



NATIONAL BANK OF SLOVAKIA

**DIRECT FOREIGN INVESTMENTS IN SLOVAKIA WITH  
FOCUS ON THE BANKING SPHERE**

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## **INTRODUCTION**

This paper is a continuation of two previous works: "Foreign capital in the economy of Slovakia Part I", which concentrated on the effects of direct foreign investments in the corporate sector, and "Foreign capital in the economy of Slovakia Part II", which dealt with the effects of direct foreign investments on selected macroeconomic areas: the trade balance, the balance of payments, economic structure, regional aspects, employment, and international transfer of technology and know-how.

In this paper we paid special attention to the export of Slovak capital. One of the reasons is the growing volume of this export year to year, and the second one involves preparations of measures associated with Slovak capital exports, on which we worked together with the Finance Ministry of the Slovak Republic.

Another area on which we focused in this paper are foreign capital investments into the banking sector, which reached 25.7 percent of total volume of foreign investments in Slovakia by December 31, 1997.

Additionally, we have monitored the development of direct capital influx and export to and from Slovakia, as well as their influence on the trade balance and the balance of payments.

# I. THE PRESENT SITUATION IN DIRECT FOREIGN INVESTMENTS IN SLOVAKIA

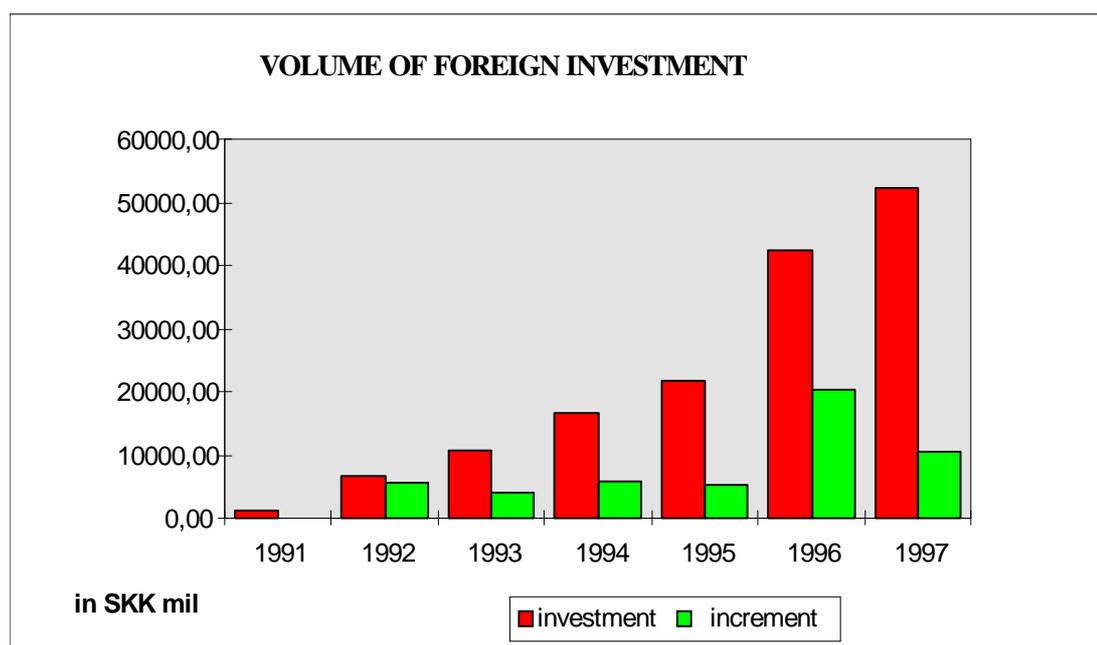
## 1. Incoming Direct foreign Investments

Table 1

Development of direct foreign investments (DFI)

Year	investment volume in millions SKK	growth over the previous year	
		in millions SKK	in %
1991	1 186.0	-	-
1992	6 607.1	5 421.1	557.0
1993	10 755.7	4 148.6	162.8
1994	16 542.4	5 786.7	153.8
1995	21 881.7	5 339.3	132.3
1996	42 300.0	20 418.3	193.3
1997	52 763.6	10 463.6	124.7

Source: FSU, Bulletin of the Statistical Office of the Slovak Republic, the NBS



Though the development of DFI in Slovakia does show a growth tendency, there has been a slowdown in 1997 compared with previous years. The significantly higher growth in 1996 was caused indirectly. It resulted from an supplementary guideline: Measure No. 4 of the NBS of May 27, 1996, according to which branch offices of foreign banks must possess a sum of financial resources that have a character of a long-term liability of a branch office of a foreign bank towards its parent bank in the volume of at least SKK 500 million, which for all branch offices of foreign banks represented SKK 5,880.0 million<sup>1</sup>.

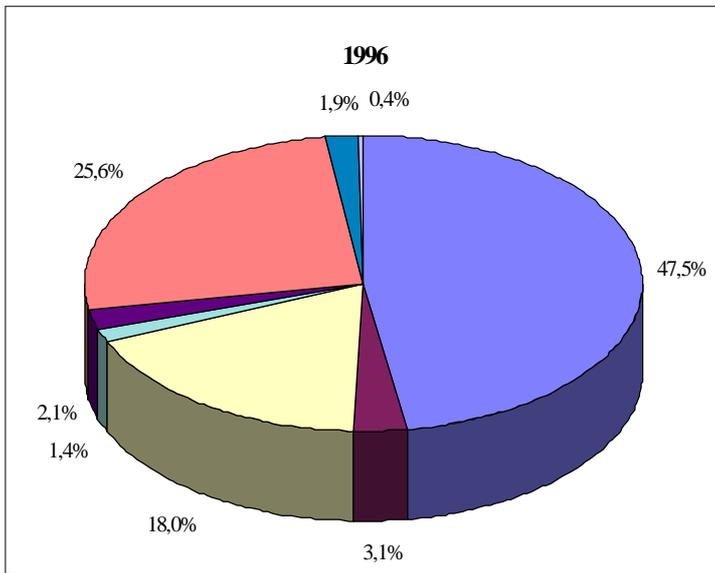
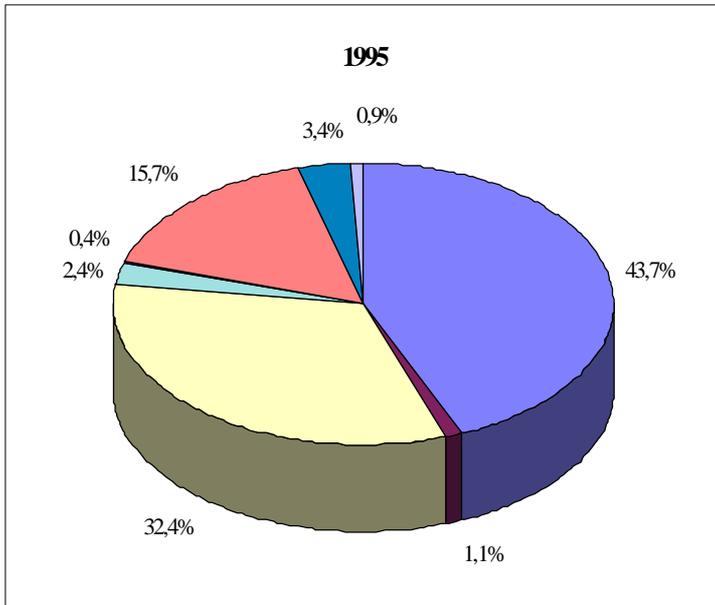
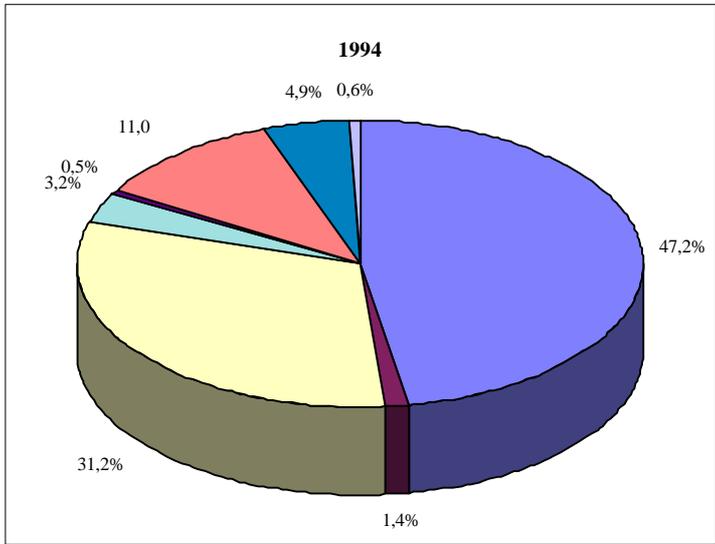
**Table 2**

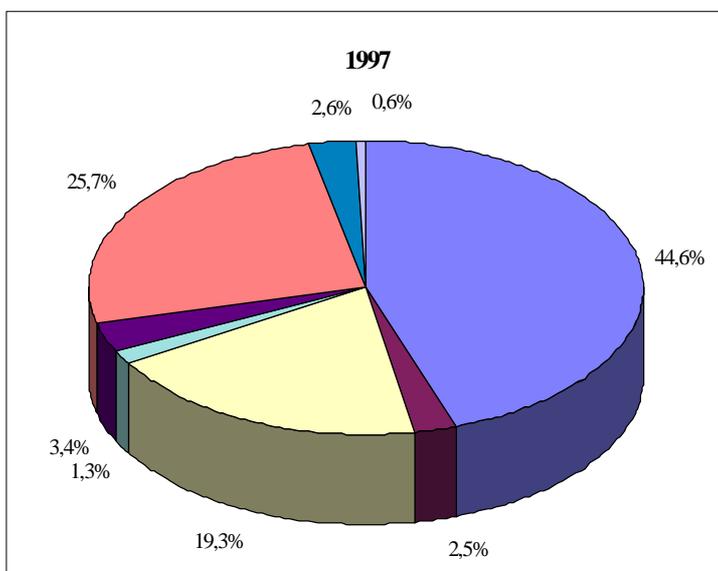
**Distribution of DFI in Sectors of the Economy**

Sectors by OKEÈ	1994		1995		1996		1997	
	SKK mil.	share of the total volume of DFI in %	SKK mil.	share of the total volume of DFI in %	SKK mil.	share of the total volume of DFI in %	SKK mil.	share of the total volume of DFI in %
all sectors	16 542.4	100	21 887.7	100.0	42 340.0	100.0	520 763.6	100
thereof:								
industrial production	7 809.7	47.2	9 546.5	43.7	20 100.0	47.5	23 501.0	44.6
construction	227.1	1.4	237.6	1.1	1 300.0	3.1	1 300.0	2.5
trade	5 155.7	31.2	7 090.7	32.4	7 600.0	18.0	10 200.0	19.3
hotels, restaurants	534.0	3.2	535.6	2.4	600.0	1.4	400.0	1.3
transport, communication	80.3	0.5	85.0	0.4	900.0	2.1	1 800.0	3.4
financial services, insurance	1 818.1	11.0	3 429.6	15.7	10 840.0	25.6	13 562.6	25.7
other commercial services	820.0	4.9	745.3	3.4	800.0	1.9	1 400.0	2.6
other public services	98.0	0.6	211.4	0.9	200.0	0.4	300.0	0.6

Source: Statistical Office Bulletin, NBS

<sup>1</sup>Article 4: Minimum volume of permanently granted financial resources by a foreign bank to its branch office on the territory of Slovakia





The structure of DFI in individual sectors is relatively stable. Approximately 50 percent are investments in industrial production and the remaining half into services. Over the past two years certain shifts have taken place, primarily between commercial services, financial services, and the insurance industry. The growth of DFI in banking and insurance sectors in 1996 was the result of the aforementioned Measure No. 4 of the NBS.

We further have to point out the low absolute volume of DFI in tourism, transport, and communication.

Within the structure of industry, DFI prevail in the production of cars, chemical products, food, metal processing, electronic equipment and instruments, and the textile industry.

The low level of interconnection between firms with foreign capital and the domestic industry still persists. Ways should be sought for widening mutual cooperation primarily by domestic companies as well as pertinent ministries, because where such cooperation already exists, considerable synergic effects are induced, and small and medium-sized companies are joining international cooperation through large joint ventures, which they could not have achieved on their own.

The territorial structure of DFI (without the banking sector) in 1997 was as follows:

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	in %
Bratislava district	62.6
Trnava, Trenčín, Nitra districts	31.6
Žilina and Banská Bystrica districts	4.9
Prešov and Košice districts	0.9

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NBS data

The structure of DFI influx by country of origin in 1997 is as follows

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	in %
Austria	27.3
Germany	25.8
France	8.7
USA	8.7
Hungary	8.0
Czech Republic	5.2
Belgium	5.2
The Netherlands	3.2
Japan	2.7
other countries	3.2

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NBS data

The volume of DFI from 1990 to 1998 by country of origin is as follows

<b>Total</b>	<b>SKK 52.8 billion</b>	<b>100%</b>
of which:		
Germany	11.9	22.5
Austria	11.0	20.8
United Kingdom	5.9	11.2
USA	3.3	6.2
Czech Republic	6.4	12.1
France	3.6	6.8
The Netherlands	5.2	9.8
Italy	0.7	1.3
Switzerland	0.7	1.3
Hungary	0.7	1.3
Belgium	0.7	1.3
Sweden	0.5	1.0
Norway	0.5	1.0
Japan	0.4	0.9
other countries	1.3	2.5

NBS data

The DFI influx over 1997 from the perspective of investor countries somewhat differs from the structure over the period from 1990 to 1997. On the other hand, from a longer perspective DFI from individual countries are relatively stable. Germany and Austria are in stable leading positions, and apart from minor shifts in the lower part of the table no significant changes have taken place.

We have analyzed the regional structure of DFI in greater detail in previous works.

## 2. Export of direct foreign investments

**Table 3**

### **Development of export of direct foreign investments**

Year	Volume in SKK millions	increase over the previous year	
		absolute numbers	in %
1995	1 470.0	-	-
1996	3 405.0	1 935	231.6
1997	6 050.0	2 645.0	177.7

NBS data

### Export of direct foreign investments



### **Destination Countries of Direct Foreign Investment Export**

From the present statistical data, only the structure of direct foreign investment exports into countries that are not members of the European Union can be monitored in detail, because in such cases a reporting duty exists. Simultaneously, these countries are the primary destinations of our direct foreign investment exports, and are therefore important sources of information.

**Table 4****Summary of Slovakia's DFI destinations in 1996 in percent**

country	number of instances	commercial activities	industrial production	construction industry	services
		%	%	%	%
Czech Republic	88	77	18	6	6
Ukraine	36	82	13	5	-
Russia	9	70	25	5	-
Hungary	25	90	5	-	5
Poland	15	70	11	8	11
Croatia	4	25	50	25	-
China	3	-	100	-	-
Bulgaria	7	30	-	10	60

NBS data

**Table 5****Summary of Slovakia's DFI destinations in the first half of 1997 in percent**

country	number of instances	commercial activities	industrial production	construction industry	services
		%	%	%	%
Ukraine	14	40	40	-	20
Czech Republic	4	30	-	-	70
Bulgaria	4	80	20	-	-
Russia	7	80	20	-	-
Croatia	5	60	20	-	20
Tunisia	2	-	100	-	-
Uzbekistan	3	-	100	-	-
Yugoslavia	2	50	50	-	-

NBS data

A certain shift in the destination of our DFI is visible in capital exports to individual countries. The number of instances also significantly dropped. The number of activities in the Czech Republic was reduced to a minimum. However, the portion of the number of investments into production activities has increased, and also the absolute volume of investments in production prevails, which can be considered positive.

### Structure of direct foreign investment exports by sectors:

	SKK billions	%
Industry	2.20	36.4
Generation and distribution of electricity, gas, and water	0.99	16.4
trade	1.50	24.8
Transport and communication	0.16	2.6
Financial and insurance services	0.97	16.8
Other	0.23	3.8
Total	6.05	100.0

NBS data

The structure of direct foreign investment export suits the initial developmental phase. Though the percentage volume of investment in industry prevails, this trend comprises of three to five large projects: diesel engines in China, shipbuilding industry in Russia, or investments in the extraction industry in Ukraine. Other activities follow the generally known tendencies, i.e. primarily entry into commercial activities (faster return of investment and lower risks). From the point of view of production orientation, capital exports concentrated in construction and assembly works, various repair works, production of packaging, electrical instruments, wood processing, and diverse services. Exports of direct foreign investment into commercial activities should also be seen positively, as long as it centers on the sale of domestic products abroad, since this helps expanding our exports.

Another positive phenomenon is that though in small volume, but activities in direct foreign investment exports have been visible from joint ventures established in Slovakia. Their activities include not only successful exports of their products, but also the first attempts to set up businesses abroad - export of capital through commercial activities, within which they primarily offer their own products (for example pharmaceutical products).

In 1997 too we continued together with the Finance Ministry in preparing "Measures supporting Slovak capital penetration abroad". The results of our work in this respect can be summarized in the following way:

With the present shortage of investment resources, it may seem almost pointless to deal with measures supporting exports of Slovak direct foreign investment. From a general perspective, this opinion is basically realistic, but a closer look at the structure of our companies shows that in Slovakia too there are some companies, primarily large ones, that have surplus funds that they want to invest abroad. By starting smaller activities at first, they would want to establish a position on potentially advantageous markets, and later expand depending on the real situation. As the present situation shows, apart from large companies there is a number of medium and small organizations that are trying to establish themselves by foreign activities primarily in neighboring countries with which we have had long lasting

contacts, and which they know the best. A better part of the activities of small and medium companies centers on commercial activities, which are often combined with assembly and servicing works. However, there is already a visible effort to succeed in production activities, frequently in cooperation with partners from the host country. This reduces risks and helps overcoming diverse restrictive measures.

Measures supporting direct foreign investments should take into account:

- a) protection against political-economic risks
- b) providing sufficient information to potential investors, primarily small and medium-sized companies.
- c) support for such foreign activities, which:
  - by their foreign investments mediate, for example, import of important raw materials, that we would be unable to get within regular foreign trade exchange, or would have to import under much less advantageous terms,
  - by establishing subsidiaries or joint ventures enable subsequent exports of spare parts, semi-finished products that would be assembled abroad to final products, which would mean a significant production expansion in the parent country, as well as growth of foreign trade, which would not have been possible without this activity.

Foreign activities may also serve to create a supply area for various goods produced by the parent company.

Basically, the subject of the "measures" should be such activities that are beneficial to our economy, have a greater extent, and a long-term character, do not significantly reduce employment in Slovakia, and need political-economic assurances for their establishment.

#### **Ad a)**

The importance of insurance against political and economic risks has been signalled to us from advanced market economies, which, in their measures to support direct foreign investments to countries of Central and Eastern Europe concentrate primarily on this area.

Various country ratings consider a prediction of political-economic risks in the aforementioned countries as being the most important pieces of information for potential investors.

If we look at the most intensive directions of our direct foreign investments, we will find specifically countries, such as: Czech Republic, Ukraine, Hungary, Poland, Russia, Bulgaria, etc. Their rating according to Euromoney from March 1997 ranks these countries from a worldwide perspective on the following places: 40, 149, 44, 80, 138, and 88. Higher political risk and the lowest economic performance must be taken into account in Ukraine, Russia, and Bulgaria. Czech Republic, Slovenia, Hungary, and Poland are evaluated much more positively, and their rating with regard to political risk is higher than that of Slovakia. This trend is even more distinct in Euromoney evaluation in December 1997, where the

country ranking is as follows: Slovenia 37, Czech Republic 44, Hungary 45, Poland 48, Slovakia 61. The greatest move was registered in the economic performance criterion, where Poland and Slovenia achieved the highest growth, Czech Republic and Hungary the lowest, and Slovakia dropped in both political risk and economic performance criteria.

Other stimulative measures, such as tax relief, various concessions or subsidies are of secondary importance for potential investors. Political and economic stability are considered the most important criteria.

All the aforementioned examples demonstrate that in Slovakia too, we must pay special attention to political and economic risks in formulating measures to support the penetration of direct Slovak foreign investments. The following alternatives are available:

- insurance of exported investments by organizations involved in this business activity. This should be done above all by the recently established EXIM Bank,
- another option is creating various support funds subsidized by the state, banks, and diverse organizations.

Insurance of foreign investments should serve all companies, but primarily small and medium-sized firms, which are much more vulnerable to potential losses, which may have very serious consequences for them.

#### **Ad b)**

Sufficient information resources about countries where our investments should be directed are the basis for decisions about investment projects. Aid in this respect should focus on small and medium-sized companies that at present do not have enough funds to pay for consulting services.

Information is needed primarily in the following areas:

- financial and non-financial support and restrictive measures in a country, and the overall legal system in a country,
- potential partners, their economic situation, primarily their financial strength,
- infrastructure in the country and specific region, structure and alternatives regarding the labor force,
- capacity and needs of the market in the host country, etc.,
- sectors suitable for investments.

Solid information sources will have to be set up this sense, and in initial phase also subsidized by the state. Companies could also cover part of the costs.

Commercial sections at embassies that we have in individual countries could become such information sources, as well as the Ministry of Foreign Affairs, which has miscellaneous other information sources apart from the aforementioned ones.

Various forms of representations of commercial banks abroad are also valuable sources of information. Mediation of business information for their clients is provided by

various forms of bank presence: representations, branch offices, and independent banks. These also provide safe payment and settlement services. However, Slovakia has very modest results in this respect thus far. Setting up offices abroad is financially very demanding. While a representation can cost several thousand German marks, establishing a branch office or a bank requires several million German marks (it requires core capital, purchase or lease of a building, etc.). Therefore only large banks can take on such activities.

At present the VUB has a subsidiary in Prague, an affiliation in Brno, and representations in London and Moscow. Preparations for a representation in Shanghai are underway, and the representation in Moscow should be transformed to a branch office. Postova banka (Post Bank) has representations in Prague and Vienna. In order to develop our activities in Asia, preparations are continuing to set up the Asian Development Bank.

Financing of "an information center" may be similar as in the first instance, from two sources, i.e. from state funds and investors themselves.

### **3. Influence of direct foreign investments on the trade balance and the balance of payments**

An important indicator of capitalization of direct foreign investments in a country is the trade balance and the balance of payments from exports and imports of joint companies or companies completely owned by foreign investors from production or commercial activities.

From the perspective of capital flows in the host country, it is important to determine the reverse impact on economic effectiveness of domesticated joint companies or companies completely owned by foreign investors. That means how are they influencing our trade balance and the balance of payments by their exports and imports, which in effect shows how have they managed to capitalize their activities here.

There is no statistical monitoring at present that would report the volume of imports and exports of joint ventures or companies exclusively owned by foreign investors. The NBS monitors the statistical report DEV (NBS) 1-12.

In combination with the report "Overview of Subscribed Capital by Countries" it is possible to select from the whole file by a somewhat complicated procedure using identification number of organizations those companies that are partly or wholly owned by foreign investors.

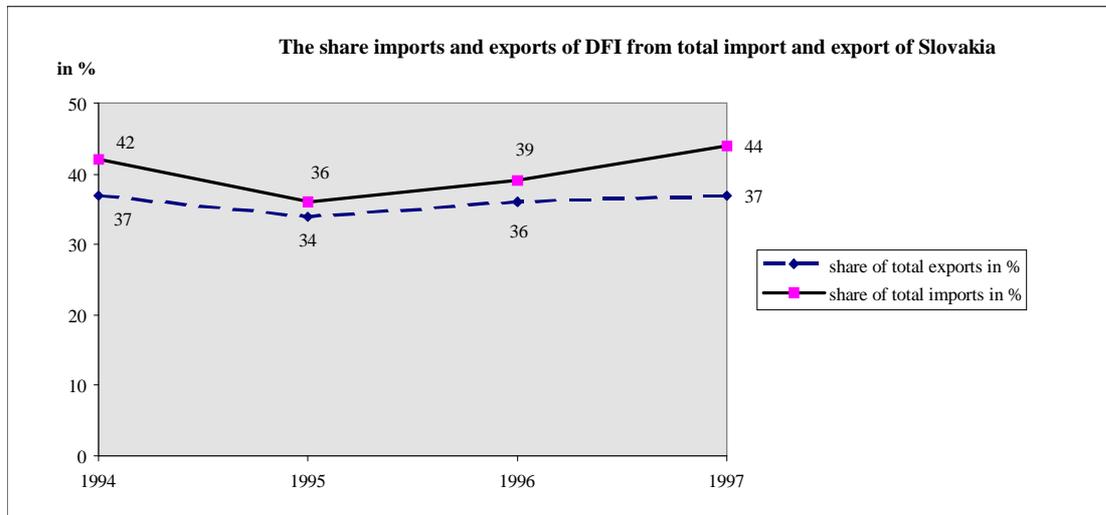
We have been monitoring this file for over four years, and the share of DFI on total foreign trade of Slovakia, its development, and partly also its commodity structure is gradually becoming more distinct.

**Table 6**

#### **Export and Import, Selected Set of Organizations (in SKK millions)**

<b>Year</b>	<b>Joint ventures</b>				<b>Slovakia total</b>	
	<b>export</b>	<b>% share on total export</b>	<b>import</b>	<b>% share on total import</b>	<b>export</b>	<b>import</b>
1994	63 649	37	65 703	42	171 972	156 042
1995	85 564	34	89 953	36	254 099	252 311
1996	96 523	36	131 700	39	270 628	335 165
1997	108 229	37	152 821	44	295 574	345 049

NBS data and Bulletin of the Statistical Office of the Slovak Republic



The following tendencies and facts can be seen in table 6:

- There is a visible constant growth on both export and import side.
- The volume of imports grew more significantly in 1996 and 1997 both in joint ventures and Slovakia as a whole, primarily because of growing prices of raw materials, and higher imports of consumer goods (cars, food) etc.
- It can be concluded from the above data that although direct foreign investments are not entering Slovakia too intensively, from the viewpoint of their capitalization through foreign trade, they now constitute a relatively important part, making up 37 percent of total exports from Slovakia and 44 percent of total imports. While in imports, large commercial companies have a dominant share, which are also importing raw materials and machines for our production companies, our export of joint ventures is principally "propelled" by production companies, above all in metal processing, pharmaceutical industry, chemical and wood processing industries, consumer electronics (household appliances) etc.
- For a more distinct characterization of the share of joint production companies from total import and above all exports, it will be necessary to try and exclude purely trading companies from the monitored file.
- The volume of imports by companies associated with direct foreign investments is significantly influenced by large commercial organizations, as well as a number of smaller joint ventures of a mercantile character that import consumer goods for the Slovak market.
- Within exports, our joint ventures are starting to export direct foreign investments, either as production activities or trade, whereby they are exporting goods of Slovak origin, and unlike in imports, in the commercial sphere too they have a positive influence, whether it be on the volume of exports, foreign exchange reserves, increasing domestic production, etc. At present this constitutes only a small part of our exports, but in the future, in particular when larger production units and components are exported for our DFI abroad, significantly higher sums may be involved.

- As in previous years, also now the expected significant outflow of foreign exchange has not been confirmed that was supposed to be associated with financing of modern technology and know-how, linked to equipping joint ventures in Slovakia. The reason presumably is that foreign investors who are participating in domestic joint ventures are primarily financing modernization of concrete companies. In many instances this takes place by a material form of capital entry into a joint venture.

At the same time we may say that when our companies do find a solid foreign partner, the result is generally positive development, including quality improvements, higher general standards of production, i.e. better technical level of production equipment, qualification of employees using that equipment, better organization of work, which has a positive effect on the overall image of the company, and this in turn reflects on foreign markets.

## **II. DIRECT FOREIGN INVESTMENT IN THE BANKING SECTOR IN SLOVAKIA**

Within the structure of direct foreign investments in Slovakia, the share of banking and insurance industries makes up 25.7 percent of the total volume of DFI.

Just as two models of direct foreign investments and international business exist in industry (the model of developed and developing countries), we can also speak about two models associated with internationalization in banking.

Developing countries are mostly not actively linked to international capital markets, and suffer from a shortage of capital. In many developing countries, a stock exchange does not exist, and where it does, it is not developed enough. Expansion of transnational banks into these countries and their participation in international business is taking place in rather traditional forms, i.e. by establishing representations, branch offices of foreign banks, or independent foreign banks. Their main role is providing services to industrial and other nonfinancial multinational corporations, and serve an as large as possible range of domestic clients. Simultaneously, foreign banks or their branch offices are taking part in forming the financial infrastructure in these countries.

In developed market economies, the rate of establishment of foreign banks is no longer as high as in previous decades, and the dominating sphere of operations of transnational banks are transactions on the international securities market. An important tendency in the functioning of the financial markets in the process of internationalization are innovations in the area of financial instruments (new types of securities, derivatives, the possibility to buy and sell debts between various entities, etc.).

Procedures characteristic for less developed countries are more or less implemented in the entry of foreign banks into our country. The advantage of our country, particularly in the early years of foreign capital influx was low foreign debt and inclination of the population to savings. One of the channels for the entry of foreign banks already at the time of the former CSFR was also their participation in some investment privatization funds. However, for known reasons it gradually faded away.

A decision to establish an own affiliated bank, a branch office of a bank, or a representation is made in accordance with a long-term program of a specific bank. Goals of a bank are

- defensive and
- expansive

**Defensive** globalization decision-making has the goal of maintaining stability and magnitude of the existing clientele, as well as creating and securing a refinancing basis in important foreign currencies. Defensive strategic goals are gaining on importance for domestic banks with growing foreign orientation of their clients. In case of a conservative approach, they could face a danger of potentially losing them in favor of banks operating internationally.

Through international expansion of its performance, a bank also offers additional services, which, until then could have been rendered only in cooperation with a foreign bank.

In case of **expansionist** strategic goals, the ambition is to win new clientele and a wider market share by offering attractive services. These must offer an above-standard performance, because within conventional strategy of standard services only price competition in individual services is possible.

The greatest chances also for renown banks are in such countries where various forms of foreign banking institutions were either under-represented or absent altogether. However, this is only possible in less economically developed countries, where more intensive development is anticipated in the near future. Finding such a region requires a certain sense for future chances of success in tapping the market potential, as well as knowledge whether such regions offer a certain level of security. If the answers are positive, it is necessary to act quickly because of strong competition, in order to get established on a potentially advantageous market.

An important reason for globalization in banking is the fact that by setting up a bank institution abroad, the commercial basis is widened not just for the demands of the bank's clients, but also for transaction opportunities for the bank itself. This primarily applies on the European level. Presence at various financial locations substantially enhances the bank's overview. This helps banks to react more readily to changes on the market.

## **1. Forms and determinants of foreign activities of banking institutions**

### **Choice of the International Form of Banks' Activity**

Criteria on the basis of which a form of chosen by a foreign bank institution are, above all: the profitability of investments, type and extent of commercial activities, bank, import, legal, and credit-political terms, tax aspects, flexibility of commercial policy, as well as personnel requirements.

#### **Representations**

Representations are considered the primary option for an independent entry into a foreign banking market. Representations cannot carry out any transactions, and they can work for their parent bank only indirectly. Apart from that, they can only settle on the lowest intensity level of foreign forms of banking activities. They primarily serve as contact locations for potential clients as well as new commercial relations. Simultaneously, they function as information collectors for their parent institute, and for their clients at the place of business.

A representation mostly serves for monitoring and assessing the market, to see whether it is worth establishing a more intensive form of presence, primarily from the perspective of profitability. This form of presence is increasingly justified in countries where obstacles exist to other forms of bank presence.

Representations are often an interim solution until a higher form of presence is established - a branch office or a subsidiary bank. Its advantages include lower investment costs associated with its establishment and required personnel. On the other hand, based on limited functions of a representation this too has its boundaries, if in the surroundings of its clients preparations are underway for a more intensive presence on the foreign market.

## Representations in Slovakia

**Table 7**

**Since 1992, ten representations of foreign banks were set up in Slovakia:**

Country	Name	Registration year
Czech Republic	Ceská spořitelna, a.s. Praha	1995
	Investiční a poštovní banka, a.s. Praha	1995
	Živnostenská banka	1996
France	Banque Paribas	1992
	Societe Generale	1994
Hungary	Magyar Kulkereskedelmi Bank RT Budapest	1994
Germany	Commerzbank AG, Frankfurt	1995
	Dresden Bank AG, Frankfurt	1995
Great Britain	European Bank for Reconstruction and Development	1994

Source: NBS, Overview of the financial sector development, January 1998

## Branch Offices

Branch offices of foreign banks represent a more intensive form of business presence than representations described above. A branch office is a legally independent unit of the parent bank. Branch offices are subject to bank supervision both in their host and home countries.

Various restrictive measures exist in individual countries regarding the establishment of branch offices of foreign banks. Nevertheless, branch offices are one of the most significant forms of presence used to enter foreign market. The ability to carry out independent business activity according to instructions of the parent bank plays a specific role. A disadvantage is insufficient flexibility compared with entirely independent subsidiary banks. The level of independence in doing business must be adapted to concrete circumstances in order to achieve profitability of a branch office.

**Table 8**

## **Branch offices of foreign banks in Slovakia**

Country	Name	License Issue Date	Share Capital Structure	
			Slovakia	Foreign bank
Czech Republic	Banka Hana, a.s. Brno	1992	-	100
	Ceskoslovenská obchodní banka, a.s. Praha	1993	-	100
	Moravia banka, a.s.	1993	-	100
Holland	ING Bank, N.V.	1993	-	100

Source: NBS, Overview of the financial sector development, January 1998

The total volume of granted funds is SKK 5,075 million, which in the case of branch offices of foreign banks does not have the character of equity capital, but permanently granted

funds by a parent bank to its branch office abroad. (According to Measure No. 4 of the NBS of May 27, 1994, Article 4)

### **Subsidiary Banks**

Legally independent subsidiary banks represent the most intensive form of bank presence. As independent legal entities, subsidiary banks are fully subject to supervision, bylaws, and credit-political measures of the host country. After receiving a license from the host country, they may carry out bank business on its territory. They may provide loans up to the volume of their own capital, as is usual in most countries.

Despite their legal independence, the directive lines of their commercial policy are formulated by administrative bodies of their parent bank. An important reason for opening a subsidiary bank abroad is frequently their link to foreign investors.

Independence from restrictive commercial rules of the parent banks and the home country may have a particularly positive effect when liberal supervision rules are applied in the host country, as well as own loan conditions.

An advantage of subsidiary banks is that on the basis of their legal independence they are not subject to bank supervision of the home country of their parent bank. For this reason an intensive interconnection with the banking market in the host country is possible.

However, independence of commercial policy of subsidiary banks abroad may pose some risks. A point may be reached when economic-political relations would not be conform with the goals of the parent bank.

Subsidiary banks are the most suitable alternative for presence on foreign markets and for making best use of local conditions. A universal form of a bank brings the best results.

## Banks with Foreign Capital Participation in Slovakia

Table 9

The following list includes only banks with over 10% foreign capital

Country	Name	License Issue Date	Share Capital Structure	
			Slovakia	Foreign bank
Czech Republic	Komerèní banka, a.s. Bratislava	1995	-	100.00
France	Credit Lyonnais Bank Slovakia, a.s.	1993	10.00	90.00
Germany	Hypo-Bank Slovakia, a.s.	1995	-	100.00
Austria	Bank Austria	1995	-	100.00
	Creditanstalt, a.s. Bratislava	1994	-	100.00
	Istrobanka, a.s. Bratislava	1992	90.00	10.00
	¼udová banka, a.s. Bratislava	1991	2.54	95.68
	Tatra banka, a.s. Bratislava	1990	36.99	63.01
Russia	Devín banka, a.s. Bratislava	1992	76.40	23.60
USA	Citibank (Slovakia), a.s. Bratislava	1995	-	100
Germany/Austria	Prvá stavebná sporiteľňa, a.s. Bratislava	1992	35.00	32.50
Germany/Austria	Stavebná sporiteľňa VUB-Wustenrot, a.s. Bratislava	1993	50.00	20.00 30.00
Great Britain	Poľnobanka, a.s.	1990	63.05	20.00
Italy				15.00
Czech Republic				1.95

Source: NBS, Overview of the financial sector development, January 1998

The overall volume of subscribed registered capital in all banks with foreign capital participation in Slovakia is SKK 6,487.7 million.

In comparison with other forms of foreign bank presence in Slovakia, representations of foreign banks have in most cases a later establishment date than the other two forms, i.e. banks with foreign capital participation and branch offices of foreign banks, where the license issue date in two instances was in 1990, in three instances in 1992, and the most in 1993 -- six instances (for example all branch offices), and other gradually in further years.

This fact provides an indication about a certain level of confidence and an effort to settle on the market already in the initial years of our restructuring (i.e. as part of the CSFR) of those foreign banks, which have chosen a higher form of bank presence when they entered our territory.

It appears, and as experience elsewhere in the world and here in Slovakia demonstrates, in most cases when foreign investors enter the banking sphere they choose the form of a subsidiary bank as the most suitable alternative.

From the perspective of further development by transforming a representation to higher forms of bank activities, two tendencies appear internationally and in Slovakia. On the one hand, several large foreign banks want to preserve the form of representation at this point. The reason is that Slovakia is a too small market for them, and additionally, already occupied as far as quality clientele is concerned. Another highlighted serious argument is relatively low presence of foreign investors in Slovakia. They would consider the level of direct foreign investments in Slovakia at about \$2 billion to be optimum.

On the other hand, some representations are calculating with expanding their services in Slovakia by transforming to higher form of activities, whereby, apart from applying their activities here they want to offer their services for our country abroad, primarily where we still do not have our own bank presence.

### **Determinants of choosing a potential business location**

From a general point of view of an almost classic definition it can be said:

As part of strategic goals of setting up a foreign form of bank presence, relevant factors of the business location must be analyzed first, including their anticipated development. Those conditions are taken into consideration that are typical for the given region and that can affect activities of the bank either positively or negatively. The most important determinants of choosing a business location are above all commercial-structural factors, market potential, as well as institutional framework conditions of a political, economic, and legal character. Then follows a size estimate of the dominant commercial potential for the bank's own performance.

Specific determinants of choosing a business location:

#### **- Profitability Analysis**

Founding a branch office or a subsidiary bank is meaningful for the parent bank only if profitability in the given area increases. Profitability in international banking business depends on a presumed commercial range and specified market potential. (Under market potential, we understand the entire scope of commercial bank relations accessible to a branch office or a subsidiary bank on the basis of an array of complex of conditions.) For market potential assessments in business groups, indicators are evaluated with a character such as belonging to a certain business group, capital strength, range, structure of clients, international links, etc. Commercial outlook of a foreign business location in the competitive situation in the banking sector is also of fundamental importance.

#### **- Economic Aspects**

Economic and political analyses have a major weight in decisions about a business location of a branch office or a subsidiary bank. These analyses contain up-to-date economic-geographic and political links, foreign trade development, as well as a prognosis of economic outlook. Macroeconomic indicators are used for an assessment of the economic situation and outlook. These primarily include the gross domestic product, price and wage developments, structure and volume of foreign debt, and the employment level. From a bank perspective, an analysis of international commercial links of a country is of special importance. Thereby the extent of foreign trade with the parent country of a branch office is particularly important, along with the range of direct foreign investors.

Eventually, a decision about establishing a branch office or a subsidiary bank depends on an estimate of economic development in a country. The fundamental determinants are: the economic policy of the government, the basic line of monetary and loan policy of the central bank, power of trade unions, as well as the international context in relation to a specific country.

Political relations in the target country are very important when foreign bank institutions are founded, because in case of essential political changes, extraordinary risks for a bank arise.

### **- Legal Framework**

The legal framework in the target country significantly influences the foundation of foreign bank institutions, above all branch offices. Since the parent bank is an integral part of the legal framework in a concrete home country, it is necessary to take into account also the domestic laws in comparison with the foreign ones. Some of the most important legal matters a bank must consider include laws pertaining to branch offices in the target country, directives governing commercial activities of banks, rules for international movement of money and capital, tax conditions, as well as accounting and reporting directives.

Specific conditions are placed on required bank capital. If these are higher than in the parent country and constitute a competitive disadvantage, the attitude of the parent banks tend to be negative.

In a majority of countries, commercial activities of banks are subject to credit-political and bank supervision guidelines. Thereby individual conditions often fundamentally determine the type and range of commercial possibilities. Some of the most important restrictive measures include own capital requirement, liquidity rules, minimum reserve requirement, and rules of foreign exchange trading.

The tax system in a target country is very important. High taxes are a limiting factor.

## **Summary of Experiences of Employees of Foreign Bank Houses in Slovakia**

In association with theoretical foundations, we have formulated several questions which we consulted in several selected foreign banks in Slovakia in the first half of 1997. We have chosen the structure of respondents to include all three forms of bank presence, i.e. banks with foreign capital participation, branch offices of foreign banks, and representations. We have addressed: Creditanstalt, a.s. Bratislava, Credit Lyonnais Bank Slovakia, a.s., Hypo-Bank Slovakia, a.s., Komerčni banka Bratislava, a.s., Ludova banka Bratislava, a.s., Ceskoslovenska obchodna banka in Slovakia, a.s., ING Bank N.V. Amsterdam branch office Bratislava, Commerzbank AG representation in Bratislava, Investicna a postova banka, a.s. representation in Bratislava, Dresdner Bank, AG, representation in Bratislava.

**- What are the main risks you see in association with your financial business activities in Slovakia?**

Already the introductory part in chapter II shows what weight is attributed to signals about the level of political-economic risks when foreign banks establish their presence. A bank monitors a given problem not only from the perspective of the organization itself, but also from the perspective of its clients who need long-term guarantees for doing business abroad. The interconnection is in the fact that a sufficient number of solvent clients provides certainly that a bank will work effectively. Apart from various political-economic factors, risks are associated with regional differences, legal systems, etc.

As to the main risks associated with financial business activities in Slovakia, the answers of almost all respondents (apart from those from the Czech Republic) were very similar:

Respondents from Czech banking houses expressed an opinion that they feel no extraordinary risks in Slovakia because we know each other well, we have about the same conditions for doing business and the legal system.

Unlike their Czech colleagues, representatives from other foreign bank institutions in Slovakia perceive certain risks more intensively. They primarily mentioned Slovakia's image, which is even worse abroad than reality. They see the reasons for this in insufficient information systems and compatibility. Differing information about a single fact cannot stimulate trustworthiness. We have a deficit of political professionalism.

Risks:

- Gradual centralization of the economy.
- Company Revitalization Act, not all companies will have identical conditions.
- Failure to join the EU, which may cause a gradual divergence of business conditions.
- Missing transparency of privatization was in several instances mentioned as an obstacle to business activities.

There was absolute unity in the opinion that an irreplaceable feeling of certainty in financial business activities is provided by functioning of the central bank - the National Bank of Slovakia. Professionalism is apparent in its work. Foreign investors consider numerical data the NBS publishes trustworthy.

**- What reservations do you have towards conditions for financial business activities in Slovakia stipulated by the Act on Banks, the Foreign Exchange Act, and other legal norms?**

The respondents concurrently presented no fundamental objections to the main legal norms pertaining to banking, i.e. the Act on Banks and the Foreign Exchange Act. Both laws are considered a standard in banking, which enable working on a solid basis.

Respondents from foreign banking institutions were similarly united in the opinion that the duty to pay taxes from uncollected interest (from blocked loans) is unjust.

Several respondents have partial objections to compulsory reports for the NBS in cases of duplicity in reporting certain data. They recommend revising the forms so that they would become unambiguous and purposeful.

They rather see problems on other laws, not the banking legislation. For example insufficient legal regulations in areas such as: real estate cadastre, the Bankruptcy and Settlement Act.

Respondents are also dissatisfied with frequent changes in our laws and differing or unclear interpretation. They are confronted with two or three possible interpretations, whereby they run the risk it might be them who decides for the wrong one. No one is willing to give them binding information.

Also the judiciary and other central administrative institutions were criticized for working with excessively long deadlines. For example one foreign bank subsidiary has asked for patent protection of its logo three years ago, and it still does not have it.

**- What advantages do you see in doing business activities in Slovakia?**

A certain availability of a banking market to occupy was cited as an advantage, in comparison with developed countries, which are already overfilled.

The fact that over the past approximately seven years Slovak banking made great progress in quality was cited as a highly positive feature. It is labelled the best functioning branch in our national economy. In this positive development, the entry of foreign banks into the Slovak financial market played a crucial role. Competition pressure forced domestic banks to modernize quickly and use professional approach to banking business. The entire banking technology and culture of banking business is undergoing modernization, which is

primarily based on human factors. Highly appreciated this respect were in university educated staff members with a solid background in theory, flexibly reacting to new conditions in the banking business, as well as great progress in language knowledge over the past period, primarily among the young people. High school administrative staff received a less positive evaluation, where workers with language knowledge are missing.

### **- What type of clientele do you focus on?**

The clientele question is very important for the existence of all forms of bank presence.

In all instances we received the answer that effort concentrates on winning the best clientele:

- the largest solvent Slovak companies,
- as well as medium-sized companies with about 200-300 employees,
- activities of foreign investors in Slovakia, as much as possible, but banks also strive to find new ones, either from their parent country or other countries,
- the stratum of solvent natural persons.

In competition for top-quality clients and for large clients, more favorable credit conditions are frequently offered, and although this direction is less risky, it is also less profitable.

A representative of a subsidiary bank of a renown foreign bank said that large and solvent companies in Slovakia are assigned a better risk rating as the country itself.

Two approaches to client selection are used in the world:

- a) the American approach considers a medium-sized or small client with good prospects typical good client.
- b) the German approach is conservative, with orientation towards larger clients.

Efforts of most of the interviewed banking houses are heading towards large clients. Resulting from intensive competition, some institutions have rather chosen different tactics and are addressing offers of their services to smaller and medium-sized companies. This primarily involved winning new solvent clients, for example in association with their international activities in countries where Slovak banks are not represented yet.

Bank institutions of large foreign banks pointed out the relatively low number of foreign investors compared with neighboring countries. They would welcome a more visible entry of foreign activities in Slovakia. Concerning foreign representation of Slovak companies, these institutions will for long fill a vacuum until a network of foreign branch offices and subsidiary banks is set up by parent Slovak banking institutions.

### **What products do you concentrate on?**

With regard to our small and thus far underdeveloped market, all the visited foreign banking institutions are oriented towards universal range of activity in the first stage of their presence here.

In concrete bank services, this predominantly includes payments and settlement of export and import transactions of their clients, taking part in founding joint ventures or companies fully owned by foreign investors, administering accounts, guarantees, short and long-term operations, introducing Slovak clients at stock exchanges, derivatives, electronic banking, homebanking, etc.

Providing mortgage loans may be presumed as a specific focus of some foreign banking institutions. They have thus far chosen waiting tactics (Hypobank obtained a license on December 23, 1997).

### **- How would you evaluate the level of the banking system in Slovakia, and what could you recommend to improve the present situation?**

The level of the banking system in Slovakia is evaluated as good or very good. In a very short period, Slovak commercial banks improved to a degree that enables them to compete with foreign banks. On the other hand, Slovak banks also have a virtue foreign banks miss, which is they are here at home where they have historically continual commercial relations, which is their huge advantage.

The National Bank of Slovakia has a decisive position in the banking system of the Slovak Republic, it is in controls of developments, which subsequently positively influences also the performance of Slovak banks. Activity of the NBS is seen as a guarantee for activities of foreign bank representations, and has high credit.

Experts evaluate the banking market in Slovakia as a market with the toughest competition in efforts to win the best customers. The entry of foreign banks into this market further increased competition pressure, and unambiguously has been and is positively pressing on an acceleration of restructuring of the domestic banking system, which in the main features remarkably approached the level of banking in developed market economies. Completing bank restructuring will require stabilization of individual banks and staff, which will require 2-3 more years, introducing missing products, improving bad portfolio where necessary, shortening of deadlines, improving productivity of bank employees and their more complex scope, a general improvement of bank utilities, we still have a high proportion of cash payments in comparison with other countries, foreign exchange arrangements will need further liberalization, etc.

Although still incomplete but generally close correlation between the level of Slovak banking and the level of banking abroad is very significant in view of the EU. Although

Slovakia has not become a member of the EU thus far, it is necessary to keep in close contact in the given area.

It will be necessary to gradually set up foreign representations of Slovak banks, because banks must be the front-runners of their clientele, otherwise they might lose it.

Mergers of smaller banks are anticipated, which would create a network of relatively strong banks, and smaller banks would cover rather specific needs of the financial market.

**- What recommendations could you give for export of Slovak capital into banking abroad?**

Export of capital from a concrete country to establish some form of bank presence for bank institutions of a parent country is quite important for various reasons:

- an advance survey of a given country for the bank's clients, examination of security of potential investments, economic conditions, the legal system, as well as market demand;
- they provide payment and settlement transactions for their clients;
- export of services and establishing affiliated companies of banks in the banking and insurance branches represents an alternative international strategy;

All respondents confirmed the importance of bank capital export.

There was an almost unambiguous answer to the question "where primarily should capital export be directed?":

Everywhere where you have traditionally good and intensive foreign trade relations, i.e. in places where we already have a solid base. At the same time, we were recommended not to orient on very distant countries, above all not in the initial phase. We have also encountered an opposing opinion suggesting that Slovak banks should establish their presence in growing markets, such as China, Indonesia, Vietnam, and Malaysia, where they should establish contacts with clients.

Our comment to this opinion is that this would simultaneously require a sufficient portfolio of clients that would keep such bank institutions afloat. One or two strong clients do not pose certainty for a branch office or a subsidiary bank. A larger number of clients from diverse spheres would be needed as safeguard against failure.

However, most respondents supported the opinion that despite the higher level of risk, countries of the former COMECON would be suitable for Slovakia, then Austria and Germany, as well as other EU countries. Presence in significant financial centers, such as London, New York, Frankfurt, Luxembourg is very important too.

Establishing a foreign bank institution, in particular a branch office or a subsidiary bank, is very expensive and can be undertaken only by large banks. Essential figures determining the magnitude of costs are above all the obligatory volume of founding capital, acquisition or renting of a building, and payroll for 30 - 50 employees in the medium level

management and 8-10 senior management staff. Up-to-date technical equipment also requires very high financial investments.

The aforementioned conditions differ by country, and for this reason it is difficult to estimate a rough sum. Specialists from foreign banks put the figure at about 40-50 million DEM. In comparison with that, establishing a representation is relatively cheap -- renting a room, furnishing, plus two to four employees.

Export of capital by a concrete bank is also a matter of ambitions of its clients who need someone abroad to mediate their transactions. They need economic and political influence there, which in many cases a strong bank can offer.

Foreign bank institutions in general, and our banks perhaps even more, can expect great pressure on introducing their "name" and above all supporting it. This will be a great challenge that requires maximum effort by all bank employees and managers.

## **2. A Comparison of Business Activities of Domestic Banks and Banks with Foreign Capital Participation**

Slovak banks and banks with foreign capital are providing banking services in Slovakia. One of the conditions for granting a license to Slovak banks is an evaluation of the composition of its share capital and other financial resources of a bank; in case of a branch office of a foreign bank the volume of permanently granted funds by the parent bank is assessed.

All bank entities are obliged to ensure permanent liquidity in Slovak and foreign currencies, whereby they must respect the rules of liquidity and safe performance of activities.

Rules are adjusted to existing conditions at a given time and can pertain to the minimum volume of liquid funds, specified limitations and conditions -- for some types of credit transactions or investments, deposits, guarantees, and commitments, to harmonization of maturity of assets and liabilities, or regarding dangerous foreign exchange positions. Banks must ensure that the sum of loans provided to a single debtor or an economically associated group of debtors does not exceed a certain percentage of capital and reserves, and also the total volume of loans to the largest debtors cannot exceed a certain percentage of capital and reserves of a bank.

Banks may have capital participation in commercial companies or other legal entities with limits stipulated by the Act on Banks, but their fundamental activities are accepting deposits and extending loans.

When we evaluate the performance of banks in deposit and loan activities from 1993 to 1997, a 91.6 percent increase of deposit activity was achieved, compared to a 31.3 percent growth of lending activity. In the 1993-1997 period, annual growth rates were volatile, whereby the highest deposit activity was achieved in 1995 and lending activity in 1996. During the evaluated period, in 1993 and 1994 banks collected a lower volume of primary resources than the volume of loans they provided. This ratio changed in 1995 by faster growth of primary resources. A moment came when in commercial activity of banks acquiring resources became more expensive. This was caused by an increased proportion of risk assets. Problematic assets are inducing the need to improve capital strength of bank entities and reinforcing the liabilities side of their balance by external resources.

This trend also reflected in a comparison of the development of extended loans and deposits from a time perspective. Until 1996, long-term loans made up the largest part of provided loans (which is the effect of intensity of their repayment), and since 1996, short-term loans began to be extended in larger volumes. During the entire monitored period, short-term deposits had a dominant position among deposits, whereby since 1995 the volume of long-term deposits began gradually growing, but their share is still very low in general.

Banks without foreign capital participation accomplished the highest portion of basic operations with clients in 1997 on the Slovak banking market on both the assets side and the liabilities side of the overall balance. Ten banks are performing bank activities in this group of banks. Far behind follow banks with foreign capital participation (14 bank entities) and branch offices of foreign banks (4 bank entities).

**Table 10**

**Share of Individual Groups of Banks on Operations with Clients According to Balance Sheets as on December 31, 1997**

	in %	
	Assets	Liabilities
Slovak Republic Total	100	100
a) Slovak banks	90.3	95.2
- banks without foreign capital	68.5	67.5
- banks with foreign capital	21.8	27.7
b) branch offices of foreign banks	9.7	4.8

**Note:** Basic operations with clients -- accounts of administrative institutions of the Slovak Republic, self-governments, state and other funds of the Slovak Republic, client accounts, not included are accounts of banks.

Banks with foreign capital participation can be divided into banks with negligible capital participation (below 20 percent), major capital participation (20 - 50 percent), and controlling capital participation (over 50 percent). In this group of banks, banks with controlling capital participation are active in bank operations with clients, whereby their activity is more evident on the liabilities part of the balance. Apart from state financial institutions, banks with negligible and major capital participation accomplish the lowest share of deposits and loan activity.

If we look at the development of **basic operations with clients** on the balance sheets of Slovak banks without foreign capital participation, the volume of operations with clients dropped in 1995 on the assets side and since 1996 began growing gradually. On the liabilities side there is clear growth of activity. Slow gradual decline of operations with clients is taking place in Slovak banks with foreign capital participation. In both groups of banks, the share of operations with clients is higher on the liabilities side than on the assets side, whereby this difference is more significant in Slovak banks with foreign capital participation. In other words, these banks are more oriented at acquiring external resources. Branch offices of foreign banks entered the Slovak bank market with a significant proportion of operations with clients on the assets side, but it gradually decreased in the monitored period from 69.3 percent

to 42.7 percent. On the liabilities side, branch offices of foreign banks reported increasing operations with clients until 1995. From that year, transactions with clients declined, and presently they are at the lowest level over the entire monitored period (26.00 percent). A comparison of assets and liabilities sides shows that branch offices of foreign banks mainly focused on extending loans.

Table 11

**Development of Basic Operations with Clients According to Balance Sheets**

	<b>Assets</b>	<b>Liabilities</b>
<b>As on December 31, 1993 in %</b>		
Slovak Republic Total		
a) Slovak banks	59.4	53.9
- banks without foreign capital		
- banks without foreign capital		
b) branch offices of foreign banks	63.2	35.4
<b>As on December 31, 1994 in %</b>		
Slovak Republic Total	52.5	55.5
a) Slovak banks	50.7	56.9
- banks without foreign capital	52.2	56.4
- banks without foreign capital	40.9	60.5
b) branch offices of foreign banks	69.3	41.4
<b>As on December 31, 1995 in %</b>		
Slovak Republic Total	48.0	57.8
a) Slovak banks	46.7	59.2
- banks without foreign capital	48.5	59.4
- banks without foreign capital	40.5	58.4
b) branch offices of foreign banks	59.7	47.9
<b>As on December 31, 1996 in %</b>		
Slovak Republic Total	47.7	56.2
a) Slovak banks	47.8	59.4
- banks without foreign capital	50.8	60.0
- banks without foreign capital	38.0	57.4
b) branch offices of foreign banks	46.5	30.1
<b>As on December 31, 1997 in %</b>		
Slovak Republic Total	45.5	55.8
a) Slovak banks	45.8	59.3
- banks without foreign capital	51.8	62.5
- banks without foreign capital	33.8	52.5
b) branch offices of foreign banks	42.7	26.0

This development shows a gradual shift of orientation of bank entities towards interbank operations, or a shift of activities from loan and deposit sphere to other bank services.

As to the structure of standard loans in 1997, banks without foreign capital participation gradually reoriented from long-term to short-term loans, the share of which prevailed in banks with foreign capital participation over the entire monitored period. Banks without foreign capital participation have the largest proportion of risky loans in their portfolio, and the share of such loans is small in banks with foreign capital participation. Savings deposits prevail in Slovak banks, whereby they evidently prevail in banks without foreign capital participation. In banks with foreign capital, their proportion is lowering in favor of time deposits and current account deposits, while time deposits prevail in branch offices of foreign banks.

**Table 12**  
**Basic Operations with Clients According to Balance Sheets as on December 31, 1997**  
in SKK mil

	in SKK		in foreign exchange		Total
	residents	non-residents	resident s	non-residents	
<b>bank sector total</b>	340 099	1 805	35 395	11 208	353 793*
Slovak banks	314 002	1 805	26 383	9 924	319 383*
- state financial institutions	27 132	0	0	0	16 755*
- without foreign capital	226 533	1 704	12 124	5 146	225 542*
- with foreign capital	60 336	101	14 259	4 777	77 084*
<b>branch offices of foreign banks</b>	26 098	0	9 012	1 284	34 410*

\* adjustments have not been included

Table 13

**Basic Operations with Clients According to Balance Sheets as on December 31, 1997**  
in SKK mil

	in SKK		in foreign exchange		Total
	residents	non-residents	residents	non-residents	
<b>bank sector total</b>	<b>380 786</b>	<b>2 782</b>	<b>47 517</b>	<b>2 496</b>	<b>433 581</b>
<b>Slovak banks</b>	<b>366 157</b>	<b>2 558</b>	<b>42 158</b>	<b>1 731</b>	<b>412 604</b>
- state financial institutions	103	0	0	0	103
- without foreign capital	260 388	455	30 991	748	292 582
- with foreign capital	105 661	2 101	11 167	983	119 915
<b>branch offices of foreign banks</b>	<b>14 627</b>	<b>224</b>	<b>5 360</b>	<b>764</b>	<b>20 977</b>

All groups of banks carry out client operations primarily in the Slovak currency. The share of transactions in the Slovak currency in Slovak banks is 90 percent, while in branch offices of foreign banks it is 75 percent. In 1997, banks without foreign capital achieved the highest share of primary resources in foreign exchange among Slovak banks, and banks with foreign capital provided the highest share of foreign exchange loans. A comparison of active and passive sides of the balance shows that banks without foreign capital acquire more resources than they provide loans, while on the other side banks with foreign capital provide loans in foreign exchange.

Clients of banks are mostly residents, the volume of bank operations with non-residents is small (about 3.5 percent on assets side and 1.2 percent on liabilities side). On the assets side, banks without foreign capital carry out the greatest volume of transactions with non-residents, while on the liabilities side most transactions are carried out by banks with foreign capital. As to volume among Slovak banks, a majority of loans to non-residents were provided by banks without foreign capital. Loans extended to non-residents in Slovak crowns are primarily included among classified loans, while in case of foreign exchange loans these are standard loans. As to the foreign exchange position of assets in the Slovak banking sector, 99.9 percent of loans in convertible currencies were provided to legal entities. The remaining 0.1 percent was provided to natural persons, primarily non-residents.

The largest volume of primary resources acquired by banks with foreign capital was in the form of time deposits. Deposits in convertible currencies from the perspective of foreign exchange position primarily come from natural persons (84.7 percent).

Finally we may conclude that apart from Slovak banks, also banks with foreign capital and branch offices of foreign banks are doing business on the Slovak bank market. On the basis of a license to perform bank activities, along with accepting deposits and extending loans, these banks may perform other bank activities, such as payment and settlement,

clearing of payments, issue and administer bank cards, invest and trade in securities, provide exchange services, financial leasing, financial brokerage, etc. Through commercial companies and other legal entities in which they have a property share, banks carry out some of the aforementioned activities. Particularly banks with foreign capital have a stake in investment companies and funds, the stock exchange, and commercial companies -- Agrotrade, AXA, Dochodkovy poistovaci fond HORIZONT (Pension Fund), PODEX, POLNO-LEAS (Po<sup>3</sup>/<sub>4</sub>nobanka); ISTROHOLDING (Istrobanka), TATRA LEASING, Tatra Raiffeisen Capital (Tatra banka).

Some more distinct changes over the five-year period of loan and deposit activity of banks in Slovakia occurred in 1995, when banks acquired a higher volume of primary resources than the volume of loans they provided, the year-on-year growth of deposit activity reached its peak, and from that year on the volume of long-term deposit began rising. In lending activity, more distinct changes took place in 1996, when banks began providing larger volumes of short-term loans, which reflected in the highest year-on-year growth during the monitored period.

Slovak banks without foreign capital are carrying out the largest volume of transactions with clients on the Slovak bank market, whereby state administration ranks among the important clients, along with self-governments, state and other funds, particularly on the liabilities side of the balance. On the assets side, operations with clients were rising apart from 1995, while on the liabilities side there was clear growth. In foreign exchange transactions these banks are accumulating the largest volume of primary resources within the Slovak banking sector. They are performing the largest transactions with non-residents on the assets side, while loans extended to non-residents in Slovak currency are primarily included among classified loans.

The most numerous group are banks with foreign capital -- their number is about 50 percent of all banks -- but their share in accepting deposits and extending loans is low.

Banks with foreign capital are gradually limiting their commercial operations with clients in deposit and loan activities. They are accumulating more resources in the form of savings deposits from clients than they provide loans. They have a low proportion of risky loans in their portfolios, and in standard loans they focus on short-term loans. These banks are more active in foreign exchange transactions and in providing loans to non-residents, who received a greater volume of loans than the volume of deposits these banks accumulated. This group of banks is characterized by trading on the bank market with relatively stable and not excessively expensive resources, whereby they are efficient in assessing the credibility of clients, which results in a low proportion of risk assets.

The share of branch offices of foreign banks on basic operations with client is low, whereby the percentage is lower on the side of liabilities. This ensues from the smaller number of bank entities in this group, which constitutes 14.3 percent of all banks. Activity in

deposit and loan transactions with clients performed by branch offices of foreign banks is declining. Unlike banks with foreign capital participation, branch offices are more oriented at providing loans than accepting deposits, whereby they gradually shifted from long-term to short-term loans. Their portfolio includes a larger proportion of risky loans as in banks with foreign capital participation. The volume of foreign exchange transactions they carry out on the assets side is greater, and the volume of transactions with non-residents is larger on the assets side.

In transactions with clients, banks without foreign capital are the most active ones, whereby they also report the highest proportion of classified loans in their portfolio. Banks with foreign capital had the most cautious approach to transactions with clients.

## CONCLUSIONS

Direct foreign investments have not registered any significant growth over in the past period (unless we consider the additional increase of capital in branch offices of foreign banks that was added to foreign investments in 1996).

Tendencies of DFI as to the branch structure and individual regions remain fundamentally unchanged (apart from the aforementioned move to banking and insurance sector). Also in terms of investors, countries in the first three places remain the same, but Japan moved up to take the fourth place at present.

Development of DFI from Slovakia is much more interesting with a much more dynamic year-on-year development than in the case of foreign capital influx. However, since no extraordinary sums of money are involved, this development had no significant effect on the balance of payments. Should this trend persist, it would become necessary to examine concrete effects on drainage of internal investment resource and decline in the number of jobs in Slovakia. On the other hand, apparent positive effects have surfaced in view of growing exports in various directions, which is a very positive phenomenon. With regard to increased foreign trade risks, it will be necessary to prepare certain measures to provide for insuring property of our investors abroad, as well as to create information sources about investment terms in countries where foreign activities are directed of primarily small and medium-sized investors who do not have enough funds to finance their own consulting services.

We have been monitoring the effects of DFI for the fourth year. We can say that despite their relatively low volume, their feedback influence on the trade balance and the balance of payments is not negligible. The share of joint ventures on total exports of Slovakia ranged from 34 to 37 percent. With the low volume of DFI, this is a major share, which shows the positive effects of DFI in this direction.

On the other hand, import of joint ventures constitutes 36 to 44 percent of total import of Slovakia. However, it must be noted that this is affected by large commercial organizations that are not importing commodities only for joint ventures, but for the entire Slovak economy. For this reason, in order to better express the influence of DFI on the trade balance, these exclusively commercial organizations will have to be omitted.

Previously suggested threat of an increased outflow of foreign exchange in association with modernization and establishing joint ventures still remains unconfirmed.

From areas examined thus far, the most notable effects of DFI can be found in the banking sector, where the share of DFI is 25.7 percent of total foreign investments. DFI have an exceptionally positive effect on the banking sector. They have caused competitive pressure on domestic banks, which, if they wanted to withstand the challenge and preserve their clientele to some extent, had to relatively quickly approach the quality level of foreign banking institutions. The entire banking technology is undergoing modernization, along with

the culture of banking business. Completing bank restructuring will require their stabilization, which will require 2-3 more years, introducing missing products, improving bad portfolio where necessary, increasing productivity of bank employees and their more complex scope, and general improvement of bank utilities.

For the future of the banking system, we will have to prepare for setting up banking institutions abroad, among others also to enable our banks to preserve their clients, to mediate important information sources for our international business activities, and formulate our international strategy in this direction.

In this area we should primarily orient on those countries with which we have long-lasting commercial contacts, above all in terms of exports. It can be assumed that specifically there our exports will be headed, which will need the services of its banking institutions.

A generally close correlation between the level of Slovak banking and the level banking abroad is very significant from the perspective of Slovakia's entry into the EU. Maintaining an as close affinity as possible will be necessary even if Slovakia does not become a member of the EU in the near future. This is necessary because we will continue to strive to carry on our international business activities with EU member countries, which will continue converging in all areas of the banking sphere, and this will lead to a single currency.

What tendencies are surfacing?

- As to the form of bank presence, since the beginning, subsidiary banks are making a headway as the most suitable alternative, which is also the international trend.
- The first results of efforts of domestic banks are surfacing to establish foreign banking institutions, that would gradually expand.
- In view of bank products, we continue noticing that primarily recently there has been a growing tendency towards savings by the population, which is being used predominately by subsidiary banks to extend short-term loans. Generally, a transition from long-term to short-term loans can be seen, and the decline of activity of banks in transactions with clients. A gradual orientation of banks towards interbank transactions is appearing, or a shift to activities from lending and deposit domains to a sphere of other banking services.

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