



THE DENATIONALIZATION OF THE BANKS – BASIC OBJECTIVE OF THE RESTRUCTURING OF THE BANKING SYSTEM IN THE CENTRAL AND SOUTH EASTERN EUROPE (CSE) COUNTRIES

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Abstract

In this study we shall try to elaborate a comparative analysis regarding the policies of the process of banking denationalization used in five Central and South Eastern Europe (CSEE) countries (Poland, Slovakia, Hungary, Romania and Bulgaria) during the transition period, as they had a great influence on the increasing domination of the foreign capital banks and we shall offer a complete image of the denationalization process that tended in the last years to sell all these banks to foreign investors. We also intend to make a comparison between the features and the structure of the banking system in the above mentioned CSEE countries and we will show that in the last years, each of the five counties noticed an increasing domination of the foreign capital banks, numerically but also from the point of view of the market share.

Keyword: banking system, foreign banks, methods of the denationalization, banking reform

JEL Classification: E50, G21

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I. Introduction

The denationalization of the state-owned capital banks represents a crucial element of transition of the CSEE countries, because the foreign ownership is prerequisite for an efficient transition of the banking sector.

The structures of the banking sector of the five CSEE countries, before the denationalization, were mainly being controlled by the big national banks, state-owned banks. In the banking sectors of the centralized economies, the domestic banks owned the central as well as the commercial banking activity (the sole banking system). The national banks together with the specialized banks were just passive institutions, operating the stake distribution, following the orders of the headquarters under the absolute control of the state. Subsequently, the structure of the ownership of the banking sector suffered a few changes, as a result of using various methods of denationalization. The main methods are as follows: *the voucher method, the initial public offers (IPO) and selling to foreign financial investors (SFFI)*.

II. A comparative analysis of the policies of banking denationalization used by the CSEE countries

The analysis of the methods of the denationalization indicates main changes round 1997. The period before 1997 has been named „first stage of denationalization” and the period after 1998 „the second stage of denationalization”. In the first stage it were used different methods in each of the country: the SFFI method in Hungary, the IPO method in Poland and the voucher method in Republic of Slovakia. Within the second stage of the denationalization all the countries adopted the same SFFI method [1]. The state lost mainly all his capital stakes and those received in the first stage of the denationalization were sold in the second stage by SFFI method.

There were different results of the denationalization, mainly because of the method used in the process. The voucher denationalization (based on vouchers) that was used initially in the Republic of Slovakia led to a quick change of the ownership, thus his economy began to be dominated 70 percentage by the private ownership in 1996. Although, the productivity and the competitiveness of the newly denationalized companies remained unchanged. The result of his denationalization, also named „the denationalization without restructuring” led to a weak performance of the Czech and



Slovak companies, especially of the banks. In Poland and Hungary, on the other hand, the denationalization was mainly preceded by restructuring, as a result of selling the state ownership to strategic investors [2].

Some countries quickly started to denationalize the state-owned commercial banks and thus, granted access to foreign banks on the domestic market at the beginning of the transition. Although, the internal legislation and the competent institutions failed to establish a smooth operation of the market economy and did not automatically lead to a proper banking performance. Consequently, some new banks were used to misdirect the loans especially to the owners of the banks, and most of them were companies that acted as „pocket banks” for their owners. The entrance requirements for new banks was initially very permissive because they thought a wrong idea that their easy access on the domestic market shall accordingly challenge the competition. The proliferation of the new banks turned to be an additional burden on an underdeveloped legislative structure [3].

The process of general denationalization was considerably different in the previous mentioned countries. Until 1995, in Hungary the foreign financial institutions owned 42 percentage of the Hungarian banking stakes, mostly due to the denationalization of two important state-owned commercial banks. The next biggest percentage of the first transition decade belonged to Slovakia, a country that granted a fast access to the foreign banks on the domestic market. On the other hand, the Czech Republic and Poland limited the number of authorizations given to foreign investors and allowed them to have only a minority authority in their banking sector. These governments mainly adopted a protective strategy and considered more significant the potential of their novice developing industry that could probably sustain at some point the domestic banks in order to become strong enough to be able to face the competition [4].

In Poland, the first banking denationalization used a combination of domestic initial public offers (IPO) and selling offers of the non-majority stake to a strategic foreign investor. As the Polish stock exchange was not a great success, this method encountered a series of problems regarding the transaction of domestic initial public offers (IPO) and thus their price was hardly established and the accusations of price fixing led to a political fall of one of the governments. The new government developed a new programme of banking consolidation, as an alternative approach to denationalization and tried to make merging and acquisitions of banks, followed by disagreements of course. In one of the



cases, the attempt of including in the programme a bank that was already partially denationalized (HBP) caused a big public disorder.

This significantly delayed the denationalization and almost a quarter of the Polish banking stakes had been further held by the state until 2005. Most of the programmes of banking denationalization have been later operated in Romania, Bulgaria, Croatia, Czech Republic and this involved a price negotiation between the government and a unique foreign bank, sometimes after a public auction.

The policies adopted in the denationalization, either in establishing subsidiaries of the foreign banks inside the countries or in acquiring stakes within the state-owned commercial banks, were also very different in the previous mentioned countries.

In some countries, the entrance policies encouraged the foreign ownership (by giving financial advantages in setting up the subsidiaries (Greenfield banks)), in other countries, the granting access was restricted and the foreign banks had only a minority ownership within the state-owned commercial banks or participated to the solving process of the issues encountered by the small domestic banks.

First country in the Central Eastern Europe that granted access to foreign strategic investors was Hungary. The foreign investors had until 1994 a minority ownership in the Hungarian banks. Although, the Hungarian banking sector encountered a few problems and suffered a budget restraint, which led to some continuing operations of banking recapitalization from 1993 to 1994. In order to improve the corporate governing of the banks and to cut the fiscal costs of recapitalization, they began in 1994 a denationalization process of the banks by selling them to strategic foreign investors.

The Balkan countries, such as Bulgaria and Romania, had been reluctant to denationalize their banks and sell them to strategic foreign investors and only the banking crisis determined them to reconsider their strategies. Bulgaria had experienced a banking crisis in 1996-1997 and Romania in 1998-1999. Bulgaria registered a credit boom in, but until 1995 almost 75 percentage of the bank loans were considered non-performing loans. In this situation, the Bulgarian Central Bank supplied with banking liquidities and thus led to a real currency and banking crisis. Thereby, in 1997, the Bulgarian authorities adopted the denationalization process and the biggest banks were sold to strategic foreign investors. Before the crisis, the biggest Romanian state-owned banks had been oriented towards an inefficient crediting of the state-owned companies, and thus they were automatically financed by the Romanian Central Bank. When the Central Bank decided to



stop this practice, a lot of big banks encountered many problems. Therefore, after an expensive recapitalization, the Romanian authorities started the denationalization process, with an active participation of the foreign investors. Poland did not support the denationalization of the banking system and did not accept its big financial costs. From 1992 to 1998, the authorizing of the foreign banks was limited by a main requirement: a foreign bank could only be authorized after accepting to help a Polish bank in difficulties. The denationalization process started in 1993. Even if the foreign investors were granted access to hold stakes, they were limited to minority ownership. The restrictions for the foreign banks were excluded in 1998, after adopting a new law in the banking services domain, adjusted to the EU legislation. The concept of denationalization had changed and the government started to look for foreign banks in order to earn big income from the denationalization. The banking reform started even later in the Republic of Slovakia. The Slovak banks accumulated many non-performing loans because of the political interferences in the crediting procedures. Although, beginning with 1999, the fast reform started to recapitalize the Slovak big national banks and sold them to strategic foreign investors [5].

The foreign ownership in the banking sector had been initially seen by most of the governments as an instrument of adopting the banking survey and training the human capital hired on the domestic market of the banking sector.

In most of the countries in transition, the state ownership disappeared in 2005. Until 2005, the medium rate of the stakes owned by the foreign capital banks was 84.5 percentage in the Central Eastern Europe and 61.9 percentage in the South Eastern Europe countries. Table no. 1 presents the percentage of the stakes owned by the state-owned banks and foreign capital banks, as well as the mediation rank for 1999 and 2005.

Table 17- The structure of the banking sector in CSEE countries following the form of ownership on 1999 and 2005

Country	Owners- % of stakes		Mediation rank		BERD Index
	State	Foreign investors	Deposits/GNP	Loans/GNP	
1999					
Bulgaria	50,5	44,7	21,3	10,7	2,7(+)
Polond	23,9	69,5	35,4	27,1	3,3 (+)



Romania	50,3	47,8	20,5	10,6	2,7 (-)(
Slovakia	50,7	24,6	57,1	48,4	2,7 (0)(
Hungary	7,8	65,3	66,1	44,6	3,3(+)
2005					
Bulgaria	1,7	72,8	36,0	34,9	3,7(+)
Poland	21,5	74,2	34,6	27,4	3,7(+)
Romania	6,5	59,2	26,1	20,9	3,0(+)
Slovakia	1,1	97,3	47,7	32,5	3,7(+)
Hungary	7,0	84,5	40,1	44,8	4,0(0)

Source: processing of, Bonin, J., Hasan, I., Wachte, P., Banking in Transition Countries Oxford Handbook of Banking Forthcoming June 2008, pp. 17

According to Table no. 1, the percentage of the stakes owned by the foreign banks was below 50 percentage in 1999 in all the mentioned countries, except Poland and Hungary that registered percentages over 50%. The three Central Eastern Europe countries, registered an average of the state owned stakes of 27.1 percentage in 2000 and 5.9 percentage five years later, and the other two South Eastern Europe countries the average was 45.6 percentage in 2000 and 8.0 percentage in 2005 [5].

The percentage of the stakes owned by the foreign banks in five Central and South Eastern Europe (CSEE) countries was the biggest one in 2005. Slovakia registered a percentage over 90 and Hungary registered a percentage over 84 in 2005. This percentage was although smaller in Romania, 59.2 percentage in 2005.

Three years later the foreign ownership prevailed in all the banking systems of the mentioned countries in proportion of 80 percentage (Bulgaria, Poland, Romania and Hungary) and in almost 100 percentage in Slovakia (see table no. 2 and chart no. 1).



Table 2 Characteristics of the banking sector in CSEE countries in 2008

Country	Owners- % of stakes		Owners- % of stakes			BERD Index 2009
	State	Foreign investors	Loans	Loans for population	Mortgage loans	
Bulgaria	2,0	83,9	74,5	26,0	12,4	3,7(0)
Polond	18,3	76,5	55,0	27,0	15,o	3,7(0)
Romania	5,6	87,7	38,5	18,8	3,8	3,3(+)
Slovakia	0,8	99,2	44,7	18,5	5,4	3,7(0)
Hungary	3,5	84,0	67,6	27,4	21,5	4,0(0)

Source: processing of Report of transition BERD, 2009, pp. 154-211

The structure of the banking system related to ownerships in CSEE countries in 2008 can be better noticed in the following chart:

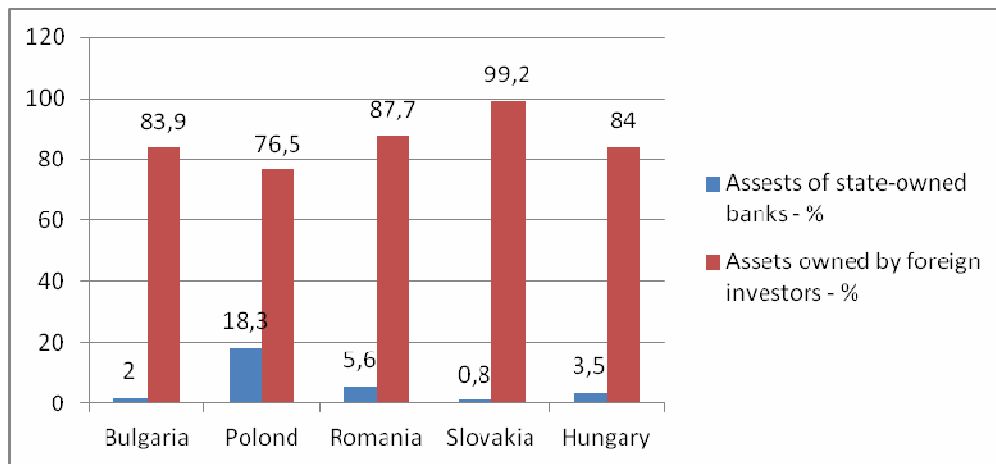


Chart no. 1 The structure of the banking system related to ownerships in CSEE countries in 2008

Source: elaborated by the author based on the information from Report of transition BERD, 2009, pp. 154-211



The banking crisis that marked the economies of the above mentioned countries had seriously influenced the region and accelerated the process of denationalization and the decline of the state ownership in the banking system [6]. In Slovakia, the state ownership decreased from 50 percentage in 1999 to 1.1 percentage in 2005 and 0.8 percentage in 2008. The percentage of the balance assets of the state-owned banks in Hungary changed a little from 1999, because almost all the banks were entirely denationalized in 1990. Until the end of 2005, the average rate of the state-owned banks was less than 8 percentage in almost all the countries, except Poland, where the state had still 18.3 percentage of the banking assets.

Analysing the structure of the banking sector of the five countries during the initial period of transition, we shall notice that despite a fast increase of the foreign banks, the state still owns the control over the banking system. The number of banks owned by the foreign investors continued to increase. Table no. 3 indicates that at the end of 2001 the banks owned by foreign investors increased to one quarter in Hungary and two quarters in the other countries.

Table 3. Evolution of the banks owned by foreign investors in the CSEE countries (1991-2009)

	1991	1993	1995	1997	1999	2001	2003	2005	2007	2008	2009
Bulgaria											
Total number of banks	75	41	44	34	35	34	35	34	29	30	30
Number of foreign banks	0	0	4	9	19	26	25	23	21	22	n.a
Poland											
Total number of banks	74	87	81	83	77	72	58	61	64	70	67
Number of foreign banks	6	10	18	29	39	48	46	50	54	60	n.a
Romania											
Total number of banks	-	-	24	33	34	41	39	39	41	42	41



Number of foreign banks	-	-	6	13	19	32	21	24	26	27	n.a
Slovakia											
Total number of banks	-	18	25	29	25	21	21	23	26	26	26
Number of foreign banks	-	3	9	13	11	13	16	16	15	16	n.a
Hungary											
Total number of banks	35	40	43	45	43	41	38	38	40	39	35
Number of foreign banks	8	16	21	30	29	31	29	27	27	25	n.a

Source: processing of Report of transition BERD, 2009, pp. 154-211, Raiffeisen Research 2010, estimations of the author

Thus, we can say that all banking sectors of the previously mentioned countries are defined by a fast appearance and domination of the foreign capital, following the process of denationalization. The information presented in the above table shows that the banking sector of the CSEE countries is currently dominated by foreign investors.

III. The effects of the entrance of the foreign banks on the domestic banking sectors of the CSEE countries

In some countries, the position of the foreign capital banks is overwhelming accessing thus the banking markets of CSEE countries during a crisis or right after a crisis, when the stability has been established. The presence of the foreign investors (in terms of company assets) is proved by: Austrian, Italians, Belgium, Germans and French. The Greek investors have as well a good position especially in South Eastern Europe.

The banking sectors in the CSEE countries are defined by a high number of foreign banks. In Romania, Bulgaria and Slovakia, the foreign banks controls over 80 percentage of the entire banking capital.

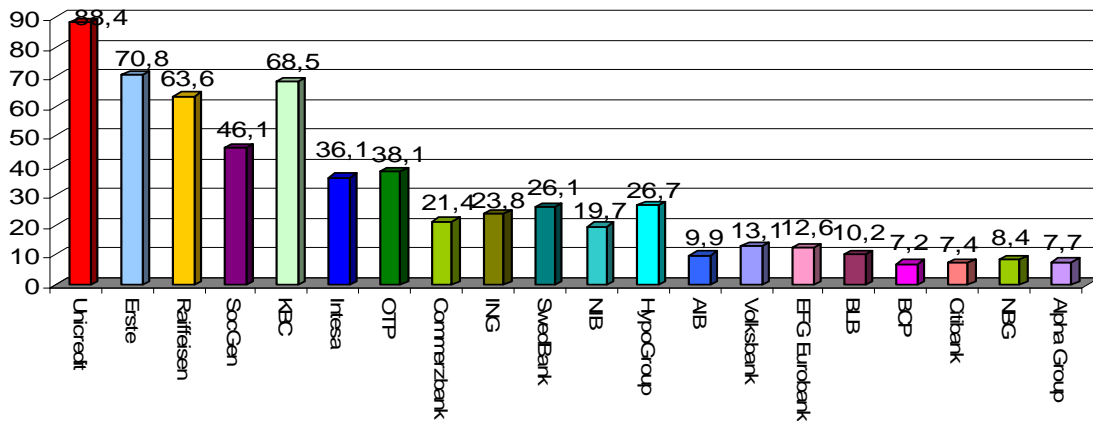


Chart no. 2 Total assets of the international banks in CSEE countries in 2009 - billions Euro

Source: processing of, CEE Banking sector Report, Raiffeisen Zentralbank Osterreich AG Vienna, 2010, pp. 51.

The market share of the foreign capital banks varies from 62.9 percentage in Poland to 94.3 percentage in Slovakia see table no. 4 and chart no. 2).

Table no. 4. Market share of the foreign banks in the CSEE countries (1995-2009)

Country	1995	1996	1997	1998	1999	2000	2001
Bulgaria	n.a	n.a	34,8	43,4	46,6	48,1	66,7
Polond	19,24	29,79	41,52	49,7	56,0	56,6	61,3
Romania	14,11	12,84	24,46	35	41,75	53,8	60,6
Slovakia	n.a	39,6	39,2	37,3	24,6	28,1	60,0
Hungary	35,6	45,9	61,2	60,4	62,1	64,0	61,0
	2002	2003	2005	2006	2007	2008	2009
Bulgaria	66,6	76,3	80,0	80,1	82,3	86,3	86,6
Polond	63,2	63,3	69,9	66,6	66,6	67,0	62,9
Romania	64,9	66,3	62,2	88,6	87,7	88,2	85,3



Slovakia	85,3	88,9	97,3	98,9	97,0	96,3	94,3
Hungary	58,6	81,9	84,5	81,5	78,4	72,7	70,2

Source: processing of Havrylchuk, O., E., Jurzyk, 2006, *CEE Banking sector Report, Raiffeisen Zentralbank Osterreich AG Vienna, 2010, pp. 51*, estimations of the author

In chart no. 2 we can notice the market share of the banks with major foreign capital in the period 2000-2009.

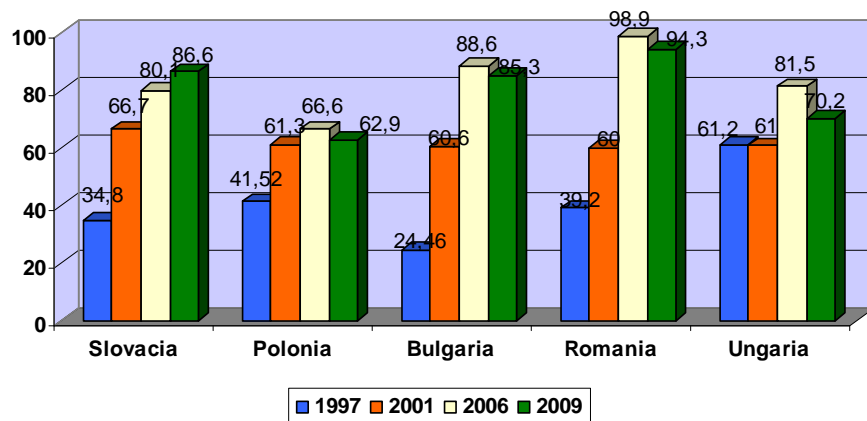


Chart no. 2 **Market share of the foreign banks in the CSEE countries (% of the assets)**

Source: *Elaborated by the author based on Havrylchuk, O., E., Jurzyk, Op.cit., 2006, CEE Banking sector Report, Raiffeisen Zentralbank Osterreich AG Vienna, September, 2010, p. 51*

The increasing number of the foreign banks in the CSEE countries determined also the increase of the concentration rate of the banking market. The barriers of entrance were very often loosened only after a crisis and stimulated the necessity of recapitalizing and establishing a smooth operation of the banking system, as the case of Baltic and Balkan countries after the crisis in Russia, Argentina and the tequila crisis in Mexico [7].



IV. The benefits and costs of the entrance of the foreign capital banks over the financial-banking systems

The benefits and the costs of the entrance of the foreign capital banks over the financial-banking systems and domestic economies are intensely studied in the specialized literature. The main benefits are as follows: - the entrance of the foreign capital banks increases the efficiency of the domestic banking sector, because the increasing competition reduces the costs and raises the profits; - improves the process of granting loans to the people due to an elaborated credit risk evaluation; - develops a better internal legislation regarding the banking survey that will increase the extent of transparency; - the foreign capital banks are expected to give more stable financing sources and thus the internal financial markets shall be less vulnerable to internal crisis; the foreign capital banks can reduce the costs associated with the recapitalization and structuring of the banking sector in the post-crisis period.

The major costs associated to the entrance of the foreign capital banks are as follows: - in the event that the market share of the domestic banks decreases together with the entrance of the foreign capital banks, they will need a financial incentive in order to be able to assume bigger risks; - shall finance the unsafe sectors; - the presence of the foreign capital banks increases the systemic risk of appearing the contagion effect; because the foreign capital banks have different priorities, their crediting type tends to ignore the priorities of the national economy.

Claessens, Demirguc-Kunt și Huizinga (1998) [8] showed that the presence of the foreign capital banks may stimulate the competition, improve the process of granting loans and giving access to world-wide markets. But still exists the costs associated to the entrance of the foreign capital banks, costs that lead to an increasing systemic risk, due to the competition and the need of banks to maintain their market share (Hellmann, Murdock and Stiglitz, 2000) [9].

Claessens, Demirguc-Kunt și Huizinga (1998) observed the effects of the entrance of the foreign capital banks over the national banking sectors. They showed that the foreign capital banks registered bigger profitability rates and interests margins in the developing countries, and the other way round in the developed countries. The conclusion is that once the foreign capital banks embrace the domestic markets, the profitability and general administrative expenses of the domestic banks are reduced [8].



Demircuc-Kunt și Huizinga (1999) presents similar results. They show that the foreign capital banks have generally bigger profits than the domestic banks in the developing countries [8].

Agenor (2001) underlines the fact that foreign investors are not familiar to the domestic issues of the countries they are investing into, and tends to quickly retreat when encountering a problem [10]. This lead often to crisis on the domestic financial markets.

The foreign ownership may have a stabilizer effect over the banking markets of the CSEE countries for the following reasons: first of all, one of the most important advantages is that the foreign capital banks have a lower degree of sensitivity towards the requirements of the host country, and secondly the access to world-wide markets and the international experience in domain. In the same time the foreign ownership may a destabilizing effect on the banking markets, because it can be significantly affected by the changes and strategies of the mother-company. Eventually, there is a fear that the foreign capital banks may take the best clients and the domestic banks remain with the most unsafe clients [11].

A recent study [12] elaborated by Olena Havrylchyk (2010) analyses the impact of the presence of foreign capital banks in Central and Eastern Europe (CEE) regarding the rate of entrance and exit of the companies, their size and the probability of surviving in the first years, but also the impact of the foreign capital banks on the crediting offer for Small and Medium sized Companies (SMC) and ascertains that the acquisition of banks on the domestic market by the foreign investors led to a lower rate of setting up or entering small sized companies, while it led to an increasing exit of the companies. In the same time, the entrance of the foreign capital banks, as Greenfield, stimulated the setting up but also the exit of the companies. Even if the foreign capital banks stimulated the improvement of the crediting offer in the CSEE countries, not all the debtors benefited from. Some of the studies indicate that the foreign capital banks grant fewer loans to small sized companies, thus being concerned in giving loans to big sized companies (Degryse, Havrylchyk, Jurzyk & Kozak (2009)). Olena Havrylchyk illustrates, through her study, that the Small and Medium sized Companies are financially supported mainly by the domestic banks foreign capital banks. The foreign capital banks only increased the competitive pressure on the increasing crediting offer of the small and medium sized companies.



V. Conclusions

As following this study, we ascertain that between all the denationalization policies used by each country, the denationalization concentrated on strategic foreign investors was by far the most successful of all the other strategies, because has stimulated the process of modernization of the banking sectors in a pretty short period of time. In the last years almost all the countries adopted the SFFI method of denationalization.

We noticed, as well, that all the CSEE countries encountered delays in the process of denationalization, mainly because of the reluctant governmental policy. The process of denationalization in the CSEE countries was mostly defined by the entrance of the foreign capital banks on the internal banking market, either by acquiring the domestic banks (private or public) or through setting up subsidiaries and branches. Nevertheless, we noticed that the denationalization of the state-owned commercial banks is substantially finalized in the CSEE countries. In all of the countries, the success of the restructuring and denationalizing the financial sector, depended on the creation of a legislative and institutional infrastructure, efficient for sustaining an appropriate ruling policy.

The entrance of the foreign capital banks was of great importance, because has brought us modern techniques of risk management and financial management, such as know-how.

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