BANKING SECTOR IN THE SLOVAK REPUBLIC

DEVELOPMENT, RESTRUCTURING AND PRIVATISATION

Part I

Ing. Dana Tkáčová
Faculty of National Economy, University of Economics, Bratislava

The interaction between the problems of efficiency and economic effectiveness facing the banking sector on the one hand and the existing macroeconomic imbalance on the other is obvious. To restore the macroeconomic balance, it is critical to restructure the banking industry. That is both a prerequisite and a condition for solid performance of the entire economy. It is not even theoretically possible to assume there would be absolutely no correlation between the national economy and its banking industry. On the contrary, a distressed and stagnating economy is bound to have a problematic banking sector, and to restructure the banks, without restructuring the economy and the corporate sector, would be nothing in the way of a systemic solution for the long haul.

We believe there are several levels to „restructuring."

The restructuring of the entire banking system, or industry, means a set of radical changes concerning in particular the banks' ownership, their position in the economy, banking business objectives, new forms of banking, new products and other aspects. This is the „broader" definition of restructuring, covering the whole banking industry and, ultimately, the entire national economy. The implementation of this type of changes is directly connected with the banking industry's transformation into a structured banking system typical for advanced economies.

In its „narrower" context, restructuring means a specific change affecting a single bank or a group of banks, or a specific change with a direct impact on individual bank products on either side of a commercial bank's balance sheet. Although its quality does have a bearing on the quality of the banking system, or its implementation is required for its further development, the call for change is not prompted by the shift to a new market-based model of banking, but often by errors and mistakes in banking operations. The restructuring of banks' loan portfolios would fall into this category.

A banking industry-wide transformation involves a qualitative shift to a standard which can measure up to the needs of a market economy. The objective is to develop a system which would be comparable with banking systems operating in advanced countries and could gradually hook up with the European financial structures.

The scope and complexity of banking system restructuring makes it impossible to go into details on all the issues that come with it. That is why we will take just a brief look, with a certain degree of abstraction, at the history of Slovakia's banking sector since 1990, focusing on the issue of bad loans, i.e. loan portfolio restructuring in selected banks, and the theoretical aspects of ownership at banks undergoing transformation.

What the transformation process kicked off in 1990 brought in the first place was a liberalisation of economic life reflected in gradual demonopolisation of the economy, privatisation of national property, price liberalisation, foreign trade liberalisation and a number of other things. It also changed the banking system in terms of both quantity and quality,

The banking system restructuring is a yet unfinished process which was effectively set underway by laws No. 130/1989 Zb. and 158/1989 Zb.

The basic design of a new banking system was laid out by a Directive on a Comprehensive Transformation of the Economic System approved by the former Czechoslovak government's resolution No. 29/1988, and its resolution No. 196/1988 on measures adopted to separate the issuing from the lending and commercial activities of the banking industry, and on lending rules.

The laws and resolutions mentioned above had set two tasks for the banking industry:

a) to provide for a monetary plan;

b) to design a new banking system.

The monetary plan was supposed to use monetary lending and foreign exchange instruments to support the objectives pursued by the economic policy:

- to restore economic balance;
- to cut deficits in a number of economic areas;
- to implement anti-inflation measures;
- to ease the pressure on the payment balance in freely convertible currencies, etc.

The basic concept for a new banking system envisioned the establishment of a bank of issue, as a bank of banks, whose job would be to:

- perform monetary functions in monetary planning and policy;
- regulate money supply and lending rules;
- manage foreign currency reserves;
- co-ordinate payments and settlements;
- issue cash and maintain cash circulation.

Commercial credit banks were designed as all-round banks with nationwide coverage. Some of the issues left to be cleared on the run included their financing schemes, basic banking procedures, organisation structure and relationships between the bank of issue and commercial credit banks, and between the banks themselves.

The institutional division of the banking sector into a central bank and a web of commercial (credit) banks was the cornerstone of the new banking system design, with the separation of tasks intended mainly to reduce the centre's influence on specific loan allocations. That, as Václav Klaus argued, was the objective pursued in the transformation of banking sector economics, or one of the main reasons for creating a structured banking system. As J. Daněček notes in this context, a bank of issue has no business participating in or interfering with the redistribution of credit resources between commercial banks and other financial institutions. A market-driven credit allocation should be done optimally by commercial banks based on the principles of profitability and return, i.e. funds should be channelled to places where they are most needed and demanded, and which can offer the highest yields. That way we can establish a link between the financial and the productive sector of an economy, in particular its investment-intensive areas. In other words, this restores the full functionality of money, which is both a prerequisite and a side-effect of the entire economic reform and banking system restructuring.

Banking system developments

The most important change rooted in the legislation mentioned earlier on was the demonopolisation of banking, a phase-out of state interventions in the operation of commercial banks.

The demonopolisation process started out with the splitting of the Czechoslovak State Bank (ŠBČS) into a likely-named bank and three commercial banks: Komerční banka, a.s., Praha; Investiční banka, a.s, Praha, and Všeobecná úverová banka, a.s., Bratislava. With that move, the banking system turned from single-tier into a two-tier structure, with the bank of issue, here the ŠBČS, forming one layer, and the three commercial banks making up the other one.

As far as ownership is concerned, most banks were private, others went private in the first round of coupon privatisation. The emergence of non-state banks put an end to the state banking monopoly, spelling a shift to all-round banking as a logical evolution from the formerly strict specialisation.

Even though banks were set free to do business in a new economic environment, the legislation lagged behind, failing to raise the necessary curbs and define the rules of banking, which soon resulted in a non-transparent business environment and high uncertainty.

The adoption of the Banking Act No. 21/1991 Zb. and Act No. 22/1991 Zb. on the Czechoslovak State Bank (ŠBČS) marked a milestone in the development of Slovakia's banking industry, laying down the legislative groundwork for the operation of the central bank and commercial banks (to put this into perspective, we need to say that it is the speed at which reforms are introduced in the financial market, i.e. the banking industry as well, which was and still is the reason why legislation gets adopted ex post).

This period (from February 1992 until the end of the calendar year) was marked by a considerable under-capitalisation of commercial banks, with the capital to risk-weighed assets ratio ranging from 0.84 to 1.22%, except for ČSOB and Živnobanka who had foreign exchange activities.

The industry-wide capital adequacy ratio was a mere 1.72%, way below the 8% standard set in the Basle agreements. More than 90% of all funds were held by state-run financial institutions.

1992 saw the privatisation of several state-owned banks: Komerčná banka, Všeobecná úverová banka, Česká sporiteľňa, Živnostenská banka, and Investičná banka, with the National Property Fund retaining a 40 – 50% stake. A 3% portion of shares was set aside to satisfy restitution claims, the rest was put up for subscription in the coupon privatisation.

Before 1992 was over, the banking infrastructure went through a bustle of evolution accompanied by a growing range of services. On 31 December 1992, the Slovak banking sector counted 15 commercial banks with aggregate subscribed capital adding up to Sk 9.149 million, with foreigners holding 7.83%. There were no foreign bank branches yet on the market in 1992.

The emerging community of commercial banks grappled with largely the same problems – in particular an unstable and still transforming economic environment, lack of skilled human resources, insufficient technical equipment, no software, etc.

The primary goal behind banking industry restructuring was to separate the issuing and commercial bank activities and to build up money and capital markets as the opposite to the commodity and labour markets. The secondary objective was to increase the central bank's role and responsibility for monetary developments and for maintaining a stable currency, and to foster commercial banks' business operations.

The rise of an independent Slovak Republic brought far-reaching qualitative changes to the entire society. The complexity and difficulties of the transformation process were felt especially in the economic sector. The banking sector, as a critical component of the financial market, can be seen as a mirror for the complicated and interconnected problems of the entire national economy.

Despite a hostile economic environment, the pace of change is considerable and still speeds ahead. At this point, we will look at banking sector developments from the perspective of evolving market behaviours.

With regard to the developments outlined above, we think it was a critical step to found the country's central bank – the National Bank of Slovakia (NBS) – which, along with several other tasks, was given the job of supervising and ensuring a meaningful development of the commercial banking sector.

The principal mission of the NBS was to introduce, and maintain the stability of, the national currency, and to carry on the formation of an economic and business environment for the system of commercial banks. This was a tough trick to do, as it was the Prague-based ŠBČS who used to take care of all these things before – monetary policy, foreign exchange operations, banking supervision, etc. Looking back, though, we can say NBS did pretty well, as a number of its accomplishments document – the introduction of a new currency, its performance against foreign currencies, the paving of way to full convertibility, as well as a fairly good inflation control track record.

In creating and forming a business environment for commercial banks to work and live in, the NBS has reached a standard typical for advanced economies.

Compared to the time before Slovakia went separate, the banking industry hasn't experienced any major changes after this milestone as far as the banking network structure goes. It still remains somewhat narrow compared to advanced economies, made up of commercial banks, savings banks and specialised banks.

As to ownership, banks organised as joint-stock companies still prevail. They are mostly all-round enterprises with a varying degree of specialisation. The two special-purpose banks – Konsolidačná banka and Slovenská záručná banka – cannot be likened to other banks, as they don't offer regular services. Given their activities, two home savings banks – Prvá stavebná sporiteľňa, a.s., and Stavebná sporiteľňa VÚB, a. s. Wustenrot, a.s., both joint-stock companies – can be measured against other banks only in some indicators.

If being an all-round bank means to provide an extensive line of banking services to a wide range of customers (including securities transactions, which add to the existing versatility), we can say all other banks operating on the Slovak banking market could dress the part.

The 1990 – 1993 period was one when the Slovak banking sector seemed to be through the main stages of the development of a structured two-tier banking system, associated with largely extensive growth (see data below), arriving at a point where the commercial banking train was already full institutionally and commercial banks had to turn to business activities focused on intensive growth.

On 31 December 1993, 18 commercial banks vied for the Slovak market, with 15 registered as joint-stock companies and three state-owned. The better part of the pack set up their headquarters in Bratislava – 15 banks, followed by Banská Bystrica, Žilina, and Košice with one head office each. There were 10 foreign banks as well, with 9 based in the Czech Republic and one in the Netherlands. Six other foreign banks had their representation offices in Slovakia. In terms of ownership, the Slovak banking sector consisted of the following number of banking operations:

As at 31 December 1993, the banking industry comprised 28 banking institutions and 1,086 organisation units.[1]

Type of bank ownership	Number of banking institutions	Number of organisation units
1. State-owned financial institutions	3	701
2. State-controlled banks	4	260
3. Privately-controlled banks	3	36
4. Banks part-held by foreigners	8	56
5. Foreign bank branches	10	33

[1] National Bank of Slovakia Statistics, 1993

To be continued in issue 9/2001