

Universal Banking Service in Russia

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Abstract

The tendency of banking universalization, which has been predominant over the past decades, is determined by three important processes in the world: financial globalization of the world economy, reduced agency business of banks, and increase in competition among banks, non-bank financial institutions, and non-financial institutions. In this regard, it is of particular importance to define the concept, role and place of universal and specialized banks in banking system. The purpose of the study is to develop the scientifically based development model of a commercial banks as a universal one upon the footing of detailing the essence, place and role of universal banks in banking system, with due account for the modern processes of universalization and specialization of credit institutions, development of competitive strategy types, which is of great importance for improving the quality of bank management at macro-and micro levels, ensuring sustainable development of credit institutions and their increasing role in Russian economy. The study is based on the dialectic method of knowledge as a means to identify trends, patterns and contradictions in banking system development. Systematic, expert and analytical, comparative, institutional, evolutionary and methodological approaches were used in the course of the study, as well as a wide range of economic and statistical methods, such as functional analysis, sample survey, expert evaluations, generalization and statistical groups. According to the study, the concepts of “universal commercial bank” and “specialized commercial bank” have been clarified based on the study and systematization of theoretical and practical approaches to the definitions. The place and the types of universal and specialized commercial banks in Russian banking system have been identified. The role of universal banks in Russian economy has been substantiated, with due account for development trends: a) global and national banking systems; b) the practice of forming the strategy of universal banks abroad. The approaches to specialized banks risk management have been suggested.

Keywords: commercial bank, universal bank, bank specialization

1. Introduction

Relevance of the study topic is determined by the necessity to identify criteria for a universal bank with a practical purpose to work out adequate approach to the formation of the development strategy of a bank and establish differentiated supervision of its activities. Inadequate development as to basic aspects of universalization theory lead to a variety of interpretations of the universal bank concept.

The relevance of the chosen topic is enhanced by insufficient theoretical development of the concept of a “universal bank”. At present, we may talk of two different directions of studies in the area of our interest; one of them is based on the formation of general theoretical approach to the formulation of the concept of a “universal bank”. The other one is based upon the empirical studies of various banks’ universalization practices. (Burakov, 2014b)

Commercial bank and its development strategy is the subject of the studies carried out by many Russian scholars, such as S. A. Andryushin, G. N. Beloglazova, O. I. Lavrushin, Y. M. Mirkin, I. A. Nikonov and M. A. Pomorina. Of special note are the works by S. V. Bochkarev and E. A. Pochikovskaya, who studied the theoretical issues of a universal bank in detail. The problems of universal and specialized banks’ strategies are illustrated in the works by foreign scientists, such as Roger LeRoy Miller and David D. VanHoose, M. Higgins, H. -U. Derig, E. Campbell and K. Summers Lachs, and many others.

The book by the Swiss international-scale bank figure Derig (1999) covers an innovative and highly professional response to the issue of choosing strategy and taking practical steps that ensure the survival in banking.

However, the lack of scientific development as to the issues of forming the strategy focused on the universalization of commercial banks also bears mentioning. The analysis of the works by the above-mentioned authors shows that the lack of common vision in terms of determining the activities of a universal bank creates serious problem in developing a bank's strategy as a universal one and in improving regulation of its activities.

The need to carry out a comprehensive study of the theoretical foundations and methodological problems of universalization as to Russian credit institutions determined the purpose, object and subject of this study.

2. The Concept of a Universal Bank

Based on the history of universal banks' origination in the world banking practice, as well as taking into account the strategic direction of their development based on the related and unrelated diversification (Note 1), we think that a universal bank may be defined as the bank that provides traditional banking and non-banking services, as well as the bank that carries out its own operations in non-bank financial and non-financial markets.

It is widely agreed that traditional banking activity is limited to deposit and credit transactions, as well as settlement and payment transactions. The General Agreement on Trade in services (GATS, WTO key document in this area) signed in 1995, and the new agreement, the so-called Fifth Protocol to the GATS, 1997, specify 12 sectors of services. These include financial services (section 7) under which, according to the WTO Secretariat's list, three groups of services are distinguished (Services Sectoral Classification List, 1991):

- A—all insurance services and insurance-related services;
- B—banking services and other financial services (except for insurance services);
- C—other services.

In turn, bank services are classified as follows:

- Receiving deposits from public;
- Full range of loans;
- All services related to payments and money remittances;
- Issuing of guarantees and financial commitments.

Other non-bank financial services include financial leasing, brokerage and dealer operations, emission of securities and underwriting, money broking, asset management, settlement and clearing services for a variety of financial assets, advisory services, provision, delivery and processing of financial information, databases and the respective software.

Bank activities going beyond traditional banking can be considered as the criterion of universalization.

2.1 Forms of Universalization

Several forms of universalization are distinguished, depending on the type of diversification—related diversification or unrelated vertical:

1) Narrow universalization. Narrow universalization banks include:

- Banks combining banking services for clients and their own non-bank transactions in their activities;
- Banks rendering banking and non-banking services to their clients.

At the present stage of development of Russian economy, the universal banks of the first type primarily include credit institutions that provide banking services, operate in the securities market on their own name and have significant investments in securities (exceeding their stock). (Burakov, 2014a)

2) Broad universalization. This is a completed form of universalization that provides for the establishment of financial supermarkets combining three main activities: classical banking services, transactions in securities and insurance.

The strategy of creating financial conglomerates are used by both banks and insurance companies seeking to increase their scale and thus to diversify their activities which brings a new form of competition into existence. It is just due to mega-mergers in banking sector that financial conglomerates, "banking supermarkets" engaged in the provision of various services, were created. As an example, we may refer to the creation of Citigroup in the USA in 1998 based on the merger of the Travelers insurance company and the Citicorp commercial bank, and the merger of Générale de Banque to the Fortis financial group in Belgium.

2.2 Commercial Banks in Russia

Depending on the development strategy, principles of diversification under the influence of a variety of objective and subjective factors, various groups of commercial banks have been formed in Russia:

- 1) Classical banks that render services within the framework of traditional banking activities;
- 2) Universal (full-service) banks, the activities of which combine classical banking and non-banking services and transactions.

We may distinguish specialized banks focused on certain types of services and transactions within each group, this is the so-called “specialization within universalization”. For example, an investment bank in Russia is a specialized universal bank because in its activities it combines both banking and non-banking (investment) transactions in its activities, the latter prevailing. In Western literature, there is a term “focused universal bank”, i.e. a universal bank specializing in the products and services that are the most favorable for it. (Derig, 1999)

The prevalence of universal or specialized banks in a particular country should be regarded as the tendency for the development of its banking system. As an example, we may refer to organizing special banks as part of banking groups that provide individual services and expand the range of banking operations. Bank specialization prevails in the UK, France, the USA, Italy, to some extent, in Japan (partially) where it is actually forbidden for classical commercial banks to be engaged in investment activities and other non-banking activities. The principle of universalization also prevails in Switzerland, Germany, Austria and other countries. At the same time, it needs to be mentioned that in the current context, the border line between classical and universal banks is becoming increasingly blurred and gives cause for controversy. This is primarily determined by liberalization of banking laws.

We can identify whether the given bank is a universal one in accordance with the main criteria:

- Eligibility to exercise full range of banking and non-banking services; in respect to Russia, availability of a general license and a license to carry out securities transactions (formal criterion);
- Carrying out by the bank of its own investment and trading transactions with securities and other financial instruments in excess of its own funds.

It should be noted that, as of the first half of 2014, 25% of credit organizations in Russia had general license, while in 2001, the number of such credit institutions amounted to 11%. The increase was mainly attributed to the significant reduction in the number of credit institutions that did not have such license. Thus, the formal prerequisites for consolidation and universalization of banks in Russia are being predetermined.

The review of the activities as to commercial banks in the securities market carried out in regard to both Russian banking system and 25 Russian commercial banks constituting the significant share of this market (Table 1), indicates the increasing investments in transactions with various securities in regard to assets and the banks' own funds (Table 2).

Table 1. Indicators of activity of the group of banks under review, %

Indicator	Value	
	01.01.2008	01.01.2014
The share of assets as to the group of banks under review in the assets of banking system	62.4	69.5
The share capital of the group of banks under review in the funds of banking system	60.2	69.8
The share of securities and investments of the group of banks under review in the volume of securities and investments of banking system	70.4	71.7

Source: Compiled by the authors according to the data of the Bank of Russia for the respective years.

Table 2. The ratio between the investments in securities and the capital of commercial banks

Facility	The ratio between the total volume of securities to the capital, %		
	01.01.2008	01.01.2010	01.01.2014
Banking system	79.81	112.53	123.8
UniCredit Bank (IMB)	75.61	39.45	53.51
MDM Bank	62.87	79.99	118.4
Gazprombank	159.41	391.04	227.2
Moscow Industrial Bank	102.70	111.37	107.2
Vneshtorgbank	84.50	84.60	105.6
Alfa-Bank	41.32	112.63	135.8
Sberbank of Russia	75.00	126.83	116.2
VTB 24	60.03	76.43	72.89
Globex	0.92	41.19	225.7
Transcreditbank*	187.46	182.54	Merged with VTB
OJSC Bank "FC Otkrytiye"	178.52	227.67	262.1
Centr-Invest	20.01	59.09	25.73
Rosbank	62.83	67.96	100.5
URALSIB	128.37	208.64	167.2
Citibank	195.45	225.90	132.3
BINbank	168.84	177.84	160.5
TCS bank	0.00	0.00	0.89
Bank of Moscow	133.65	161.90	240.3
OTP Bank (Investsberbank)	124.47	71.30	46.48
Tatfondbank	28.13	30.98	95.72
Bank Zenit	114.50	112.62	131.8
Raiffeisenbank Austria	94.45	84.74	79.72
Deutsche Bank	160.85	192.86	108.0
Rosselkhozbank	43.22	35.30	72.73
Northern Sea Route	37.31	188.88	268.5

Source: Compiled by the authors according to the data of the Bank of Russia for the respective years.

The calculations have shown that the share of securities in the banks' assets increased in 2014, from 11% to 14%, as compared to 2008. In 2008, the ratio between the investments in securities and the capital amounted to 80%, in 2014 the ratio amounted to 123%. Conspicuous is the fact that investments in securities designated primarily for sales and investments have been growing much more rapidly than investments in securities valued at fair value.

In 2008, the rate of capital investments in securities valued at fair value amounted to 52%, and in 2014 the ratio amounted to 28%. While the rate of capital investments in securities designated for sale and the shares amounted to 27% and 96%, respectively. In some banks under review (Moscow Industrial Bank, Citibank, Deutsche Bank), the relative investments in securities have decreased for the over of the study. However, as to the majority of the banks, the situation completely reflects the overall trend.

2.3 Risks of Bank Investment Activities

In order to improve the liquidity or profitable use of assets, commercial banks have actively increased the portfolio of debt securities, thereby increasing the impact on market risks balance (changes in stock market indices, processes in the stock markets). It should be noted that commercial credit institutions are not interested in accounting for their securities transactions, with direct allocation of revaluation financial result to profits and losses. This is to some extent contradictory to international financial reporting standards. Based on the reports of Russian banks, it is difficult to distinguish between the trade portfolio that maintains liquidity and the investment portfolio.

Stimulating investment activity and attracting private investors to capital markets has become especially important in the context of stagnating economy. Universal banks have great potential to address the issues of implementing national-scale government programs for economic advancement due to substantial diversification of activities and the development of their own investment operations. In this case, the regulator must protect insured deposits by way of minimizing the risk of investment activities of commercial banks.

Foreign experience shows that the banks' excessive interest in risky operations with securities and derivative financial instruments during the periods of crisis may lead to the loss of liquidity and to bankruptcy. At present, complex issues of minimizing the impact of crises are being addressed in many countries, including through imposing restrictions on investment operations for classical commercial banks aimed at protecting the basic banking services that constitute the backbone of daily economic operations. For example, the Federal Deposit Insurance Corporation (USA) is developing a model making it possible to fold the operations of sophisticated financial conglomerate by way of dividing it into the holding company with the capital required to deal with insolvency, and the financially reliable subsidiaries that are allowed to continue their operations. This regulation domain is covered by the Dodd Frank Act (USA), the recommendations by the Vickers commission in the UK for the division of banking activities, as well as the reforms proposed in euro-zone by the expert group led by E. Liikanen.

In Russia, this issue is under discussion, whereas the Bank of Russia, expanding the Lombard List and encouraging the operations of commercial banks in the securities market, actually contributes to the formation of "bubble". In case of the market collapse, such as the one that occurred in 1998, the majority of credit institutions will appear completely dependent on the Bank of Russia despite the quality of their risk management. (Burakov, 2014c)

2.4 Universalization or Specialization

It appears that the suggestion as to the separation of the universal banks entitled to carry out active investment activities in the capital market into a group with statutory status is an important contribution to the improvement of their institutional role in the development of Russian economy. At the same time, establishing special supervisory requirements for universal banks and imposing some restrictions upon transactions in the capital markets for classical commercial banks will make it possible to reduce market risks and preserve the concept of small and medium-sized banks in Russia, having deprived them of the right to have a universal status.

The study conducted by a group of economists from London Business School, New Jersey Institute of Technology and the Stern Business School under New York University, presents some feature of interest. The researchers set a task before themselves to investigate the benefits of universalization, diversification and specialization. In the course of the study, which was conducted in regard to 105 Italian banks, it was found out that in most cases universalization contributed neither to the security nor to the profitability of those banks. (Franklin & Grant, 2003)

The conclusion of the group of economists was as follows: the advantages of universalization may occur only in cases when a bank distributes risks in the sectors where it has sufficient expertise, which, in turn, requires significant investments in technology and staff training. Universalization itself gives no guarantee that a bank will reach the best balance between risk and profitability. The researchers came to the conclusion that geographic diversification and branch-based diversification, as well as specialization, can become an important prerequisite for the development of the better part of medium-sized commercial banks.

2.5 Bank Specialization

It appears that a bank may be regarded as a specialized bank, if it is focused on certain banking transactions or market segments, and the level of resources concentration must exceed 50% of its total assets.

At the same time, bank specialization can take place according to certain areas of activities, as well as various levels (types of specialization).

We may distinguish the specialization of financial institutions in accordance with the following lines of activity:

- 1) Functional specialization. For example, investment banks, savings banks, mortgage banks, loan and deposit banks, payment clearing banks;
- 2) Sectoral specialization. With regard to various sectors, we can distinguish construction banks, foreign trade banks, social development banks, industrial banks. It was exactly industry specialization based on which credit institutions in Russia were created in the course of forming the market-based banking system;
- 3) Client-oriented specialization. This type of specialization is focused on a certain segment of credit institution service consumers. For example, banks that operate in the “wholesale” market render services to small and medium-sized businesses, and they are focused on private individuals;
- 4) Territorial specialization. With regard to territory, we can classify local, regional, and international credit institutions.

We may also speak of a bank specialization based on banking operations (lending and deposit operations, clearing and settlement operations, etc.), as well as based on portfolios and sub-portfolios. Thus, a bank specializing in credit and deposit operations (Level 1) can work with corporate clients and/or private individuals (Level 2). Specialization in the segment of corporate lending can have an emphasis on large, medium and small-sized businesses (Level 3), and so on.

The analysis indicates the prevalence of functional specialization in Russia, although there are specializations based on other areas (Table 3).

Table 3. The best known Russian specialized banks

Name	Specialization	Notes
OJSC “Rosselkhozbank”	Sectoral	80.7%—the share of AIC loans
BCS	Functional	over 50% of assets—investments in securities, focus on universalization;
CB “MIA”	Functional	Regional Representative of OJSC “HMLA” in the Moscow region, 100% of the shares owned by the Moscow City Property Department
VTB 24	Client-oriented	All-inclusive services for individuals, included in the VTB group
JSB “GPB-ipoteka”	Functional	Specialized mortgage bank of Gazprombank Group
MSP-bank	Client-oriented	Support of small and medium businesses, VEB group
CBDeltaCredit	Functional	Mortgage bank of Société Générale Group
Russian Standard Bank	Client-oriented	Specialization in retailing
NB Trust	Client-oriented	Investment Bank that adopted the strategy of retail area development
National Clearing Centre	Functional	Functions of a clearing organization and a central counterparty in financial market; included into the “Moscow stock exchange Group”
Tinkoff Credit Systems	Client-oriented	Internet bank for natural persons
Toyota Bank	Functional	Specialization in automobile lending; included into Toyota Financial Services Corporation (Japan)
Chelyabinvestbank	Territorial	The largest bank in the Southern Urals
Volkswagen Bank RUS	Functional	Specialization in automobile lending; included into the international group

		Volkswagen Financial Services AG
Mercedes-Benz Bank Rus	Functional	Specialization in automobile lending; included into the international concern “Daimler”
BMWBank	Functional	Specialization in automobile lending; included into BMW Group
BankOrenburg	Territorial	The main shareholder—the Orenburg region
Housing Finance Bank	Functional	Specialization in mortgage lending
NovosibirskMunicipal Bank	Territorial	Included into the group “FC Otkrytiye”
Stavropolpromstroybank	Territorial	
Ural Interregional Bank	Territorial	
Kamchatkomagroprombank	Territorial	

The analysis as to the development of specialized banks in Russia leads to the following conclusions:

In Russia, there exists the pronounced tendency to diversify the business of the banks that were created in the course of banking system formation as specialized credit institutions for rendering preferential services to certain industries. In all likelihood, this is due to a number of reasons: first, due to the complicated state of the respective sectors of economy; second, due to the desire of banks to minimize risks by diversifying their operations; and, finally, due to the desire to occupy new niches that provide significant increase in business. It should be mentioned that this tendency has also affected government-owned banks.

2.6 Modern Specialization of Banks in Russia

Specialized banks currently operating in Russia can be conditionally divided into two main groups:

- Banks with various levels of state participation (the Russian Federation, the subjects of the Russian Federation) created for the purpose of implementing certain economic development programs;
- Private commercial banks that choose the specialization as business strategy, often in conditions suggesting good prospects for the development of certain market segments.

The most important banks included into the first group are as follows: OJSC “Rosselkhozbank”, CB “MIA”, CJSC NSP-Bank, CJSC JSCB “National Clearing Centre”. The second group is represented by the banks, the strategy of which is working with individuals in the context of significant market capacity. Those banks include, for example, Russian Standard Bank, Tinkoff Credit Systems, CB Delta Credit, Housing Finance Bank, and others. In this case, specialization may be both “client-oriented” and functional. The first two of the above-mentioned banks have client-oriented specialization, the other two banks have functional specialization, since they specialize in mortgage lending and work with natural persons and legal entities.

The analysis of the financial results of the banks under review for 2013 confirms that the banks that have found their niche within the specialization show positive results (Table 4).

Table 4. Development dynamics and financial results of specialized banks under review

Bank	Assets, mln. rubles. 01.01.2013	Assets, mln. rubles. 01.01.2014	Net profit in 2013, mln. rubles.	Profitability of assets in 2013, %
VTB 24	2 029,498	1 472,036	20,729	1.2
OJSC “Rosselkhozbank”	1 816,269	1 577,886	1,018	0.06
National Clearing Centre	319,623	212,137	6,357	2.39
Russian Standard Bank	368,784	288,473	2,246	0.68
NB Trust	195,036	171,713	1,035	0.56
MSP-Bank	127,403	113,349	281	0.23

CB Delta Credit	98,790	79,690	2,350	2.63
Tinkoff Credit Systems	105,181	72,863	4,250	4.77
Toyota Bank	514,63	40,445	728	1.58
Chelyabinvest Bank	35,759	33,242	556	1.61
Volkswagen Bank RUS	29,974	18,192	1,966	8.16
BMW Bank	22,922	22,294	702	3.11
BCS	22,258	17,257	143	0.72
JSB “GPB-ipoteka”	17,448	21,782	374	1.91
Bank Orenburg	10,682	9,164	44	0.44
Housing Finance Bank	10,256	7,772	9,1	0.1
Novosibirsk Municipal Bank	8,495	7,982	241	2.93
Kamchatkomagroprom Bank	3,603	3,481	63	1.78
CB “MIA”	16,315	12,121	446	3.14
Mercedes-Benz Bank Rus	21,076	16,258	373	2.00
Stavropolpromstroy Bank	7,318	6,629	64	0.92
Ural Interregional Bank	6,125	2,925	103	2.28

Creating the banks to be included into the holdings that represented the leading foreign automobile concerns has become relatively new practice in Russia since mid-2000s. The rapid development of these banks (LLC “BMW Bank”, Mercedes-Benz Bank Rus, Volkswagen Bank RUS, etc.), and their performance indicators are determined by the use of the benefits that provide the status of a captive bank. With that, it can be assumed that in the context of the sanctions imposed by the Eurozone countries, the development of those banks will not be as active as a result of the decrease in consumer demand for vehicles on the part of Russian citizens.

There remained few independent banks in Russia that would declare investment activity as their specialization. Previously, the largest investment banks, such as KIT Finance Investment Bank, National BankTrust, BCS—Investment Bank, gave up on specialization or changed it. Nowadays, banks usually carry out investment business within the framework of Universal Credit Organization.

Finally, we need to mention the fact as to the existence and successful development of some banks within territorial specialization, the so-called local banks. A number of banks that have been established and operate in the regions, both government-owned and private ones, proved to be effective.

3. Territorial Bank Specialization

The analysis of the data from Russian banking sector indicates extremely uneven distribution of credit institutions within the territory of Russia and, therefore, the assets are under control and the resources are involved. Quantitative analysis confirms unessential share (in terms of volume indicators) of small and medium-sized local banks in Russian banking sector. Nearly 500 of the smallest banks control less than 1% of banking sector assets. (Bank of Russia).

Quite the opposite, local banks abroad play an important role in the economic development of many countries, according to research data. (FDIC, 2014) For example, in the USA, their significant role in the promoting loan products within the country’s territory has been recognized. In the USA, local banks have nearly a third of small commercial and industrial loans and nearly 40% of small loans in real estate area. Local banks play a major role in lending to farmers. The advantage of such banks is manifested in the so-called lending to borrowers who have no credit history and, therefore, do not meet the scoring assessment criteria and the requirements of credit risk assessment models used by major commercial banks.

The studies carried out by economists show that local banks with a more flexible approach to collection and evaluation of data have comparative advantage in the provision of loans to borrowers who are obscure in terms of information, and these advantages help them to review and monitor loans granted to small businesses. In addition, those banks have even greater risk-adjusted income on loans than major credit institutions. Local banks provide

greater volume of proportional involvement of deposits for fund assets, which has been positively assessed in terms of operations funding quality.

The third major effect of local banks' role consists in the type of interaction with customers. Despite the appearance of new technologies, many customers prefer personal contact with manager. Many banks are of the opinion that rendering personal services represent their most distinct competitive advantage making it possible to retain customer base.

However, local banks also have also weak points, including the following: low level of own capital that restrains the development, lack of access to international capital markets, often non-diversified loan portfolio, low effective demand for loan products from local businesses and natural persons. If Government recognizes the practicability for the economy as to the existence of such financial institutions, then there is definitely the need for programs in their support. For example, there are community development financial institutions (CDFIs) functioning in the United States that are supported by the Ministry of Finance and implement various development programs in interaction with local banks. This interaction is actively supported by the Federal Deposit Insurance Corporation.

Thus, specialized banks in general have a number of advantages, the main ones being as follows: concentration of resources on the development of certain type of operations, highly qualified staff in the respective area, good knowledge of the market, which is necessary for the successful business. At the same time, specialization involves substantial dependence of the results of the banking operations on the situation in a particular industry, or segment of the market. That is why the risk of specialized banks to a large extent is determined by high concentration due to non-diversified business.

4. Conclusion

The need for universalization is explained by the high level of competition in the banking market, the tendency for the consolidation of banks. However, the strategy to focusing on individual transactions may also be successful; it depends, inter alia, on the potential of a certain credit institution.

The analysis of the experience of some countries shows the advisability of classifying universal and specialized banks for the purpose of more effective implementation of core banking functions and differentiation of banking supervision. Specialized banks, despite some advantages as to the possibility to carry out business, bear the risk related to the operations concentration level. In this regard, bank specialization, in our opinion, should be taken into account in the calculation of regulatory requirements with regard to capital (capital adequacy indicator) as the increased risk factor, with the subsequent introduction of the respective amendments in the regulatory requirements of the Bank of Russia.

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Note

Note 1. Related diversification means expansion of the core business scope, or penetration into other area related to the main activity. The first case is a related horizontal diversification type; the second case is a related vertical diversification type. Unrelated diversification means penetration into new areas of activity that have no apparent connection to the core business.

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