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BANKS WITH FOREIGN CAPITAL VERSUS DOMESTIC BANKS IN POLISH BANKING SECTOR[1]

Abstract

Foreign investors control the vast majority of commercial banks operating in Poland. Polish capital is represented only by co-operative banks and 10 commercial banks, including four banks under the control of the Treasury. In 2009, foreign investors owed above 68% of the Polish banking assets. The structure of the banking sector directly results from a privatization process after 1989, when foreign investors played a role of strategic investors in privatized banks. The wide presence of foreign capital brought many benefits. Increased competition forced banks to greater efficiency and improved quality of banking services, making them comparable with the Western Europe countries. However, the increasing involvement of foreign investors in that strategic economy's sector, as banking is, aroused a lot of controversy.

The article presents the Polish banking sector in the context of involved foreign capital there. The paper includes also a profitability analysis of banks. Drawing comparison between banks with 100% foreign equity and cooperative banks representing Polish capital is intended to verify the thesis of the higher efficiency of banks with foreign capital. The article also contains reflections on how Polish banking sector may look like without such substantial inflow of foreign capital. The background of these considerations are the case studies of banks controlled by the Treasury.

Key words: Commercial banks, cooperative banks, banks with foreign capital, Polish banking sector.

Introduction

The banking sector is one of the strategic economic sectors and involvement of foreign capital there is considerably high. Its inflow was accompanied with a conviction of high efficiency and positive results for the Polish banking sector.[2] The aim of this article is a comparative analysis of profitability rates in banks with foreign and Polish capital in order to verify a hypothesis of higher rate of return in banks with foreign capital. The article also includes a brief discussion concerning an influence of foreign investors on the quality of banking services offered. This was to answer a question if the current standard of banking services in Poland is only a contribution of foreign investors.

Polish banking sector

The current Polish banking sector structure is a result of privatization processes after 1989. At the moment of starting an economic transformation, the banking sector was characterized by dominating share of the state in proprietary structure, very high business concentration, lack of experience in terms of how to function in market economy, low level of technology and high share of "bad credits". The banking sector was faced with a serious crisis and that is why it was necessary to take actions in order to improve its condition. It was decided to make changes in three phases: 1) restructuring, 2) privatization, 3) consolidation of the Polish banking sector. The restructuring process consisted mainly in separating 9 banks from the National Bank of Poland structure and their recapitalization. The next step was commercialization of state-owned banks, that is readjustment into companies wholly owned by the State Treasury. These processes were a first step to begin privatization with the use of foreign capital. In Poland, a privatization model with a share of an active strategic investor was used while in the majority of European countries with longer free-market traditions, the most common is the model with dispersed capital structure. (Echaust 2007) Such a form of privatization directly contributed to an increase in foreign capital involvement in the Polish banking system. Measures of this involvement are both number of commercial banks with predominantly foreign capital and share of foreign investors in bank assets.

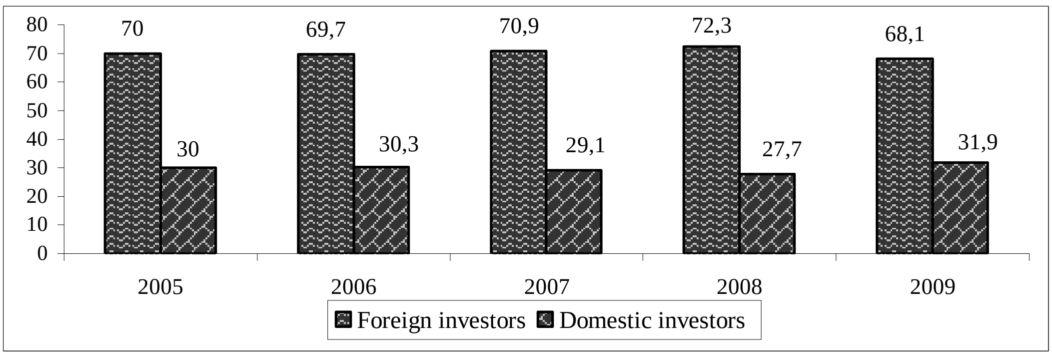
Table 1 Number of banks in Poland in 2005-2009

Specification	Years				
	2005	2006	2007	2008	2009
Banks in general	649	647	645	649	643
Commercial banks (excluding cooperative banks)	54	51	50	52	49
Departments of credit institutions	7	12	14	18	18
Cooperative banks	588	584	581	579	576

Source: (Kotowicz 2010: 2).

In the proprietary structure of the Polish banking sector there is a predominance of banks with foreign capital. At the end of 2009, 39 commercial banks and also all 18 departments of credit institutions belonged to foreign investors. As for domestic investors, they owned merely 10 commercial banks. Four of them, i.e. PKO Bank Polski SA, Bank Gospodarstwa Krajowego, Bank Pocztowy SA and Bank Ochrony Środowiska SA remained under the control of the State Treasury. (Kotowicz 2010: 2)

Graph 1. Share of foreign and domestic investors in national assets of banking sector in 2005-2009 (in %)



Source: own work based on (Kotowicz 2010: 22).

The power of foreign capital in banking sector is revealed most strongly when share of foreign and domestic investors in sector assets is considered. In 2009, the share of investors representing the domestic capital was slightly under 32%, including 20.8% owned by banks controlled by the State Treasury. The remaining part of sector assets, which is over 68%, was owned by foreign investors.

An integral part of the Polish banking system are cooperative banks representing Polish-only capital.[3] In 2009 in Poland there were 576 such banks. Although their number is significantly higher than that of commercial banks, the importance of cooperative banks in the banking system is incomparably lower. It is mainly a result of local scope of operation of such banks. As a result, their assets are relatively low in relation to those owned by commercial banks, and are slightly over 10%.

In the coming years the Polish banking sector will probably undergo some consolidation processes rather than an intensive inflow of foreign capital to this sector as it did in the 90s of the 20th century. Attractive privatization offer is basically already unavailable. However, one cannot rule out the possible emergence of new players in Poland. The ROA in banking sectors of other European Union countries is lower than in Poland, which makes the Polish banking system still attractive for potential investors.

Profitability of the Polish banking sector – comparative analysis: banks with foreign capital and banks with Polish capital

Three profitability rates were applied in the paper calculated for three categories of banks: commercial banks generally representing an average in banking sector, commercial banks with 100% foreign capital and cooperative banks representing Polish-only capital.

Taking the net turnover profitability ratio into consideration, banks with 100% foreign capital were achieving lower rates than commercial banks in general. In 2005-2008, lower profitability of banks with foreign capitals could be the result of intentional lowering of profitability and transfer of profits to foreign parent companies in order to lower the taxation. (Maltańska 2009: 139) In 2009, the net turnover profitability ratio reached a negative value. Therefore, in the times of deteriorating economic situation connections had appeared between banks with 100% foreign capital and world markets. Parent companies were generally in more difficult situation than their national branches in Poland and therefore the latter supported banks in their mother countries.

Profitability rates of equity capital (ROE) and assets (ROA) for banks with 100% capital indicated similar tendencies. In all analyzed years it had been under the rates for commercial banks. Moreover, in 2008-2009, banks with 100% capital suffered more from deteriorating economic situation. It resulted in significantly lower (and negative in 2009) profitability ratios than in other bank categories.

Table 2. Selected profitability ratios in the Polish banking system by bank categories

Specification	2005	2006	2007	2008	2009
	Net turnover profitability rate, in %				
Banks with 100% foreign capital	5.8	6	4.9	2.6	-0.3
Cooperative banks	14.2	13.6	15.9	16.4	12.7
Commercial banks in general (excluding cooperative banks)	9.6	11.0	10.6	6.5	4.1
	ROE – return on equity ROA - return on assets				
Banks with 100% foreign capital	13.0 1.4	10.9 0.9	13.2 0.9	7.3 0.5	-1.2 -0.1
Cooperative banks	13.6 1.5	11.8 1.2	13.7 1.4	15.4 1.6	10.6 1.1
Commercial banks in general (excluding cooperative banks)	15.0 1.6	16.4 1.6	16.5 1.6	15.5 1.3	8.0 0.8

Source: own work on the basis of: Monitoring of Banks 2005-2010.

Surprisingly cooperative banks achieved good profitability performance. The net turnover profitability ratio in all analyzed years exceeded analogous rates in banks with 100% foreign capital and commercial banks in general. Moreover, in the prosperity period, i.e. in 2005-2007 this ratio was even twice as high as in banks with 100% foreign capital. Higher profitability of cooperative banks appeared also during comparison of ROE and ROA rate. In 2008 when the first symptoms of economic slowdown appeared, ROE and ROA for cooperative banks increased in comparison with the year 2007, whereas for banks with 100% foreign capital, ROE and ROA decreased almost by 45%. In 2009, profitability of cooperative banks decreased but remained positive, whereas ROE and ROA for banks with 100% foreign capital were negative, which means that these banks achieved a negative financial result.

Polish banking sector without the involvement of foreign capital?

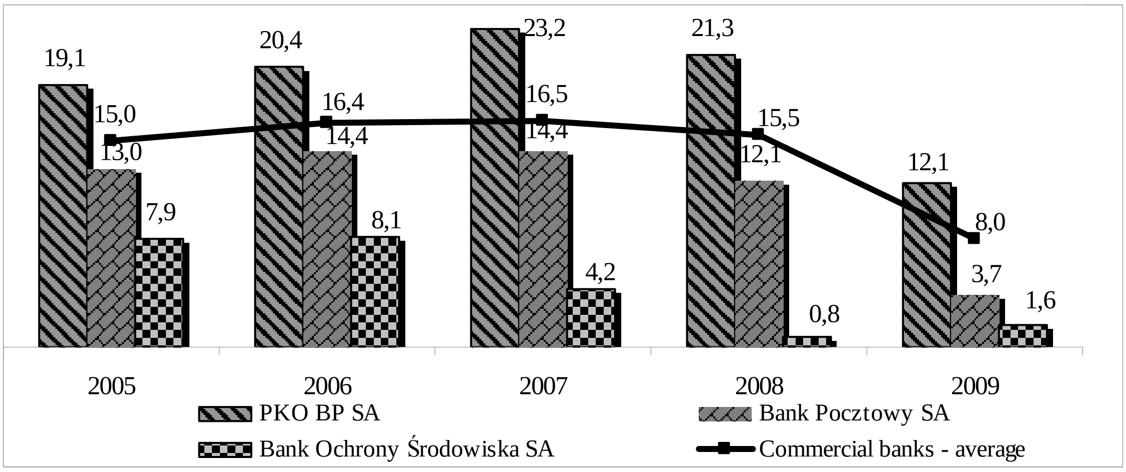
In economic literature, many advantages of foreign capital inflow to Poland are emphasized. Privatization with the involvement of foreign investors forced banks to operate in free competition conditions and to strive for achieving as high efficiency as possible. Foreign investors also contributed to:

- modernization of the offer by technology transfer;
- developing many new products and banking services;
- increasing stability and reliability of banks by strategic investor’s guarantee and increasing the capability of granting high credits.

It is worth asking how the Polish banking sector would look if the foreign capital had not flown in such a quantity as it had. Discussions were made according to a case study of banks with Polish capital considering their profitability and banking offer. For analysis, the largest banks were selected: three banks owned by the State Treasury: PKO BP SA, Bank Pocztowy SA and Bank Ochrony Środowiska SA. Bank Gospodarstwa Krajowego - also a considerable state-owned bank, was excluded from the analysis. Its way of functioning much differs from a standard commercial bank as it is a national bank performing over a dozen government programmes and appropriated funds.

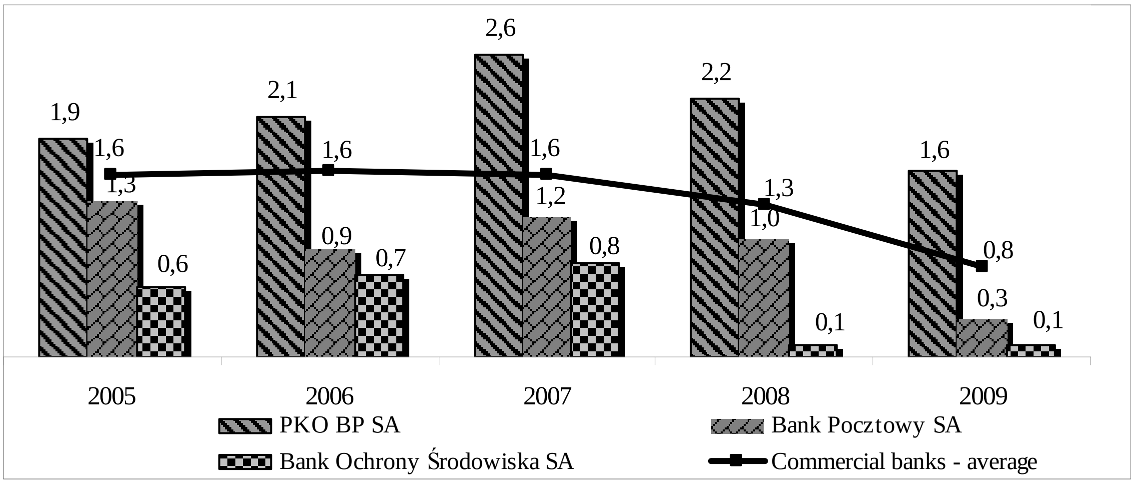
Graph 2 Profitability rates in banks with Polish capital against the average profitability of commercial banks

1) ROE



Source: own work on the basis of: annual reports of PKO BP SA, Bank Pocztowy SA and Bank Ochrony Środowiska from 2005-2009.

2) ROA



Source: own work on the basis of: annual reports of PKO BP SA, Bank Pocztowy SA and Bank Ochrony Środowiska from 2005-2009.

Considering the ROE and ROA rates, PKO BP SA achieved the best results. In 2005-2009 both rates were higher than banking sector average. Average value is made mainly by banks with foreign capital and therefore, it can be stated that PKO BP SA is more profitable than competitive banks with foreign capital participation. Rates achieved by Bank Pocztowy SA oscillate around the average (particularly in the case of ROE) but more often they are under this value. In turn Bank Ochrony Środowiska SA is featured by the weakest profitability rates. It indicates its difficulties to generate profit at conditions of competition from other commercial banks.

Like competitors with foreign capital, all three Polish banks use segmentation of clients and offer separate banking products for individual clients, corporations (depending on the size of corporation) and institutions (e.g. condominiums). Against the background of the analyzed banks, PKO BP SA bank uses the widest range of products as a result of higher number of serviced clients and the necessity of adjusting the offer to their expectations. All banks provide a possibility of choosing a form of investment exceeding bank deposits e.g. that is of investing one's savings in investment funds. Purposely, electronic banking is not mentioned here because it is a standard in commercial banks regardless of capital ownership.

Conclusion

Accessibility of statistical data and size of this article disables determination of all rates which would give a full view of functioning of banks with 100% foreign capital. The calculated indexes are only part of necessary analysis. Profitability rates of banks with 100% foreign capital are lower than the average of commercial banks in the Polish banking system and that of cooperative banks. This is why there is no advantage of foreign over Polish banks in view of profitability.

After the analysis of profitability and offer of banks controlled by the State Treasury it is hard to tell how the Polish banking sector would look without such a large involvement of foreign capital. The offer of banks representing Polish capital, especially PKO BP SA, is comparable with offers in banks owned by foreign investors. It can be stated that without the inflow of foreign capital to the Polish banking system, cash dispensers, credit cards, Internet accounts, modern financial services would also be present, but would appear much later. However, one should emphasize the role played by foreign investors in forcing other banks to adjust to new realities. Polish banks have aptly adjusted their offer to conditions dictated by such strong competition.

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[1] *Thesis co-financed from the assets of the European Social Fund, National Budget, Podlaskie Voivodeship Budget and Polish Innovation Strategy project – development of implementing system.*

[2] Simultaneously increasing involvement of foreign investors in such a strategic economical sector as banks caused controversies. Concern was caused predominantly by the fact that taking over majority of assets will result in a situation where majority of decisions concerning economy will be made abroad.

[3] Main objective of such banks is to guarantee the access to basic banking services to members of cooperative and clients in local environment.