

44 YEARS IN BANKING

THE TRANSFORMATION PROCESS – THE POLITICAL AND ECONOMIC ENVIRONMENT OF BANKS

PART 5

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Banking is a special area of the economy and life of society. Although it is about money, people remain the most important. The basis is system, exactness and consistence, but they cannot lead to self-serving and all-powerful bureaucracy, which suppresses fantasy, spirit and intelligence.

Profit is a measure of success, but an acceptable level of risk and constant strengthening of the favourable image of the bank cannot be forgotten.

Competition is the motor of effectiveness, but it cannot go beyond the essential framework of correctness or temporary victory in battle will mean defeat in the war.

The basic characteristic of the banker is the ability to gain the trust of the client, but in contrast to the fraudster, he must be able to permanently keep it, because banks work with money, especially with other people's money. In the most modern conception, the banker is a globetrotter, but he cannot underestimate the specifics of the

given environment or country. The banker must be an expert, a professional, but if enthusiasm is added, it can do no harm. The banker must have healthy self-confidence, but he must also have some humility and empathy in communication with the client, because without understanding of the problems and values of others he will write his professional death certificate.

From the point of view of the values, destinies and priorities of people, communities, companies and regions, banks are literally the modern cathedrals, but they cannot become museums. This means that they must react to every significant change in the economy, society or life of an important client, and if possible they must not only react to events, but foresee them and anticipate their development.

This constant adaptation to crossroads in development is another essential characteristic of banks.

A Shift in Economic Thinking

The transformation process confirmed that the timid cosmetic adjustments of the 1980s in the framework of „perfecting the planning system“ or „reconstruction of the economic mechanism“ were not sufficient for the transition to a market economy and transformation of the whole society according to democratic and civil principles. Society and the economy were ready for fundamental surgical operations, which are sometimes painful, but unavoidable.

Our transformation process can also be compared to a storm in nature, which comes with its torrents of water, earth movements and uprooting of centuries old trees. Stagnant water, dried up bottoms and small streams are changed into raging torrents, which also bring mud and dirt, but, at least in nature, everything becomes calm after a time and clean water flows in the river.

The use of new opportunities, the use of the best we have, the way forward, is not always simple and easy. The French thinker Voltaire said: „Doubt is not a very pleasant

state, but certainty is ridiculous“. The French daily L Monde comments: „It is necessary to thoroughly shake up the economy, because thoughts and ideas remain at the bottom“. The recipes sometimes seem very simple and within reach. The British premier Tony Blair recommends: „say what has to be done and then do what has been said“.

From the point of view professional possibilities, time and space, we cannot produce a comprehensive assessment of the complex, multi-current transformation process. This task still awaits historians and politicians. In the context of the whole development of banking from 1950 to 2004, it is interesting to evaluate the transformation process from the point of view of the economic, legal and business environment for banks. In the preceding articles of our series, we showed that the environment significantly effects the position, profile, orientation and effectiveness of the activities of banks.

The significant changes in the economic and business environment in the framework of the transformation process can be documented in the huge shifts in the econo-



mic thinking and economic realism of economists and managers of companies.

In the conditions of the preceding mostly demand, allocating and re-distributing economy, the most important thing was „to secure a good plan“ and „be allotted“ appropriate limits. Instead of the objective criteria of return, effectiveness and profitability, subjective wishes and criteria were smuggled in. A good economist, who knew how to keep account records, calculate and analyse balances was pushed into the background, while the experts in contacts and human relations came into the foreground. These conditions of the prevailing of demands and claims over the supply of proposals and starting points raised the huge economic power of the suppliers, distributors of limits and setters of tasks to an unprecedented level. On the other hand, the economic and moral dependence of those economic entities, which needed something, declined to an incredible extent.

During the existence of weakened economic realism, the economic laws brought about deforming of productive processes and deepening economic imbalance. In the existing logic of economic thinking, they sought a starting point in the centre blaming the enterprise sphere, leading to reduced authority and effectiveness of the managing bodies in the eyes of the enterprise sphere, which clearly could not lead to strengthening of mutual trust.

The „cultural revolution“, the employees of enterprises had to undergo on the way to an entrepreneurial approach, had several phases and „shocks“. After the break up of the COMECON, the first shock was the realization that it is not enough only to produce, it is also necessary to sell. The second shock was the realization that it is necessary to produce good quality products and innovate in conditions of demanding competition. The third shock was the realization that the owner of a company is not somebody, who sits in a casino every evening, but a good and successful entrepreneur, who is able to constantly repeat business success.

In connection with the extraordinary growth in the number of new entrepreneurs in the process of lesser and greater privatization, the risk of non-payment and the risk of reduced return of credits also greatly increased. In mature stabilized market economies, banks such as the French Sofaris and Austrian Burger Vorderungs Bank observed, for example, at the time of the establishment of our Slovenská záručná banka, that from every ten new companies, four would not survive.

Economic reality today is nowhere idyllic, the complexity and variety of economic policies and practices is deepening. The economic policy of a state may set various aims such as economic growth, full employment, price stability or external equilibrium. The ideal would to achieve the „magic square“ of attaining all four aims at the same time, but experience shows that this is not simple.

For example, already at the beginning of the economic reforms, the State Bank of Czechoslovakia as the central bank set the „monetary targets and rules for directing banks“ in the monetary programme for 1991. The aim was above all to renew economic equilibrium by using restrictive instruments. In the conditions of commercial banks, this meant setting strict limits for the loans of individual banks.

Things were also not always clear in the philosophy of economic management. There were passionate discussions with views ranging from the naive superficial position that „the market will solve everything“, through liberal efforts to ease the „flow of economic reform“, to efforts at strong state interventionism. There was often no precedent from the practice of other states concerning how to transform the economy and the whole society. It was sometimes necessary to pursue dead-ends such as coupon privatization. Sometimes quantification and analyses were lacking as can be documented by the meeting of three governments at Kroměříž in 1990 concerning lesser privatization. Only the representative of the State Bank of Czechoslovakia had a numerical quantification of the number of units falling into the lesser privatization, to which President V. Havel and the members of the governments could refer.

The degree of lack of understanding is also shown by a small episode sometime in 1994, when the then well-known and popular economist V. Dlouhý claimed at the Club of Economic Newspapers in Bratislava, that the Czech Republic had already reached the post-transformation phase. The fact that nobody from the several hundred present opposed his view testifies to the „timidity“ of our economists.

The constant changes and ambiguity of interpretation of legislation after November 1989 did not contribute to the stability of the legal environment. This is a logical result of the approval of innumerable legislative norms, in many cases proposed by unqualified people. For example, the income tax act approved in 1992 was amended twice in 1992, twice in 1993, twice in 1994, three times in 1995 and twice in 1996. The Ministry of Finance also issued 3 decrees clarifying this act from 1992.

The variable interpretation of individual legislative norms was another typical and negative feature. An item accepted as an expense by the tax office in one district might not be accepted by the tax office in a neighbouring district (see: Zborník 1955-1996 of Trend and MESA10).

It is not surprising that in the conditions of this delayed early capitalism, as always and everywhere before, „talents“ appeared and skilfully used or misused the given legal vacuum or provisional situation and pushed to the limit not only of minor offences, but also of criminal activity according to the legal consciousness of the time. The dividing line was whether they remained only parasites



and profiteers or also participated in regular entrepreneurial activity.

It is not surprising that in some phases of the transformation process, the banks also „paid a price“ for this process. As stated in the above mentioned Zborník of Trend and MESA 10 „the banking sector was regarded as one of the weakest links in the framework of the transforming economy. Its restructuring, consolidation and stabilization were much discussed questions in the Slovak Republic“. It was also emphasized that „the transformation of the economy, especially in the Central European states, has entered a phase in which the stability of the banking system is one of the criteria for success of the transformation and a condition for entry to the European economic structures.“

The development of banking in Slovakia in the framework of the transformation process occurred in several very clear phases:

1990 – 1993 – 1996:

The beginning of new economic and banking reform, explosive origin of new companies and new banks. At first there was still euphoria from the new possibilities for business, but the cry: „O God, we have freedom!“ was gradually replaced by the question: „But what are we going to do with it?“

1993 – 1996 – 1998:

The maladies of early capitalism began to appear significantly. The proportion of classified loans increased and the return of loans worsened, the level of trust between banks and their clients weakened. Crisis came when some banks went bankrupt or were placed under imposed management (see the third part of this series – Biatec No. 12/2004, p.19). There were various break downs in communication. This led to increased caution of the banks when granting loans and unprecedentedly high interest rates of more than 20%.

According to the Institute of Monetary and Financial Studies (see material of the IMFS NBS from 2002 „Development of the credit portfolio 1993-2000“), long-term analysis of imbalances and capital stability of individual banks showed that stable reproduction of the credit portfolio requires a value of the coefficient of credit risk of up to 0.100, meaning that from every crown granted in loans 10 haliers are not paid back. A higher risk level exhausts the potential for simple reproduction of the credit portfolio. A value of the coefficient of credit risk of over 0.300 threatens the capital stability of the bank. A level of credit risk above 0.500 is not only a threat to the liquidity of the bank, but also to its solvency. The banking system in Slovakia recorded its worst level of coefficient of credit risk in 1998, when 37 haliers from every crown lent were not returned by the deadline for payment.

Several groups of reasons can be given to explain this extremely unfavourable situation:

- A „tax“ by the transformation process itself. The explosion of the number of new businesses and low quality of business activity meant increased short-term risk and the banking sector was not fully prepared, especially from the point of view of quality and the mechanisms for measuring risks and using instruments for their minimization.
- Inadequate legislation, for example, in the areas of bankruptcy and protection of creditors. Development showed that also some Czech banks were founded deliberately so that their founders could get access to credit. At the beginning of the 1990s, all credit resources were available to 2 banks: the Všeobecná úverová banka and Slovenská sporiteľňa. The latter also provided credit resources to the newly established banks, which used it for rapid growth of loans. Break downs and inadequacies in the formulation, conditions and guarantee agreements can also be placed in this category. All this was multiplied by the worsened enforceability of the law in the courts.
- Activities bordering on criminal activity and speculation by businessmen – debtors, some of whom took loans with the knowledge that they would never be paid back. Some of the banks and some of their leading employees succumbed to temptations to accept „attention“ from new entities in the area of credit. From the point of view of the good reputation of the banks and the great majority of their staff, these isolated criminal acts must be strictly and precisely identified and solved in the criminal law area.

The question of the security and protection of deposits was gradually opened, and forms and mechanisms were sought to reduce the high level of classified credits.

All these factors led inevitably to the third phase:

1999 – 2000:

Reclassification of bad loans. The first removal of bank debts happened in 1993-1994, when the National Property Fund of the Slovak Republic provided the banks with financial resources to remove their debts, and with the agreement of the political opposition of the time. However, this was not enough. The banks were not able to write off unrepayable loans by their own efforts. According to the views of bankers and economists, if the commercial banks were not consistently restructured, the NBS would have taken away the licences of the Všeobecná úverová banka (VÚB) and Slovenská sporiteľňa (SLSP) as well the Investičná a rozvojová banka (IRB). However, this would cause mass withdrawal of deposits and panic, which would cause the financial collapse of the whole economy.

Therefore, the restructuring of banks or removal of their debts was regarded as the most important economic reform by the government, which came to power in 1998. The restructuring was done in 1999 – 2000 by transferring



bad debts to the state agency Slovenská konsolidačná a.s. of Bratislava and capital strengthening of the SLSP, VÚB and IRB. According to the data of the data of the NBS, 82 217 mil. Sk of credit receivables were effected by the first stage of restructuring and 34 198 mil. Sk of classified loans were involved in the second stage.

A similar process of restructuring bad loans occurred in Hungary in 1993-1994, where the total of bad loans represented 37% and in the Czech Republic in 1994 – 1996 with a share of bad loans of 38%. In comparison, the proportion of bad loans in Slovakia was 42%. This was partly because the restructuring came later in Slovakia. For completeness, Poland restructured its bad loans in 1993 – 1994.

2000 – 2003:

After the reclassification of bad loans and after thorough privatization and restructuring, it was possible to progress to the gradual stabilization of the banking system, which brought higher quality, a wider range of banking products and a general renewal of the balance between supply and demand for banking services.

Another favourable result was the renewal of confidence and the good reputation of banking. The accessibility of credit to the company sphere gradually improved, and so did the conditions for the reduction of high interest rates.

2003 – 2004:

After solution of the „internal“ problems of banking in the Slovak Republic, especially in its fourth phase of development, it is possible to proceed more intensively to dealing with the challenges of globalization and European integration. This has extraordinarily increased the role of the Association of Banks and its cooperation with the NBS and other partners in the centre and in the business sphere.

The year 2003 was an important milestone. Work was completed on the personal and material-technical infrastructure of the Association of Banks and on the identification of the basic strategic aims and directions of banking. Cooperation deepened with the Federation Bancaire de l'Union Europeenne.

The president of the Association of Banks is Regina Oveny Straka and the executive director was Vladimír Valach up to May 2004, when Ladislav Unčovský took his place.

After accession to the EU, the Association of Banks and the whole banking sector have three main groups of priorities:

a) To contribute to creating a stable, standard and transparent legal and business environment, analyse the impact of the implementation of pro-reform policies by the government, strengthen the position of the creditor and raise the level of enforceability of the law.

b) Intensify cooperation with the Federation Bancaire de l'Union and individual associations of banks in the area of creating a single financial market in the EU, a single payments zone in the euro, international accounting standards in preparation for entry to the Eurozone and so on.

c) React in time and prepare for measures and projects connected with the globalization processes, especially concerning risk management (Basel II), measures against laundering of dirty money, and dealing with trends in the speed and sophistication of banking products and communication between the banks and their clients.

Conclusion

Banking and the whole of Slovakia passed through immense development in this period, not only from the position as an object of centralization and various monopolies in the framework of an administrative – command model to the position of an independent state, but also in the integration and globalization processes. The multi-current transformation process of 1990 – 2004 contributed to a substantial acceleration of this process, especially in the areas of economic and banking reform, opening to the world and adapting to global trends. Continuation of the integration and globalization processes is secured both institutionally and generationally.

The banks and banking have been playing a very active role in this progressive process.

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