ABSTRACT

A successful implementation of an overall reform program will enable Georgian banks to provide intermediation and assist in the country's development from a weak market economy to a mature financial system. The changes for reform are better now than at any time during the last decade. Favorable economic and political conditions and changes in attitude among bank management have created an usual opportunities for development and growth.

This study attempts to analyze the effects of financial liberalization and deregulation on competitive conditions and foreign investment in the banking industry of Georgia economies, using firm-level data for the period 1999- 2010. Later sample year is divided into two and three main subseries before and after rose revolution to see effect of economic and financial reforms in different periods. The basis for the evaluation of competitive situation is the extant oligopoly theory in the new industrial organization literature, specifically, the competition model developed by Rosse and Panzar (1977), and Panzar and Rosse (1982, 1987). I used reduces revenue equation and 3-input factors PL(unit cost of labor), PK (unit cost of capital) and PF (unit cost of fund). This approach relies on the premise that, in their long-run equilibrium, banks will employ different pricing strategies in response to a change in input costs depending on the market structure in which they operate.

The results of the competition analysis suggest that the banking markets in Georgia cannot be characterized by the bipolar cases of either perfect competition or monopoly over 1999-2010 but finding results are very near to monopoly competition. That is, banks earned their revenues as if operating under conditions of monopolistic competition in sample period. Just after rose revolution competition (PR H Statistic) is increased and reached to norms of development countries. Finally, the cross sectional analysis of competitive structure shows initially a decreasing trend between 1999 and 2003 and a subsequent increasing trend in competitive conditions after 2003-2006 then after again decreasing trends in the period of 2006-2010.

There is a growing interest in the impact of foreign banking on the financial system and the economic development of emerging and transition countries (Claessens et al. 2001; Iakova and Wagner 2001; Mathieson and Roldos 2001). During the past decade, many former communist countries have made substantial progress in the transition from a centrally planned economy to a market-based economy. In recent years, progress has been particularly significant in restructuring and consolidating the banking sector. Most of banks in Georgian are being controlled by foreign banks. Foreign capital investment reached to 90 % in 2009 and control 15 banks in the sector,

thereby indicating the effects of foreign investment in banking sector became important issue to enhance economic growth in the country. Therefore, the second essay in the research is the effects of foreign investment on Georgian banking sector. I estimate empirically the effects of foreign banks entry on domestic bank performance in the Georgian banking sector. A sample of banks from 1999 to 2009 is used in the analysis. The annual data is used in the following subgroups: bank-level accounting data, foreign banks entry data, the country's specific variables and the banking market development data. First, I use two variables measuring the income of banks: net interest margin (NIM) and non-interest income to total assets (OOITA). Second, a bank's profitability is characterized by the ratio of its before-tax profits to total assets (PTPTA). Third, a bank's costs are measured by two variables: overhead costs to total assets (OHTA) and loan loss provisions to total assets (LLPTA). These variables are calculated on the basis of the bank's income statement and balance sheet. I also present the econometric analysis of the economic effect of foreign bank presence on Georgian banks in different way as well. Here, I specifically determine which effect dominate – whether spillovers that could lead to the increase in the profitability and reduction in the overhead costs of banks in Georgia or competition effects that could lead both to the reduction in the profitability and overhead costs of domestic banks.

Lastly, I establish an empirical model which is suitable to study the effects of foreign bank penetration on banking competition in Georgian banking market. To this end, I estimate the foreign bank penetration and domestic banking market competition link equation. The determinants of banking market competition are categorized in three groups: (1) market structure in the banking industry; (2) bank-specific factors; (3) macroeconomic environment factors.

Our results indicated that foreign banks entry is associated with lower before tax profits, non-interest income, average loan interest rate and loan loss provisions. I also found evidence that foreign entry reduces a bank’s overhead costs in the short run. The results generally suggest that foreign bank entry enhances competition in the market. Empirical results determine that foreign penetration impact on banking system in Georgia through competition effect. Increase in market share of foreign investment and mere number of foreign banks reduce the profitability and cause reduction in overhead costs. Competition of banking in Georgia over all sample periods determines monopolistic competition structure. Market structure indicators indicate that concentration in banking assets, loan and deposit especially increased in the period of 2006-2010.Results are consistent with previous studies, increase in concentration (indicators of HHI and CR_k) impair the competitiveness of banking sector during the periods.