
Development of Banking sector and PSE

Banking sector

- One of the most tickler problem of whole economic transformation was development of the banking sector.



Banking sector before 1989

- Mono-structure banking system
 - In 1950 was established State Bank of Czechoslovakia (SBCS).
 - SBCS “hybrid” between state and private bank.
 - Central bank functions
 - Monetary police
 - Issue of paper money and
 - Foreign exchange rate policy
 - Government function
 - Tax collection
 - Control of wage development
 - Commercial bank functions
 - Collection of savings
 - Granting credits
 - Exchange of foreign currencies
 - Organization and running of payment mechanism
 - Clients of SBCS were only business companies not households.
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Banking sector before 1989

- In Czechoslovak banking system existed banks with specific functions
 - Trading bank (Zivnostenska banka) the most important bank during interwar period that was confiscated in 1945.
 - In communism regime provided foreign exchange operations for private clients
 - It had business branch in London for
 - Arrangement relations with foreign banks
 - Foreign trade and other international transactions
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Banking sector before 1989

- Czechoslovak business bank (CSOB) was established in the 1960's
 - Owned by SBCS and businesses of international trade (monopoly for trading with foreign countries)
 - Provided international payment with subjects in RVHP markets (social countries in Europe, Asia and Africa)
 - In banking sector existed two saving-banks
 - Czech state saving-bank
 - Slovak state saving-bank
 - Collected savings from households and granted credits for households.
 - Surplus of savings were transferred in SBCS and divided into state companies.
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Banking sector before 1989

- Communism regime was aware of problems in banking system.
 - In 1989 was decided about transformation of mono-structure banking system in two tier banking system.
 - From SBCS were set off three state banks
 - Commercial bank (Komerčni banka)
 - General Credit bank (Vseobecna uverova banka)
 - Investment bank (Investicni banka)
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Development of banking sector in the 1990's

- Development of banking sector in the 1990's can be divided in three phases
 - Establishing of new small banks
 - Privatization of large state banks
 - Banking crisis
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New banks

- The number of new banks in Czech market was growing since the beginning of the transformation process.
 - At the beginning of transformation process conditions for establishing of new banks were weak.
 - Shareholder's capital 50 million CSK in 1990
 - But was accepted every tenth application for banking license
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- Government and State bank set these weak and liberal conditions to improve competition in banking sector.
 - This conditions were getting more restrictive in the process.
 - In April 1991 basic capital 300 millions of CSK and
 - from 1993 till nowadays 500 millions CZK
 - Despite of these liberal conditions banking sector in the Czech Republic was concentrated.
 - Small banks were weak and financial resources for their business activities were getting in the form of credits from large banks in interbank market.
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New banks

Share of commercial banks in savings and credits in 1990		
Bank	% of credits	% of savings
Commercial bank	47,8	17,5
General Credit bank	20,1	7,9
Investment bank	14,6	8,3
State credit-houses	10,3	62,3
Others	7,2	4

New banks

- In 1991 were established first credit banks (kampelicky)
 - Simultaneously the number of small Czech bank was growing and also foreign banks opened their subsidiaries in the Czech republic.
 - Foreign bank focused only on the best clients -
 - Foreign companies that they were familiar with them from their domestic market.
 - According to government expectation:
 - Foreign banks should have promoted real competition in banking sector.
 - But these institutions were interested only in the most lucrative clients with the lowest rate of risk.
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New banks

- In domestic market arose double pressure
 - Foreign banks overtook the most profitable clients and domestic banks cared only about subject with high level of risk or insolvent clients
 - Foreign bank pushed down banking fees for this profitable clients and thus limited possible fees of domestic banks
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New financial institutions

- Specific group of institutions in banking sector were transformation institutions.
 - The best known is Consolidate bank
 - In consolidation bank were transferred
 - Bad liabilities of companies doing business in central planned economy
 - Bad loans in time of cleaning assets of banking sector
 - Other institution is Bohemia and Moravia Guarantee bank established in 1992 by government and large banks
 - Support of small and middle companies with credits and bank guarantees
 - Czech Export bank
 - Granting cheap credits for export companies.
 - Owned from 66,7% by state
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Consolidation bank/agency

- Established in February 1991 originally only for 126 days but in fact existed till 2007.
 - In this bank were transferred
 - bad debts from state companies in the value of 80 billion CSK and
 - bad assets from large state banks.
 - Primary aim of Consolidation bank was
 - restructure or decay of companies that transferred assets in Consolidation bank.
 - This aim was not never fulfilled.
 - Consolidation bank became a store for bad loans and played important role in cleaning of Czech bank before their sale to foreign investors.
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- In Consolidation bank was during 1999 – 2000 five institutions
 - Revitalization Agency – cleaning financial accounts of specific companies like Aliachem, CKD Praha, Skoda Plzen
 - Czech Financial – buyout of classified credits in small banks
 - Konpo – control and debt recovery of Commercial Bank
 - Prisko – transferred all liabilities from former state company Skoda – Car
 - Sanakom – transferred bad credits of bank Investment bank
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- Because Consolidation bank was established as a bank it had to fulfill all conditions suitable for commercial bank although its purpose was different
 - E.g. According to Banking Act
 - Consolidation bank had not acquired a majority share in non-banking subjects and it limited its restructured aims in controlled companies.
 - In 2001 Consolidation bank was transferred in Consolidation agency and became its continuator without limitation related with its former bank statue.
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Bank privatization

- At the beginning of the 1990's existed 4 large fully state banks
 - Czech state saving-bank
 - Trading bank
 - Commercial bank
 - Investment bank
 - And Czechoslovak business bank with significant state share.
 - According to current opinion the highest revenue from bank privatization could be obtained in 1991-1995 because of weak position of foreign bank in Czech market and Czech banks were not suffered by classified credits from transformation process.
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- In 1992 were 4 fully state banks transferred in joint stock companies and part of their stocks designed for privatization process.
 - After privatization process state became minority shareholder in these banks with share from 48-49 %.
 - In next years privatization process left off
 - Because of lack of rules for sale of banks to foreign investors.
 - Whole process was slowed down by several minority shareholders actions against important bank decisions.
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- Dispute point of whole transformation process is slow privatization of banking sector.
 - The main problem was existing credit channels between banks and state companies established in central planned economy
 - This credits became uncollectible and in final phase they were paid off by tax payers.
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- Privatization process of banks was postponed because of privatization process as a whole.
 - The main fear was related with turn off the financial resources for domestic companies that did not fulfill strong international criteria.
 - If privatized bank stopped credit granting to state companies these companies would get in troubles.
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- On the other hand postpone of bank privatization arose opportunity for political pressure in banks to grant credit to companies that did not satisfy bank conditions.
 - Banks nourished companies that should have bankrupted and granted credits for losing projects.
 - It is reason why important part of credits became classified.
 - State proprietorship encourage morale hazard
 - Bank expected that in case of financial problems will get financial support by government that also happened for several times.
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What does term-classified credits mean

- All bank's credits are classified according to Czech National Bank criteria
- Five main groups:
 - Standard credits
 - Watch credits
 - Substandard credits
 - Doubtful credits
 - Loss credits

What does term-classified credits mean

- Standard credits - no doubts about future pay-off of the credits. Instalments and securities are settled regularly.
- Watch credits - high probability about future pay-off. Instalments and securities are settled with some troubles, but there are not longer than 90 days after settlement.
- Substandard credits- higher improbability of total settlement, but partly settlement high probable. Instalments and securities are settled with troubles, but there are not longer than 180 days after settlement.

What does term-classified credits mean

- Doubtful credits - total settlement high improbable. Instalments and securities are settled with troubles, but there are not longer than 360 days after settlement.
- Loss credits total settlement impossible, will not payoff or payoff in small rate. Instalments and securities are longer than 360 days after settlement.
- Classified credits are the last three groups of credits.
- In the Czech Republic in the 1990's high share of these classified credits, mainly loss credits.
- For example: in 1995 21.3% of credits were loss credits.

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- In 1998 was privatized Investment bank to Japan investment company Nomura
 - Price of this bank was low only 6 billion CZK
 - Bank was weak with classified credits about 20%
 - Nomura was not a strategy partner and their main purpose for this business was getting the portfolio of companies owned by this bank
 - Especially brewery and glass companies
 - In recession this bank got in serious trouble with high flow off of savings (34 billion CZK) and became insolvent.
 - In 2000 bank was move on Czechoslovak Business bank.
 - Sometime is this process labeling as a state confiscation
 - Czechoslovak Business bank overtook this bank with government guarantee (it is expected that this guarantee are in value of 160 billion CZK)
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- In 1998 was elected left oriented party Social Democracy that promised no other state aids in banking sector.
 - In reality new government started looking for foreign owners for state banks and offered state guarantees.
 - Government promised sell all state banks till 2000.
 - In spring 1999 Czechoslovak business bank was sold KBC
 - 40 billion CZK
 - The higher revenue from bank sale in transformation period
 - This bank was the most healthy bank in Czech banking system
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- In 2000 was sold Czech state saving-bank to Austria Erste Bank
 - Erste Bank paid for 52 % shares 19,3 billion CZK
 - Government must invest in his bank 46 billion CZK before sale to recover bank balance sheet.
 - Classified credits were transferred in Consolidation bank.
 - The main loses of this bank were from
 - Bad loans from the beginning of the 1990's
 - Poor quality guarantees
 - Losses form collapse of Russian market after 1998
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- Privatization of Commercial bank was stopped by company B.C.L. Trading when bank lost 8 billion CZK in single trade
 - Between 1998 and 1999 Commercial bank lent 100, 150 and 200 millions dollars.
 - Documentary credits were bound by delivery of agricultural products from Ukraine and Russia.
 - Investigation found out that this supplies never happened.
 - Commercial bank was privatizes as a last large bank in 2001 when was bought by Societe Gererala in 40 billion CZK.
 - Total cost for recovery of this bank are estimated in value of 75 billion CZK.
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Crisis in banking sector

- During the 1990's banking sector in the Czech Republic passes several crisis
 - At the beginning of transformation process there was a need of credit and fears from oligopoly structure of banking sector.
 - Bank licensing was benevolent till the first banking crisis in 1993.
 - In first transformation phases only small banks were suffered by crisis.
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- First small bank in troubles was
 - Credit and Industry bank
 - Classified loans in this bank got 90 % and in bank lost 450 millions dollars.
 - The reason was over limit granting of credits in general manager that was also owner of the bank.
 - CNB withdrew license this bank.
 - In the same year other banks got in financial troubles
 - AB bank
 - Credit bank
 - Czech bank
 - In largest debtors of these bank were their shareholders.
 - Other bank that went bankruptcy was Bank Bohemia
 - Managers of this bank signed guarantee in value 30 times higher that was basic capital of this bank.
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- As a reaction to problems in small bank sector there was announced program for consolidation of banking sector.
 - Consolidation program II
 - Central bank stopped licensing for new banks
 - Banking supervision became more restrictive
 - But other small banks got in troubles.
 - In 1996 the largest private Czech bank Agrobanka got in troubles with total lost 35 billion CZK.
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- Total costs for recovery small banking sector were insignificant in compare with recovery of large bank sector.
 - Large bank with some level of state proprietorship were consider to be too large for fail.
 - Large banks were supported during pre-privatization period.
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- Sector of credit banks get in trouble at the end of the 1990's.
 - Since 1996 they became more popular and had approximately 110.000 members with savings 10,3 billion CZK
 - They were attracted because of higher interest rate in compare with commercial banks
 - In 1999 problems in three largest credit banks
 - In these three credit banks was concentrated 60% of all deposits
 - In next year in the troubles get next 12 credit houses.
 - As a reaction in 2000 was adopted of Credit houses act that
 - forbidden transfer of credit house savings in subsidiary companies
 - Limited licensing
 - Restricted supervision
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Reasons of banking crisis

- I. Debts of companies and problems with debt redemption
 - In banking sector existed 1900 billion CZK bad debts from central planned economy.
 - Banks were vulnerable in face of failure of large debtors.
 - In the lack of capital companies oriented only in credits because capital markets did not work.
 - II. There was a lack of experiences with market oriented economy at the beginning of the 1990's.
 - Subjects in the market existed without any business history
 - No market skills of bank employees
 - Information asymmetry in banks
 - Most active credit applicants were applicants with the most risk projects
 - Problem with bank supervisory
 - In small banks lots of cheap credits granted to shareholders
 - In large state bank no control of bank activities by government.
 - Political pressure for credit granting to support privatization and whole transformation
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- III. Worst situation in small bank in compare with large banks.
 - In these small banks were lack of basic capital thus carried out operation with higher risk
 - Lack of capital influenced the confidence of savers and limited possibilities for gaining cheap financial resources.
 - In this sector was also significant level of criminal acts
 - In whole sector was combination of lack educated management, disproportionately high interest rates and criminal acts
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Recovery of banking sector

- In 1991 number of classified credits between 15-20 %
 - Consolidation program I for large state banks
 - Cleaning of banking sector from bad debts
 - This bad debts were taken over Consolidation bank
 - Total costs of this program 100 billion CZK
 - Problems in sector small banks solved by
 - Consolidation program II
 - Designed for banks that did not pass capital adequacy (8 %)
 - Total costs of this program 33 billion CZK and bank in this program finished by withdrawing of license
 - Rescue of credit houses sector was related with withdrawing of licenses
 - Total loss from this sector 90 billion CZK.
 - Total cost for recovery of banking sector are differentiate
 - Recovery of 4 largest bank costs – 216 billion CZK
 - Revenue from sale of this banks – 112 billion CZK
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Stock Exchange

- Beside banks other important institution is capital market.
 - Important event for establishing Prague Stock Exchange (PSE) was voucher privatization.
 - Until establishing of PSE all trades was realized in temporary market.
 - First issue outside of PSE was Commercial bank stocks traded since 1990.
 - Total volume was 1 billion CZK and was traded in primary market
 - In 1990 Ministry of Finance issued first Government securities for financing property restitutions.
 - At the end of 1992 all activities of temporary market was overtaken by PSE.
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- In 1993 was in PSE placed 622 issuances from voucher privatization and till the end of the year next 333 issuances were added.
 - 8,5 million Czechoslovak citizens became shareholders.
 - In 1993 first official Government bond was placed
 - 1994 was started day-to-day trading
 - In the half of the 1990's was traded with more than 100 issuances in PSE.
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- The interest about securities in PSE was low.
 - The main volume of trade was with bonds.
 - The character of trade was “direct trade”
 - Bilateral trade with subjects out of PSE
 - Only with registration in PSE
 - Direct trades had no influence in prices of securities
 - 90 % of trading with stocks
 - 100 % trading with bonds
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- In 1996 a lot of foreign investors left PSE
 - Weak regulation
 - Fraud conductions
 - Lack of interesting investment possibilities
 - In the process the rules and trading conditions were improved.
 - Market was spitted in
 - main with the most quality stocks – blue chips (13 blue chips in 2009)
 - Mid market and free market
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SPAD On-line

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Název	Akt. kurz [Kč]	Změna [%]	Objem [tis. Kč]
AAA	14,08	0,50	0,00
CETV	481,10	1,28	5 159,51
ČEZ	869,10	1,13	196 497,97
ECM	352,60	-0,82	0,00
ERSTE GROUP BANK	775,50	-1,27	9 359,00
KOMERČNÍ BANKA	3 715,00	0,43	43 619,83
NWR	172,05	0,03	5 496,26
ORCO	196,51	1,56	2 265,20
PEGAS NONWOVENS	433,50	-1,03	1 890,60
PHILIP MORRIS ČR	8 926,00	0,28	4 010,35
TELEFÓNICA O2 C.R.	422,10	-1,15	17 754,29
UNIPETROL	137,17	0,12	0,00
VIG	1 093,00	-0,73	0,00
Celkem			286 053,01

Sum up

- Whole transformation process was closely connected with banking sector.
 - Banks play key role in process of transformation money in investments and if this relation is harmed it will influence whole economy.
 - Czech banking sector cumulated troubles during transformation
 - Faults in management
 - Lack of banking skill
 - Fraud conduction
 - It led to crisis of banking sector as a whole.
 - Suffered were small banks as well as large.
 - Small banks left banking sector
 - Large banks were rescued by tax payer's money
 - Development of PSE was questionable
 - PSE did not become alternative resource of financing and in transformation process helped in concentration of proprietorship.
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