

**Comparative Research Project  
on Credit Card Markets  
in Transition Countries**



**The Bulgarian credit card market**

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**A draft version**

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# 1 Introduction

Suggestions on quotes:

**” In two years it will be like in Turkey, everybody in Bulgaria will have a credit card”<sup>1</sup>**

**“Come to see us in six months, everything will be far more advanced”**

**“If we start using credit scoring on cards, we will have to stop issuing them”**

Following the optimistic citation in the beginning of this chapter, one would expect to read a success story for the development of credit cards in Bulgaria. This impression however is far from being even close to the truth, the establishing of new bank services were certainly not a priority for a slowly and unevenly transforming economy as Bulgaria. In fact, there were some insuperable obstacles which have impeded the development of consumer lending and bank cards until recently. In fact, the real credit cards in Bulgaria were launched as late as 2001-2002. Prior to that, banks did not have a strategy for issuing credit card, they looked at them as a as part of the whole package they offered to corporate clients and their managers.

At different times, various factors impeded or facilitated the creation of this new product. In the early years of transition, the political and economic instability, the lack of adequate legislation and the unstable banking system were the major obstacles for the development of the credit card market. In the aftermath of the crisis, it was the restructuring of banks and their preferences for holding less risky assets as foreign deposits and corporate loans that delayed the start of this market. Households also needed some time to overcome the devastating effects of the banking crisis of 1996-1997 and regain their trust in banks. Since 2001 - 2002, the steadily growing economy and income, the prospects for EU Accession and mostly the role of foreign capital have had strong positive influence on the development of the credit card market. Both strategies, relational and mass retailing was used by the different banks and the newly established non-bank credit card issuers. The banks, which were traditionally strong in both consumer credit and card markets, were among the pioneers on the credit card market. The strong concentration of the consumer market, however, proved to be a major obstacle for information sharing among banks. The lack of sufficient information and relatively low volume of cards issued could serve as explanation why the majority of screening methods were rules based, and only one bank applied credit scoring. And yet, the credit card market in Bulgaria is certainly one of high growth potential with domestic cards taken over the international ones.

The first section of this chapter is analyzing the set of conditions was needed for creating a favourable environment for the emergence of the credit market. Next, we will focus on the main players - banks and households and see how they responded to these factors and when they were ready to embrace the idea for entering this market. Taking into consideration the hybrid nature of credit cards, we will discuss two bank activities – consumer lending and card issuing. The third section will analyze a specific feature of this market, which ensures its sustainable development and requires interaction between all actors – information sharing. Next, we will focus on the peculiarities of the credit card market in Bulgaria, and will try to relate its development to current practises.

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<sup>1</sup> All quotes are from the interviews with bank officials

## 2 Environment for the emergence of the credit card market in Bulgaria

### 2.1 Macroeconomic environment

The macroeconomic environment has strong influence on all actors of the credit card market; it affects the credit activity of banks, and determines households' income and their ability to repay credit. There is a strong correlation between macroeconomic fundamentals and the future expectations of all economic agents, which to great extent determines their spending and saving preferences. Last but not least, economic instability triggers uncertainty, which serves as a serious obstacle to financial intermediation.

Following these arguments, it is not difficult to see why consumer credit could not have developed in the early years of transition (1991-1997). This period was marked with considerable worsening of the macroeconomic fundamentals. Aggregate demand and savings shrunk, industrial output also decreased radically, resulting in massive layoffs<sup>2</sup>. The GDP in purchasing power parity decreased significantly in all years but 1995. The shrinking of real wages was even more significant - with more than 50% just for one year. According to World bank Statistics in 1992 around 4% of the population lived with less than 2\$ per day. In the period 1995- 1997, this percent increased by more than three times and was in the range 13% - 17% of the population. The political and economic instability together with the problems in the banking system finally escalated in the severe financial crisis of 1996-1997. The national currency collapsed, boosting an unforeseen hyperinflation. Real wages fell by more than three times, putting a halt for the demand of bank credit. Indeed, in 1995, the share of credit to households was only around 1% of GDP and shrank to 0.5% during the crisis to follow.

The period of economic distress ended by the establishment of the Currency Board Arrangements (CBA) in July 1997 when the Bulgarian national currency was irrevocably fixed to the Deutsche mark (since 1999 to the Euro). What happened to the economy afterwards was considerably different from the past experience as we can see on figure 1. GDP grew for 8 subsequent years; inflation was far below 10%<sup>3</sup>. low since the introduction of the Currency Board Arrangements. Unemployment decreased considerably –from 17.9 in 2000 to 12.2 in 2004. The real wages grew steadily and so did real household expenditure, in some years with rates higher than the GDP growth rate.

**Figure 1. Macroeconomic fundamentals**

Macroeconomic indicators (1991-2004)														
	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Real GDP growth in %	-6.9	-7.3	-1.5	1.8	2.9	-9.4	-5.6	4.0	2.3	5.4	4.1	4.8	4.5	5.7
Gross domestic product based on purchasing-power-parity (PPP) per capita	6,665	6,311	5,752	5,684	5,731	5,398	5,209	5,515	5,758	6,229	6,762	7,370	7,871	8,500
Real growth in GDP at PPP per capita	-6.7	-5.3	-8.9	-1.2	0.8	-5.8	-3.5	5.9	4.4	8.2	8.6	9.0	6.8	8.0
Inflation in %	333.5	82.0	72.8	96.0	62.1	123.0	1,061	18.8	2.6	10.4	7.5	5.8	2.3	6.1
Real growth in % in real wages	-48.4	-0.1	-9.2	-20.0	-8.0	-11.9	-21.7	14.5	6.9	1.3	-0.5	1.4	3.7	3.0
Household expenditure as a share in GDP		53.9	65.3	73.2	73.8	70.3	74.2	72.6	67.2	70.9	68.8	69.0	68.3	68.3
Real growth in household expenditure		1.0	-0.7	-2.6	-0.6	-3.8	-10.6	2.8	9.6	4.3	5.2	3.6	6.3	5.5
Unemployment	11.1	15.2	16.4	12.8	11.1	12.5	13.7	12.2	16.0	17.9	17.3	16.3	13.5	12.2

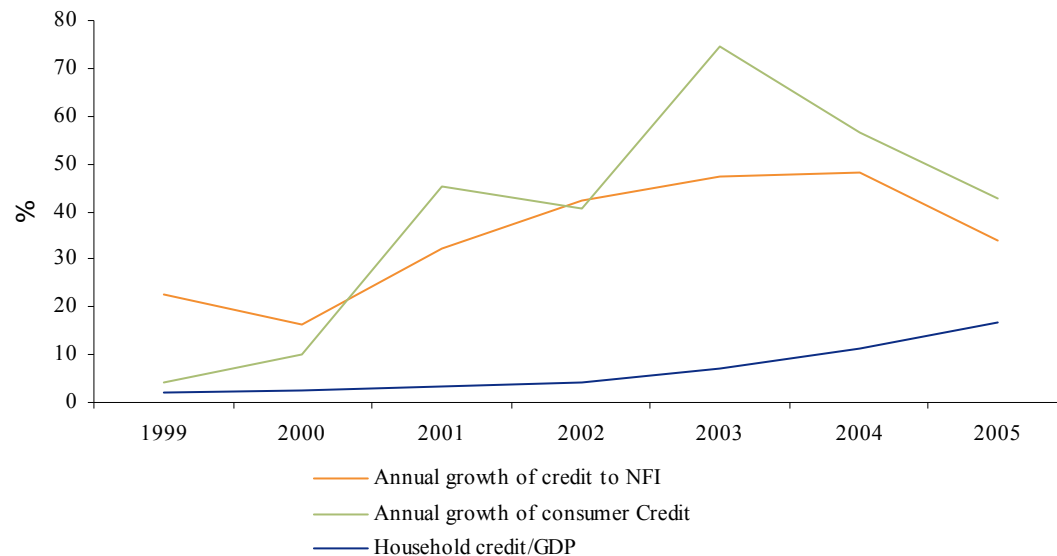
<sup>2</sup> For a comprehensive study of the Bulgarian transition process see Nikolov, B, N.Markov, N.Dochev, D.Dimitroev, R. Kolarova and R.Dobrinsky (draft, October 2004)

<sup>3</sup> With the exception of 2000, when it reached 11.3%

Source: NSI, World bank (GNI) and IMF (on GDP at PPP)

The stable macroeconomic and political environment and the elimination of the currency risk led to high rates of foreign investment. A strong inflow of capital was observed in the banking system after 2002 as domestic lending became more profitable due to the low international rates and the much higher domestic lending interest rates.

**Figure 2. Growth rates of lending to NFI<sup>4</sup> and household credit**



Source:BNB

## 2.2 The Bulgarian financial system

The overall state of the banking system determines to great extent the strategies of the banks as actors on the consumer credit or the card issuing market. Without the proper functioning and restructuring of the financial systems it is hard to imagine any opportunity for the creation of the credit card market.

### 2.2.1 The malfunctioning of the banking system and the bank crisis

As in communism, the banking system in Bulgaria in the early years of transition was far away from performing one of the main functions of financial intermediaries – efficient allocation of resources. Burdened with inherited from communism huge corporate debt, the banking system in Bulgaria soon became too fragmented and helpless, lacking any lending experience (see Miller and Petranov (2001)). So, state owned banks simply continued to finance the loss-making state owned enterprises, strongly encouraged by the government. The private banks, which entered the market as early as 1991 also lacked the needed know-how and were more or less created as vehicles for siphoning money by their managers and shareholders. As a result, the credit portfolio of both private and state owned banks was expanding quite fast, but the share of non-performing loans was growing even faster. In 1995 the percent of performing loans was only 25.9%. While credit rocketed and reached levels, higher than the observed in any other of the transition economies

<sup>4</sup> Credit to NFI includes credit to state owned companies, corporate lending and household lending

(OECD report (1999)), consumer credit remained rather unexplored and banks were seeing in household only a source of deposits(see Miller and Petranov (2001 ))

After the banking sector was merely devastated during the crisis of 1996-1997, with one third of the banks going bankrupt, finally the long-awaited restructuring and privatization took place with the active participation of the government.

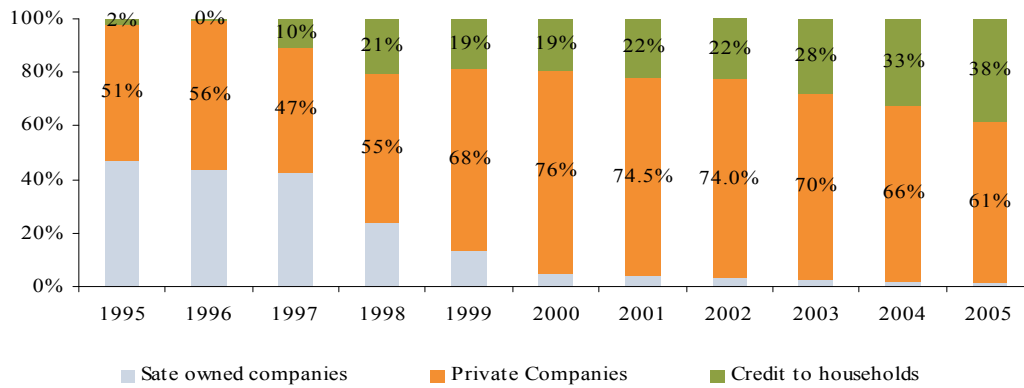
### *2.2.2 Restructuring and privatization*

Three were the main processes going on in the post-crisis period, which delayed the emergence of the credit card market until 2001-2002. These were the privatization and restructuring of the banking sector, the changes in their assets structure towards holding foreign deposits and the shift in their domestic credit portfolio towards corporate credit.

Privatization began with the selling of UBB (United Bulgarian Bank) and not surprisingly this bank was one of the pioneers in offering new banking services and credit cards in particular. In the period 1999-2001, four more banks were privatized, including the giant Bulbank. In the next two years, privatization was basically completed. DSK, the biggest bank in terms of consumer credit was sold last, in 2003 to OTP Group. This delay have certainly impeded the early start of the credit cards market, as it would be easiest for the bank with the most numerable history records on consumer credit to launch this new project. But on the other hand, the late privatization of DSK gave comparative advantage for other banks to enter the consumer market and this increased to great extent competition.

In this period of restructuring, the banks were still not ready to act as an efficient financial intermediary or perhaps they were waiting for the real sector to recover. They made a considerable improvement in terms of soundness and prudence: their liquidity and capital adequacy ratios were higher than required, the ratio of performing loans increased from 58.2% to 92.3%. But the return on equity was constantly falling (from 22% in 1998 to 19% in 2001), indicating that banks prefer to invest in less profitable deposits abroad than invest in domestic credit. Indeed the net foreign assets of commercial banks in that period were constantly growing- from BGN 2.2 billion in 1998 to BGN 3.9 billion in 2001. While the preferences of banks in favor of foreign versus domestic assets have certainly affected consumer credit, probably stronger was the influence of the changes in banks domestic credit portfolio. Lending to state owned enterprises in 1997 decreased radically and these sources were reallocated to both corporate lending and household lending. In the years to follow, the focus of banks was more on corporate credit and household loans credit fell from 21% in 1998 to 19% in 2000. This affiliation towards corporate clients could be easily explained by the fact that the new foreign owners of the companies were devoted to serve the foreign companies, investing in Bulgaria in the period. This type of relationship banking, for the subsidiaries to work with the same companies their mother companies work in the country of origin, was typical in all transition economies. As international companies were supposed to get the same quality and range of services from the subsidiaries as from the mother banks, domestic banks started to issue credit cards for their top managers in Bulgaria.

**Figure 3. Structure of the credit portfolio of banks (credit to non-financial companies and households)**

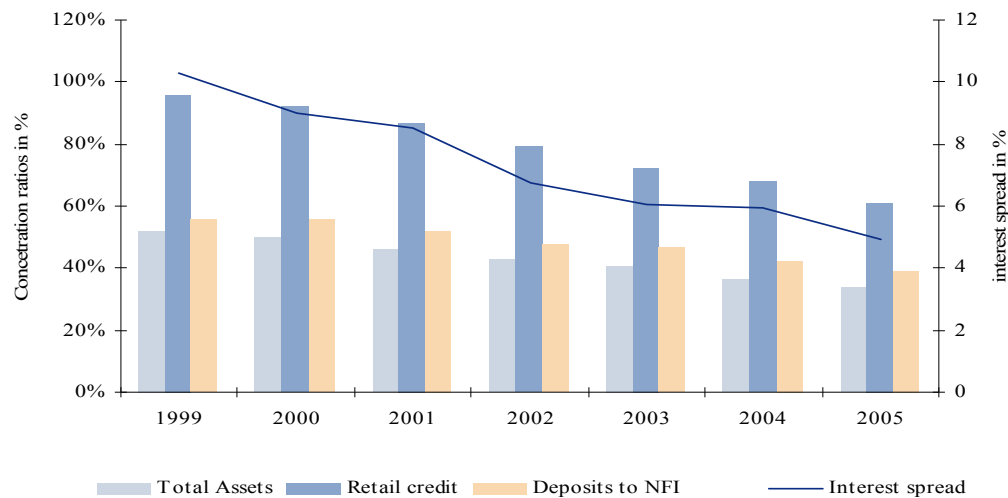


Source: BNB

### 2.2.3 Credit expansion

The restructuring and privatisation of banks, which took place in the pre-crisis period, was a solid ground for fostering consumer credit and credit cards in particular in the period after 2001. Banks had more or less the needed know-how, sufficient finances from abroad, and they have already gained their market share in corporate lending. In that period, there was a shift in banks credit portfolio towards consumer lending in search of higher profitability. In addition, household lending became more attractive to banks as the wealth of households increased, triggered by the high growth in real estate prices. As a result, the share of corporate lending decreased from 74.5% to 61% in the period 2001-2005 and consumer loans reached 20% of credit to non-financial institutions. Competition in the market became much more intense as can be seen from Figure 4. Interest rate on consumer loans were decreased significantly thus reducing adverse selection problems and increasing household access to all bank credit services.

Figure 4. Concentration ratios and interest rate spread<sup>5</sup>



Source: BNB

It is difficult to imagine the emergence of the credit cards without the enhanced competition, the strategic interest in consumer markets, the access to more financial resources and foreign know-how. All these factors explain why banks started to explore this market, but they do not provide the answer how. To great extent this answer is incorporated in the banks-firm relationships. In Bulgaria there was “a mono bank corporate culture”<sup>6</sup>- most companies preferred to be serviced only by one bank. In this way, banks had a pool of potential retail clients, which included all the employees of their corporate client. By having assessed the company’s potential for growth and stability, banks have already decreased to great extent the uncertainty when assessing individual creditworthiness. Thus a natural way of further exploring the bank- firm relationship was to expand its credit services to its employees. As mentioned before, banks first started issuing credit cards for the top managers of their VIP corporate clients. Soon, they began offering overdrafts on debit cards to all employees. If individuals were able to repay these overdrafts they were offered all other types of consumer credit, including credit cards.

A completely different approach was followed by some banks and namely the non-bank credit cards companies, established in 2002- 2003. They were ready to give credit card to everybody, but with very low credit limit, and later upgrade the credit card terms once the credit is repaid. This both relational and mass retailing was present in Bulgaria in the outset of the credit card market.

### 2.3 Legal framework and institutions

In the early period of transition, the legal and intuitional framework rather triggered than prevented the collapse of the banking system. The Law on the Bulgarian National Bank (1990) and the Law on Banks and Credit Activity (1992) allowed for the establishment of a poorly regulated and strongly fragmented banking sector. There were no legal procedures for bank bankruptcy, no legal restrictions on extending non-collateralized loans or credit to related individuals and firms, no requirements for the origin of the initial capital.

<sup>5</sup> Concentration ratios show the market share of the first three banks. The interest spread is the difference between short term interest rates on credit and deposits it NFI

<sup>6</sup> As mentioned during the interviews



The establishment of CBA put an end to the practices of the government to finance the loss-making state enterprises through the banking system. In addition, BNB was no longer able to refinance the banks and perform its function of lender of last resort unless there was a systematic risk for the banking system. Furthermore, the new Law on Banks imposed much stricter requirements for the initial capital, capital adequacy, liquidity, accounting, auditing and reporting activity as well as supervision from BNB. Credits to shareholders, bank managers, officials and related firms and individuals are prudentially regulated. In 1998, a Central Credit Register was established by BNB. Initially, it covered only sizeable loans, which practically excluded the whole segment of consumer credit. In 2004, some very important amendments were made in the Law on the Central Credit Register, which certainly decreased to great extent in the asymmetric information in the consumer market.

An important step towards regaining people's confidence in banks was the introduction of the deposit guarantee fund in 1998, ensuring the deposits of citizens in all banks not exceeding 15 000 levs (around 7500 Euro).

Apart from the banks-households paradigm, there was another regulatory change, which had a strong positive, though not straightforward effect on consumer credit. It was the adoption of the Foreign Exchange Law in January 2000, which fully liberalized capital inflows.

The advances in the legal and institutional framework in Bulgaria at that period had a strong impact on the size of the shadow economy. The grey economy creates lot of difficulties in bank intermediation as the real creditworthiness of the applicant for credit is impossible to access and verify. In the early period a lot of the companies in the services and the trade sector were on the shadow, and were certainly not ready to exposing their real turnover by installing POS. In this period, the share of shadow economy finally began to decrease and fell from 34.4% in 1996 to 22 in 1999 (See Kyle et al (2001)).

Not all recent changes in the legal and institutional framework in Bulgaria have a positive influence on the development of the credit cards market. Concerned with the high growth of banks credit portfolios, in 2004 and 2005 BNB, advised by IMF introduced some restrictive measures, targeting cooling down of the credit expansion. The results from these measures were felt in 2005, with the growth of credit slowing down. So far, corporate credit seems to be more affected from these sanctions, and it is not likely that the growth of the credit card market will be seriously affected by these measures. This regulation, however, provides comparative advantage to the non-bank credit issuers, who can expand their portfolio without being subject to any restrictions.

## **2.4 The political environment**

Again the same borderline is present in the government's role of the development of the credit card market. The unstable political environment in the early period of transition was a prerequisite for the deepening of the external debt problems and for unreasonable postponing of the privatization process. There was no fiscal discipline and the government kept financing the loss-making state owned enterprises through loans, extended by the state-owned banks. The government feared to limit the credit to the loss-making enterprises as this could provoke too much economic and political turbulence. The government further contributed to the collapse of the banking system by its protectionist policy limiting the foreign access to the Bulgarian banking sector until the outset of the crisis.

After the democratic government of Mr.Kostov was elected in 1997, there was political will to undertake the needed structural reforms. Since then, the role of the government was one of strong support for sustaining the economic growth of the country. Moreover, Bulgaria made considerable progress in its negotiations towards EU entry. In 2001, visas to the European area, defined by the Shengen treaty were abolished and Bulgarian could finally travel abroad freely. In 2004, the

accession treaty was signed and Bulgaria is expected to join EU in 2007. The Bulgarian progress toward joining EU is certainly one of the most powerful factors behind the improvement of the expectations in all economic agents. With the more intense trade integration between Bulgaria and the EU, there is also more human mobility and Bulgarians, who often travel abroad, began to feel what advantages a credit card offers.

Besides the many positive effects of the current political environment, the modernization of payment processes in the budget organizations has played a negative role in respect to people's attitude towards cards. In the process of the restructuring of public finance, the salaries of all state employees were transferred in debit cards accounts. This massive swift toward debit cards, was somehow not very welcomed by some of the employees, who felt as they are forced to use debit cards. They viewed the withdrawal fees as deduction of the salaries and this tried to withdraw all money at once without using the debit card further during the month

## 2.5 The role of foreign capital

Foreign capital has certainly played a major role in the creation of the credit card market in Bulgaria. Its influence spread on all actors in the credit card market, including banks, non-bank card issuers, the collection company and the credit bureau, and last but not least, on households. Foreign investors insured both the financial resources and the know-how for issuing credit cards, and through the modern retail chains they changed the consumer habits of Bulgarians.

As could be expected, the role of foreign capital in the early period of transition was quite limited both because of the delay in privatisation and the high country specific risk associated with worsening of the macroeconomic fundamentals in Bulgaria. In respect to the banking sector, the protectionist policy of the government also delayed foreign entry and the first banks to enter the Bulgarian banking sector were the Greek Xios Bank and ING Bank in 1994. Few more banks came in 1995. These foreign branches specialised in a narrow range of activities, namely international settlements (see Miller and Petranov (2001)). Thus, their influence on consumer credit was very limited. It was not until 2000, when foreign banks began to play a major role in the Bulgarian banking sector. While the share of foreign banks in terms of total assets in 1999 was only 28.4%, in 2001 it reached 70.6%. Foreign banks soon began to apply their experience and know-how in the restructuring of the privatized banks and the establishing of efficient lending procedures. Moreover, after assessing the potential of the domestic market, they began to redirect lots of resources for lending activities in Bulgaria.

Foreign influence spread not only to the banks but to the non-bank credit issuers. Bulgarian Retail Services, the issuer of euroline credit cards, was established by the Greek company Eurobank Cards S.A. Transcard, the other entity issuing non-bank credit cards was launched as a Bulgarian company but in 2005 it established partnership with the international card issuer JCB and began to offer the first chip cards on the market with the cooperation of JCB. Foreign experience was also used to establish the first collection bureau in Bulgaria, owned by a Greek company Europe Matrix with experience in the South Europe region. Furthermore, the first private credit bureau in Bulgaria was foreign-owned a subsidiary of well known Experian Scorex.

Apart from the huge role foreign capital played in triggering the supply of credit, it affected seriously demand through the financial wealth and the preferences of the households. The high level of FDI was one of the factors behind the increase of the level of salaries, both in the privatised and the competitive Bulgarian companies. Foreign capital gave rise to consumerism by the entry of foreign supermarkets and chain stores. Until 2001, many such chains as the German chain Metro and the Austrian Billa, Greek Ena, the Turkish Ramstore, entered the Bulgarian market. As a result, the share in modern retail shops increased from 5% in 1998 to 23% in 2002(see Dreis et al (2004)).

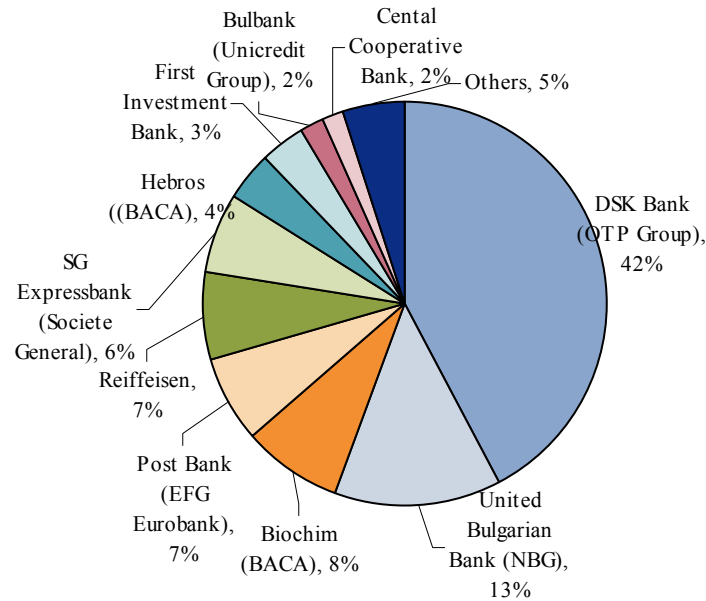
### 3 Main players

#### 3.1 Players on the consumer credit market

As we have mentioned in the last section the market in terms of retail credit and especially consumer credit has been traditionally more concentrated than the market in terms of deposits of non financial institutions<sup>7</sup>. The top ten banks in consumer lending hold 95% of the loans, and among them, there are only two local banks. (First Investment Bank and Central Cooperative Bank with market shares of 3% and 2%, respectively).

Ever since the end of communist times, DSK has been the leader on the household credit market. Sociological surveys<sup>8</sup> have shown that it remained the most trustworthy among all banks even after the banking crisis. Perhaps the reason behind this high rating of DSK is that during early years of transition it had a special status of a savings institution and was not burdened with bad debt. Until 1999, DSK was the one of the few banks to provide household credit and its market share was as high as 92%. The delay in the restructuring of the bank showed in practise how important was privatisation for household as the bank lost half of its market. At the end of 2003, its market share was only 47%. However, the market share in consumer credit of DSK in 2005 exceeded the aggregate shares of the next four banks.

**Figure 5. Market shares of the top ten banks in consumer banking at the end of 2005**



Source: BNB

<sup>7</sup> There is no information available for the consumer deposits market, only the aggregate numbers for deposits of non-financial institutions

<sup>8</sup> See GFK (2000) and Alpha Research(2002)

## 3.2 Players and trends on the card market

### 3.2.1 *Early developments in the card market in Bulgaria*

The first attempts to introduce bank cards in Bulgaria started as early as 1992, with two banks issuing debit cards with magnetic chip and one bank being quite forward looking to offer smart cards. All three banks operated independent networks, but their initiative was rather short lasting as all three banks went bankrupt in the period 1996-1997. Along with these early attempts the Bulgarian National Bank recognized the need for establishing a unified system for card payments and this is how Borica Ltd. (100% owned by BNB) was created in 1995. Initially, primarily state-owned banks joined the system and UBB was one of the first to join (see Bojinov (2002)). By issuing the first regulation "Payments Initiated by Bank Cards" in 1995, BNB secured Borica a monopoly position in card payments authorization. For a certain period, the advantages of having one operator, one clearing house, one system of POS and ATM terminals were notable. Many banks were still in a poor financial condition so they could lend the ATM and POS terminals from Borica. Within the period 1996-1998, Borica joined the networks of MasterCard, Visa and American Express and thus all domestic and international card were compatible with the existing ATM and POS network. Neither this advantage, nor the introduction of the first e-pay system, where Borica cards could be used, however were not sufficient to popularize the usage of debit cards and in 1999, there were less than 300 ATMs and less than 500 POS terminals, most of them concentrated in Sofia in the bank offices and less than 300,000 card issued.

Since 2002, debit card in Bulgaria are growing quite rapidly, with an average annual growth of more than 60% for the period 2000-2005. This growth is actually even higher as two more independent networks were established in 2002 and 2003 - transcard and euroline networks of POS terminals, respectively. Three more banks also left Borica system, among the two biggest card issuers (UBB and DSK).

### 3.2.2 *Leaders on the card issuing market*

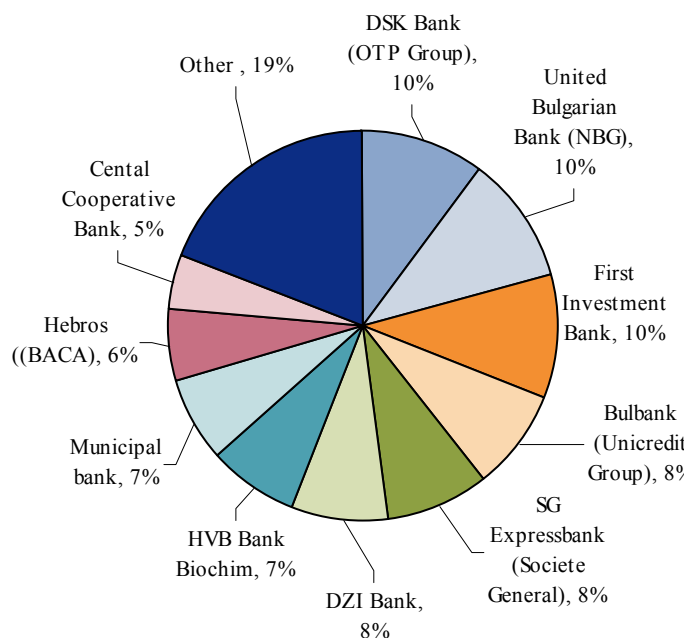
#### ■ Banks

There is not official statistics which shows how many cards (debit and credit) were issued by each banks. The fact, that some banks as UBB, DSK, DZI have created their authorization centres which makes the attempts for assessing the market share in terms of cards issued even more difficult. Our best estimate is based on the shares, which the commercial banks received the privatisation of Borica (these shares were calculated taking into consideration the number of ATMs and POS terminal each bank had and the number of transactions with cards, issued by the bank). While its approach is perhaps indicative for the positions of each bank on the card market, the results in respect to the exact market shares of the leaders should be taken with caution<sup>9</sup>. As it can be seen from the next figure, the market leaders in card issuing do not differ significantly from the leaders on the consumer market. The top two banks, DSK and UBB banks are also the leaders in consumer credit. The card market is not so concentrated as the consumer lending market but the it is very likely, that the first three banks, which have already established or plan to established their independent authorisation centres, will adopt more aggressive strategies to gain higher market share.

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<sup>9</sup> This information is confirmed by FIB, which claims to be the third in the card market in 10% share.

Figure 6. Market shares of the top ten card issuing banks in 2005



Source: BNB

#### ■ Non-bank credit card issuers

Currently, two major non-bank credit card issuers were present in Bulgaria. Transcard was established in the middle of 2002, a year later BRS began to offer the euroline cards. Lately, a third company, subsidiary of the financial group TBI also started offering credit cards. There is no official statistics on these cards, offered by these issuers. BRS claim to have issued 200,000 cards and ensured 45% market share in domestic credit cards<sup>10</sup>. The number of acquired merchants is 5,400 compared to 4,300 for Transcard. According to media publications, Transcard had around 180,000 cards issued as of October 2005, which would imply a market share of 38%.

Diners club used to be one of the non-bank credit cards issued in Bulgaria until recently, when it was acquired by FIB. Its activity before the acquisition was quite limited –for the period 1994-2005 only 3,700 cards were issued, due to the extremely high fees of the cards.

#### 3.2.3 International versus domestic cards

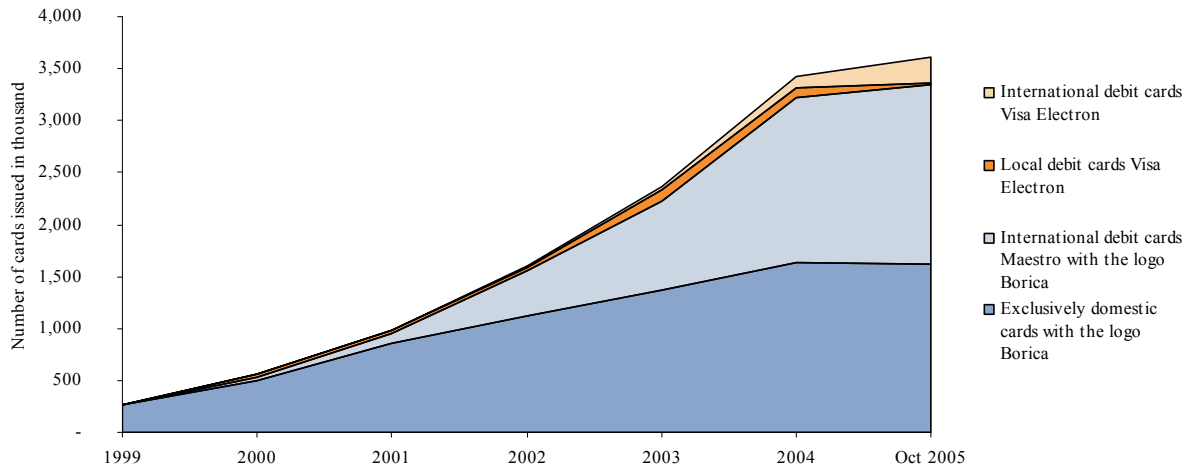
The only statistics on bank cards is the one provided by Borica. Unfortunately, it does not supply information on what is the share of debit cards with extended overdraft and it provides no classification of credit cards either (revolving or charge cards). Borica statistics, however, provides a basis to assess the degree of market penetration of the international cards. As we can see from figure 10, the majority of the bank cards issued in Bulgaria are the debit cards with the logo Borica which account for more than 90% of the cards used in Bulgaria. Around 52% of these are international debit cards Maestro. There is no difference between the fees of using Maestro cards and the exclusively domestic debit cards with the logo Borica. The trend, which is clearly observed in the last years, is to shift from exclusively domestic cards to Maestro cards. So far, the share of international Visa debit cards Visa Electron is only 7% of all cards issued in

<sup>10</sup> In my understanding, this is market share in respect to domestic credit cards, but it is not clear from the website

Bulgaria. The share of Maestro and international Visa Electron cards have increased significantly in recent years and reached 54% of debit cards issued

The major reason why the Bulgarian card market started as exclusively domestic one is that the Bulgarian cardholders could not afford the maintenance and withdrawal fees of the international brands. As mentioned above, many of the debit cards were issued for the purpose of transferring salaries and later on pensions and social security payments. No employee would agree to pay a third of his salary in withdrawal fees. The current growth of international cards could be explained by the increased number of Bulgarians travelling abroad.

**Figure 10. Debit cards in Bulgaria in the period 1999- 2005**

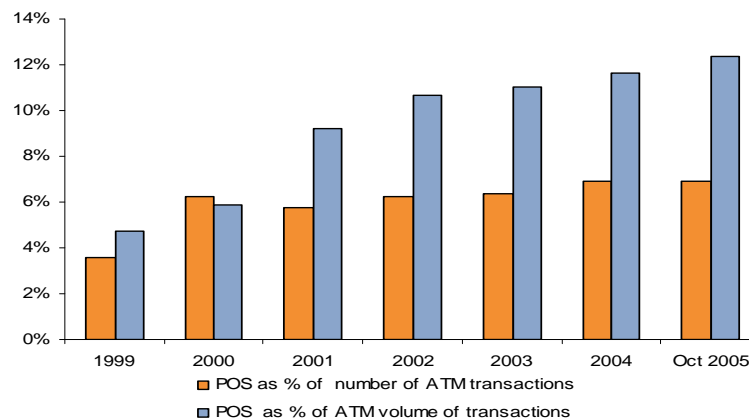


Source: BNB

### 3.2.4 The usage of ATM and POS terminals

There are changes not only in the structure but also in the usage of bank cards. The number of volume of transactions with POS versus ATM terminals is steadily increasing. The average value of POS transactions steadily increases and in 2005 to BGN 157 as compared to average ATM transaction (BGN 88). The number of e-pay transactions as well as payments of services and telephone bills is still as low as 1% of all ATM transactions.

Figure 10. POS versus ATM transactions in the period 1999- 2005



Source: Borica

### 3.3 Households

#### 3.3.1 Income and its distribution

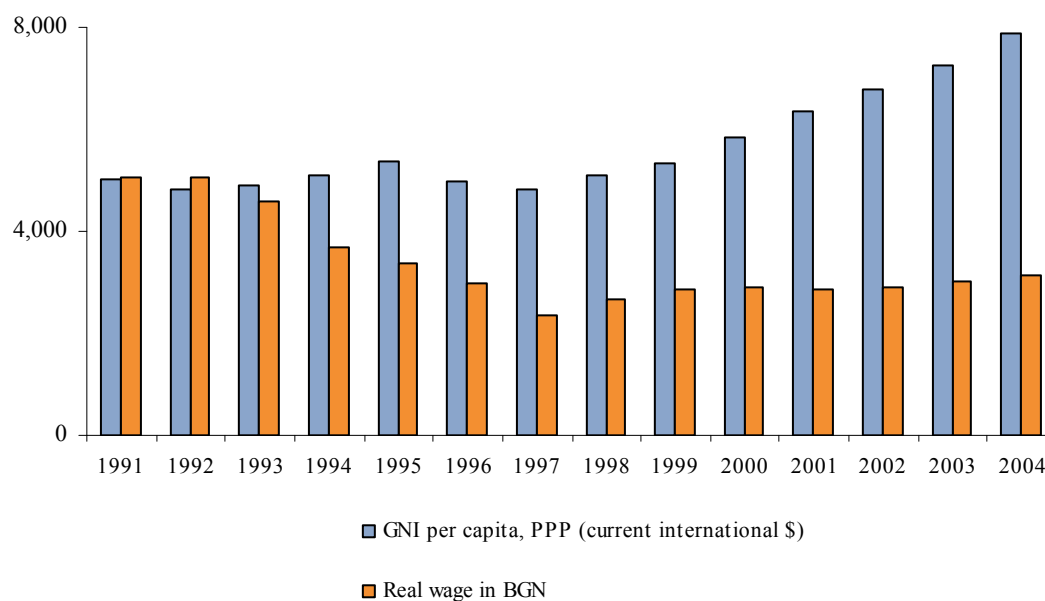
The household income is certainly one of the main determinants for the demand of credit, especially when households face uncertainty about future proceeds. As we can see from Figure 10, real wages have decreased radically in the first years of transition, and have increased ever since but with much moderate rates. It was not until 2001, when real salaries reached the pre-crisis levels. However, their sustainable increase together with the improvement of the macroeconomic fundamentals, certainly boosts optimistic expectations about future incomes. In line with this suggestion are the results of a study, undertaken by Unicredit Group(2004) showings that the positive developments of the political and economic environment had a strong positive impact on the financial wealth of the households, which increased steadily since 1997 and in 2003 accounted for 34% of GDP.

While income in Bulgaria was steadily growing, the inequality of distribution ( as measured by inequality of income distribution ratio<sup>11</sup> ) deepened from 3.8 in 2001 to 4 in 2004<sup>12</sup>..The World Bank poverty indicators, measuring the poverty headcount ratio at \$2 per day (PPP) in percent of the population decreased significantly from 16% in 2001 to 6% in 2003. The percent of people living at the \$1 PPP poverty line was only 2 % in 2003 as compared to 5% in 2001.

<sup>11</sup> This indicator is taken from a monitoring report report of the European Commission and measures the ratio of total income received by the 20 % of the population with the highest income (top quintile) to that received by the 20 % of the population with the lowest income (lowest quintile). Income must be understood as equivalised disposable income.

<sup>12</sup> It should be noted that the statistics on income distribution in Bulgaria is scarce. The World Bank has done some research on inequality of distribution until 2003, but the only complete data set is for 2001. Eurostat has statistics for the period 2001-2003, the European Commission in its monitoring report provides only one indicator – inequality of distribution

Figure 10. Income indicators in the period 1991-2004



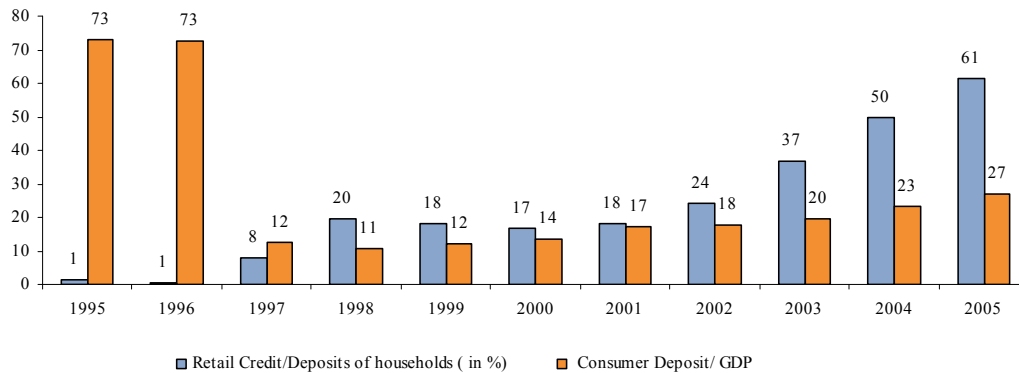
Source: NSI, World bank on GNI, own calculations

### 3.3.2 Attitude towards saving

During communism, people had the practise of saving considerable amounts of money simply because they had nothing to buy with it. This over-saving resulted in the so called “monetary overhang”, which was quite strong in Bulgaria and was one of the reasons for the sharp inflationary pressures at the outset of transition (Miller (2001)). Even in the early stages of transition people continued to save, perhaps trying to ensure themselves against being laid off. Despite their heavy financial condition in the pre-crisis years, households continued to be net savers, with credit accounting for only 0.7% of their bank savings. While in the post crisis years people’s savings as a share of GDP have steadily increased, more notable is the increase in the household credit/deposits, which certainly indicated a change in the people’s attitude toward credit, and this changes is especially notable after 2001.



**Figure 2. Household spending**

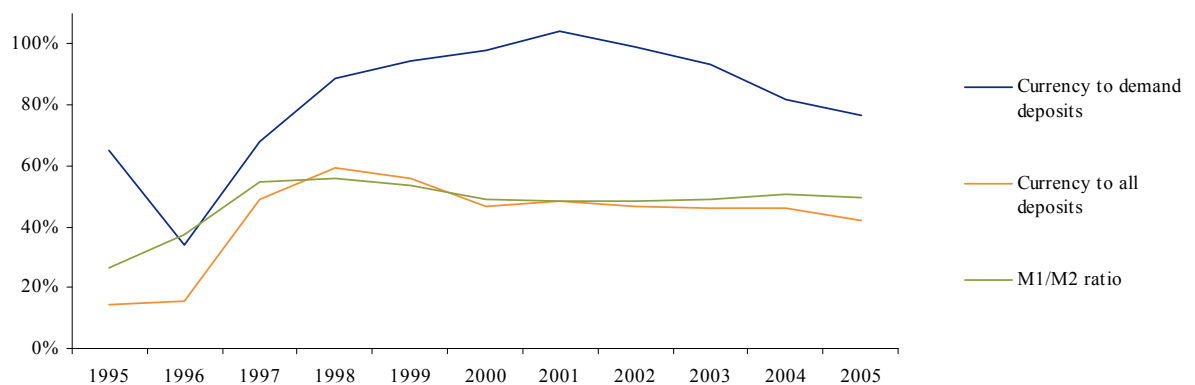


Source: BNB

### 3.3.3 Trust in banks and preferences for holding cash

Perhaps one of the most important factors for the delay of the credit card market in the post-crisis period is people's attitude towards banking services and cards in particular. The HVB and Hebrus presentation by Harold (2005) shows that in 1999 only 20% of the people were bank clients, which is the lowest from all CEE and SEE countries. The next figure confirms the thesis that people's trust in banks was seriously undermined in the post-crisis period. It was not until 2001 when the confidence indicators, showing the preferences of people to hold money, started to improve. This positive trend was confirmed by the study of HBV and Hebrus bank, which showed that the share of people, who are bank clients increased in 2003 to 25% but still remained the lowest from all CEE and SEE countries. The study by Unicredit Group (2004) also provided evidence for regaining trust in banks, showing that the share of money of households' financial assets has decreased from 37% in 2000 to 33% in 2003.

**Figure 4. Confidence indicators**



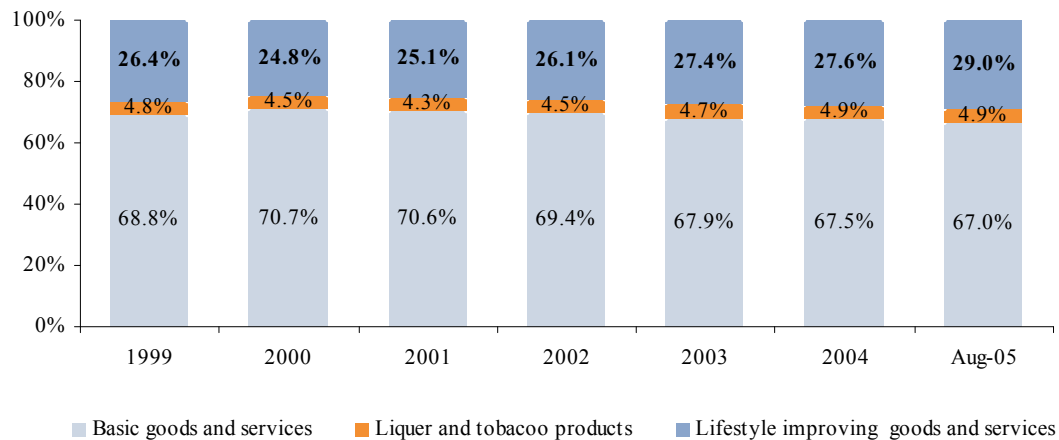
Source: BNB

### 3.3.4 Consumption and spending preferences

Bulgaria's progress towards joining EU has also played an important role in people's preferences by improving expectations about the future. Anticipations for higher future income are expected to trigger less spending and higher current consumption. The share of household expenditure in GDP,

however has not changed radically (see figure 1), but the structure of these expenditures has shifted towards durable goods. The share of spending on equipment, furniture and leisure had increased from 24.8% in 2000 to 29% in 2005. A survey, undertaken by Alpha Research (2002), showed that 39% of the respondents were planning to buy some expensive durable goods. Computers, mobile phones, cars and furniture were among the most wanted acquisitions. When asked about how they would pay for the planned purchase, it appeared the most used source of financing remained the owned resources (88%), followed by instalments (48%), money from relatives and friends (23%) and bank loan (17%)<sup>13</sup>.

**Figure 8. Structure of households spending**



Source: National Statistics Institute

### 3.3.5 Usage of Internet and new technologies

The frequent usage of Internet is essential for promoting credit cards through on-line transactions. In Bulgaria the usage of Internet is still very common and concentrated in Sofia. According to a study by Alpha Research (2005) only 22% of the Bulgarian population uses Internet as compared to 46% of the population in Sofia. The same is relevant for the frequency of usage - 52.2% of the Internet users in Sofia are every-day users as compared to only 35.1% for the country. Only 5.5% of the respondents in the capital use the Internet for payments.

Bulgarians seem to be much more open to other high technology products as mobile phones with their number increasing from 40(1999) to 621(2004) per 1000 inhabitants.<sup>14</sup>

### 3.3.6 Attitude towards credit, sources of borrowing and credit instruments

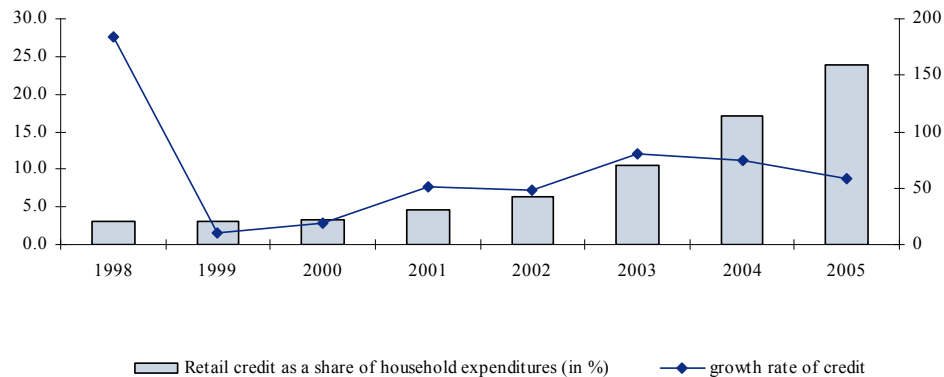
Similarly to all communist countries, prior to 1990, in Bulgaria consumer credit was considered rather as a sign of decay than as one of prosperity. Neither were people willing to take a loan nor were banks there to promote consumption related spending. People's attitude towards credit could not be changed at once, and even after the crisis credit was used to finance a very small share of consumer expenditure as it can be seen for the next figure. What macro data shows is that the share of credit, financing expenditure, increased considerably - from 4.6% in 2001 to 23.9 % in 2005. A study by GKF in 2002 confirmed the under-usage of household lending - only 3% of the respondents were using bank credit as opposed to 11% of the respondent with time deposits. As little as 2% of the people included in the survey used debit or credit cards.

<sup>13</sup> The total sum is over 100% as the interviews gave more than one answer

<sup>14</sup> Eurostat data

A survey by Alpha Research, done in 2002 showed that the share of people currently relying on bank credit in respect to people using other sources of financing (74%) has increased as compared to the past (36%). The higher growth of consumer credit and housing loans was essential for creating demand for credit cards in Bulgaria. The Alpha research survey showed that people, who used certain types of credit before (instalment plan, debit card with overdraft and consumer credit) are more willing to have a credit card. Many of the respondents, however, were not aware of the product and confused debit with credit cards. Only 1% of the respondents at that time were currently using a credit card.

**Figure 8. Structure of households spending**



Source: BNB

### 3.4 Trends

- Household credit is growing rapidly with mortgages being the fastest growing sector with rates close to 100% per year. Soon, this market segment will be exhausted and banks will switch to consumer credit, the most risky of all sectors
- On the other hand, banks believe that traditional consumer credits up to 7,500 BGN (EUR 3,800)<sup>15</sup> will be replaced by credit cards. It will save time give more freedom for the customers whenever they want to buy an electricity appliance or new furniture. Credit cards make all this process much easier and they are more profitable for the banks
- The current credit restrictions of BNB for the commercial banks will perhaps shift some portion of consumer credit to leasing companies, non bank credit institutions and non-bank credit cards issuers.
- While the number of international credit cards will continue to grow considerably as people would need them when they travel, domestic credit cards will keep their leading position as they offer terms on the cards, affordable for the mass population
- Currently, the cardholders are concentrated in Sofia and the big cities. Soon, as the big retail chains move to the small cities, cardholders becoming more and more inclusive groups
- Launching of co-branded cards with the mobile operators and some of the retail chains

<sup>15</sup> See Capital publication 1

### 3.5 Innovations

All innovational offers, related to credit cards aim to improve the attractiveness of the product, by increasing the value added of the service and by ensuring safer usage of the cards. Banks and non-bank credit institutions were inventive in fighting with the reluctance to use cards. An innovative approach was applied by Transcard by designing unique kiosks, installed in all gas stations Petrol. These kiosks served as ATMs where people could withdraw money, but they could perform many other functions as well. Through them the clients could check their mail, receive some tourist information, see the weather forecast and check their mobile phone and utilities balance.

A further step towards promoting the usage of cards for purchases instead of simply withdrawing money was made some banks by offering lower interest on POS transactions. In addition, banks began to offer the sms alert service – all or only the unusual transactions are reported to the card holders through messages on their mobile phones. This innovation certainly ensures the cardholders against thefts and frauds and is especially useful especially in respect to Internet purchases, which are considered too risky in Bulgaria.

## 4 Information sharing

### 4.1 The BNB Central Credit Register

In the aftermath of the crisis, there was strong decisiveness to take all the regulatory measures for ensuring that the same mistakes will never be repeated again. Among the measures, taken to ensure the soundness of the banking system, was the establishing of a public credit register in Bulgaria, managed by the BNB. The register was set up in 1998 but until July 2004, it covered loans above BGN 10,000(EUR 5,000), which automatically excluded the majority of consumer loans. The coverage of the register was 5 borrowers per 1000capita, which was twice lower than that of the Czech register<sup>16</sup>. Initially the register had many disadvantages: the fee for each inquiry was high (BGN 40) and data updates were done once in a month. Some of the banks were not reporting in time<sup>17</sup>, which further decreased the reliability of the information. The low degree of usefulness of the register was confirmed by many of the bank officials. The register had low coverage as compared to public credit bureaus in other countries

The necessity of improving the register was realized when BNB became concerned about the active their lending activities of the banks, especially in respect to household credit. In 2004, along with some measures for draining liquidity from the banks, BNB finally made amendments to Regulation 22 on the Central Credit Register of Banks and changed the scope of the register in favour of consumer lending. Banks were required to report all their credits, but the governmental and BNB payables and overdraft loans up to BGN 1,000(EUR 500). Both the quality of data and its availability were considerably improved. The register became an on-line system, facilitating greatly the speed and effectiveness of the inquiries. Each bank has to report the new loans within five working days. Banks are obliged to update the information on existing loans once a month. The inquiry fee was reduced to BGN 0.5. In line with article 11 of the Regulation, BNB provides free of charge monthly reports to the commercial banks with information of the total indebtedness of their clients and related parties. The inquiry fee was set at BGN10<sup>18</sup>, reducing significantly the cost of using this source of information.

Currently, the register contains data on the number of loans of each individual or company, when these loans were taken, how they are serviced, what the amount of the loans and their outstanding balance is. The register is designed in such a way to avoid cherry-picking of the best clients. The bank officers, authorized to use the register can't see what other banks a particular client is working with. No personal data such as marital status, gender etc could be found in the credit register.

The access to the register is in line with the bank secret policy- only bank are allowed to use the system and only few officers in each bank have password and smart card, both of which are needed to authorize each data inquiries.

The main advantage of the credit register is that it contains data on all commercial banks, as they are obliged by law to provide data on their credit portfolio. The register, however, does not include data from the utility and telecom companies, which, according to some of the interviewees, proves to be more useful when assessing the creditworthiness of cardholders. Moreover, data on all banks is not that useful when only one third of the banks actively participate in the household market and

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<sup>16</sup> See Institute for Market Economics (2004)

<sup>17</sup> See Due Diligence report for establishment of a private credit bureau in Bulgaria, in relation to the project of the Bulgarian-American Enterprise Fund

<sup>18</sup> The inquiry fee is set in the Regulation, its amount was provided by BNB officials

there are also non-bank leasing and credit card companies, with fast growing shares in consumer lending.

## 4.2 Private credit bureaus

The idea for establishing a private credit bureau in Bulgaria became appealing in 2002, when banks became active in consumer lending. While most of the banks realized that they need a better source of information than the Central Bank Credit Register, their willingness to participate in the bureau was not unconditional. According to a survey<sup>19</sup>, undertaken with bank officials, eight out of the ten banks were willing to start sharing information within the private credit bureau. Four of the banks, however, stated that they will require the involvement of the Association of Commercial Banks (ACB) in deciding whether to join the bureau and recommending it to its members. Officials from three other banks stated that they will prefer to wait until the bureau starts to operate efficiently with data from the bigger banks and then join.

Attempts for establishing the private credit bureau were initiated by both domestic and international companies.<sup>20</sup> The failure of Bankservice was indicative of how important the cooperation of the leaders in retail banking was for the success of the private register. The project to maintain a credit register for all loans up to BGN 10,000 was approved by the ACB in 2002, but being not supported by DSK<sup>21</sup>, the project never started.

While the market power of DSK was decreasing in the next years, its participation in the credit bureau remained a key issue for the banks as confirmed during the project interviews. Many of the bank officials were concerned whether DSK will join the bureau and with what kind of information. While the majority of the big banks were ready to join the register from the beginning, they were aware that many of the banks won't buy the product if their focus is not the retail market. However, some of the banks officials believed that the information sharing with the mobile operators and the utility companies would be of a great use. They suggested that initially the bureau will start only with negative information, while in future sharing of both positive and negative data would be crucial. Few officials stressed the fact that it will take at least two years before the bureau gathers sufficient information and using it becomes efficient. Concerning the particular initiatives for the establishing of the credit bureau, it was mentioned that there is room for only one bureau on the Bulgarian credit market and whoever manages to start first will gain the critical mass of the banks. Most of the banks officials suggested that this project would be the one by Experian- Scorex the credit bureau would start at latest at the end of 2004.

The launch of the credit bureau, however, was delayed until March 2005. The international company began to offer credit scoring products to Bulgarian banks prior to launching the credit register. Despite this fact and the worldwide experience of Experian-Scorex, it did not manage to attract the critical mass of banks. Only two Bulgarian banks<sup>22</sup> and one leasing company joined the bureau at the outset. Four months later, the bureau managed to attract the third GSM operator in Bulgaria, Vivatel. However, it is worth examining the way this bureau functions as the first private and non- compulsory initiative.

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<sup>19</sup> See Due Diligence Report prepared as part of the initiative of the Bulgarian-American Enterprise Fund for establishing a private credit bureau. The project includes interviews with officials from 10 commercial banks, the Bulgarian Telecommunication Company, a leasing company and the oil company OMV Bulgaria

<sup>20</sup> According to Due Diligence Report, these companies were Bankservice, Credibul, Experian Scorex, CRIF and FINSYS .Bankservice is a Bulgarian company, owned by BNB and the commercial banks, in charge of the national settlement system. Credibul is an American company, associated with other Bulgarian software and IT companies, interested in developing the bureau in cooperation with internationally renowned companies as Experian and CRIF. FINSYS is a Bulgarian company specialized in financial software.

<sup>21</sup> According to a publication in Capital as of 11 November 2003, DSK refused to cooperate.

<sup>22</sup> One of these banks is Bulbank, the leading Bulgarian bank in terms of total assets

According to an interview with a representative of Experian- Scorex Bulgaria, the scope of the operations of the bureau is national. The prospective clients of the bureau are not only commercial banks, leasing companies and telecoms, but also insurance companies, utility companies, retailers and credit card issuers. Loans of both individuals and legal entities are included in the data base, irrespectively of their size. Similarly to the Central Bank Credit Register, the data on credit account balances is updated once a month. New loans, however are reported on-line, as compared to the 6-day reporting period, allowed by the BNB. The fees for data inquiries vary among clients. In contrast to BNB register, companies and individuals can also get credit references and are provided with one free of charge report per year and every next inquiry costs BGN 5. The level of access institutions get to the database is reciprocycal by the inclusiveness of the data they contribute. The bureau is a full reporting system and contains both negative and positive information. The scope of information is much broader, and apart form the loan details (type of loan, amount, maturity, credit account history, current and history account balances) personal details such as address, gender, age, occupation, employer details is also included.

Currently, a contract with the National Social Security Institute is signed for contributing information on legal entities and in future Experian-Scorex plans to cooperate with other public registers.

The Experian-Scorex credit bureau has certainly some advantages as compared to the Central Bank Credit Register. It contains more detailed information in format, which can be used by the banks to facilitate processing of information. More importantly, it contains data to be used for the purposes of the data verification and assessing creditworthiness of the loan applicants. The system also supports the usage of other products for credit scoring and fraud detection. Such products, designed especially for credit cards were already presented on the Bulgaria market<sup>23</sup> and they will be implemented once the credit history is long enough.

Despite all these advantages, the private credit bureau lacks the cooperation of more banks and financial institutions. So far, the activity of the bureau is limited and has no significant impact in increasing information sharing among banks. Again DSK reluctance to join could be essential in explaining the limited success of the Experian-Scorex credit bureau.

While Experian-Scorex is the first and only credit bureau in Bulgaria to deal with full set of both company and households data, the activity of Credit reform should also be mentioned. This company is in Bulgaria for already 11 years and is part of the German - based international company Creditreform. In Bulgaria, the company exercises the functions of a collection agency abut also supplies 8 Bulgarian banks (OBB, Post Bank, Reiffeisen, ING, First Investment Bank) with negative information. Among its clients are the telecoms, utility companies and more than 80% of the foreign investors in Bulgaria<sup>24</sup>

In addition, there are two more companies with some experience in respect to corporate databases. These are the Kofas International and Data and Information Consult, representing the international Dun & Bradsheet. The later, has expressed its ambitions<sup>25</sup> for setting up a private credit register, but only after ensuring at least 50% of the data on borrows, contained in BNB registers or information on at least 500,000companies and individuals, which at this point sound difficult to achieve.

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<sup>23</sup> According to ESBCB Bulletin, [http://www.experian-scorex.com/Web/News/Newsletters/ESBCB\\_Bulletin\\_Eng\\_05-07.pdf](http://www.experian-scorex.com/Web/News/Newsletters/ESBCB_Bulletin_Eng_05-07.pdf) Experian-Scorex presented the products “Card Protector” and “Merchant Monitor”, which are designed to help both issuers and acquirers to effectively identify fraudulent behaviour and allow fraud analysts not only to isolate the sources of fraud but also to reduce losses

<sup>24</sup> See Standart newspaper (20<sup>th</sup> of April 2004) “Лишават от заем за неплатен телефон” [http://xdata.gateway.bg/htmls/read\\_news.htm?id=4004](http://xdata.gateway.bg/htmls/read_news.htm?id=4004)

<sup>25</sup> See Banker (11.02.2205)

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Another small company plan to start a regional credit register, gathering information only from leasing companies in Varna

### 4.3 Banks sharing of formal or informal black lists

The majority of the bank official stated that there is not information sharing among banks on fraudulent individuals. There is, however, a Bulgarian Fraud Forum, established two years ago with the assistance of Master Card. Each of the banks has agreed to participated in the forum, gathered once quarterly. Within the forum, banks share information only on fraudulent merchants. Some of the bank officials however doubt that the forum is working properly. There are also work-shops, organized by the representatives of Visa, MC and Amex, which aim to cover the latest fraud trends.

Sometimes, fraud examples are discussed on the ACB meeting, but these debated does not incur on a regular basis. There are no discussions, however on the implementation and the effectiveness of credit scoring systems in the different banks.

### 4.4 Main impediments to information sharing

According to some of the bank officials, one of the problems with information sharing would be the development of a unified working interface as all the banks use different IT systems.

Another major problem is the concentration of the retail sector. The establishment of the private credit bureau was probably delayed because of the unclear position of the leader in consumer loan DSK towards sharing information. Even though DSK was gradually losing its share in consumer lending (which decreased from 65% to 50% within few years), it was not enthusiastic about taking part in the bureau. Many of the banks, however, realised that the register will be useful only if DSK joins and set their involvement conditional on DSK entry<sup>26</sup>

Data protection laws did not seem to be a concern for the establishment of the credit bureau. Initially, two alternatives to override the Data Protection Law were discussed. First, there could be amendments in the Law on banks, allowing banks to contribute data to a private register. The second alternative proved to be easier to implement – the new loan contracts included a data sharing clause. Many of the credit card contracts available on the Internet contain a clause with which the client agrees that his personal data will be used for marketing and statistical purposes. By signing some of these contracts<sup>27</sup>, the card holder allows access to his tax and social security information.

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<sup>26</sup> See IME (2004) Credit Bureau Developments in Bulgaria

<sup>27</sup> See FIB contract for MC and Visa cards without a security deposit  
([http://www.fibank.bg/data/files/GTC\\_VISA&MC\\_nd2.pdf](http://www.fibank.bg/data/files/GTC_VISA&MC_nd2.pdf))



## 5 What are the peculiarities of the credit card market?

### 5.1 Banks cooperation in card issuing and processing

There is no explicit cooperation between the banks in card issuing and processing. Moreover, there is no association, dealing with card issues in particular; such problems may be discussed within the ACB.

Until now most of the banks were using a common POS/ATM structure maintained by the national card operator Borica. Established in 1994, Borica became a single provider of such services in 1997, when the three banks operating the alternative card payments systems went bankrupt. In 1995, BNB adopted the Regulation 16 on Payment Initiated by Bank cards, according to which only banks can issue debit or credit cards and the card payments authorization can be made only by the national card operator Borica. Borica bought the first ATM and POS terminals and leased them to the banks. Until 2004 Borica was the only authorization center in Bulgaria. It is still the only card payment system connected with the settlement system RTGS.

Having a single authorization center was first considered as a great advantage by the banks but gradually they began to disprove of the quality of service. The first bank to opt out of the system was UBB, a pioneer in the issuing of the bank credit cards. UBB launched its own system of ATM and POS terminals in May 2004. The cost of developing of own authorization and card center was quite high and unbearable for the majority of banks – EUR 2 million. Biochim also had the intentions of leaving Borica system and launching its own authorization center<sup>28</sup>, but so far has given up the idea. The next banks, which have already or are planning to create their own authorization centers were DZI and DSK and FIB. In October 2005 DSK launched its own credit cards (DSK shopping) serviced by the authorization center. The bank has transferred 150 ATMs to its authorization center and is planning soon to begin the transfer of POS terminals<sup>29</sup>.

While the majority banks still use a common ATM/POS structure, the non-bank credit issuing companies have developed their own POS structures. The Transcard Company maintains around POS terminal in gas stations, supermarkets and restaurants. The Euroline cards can be used in a own network of 3,500 POS terminals. Transcard and Euroline POS terminals do not accept the other bank cards and the vice versa.

In line with the trends towards breaking off the monopole position of Borica, the latest amendments in Regulation 16 adopted in October 2005, allowed for a liberal licensing of card payments systems operators. The privatization of Borica (2005), however, will probably slow down the process of authorization system disintegration. Being the main shareholders in Borica, the bank will be able to make use of the advantages of a more unified card payment system, without thee need to invest in their own authorization centers.

### 5.2 Merchants acquisitions

According to some of the bank officials interviewed one of the major obstacles in the development of the Bulgarian credit card market is the unwillingness of the merchants to accept cards. Retailers prefer not to have POS terminals installed. They are still unwilling to pay the charges for maintaining the POS and covering Visa and MC fees, accounting for around 4% of the transaction

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<sup>28</sup> See Capital Weekly Publications 1 (2004)

<sup>29</sup> See publications on DSK web-site

value. This percent is too high for the small shops, which could not offer competitive pricing when the credit card fee is charged. Retailers find the installation of POS profitable only if the average transaction is above BGN 40<sup>30</sup>.

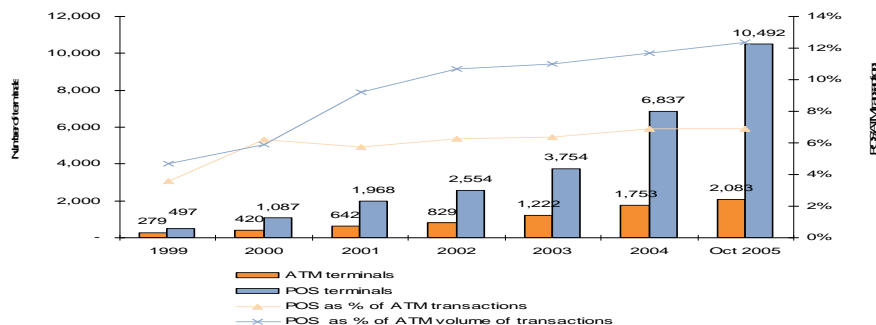
However, one of the major reasons for the unwillingness of retailers to accept cards is that they preferred to keep their turnover in secret. In part, this is because of tax invasion purposes. Also, the merchants often have significant amount of trade payables and fear that if the suppliers have information on their bank accounts they will be forced to pay the arrears. These fears, of course, are unjustified as POS contract include bank secret clauses<sup>31</sup>. Another problem retailers face is the fluctuation of labor, resulting in additional expenses for training the new employees to use the terminals<sup>32</sup>.

The unwillingness of the small retailers to accept cards and the high costs of POS installation<sup>33</sup> and maintenance have limited the bank's marketing strategy to the big retailers. Most bankers share the opinion that people's attitude towards cards should change before they start more active policy of merchants' acquisition. Hence, the policy of banks should be focused on providing more incentives for the individuals to become cardholders through cash-back options. Gradually, the merchants will have to change their attitude towards POS terminals in order to meet clients' demands<sup>34</sup>.

There are also quite radical views that the merchants' acquisition problem should be solved by amendments in the law, transforming the bank cards into a legal tender. Thus, merchants will be forced to accept cards<sup>35</sup>.

Judging from the latest Borica statistics, considerable progress has been achieved in solving the "chicken-or-egg" problem with merchants. The rate of increase of POS terminals in 2005 is much higher than the one of ATMs – for the first ten month of 2005 the number of POS terminals has increased by 53% as compared to a 19% increase in ATMs. The share of POS versus ATM volume of transactions is also steadily increasing in the period 1999-2005. These statistics however, underestimate the real growth of POS terminals as they do not include Euroline and Transcard terminals, which have also increased considerably in the last two years.

**Figure 1. ATM and POS statistics**



Source: Borica Statistics

<sup>30</sup> See Capital weekly 3

<sup>31</sup> See Capital weekly 3

<sup>32</sup> See Capital weekly 2

<sup>33</sup> According to Capital weekly 3, the installation and maintenance of one POS cost around EUR 200. The credit cards fee cover the interbank, Borica, Visa and MC charges, leaving almost nothing to cover the banks' expenses.

<sup>34</sup> See Capital weekly 2

<sup>35</sup> See capital weekly 2

### 5.3 Card marketing

As already mentioned, since the emergence of the credit card market, banks have applied different strategies for marketing cards. The variety of distinct approaches did not seem to disappear with the development of the market, as confirmed by the project interviews.

A natural way to explore the credit card market was by using the already established relations with corporate clients. This strategy of marketing cards and other retail products through corporate customers was preferred by green field foreign banks or Bulgarian banks with little experience on the household market. For these banks, the uncertainty in consumer credit was high because their lack of experience and one way to reduce it was by using their knowledge about the employer of the cardholders. Banks, following this strategy usually offered overdrafts to all employees. Credit cards, if any were offered to top managers and people from their VIP lists. These cards had the standard Visa and MC fees and quite high interest rates, and were a product, designed to be used mainly abroad.

Many of the banks marketed cards to their existing clients. On one hand, these were clients with substantial deposits; these clients were also included in the VIP list. On the other, bank offered credit card to customers, who have already taken another loan. This approach decreased the cost of assessing the individual creditworthiness as this was already done when the other credit was extended. Some banks applied this marketing strategy by offering credit cards to the clients with mortgages and the credit line on this cards was rising with the housing loan being repaid. This strategy, however, was rather complimentary than a leading practice in approaching potential cardholders.

An innovative strategy of marketing credit cards was by introducing co-branded credit cards with the telecoms. This was done by two banks UBB and Biochim by offering co-branded credit cards with the mobile operators Globul and Mtel, respectively. In this way, banks could use the impressive database of the telecoms and give cards only to the clients, who paid regularly their telephone bills. Moreover, the amount of bills could be used as a comparatively good proxy for the real income of the card applicants.

Last but not least, the non bank credit card issuers and lately some of the banks marketed cards to the mass of people. They tried to attract clients by massive advertisement campaigns. Currently these campaigns have become more but the difference in the message of Transcards and Euroline and those of the banks remains different. While banks advertise cards as a matter of prestige product, the non-card credit issuers emphasize that everybody can card a cards. Their campaigns are much more aggressive, focusing on the cash back incentives for cardholders. Euroline has lately started a campaign for attracting clients by offering large discounts to existing customers who have recommended the product to their friends. Transcard issues its own monthly magazine, containing a list of the retailers, the cash-back and other discounts.

### 5.4 Types of credit cards

Currently, the following types of cards are issued in Bulgaria:

- International credit cards MC and Visa

According to Borica statistics, at the end of 2005, 10 banks issued Visa and MC cards. Visa cards were more spread among the top ten banks<sup>36</sup> with 60% of them issuing them as compared to 40% of the banks, issuing MC. The number of MC credit cards, however, exceeded by nearly three times the number of Visa credit cards. In the last few years, the growth of both brands has been

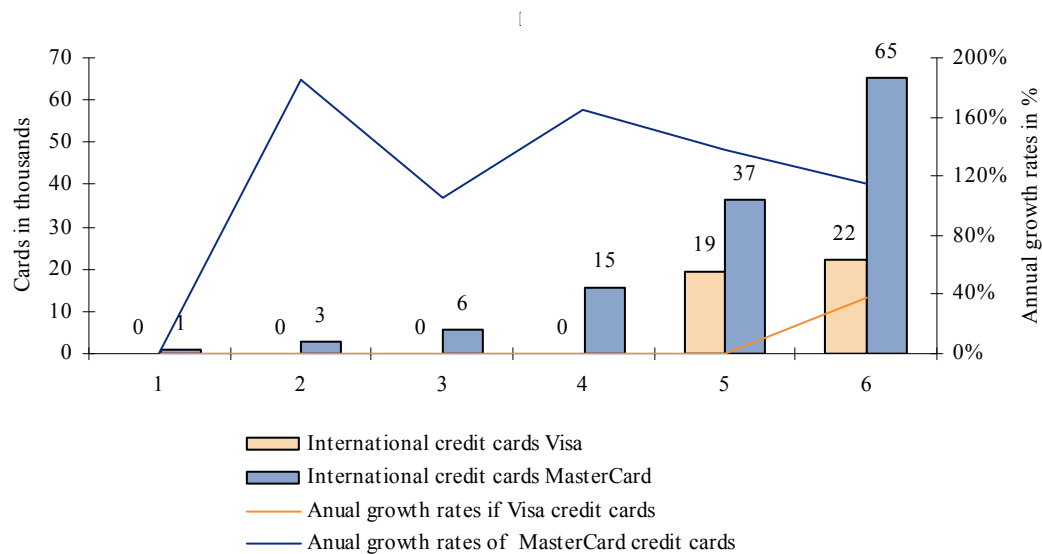
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<sup>36</sup> The BNB classification was used

impressive. While the number of international credit cards as a share of total cards in Bulgaria is still extremely low ( 2.3% in 2005), these cards certainly have considerable growth potential<sup>37</sup>.

When the interviews were taken, only 3 out of the 10 banks interviewed offered revolving credit cards and two of these institutions have just started issuing such cards. In addition, the two non-bank credit card companies were also offering revolving cards. According to information, from the websites of the banks, at least three more banks are currently issuing revolving MC and Visa cards.

**Figure 10. International credit cards in Bulgaria in the period 1999- 2005**



Source: Borica statistics

#### ■ Diners club and Amex credit cards

Unlike in other countries, in Bulgaria both Diners club and Amex credit cards are currently issued by banks. Postbank and Hebros both offer Amex Cards<sup>38</sup>. Since 1994 until recently, Diners club cards were issued by the representative of Diners Club in Bulgaria, but with limited success –only 3,700 cards were issued until 2005<sup>39</sup>. Recently, the company was acquired by First Investment Bank and a co-branded diners club cards were also offered. There is, no statistics available on the number of Diners Club and Amex card issued in Bulgaria, but they growth potential is limited because of the considerable high fees and income requirements.

#### ■ Domestic bank credit cards

Some banks began to offer domestic cards with much lower maintenance fees, which could be used in Borica network and are designed mainly for purchases. Some of these cards are the DSK bank Shopping card and the Central Cooperative Bank Market card and the Hebros bank Credo card.

<sup>37</sup> It should be noted that the number of international credit cards in Bulgaria is probably higher as Borica statistics do not account for the cards issued within the independent authorization systems of UBB, DZI and DSK (since end of 2005)

<sup>38</sup> According to the banks websites

<sup>39</sup> See Diners Club website

These cards are the banks' alternative of the card euoline and transcard, they have similar terms and supposedly the same high growth potential. .

■ Non-bank domestic credit cards

There are two brands of non- bank credit cards, issued in Bulgaria. The Euroline cards are issued since 2002 and according to publication in the press have reached 170,000 cards in 2005<sup>40</sup>, which it nearly twice as much the international credit cards in Bulgaria. According to information on Euroline web site, these number of cards issued approaches 200, 000 cards only for 3 years. Judging from these numbers, the non-bank credit cards are certainly growing much faster than the other types of cards. With the migration of Euroline cards to Borica POS and ATM network, the potential of these cards will increase further.

To sum up, while in the outset of the credit card market, international cards were in the lead, currently domestic credit cards are taking over. Their low fees and eased requirements for minimum income make them affordable for the mass of people, while the market for international cards remains more limited. Both domestic and international cards, however, have substantial growth potentials. Still, there is not clear tendency to move from debit to credit cards as many of the debit cardholders use these cards only for withdrawing money and have no incentives to replace them with credit cards.

## 5.5 Credit card conditions

The typical conditions bank applied for extending overdrafts and credit lines were more or less determined by their marketing strategies. In banks, where credit cards were marketed mainly through the corporate clients of the bank, the requirements were set lower and the size of the credit lines and the overdrafts was higher than in the general case. Usually no security deposit or other kind of collateral required, at least up to a certain credit limit. Cardholders were not required to have an account with the bank other than the card account, on which in most cases salaries were transferred. In these cases, the stability of the employer, already evaluated when the company became client of the bank, seemed to be more important than the profile of the employee. There was no implicit required for minimum income, but usually credit cards were issued to top and middle management, which already implied income, much higher than the average. Rarely, these banks issued cards to new clients and required either security deposit or impressive monthly remuneration.

The banks, offering cards to a broader mass of people, were quite heterogeneous in the conditions they have set for extending overdrafts and credit lines. Some of them required a minimum guarantee deposit and some minimum income. The guarantee deposit seemed to be the most often required collateral, although other opportunities such as other financial assets and guarantors were also feasible. The amount of the guarantee deposit varied a lot from no such collateral required to 125% of the credit lines. The variations in the minimum income required were also significant, starting from EUR 250 for revolving credit cards. In some cases, these requirements were not explicit but banks would offer a card to a target group with certain income levels. Again, the stability of both employment and the employer was considered quite important. In case the card applicant was an employee of budget organizations, these requirements were set lower or even fully neglected. Of course, in such cases, the salary of the cardholders was to be transferred on his card account. The same policy for easing the requirements was observed in respect to the existing clients. Self-employed seemed to be treated as in the general case, when they did not had security deposit, they needed to prove income with the tax declaration proving last years income.

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<sup>40</sup> See Banker Publication (2005)

The non-bank credit card issuers, offering cards to the most inclusive group of people, have not explicitly set any requirements on guarantee deposits and minimum income, implying that even low income applicants can get a card but with very low credit limit.

## 5.6 Screening

At the time of the interviews, only one bank out of the ten credit card issuing institutions used a scoring system to screen the credit card applicants. One more bank has already implemented a credit scoring system on consumer and mortgage loans and planned to introduce it in the cardholders screening process. In all other cases the decision making was rule-based.

Before summarizing the specifics of the screening process of the institutions applying rule-based approach, it should be noted that more than 70% of them offered charge cards with security deposits or debit cards with overdrafts. Hence, even in the event of default there was a minimal risk for the card issuer and the introduction of an expensive scoring system would be inefficient

In the cases of cards with a guarantee deposit, banks asked only for a copy of the ID and no verification of income was required. When individual were applying for overdrafts or charge credit cards, guaranteed with their salary proceeds, there was a requirement for a document proving income. This document could be a copy of the labour contract, a salary slip or tax declaration. In most of these cases the employer was also a client of the individual and would probably inform the bank if the employee leaves the firm. The usual notice period in Bulgaria is between 1 and 3 months and if the employees are fired they receive four monthly remunerations by law. These peculiarities of the national labour market also provide a hedge against defaults. Moreover, banks rarely offered overdrafts larger than two monthly remunerations. Few of them were concerned about the stability of employment and determined the limit of the overdraft on the type of the employer. If the employers were budget institutions, it was more likely to offer bigger overdraft because of the law degree of labour fluctuations in such institutions.

All banks but one required the applicants to be at least 18 in line with the legal requirement. Only one bank has imposed restrictions on the minimum and maximum age of cardholders –between 18 and 63 years. In most of the banks, there was no requirement for the citizenship of the applicant, only permanent residence was needed. While the gender of the applicants could be seen from the ID, it did not play a role in the decision-making process. The other personal data required was the address and telephone number. This information was randomly verified. Only in the case of business credit cards, there were internal checks with the company register.

In the majority of the institutions there was no eye contact between the applicant and the credit officer; hence no personal judgement could take place. If the applicant fulfilled the requirements and provided the needed application documents, he/she was given a card.

Only one bank had a specific decision- making procedure according to which the appraisal process was either undertaken by the foreign-based headquarters or by a credit committee, comprising the senior credit officers. Usually, the applicants were CEOs of client companies, which had individual conditions on their cards.

In the bank where both charge and revolving cards were issued the screening process was stricter. The history of the applicant with the bank was reviewed, there were questions asked both on the income and the wealth of the client. Also, the work experience was reviewed in more details. In one of the banks, the decision-making process on company credit cards.

Surprisingly, in the non-bank card institution, offering real credit cards, there was no specific or larger- scale screening process. The two required documents were ID and permanent labour contract. There was only one additional requirement on minimum income

While the screening process of banks using rules-based approach was quite unified, it was considerably different in the institution applying statistical credit scoring system. In addition to ID card and documents proving income, some applicants were asked to describe their payment history in the last five years. The only rule applied before running the scoring system was for applicant to have been UBB's client for at least 4 months.

The score system used was a statistical future predictive system, common for all types of consumer loans. It replaced the point system used until 2002. The software was developed by an external company, but the criteria for decision-making were not predefined and could alter with time. One of the major variables in the model was the payment history of the applicant. The system was used not only to decide whether to approve or reject the applicant but also to define the credit limit of each individual. The credit limit can be up-graded with time. There was a zone of indecisiveness, where personal judgement was also needed. The average approval rate was around 35-40%.

## 5.7 Monitoring and collection

All banks interviewed had quite unified monitoring procedures. The authorization of all transaction is done in real time, and the changes are recorded into the account twice a day. So in most banks a daily monitoring system was introduced. The banks were able to respond immediately to Visa and MC alerts for stolen cards and block them. In the case, when the headquarters of the bank were initiating the credit card process, the movements on the card were done in the Visa and MC offices abroad.

In addition to the monitoring of transactions, monitoring of the existing clients was done in some banks. It aimed to reassess the credit limit of the individual and update if needed. This type of monitoring was done twice a year

At the time the interviews were taken none of the institutions had outsourced the collection of non-performing loans and all collection were done in house. As a whole, they were not concerned with the collection of the card loans as the default rate was relatively low –below 1% on average. The collection process was initiated when the card payments were in a 30 day arrear. The first step was to call the client, next to send an official letter and finally send a lawyer. Most banks prefer to avoid turning to the court system due to the ineffectiveness and high cost of the creditor satisfaction procedures.

The collection process is about to change considerably with the establishment of the first collection bureau in Bulgaria – a subsidiary of the Greek company Europe Matrix. The company has experience in the South Europe region. In Bulgaria it managed to attract one of the leaders on the credit card market UBB as well as three more banks and two telecom companies. The credit portfolio to be collected by the company was around EUR 23 mln, 10 of which have been successfully collected<sup>41</sup>. The company has been recently acquired by the international collection company IOS, which implies further improvements in the collection process of the company.

## 5.8 Main problems of the credit card market in Bulgaria

Banks officials saw three major problems for the development of the Bulgarian credit card market – screening, insufficient demand and underdeveloped POS network. An area of major concern was the assessing of the creditworthiness of the card applicants. Precise credit scoring systems were quite expensive to introduce, and the information was not enough to utilize the usage of these sophisticated models. The delay of the private credit bureau project and the unwillingness of all banks to contribute both negative and positive information was also an issue.

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<sup>41</sup> See Dnevnik Publication, The Europe Matrix company had become part of IOS Group, *July 19 2005*

Both people's attitude towards cards and their income were considered as a serious problem for the development of the card market. Many people simply used their cards to withdraw money and were reluctant to explore the advantages of card usage. In addition, a considerable share of the people could not afford the high taxes and fees, incurring on the international credit cards.

Not only people were educated to use their cards for purchase, but also many of the retailers were not willing to accept cards due to tax evasion purposes. Thus, the POS network in Bulgaria was still insufficient to promote the development of the card market.



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