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*Market of financial and banking services*

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# FOREIGN CAPITAL IN THE BANKING SYSTEMS OF POLAND AND UKRAINE (COMPARATIVE ANALYSIS)

## Abstract

The influence of foreign capital on the development of banking systems in Poland and Ukraine has an undoubted practical interest with respect to intensification of information processes in Europe. Historical and systemic aspects of the problem of determining positive and negative results in every stage of each country's banking system reformation are examined.

## Key words:

Banking system transformation, independence of banks, competition, privatization, securities market, foreign capital, banking groups of capital, unforeseen threats, foreign banks' affiliated branches.

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It is well known that questions related to the role that foreign banks play in national banking systems of countries with transition economies and the overall influence of foreign capital on development of such systems are of interest to specialists, as well as to society in general. For Ukraine this issue lately acquired additional importance because of its intentions to join the World Trade Organization. It is known that one of the requirements to entry is removal of restrictions on opening uncapitalized branches of foreign banks in the country. Similar requirements may be expected in the course of eurointegration. With regard to this, a study of experience of other post-socialist countries is appropriate: foremost Poland, which due to some objective and subjective reasons found itself ahead of us in all afore-mentioned processes – development of the banking system, entry in the WTO, and integration into the European Union.

Such analysis is also interesting because a comparison can be made beginning with a common starting point for both countries. The first Polish banks appeared in the XIV century, when both countries were parts of one state – Rich Pospolita. Initially in Kraków, and by XVIII century in Warsaw first bank houses were established.

The first mention of bank establishments in Ukraine are dated to XV–XVI century. Originally, the main centres for bank establishments were Galychyna and Podillya. First exchange houses appeared in Kam'yanets-Podilsk, and by 1586 in the Statute of Uspensk Stavropigiysk Brotherhood in Lviv a record was made regarding non-interest bearing loans to brothers [1].

In 1783, the first savings bank appeared in Galychyna, and by 1790 the Armenian bank «Mons pius» («mountain of mercy») restarted its activity in Lviv. In 1826, an Austrian savings bank was opened in Lviv, and in 1853 a branch of the Austrian National Bank was activated [1].

An Austrian credit bank (1862) and an English-Austrian commercial bank (1865) were soon established in Lviv. An Austrian-Hungarian bank began operations in Galychyna and Bukovyna in 1881.

At the beginning of the 20$^{th}$ century, subsidiaries of many different banks operated in Lviv: Warsaw trade, Prague credit, Łódz depository, Warsaw discount, Italian insurance «Assicuratsioni Generali», Armenian, Russian-Asiatic, and others [1].

Since 1781, the offices of Saint Petersburg Banknote Bank have been functioning on the territory of Ukraine (Kyiv, Kharkiv, Nizhyn), which was part of the Russian Empire. By the end of the 19$^{th}$ century, Kyiv, Kharkiv, Simpheropol, Katerynoslav, and Odessa were the major banking centres in the Ukrainian part of the Russian Empire.

The Bank of Poland, the eighth largest bank in the world, was created by the will of Russian tsar and King of Poland at that time – Nicholas I. It is worth mentioning that the Bank of Russia was not established until 1860. In the royal decree on establishment and activities of the Bank of Poland Nicholas I wrote, that the aim of the newly founded Bank of Poland was «financing of internal debt, as well as expansion of trade, crediting, and national industry. The bank obtained the right to issue bills, which could be exchanged without any delay or refusal at the will of any who so wished» [14].

Thus, the original Polish Central Bank was tasked with some very important duties. Likewise, the modern Polish central bank also performs many critical functions. Foremost, like the first Polish Central Bank, it is the issuing bank, as well as the bank of the state, bank of banks, lender of last record, and the central currency unit (manages currency reserves of the state).

It is interesting that the birth of the independent Ukrainian banking system is connected to Poland, namely – to cities of Tarnów and Częstochowa.

On December 22, 1917, Central Rada passed an act of formation of the Ukrainian State bank. When hetman Skoropadsky came to power on August 10, 1918, the Council of Ministers approved the Statute of Ukrainian State bank. In this Statute the mission of the bank was formulated. The first paragraph read: «The aim of the Ukrainian state bank is to make easier the monetary circulation, to support state trade, industry, and agriculture in Ukraine by means of short-term lending, as well as to maintain a monetary system» [2].

In order to satisfy the needs of the landlords and to develop the agriculture industry the State Land Bank was founded on August 23, 1918.

However, civil war stopped the development of the young Ukrainian banking system. As early as February 1919, the Ukrainian State Bank was evacuated to Vynnytsia, then it was placed in Ternopil, and later on – in Zalishchyky. From there it moved to Kam'yanets-Podil'sk and, eventually, ended up on the territory of Poland, first in Tarnów, and after a few more moves in November 1920, stopped in Częstochowa. In August 1944, Nazis moved the property and documents of USB to an unknown location [2].

So ended the pre-war history of the independent Ukrainian banking system. After the war concluded and Western Ukraine was united with the rest of Ukraine, banks developed within a single banking system of the Soviet Union. At that time, in addition to the State Bank of the USSR, four specialized banks (Prombank, Silgospbank, Torgbank, Tsekombank) operated together with a system of community banks, which reported to local authorities. In 1955, pursuant to resolution № 1104 RNK USSR dated June 9, 1955, the Ukrainian republican office of the State Bank of the USSR was organized in Kyiv. A new era began on March 20, 1991, when Verhovna Rada approved the law «About Banks and Banks' Activity». Article I of this law promoted independence of the banking system of Ukraine and established that it consists of the National Bank of Ukraine and commercial banks. This law made a necessary legal foundation for activities of banks under the conditions of market economy. The passage of the 1999 law «About the National Bank of Ukraine» was an important moment. But this is the historical way of the two central banks only.

Modern central banks and their policies face problems and obstacles never encountered before, such as threats to the national banking systems from globalization (bank crises, mergers and acquisitions of local banks with foreign banks, difficulties of controlling capital inflows). Central banks handle these problems with varying success.

Under conditions of socialistic method of management in Poland, according to principles, established in this case, the dominant position was occupied by the National Bank of Poland (Narodowy Bank Polski), which, as a monopolist, executed all functions of financial mediation through its branches.

Several basic stages can be singled out in the process of the Polish banking system's transformation to market relations.

The first stage of reformation began in 1982.

Creation of the market banking system in Poland started in 1982, when the first reforms of the banking system and banking law were conducted on the basis of the new Law «About Banks», enacted on February 26. This law allowed:

- to separate the banking apparatus from financial authorities thus forming an independent economic vertical structure;
- to assign subordination of the bank apparatus not to the Ministry of Finance, but to the Council of Ministers and the Parliament.

These changes were substantial due to the following reasons:

- first, the banking system was now detached from the ordinary economic system in an institutional sense;
- second, substantial independence and autonomy was provided to commercial banks;
- third, the law established new relations between banks and enterprises and created conditions for collaboration on contractual basis.

In 1982 the following banks functioned in the Polish banking system in addition to the National Bank of Poland:

Bank Handlowy SA (Foreign Trade Bank), Bank Polska Kasa Opieki SA, (Bank PEKAO SA) and Bank Gospodarki Zywnosciowej SA (Agricultural Bank), including cooperative banks (1663 at the time) related to it.

However, the new Law had already provided for the possibility of establishment of new banks with the approval of the Council of Ministers. The General Savings Bank was split out of the NPB and named the State Bank (PKO BP). Today it is known as General Savings-bank Bank Polish SA (with a 100% state ownership). In 1986, in response to the necessity to develop Polish foreign trade, the JSC Export Development Bank was established (BRE SA).

The second stage of the banking system transformation started in 1988.

As a result of change in statutory provisions it became possible to earn interest on credits and deposits, and also tariffs for bank services real.

By decision of the Council of Ministers, commercial activity began to be separated from the central bank. Nine State credit-savings banks that were set up on the basis of affiliation with the National Bank of Poland started their operations on February 1, 1989. These banks took over NBP's credit-deposit operations and formed the foundation for universalism in the Polish banking system. Initially, they functioned as state-owned, but quickly grew into joint-stock companies with 100% ownership in the public domain. In this way they prepared themselves for privatization. These banks are Bank Gdański in Gdańsk, Bank Sląski in Katowice, Bank Przemyslowo-Handlowy in Kraków, Bank Depozytowo-Kredytowy in Lublin, Powszechny Bank Gospodarczy SA in Łódz, Wielkopolski Bank Kredytowy in Poznań, Pomorski Bank Kredytowy in Szczecin. Powszechny Bank Kredytowy SA in Warsaw, and Bank Zachodni in Wroclaw.

Four specialized state banks functioned in Poland in addition to these banks:

- General Savings Bank (PKO BP), which accumulated savings from individual clients;
- Foreign Trade Bank, which conducted international payments servicing;
- Bank PEKAO SA, which focused on individuals' deposits in foreign currency;
- Agricultural Bank, which was the financial and organizational centre for cooperative banks and engaged in financial maintenance of the agrarian sector.

The third stage of reforms began in 1989.

It was the year of important market reforms in the Polish banking system. On January 31, 1989, two laws fundamental for development of the banking system were passed by parliament and put into force - the Law «About banks» and the Law «About the National Bank of Poland» [3]. Major changes to the activity of NBP in the Law «About NBP» were as follows:

- two-tier banking system was formed (central bank and commercial banks of universal type);
- measures to fully separate the central bank from commercial activity were taken;
- the Bank of National Economy was reestablished as a state bank that would realize the aims of the state economic policy;
- the system of budget crediting by NBP was changed to remove automatic coverage of the budget deficit;

- discounts, rediscounts, and Lombard credits were introduced as major instruments of monetary banking policy;
- bill of exchange turnover was reinstated;
- requirements of licensing policy were simplified and liberalized; creation of private banks with a share of foreign capital and with foreign capital only became easier.

New rules for the banking system caused the following advancements of the Polish commercial banks to market relations:

- economic basis for banking independence was strengthened, fair value of deposits and credits was determined;
- state banks' privatization process has begun;
- conditions for banking competition were created;
- partner relations among firms and banks were set; everyone was granted an opportunity to choose among banking services offered;
- possibilities for bank competition were created by means of distancing from particular branch specialization and domicile.

The fourth stage covers a period between 1991 and 1992; the preparation for the Polish banking system to privatization had begun. Early signs of privatization were:

- equity market creation with participation of banks (broker houses at banks);
- transformation of nine state banks into joint-stock banks with 100% state ownership;
- actual privatization of some banks: Bank of Economic Initiatives JSC (BIG SA) and Bank of Development and Export JSC (BRE SA). The stocks of BIG SA and BRE SA appeared on the Warsaw Securities Exchange.

The fifth stage – 1993–1996.

Legal foundation for bank transactions was improved in order to stabilize and refine the banking sector and to eliminate bottlenecks in payments; a market for banking bond circulation was also created. These were the applicable laws:

1. The 1993 Law «About Financial Restructuring of Firms and Banks» created legal foundation for enhancing state banks' credit portfolio, burdened by unrepaid loans that were awarded to state structures in 1980s-1990s. This was accomplished by turning unrepaid loans into restructuring bonds, financed by the state budget [4].

2. The 1994 Law «About Restructuring of the Agricultural Banks and Cooperative Banks' was aimed at restructuring bad debts of state agricultural enterprises by also turning them into state bonds [5].

3. The 1994 Law «About Bank Guarantee Fund» established a system of deposit guarantees, obligatory for all banks. According to this law, deposits up to 1000 Euro were guarantied 100 percent. This quota has been increasing systematically since 1995, and is 22 500 Euro today [6].

The other reasons for changes in Polish economic Law included the necessity to make compatible the Polish legislation (laws about economic partnerships, accounting, financial services, fundamentals of competition, consumer rights protection, bank supervision, and measures against «money laundering») to the standards of European Union, as well as a difficult economic situation of the Polish banks.

The sixth stage – 1997.

The Polish banking system stepped into the next stage of its development in 1997, when new banking laws were approved by the Parliament. The Law «About the National Bank of Poland», the Law «About Banks», and the Law «Collateral and Mortgage Banks» were the three important legislative acts ratified on August 29, 1997, and came into force on January 1, 1998 [7].

Eliminating the defects of their predecessors, these laws brought the legislation up to the present development level of the national banking system. The new banking rules considerably extended the legal basis of Polish banks and adjusted banking laws to the standards of the European Union. With the introduction of this legislation, new institutions appeared in the banking system: Monetary Policy Council and Commission on Bank Supervision. Monetary Policy Council is a deliberative and consultative unit of the Chairman of the NBP in the field of its monetary policy. CBS is an organ that supervises over the banking system (together with chief bank supervision inspector).

The seventh stage occurred after 1997.

The following events happened in the Polish banking system after 1997:

1) although an inflow of the EU banks' capital did not reach the expected level, the competition on the side of the EU banks became substantial (since the beginning of Poland's preparations for integration into the EU on January 1, 1999, foreign banks gained free access to form affiliations in the Polish banking market without having to be licensed by the Polish supervisory authorities);
2) further privatization of the banking system, mainly with foreign capital;
3) consolidation in the Polish banking system (liquidating – by liquidation of the weakest units, administrative – conducted by a proprietor or the State treasury with a special approval, voluntary – by voluntary bank unification);

4) adjustment of banking laws to the EU requirements [8];

5) increasing share of foreign capital in the Polish banks.

From the very beginning, the process of the Polish banking system privatization was financed by foreign capital, because the analyses of private savings in Poland showed their insufficiency for privatizing state capital in banks. Therefore, it is possible to assert that the economic situation in Poland, as well as the necessity in development of the banking system, forced Polish commercial banks to search for strategic foreign partners who would support the changes in Polish banks with their capital and know-how. Chronologically, this collaboration took the following forms:

- technical assistance to Polish banks in the form of stand-alone projects in structural modernization and reorganization;
- «twin-agreements» with foreign banks, aimed at adopting polish banks to market conditions;
- participation in privatization of the Polish banks [9].

The main argument of the supporters of foreign (private) capital in Polish banks was that private (foreign) banks operate more effectively and have lower maintenance costs than state banks. An expectation for inflow of modern technology from foreign parent banks was another argument.

Foreign capital inflow to Polish banks, methods of taking over the shares, and the share of foreign capital in the Polish banking system are shown in the following examples of several banks.

*Table 1.*

**Polish banking system privatization process**

**Bank Śląski (The Silesian Bank) was founded in 1989**

| | |
|---|---|
| 1993 | ING Bank acquired 25.9% of shares, issued at the primary market |
| 1997 | ING Bank increased the share holding to 54.1% |
| 2000 | ING Bank acquired 75% of shares, through public announcement about purchase of retail shares; Bank Śląski changed its name to The ING Bank Śląski SA |

**Bank PEKAO SA (Bank Polska Kasa Opieki SA) was formed in 1929**

| | |
|---|---|
| 1996 | Until September 16, 1996, about 99% of shares belonged to the state. On September 16, 1996, according to a special order aimed at consolidation of banks with 100% State Treasury's share, a PEKAO Group SA was formed with the dominant Bank PEKAO SA in Warsaw and Deposit–Credit Bank SA in Lublin, Pomorian Credit Bank SA in Szczecin, and General Economic Bank in Łódz [8]. The PEKAO Group SA functioned until the end of 1997 |
| 1998 | At the beginning of 1998, banks that formed the PEKAO Group SA were liquidated, becoming part of Bank PEKAO SA In August 1999, Bank PEKAO SA was privatized. Shares were acquired by:<br>Unicredito Italiano and Allianz Aktiengesellschaft – 52.09%;<br>EBRD – 5.29%;<br>Employees – 14.20%;<br>State treasury – 4.37%;<br>Other shareholders – 24.05% |
| December 31, 2001 | On January 31, 2001, the list of main shareholders looked as follows:<br>Unicredito Italiano and Allianz Aktiengesellschaft – 53.17%;<br>EBRD – 6.63%;<br>State treasury – 4.15%;<br>Bank of New York – 5.85% |

**Bank Przemyslowo-Handlowy (Bank of Trade & Industry) was founded in Kraków in1989**

| | |
|---|---|
| 1995 | In the first stage of privatization, European Bank for Reconstruction and Development bought out 26.4% of shares |
| 1997 | ING Group became a strategic investor, acquiring 12.6% of shares |
| 1999 | Bayerische Hypo-and Vereinsbank bought out 36.7% of shares from State Treasury |
| 2000 | Germans further increased their share in the BTI, through purchase of the shares from the ING Group, acquiring other BTI shares with its two associated companies, and public announcement about purchase of shares, issued by this bank |
| January 1, 2001 | The structure of shareholders in the BTI was the following:<br>Bank Austria AG/HVB – 71.07% *;<br>Bank of New York – 5.15%;<br>State treasury – 3.68%;<br>Other shareholders – 20.10% |

After the Bank Austria AG and the HVB merged, a new banking group was formed.

**Powszechny Bank Kredytowy SA (General Credit Bank Inc.) was founded in Warsaw in 1989**

| | |
|---|---|
| 1997 | Initial public offering on the market resulted in the following structure of shareholders:<br>Creditanstalt – 19.5%;<br>Wiener AG – 9.88%;<br>Westdeutsche Landesbank – 9.9%;<br>State treasury – 6.2% |
| 1999 | Creditanstalt merged with the Bank Austria AG, and acquired the shares from State Treasury and increased its share in the GCB Inc. to nearly 56% |
| 2000 | Bank Austria Creditanstalt bought out additional 10% of the shares |
| December 31, 2001 | When Bayerische Hypo-und Vereinsbank and Bank Austria Creditanstalt AG – two investors of the Polish bank of Trade and Industry Inc. and General Credit Bank Inc., merged in 2000, it became apparent that the two Polish banks must also merge. On December 31, 2001, that occurred, and the structure of shareholders became the following:<br>Hypo Vereinsbank – 71.07%;<br>Bank of New York – 5.15%;<br>State treasury – 3.7% |
| 2002 | The newly established Bank of Trade and Industry Inc. is controlled by Bank Austria, which bears responsibility within Hypo Vereinsbank Group for financial structures in Poland and other countries of Central and Eastern Europe |

**Wielkopolski Bank Kredytowy (Wielkopolski Credit Bank) in Poznan was founded in 1989**

| | |
|---|---|
| 1993 | European Bank for Reconstruction and Development acquired 29% of shares |
| 1997 | Allied Irish Bank European Investments Limited bought out shares from EBRD and increased its total share in capital of the bank to 60.2% |

**Bank Zachodni (Western Bank) was founded in Wroclaw in 1989**

| | |
|---|---|
| 1999 | Was not privatized until September 1999, when AIB European Investments Limited acquired 80% of shares |
| 2000 | Under aegis of the investor, Wielkopolski Credit Bank and JSC Western Bank merged |
| January 1, 2001 | On January 1, 2001, the structure of shareholders of the united Western Bank WCB Inc. was the following:<br>AIB European Investment Limited – 70.5%;<br>State treasury – 4.7%;<br>Workers – 5.8%;<br>Other shareholders – 19.0% |

**Bank Handlowy SA in Warsaw (Foreign Trade Bank) had been operating in Poland since 1860**

| | |
|---|---|
| 1997 | Market debut (initial public offering) which resulted in the following structure of shareholders:<br>Bank of New York – 21.0%;<br>JP Morgan – 21.0%;<br>Zurich Insurance – 6.2%;<br>Swedbank – 5.0%;<br>State treasury – 41.0% |
| 2000 | Citibank acquired 88% of the shares |

**Bank Rozwoju Eksportu SA (Export Development Bank SA) was founded in 1986 in Warsaw**

| | |
|---|---|
| 1992 | Commerzbank acquired 48.74% of shares |
| 2000 | Commerzbank increased its share in capital to 50% and remains the same today |

**Bank Gdański (Gdańsk Bank) was founded in 1989**

| | |
|---|---|
| 1995 | The Bank for Business Initiatives (BBI Inc.) acquired 24.07% of the shares, Bank of New York acquired 20.84% of the shares, and about 40% remained in the hands of the state |
| 1997 | BBI Inc. bought out all shares from the state, thus obtaining 63.43% of the shares, and the two banks merged in order to establish the BBI Bank Gdansk Inc. |

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The examples of privatization of the largest Polish banks show that statutory capital of these banks passed into the hands of foreign banks in a relatively short period of time. Foreign banks tried to gain control over Polish banks in order to be able to manage their future operations.

Formation of banks with participation of foreign capital in Poland began in 1990. At that time, the first three licenses for banking activity were given out. Since 1997 Commission on Bank Supervision has been issuing licenses. It also supervises the acquisition of shares on the exchange during bank privatization. When a buyer gets more than 5% of shares of some bank, he must inform the Commission through this bank. The purchase of 20%, 25%, 50%, 66% and 75% of shares at a General shareholders' meeting requires prior authorization of the Commission on Banking Supervision.

After privatization and consolidation the number of banks decreased in the Polish banking system. Stated-owned banks are in the minority; only 17 such banks remain.

*Table 2.*

**The structure of the national banking system of Poland**

| Year | Total number of banks | Including those with majority of capital | | | |
|---|---|---|---|---|---|
| | | Polish | | Foreign | |
| | | Units | % | Units | % |
| 1987 | 5 | 5 | 100 | | |
| 1988 | 7 | 7 | 100 | | |
| 1989 | 25 | 25 | 100 | | |
| 1990 | 67 | 7 | 100 | | |
| 1991 | 78 | 78 | 100 | | |
| 1993 | 87 | 77 | 89 | 10 | 11 |
| 1994 | 82 | 71 | 87 | 11 | 13 |
| 1995 | 81 | 3 | 78 | 18 | 22 |
| 1996 | 81 | 56 | 69 | 25 | 31 |
| 1997 | 83 | 54 | 65 | 29 | 35 |
| 1998 | 83 | 52 | 63 | 31 | 37 |
| 1999 | 77 | 38 | 49 | 39 | 51 |
| 2000 | 74 | 27 | 36 | 47 | 64 |
| 2001 | 71 | 23 | 32 | 48 | 68 |

Because of powerful pressure for privatization, on June 4, 2002, the Council of Ministers of Poland adopted a new strategy in respect to banks partly owned by the state. It concluded that the state would keep control over four banks: Bank Gospodarstwa Krajowego, Powszechna Kasa Oszczednosci Bank of Poland – PKO BP Inc (General Savings Bank), Bank Gospodarki Zywnosciowej – BGZ (Agricultural Bank), and Postal Bank Inc.

As it is shown in Table 3, foreign capital convincingly prevails in the Polish banking system. The following table shows the countries of the capital origin.

The Polish banking system clearly reflects an increasing global tendency to create banking groups of capital. According to the Polish «Code of Trading Partnership» dated September 15, 2000, a banking group is defined as a group of banks, permanently bound by capital and organizational factors. Only joint stock banks may participate in such a group. A banking group can be established if the dominant bank owns more that 50% of the shares and more than 50 % of shareholders' votes in each dependant bank. A dependent bank cannot be a shareholder in the dominant bank. Another condition for creation of a banking group is the signing of an appropriate agreement. A bank can belong to only one banking group. All banks of the group guarantee solvency of each participant. Participating banks must use names and symbols that indicate their belonging to the group [10].

*Table 3.*

**Figures that illustrate the level of foreign capital in the Polish banking system***

| Year | Size of balance | Credits to non-financial sector | Deposits non-financial sector | Funds |
|---|---|---|---|---|
| 1993 | 2.6% | 2.7% | 2.1% | 2.2% |
| 1994 | 3.2% | 4.4% | 2.7% | 3.7% |
| 1995 | 4.2% | 5.8% | 3.0% | 7.6% |
| 1996 | 13.7% | 16.0% | 12.2% | 20.9% |
| 1997 | 15.3% | 18.2% | 12.7% | 24.0% |
| 1998 | 16.6% | 21.9% | 13.7% | 24.7% |
| 1999 | 47.2% | 50.9% | 45.6% | 50.2% |
| 2000 | 69.5% | 70.2% | 63.5% | 77.6% |
| 2001 | 68.7% | 71.3% | 63.9% | 80.2% |
| 2002 | 68.0% | 71.3% | 63.1% | 79.0% |

* All data relates to the banks controlled by foreign capital.

Most banks with a share of foreign capital that operate in Poland function within international capital groups [11]:

1. Bank Polska Kasa Opieki SA (PEKAO SA) is controlled by the consortium of Italian Unicredito Italiano and German Allianz.
2. Western Bank Wielkopolski Credit Bank Inc. is controlled by an Irish capital through Allied Irish Bank European Investments.
3. Bank of Trade and Industry General Credit Bank (BPH PKO SA) is under control of the German Bank Bayerische Hypo-und Vereinsbank AG.
4. Bank of Regional Collaboration Inc. together with BWR Real Bank Inc. was taken over by the German capital, and on this basis the Deutsche Bank Polish Inc. was established
5. Bank Communal Inc. in Gdynia and Bank Owned by Workers united under patronage of banks Merita Nordenbanken and Unibank.
6. Foreign Trade Bank Couproum Bank and Bank of Development of Sugar Producion Inc. merged within the group Citibank Overseas Investment Corporation, which owns about 90% of shares of Foreign Trade Bank.
7. ING Bank Silesian Inc. (Dutch capital).
8. Export Development Bank, controlled by Commerzbank, has in its group MBanK and Multibank (electronic retail sale of banking products).
9. The group of automobile banks with foreign capital (Fiat Bank Polska Inc., Ford Bank Inc., Opel Bank Inc., Volkswagen Bank Polska Inc.).

*Table 4.*

**Direct foreign investments in banking sector** (in %)

| Country | | Contribution (million PLN) | Structure of foreign investments in Polish banking sector (%) | Share in statutory capital of the banks, controlled by foreign capital (%) |
|---|---|---|---|---|
| Germany | 1995 | 126.3 | 21.49 | 4.13 |
| | June 2002 | 1556.3 | 24.2 | 15.56 |
| The USA | 1995 | 88.5 | 15.06 | 2.9 |
| | June 2002 | 1238.4 | 19.26 | 12.38 |
| The Netherlands | 1995 | 191.2 | 32.53 | 6.26 |
| | June 2002 | 736.2 | 11.45 | 7.36 |
| Ireland | 1995 | 14.0 | 2.38 | 0.46 |
| | June 2002 | 514.1 | 8.0 | 5.14 |
| Portugal | 1999 | 110.6 | 2.7 | 1.51 |
| | June 2002 | 465.6 | 7.24 | 4.65 |
| France | 1995 | 47.7 | 8.12 | 1.56 |
| | June 2002 | 445.3 | 6.92 | 4.45 |
| Austria | 1995 | 58.0 | 9.87 | 1.90 |
| | June 2002 | 407.0 | 6.33 | 4.07 |
| Belgium | 1995 | 8.6 | 0.65 | 0.19 |
| | June 2002 | 386.7 | 6.0 | 3.87 |
| Sweden | 2000 | 86.7 | 1.9 | 1.07 |
| | June 2002 | 343.9 | 5.35 | 3.43 |
| Italy | 1995 | 6.2 | 1.05 | 0.08 |
| | June 2002 | 126.6 | 1.97 | 1.27 |
| South Korea | 1996 | 60.6 | 4.56 | 1.36 |
| | June 2002 | 60.4 | 0.94 | 0.60 |
| Czech | 1995 | 33.9 | 1.38 | 0.57 |
| | June 2002 | 59.3 | 0.92 | 0.59 |
| Denmark | 2000 | 25.2 | 0.55 | 0.31 |
| | June 2002 | 41.1 | 0.64 | 0.41 |
| Great Britain | 1995 | 0.9 | 0.15 | 0.03 |
| | June 2002 | 38.2 | 0.59 | 0.38 |
| EBRD | 1995 | 28.3 | 4.81 | 0.93 |
| | June 2002 | 11.0 | 0.18 | 0.11 |
| Other | 1995 | 21.8 | 3.71 | 0.71 |
| | June 2002 | 0.0 | 0.0 | 0.0 |
| Total | 1995 | 587.8 | 100.0 | 19.24 |
| | June 2002 | 6430.0 | 100.0 | 64.27 |

Assessing the role of foreign capital in the Polish banking system must reflect not only gains, but also visible threats. Gains are predetermined by the following factors:

- Accelerated development of banking sector in Poland and its diversification;
- Intensification of competitiveness in banking sector;
- Higher quality of client service;
- Contemporary, compared to developed countries, supply of financial services in the Polish banking market.

Threats include the following factors:

- Strong commercialism of banks, income as a short-term objective, sales of real estate and property of a bank, growing gap in deposit and credit interest rates;
- The unwillingness to increase a number of establishments in a network due to economy of funds;
- Absence of incentives to increase crediting to companies that are financed by capital of countries other than those, which finance the banks;
- Low interest to provide loans to small- and medium-sized enterprises;
- Appearance – due to parent banks – of certain monopolist that allows banks to react selectively to impulses of the Central Bank's monetary policy and leads to a decrease in the effectiveness of Central Bank's instruments [12];
- Complicated supervision over banks that belong to international groups due to lack of mechanisms, as well as formal and legal means of supervision over such institutions;
- Threat of Polish banks within the EU banking groups to become affiliations of these banks inferior to the Polish banking supervision after Poland joins the EU.

Several-year observations over the Polish banking system with prevailing foreign capital lead us to some unexpected conclusions.

One of them is that the privatization of the Polish banks brought in a necessity in foreign capital attraction to investing into Polish banks (e.g. high technology, higher effectiveness), not the expected gains that substantiated a need in this capital.

At the same time unexpected threats appeared. Surprisingly, large banks with foreign capital – despite severe economy of costs, dismissal of thousands of workers, and increase in interest margins – performed worse than the state bank Bank PEKAO SA that lacks modern information infrastructure, provides services to small clients, and is underinvested. A serious threat to Polish economy is that foreign banks reluctantly provide loans to small clients and invest into safe non-labor-intensive state securities instead. This means that private foreign capital in the Polish banks today strives for receiving secure high incomes, not for financing development of small- and medium-sized enterprises that constitute a foundation of the country's economy.

Foreign capital in the banking system of Ukraine appeared in 1994, but its presence in this market was not as dynamic as in Poland. However, taking into account possible rapid invasion, there exists a necessity to elaborate optimal strategy and tactics of regulating foreign capital so that to avoid financial crises.

In Ukraine at the beginning of 2002 20 banks with participation of foreign capital, including 7 banks with 100% foreign capital, were registered. In general, only 12 of them can be considered as establishments controlled by transnational bank groups or foreign banks (see Table 5).

The volume of foreign banking capital in registered statutory capital of the Ukrainian banks as of 01.10.2002 made UAH 722,2 million, or 12,9%. From the beginning of the year, nominal volume of foreign capital has grown by UAH 84,0 million, the share did not change.

As of October 1, 2002, the largest shares in foreign banking capital belong to:

- Austria – 18,9% of total volume of foreign capital;
- Poland – 16%;
- The Netherlands – 10,0%;
- The USA – 9,1%.

Advantages and disadvantages of foreign bank affiliations' entrance into Ukraine are still being discussed today. It is considered that their creation would considerably intensify entrance of foreign banks into the Ukrainian market. At the same time the experience of Poland and other countries with transition economies does not give grounds for ambiguous conclusion about existence of such dependence. As we can see from the experience, foreign banks give consideration to the presence of their global clients and the prospects for the country-recipient's banking sector development in the first place.

On the one hand, the permission to create foreign banks' subsidiaries simplifies the procedure of establishing banking institutions and increases possibilities for obtaining credits for Ukrainian economy (capital of parent banks is larger than that of the subsidiaries). On the other hand, the supervision over their activity and lending procedures become more complicated. World experience provides a lot of instruments for creating an effective system of banking supervision, but this is not, presumable, point under discussion. It is necessary to answer the question: how does the entrance of foreign banks meet the interests of national economy?

*Table 5.*

**Ukrainian banks with strategic foreign capital**

| № | Legal name of the bank, city of registration | Parent bank/group (indirect ownership) | Country of origin | Net assets as of 01.01.2003 | Share in net assets, % | Place in banking system, % | Operational network |
|---|---|---|---|---|---|---|---|
| 1. | JSC CB «Raiffeisen Bank Ukraine», Kiev | Raiffeisen Zentralbank Öesterreich AG (35%) Raiffeisen Investments AG (30%) Raiffeisen International Beteiligungs GmbH (35%) | Austria | 1 463.3 | 2.30% | 9 | 3 branches, 2 divisions |
| 2. | JSC «First Ukrainian International Bank», Donetsk | Fortis Bank (20%), EBRD (10%), Deutsche Investitions und Entwicklungsgesellschaft mbH (10%) IFC (10%) | The Netherlands | 1 359.1 | 2.14% | 10 | 10 branches, 2 divisions, 2 representations |
| 3. | JSC CB «Citibank (Ukraine)», Kyiv | Citi group | USA | 873.9 | 1.37% | 15 | |
| 4. | JSC «Kredyt Bank (Ukraina)», Lviv | Kredyt Bank SA (66.7%) (owner-KBC Bank N.V.) EBRD (28,2%) | Poland (Belgium) | 860.1 | 1.35% | 16 | 18 branches, operational units |
| 5. | JSC «ING Bank Ukraine», Kyiv | ING Group N.V. | The Netherlands | 716.9 | 1.13% | 18 | |
| 6. | CJSC «Alfa-Bank»,Kiev | «Alfa-Bank» (directly) | Russia | 432.8 | 0.68% | 29 | 2 branches, 1 division |
| 7. | «HVB Bank Ukraine» Kyiv (formerly «Bank Austria Creditanstalt Ukraine») | Hypo-und Vereinsbank / BACA | Germany / Austria | 408.0 | 0.64% | 31 | |
| 8. | «Credit Lyonnais Ukraine», Kyiv | Credit Lyonnais | France | 299.4 | 0.47% | 40 | |
| 9. | JSC «Commercial Bank NRB-Ukraine», Kyiv | National Reserve Bank (through subsidiaries) | Russia | 244.2 | 0.38% | 47 | |
| 10. | JSC «Petrocommerce-Ukraine Bank», Kiev | «Bank Petrocommerce» | Russia | 214.7 | 0.34% | 54 | 3 branches, 6 divisions, 2 representations |
| 11. | CJSC «Microfinance Bank», Kiev | IFC (20%) EBRD (20%) NUF (20%) WNISEF (20%) IMI AG (10%) DOEN Stichting (10%) | USA Great Britain Netherlands Germany | 164.2 | 0.26% | 70 | 21 divisions and representations |
| 12. | «Bank PEKAO (Ukraine)» Ltd, Lutsk | Bank PEKAO SA with subsidiaries (100%) (owner – UniCredito) | Poland (Italy) | 44.3 | 0.07% | 127 | 1 branch |

Dynamics of foreign investments in the banking system of Ukraine during 1995–2001 may be characterized by the following data.

*Table 6.*

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 01. 01. 2002 |
|---|---|---|---|---|---|---|---|---|
| Foreign Investment (mln USD) | 484 | 897 | 1438 | 2064 | 2811 | 3282 | 3825 | 4594* |
| Foreign investment into national banking system in national currency | 52,8 млрд. крб. | 286 млрд. крб. | 36,5 млн. грн. | 197,2 млн. грн. | 317,8 млн. грн. | 455,2 млн. грн. | 3825 млн. грн. | 666,8 млн. грн. |
| In foreign currency** | | | | | | | | |
| USD Mln | 6.1 | 7.75 | 8.3 | 8.1 | 101 | 122.3 | 126.8 | 79.24 |
| ECU/EUR Mln | | 4 | 6.4 | 22.4 | 34.6 | 48.6 | 96.4 | 58.68 |
| FRF Mln | | | 66 | 66 | 66 | 66 | 66 | |
| DEM Mln | | | | 3.2 | 3.2 | 3.2 | | |
| AUS Mln | | | | | 139 | 139 | 139 | |
| Share of foreign capital in banking system of the country (%) | 0.85 | 1 | 3.9 | 13 | 14.8 | 14.3 | 14.5 | 13.45 |
| Number of banks with foreign capital | 12 | 12 | 14 | 22 | 28 | 30 | 31 | 24 |
| Including those with 100% foreign capital | 1 | 1 | 2 | 6 | 9 | 8 | 7 | 6 |

* taking into consideration privatization
** share in statutory fund (in freely convertible currency)

Analyzing the above data, it is possible to foresee certain positive consequences of Ukrainian banking law liberalization and foreign bank branches' access to the market:

- creation of uncapitalized branches at other favorable terms substantially intensifies the process of bringing foreign banks into the financial market of Ukraine;
- quality of servicing bank transactions will rise, their terms will reduce, new banking products will appear, and technology of their providing will improve;
- new offerings of foreign banks will stimulate the development of Ukrainian banks and the expansion of their services range through competition;
- permission to create uncapitalized branches will increase landing volumes due to parental capital.

However, the cited data on Polish experience shows that certain banks with foreign capital on a certain stage of activity begin to give advantage to interests of the state of capital's origin. At the same time, there is a tendency to reduce a share of non-residents in the credit portfolio of such banks. The following table provides information on the percentage of loans to non-residents within credit portfolio of certain banks with more than 80% share of foreign capital.

*Table 7.*

| Years | January 1, 1999 | January 1, 2000 | January 1, 2001 | December 1, 2001 |
|---|---|---|---|---|
| JSC «WUCB» | 4.28% | 26.76% | 2.74% | 1.43% |
| JSC «Credit Lyonnais Bank Ukraine» | 0.58% | 40.04% | 23.74% | 20.75% |
| OJSC Kreditprombank | | 11.53% | 1.32% | 12.39% |
| JSC «Credit Swiss First Boston» | | | | |
| JSC CB «Creditanstalt Ukraine» | 15.84% | 35.5% | | |
| JSC «ING Bank Ukraine» | 70.53% | 8.67% | | 2.66% |
| JSC CB «Raiffeisen Bank Ukraine» | 3.56% | 19.15% | | |
| JSC CB «City Bank Ukraine» | 89.3% | 39.13% | | 7.5% |
| CJS CB «Microfinance» | | | | 21.1% |

Thus, it is possible to conclude that permission for opening branches of foreign banks in Ukraine will promote an increase in participation of external capital in its economy, and in a banking sector in particular. But such increase will not be substantial, since the main reason for the slow entrance of foreign capital into the Ukrainian market is an unfavorable investment climate and high degree of risks in our country on the whole.

In our opinion, the number of foreign banks in Ukraine will increase gradually: on the first stage – because the banks from countries with a similar credit rating (for example, Russia or Kazakhstan), on the second – because of middle-size western banks.

The former will be interested in servicing their clients, especially in privatization processes. The latter will focus on attempts to use Ukrainian capital and speculative operations, not crediting.

Of course, the branches of the Eastern European banks, which belong to or are controlled by western banks, will be established.

However, taking into account unsatisfied demand for banking services in Ukraine, the losses of domestic banks from reorientation of their clients can be not as substantial, as it could be expected, because:

- foreign banks will service first of all their (foreign) clients that will come into market together with banks;
- foreign banks will conduct long-term (investment) lending, which cannot be realized today by the domestic banks in terms to time period and volume;
- there will be almost no competition in high-risk lending operations.

Within a few years the arrival of branches of large banks, which would substantially affect banking sector, can be expected. That is, the increase of a number of foreign banks at this stage will result in positive changes in the economy of Ukraine.

It is possible also to forecast certain negative moments in access of foreign banks' branches to the Ukrainian banking market:

- supervision over such establishments is complicated;
- cheaper resources of foreign banks, higher technologies, and better labor productivity will entail pressure on the competitiveness of Ukrainian banks;
- foreign banks, at certain stage of the activity, begin to give advantage to satisfying interests of the state of capital's origin.

Materials of this article prove substantial difference in shares of foreign capital in the banking systems of Ukraine and Poland, but in the future inflows of external investments, similar to Polish, into the banks of Ukraine are real. In this situation, the proper equilibrium between the shortage of domestic savings for economic development of the state and critical volume of foreign investments must be determined.

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