Structural changes in the Polish banking industry – three dimensions of consolidation processes in an emerging economy

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1. Introduction

The history proper of the Polish banking system began only at the end of the 1980s when the two-tier banking structure was introduced in 1989. This new legal framework reshaped the conditions for both the old specialised state-owned banks and the new universal banks, created from the commercially active branches of the National Bank of Poland – the country's central bank.[2] At the same time, the new legal framework made it possible to establish new banks, though this feature became effective only in 1990, with the beginning of the transformation process proper (Table 1). The new supervisory system set up in 1990 provided for both entry and exit rules and prudential norms. There was, however, strong pressure for relatively low barriers to entry,[3] due to the idea that private ownership was to be a major pillar of the new economic system. The number of new private enterprises established in trade, services and some industries grew very rapidly at the beginning of the 1990s. However, low interest on the part of potential foreign investors and very limited domestic capital made it impossible either to privatise quickly the state-owned banks or to create strong new "generic" private banks. Privatisation, especially with the participation of foreign capital, was seen as something for the rather distant future – Poland had not been servicing her foreign debt at that time, so perceived country risk was very high. Moreover, both the macroeconomic situation and the condition of the Polish banks constituted a strong disincentive to foreign investment. Given the desire to increase the role of the private sector in banking, low initial capital requirements were the natural outcome.

Table 1
Number of commercial banks in Poland

1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
5	17	43	89	103	104	82	83	81	83	63	77	74

Source: NBP.

The number of banks in Poland grew quite substantially in that period. However, with the fears of a monopoly of the state-owned banks predominant in the minds of policymakers and the general public alike, this development was regarded as a positive one.

To summarise, we may note that the beginning of the transformation of the banking system in Poland was a period of relatively low entry barriers due to two main reasons: the need to promote the growing share of the private sector in banking and the need to increase competition among banks. The share

[1] I would like to thank Marta Gołajewska and Monika Józefowska for their able research assistance.

[2] The National Bank of Poland, under the old regime of the centrally planned economy, was a typical case of the so-called monobank, ie it was simultaneously an issuing authority, credit regulator and commercial bank.

[3] These low barriers meant that only the minimum amount of capital needed when applying for a banking licence (in 1989 it was 0.4 million zloty) with other norms, more prudential in nature, being similar to standard requirements (eg presentation of a viable business plan, professional and moral requirements for owners and management). This capital limit was increased several times in the early 1990s, up to the equivalent of 5 million ecu in the mid-1990s. A detailed description of this period may be found in Wyczański and Gołajewska (1996).

of these private banks in the loan and deposit market went up from 1% in 1989 to 14% in 1991 and 20% in 1992. The major constraints necessitating this approach were the lack of adequate domestic capital resources and the reluctance of foreign investors to come to Poland at that time.

2. Structural changes as a result of policy reassessment

A change in this policy came only around 1992. The economic transformation, recession, the breakdown of intra-Comecon trade and other economic disturbances, coupled with the weaknesses of many new and old banks, plunged the banking system into a quasi-crisis. Its major feature was a bad loan problem that endangered a substantial number of banks – the share of non-performing loans peaked in 1993 at around 31% and only declined to 29% in 1994.[4] This led the government and the central bank to reassess the policy principles behind decisions shaping the structure of the banking system. The sheer growth in the number of banks was no longer the decisive factor in licensing and supervisory practices.

One important, and often overlooked, factor in this reassessment was the lack of any deposit guarantee facility for newly established banks.[5] However tempting it would have been to allow weak and badly managed banks to go bankrupt, one had to bear in mind the issue of future public trust in the private banking system. Hence, this consideration became another important constraint for the restructuring process.

On the other hand, around the same time internal restructuring processes under way at the state-owned banks made them more attractive for privatisation. Initial attempts to privatise these banks drew on both the existing potential of the domestic capital market and the interest of foreign investors (including public international financial institutions). However, some foreign banking institutions attracted to the growing Polish market wanted to start their operations in a different way – by creating their own branch or subsidiary.

The major reaction to all these developments materialised in a change in licensing policy. All applicants not only faced higher requirements for initial capital, but also were pressed into either participating in the privatisation of state-owned banks or taking over ailing private institutions established after 1990. This second process was intended as a means of protecting the household deposits placed with these institutions. Domestic banks looking for a faster and – at least sometimes – cheaper way to expand also used takeovers of small and weak institutions to that end.

These processes may be thought of as a first wave of consolidation within the Polish banking system. They did not bring about any major changes in concentration, or have much effect on the number of banks, but they did give rise to a novel way of introducing changes within the system.

3. The second wave of changes

After the period of rapid growth in the number of institutions and then the bad debt problems, the main feature of current developments in the banking industry in Poland is the increasing competition. Seeking a better competitive position and the possibility to lower the cost of banking activity seems to be an important incentive for domestically designed and driven mergers.

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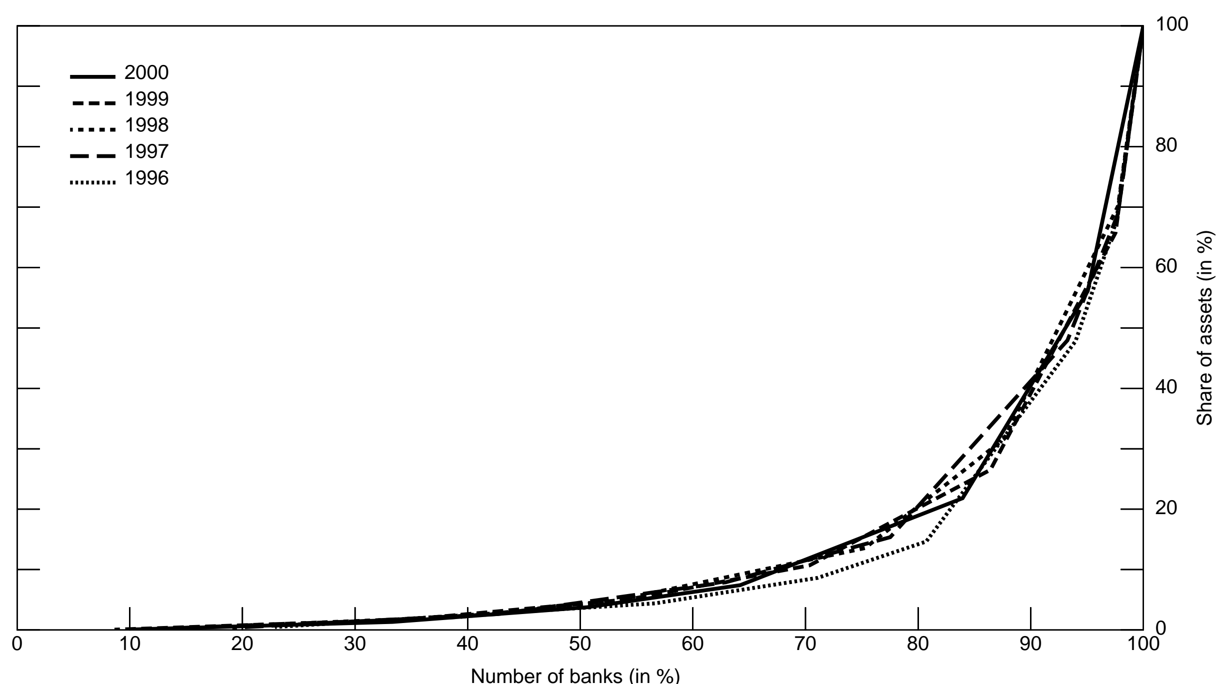
[4] There is already a vast literature on the bad loan problem and the various approaches adopted in transition economies to solve it; for a brief description of the Polish approach, see various papers in Simoneti and Kawalec (1995).

[5] In formal terms, the government had guaranteed deposits at all banks offering deposit services to private households before February 1989. However, in practice only old state-owned banks were covered by this facility. A formal deposit insurance system covering all banks was introduced only in 1995, but the central bank made a semi-formal commitment to guarantee household deposits at private banks according to this system's design a couple of years earlier.

Graph 1

Concentration in the Polish banking system, 1996–2000



Some banks look for opportunities to buy weaker or troubled banks cheaply, so as to improve quickly their market share. Such processes, welcome from the point of view of enhancing stability, used to be supported by the central bank and the Bank Guarantee Fund. The former offered temporary suspension of required reserves and the latter granted long-term loans.[6] The financial assistance provided by these two institutions was of major significance in the period after the takeover of an unprofitable bank. This kind of activity is rather rare now in the case of commercial banks, but is still common within the cooperative sector of the banking system.[7]

Another process, similar to some extent, is the takeover of small niche banks by larger, though usually only medium-sized, institutions. The major reason for this is usually the perception that it is a short cut to establishing a group of services being demanded by the customers of the larger institution. The number of these cases is very limited and the approach seems to be losing its appeal.

Both processes described above can be classified as market-driven consolidation, though in the past some state-owned banks' activities in this area could be motivated by their desire to influence the government positively and therefore have more control over the privatisation processes to which they were subject.

Apart from the aforementioned takeover processes, three other types of consolidation have been observed recently. Their role in shaping the new banking landscape in Poland is increasing gradually and may prevail in the future.

The first type of consolidation occurs mainly among small and medium-sized banks. Most of them are either limited in term of geography or in the range of services they provide. Quite often in the past they established strategic alliances, offering standard services, but the increasing competition clearly shows that this is not enough to ensure their viability. Their controlling shareholders are often reluctant to lose their influence, so they are more eager to merge with banks having similar features and size. These processes concern a group of some 20 banks, where the number of completed mergers is no

[6] These measures were not introduced automatically but required special conditions to be met.

[7] Poland had a cooperative banking sector established as far back as the 19th century, organised in a similar way to the German cooperative system. The banks involved are, however, a very minor part of the banking system in Poland (representing less than 5% of total assets), so they are not described in this paper.

more than three. I do not think that they will influence the shape of the Polish banking system very strongly, mostly because they do not constitute a substantial part of the system. However, I think this process deserves to be mentioned in a paper like this one because of its “learning value”. This type of consolidation is purely market-driven, allowing a lot of legal experience to be accumulated, and some solutions may be applied usefully for mergers among larger players.

The second type of consolidation is a specific outcome of the privatisation processes. Some foreign banks began their operations in Poland relatively early by opening branches or creating small subsidiaries. With their interest in the Polish market growing, they have chosen participation in the privatisation of relatively large state-owned banks as a means of fast expansion. Both their internal considerations, eg the parent company’s policy, and the encouragement of the banking supervisor have given impetus to these kinds of mergers.

Three mergers of this type have been completed so far: in 1999 HypoVereinsbank Polska SA was merged with Bank Przemyslowo-Handlowy SA and in 2000 Bank Austria Creditanstalt SA with Powszechny Bank Kredytowy SA and Citibank Poland with Bank Handlowy. Some other similar mergers will probably take place in the near future.

Before this kind of merger, the banks concerned usually covered different areas of activity. To simplify, foreign banks focused on corporate and trust services whereas Polish banks had a stronger presence in retail banking. Polish banks, which had usually been present on the market for longer, were much bigger in terms of assets, while foreign counterparts were quite small in this respect. There were therefore no significant changes in the market shares of merged institutions (Table 2). Polish banks’ branch networks were much more developed and their customer base was significantly larger as well. These two components provided a solid base for expansion for the “new” foreign bank. In the longer term, this type of merger may allow banks to reduce expenditure by achieving synergies. The other side to these mergers, which was well recognised by the supervisory authorities, was the elimination of unnecessary competition between banks belonging to the same investor and an increase in market transparency.

Table 2

Market share in terms of assets, before and after merger

	Before merger		**After merger**	
	Market share (%)	**Ranking**	**Market share (%)**	**Ranking**
Bank Przemyslowo-Handlowy SA	4.2	7	4.5	7
HypoVereinsbank Polska SA	0.4	31		
Powszechny Bank Kredytowy SA	5.1	3	5.7	5
Bank Austria Creditanstalt	0.6	24		
Bank Handlowy SA	5.0	4	7.6[1]	3[1]
Citibank Poland SA	2.6	13		
Bank Slaski SA	4.3	7	5.8[1]	4[1]
ING branch	1.5	16		

[1] Hypothetically, December 2000. Source: NBP.

In a certain sense, then, the government (in a broad sense) played a role in pushing forward this kind of consolidation, but at the same time there are also efficiency advantages. In my opinion, an unambiguous classification of these types of developments into government- or market-driven consolidation is impossible.

The last important kind of consolidation process in the Polish banking system is the domestic manifestation of the global M&A phenomenon. Most global banks maintain some presence in the Polish banking market, so whenever any consolidation occurs among them, it soon affects their subsidiaries in Poland. A major example, as yet incomplete, is the merger between Bank Austria Creditanstalt and Hypovereinsbank. Both banks are strategic investors in large Polish banks, and their Polish subsidiaries are now in the initial stage of negotiations on how to organise their future activities

in Poland. There is a strong probability that this type of consolidation will continue to be important in the near future.

Table 3

Ownership structure of the Polish banking system (% of net assets)

	1993	1994	1995	1996	1997	1998	1999	2000
All commercial banks, *of which*	93	95	95	95	95	96	96	96
• banks with majority state ownership	80	76	68	67	49	46	24	23
- directly state-owned	76	71	63	51	38	37	22	21
• banks with majority private ownership	13	19	27	29	46	50	72	73
- domestic	10	15	23	15	31	33	25	3
- foreign	3	3	4	14	15	17	47	70
Cooperative banks	7	5	5	5	5	4	4	4

Source: NBP.

BOX: Case study of a bank merger

A separate example of a bank merger in Poland is the case of Bank Pekao SA. It was created from a former specialised bank and three regional banks spun off from the NBP. The legal basis for this merger was a special act passed by parliament in 1996 to promote mergers between state-owned banks. In September 1996 shares of the three banks owned by the State Treasury were used as an instrument for increasing the capital of Bank Pekao SA. This led to the creation of the Group of the Bank Pekao SA. After a few years all group members merged into a single entity under the brand name of Pekao SA.

All the banks chosen to participate in this merger offered a wide range of services and were recognised as universal banks, though Pekao SA operated nationally while the other three banks were regionally anchored. At the same time they had certain areas of individual specialisation, so that the group's activity was not totally overlapping.

The final result of this process is Pekao SA becoming the largest bank in Poland in terms of assets (approximately 20%). However, the almost concurrent privatisation of this bank (partially through the domestic capital market) with a large foreign bank coming in as a major strategic investor makes it currently impossible to identify the role of this government-driven merger in the further development of Bank Pekao SA.

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