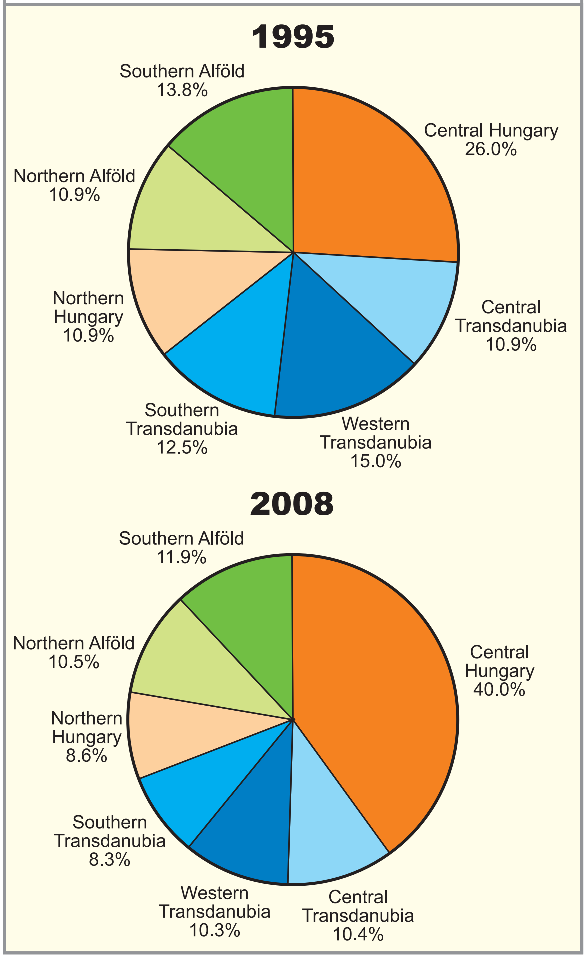
Banking Network

Balancing Branch Network Disparities During the Early Transition Period

The creation of a two-tier banking system in 1987 "re-established" modern Hungarian banking, in which today 80% of all banks are majority foreign owned. There can be no doubt that the Hungarian financial sector lagged significantly behind that of more developed countries in the 1990s, even as regards territorial distribution. The location and regional expansion of bank branches reflect economic developments in Hungary during the 1990s. Following the economic and political transition, commercial banks embarked on a rapid development of their branch networks in Hungary's western counties, a region that had been neglected during the period of socialist industrialisation.

As a result of these developments, disparities between regional branch networks had disappeared by 1990 and the previous disadvantage that western parts of the country suffered, had been eliminated. The aim of domestic financial institutions was to cover the country with an evenly distributed branch network, in what was at the time, a relatively small banking market. Branch developments in the 1990s worked towards restoring the balance between western and eastern parts of the country (*Figure 154*). Having relatively saturated the western regions, from the mid-1990s onwards, the main targets were the major towns of eastern and southern Hungary.

Fig. 154 BANKING NETWORK BY REGION



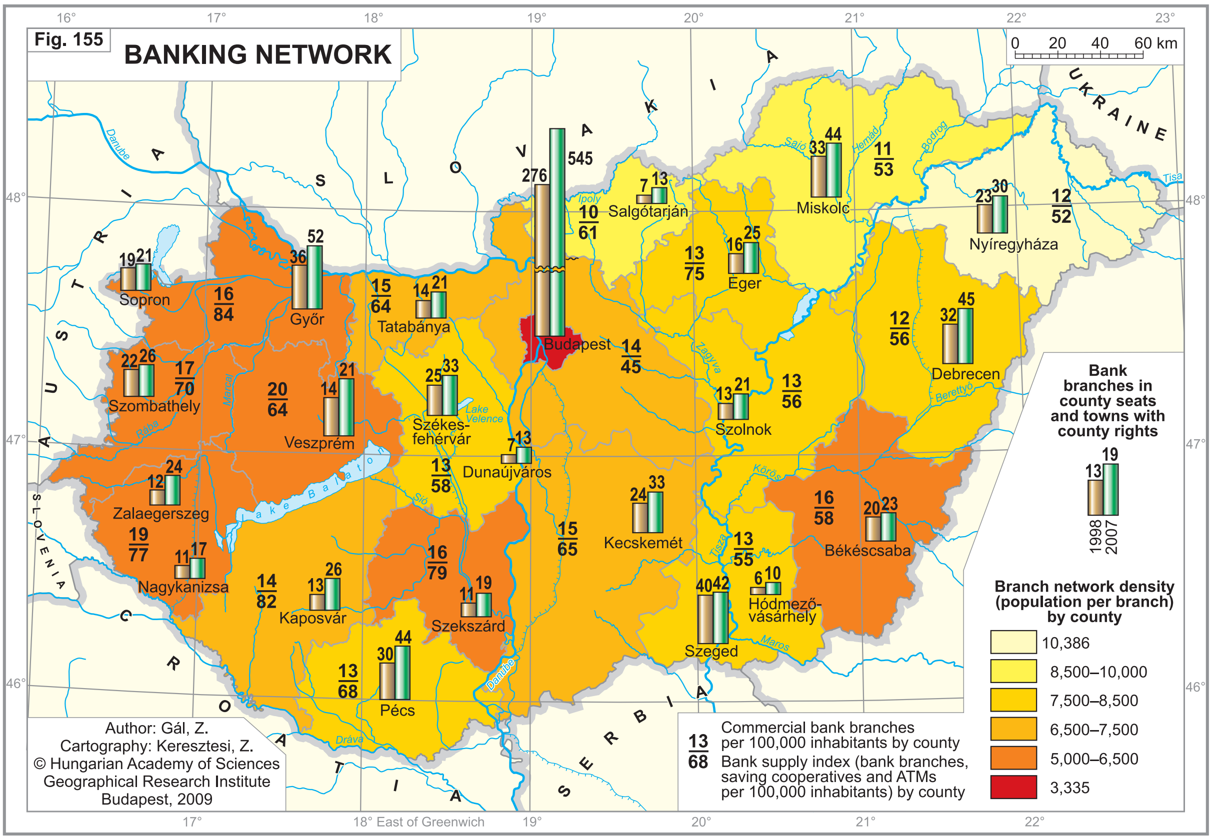
Territorial Characteristics of the Bank Branch Network

Although the territorial enlargement of the branch network has improved accessibility to banks, the country is still conspicuous by the sparseness of its network density, especially when compared to the EU-15 average (1,923 persons/branch). Even though the number of banks is high relative to the overall size of the Hungarian market, ***branch density*** is still quite low. Despite a 76% increase in the density indicator between 1998 and 2008, the current figure of 6,061 persons per branch reveals that the country is still insufficiently covered by operating branches (*Table 41*) and accessibility indicators of financial services continue to show considerable differences between western and eastern parts of the country. There are inner disadvantaged peripheries to be found at the micro-regional level in Transdanubia as well, and such areas dominate the regions of the Alföld (Great Hungarian Plain) and North Hungary. The ratio of bank branches per capita clearly ranks the region of Central Hungary and West Transdanubia first. As a consequence of intense development of the branch network in Budapest, the capital further increased its share in the network. While in 1997 11% of all branches operated in Budapest, this figure was already at 31% in 2008. There the network density is nearly double the national average (3,335 persons per branch). However, the poorest density and service figures are recorded in the regions of the North Alföld and North Hungary. The territorial distribution of banks clearly points to a more intense financial intermediary activity that correlates strongly with economic development (*Figure 155*).

Table 41. ***Territorial distribution of the bank branch network and branch density (1998–2008)***

Regions	Number of bank branches		Ratio of bank branches		Branch density (population per branch)	
	1998	2008	1998	2008	1998	2008
Central Hungary	304	666	32.0	40.0	9,434	4,266
– Budapest	*253*	*509*	*16.0*	*31.0*	*7,356*	*3,335*
Central Transdanubia	96	173	10.0	10.4	11,594	6,421
Western Transdanubia	114	171	12.0	10.3	8,711	5,850
Southern Transdanubia	101	139	11.0	8.3	9,762	7,032
Northern Hungary	88	144	9.0	8.6	14,591	8,827
Northern Alföld	109	175	12.0	10.5	14,073	8,810
Southern Alföld	132	198	14.0	11.9	10,295	6,843
Hungary	**944**	**1,666**	**100.0**	**100.0**	**10,736**	**6,061**

Source: Calculated by the author, based on yearbooks of the Hungarian Financial Sector and Stock Exchange



Viewed from the perspective of the banks themselves, the network development was not primarily driven by any regional preferences,

Table 42. ***Distribution of the bank branch network by settlement category by size (1998–2004)***

Settlement category by size	Number of settlements	Ratio of population	Territorial ratio of branches		Network density (Population per branch)	
	2004	2004	1998	2004	1998	2004
1,000–1,999	641	9.0	0.6	0.2	230,771	461,543
2,000–4,999	505	14.8	7.3	6.2	29,826	29,252
5,000–9,999	136	9.2	13.0	12.0	10,408	9,378
10,000–49,999	122	22.6	36.9	41.5	8,961	6,612
50,000–99,999	12	7.5	17.8	17.9	6,109	5,057
100,000–	8	11.4	24.4	22.2	6,807	6,192

Source: Calculated by the author from the Handbook of the Hungarian Financial & Capital Markets (2004).

rather it was directed by the urban hierarchy. During the early stages of network enlargement, banks attempted to provide countrywide coverage while following the hierarchy of settlements, i.e., starting with regional centres and county seats, then proceeding onto smaller urban centres. Given that by the early 1990s the number of bank branches had equalled the number of major cities, financial institutions turned their attention to towns with smaller populations. Formerly, cities represented a 50% share of the branch network (or 60% by including Budapest). This figure fell to 22% due to the opening of branches in smaller towns (*Table 42*). Today, the bulk of the branch network (41.5%) is located in towns with 10 to 25 thousand inhabitants. At the same time, the accessibility of services corresponds with the economic prosperity of individual towns. The relative positions of larger towns are best characterised by reference to the range of financial services offered and the intensifying competition among banks rather than the mere enlargement of branch networks. In terms of these indicators, some cities (Pécs, Győr, Debrecen, Miskolc and Szeged) could be viewed to have started to assume the status of financial centres. In settlements with populations of between 5 to 50 thousand, branch networks have slightly enlarged, while in those with populations of 2 to 5 thousand, the number of branches has decreased.

Territorial Polarisation of the Banking System

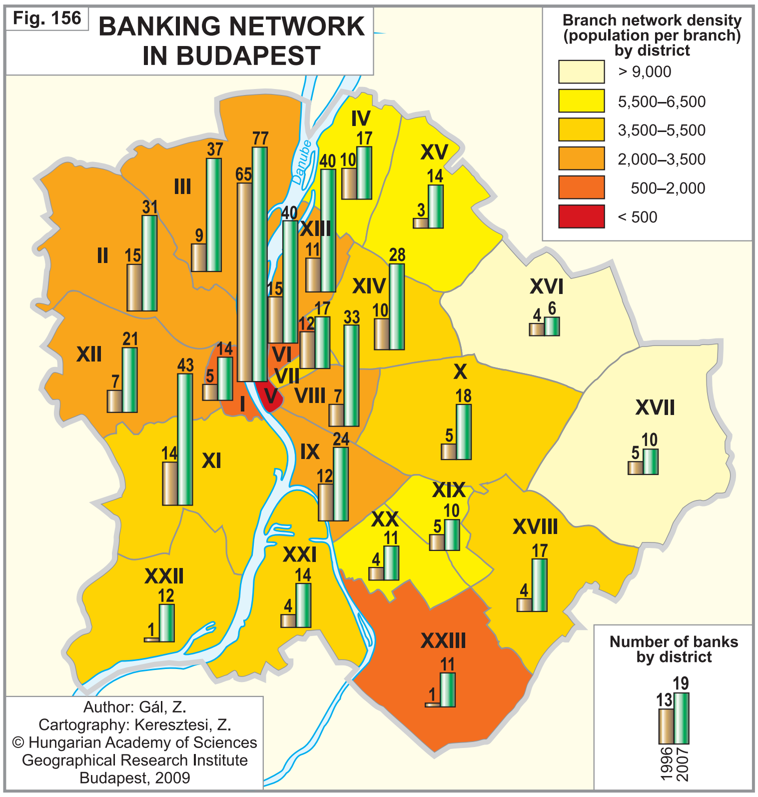
Among all of Hungary's economic sectors, territorial concentration and polarisation are highest in the banking and insurance sectors. The banking sector is characterised primarily by strong organisational centralisation and territorial polarisation, the latter being crucially reflected in a centralisation bias of the entire sector highly concentrated on Budapest. Following a decade of territorial expansion in the banking network, organisational centralisation appears to have become more dominant in the early 2000s.

– This means that virtually 95% of ***banking capital stock*** and 86% of those ***employed in the financial sector*** (registered at company headquarters) are ***concentrated on Budapest***. Since banks tendered for privatisation were exclusively located in Budapest and so were greenfield banking investments, in effect 100% of capital invested in the sector is concentrated here (*Figure 156*).

– The Hungarian banking sector is characterised by the ***lack of locally founded banks***. Only mutual savings cooperatives, with their significantly lower equity base (5.2% of total Hungarian bank capital) have their headquarters outside the capital. These mutual savings cooperatives, which previously had 1.8 times as many branches as the banks, today account for only 51% of all branches of financial institutions, owing to a more rapid expansion in the bank branch network.

– The main cause of polarisation is the ***strongly centralised hierarchical control of the branch network***. Due to this structure, the competencies of branches outside the capital are restricted. In some cases, even their access to information is limited (informational asymmetry).

Fig. 156 BANKING NETWORK IN BUDAPEST



– A further cause of polarisation is the ***relatively low level of access to services throughout the country***. This is manifest in the highly uneven territorial distribution of branch networks in terms of both urban hierarchy and regional levels.

Against the general tendency observable in the EU, consolidation in the Hungarian market was not accompanied by a decrease in the number of branches. On the contrary, the Hungarian branch network continued expanding until the financial crisis of 2008, with the most rapid pace in the last 2 ½ years witnessing the opening of 400 new branches. This was more than had been opened during the entire previous decade, reinforcing the advantage of the central region on the expenses of the rest of the country (*Figure 154*). The current state of accessibility to financial services is most importantly characterised by the concentration of such services in the capital, contrasted with the almost total absence of banks in rural areas (i.e. villages). At present, branches of commercial banks operate in 223 settlements, 99% of which are towns. To put it differently, bank branches are virtually absent from villages, which account for 93% of all settlements. While nationwide the ratio of population per bank branch improved by 18% between 1998 and 2004, this figure worsened by 5.3% in microregions which display the worst branch accessibility figures. The number of microregions with access figures below the national average increased from 97 to 102. Domestic banks continue to resort to the so-called "redlining strategy" not only in network development but also with regard to certain service segments. Organisational centralisation, rationalisation of branch networks (sometimes resulting in financial exclusion, i.e. the closing down of branches in some less profitable regions and socially segregated residential areas), and the organisational and territorial concentration of certain back office activities further widened the gap between Budapest and the rest of the country. The peculiarity of these negative developments – in contrast to those in Western Europe – is that they began before branch networks of a reasonable size had been established.