accounts in western banks. However, the amount of deposits on Russian companies accounts in western banks is not known. At the same time, the Russian government was not able to service the country's foreign debt (Izvestija, November 3, Financial Times, November 4, 1993)

Foreign exchange used to be the most lucrative business for the banks in St. Petersburg in 1992, but since then an increasing number of banks have set up exchange offices in the city and the new competition has squeezed the margins. Foreign bank-notes can be bought and sold against rubles in the exchange offices also in the future but the ban on using foreign bank-notes in Russia is likely to decrease the trade volumes, which reached some USD 5–6 million daily in summer 1993.

The largest banks in the city are also members of the St. Petersburg Currency Exchange, where the volume of traded currencies has reached USD 40–50 million daily. This is about one tenth of the volume traded in the Moscow Interbank Currency Exchange. The rates follow quite closely those of Moscow, but it is practically impossible to do undertake inter-city arbitrage when rates differ because of the problems involved in making payment transfers between the cities.

The Central Bank is in the best position to influence the rates in both cities through its own dealer.

Companies wishing to buy foreign currencies for import payments can authorize one of the member banks to buy the needed currencies when they are traded at the exchange. In September 1993 foreign companies also gained the right to buy and sell foreign currencies at the currency exchanges. Three foreign currencies are currently traded at the St. Petersburg exchange: the dollar, D-mark and the Finnish markka. The dollar is traded every day, the D-mark and Finnish markka only once a week. Companies wishing to buy either D-marks or Finnish markka may have to wait up to a week for the next trading day for that currency.

Direct transfers between St. Petersburg and the Baltic states are practically impossible since the introduction of new national currencies in the Baltic states. Occasional payments are effected in western currencies through accounts held in western banks. The same applies to payments between St. Petersburg and those CIS states, that have introduced currencies of their own or temporary replacements for the ruble. To these countries direct transfers in rubles are also no longer possible since summer 1993 when the Central Bank of Russia detached the Russian ruble from rubles in circulation in the other CIS states. Banks in St. Petersburg seemed reluctant to recognize the existence of national Baltic currencies, apparently for political reasons. However, some banks in Moscow have already announced their intentions to start trading in these soft currencies.

3.3 Lending and other activities

There is a limited interbank money market in St. Petersburg in which the Savings Bank and Promstroibank have acted as lenders to other banks. However, in comparison to Moscow, the St. Petersburg market is much less developed. Interest rates follow the refinancing rate of the Central Bank, which was 170 per cent in August and was raised to 210 per cent in September. Notes issued by the Savings Bank have been the prime instrument in the interbank money market. Recently, the commercial banks, notably Promstroibank, have also started to issue promissory notes, which have met with a growing demand in the market (Kommersant-Daily, October 1 and 5, 1993).

The banks in St. Petersburg have shifted the focus of their activities from the exchange of foreign currencies to short term (1–6 months) lending, both in rubles and foreign currencies. Longer term lending is not possible in the present hyperinflationary situation. Neither the corporate customers nor the banks are willing to tie their hands with longer-term commitments. The interest rates charged for short term (3 month) ruble credits range from 197 to 206 per cent per annum, depending on the negotiating power of the customer, which is somewhat below the present rate for Central Bank credits, 210 per cent p.a. (Kommersant-Daily, October 20, 1993). The interest rate margin charged by the banks is limited to 3 percentage points, if the credits are refinanced with Central Bank credits. Otherwise, the banks are free to set the interest rate as high as they wish. Central Bank refinancing is no longer widely used, as can be seen from the level of interest rates.

In order to secure their loans, Russian banks require either a guarantee of another bank, credit risk insurance or a mortgage backed by machinery and equipment or inventories of the borrower. Real estate mortgages are still rare due to the unclear situation in the ownership of real estate and complicated legal and administrative procedures. Banks, which finance exporting companies can receive deposits in foreign currencies as collateral for ruble loans, but such cases are relatively rare. The recent changes in the repatriation rules concerning foreign currency earnings have shortened the repatriation period to seven days, which in turn reduces the possibilities of using the foreign currency earnings as collateral.

Some banks have paid foreign currency-interest rates on deposits, which have far exceeded the market rates on the same currencies. Such banks have counted on the appreciation of these foreign currencies against the ruble to compensate for the higher interest rates. The stabilization of the ruble/dollar exchange rate in October–November eliminated this possibility.

The deposit rates quoted by the banks also increased in 1993, reflecting the reluctance of depositors to keep money in bank accounts as they see the inflation tax rapidly devouring their deposits. The Savings Bank quoted deposit rates of 130–140 per cent p.a. in August and 170–200 per cent in September, whereby the bank hopes to attract more savings from private persons. Commercial banks quoted rates as high as 150–190 per cent p.a. already in August, depending on the size and term of the deposit. Because the inflation rate has been about 20 per cent per month and rises cumulatively to 800 per cent per annum, the level of real interest rates is still negative. The difference between the level of interest rates and inflation is, however, smaller than would appear at first sight, because the Central Bank calculates the monthly interest rate by simply dividing the yearly rate of interest (210 per cent) by 12, without allowing for the compounding effect. Thus the monthly interest rate of 17.5 per cent is only slightly below the inflation rate. More recently, as the inflation rate has declined somewhat, the real interest rate has even turned positive.

In addition to short term lending, the banks have developed other kinds of activities, including trading in shares, factoring, leasing and insurance business. They also have set up a large number of investment funds. The banking law does not limit these kinds of activities of the banks. Nor does it set any limits on banks' ownership of shares in commercial or industrial companies. The relatively good profitability of banks has enabled them to expand operations rapidly into these related areas of business, which in many western market economies have proved to be very risky.

Table 2 depicts the development of the balance sheet of the St. Peterburg Bank during the last couple of years. In analyzing the balance sheet figures one should keep in mind that the structure of the balance sheet cannot be compared to that of a western bank. Some interesting observations can be made, however. The balance sheet total has grown at a remarkably rapid pace due to the high inflation. A striking phenomenon is the decrease in loans relative to total assets. Whereas in 1991 formed loans made up 70 per cent of total assets, by 1993 their share had dropped below 30 per cent.

At the same time the balance on the correspondent account in the Central Bank had diminished considerably, which probably signifies increased efficiency in payment transfers. Deposits in foreign currencies have also increased considerably due to the ruble's depreciation against foreign currencies, even though the St. Petersburg Bank has not reached the situation of Bank Imperial in Moscow, wherein 50 per cent of its assets are in currency accounts (Euromoney, September 1993, p. 136).

The structure of liabilities has changed less than that of assets. Deposit accounts have diminished somewhat in relation to other sources of funding. The bank's profits have improved, but share capital has diminished in spite of the floating of several share issues during the period. For a deeper financial analysis, more detailed information would be needed, especially concerning the structure of the bank's loan portfolio.

Balance sheet of Bank Saint–Petersburg Plc (in thou. roubles)

	1.7.93		1.1.93		1.1.92		1.1.91	
Assets								
1 Cash in bank notes	10317145	5.40	3783703	6.19	141074	1.89	42064	1.86
2 Correspondent account with the Central Bank of the Russian Fed.	39776598	20.81	17163989	28.07	3388571	45.36	390513	17.29
3 Nostro correspondent accounts	28460786	14.89	8475217	13.86	–	–	–	–
4 Clearing account	–	0.00	–	0.00	–	–	–	–
5 Correspondent accounts of credit institutions	48305	0.03	1545	0.00	635	0.01	–	–
6 Investments in securities	1421524	0.74	357522	0.58	22584	0.30	–	–
7 Financing of State capital long–term investments	3146193	1.65	–	0.00	–	–	–	–
8 Expenses	–	0.00	98398	0.16	8871	0.12	2431	0.11
9 Currency Fluctuation Account	–	0.00	–	0.00	–	–	–	–
10 Loans	48862601	25.57	18608122	30.43	3674954	49.19	1744231	77.24
11 Reserve account	19122886	10.01	7357337	12.03	87899	1.18	–	–
12 Debtors of the Bank	3425463	1.79	642948	1.05	11349	0.15	31072	1.38
13 Fixed assets	1318554	0.69	267386	0.44	9647	0.13	5742	0.25
14 Assets transferred to enterprises for participation in their econ. activities	789812	0.41	299401	0.49	–	–	–	–
15 Profit distribution	5709363	2.99	2760061	4.51	118462	1.59	41811	1.85
16 Other assets	28716213	15.03	1335826	2.18	6870	0.09	210	0.01
Balance	191115443	100.00	61151455	100.00	7470916	100.00	2258074	100.00
Liabilities								
1 Capital	746596	0.39	500000	0.82	183492	2.46	75000	3.32
2 Reserve Fund	727473	0.38	302300	0.49	35099	0.47	–	–
3 Other funds	1869921	0.98	1285334	2.10	49154	0.66	8542	0.38
4 Clearing account	296860	0.16	409499	0.67	–	–	–	–
5 Current account	104666732	54.77	38625550	63.16	6778353	90.73	1653896	73.24
6 LORO accounts	12112622	6.34	960671	1.57	109241	1.46	25234	1.12
7 Deposits	778741	0.41	432115	0.71	123680	1.66	74012	3.28
8 Income	30844597	16.14	7381770	12.07	–	–	376173	16.66
9 Currency Fluctuation Account	94955	0.05	–	–	–	–	–	–
10 Inter Bank Loans	5601803	2.93	1599773	2.62	–	–	–	–
11 Creditors of the Bank	2184636	1.14	836811	1.37	29760	0.40	3019	0.13
12 Profit	13334760	6.98	2760061	4.51	159810	2.14	41811	1.85
13 Other liabilities	15689342	8.21	6043596	9.88	2327	0.03	387	0.02
14 Debts	2166405	1.13	13975	0.02	–	–	–	–
Balance	191115443	100.00	61151455	100.00	7470916	100.00	2258074	100.00

4 Banking services offered to Finnish companies in St. Petersburg

Whereas the above account is based on discussions with the banks in St. Petersburg, the following description is based on the recent experiences of Finnish companies in St. Petersburg.

Subsidiaries of Finnish companies and Finnish-Russian joint ventures are small companies in the St. Petersburg market and are treated accordingly by the Russian banks. Most of these companies had learned from experience that the large Russian banks were not interested in small companies as customers. This probably reflects the low level of information technology in the banks. All banking transactions take a long time to execute and the banks prefer to use the time to serve large old customers rather than small foreign-owned companies. Even the large banks do not have enough personnel to accommodate all their customers. The smaller banks are more marketing oriented and have adapted their services better to the needs of small customers. However, in all the banks cashiers handling Finnish companies had to get used to spending several hours almost daily in order to get payments flowing. The short opening hours of the banks have further complicated the daily payment routines.

However cumbersome the banking routines may be, foreign companies cannot operate in Russia without opening a bank account. For registering companies, it is required that they have previously opened both ruble and currency accounts in a local bank. The company may open several ruble accounts but only one account can be used for current payments.

According to those companies that were operating in the city already in 1992 the speed of payment transfers has increased both in foreign currencies and in rubles in 1993. However, the banks claim that 1–2 days is much too short a time for payments from one bank to another in the city. The normal period is close to one week or more. One respondent had even experienced long delays in transferring money from one account to another within one bank.

Generally, payments in foreign currencies from St. Petersburg to Finland or other western European countries or vice versa go relatively smoothly. In channeling such payments, the St. Petersburg banks use their correspondent accounts in Finnish and other foreign banks. Payments are technically transferred through telex, Swift or electric mail. The swift system is used by St. Peterburg Bank and is being installed in a couple of other banks.

Even though the Russian banks advertise high deposit rates, none of the interviewed companies had been promised any interest on their foreign currency or ruble accounts. This is most likely related to the fact that the companies are not interested in keeping large sums in the banks while the real interest rate is negative. Rubles are used as soon as possible for something that holds its value better. Moreover, significant sums of foreign currencies are not deposited with Russian banks in the fear that a refreezing of the accounts could occur, which illustrates the extent of distrust the companies have of the local banks. On the other hand, companies try to circumvent the 50 per cent repatriation requirement by arranging barter deals, which minimize payment transfers.

Finnish companies have generally not borrowed money from Russian banks because the interest rates are considered exorbitant. Whereas some companies may have paid attention solely to the high nominal rates without realizing that the real interest rates are negative, others claim that it has not been possible for them to raise prices in line with local inflation. Moreover, it has been very difficult to arrange for the collateral that the banks require. For these reasons, most companies are financed by their parent organizations in Finland. Many companies are eagerly waiting to avail themselves of the services of foreign-owned banks in St. Petersburg, while some are sceptical of the possibilities of foreign banks to offer better services than Russian banks in the present situation.

5 Summary and conclusions

Two large Russian banks, both rooted in the former system of specialized Soviet banks, Promstroibank and St. Peterburg Bank, dominate the banking industry in St. Petersburg. The position of these banks, which today are independent limited liability banks, was challenged in 1993 by increased competition from two groups of new banks in the city. The first group consists of Moscow based commercial banks, which have opened branches in the city, and the second group comprises foreign-owned banks.

The competition from foreign banks is going to be more keen in St. Petersburg than in Moscow, because there are already three foreign banks operating in the city: Credit Lyonnais Russie, the joint venture of Dresdner Bank and Banque Nationale de Paris and a branch of the Moscow based International Moscow Bank. While restrictions were imposed recently on the operations on foreign banks in Russia, these banks, which were already operative, can continue to function normally. Further, they do not have to worry about other foreign competitors entering the market until 1996.

Russian banks have generally been charged with increased responsibilities in monitoring the introduction of a new payment system for the whole country. In domestic transfers the use of promissory notes and in foreign payments the repatriation of foreign currencies involve new and wider responsibilities for the commercial banks. The introduction of promissory notes in all domestic payments also involves higher risks for the banks, because the enforcement of the stipulated due dates might uncover bad debts problems, which have so far been hidden behind the growing interenterprise arrears.

The enforcement of the repatriation requirements together with the recent stabilization of the ruble and the appearance of positive real interest rates all point toward possible changes in future banking strategies. Investment in foreign currencies has become relatively less attractive and domestic lending more attractive to the banks, provided that the problem of interenterprise arrears can be replaced by a more transparent and enforceable payment system.

From the point of view of Finnish companies operating in St. Petersburg the choice of banks was widened by the entry into the market of three foreign-owned banks. Increased competition is also expected to influence the behaviour of Russian banks in the city.

The companies have already experienced an improvement in the level of banking services from 1992 to 1993, though there is still a lot of room for improvement.

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