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The process of privatising banks in Poland: successes and failures of a multitrack path

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THE PROCESS OF PRIVATISING BANKS IN POLAND: SUCCESSES AND FAILURES OF A MULTITRACK PATH[*]

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1. Introduction

Poland is one of the fastest growing post-socialist countries of Central and Eastern Europe. In 1990 the government initiated a radical economic reform programme pivoted on microeconomic liberalisation, macroeconomic stabilisation and institutional reconstruction. Privatisation has become one of the important elements of the strategic economic policy measures, targeted at the gradual emergence of a capitalist market economy in the country. In the centrally planned economy, the banking sector was among those most vulnerable to the adverse effects of the attempts at practical implementation of the "socialist economy" dogma. The monobank model, which dominated the Polish banking sector, totally ignored market mechanisms. Only state-owned and the co-operative forms of ownership were accepted and the actual status of the latter - given a whole series of restrictions on its scope and presence in the sector - was actually tantamount to state control. Changes required in the banking sector to subject it to the market-driven principles, called for both demonopolisation and a complete turnaround of its ownership structure. The privatisation programme designed for the banking sector was based on principles different than those applied to the other sectors of the economy, due to the specific and unique role of the financial system in the economy. One of its hallmarks was the plan to privatise all state-owned commercial banks on a case-by-case basis by selling part of their equity to a strategic investor and making the remainder available - in a public offer - to institutional and individual investors.

The main purpose of this paper is to present the strategy behind the privatisation of the Polish banking sector during the period of transition, discuss the experiences gained during the implementation of this process and review its effects. A number of different approaches to privatisation sales of banks are discussed in detail in the case studies on privatisations of Wielkopolski Bank Kredytowy S.A., Bank Gdañski S.A. and Bank Handlowy S.A. w Warszawie.

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2. The condition of the Polish banking sector at the outset of the period of transition

Central planning and a massive state ownership were the main characteristics of the socialist economic system which dominated in the countries of Central and Eastern Europe. In the closing years of socialism, efforts were undertaken to modify the omnipresent command planning system in certain countries (Hungary, Poland) and replace it with a centrally planned investment processes. The advocates of these changes argued that the introduction of curtailed market economy would gradually result in the decentralisation of the current operations. Those reformers, however, shied away from attempting to privatise the state-owned enterprises, and the efforts to revamp the socialist economic system failed. The mixed system which was put into operation in Poland in the 1980s neither helped to improve economic efficiency, nor prevented the country's continuous economic decline. With hindsight it was clear that such limited changes to the socialist economy were doomed to fail and in 1989, it became true with the disastrous downturn of the country's economy and a profound macroeconomic disequilibrium, hyperinflation and substantial foreign debt.

Likewise, it should be noted that companion to the absolute supremacy of the state ownership and the existence of the central command planning system that pervaded the whole economy, was also the role of money in the socialist economy being reduced to that of a medium of exchange; the structure and *modus operandi* of the banking system were dwarfed accordingly. The key characteristics of the socialist model of banking system can be summarised as:

- domination of a monobank system;
- absence of a clear dividing line between the banking system and the state budget;
- non-economic criteria driving lending decisions;
- total rationing of credit amounts.

The supremacy of the so called monobank was the main hallmark of the socialist version of the banking sector and was clearly visible in an extreme centralisation of the banking sector. The central bank served both as a direct lender and provider of essential everyday banking services to the public and to businesses. Given that the principle of one-bank one-account one-lender was translated into business practice, competition in the banking sector was wiped out altogether. Businesses and people alike were not offered any possibility to choose between banks and, moreover, were even administratively assigned to one branch.

The beginning of the 1980s was the heyday of the monobank's supremacy in Poland and witnessed a strong expansion of its structure during this time period; the Bank's supremacy was so pronounced that the whole Polish banking sector was reduced to the four financial institutions:

- Narodowy Bank Polski [NBP] – the National Bank of Poland – subordinate to the Ministry of Finance (the President of the NBP was at the same time deputy Minister of Finance), which fulfilled the function of a central bank and was the lender to the country's economy and its overseer;

- Bank Gospodarki Zywnosciowej which specialised in lending to the agricultural and agribusiness sectors and was also the organisational and financial centre for 1550 co-operative banks which in turn were both savings institutions and finance providers to private farmers and craftsmen;

- Bank Handlowy w Warszawie S.A. which was responsible for handling foreign settlements of the central government and acted as a dedicated bank to foreign trade enterprises and enjoyed exclusive rights for foreign business transactions;

- Bank Polska Kasa Opieki S.A. which specialised in handling foreign exchange transactions for the members of the public.

In the decadent days of the socialist era in Poland a number of efforts were undertaken to reform the banking system in Poland. They were part of a series of attempts to revamp the existing system and ensure an increase in its efficiency and the preservation of macroeconomic stability. When the economic collapse of the system as such was already imminent, a few institutional and functional modifications were effected.

The principal changes were implemented at the beginning of 1989, when a two-tier banking system was introduced. This new stratification of the system was meant to increase the role of the NBP in shaping the monetary policy and to concomitantly limit its functions to those of a central bank, an issuing bank and a bankers' bank. It required that the NBP's role of the country's central bank be organisationally made distinct from lending and serving everyday financial needs of the public and business. In 1987 the Powszechna Kasa Oszczêdnosci Bank Pañstwowy and two years later nine commercial banks, established on the basis of 430 of its branch offices, were carved out from the NBP. Although the regulatory framework was changed in 1982 and since then both domestic and foreign persons had been allowed to set up new banks, before the end of 1989 only two new banks came into being: Bank Rozwoju Exportu S.A. (with shareholdings acquired by the Ministry of Foreign Trade, Ministry of Finance and a few foreign trade enterprises) and Lódzki Bank Rozwoju S.A., established by state-owned enterprises and individuals.

In theory lending decisions with respect to enterprise financing were expected to be based on the principle of creditworthiness. Therefore, decisions to lend and offer everyday financing to businesses were subordinated to the commercial criteria. In case of borrowers' default, banks were obliged to refuse further financing and demand immediate repayment of outstanding debt. If such steps had been taken bankruptcy or liquidation of such distressed enterprises might have ensued. However, business practice was indeed different and showed that reliance on the magic of capitalist economic concepts in a socialist environment could not ensure any improvements in the efficiency of the system as such. Thus enterprises facing bank instigated action were as a rule aided by the State and supported by either direct subsidies or rescued on the grounds of eligibility to one of a range of many financial reliefs available; or, alternatively, were acquired by another state-owned enterprise. Bankruptcy and liquidation were still just catchwords in the book on the theory of "market socialism" (L.Balcerowicz, 1989). Without a genuine commercialisation of banks any attempts to subject lending to the market mechanisms were doomed to fail. A bank which is not a truly commercial institution is vulnerable to external pressures (central and local government agencies acting on behalf of the enterprises as well as other political organisations meddling in their business). Absent are also internal incentives to comply with the rigorous prudential provisions - this in turn is mainly due to the lack of commercial rules to assess the effectiveness of operations and stems from the fact that bankruptcy was only a remote, and indeed even theoretical, possibility.

For want of competition in the banking sector and owing to the lack of commercially viable principles to direct the bank's operations, the banking system was capable of performing reasonably well only with respect to handling cash and non-cash settlements, whereas in other key areas, where it was supposed to exert its influence, it was malfunctioning. Thus it failed to ensure a rational allocation of capital, stability of the purchasing power of money and the rate of foreign exchange alike, and, furthermore, was incapable of properly handling its function of an intermediary in the process of financial assets transformation. The situation of the banking system at the outset of the transformation processes, launched in the post-socialist countries of Eastern and Central Europe, is aptly summarised by L.Balcerowicz and A.Gelb (1995) *"But nowhere was the legacy of the destruction of state capitalism so distinctly perceived as in the financial sector. Banking systems may have even been "deep" (as measured by the ratio of balances to outputs) but financial flows were merely passively adjusted to decisions related to real economy. There was no experience of indirect, market-based monetary policy. Payment systems were primitive. Passive, monopolistic state banks lacked the capability to evaluate creditworthiness and risk was socialised".*

3. The main guidelines of a banking sector development model for the period of transition

The vision of an open and competitive market for financial services permeated the ideas of all contributors to the discussion of the target model of the financial sector in Poland. Given the sector's pivotal importance to the success of system transformations afoot in the country's economy - especially affecting the key areas of restructuring of accumulated bad debts and support for the growth of solvent enterprises - restructuring of the banking sector became one of the key objectives of Poland's economic policy. The core assumption underlying the modernisation processes was that the principal constituent part of the banking sector model should be a universal bank, trading as a joint stock company, and legally structured in such a manner so as to enable it to provide an unlimited scope of services and endow it with a freedom of operations in the financial markets.[1] The new banking law provisions enacted in Poland were meant to facilitate the development of the banking system and bring it in line with the system of universal banking operating in the European Union. The model of banking sector development adopted in Poland provides for a legal possibility of combining the banks' deposit-taking and lending business with their presence in the market for insurance, and permits activities in the securities markets as well. In terms of the banks' ownership structure, it was assumed that the majority of bank shareholdings would be held by foreign and domestic persons, independent of the State Treasury.

Steps were taken to restore the functioning of capital markets in recognition of their importance and role in ensuring an optimum mechanism of capital allocation, emergence of effective corporate governance and monitoring of enterprises' activities. In this context, the legal and institutional infrastructure for the capital market was, virtually overnight, created from scratch. Therefore following the enactment of *the Act on Public Trading of Securities and Trust Funds* in 1990 pursuant to its provisions the Securities Commission and the Warsaw Stock Exchange were established soon thereafter. The capital markets have thus become an important constituent part of the target model of the financial system.

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[1] Cf., Rozwój i modernizacja systemu bankowego w Polsce. NBP, Warsaw 1990.

4. Strategy of the banking sector privatisation in Poland

The progress and success of the economic transformations in post-socialist countries depends upon:

(i) economic and political conditions at the outset;

(ii) external factors; and

(iii) central government policy.

The transformation of the Polish economic system from the very outset involved the implementation of a radical strategy, referred to as the Balecrowicz Programme and named after its architect, Mr Leszek Balcerowicz, who between 1989-1993 was the Deputy Prime Minister and the Minister of Finance. This radical strategy envisaged a two-stage transition to the market economy. In the first stage, increase in the presence of market mechanisms was to be generated by simultaneous implementation of two policies, namely microeconomic liberalisation and macroeconomic stabilisation. The second stage was in turn expected to cement both policies, although its main focus was on the completion of profound institutional transformations. Only after such far-reaching changes are put in place can a point of no-return be reached and the critical mass of changes thus achieved lead to their irreversibility. Following such a breakthrough the economy can gradually evolve into a fully-fledged capitalist market system. Privatisation therefore, as one of the pivotal components of an overall policy targeted at achieving a deep institutional change, is of profound importance to the success of the transformation processes in Poland.

The meaning of privatisation is as a rule narrowed down to a process of ownership transformation of state-owned enterprises. Such an interpretation stems from an attempt to directly transfer western models into a fundamentally different reality. A comparative analysis of the transformation process in the post-socialist countries calls for a broader concept that can be aptly summarised as *"transition from the less to the more privatised economy"* (M.Bernstein, 1992; L.Balcerowicz, 1994; J.Kornai, 1995), where progress of privatisation is gauged by the change in private sector's share in the economy.[2]

- Privatisation defined in such a way is the result of the operation of a number of diverse processes:
- spontaneous growth of the private sector
- asset reallocation[3]
- privatisation of SOEs

[2] With regard to the banking sector it might be the share of private banks in assets or in the own capital of the sector.

[3] Resulting from - for example - sale of surplus assets, or break-up asset sales following the liquidation or bankruptcy of owners - the state-owned enterprises.

The speed, scope and methods of the privatisation process depend on the environment in which it is launched and is shaped by the policy of the central government. Banking sector privatisation strategy is a constituent part of the overall economic policy strategy.

At the outset of the transformation processes the banking sector in Poland was, like in the other post-socialist countries, a combination of state monopoly with respect to the ownership of banking institutions and of a high degree of concentration in its activity. Its hallmarks were also want of capability and experience to operate in a competitive environment, poor standards of management and of the quality of services offered. To complete this gloomy picture the sector was also burdened by a dangerously high share of bad debts in assets and its position was additionally adversely affected by a profound macroeconomic imbalance and raging hyperinflation. Such a heritage of the communist past made privatisation of the banking system in Poland indeed a unique and daunting challenge. The unprecedented singularity of this privatisation process resulted from the hitherto unknown scope of institutional restructuring which was required to make the sector shift into a market-driven capitalist structure. Many of the financial institutions that are crucial to the existence of the capitalist system - like the stock exchange and the capital markets - had to be created from scratch. The microeconomic liberalisation,[4] which helped invigorate the hitherto dormant entrepreneurial resources and potential, was also an equally important factor which permitted a successful privatisation, since only in an environment characterised by *laissez faire* were the spontaneous emergence and growth of new businesses finally made possible.

Large state owned banks may be privatised in many ways. It is possible to design a considerable number of sophisticated theoretical privatisation-deal models, but in business practice only a few are encountered. When privatisation processes are classified according to the type of investors involved in the transactions the following privatisation models can be identified:

- active strategic investor holding a controlling stake of equity is involved
- ownership of the share capital of the investee financial institution is dispersed among a number of investors:
    - different variants of mass privatisation programmes
    - dominating share of small private investors
    - mixed ownership of stock - with a committed group of so-called stable investors as the backbone of the deal.

The privatisation model resting on the involvement of an active strategic investor is in practice encountered in two variants. In one case a strategic investor purchases a majority stake and only a small portion of equity is admitted to public trading. In the former communist countries, as a rule foreign banks come forward as strategic investors and the sales were structured as tenders. This type of privatisation approach offers many benefits, the most important being the possibility to ensure a transfer of the latest and state-of-the-art banking technologies and best practices, as well as warrants of high management standards and easier access to capital. The

[4] Removal of various restriction on the activities of businesses imposed by the State.

key strength of such an approach lies in a radical improvement in corporate governance and this appears to be a prerequisite to ensure acceleration of internal changes in organisations and is meant to boost their competitiveness. The participation of foreign capital in bank privatisation is often subjected to certain restrictions. Since many politicians view the financial system as a major contributor to proper operations of the country's economy, they proceed to claim that it should therefore be controlled by domestic capital. Such a viewpoint, with the number of supporters varying across individual nations, is advocated in a number of countries - both in developing economies and in those with fully-fledged market economies with stable systemic frameworks. Among the former, supporters of such an approach are in many cases driven by the fear of competitive pressure coming from large banks playing a leading role in the international financial markets; sometimes this apprehension is imbued with the undertones of xenophobia. Endeavours to preserve the "national" character of the financial sector are also undertaken in some developed countries, where privatisation deals are structured so as to ensure a privileged position of local entities.[5] The efforts to sustain protectionist barriers restraining entry of external investors are becoming even more difficult to implement given increasing deregulation and freedom of cross-border capital movements. Those in support of the preservation of the national character of the financial sector tend to forget however that the efficiency of economic operations is not in any way connected with the origin of capital but is shaped by technologies and skilful management supporting improvements in efficiencies. As a result, restrictions may produce results which are contrary to those intended by their creators and eventually lead to undermine the competitiveness of the banking sector and of the whole economy; on top of that, from a long term perspective, foreign investors will find another way to achieve their objectives when their investment expectations are based on sound benefits. Privatisation model incentivising foreign strategic investors to acquire minority stakes in investee companies and at the same time assuming that a blocking stake would be retained by the State (entitling it to frustrate strategic decisions) was common in Central and Eastern Europe.[6] This is a comfortable situation for politicians but it fails to provide conditions

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5 The privatisation of Kreditanstalt Bankverein may serve as an interesting example here. The privatisation process spanned over an exceptionally long period of time from 1991 – 1997, and involved many recognised major international financial institutions among prospective investors, such as GE Capital Bank, Credit Suisse, Allianz Holding teamed with Bayerische Hypotheken und Wechselbank. Eventually Kreditanstalt, the second largest Austrian bank in terms of asset total and shareholders' equity, was acquired by the largest local bank - Bank Austria, which led to the emergence of a financial institution ranked among 100 biggest financial market players in the world. The privatisation of the banking sector in Italy followed similar patterns, and the main winners became Italian financial institutions or industrial conglomerates.

6 This is true of the initial stage of the bank privatisation process in Poland and the Czech Republic (Cf. Mortimer,K. Bank Privatization Policy in Poland and Czechoslovakia). Hungary is also an example of a state where during the first phase of banking sector privatisation, a strategy relying on the privatisation of the largest banks was pursued (top six with respect to asset total) and it was envisaged that control over those banks would remain with local entities; majority stakes in foreign hands were permitted only in small banks. Cross-shareholdings, which existed between banks and Hungarian enterprises, were one of the key drivers behind the surge of bad debt portfolios and thus the classic conflict of interests surfaced. As a result restrictions imposed on foreign capital were lifted and consequently privatisation deals were concluded for Hungarian Credit Bank – in which 90% of equity was acquired by ABN-AMRO, Hungarian Foreign Trade Bank (Bayerische Landesbank - 50.8%, EBRD - 17%) and Budapest Bank (GE Capital and EBRD hold 58.9% and secured a call option with the State – warranting purchase of the remaining stake in equity (22.8%) over the following five years (see also Jones C. „Foreign banks welcome in The Banker. 1/1997).

enabling an optimum utilisation of foreign capital, which acts like an agent of change driving progress in the sector.[7] The position of a foreign investor who is made to hold only a minority stake does not secure independence and the desired effectiveness of owner's decisions necessary to develop and implement own development strategy. The presence of the State among shareholders - when backed by a blocking stake ensuring that a say on strategic decisions ultimately rests with the government - clearly has an adverse impact on the effectiveness of owner controlled management. That is why minority strategic investors are more often than not passive, and their active involvement as a rule surges as soon as they assume full control. Privatisation through a public offer targeted mainly at small investors stimulates the growth of the capital market, which is undoubtedly beneficial. In quite a few cases for enterprises with promising growth prospects and of crucial importance to the country's economy, privatisation strategies based on public flotation of shares targeted mainly at small investors (individuals) are chosen. Their attractiveness is bolstered by many additional incentives such as various forms of price discounts or concessions, or warranted eligibility to benefit from future share issues. This category of enterprises includes some financial institutions: large banks and insurance companies. Their good reputation and wide-spread brand or name awareness among the populace make successful privatisations an easier task, when the sellers goal is to ensure participation of many social strata in the privatisation of the most valuable chunks of national wealth and to boost a new method of savings through involvement in capital market sales. Nevertheless this approach to privatisation has a number of drawbacks. Dispersed ownership of equity is typical of stock exchange listed banks which operate in highly developed capitalist countries and where the capital market in addition plays an important role in the financial system. The bargaining position of the directors of such banks vis a vis the shareholders is very strong and the actual direct impact such equity holders can exert on management actions is relatively small. In such circumstances, progress to higher management quality is conditional on high calibre management personnel and rests to a considerable degree on historical patterns of developments in its corporate culture which must be conducive to winning a competitive edge. Insufficient quality of management is quoted among the weaknesses of the banking sector noticeable at the outset of the process which was meant to bring the sector in line with sound principles of the market economy. Therefore having in mind maximum speed in the implementation of banking sector privatisation, the decision to privatise through dispersed share ownership in this period is by no means the best available option. Similar criticism is equally applicable to the "voucher" privatisation where cross-shareholdings negatively influence the effectiveness of corporate governance.[8] A conflict of interest which is likely to emerge in such situations gives way to soft lending policies pursued towards indebted enterprises since the banks concerned – directly or indirectly – own their clients. Such a set up is loaded with a number of dangers, especially in countries with

[7] This is apparent when a comparison is made between operations and performance of banks - before acquisition of full control by foreign investors and afterwards. E.g. Bank Slaski and Wielkopolski Bank Kredytowy following the acquisition of majority stakes by ING BANK and AIB.

[8] The biggest investment funds which acquired shares issued in connection with the kuponovka privatisation are controlled by large banks, whose shares in turn are held by those funds. Cf. A.Capek „Privatisation of Banks and their Credit Policy during the Transition in the Czech Republic" CASE, Warszawa, 1995

economies in transition, owing to low quality of management, absence of adequate lending procedures and inability to gauge lending risk properly.[9]

A mixed privatisation model, involving the participation of stable institutional investors, exerts a positive influence on the growth of the capital markets - which is driven by many small individual investors - and since it is coupled with the involvement of stable institutional investors it may also positively influence improvements in corporate governance and plant seeds for future strategic co-operation.[10]

The bank privatisation strategy, masterminded by the government, is in itself shaped by many factors, yet the main decisive driving force should be the maximisation in speed of sector transformations and its development. The main difficulty does not lie in defining the best solution; instead a major difficulty is to muster political will to approve the first concepts and ensure commitment to translate plans into actions. The progress of the privatisation process puts credibility of assumptions to test and verifies the effectiveness of their implementation. The results of the privatisation process should be gauged by the degree to which the direct influence of the State on the economy is reduced and are visible when the State's role is eventually limited to that of an effective regulator and supervisor.

4.1. Spontaneous growth in the number of new banks

The liberalisation of the regulatory framework, whereby the possibility of establishing new banking institutions was ensured, was meant to reduce the barriers of entry into the banking market for new domestic economic entities and for foreign banks. The NBP's licensing policy pursued between 1989 and 1991 led to a rapid increase in the number of banks.

Table 1. The number of licenses granted and banks operating in Poland, 1989-1995

Year	No. of licences granted	No. of banks in the market	Of which those with foreign shareholdings
1989	8	18	0
1990	45	40	1
1991	17	72	6
1992	6	84	9
1993	1	84	9
1994	1	79	10
1995	7	75	14

9 The dangers become even more imminent when banks are taken over by business which bank with them. Motoinvestment Investment Group is a blatant examples of how advantages of owner's rights are taken to influence lending decisions -- the customer's pressures eventually drove its banker – Kreditni Banka – to bankruptcy and caused serious financial distress for another of its bankers – Agrobank. Cf. Jones C. *Prickly in Prague.*

10 This method was followed on a large scale during the privatisation of banks in Italy. In 1992 the share of the State in the banking sector equity holdings was as high as 90%. In 1997 the Italian government intends to privatise the last few banks that are left in the State's hands.

1996	6	82	25

Source: The National Bank of Poland

Out of the total of 92 licenses issued by the NBP between the beginning of the transformation process and June 1997, as many as 72 were issued during the first two years (1990-1991), characterised by deep institutional changes afoot in the Polish economy at large.

The greatest increase in the number of banks active in the market was noted between 1990 and 1992, which confirms that market players quickly took advantage of the possibilities to enter the banking market created by the new regulations and the underlying strategy of the licensing policy targeted at ensuring an accelerated increase in the market competition and breaking the oligopoly of the existing big state banks that hitherto enjoyed supremacy in the market. At the end of 1992 as many as 84 banks had their operations in Poland, of which in 40 private capital had a majority. Much less stringent criteria of entry to the banking market gave way for the dangers related to a likelihood of emergence of weakling-banks, having poor capital resources and lacking in experience and skills. This risk was taken on board purposefully and recognised as an indispensable by-product of the desirable and intended acceleration in the process of establishing competition in the banking sector. Since 1992, and in particular from 1993 onwards, the NBP increased its requirements with respect to potential founders of new banking institutions and made granting of new licences conditional on the applicant's consent to sustain a share of costs to be borne in connection with the restructuring of the Polish banking sector.[11] It is therefore not a coincidence that such a change in the stance of the central bank occurred almost contemporaneously with an increased interest among foreign banks in establishing their presence in a fast-growing market for banking services

In the whole period of transformations the NBP initiated bankruptcy proceedings with respect to ten commercial banks, of which three were eventually declared bankrupt by courts.[12]

The emergence of a few dozen new banks, mostly private, contributed to an increase in competition in the financial services market. Most of them survived the difficult teething period and are now actively striving to strengthen their competitive positions. Their market share, as measured by the size of assets and shareholders' funds, has enjoyed a steady growth. Some of them were a driving force behind further structural changes taking place in the banking sector. The example of Kredyt Bank S.A is worth quoting in this context, since – in a spectacular way – the bank increased its presence in the market and achieved its status through a number of successful take-over deals and is therefore deservedly called the leader of mergers and acquisitions in the Polish market.[13] The activities of another major player in the Polish

[11] In the form of financial and/or technical assistance to banks in distress or those implementing specific restructuring measures (Bank of America's support for Zachodni S.A., which earlier acquired the ailing BRR Rolbank S.A.)

[12] In the rest of cases the NBP discontinued bankruptcy suits in view of the emerging chances for restructuring (take- over by another bank, restructuring with strategic investor's participation).

[13] First, it took over 4 smaller regional banks (Bank Ziemski S.A., PBH Gecobank S.A., Bank Regionalny S.A. w Rybniku, BDP GLOB S.A.), and next in 1997 it bought from the NBP Polski Bank Inwestycyjny S.A. - the 12th bank in Poland with respect to the size of assets . It also took-over Prosper Bank S.A. (in the midst of its restructuring)

financial services market, Bank Inicjatyw Gospodarczych S.A., are described in detail in the case study included as one of the sections of this paper.

The contribution of foreign capital to the development and growth of the Polish banking sector merits a special attention. The involvement of foreign capital in the banking sector is visible in:

(i) participation in the promoters' funds;

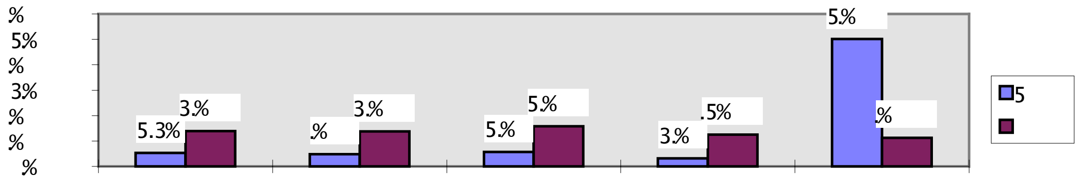
(ii) requesting permission to open branches of foreign banks in Poland;

(iii) equity involvement in subsidiaries established under Polish law;

(iv) equity injections in existing private and state-owned banks.

Among the banks established after 1989, ten were co-founded by foreign investors. Major foreign banks started their operations in Poland and established a permanent presence either through branches or subsidiaries established under Polish law. At present in Poland there are three branches of foreign banks and seventeen foreign banks representing the biggest banking institutions from Western Europe and the United States. The number of banks with majority foreign stakes (defined as at least 50 per cent plus one vote at the General Meeting of Shareholders) reached 26, given the total number of 82 banks operating in Poland as at the end of August, 1997. Foreign investments in the financial sector to date amount to approximately US$ 1.4 bln., of which funds invested in the banking sector total US$1.1 bln..[14] Banks with foreign capital majority have a 13.8 per cent share in total assets of the Polish banking sector, 13.8 per cent of internal funds and 15.8 per cent of lending to the non-financial sector.

Table 2. Share of the banks with foreign capital majority in the Polish banking system



Source: General Inspectorate of Banking Supervision (GIBS) of NBP

When compared against other players in the Polish banking sector, foreign banks stand out with respect to a high share of lending and operating income in total revenues,[15] and also boast a high share of loans in their assets. Their performance – as revealed by ratios of interest and

[14] Zycie Gospodarcze, 1997, No.16.

[15] In accordance with GIBS, operating income was 70.3 percent, as compared with 53.8 per cent for the sector's average for the first nine months of 1996.

non-interest income to assets – is significantly better than that of their domestic competitors – with 15.9 per cent (5.8 per cent average for the banking sector in Poland) and 6.8 per cent (1.8 per cent sector average) respectively recorded for foreign banks. (P.Wyczañski, M.Gotajewska, 1997, pp.28-33). Banks with majority foreign shareholdings also fare better - with respect to financial performance and a higher asset growth rate - than other players in the banking sector. Also their operating efficiency is indeed commendable and so are their returns on equity and assets and hence, when all those indicators are considered, they outperform even the best players among the domestic banks.

Table 3. Return on equity and assets for foreign banks as compared with the best domestic banks, 1996

Banks	Return on assets (ROA)	Return on equity (ROE)	Equity[a] share in assets[b]
Foreign banks	6,6%	50,1%	12,9%
Bank Handlowy S.A.	4,5%	39,3%	10,9%
Bank Przemystowo-Handlowy SA	4,2%	55,15	8,3%
Bank Rozwoju Eksportu SA	3,8%	46,3%	7,6%
Bank Slaski S.A.	3,7%	59,2%	6,6%
Wielkopolski Bank Kredytowy SA	3,0%	55,8%	5,5%
Bank Depozytowo-Kredytowy S.A.	3,0%	43,1%	6,6%
Powszechny Bank Kredytowy SA	2,4%	44,1%	5,8%

[a] Registered share and reserve capitals aggregated
[b] As at the end of 1996
Source: the National Bank of Poland

The experiences to date have clearly revealed several positive aspects of foreign capital activity in the banking sector.

Foreign banks play an important role in stimulating overall management quality improvements in Polish banks and their competitive pressure translates into an ever broadening and improving range of quality banking services available in the market. Their increasing market share bolsters competition and thus forces positive transformations in the rest of the sector.

4.2. Privatisation of state-owned banks - status before 1995

Corporatisation of the banking sector in Poland, expected to be followed at a later stage by privatisation, was one of the key assumptions underlying Poland's economic policy goals in the field of the institutional turnaround. In December 1989 the government adopted *The Memorandum on Economic Policy,* where among the key macroeconomic objectives demonopolisation and corporatisation of the banking sector as well as the emergence of a securities market were spelled out. *The letter of Intent* signed by the Minister of Finance and the President of the NBP and addressed to the IMF in April 1991 further reconfirmed the government's determination to pursue those objectives. Banks are unique in each economy as the institutions of public trust and ownership transformations affecting them were therefore subjected to regulations different than those applied to privatisation of SOEs in the industrial and service sectors.[16] The Resolution adopted by the Council of Ministers on May 14, 1991 contains an outline of the program of corporatisation and privatisation of the nine commercial banks hived off from the NBP. The document envisaged that those banks were to be transformed into wholly owned joint stock companies of the State Treasury and thereafter privatised, all of them before the end of 1996. The key benefits to be generated by the privatisation of banks are aptly summarised below: (P.Wyczañski, M.Gotajewska, 1995, p.141):

- enhanced *corporate governance* and a parallel increase in the efficiency of the banks' operations;

- relieving administrative authorities of the responsibility for management of banks and thus removing a possibility of officials meddling in their activities;

- increased quality and extended scope of banking services and better standards of customer care in a competitive environment;

- reduction in the costs of financial intermediation, achieved through labour productivity improvements, introduction of new technologies, innovative management, organisation techniques and human resource development;

- acceleration of the development of capital market through increased capitalisation of the Warsaw Stock Exchange and a larger number of listed companies; and

- implementation of institutional changes ensuring that the Polish banking system gradually evolves into one more compatible with those operating in fully fledged capitalist market economies.

The transformation of the nine commercial banks into wholly-owned joint-stock companies of the State Treasury came into effect in October and November 1991. Supervisory Boards of those banks were appointed by the General Meetings of Shareholders and evaluated the operations of banks, the performance of their management boards and drafted agendas of changes necessary to improve their banks' competitive position. Bank privatisation was to be accelerated by the diagnostic studies, commissioned for each of the Nine with major auditing firms in 1991, and especially by establishing twinning agreements with Western banks, which were concluded in 1992. Such arrangements were secured for seven Polish commercial banks and focused on co-operation in the fields of modernisation and organisation, and *modus operandi* in the principal areas of strategic planning, introduction of modern banking technologies, risk management, human resources management, etc.

Yet a dangerously excessive share of bad debts in banks' assets was one of the principal problems which Polish commercial banks had to tackle at the beginning of the transformation period.

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16 *State Owned Enterprise Privatisation Act* of July 13, 1990 was directed to the privatisation of state-owned enterprises except banks, insurance companies, co-operatives and co-operative organisations and certain other state institutions such as research-and-development entities, and institutions operating in the field of fine arts and culture.

Adequate statutory provisioning for such huge debts was beyond the means of almost all the banks, with the exception of Bank Slaski S.A. and Wielkopolski Bank Kredytowy S.A. In order to restore safe levels of solvency ratios in a short period of time, those banks required additional equity injections which their owner - the Ministry of Finance – had to provide. This stemmed from a sound assumption that financial restructuring of banks should precede their privatisation.

The necessity to undertake financial restructuring of commercial banks significantly delayed and slowed down the implementation of the privatisation programme in the Polish financial sector.[17] The programme originally assumed that privatisation of the nine commercial banks would be completed before the end of 1996 and be followed by the privatisation of specialist banks (Bank Handlowy S.A., Powszechna Kasa Oszczêdnosci BP, Pekao S.A., and Bank Gospodarki Zywnosciowej). In recognition of the success of financial restructuring of banks some countries which co-funded the Zloty Stabilisation Fund, established in 1989, agreed to transfer US$450 million from the Fund (US$350 million in grants) to the Polish Banks Privatisation Fund. In line with the *Memorandum of Understanding,* signed by the donor countries, those funds were to be used to redeem the restructuring bonds (inclusive of interest) which had been given to the seven commercial banks as part of the equity injection operation. The availability of the funds committed in the aforesaid *Memorandum of Understanding* was made conditional on the timely implementation and progress of the privatisation process.

The privatisation of state-owned banks strategy originally envisaged:

- securing a strategic investor who would acquire a minority stake (20 to 30 per cent) in the first stage of the deal and ready to commit itself to actively participate in management;
- retaining a significant equity stake with the State Treasury (up to 30 per cent),while preserving tentative option to sell this lot in the future;
- enabling domestic and foreign institutional investors to participate in the privatisation of banks and acquire up to 30 per cent of equity;
- sale of a portion of shares to bank employees on preferential terms.

The first commercial banks slated for privatisation in 1991 were Wielkopolski Bank Kredytowy S.A. (WBK) and Bank Slaski S.A. They were, at that time, the best performers among the group of “Nine”. The Ministry of Finance retained consultants to complete comprehensive audits combined with valuations and take care of the promotion of share issues as part of the structured privatisation process. For WBK S.A. the British investment bank Schroders was appointed, whilst for Bank Slaski S.A. the French Banque Paribas was retained.

[17] Since the banking sector privatisation programme was positively evaluated by capital marker analysts and foreign observers of Polish reforms at the outset, such good reviews of Polish turnaround strategies were to a certain extent treated as a justification for slower pace of the privatisation process than that originally assumed. Soon however the approach of commentators changed and accusations were put forward that political reasons were behind the lack of expected progress, see in The Banker 11/1996.

In April 1993, the time chosen for the privatisation sale of WBK S.A, external conditions were not advantageous – with the bear market on the Warsaw Stock Exchange accompanied by a limited interest shown by foreign investors. Given such poor success of the issue, the European Bank for Reconstruction and Development (EBRD) supported the issuer and chose to become WBK's strategic investor and acquired 28.5 per cent of the bank's equity (details of the deal are discussed in the *case study* describing the privatisation of this Poznañ based bank).

The privatisation of Bank Slaski's took place in a totally different external environment. The strategic investors in this case was the Dutch ING Bank which acquired 28 per cent of shares. The Warsaw Stock Exchange index was on its way to record high levels,[18] and in front of all the Polish brokerage houses huge crowds of private investors queued to seize the opportunity of cashing on the stock market frenzy. The interest in the issue among subscribers was so high that share allotments had to be cut by 70 per cent. The sale of Bank Slaski shares was crowned with an unprecedented success in promoting the capital market. Practically overnight the number of investment accounts held by individuals mushroomed and increased by over 800,000 in less than three months. But the backroom backlog of young and inexperienced brokerage houses, in particular those operated by Bank Slaski itself, could not handle made quick registration of deposit certificates with the National Depository of Securities almost impossible and thus liquidity of trading in BSK shares in the initial period of their presence on the Exchange was significantly reduced. Given a soaring demand among investors and a mere trickle of stock on the supply side, BSK shares continued to go through the roof and soon were traded at 13 times their issue price. Investors willing to jump on the bandwagon to riches and suddenly deprived of the possibility to freely dispose of their shares were disgruntled and aired their grievances complaining about purposeful irregularities in the process of sale and the share valuation method chosen. Such stance of the public undoubtedly affected further actions taken by the Ministry of Finance in the field of privatisation and the process visibly lost its momentum. Privatisation efforts undertook afterwards were clearly made with excessive caution and sometimes conservatism verged on a wait and see attitude.

The next state-owned bank on the block was Bank Przemystowo-Handlowy (BPH) S.A., which had to await its turn until 1995. The mechanics of share sales to institutional and public investors were changed and interested investors were made to register in order books available in brokerage houses (the so-called bookbuilding process). Also the manner in which share prices were determined was altered and the final sale price was fixed during a separate "bidding" session of the Exchange. The seller's attempts at finding an active strategic investor for BPH S.A. finally misfired and the mood on the Exchange was altogether different than two years before. In order to ensure success of the issue individual investors had to be attracted by tax incentives and in the tranche for large institutional investors underwriting arrangements had to be made. The principal shareholders in the BPH became: the EBRD (15.06 per cent), Bank Slaski (4.79 per cent), ING Branch in Warsaw (5.31 per cent), Daiwa Europe (4.57 per cent), and WBK (2.48 per cent).

The last privatisation sale of a commercial bank belonging to the group of "Nine" was that of Bank Gdañski S.A. which was competing with Powszechny Bank Kredytowy S.A on the "privatisation waiting list" and was eventually slated for privatisation. If the original time-

18 Between the floatation of Bank Slaski shares, i.e. the date when their issue price was communicated to the public (October, 1993) and the stock's debut on the WSE (February, 1994) – the Exchange's all-share index WIG sky-rocketed from 8000 to 20,000 points.

scale contained in the bank privatisation programme were to be adhered to, at least two bank sales would need to be completed each year. In addition, by privatising Bank Gdañski in 1995 the government was in keeping with the requirements of the arrangements made with the Zloty Stabilisation Fund and another tranche of funds from the Polish Banks Privatisation Fund could thus be disbursed. Therefore, given the "privatisation doldrums" in 1994, the government was keen to see at least two banks privatised in 1995.

Table 4. Ownership transformations in state owned commercial banks in Poland between 1993 and 1997

Bank	Year when privatised	Share of strategic investor as at share acquisition date	Share of strategic investor as at 30 June 1997
Bank Rozwoju Eksportu S.A.	1992	Commerzbank AG 23.00%	31.78%
Wielkopolski Bank Kredytowy S.A.	1993	Irish Allied Bank plc 16.30%	60.20%
Bank Slaski S.A.	1993	ING Bank 25.92%	54.08%
Bank Przemystowo-Handlowy S.A.	1995	EBRD 26.40% ING Bank 5.31%	15.05% 12.60%
Bank Gdañski S.A.	1995	Grupa BIG S.A. 24.07%	63.42
Polski Bank Inwestycyjny Prosper Bank S.A.	1997	Kredyt Bank S.A. 100.00%	100.00%
Bank Handlowy S.A.	1997	J.P. Morgan, Zurich Group, Swedbank 28.86%	28.86%

Source: author's own studies

Bank Gdañski S.A. was privatised at the end of 1995 with one of the Polish banks as its strategic investor (for details consult the Bank Gdañski privatisation *case study*). It should be highlighted here that Bank Inicjatyw Gospodarczych, S.A. and its subsidiaries which acquired 24.07 per cent of BG S.A. shares was itself established by SOEs and private individuals as a joint stock company during the first stage of the transformation processes in Poland. In 1991 it was privatised and on 13 August 1992 was - as the first bank ever - quoted on the Warsaw Stock Exchange.

As it turned out later the Gdañsk based bank was the last privatisation deal completed under the commercial bank privatisation programme designed at the beginning of the 1990s.

4.3. Privatisation of state-owned banks - status after 1995

Already at the beginning of 1995 the government realised that it was impossible to make up for the time lost due to the delays in the progress of the privatisation programme and started to probe for ways to modify it. At the same time authorities purported that the principal causes underlying the delays and confusion in the implementation of the original programme were as follows:

- lack of interest among prospective strategic investors in participation in the privatisation process;

- a big share of banks in the total capitalisation of the Warsaw Stock Exchange (30 per cent) and the shallowness of the capital market in Poland;

- no demand for shares of Polish banks in the foreign capital markets.

Thus, seemingly, as time went by, the government gradually became a slave of its own privatisation concept. The privatisation strategy, adopted at the beginning of the 1990s, took into consideration the situation of the sector at the outset of economic transformations and was also shaped by external and internal economic and political factors. Initially it was assumed that the success of privatisation could be secured when efforts in that field are supported by the following: enticing individual investors interest in renowned banks with sound track record, support of the EBRD and equity involvement of foreign banks. At the same time however restrictions with respect to the shareholdings held by foreign strategic investors were put in place and such institutional buyers were allowed to acquire minority stakes only. This solution was adopted mainly because of political reasons although it is true that at that time foreign capital was not particularly eager to invest in the Polish financial sector, primarily because overseas investors were deterred by political and economic risks associated with investing in Poland. As the implementation of economic reforms progressed, institutional changes were crystallised and the country’s economic growth took off, a certain critical mass was reached and the interest among foreign investors literally soared. Since the decisionmakers failed to follow up with the removal of the aforesaid restriction on minority stakes, the number of investors who could muster enough capital to closed public floatations was severely limited, whilst in practice genuine interest among foreign investors did exist and was manifested in increasing activity of foreign banks who sought to secure a banking licence and confirmed later by considerable number of bidders when banks owned by the NBP[19] were put on the block. On the other hand, the absence of trust in the strength of market mechanisms became ever more pronounced. The theory about the shallowness of capital market was shortly thereafter refuted by the market itself, when a series of public bank offerings was successfully absorbed by investors.[20] The massive inflow of individuals into the privatisation market was gravely underestimated and the seller focused on appealing to institutional investors. The Ministry of Finance, still suffering from lessons learned during WBK and Bank Slaski IPOs failed to take advantage of comprehensively structured instruments capable of attracting individuals keen on becoming shareholders (share price rebates, leveraged share buying etc.) which proved their effectiveness with flying colours much later - when Bank Handlowy and Powszechny Bank Kredytowy were floated.[21]

The attractiveness of the state-owned banks privatisation model which was created at the beginning of the transformation process gradually waned owing to profound changes that

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19 Creditanstalt and GE Capital expressed their interest in acquiring PBI S.A.; PBK S.A. was screened as a potential investee entity by Citicorp and Samsung Life Insurance, Deutsche Bank and Daewoo in turn were interested in purchase of Pierwszy Bank Komeryjny w Lublinie.

20 Public offers of the Bank Ochrony Srodowiska and, finally, that of the Bank Handlowy were significantly oversubscribed.

21 Such benefits available to individual investors are also used when it comes to selling very attractive companies as they create a lot of hype and good market atmosphere before the company is floated. It is also of importance that such activities boost the debut prices of such stock on the Exchange. It is noteworthy to quote here Deutsche Telekom or Spanish banking group Argentaria as they confirm those patterns.

affected the whole Polish economy. In order to achieve faster progress in privatisations, the following had to be determined:

- personal scope of privatisation - banks slated for sale and entities eligible to acquire equity
- principles of privatisation, especially including:
  - principles of determining selling prices;
  - participation of domestic and foreign entities, and the role of staff of banks sold;
  - size of lots sold;
  - action plans and time-scales specifying milestones and entities responsible for implementation of individual components of privatisation process.

Privatisation delivers and leads to improvements in management, better utilisation of resources and increase in operating efficiencies only when it is an effective privatisation. When it is "crowned" with the emergence of diluted shareholdings or domination of passive investors (while the State as minority shareholder still actively controls the operations of a privatised entity) privatisation as such fails to meet those expectations. Effective privatisation is possible when ownership structure enforcing improvements in corporate governance is ensured. Such improvements occur when among the entity's shareholders a strong and independent equity holder emerges and exercises genuine owner's control over the business. It seems that in order to ensure restructuring and further growth of the Polish banking sector such a model of ownership changes was most advantageous in the mid 1990s. However, following long lasting preparations and public debate which vocalised criticism of planned undertaking, the government finally, in October 1995, adopted the Bank Privatisation Programme - Wholly Owned Joint Stock Companies of the State Treasury. The provisions of the new programme actually turned the existing priorities and focused them on the direction contrary to the desired course of privatisation.

The programme assumed that two commercial banks - Powszechny Bank Gospodarczy S.A. and Bank Zachodni S.A. would be privatised and among the key objectives spelled out the administratively managed consolidation of banks under the aegis of Bank Handlowy S.A. w Warszawie and Pekao S.A. - two banks with longest established tradition and position in the Polish market. The government went on to assume that the remaining three commercial banks (PBG S.A., BDK S.A. and PBKS S.A), Polski Bank Rozwoju S.A, Polski Bank Inwestycyjny S.A. and BPH S.A., which was privatised before, would be merged with the two consolidation leaders (see "Programme ... 1995"). Privatisation was to follow shortly thereafter and was to be concluded through gratuitous transfer of 51 per cent of equity to public sector employees - this was meant to compensate them for lack of possibility to take advantage of any preferential terms when industrial SOEs were privatised. The programme envisaged that holders of those shares would be mandated to contribute them as assets to the pension funds – which the government planned to set up. The programme failed to be specific as to how and when the remaining 49 per cent of shares were to be made available to investors. This vague stance gave way to concerns that the primary dilemma which the programme creators wanted to solve was "How to privatise Polish banks and still retain control over them?"[22]

Following pressures from government, in 1996 Pekao S.A. Group was established with Bank Pekao S.A. as parent company and the following banks as subsidiaries: Bank Depozytowo-Kredytowy S.A. w Lublinie, Powszechny Bank Gospodarczy S.A. w Lodzi and Pomorski Bank Kredytowy S.A. w Szczecinie. Attempts at putting together another group of banks - Bank Handlowy S.A. Group - failed, mainly due to a negative attitude to the government's ideas among the banks concerned. When it comes to the criticism of consolidation ideas, also foreign commentators were in concert and stressed that such an approach was a reflection of the State's zeal to retain its influence in the banking sector.[23] The behaviour of Bank Handlowy in the period when the government was putting together the banking sector consolidation is indeed praiseworthy as its management showed a great deal of maturity and commitment. With hindsight it may safely be assumed that the managers of Bank Handlowy were actually willing to go along with the idea of consolidation but were keen on structuring it differently, however, the discrepancy with the masterplan engineered by the government was considerable. At the same time the directors were determined to reject an offer which was seemingly attractive. The analysis of opportunity costs - focusing mainly on computing benefits which would have been lost if another privatisation path were chosen as well as the review of consolidation costs in the event that synergies were not achieved may have prompted the bank to stay away from the gratuitous acquisition of considerable equity stakes of other banks. This was not easy given that the Ministry of Finance as the sole owner of the Bank was pressing on its directors to pursue the idea of consolidation. Nevertheless Bank Handlowy succeeded in frustrating the MOF's masterplan and was aided by criticism raised in the Parliament as to the idea of such consolidation as well as encouraged by the opposition among industry pundits. As soon as the threat of consolidation was removed, Bank Handlowy initiated its own privatisation path and was successfully sold in spring 1997. This case clearly shows that the vision of bank development strategy implemented by its management was appreciated by the domestic capital market and foreign investors alike (the details of this self originated privatisation path are discussed in the Bank Handlowy case study). The privatisation of Powszechny Bank Kredytowty S.A. was originally slated for the end of 1996 but was later rescheduled for first half of 1997. A non-public tender for 65 per cent of its equity was declared and a few interested entities decided to submit their offers. The closing date for bids was postponed a number of times and in 1997, when the tender was finally cancelled, the seller did not communicate any reasons for its decision.[24] The MOF wetted its appetite after the success of Bank Handlowy floatation and chose to float 70 per cent of PBK S.A. equity and sold the shares during a special „fixing" session of the Warsaw Stock Exchange. The privatisation deal

22 L. Pawtowicz, in his evaluation of the programme additionally remarks that "combining the reform of the social insurance system with bank consolidation is an artificial move and was perhaps taken only to secure social support for the ideas of consolidation." See Pawtowicz, L. *Privatisation, consolidation and pension funds* (1996) - unpublished paper.

23 See Ch. Bobinski *Poland's fast track privatisation breaks down - Change of plans means regional commercial banks will now be consolidated before they are floated*, Financial Times, 1995, Dec 08; R.Paterson *Out with the body builders*, May 1996, C. Jones *Shadow falls over sales*, The Banker, November 1996

24 It is known that the main contenders for this stake were Samsung Life Insurance and the consortium of Polish financial institutions - (PBR S.A., BPH S.A., Kredyt Bank S.A. and TUiR Warta S.A.)

structure proved effective yet again when PBK S.A. was sold. The seller chose to sell the shares in two tranches – 52 per cent of equity was set aside for large investors and 18 per cent was to be made available to small investors. Maximum size of a single lot that could be subscribed for in the large investors[25] tranche was 13 per cent. Small investors were, as was the case with Bank Handlowy, again offered a price incentive and could buy shares at 5 per cent discount, they were also eligible to a scrip issue provided they agreed to hold on to their lots for at least 12 months. Since the size of the lot set aside for small investors was relatively small, demand among buyers was not met and allotments were cut by 92 per cent. Also the interest among large investors was very considerable. The issue was oversubscribed three times. After the allocation of shares was concluded two major shareholders of the Bank emerged: TUiR Warta who after a subsequent purchase of a lot from Kredyt Bank S.A. holds 20 per cent and Creditanstalt with 13 per cent of equity.[26]

To date no efforts have been made to privatise Bank Zachodni S.A. the last of the Nine still in the hands of the State. Privatisation of Bank Polska Kasa Opieki S.A. - Grupa Pekao S.A. is expected for the first half of 1998. It is envisaged that 30 per cent of its shares will be transferred to the Pension Funds, whilst some shares will be gratuitously transferred to the staff employed in the parent bank and its subsidiaries; on top of that 5 to 15 per cent will be offered to individual and institutional investors in an IPO. In order to completely privatise the nationalised banking sector it is necessary to ensure that ownership transformations also affect the largest specialist banks: Powszechna Kasa Oszczêdnosci BP and Bank Gopodarki Zywnosciowej S.A. Given a peculiar profile of those banks and their sheer size it may be reasonable to expect that a special approach to their privatisation will need to be developed and hence it may be assumed that those banks will be privatised after the year 2000.

5. Successes and failures of the Polish banking sector privatisation - conclusions

The privatisation process of the Polish banking system reflects all the acute problems of the system-wide transformations in Poland. Some of them are even more pronounced than in the other economic sectors. In particular this concerns the liberalisation of market entry criteria, fundamental institutional change, range of necessary system-wide regulations, the participation of the state in the ownership structure of the sector, and finally - the role to be played by domestic capital and the contribution of foreign capital to the transformations of the banks' ownership structure. The privatisation of the banking sector, which was part of the heritage of the socialist economy was, as Polish experiences clearly show, vulnerable to political changes. Reasons that were frequently put forward in support of the authorities moderation with respect to the speed and scope of privatisation emphasised the specific role of the banking sector (and of universal banks in particular) in financing of and control over the enterprise sector. This was quoted as an irrefutable argument which was to justify restrictions with respect to the limits imposed on sale of majority stakes to foreign strategic investors which were put in place in the

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25 By way of comparison, in the cancelled tender Samsung Life Insurance was ready to acquire a controlling stake - 65% of equity.

26 Initially the consortium grouping Warta/Kredyt Bank S.A./PBR S.A. was striving to acquire a majority stake but since the results of the sale were different, the consortium fell apart completely. BPH chose not to subscrive, PBR did subscribe but got a mere 1%, whereas Kredyt Bank S.A., which had equity links with PBK S.A., was allocated 13% of shares and almost immediately sold 7% of equity to Warta S.A.

initial stage of the privatisation process. The process of privatisation of state owned banks in Poland was indeed an ebb and flow exercise. The strategy of the ownership transformation pivoted on the opening of the banking sector to new operators and on privatisation of state-owned banks. The latter was carried out on a *case-by-case* basis so that each time only good banks, with a sound financial standing, were slated for sale since, given their substantial market value, privatisation sales ensured considerable proceeds to the State Treasury. The fiscal stance permeating this approach was to a certain extent disadvantageous to the banks concerned, because the benefits of the change in ownership structure of the state-owned banks and the emergence of a strong and active strategic investor cannot be overestimated. The history of privatisation related transformations of the state-owned banks to date can be divided into two distinct periods. Initially, the programme of bank privatisation, elaborated at the outset of the transformation processes and envisaging first of all privatisation of commercial banks (those hived off from the NBP) to be followed by a sale of the remaining specialised banks in the second stage, was implemented. After a number of initial successful privatisation sales, delays to the implementation of the programme occurred and stemmed, to a large extent, from lack of the authorities' commitment and consistency and were also aggravated by a series of objective difficulties (the need for financial restructuring of banks, capital market peaks and troughs). In 1995 the original privatisation programme was altogether abandoned and the administrative consolidation plan gained priority. The far-reaching designs for consolidation of state-owned banks were in practice reduced to the establishment of one bank group which now controls about 25 per cent of the market.

Table 5. The share of banks with different structures of shareholdings in equity capital and assets of commercial banks in Poland.

	Number of banks	Share in registered share capital (%)	Share in net assets (%)
Banks with lead shareholdings of State Treasury	21	37.0	59.4
Banks with private majority	35	29.3	26.2
Banks with foreign capital majority	25	33.7	14.4
Total commercial banks	81	100	100

Source: NBP June 1997, see footnote [*20] for further explanation

It will soon be clear whether the government's hopes attached to the consolidation of banks come true. Whether consolidation will deliver will depend on the ability of managers at the helm of consolidated banks, and especially those of the parent bank (i.e. Pekao S.A), to correct negligence and mistakes encountered in the initial period. Effectively implemented privatisation ensuring improvements in corporate governance could be the driving force that will actually decide the success of consolidation. Otherwise difficulties which cropped up in the course of designing the operating strategy to be adopted by the Pekao Group in the financial market, coupled with deficiencies of management at the executive level, may soon become the key reasons behind the failure to attain synergies and hence lead to a sudden slump in competitive position. In the meantime, a number of banks which escaped the administrative consolidation into similar groups were successfully privatised. Bank Handlowy S.A. was sold due to a self-originated privatisation blueprint developed by its management board. Polski

Bank Inwestycyjny S.A. and Prosper Bank S.A. owned by the National Bank of Poland were, however, sold to one of the private banks established during the transformation period - Kredyt Bank S.A. Also the bold decision of the Ministry of Finance to sell the remainder of shares of Bank Slaski, Wielkopolski Bank Kredytowy, and Bank Gdañski it retained after the public offer merits attention. As a result of this sale the existing strategic investors - namely ING Bank, AIB and BIG - acquired full corporate governance and increased their holdings to majority stakes. Most of the changes that occurred over the last two years in the ownership structure of the Polish banking sector were triggered by the operation of the ever more effective market mechanisms. The wave of mergers and acquisitions that swept the sector as well as a number of privatisation sales were forced by the market bolstered by the entrepreneurial spirit of bankers endowed with a clear vision.[27]

The history of the Polish banking sector privatisation to date witnessed the application of various approaches. In the first stage the privatisation designs masterminded by the government favoured privatisation with limited share of foreign strategic investors and opted for solutions which enabled retention of significant chunks of equity with the State. Minority stakes were sold through tenders and the entry of a strategic investor was accompanied by an IPO targeted primarily at individual investors. Such was the method which was expected to generate improvements in the corporate governance and lead to the growth of capital market. Privatisation deals completed and fashioned after this model should be considered successful, primarily since in the second stage of privatisation the position of strategic investors was strengthened as they acquired majority stakes in investee entities. The redesign of the privatisation programme effected in 1995 was first and foremost meant to consolidate selected banks - wholly owned joint stock companies of the State Treasury. It seems that the time devoted to the political tug of war could have been more effectively used if the privatisation efforts had been further continued. Between 1996 and 1997 the privatisation programme implemented in accordance with the government originated programme was in practice frozen. The success of the Bank Handlowy privatisation is largely owed to the determination of its directors, who displayed creativity and professionalism, the qualities seldom visible elsewhere in the Polish banking sector, and showed their ability to seize the opportunity to launch privatisation quickly, as if bypassing the queue to the block overseen by the powers that be. This event is also noteworthy as at the same time a new privatisation model in Poland was invented. An IPO targeted at domestic individual and institutional investors was immensely successful and witnessed a significant oversubscription. The interest in Bank Handlowy and PBK shares floated later, which was noted among small investors, became an excellent promotional event disseminating the idea of investing through capital market and simultaneously invigorated further growth of the Polish bourse. It seems that such an approach to privatisation best supports the attainment of the two major objectives underlying financial sector development while good development prospects awaiting privatised entities offer hopes to investors that the future will bring sizeable benefits. Participation of a group of stable investors with triple A market ratings created a new quality in privatisation business practice. In the case of Bank Handlowy this privatisation approach does not give way to any fears that the absence of a strategic investor will not enable the bank to cash on the advantages stemming from stronger corporate governance. The sale of left-over share lots held by the State Treasury in Wiekopolski Bank Kredytowy, Bank Slaski and Bank Gdañski created a favourable ground

[27] It should be acknowledged that the most important events in this field were encouraged by the presidents of boards of directors: in Bank Handlowy - by Cezary Styputkowski, in Kredyt Bank - by S.Pacuk, and in BIG - by B.Kott.

for the emergence of a new privatisation model. Following those transactions, from among shareholders strong and independent strategic investors emerged. In two cases this role was played by foreign banks and in one case a domestic bank assumed the position of a leading equity holder. The degree to which such ownership structure influences the ease of owner's control is best visible when the case of Bank Gdañski is reviewed, as just a few month after privatisation it was acquired by BIG S.A.. The sale of Polski Bank Inwestycyjny S.A. to Kredyt Bank S.A. was the first ever privatisation sale in Poland when as a result of tender, all shares were allotted to one investor. Also, in this case, the acquirer very soon decided to effect a merger. Those examples clearly show how an effective privatisation model can tangibly improve corporate governance.

The participation of the EBRD in the privatisation of Polish state-owned banks is a noteworthy milestone. EBRD closed WBK and BPH floatations. Its share in the first privatisation deals triggered interest of other investors as well as stimulated trust of customers using services of Polish banks.

However, the share of the banks with the majority of state holdings in the assets of the Polish banking sector is still excessive, and in this area Poland lags far behind the Czech Republic and Hungary.[28] In the document developed by the European Commission and containing the appraisal of the progress which the Polish economy made on the road to meet standards securing possible eligibility to joint the EU and entitled “Agenda 2000”, critical remarks about the scope and speed of Polish banking sector privatisation are included. European analysts stress low skill levels among Polish bankers and poor quality of management. The ownership structure of the share capital is more desirable nowadays but nevertheless the State's presence in the sector should be considered too big. Out of the total of 81 institutions currently operating in the market, the state still has majority ownership in 21 banks. Among the top ten Polish commercial banks - with respect to the value of assets - only four are private. When the players' market positions is in turn gauged by the value of own funds the Polish top ten still boats only five institutions with majority stakes held by private shareholders. The state still enjoys a dominating position in the aggregated share capital of the sector,[29] and as of 30 June 1997 its aggregated holdings neared 40 per cent with foreign and domestic private persons holding approximately 35 and 25 per cent respectively. The domination of banks with majority stakes still in State hands is especially visible in the assets of Polish commercial banks (59.4 per cent). Further consistent privatisation of the banking sector should be the government's priority for a few years to come. The visions of an open and competitive market for financial services should inspire the target model of the banking sector in Poland. The responsibilities and role of the State should be limited to those of a regulator defining the legal framework of credit institutions operations and of an overseer enforcing compliance. In the ownership structure of the sector, private ownership in individual or institutional form should dominate. Privatisation is not a goal in itself but is indeed a prerequisite for the emergence of a system which is effective - both in micro and macroeconomic scale - and capable of competing on the

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28 At the end of 1995 the share of banks with majority of state capital in the Czech Republic and in Hungary were 17 percent and 27 percent respectively. Cf., Borish, M.S.; Ding, W.; Noel, M.: *On the Road to EU Accession. Financial Development in Central Europe,* World Bank, Washington D.C. 1996, pp.7-15.

29 As indicated by General Inspectorate of Banking Supervision figures for 1st qtr 1997 and author's own estimates on the impact of new privatisation sales -- Bank Handlowy S.A., Polski Bank Inwestycyjny S.A. and ProsperBank S.A.

international financial marketplace. Given Poland's commitment to join the European Union there is no other choice but to continue the privatisation of the banking.

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6. Illustrative case studies – a variety of methods applied to the privatisation of state-owned banks - *Anna Wydrzyñska (under the supervision of Slawomir Lachowski.)*

6.1. Wielkopolski Bank Kredytowy - the first privatisation

The growth of Wielkopolski Bank Kredytowy (WBK) between 1989 and 1996 is in a nutshell the reflection of changes that have swept the entire Polish economy since 1989. The hallmarks of this period were, first of all, ownership transformations, overall economic growth achieved (after the problems of the teething stage of Polish transition were overcome), and, allowing for some necessary changes, the implementation of Western experiences in the conditions of the Polish market economy.

6.1.1. From state to private ownership

WBK emerged on the market after fundamental changes that overturned pre-1989 institutional and functional structures of the Polish banking system. Following the enactment of two major statutes – the amended *National Bank of Poland Act* and the *Banking Law* – pursuant to their provisions and by virtue of the decision by the President of the NBP, WBK was established and endowed with 41 ex-NBP branches spread over the central and western part of the country.

Less than two years since its foundation, on October 31, 1991, the Bank was transformed into a wholly owned joint stock company of the State Treasury, and the decision-making powers with respect to it were vested in the owner's representative - the Minister of Finance. The share capital of the Bank was fixed at PLN 45,740,000 and divided into 4,574,000 bearer shares with a nominal value of PLZ 10 each.

The major breakthrough occurred in 1993 - the year deservedly considered crucial for the bank - when WBK, as the first among the nine commercial banks hived off from the NBP and established in 1989, was privatised. Preparations for its privatisation began earlier. In August, 1991, the Ministry of Finance decided that the WBK and Bank Slaski would be privatised first as the best performers among the "nine" commercial banks. Following the selection of a strategic investor - chosen from a group of major foreign banks - the plans envisaged a public offering of WBK shares; this was finally slated for January 1992. But foreign banks were not keen on investing in Poland as they were clearly discouraged by lack of progress in the negotiations with the London Club on restructuring of the Polish foreign debt. Eventually, the European Bank for Reconstruction and Development (EBRD)[30] chose to become a strategic investor in WBK, wishing to express its support for ownership transformation in Poland in this way. The EBRD, however, made its involvement conditional on the Bank's privatisation, i.e. bringing the State's stake in equity below 50 per cent.

30 The European Bank for Reconstruction and Development (EBRD) was established in 1991 as an international institution with the share capital of ECU10 million by 59 co-founding states. The main objective of the organization is to provide consulting and financing services to public and private enterprises in the process of transition. The EBRD is the shareholder in some Polish financial institution mainly in the banking and insurance sector i.e. 15.1% in Bank Przemystowo-Handlowy, .7,8% in Kredyt Bank S.A., 35% in Azur Zycie, ,35% in Azur Ostoja, and 15% in BTUiR Heros).

The Bank was eventually privatised as a result of the sale of a lot of shares hitherto held by the State Treasury (1,740,000 A series shares) and a new share issue (fresh 1,826,000 B series shares), which increased the share capital of WBK S.A.

Shares allocated to public offer were sold in two tranches. The first, targeted at big investors, purchasing lots of 5,000 shares or more, totalled 460,000 shares i.e. 7.2 per cent of the issuer's share capital (the State Treasury reserved the right to increase it to 17 per cent). In the tranche offered to small investors – i.e. those purchasing between 10 and 5,000 shares – 1,280,000 shares were made available. The sale of shares from the first tranche (for big investors) was a tremendous success; over 6.1 million shares were subscribed for – in other words, investors were ready to buy almost the whole bank. The Ministry of Finance discarded all the subscription orders coming from state-owned enterprises and from those with State majority. The remaining allotments were reduced pro rata to 9.2 per cent of the original order value. Since such a huge reduction to the subscription orders had to be applied, none of the investors obtained a block of shares worth more than one per cent of the bank's equity. Subscriptions lodged by foreign investors involved over 1.1 million shares, which was 18 per cent of the total subscribed for in the tranche. The successful sale of this tranche was the key prerequisite for the EBRD's investment, since the lot sold to large investors, when combined with shares held by the employees of WBK S.A. and those to be acquired by EBRD, in the aggregate totalled 50.1 per cent of share capital - thus the majority of private capital was ensured. As this condition was fulfilled, the EBRD bought 1,826,000 shares, taking hold of 28.5 per cent of WBK's outstanding stock.

Shares from the second tranche which was targeted at small investors were available in 147 points of sale operated mostly by brokerage firms, where - owing to a large interest among investors - crowds started queuing already two weeks before the "doors open" day and spontaneously emerging "queue watch-dogs" checked, on a daily basis, everybody's presence in front of sales offices. High appeal of WBK stock to investors was undoubtedly boosted by the involvement of such a respectable financial institution as the EBRD, which in itself was tantamount to a "triple A" rating. The new share offering was even more of a bargain when the P/E ratio for WBK was examined – just 2.7, with P/Es for WSE blue-chip at the level of 3.6 and the Exchange average of 5.3. The employees of WBK were to receive 14.3 per cent of shares and were additionally entitled to purchase them at a discount – half of the issue price paid by the public – on top of that, they could spread their payment for shares over a year.

The Minister of Finance, when commenting on the WBK privatisation, expressed his satisfaction that the sale went smoothly and ironically concluded that the only snag was that the demand for shares exceeded their supply. The Minister's statement actually meant that the seller, albeit indirectly, wished to admit that an error was made in valuation of the bank's shares and hence their excessively low issue price led to a demand/supply imbalance. When fixing the price the Ministry of Finance relied on the current level of the bank's net profits, the size of its share capital and the level of prices of other banks and companies listed on the Warsaw Stock Exchange. When making this pricing decision the Ministry was also obviously driven by the consent of EBRD to the price. That is why the issue price of PLN 1.15 was stated in the Prospectus. The State Treasury's proceeds from WBK privatisation totalled PLN 200 bln.. The principal shareholders became the Treasury (30 per cent) and the EBRD (28.5 per cent).

In order to increase the marketability of the Bank's shares, in August 1994 the WBK management declared an 8-to-1 split; afterwards the bank's share capital was therefore divided into 51,200,000 bearer shares with nominal value of PLN 1.25 each. The composition of the bank's shareholdings at the end of 1994 was as follows: the State Treasury - 30 per cent of share capital, EBRD - 28.5

per cent, and the remaining shareholders - 41.5 per cent. In December, 1994, the Bank finalised a fresh issue whereby another 6,400,000 series C shares were sold, this time at the issue price of PLN 1.25 each. The issue was a novelty on the Polish young capital market – since it was the first ever scrip issue on the Warsaw Stock Exchange, whereby for every 8 „old" shares one new was issued and paid up from shareholders' reserves (profit). The decision to launch a capitalisation issue was in essence driven by the combination of two factors: the Treasury's refusal to reduce its stake in equity below 30 per cent and its inability to fund the purchase of fresh D-series shares. This apparent deadlock could only be solved by a fresh issue, whereby the existing shareholders were entitled to free shares, in lieu of a cash dividend. Besides, for tax reasons, a scrip issue was more advantageous to the Bank than a cash dividend. When 20 per cent of its profits were withheld in taxes, the company was still left with 80 per cent which it otherwise would have paid to the shareholders in cash dividend.

Almost concurrently the WBK launched a fresh issue of 11,216,000 series D shares, arguing that the need for a new issue was caused both by the likelihood of exceeding credit exposure limits set by the NBP and the need for additional, restructuring induced, spending. The issue, sluggishly and painstakingly put together for 11 months, was not a success as its sales were depressed by a downturn on the Warsaw Stock Exchange. The launch of the new issue, originally priced at PLN 13 per share and slated for December 1994, had to be rescheduled since the stock market was in the tank since December. Management, having analysed the mood in the market and reviewed projected trends on the WSE, decided to launch the issue at the turn of January 1995 as well as slashed the issue price to PLN 5.4. Given such changes the Securities Commissions consented to extend the validity of the prospectus until 20 February, willing to aid the likelihood of the offer's market success. The entire issue was underwritten by the Allied Irish Bank (AIB), the second largest bank in Ireland, which could acquire WBK shares at a 20 per cent discount i.e. for PLN 4.3 each. Since the Irish had a long-standing business relationship with the Bank and co-operated with it closely since 1992 under the Twinning Agreement, from the very outset they treated the acquisition of WBK stock as a long-term investment. In addition AIB signed an agreement with the EBRD, whereby it secured an exclusive call option to ensure repurchase of the latter's stake.

With the "Polish meltdown" still raging on the WSE and share prices reaching their record troughs, weary investors acquired only 25,170 D series shares, and the underwriter – Allied Irish Bank plc – took hold of 1,190,830 shares, which gave the Irish a 16.3 per cent share in the bank's equity. Post-issue composition of the bank's shareholdings was significantly changed - with AIB European Investment /AIB EI/ Limited - part of the Allied Irish Banks plc group - becoming one of the three major shareholders with a 16.3 per cent stake. The State Treasury held 25.1 per cent and EBRD 23.9 per cent.

In June 1996 AIB EI Ltd purchased 13,763,200 shares from the State Treasury and thus increased its holdings to 36.26 per of equity (while the State Treasury interests declined to 5.1 per cent). In 1997 AIB EI acquired the entire lot held by the EBRD and - since in the meantime it continued to accumulate more stock dealing on the WSE - its holdings increased to 60.2 per cent of equity. The EBRD made a real killing on the support for WBK privatisation - for each share from a block of 14,608,000 shares it acquired for $12.05 million and for the 1,825 thousand new shares it later received in lieu of a cash dividend, just four years later in 1997 AIB paid PLN 13.95. Thus upon exit form this investment EBRD collected $72.97 million, which translates into a profit of 464 per cent made in 4 years.

Now the principal WBK shareholders are: Allied Irish Bank - 60.2 per cent, the State Treasury - 5.1 per cent, and CA Bankverein - 5.05 per cent; its share capital amounts to PLN 86,020,000 and is divided into 68,816,000 (Series A to D) bearer shares with the nominal value of PLN 1.25 each. All the shares are quoted on the Warsaw Stock Exchange.

6.1.2. The Growth of Wielkopolski Bank Kredytowy S.A.

In terms of its asset total, gross value of loans extended and of own funds, all of them reviewed in the ranking of the biggest Polish banks in 1996, WBK ranked 9th, 10th, and 12th respectively; its solvency ratio amounted to 11.9 per cent, ROE - 47.9 per cent (here it came second after PKO BP), and ROA - 5.4 per cent. Among all the Polish commercial banks WBK is third major player (after PKO BP and Pekao S.A.) in the market for retail services. In 1996, WBK shares were among the hottest deals on the WSE, with a surge of 280.4 per cent in its share prices recorded over the 12 month period.

The key strengths of the bank include dynamic growth of lending business, considerable net profit growth rate and a consistently applied deposit/credit ratio policy.

In 1991 and 1992 when the bank and the whole Polish economy struggled with the difficulties of the teething stage of economic transition - manifested primarily in a high inflation rate and a slump in the activity of businesses [31] - few would have ventured to imagine that WBK would have eventually evolved to enjoy such a strong position in the Polish banking sector. Very dynamic growth recorded in 1991 in its asset total (threefold) and in operating income (sixfold) was made possible by the introduction of the principle of positive real interest rates, to which the bank adhered despite a highly inflationary environment. But already as early as in 1991, due to a severe slump in revenues associated with the provision of financial services to the public sector, its asset total declined by 19 per cent; whereas in 1992 a decrease in the nominal operating income occurred and was caused by a drop in demand for expensive credit and by loss of creditworthiness that affected many of the bank's customers. In 1991 the bank registered a 76 per cent decline in net profits, which was followed by a further slump – of 23 per cent – a year later. Yet the principal causes for a continued downward slide in financial performance should be attributed to a combination of two factors. First of all, the requirement to comply with banking regulations and hence establish adequate provisioning for its bad debts. Secondly, the financial performance of the bank was further depressed by the burgeoning size of non-performing assets and a resultant margin squeeze. Therefore in 1992, when the Bank was mandated to establish statutory bad debt provisions, a decrease in the level of own funds occurred. Unlike the other seven banks from the group of „Nine" commercial banks hived off from the NBP, in 1993 neither WBK (nor the Katowice based Bank Slaski) received any restructuring bonds from the State Treasury which could aid their bad debt workout efforts and its competitive position in the market was thus handicapped.

Given a downward trend in financial performance of the Bank, its management implemented a number of measures which were meant to ensure financial recovery and result in adjusting the WBK to play the role of a universal commercial bank. There were two principal thrusts of changes, structured attempts at increasing the share of income-generating assets and reducing portfolio risk – this was to be achieved by an increase in the share of low-risk assets: debt

[31] The rate of inflation in Poland was as follows: 586 per cent in 1990, 70.3 per cent in 1991, 43 per cent in 1992, 35.4 per cent in 1993, 29.5 per cent in 1994, 21.6 per cent in 1995, and 18.5 per cent in 1996. The rate of GDP in Poland was as follows: (11,6) per cent in 1990, (7,6) per cent in 1991, 2,6per cent in 1992, 3.8 per cent in 1993, 5.0 per cent in 1994, 7.0 per cent in 1995, 6.0 per cent in 1996

securities and money market investments. The contribution of improved equity position to success must not be underestimated since the bank decided to issue fresh shares and plough back most of its 1993 profits in the business to increase equity.

Since 1992, the asset total has enjoyed a steady increase with a companion of constant growth in the share of securities in its assets (from 4.6 per cent in 1991 to 22 per cent in 1996). On top of that, the bank managed to stop the growth of its non-performing assets and to boost the share of deposits in liabilities (from 68.6 per cent in 1989 to 73 per cent in 1996), as well as succeeded in reducing the share of dues to financial sector institutions in liabilities (from 22.4 per cent in 1989 to 5 per cent in 1996).

In 1996 the WBK, in concert with the whole country's economy, continued to enjoy growth. The asset total grew by 28.2 per cent, gross profits by 15.5 per cent, net profits by 32.1 per cent, and ROA and ROE were at the levels of 3.6 per cent and 36.6 per cent respectively. The rate at which equity continued to increase was double the inflation rate and amounted to 36.5 per cent. Therefore the bank deservedly earned a record number of awards and distinctions, having won the second place in the most prestigious Polish professional ranking of outstanding banks and being listed in public opinion polls as the best Polish bank.

6.1.3. The Strategic Investor

At the beginning of 1992, under the programme for Institutional Development of the Banking Sector in Poland, WBK signed a "Twinning Agreement" with the Allied Irish Bank, whose key objective was to provide for the transfer of technical and organisational know-how from the Irish partner to its Polish counterpart. The most important benefits derived from the co-operation, which according to the agreement was to last until end of 1995, were as follows: optimisation of IT systems, development of new strategic planning techniques, introduction of new lending policies and implementation of the credit risk diversification principle, centralised MIS for the Head Office and, last but not least, turnaround of the Bank's organisational structure. The conclusion of the twinning programme did not however result in breaking of the links with AIB. Indeed, WBK still continued to benefit from its counterpart's assistance, which in the meantime became its strategic investor.

The Allied Irish Banks Group represents the biggest group of banking and financial companies in Ireland and was established in 1972, following the merger of three Irish banks, all of them with market presence and experience dating back to the nineteenth century. The assets of the group - as of 31 December 1996 - totalled IRŁ 26.1 bln. (PLN 125.2 bln.). In 1996 the Group's financial performance was excellent, its gross profits went up by 13 per cent to IRŁ 412 million and net profits by 13.5 per cent to IRŁ 260 million. Its ROE outperformed the inflation rate by 20 per cent and amounted to 13.5 per cent.

The AIB Group is a conglomerate of three big organisational units that offer a broad range of services targeted at both individual and institutional customers and caters for all the financial needs of 40 per cent of the Irish population using bank services. The Group's strategy over the last 20 years has relied on a consistent diversification in the financial services market and focused on its presence in all the key financial markets. A series of acquisitions - completed between 1983 and 1989 - is an example of the Group's consistent implementations of the second pillar of its corporate mission. Between 1983 and 1989 the Group took over a US regional bank - First Maryland

Bancorp, purchased York Bank & Trust Company (1991) and later, in 1997, acquired Dauphin Deposit Corporation.

At the beginning of 1995 AIB purchased 16.3 per cent of Wielkopolski Bank Kredytowy shares, which was the first ever capital investment of the Group in Central and Eastern Europe. In subsequent years AIB continued to cement its position of the strategic partner and investor in WBK and in June 1996 acquired another 20 per cent of the bank's equity from the State Treasury and later purchased all the WBK shares held by the EBRD; as a result of both deals its share in the bank's equity increased to 60.2 per cent. This was in line with AIB's strategy, as the acquisition of a bank - enabling to reap the benefits of Poland's dynamically growing economy – and offering services to both individual and institutional customers was in perfect concert with the international activities of AIB.

In 1996 two major goals shaped the WBK's operations: a greater emphasis on retail services and establishment of a group of subsidiaries. In 1996, the WBK, which already earned an enviable third position in the retail banking services market, launched a new policy and chose to establish a network of customer service outlets which, albeit small, were to offer a limited "core" range of services and were expected to win the markets on the strength of their number and proximity to the places of customers' residence or work. In 1997 the Bank expects to open 30 such small outlets which are to be located in shopping malls and transport centres and in office developments where its corporate customers reside (in such cases counter access to other members of the public will be ensured).

The expansion of the WBK Group of companies involved a series of deals and began with the purchase of a 87.45 per cent stake in Gliwicki Bank Handlowy S.A., an ailing medium-sized retail bank but with 29 branches which could perfectly supplement WBK's own network in southern Poland. Later, the Group chose to increase its stake in share capital of Polsko-Amerykañski Bank Hipoteczny S.A. up to 49.98 per cent, and purchased a branch of Bydgoski Bank Budownictwa. In addition, the Bank has a 10 per cent stake in the share capital of Commercial Union Towarzystwo Ubezpieczeñ nazycie (Polska) S.A., 33.33 per cent of equity in Auto Leasing S.A., and 49.95 per cent in WBK. In AIB Asset Management S.A. - a company established in April, 1997, and specialising in asset management - AIB has 50 per cent of equity. The Bank also signed an agreement with AIB Investment Managers Ltd in order to establish a Towarzystwo Funduszy Powierniczych (Mutual Funds Association).

Changes in the Bank's strategy outlined above, on the one hand, reflect its response to the process of consolidation of the banking sector in Poland and are a result of the pressure from its strategic investor on the other. From the investor's perspective, attractiveness of investing in the WBK is closely related to the number of branches that give it a greater potential to operate in a country with the population of over 40 million.

Wielkopolski Bank Kredytowy S.A.

Summary of Key Indicators

(all figures in thousands of PLN)

	31.12.93	31.12.94	31.12.95	31.12.96
Total Assets	2 128 889.4	2 942 339.6	4 262 120.2	5 427 500.3
Loans	722 850.7	820 559.9	1 349 958.1	2 168 997.9
Funds received from customers	1 574 441.1	2 318 381.1	2 976 640.3	40 055 964.3
Shareholder's equity	64 000.0	64 000.0	86 020.0	86 020.0
Interest income	361 442.2	544 835.2	682 028.2	803 954.4
Interest expense	253 715.5	318 862.6	407 201.8	474 798.4
Provisions	29 623.3	50 682.7	60 568.9	83 063.4
Net banking profit	164411.1	308 442.0	365 384.9	449 698.7
Income taxes	24 134.1	76 261.2	74 839.6	63 802.0
Gross profit	59 141.9	138 745.0	190 601.4	220 729.4
Net profit	32 156.5	62 483.8	115 761.8	156 927.4
Number of branches	54	60	61	64
Number of employees	3 803	3 912	4 108	4 415
Solvency ratio	9.3%	10.6%	14.5%	11.9%
Return on Assets (ROA)	1.5%	2.5%	3.2%	5.4%
Return on Equity (ROE)	50.2%	57.8%	58.5%	47.9%
Earning per Share	0.7	1.1	1.7	2.3
Price-Earnings Ratio	27.0	6.3	3.6	8.7
Price-to-Book Value Ratio	2.7	2.4	1.0	2.7
Market Capitalisation to Sales	-	0.8	0.6	1.7
Return on Investment	602.6	-45.9	-23.9	280.4
Share price				
Trough	12.5	24.8	7.5	20.0
Peak	4.0	4.9	4.1	5.2

6.2. BankGdanski S.A. - through acquisitions to consolidation

Consolidation through acquisitions - these two words can aptly describe the process of the Bank Gdañski privatisation which lasted from 1995 to 1997.

Bank Gdañski is, in terms of its asset total, the tenth largest bank in Poland and ranks eighth with respect to the size of its own funds. The history of the Bank dates back to 1989 when it was hived off from the NBP and endowed with its 42 regional offices and 4 branches. In 1991 it was transformed into a wholly owned joint stock company of the State Treasury. As one of the nine commercial banks spun off from the pre-1989 NBP structures in 1993 it received PLZ 1,160 trln. worth of restructuring bonds participated in the restructuring program, concluded 13 bank-led conciliations involving large SOE debtors which permitted a release of 33 per cent of bad debt provisions.

Bank Gdañski is an universal commercial bank offering financial services to businesses and individuals. The Bank's strengths include a share of deposits in the balance sheet total which is higher than in other universal banks, good quality of loan portfolio, and steadily increasing, in real terms, financial result on banking operations. The weaknesses of Bank Gdañski include a low share of loans in the asset total (loans account for 28 per cent of assets, while securities have a 38 per cent share) and relatively poor financial ratio, when compared with other universal banks; this to a large extent stems from the conservative lending policies operated in the Bank and, as a consequence, a high level of provisions depresses the bank's performance measured by a number of indicators.

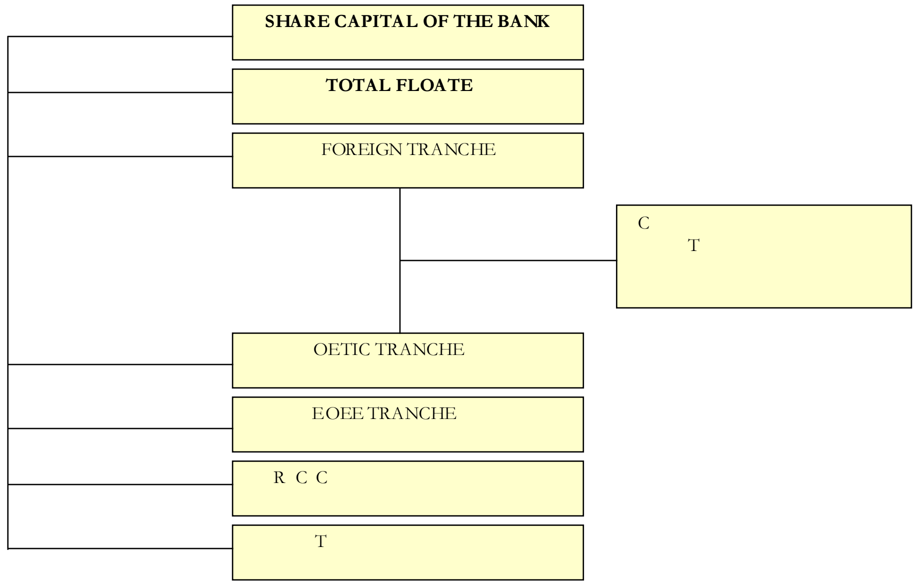
At the end of 1994 Bank Gdañski, as the fourth bank from the "Nine", was slated for privatisation (whereby it followed the examples of the Wielkopolski Bank Kredytowy S.A., Bank Slaski S.A. and Bank Przemystowo-Handlowy S.A). British consultants, Samuel Montagu, were retained as advisers to the issuer.

Bank Gdañski managed to outpace another commercial bank (PBK) on its path to the privatisation block by presenting an interesting privatisation concept envisaging the sale of a portion of its shares in the foreign markets.

The total of 19,612,00 ordinary bearer shares with the nominal value of PLN 2.5 each were admitted to public trading, of which 16,827,096 were floated. Shares were made available in three tranches: for domestic investors, foreign persons and corporates, and for employees.

The mechanics of Bank Gdañski offering is illustrated in the chart below:

The mechanics of Bank Gdanski offering:



During the special session of the WSE on 9 December 1995 the State Treasury sold all the domestic tranche shares at PLN 42 each to 21,768 investors, and given excess of demand over supply allotments were reduced by 18 per cent; in order to balance the market the Treasury exercised its claw-back option and reallocated 527,518 shares from the foreign to the domestic investors tranche. In the aggregate all the shares sold to domestic persons accounted for 35.6 per cent of the issuer's share capital. The success of the issue was ensured by a number of large placements, whereby Bank Inicjatyw Gospodarczych and its subsidiaries – mainly Bel Leasing S.A. and Forin – acquired the total 67 per cent of all domestic tranche shares available, seizing 24.07 per cent of Bank Gdañski equity. The sale of shares to bank employees ended in February 1992; in total, its staff acquired 2 per cent of their employer's shares from the State Treasury.

The privatisation of Bank Gdañski was the first ever floatation in Poland to involve Global Depository Receipts (GDRs) which were offered to foreign investors. In accordance with an agreement concluded beforehand, the Bank of New York bought 4.8 million shares from the foreign tranche from the State Treasury and thereafter in lieu of shares, which were in its custody, issued GDRs. Shares – traded as GDRs and priced at par with issue price for domestic investors in Poland – were purchased on behalf of their customers by seven investment funds, including the likes of HSCB Investment Bank, Daiwa Europe (the underwriter of the issue), Creditanstalt Securities, Morgan Grenfell and the First Bank Corporation.

On 19 December 1995 Bank Gdañski was the first ever Polish company to make a début on the London Stock Exchange and its shares - traded within the system of the so called continuos quotations - fetched a price close to their original issue price. Legally speaking, foreign tranche Bank Gdañski shares are owned by the Bank of New York which at the AGM acts as proxy of their actual owners (under Polish law one shareholder cannot vote differently on any issue on the agenda by way of splitting rights attached to the shares he holds, therefore the manner in which BNY votes is a net result of the "tug of war" of conflicting votes contained in the proxies submitted by individual GDR holders - who are in essence owners of the underlying shares. In practice, therefore, BNY - having collected instructions on how to vote from GDR holders and scrutinised the votes supporting each of the optional decisions that may be made on the given issue on the agenda - proceeds to vote on behalf of those of the investors who had a majority in support of a specific option). Bank Gdañski's shares had their Warsaw Stock Exchange debut on 22 December 1995 and were traded at a price close to the public offering and GDR price in London.

By virtue of the agreement concluded - at the time of the Bank's privatisation - between the State Treasury and HSBC Investment Bank, underwriter of the GDR issue, the Treasury committed not to dispose of its shares - equal to 39.94 per cent of the bank's equity - within twelve months from the issue of the Global Depository Receipts.

The Bank Inicjatyw Gospodarczych S.A. - the strategic investor in Bank Gdañski S.A. - was established in 1989 by individuals and a number of corporates, mainly from the insurance sector. Given the sheer size of its own funds - totalling a mere PLN 302 million at the end of 1996 - BIG S.A. cannot directly compete with the biggest Polish banks. Therefore it has consistently strived to become a leader in a number of market niches and has already developed a wide range of investment-capital type services. BIG S.A. has also successfully expanded its capital market activities handled by its "in-house" brokerage office "Dom Maklerski BIG S.A." and has established a permanent and active presence on the wholesale capital markets, both domestically and abroad. In recognition of those successes, in 1993 *The Central European Magazine* awarded the title of the "Best Bank in Central and Eastern Europe" to BIG, and *Euromoney* was only slightly less enthusiastic and called the Warsaw bank "The Best Bank in Poland".

BIG S.A. established several subsidiaries to implement the above mentioned goals and support its activities in the financial sector. The most important of them are: BIG Bank, BEL Leasing S.A. (in respect of size of operations fourth provider of fixed asset lease services in Poland), Forin S.A. (a company active in the field of securities portfolio and asset management), Dom Maklerski S.A (the Bank's, formerly in-house, securities brokerage operation), Polcard sp.z o.o. (handling credit card settlements). The subsidiary companies of BIG S.A. also act as vehicles through which the parent company makes its investments. When Bank Gdañski shares were offered, BIG S.A. on its own could not acquire the 24 per cent of the issuer's equity owing to the restrictions spelled out in the Issue Prospectus (any single investor could not acquire more than 10 per cent of share capital) and the statutory threshold - of 25 per cent - applying to capital exposure. That is why BIG S.A. and its subsidiaries pooled their resources and in addition to 7.94 per cent of Bank Gdañski equity acquired by BIG S.A itself, BEL Leasing bought another 7.94 per cent and Forin S.A. purchased 6.38 per cent. The shares of BIG S.A. have been listed on the WSE since 1992.

A consistent implementation of the strategy focused on the emergence of a strong group of banks and financial institutions - called Grupa Banku Inicjatyw Gospodarczych - and was also reflected in the increase in its stake in Bank Gdañski - to 31.23 per cent of equity in 1996. When the agreement between HSBC Investment and the State Treasury expired in January 1997 and the Minister of the Economy put the lot out for tender (totalling 34.94 per cent of the Gdañsk bank equity) the BIG Group quickly seized the opportunity and, as the only bidder, obtained the consent of the NBP to effect investment from own resources not exceeding 50 per cent of BIG Bank's own funds.

On 24 February 1997 the BIG S.A. – in consortium with its subsidiaries – bought 31.92 per cent of Gdañsk shares from the Treasury, paying PLN 40 for each share (then traded at PLN 47 on the WSE). Following the completion of this deal, BIG S.A. and its subsidiaries had 63.43 per cent of votes at the AGM, of which: BIG Bank had 19.72 per cent, BEL Leasing 19.9 per cent, Forin S.A.

10.33 per cent, and Forinvest S.A. 9.65 per cent. As a result of this transaction the biggest ever merger in the Polish banking sector was finalised.

Now the equity of Bank Gdanski is split among the following shareholders:

- 63.42 per cent - the BIG Group
- 19.46 per cent -the Bank of New York
- 7.52 per cent - the State Treasury
- 9.60 per cent - other shareholders

On 22 May 1997 the Boards of Directors of Bank Inicjatyw Gospodarczych S.A. and Bank Gdañski signed an agreement about the merger of the two banks. A day later, on 23 May 1997, the deal was approved by the Councils of the two Banks and thus the process, leading to the eventual merger of BIG S.A. and BG S.A. into a single new economic organism, could formally begin. The new company, named BIG Bank Gdañski, will formally come into being in September this year, although the actual merger-related processes will have continued much beyond the incorporation date. Following the merger with Bank Gdañski S.A. the Bank Inicjatyw Gospodarczych will become one of the biggest Polish banks. When aggregated, the funds of both banks amounted to approximately PLN 0.89 bln. (as at the end of 1996) and the balance-sheet total was PLN 8.19 bln.. The new entity thus enjoys fifth and the seventh position in the Polish banking sector (as measured by the respective indicators reviewed above). The assets of the new bank will account for a little less than four per cent of the aggregated asset total for the sector and the two networks, when combined, translate into a branch system fifth in size in Poland.

The merger will be effected through the transfer of all the assets of BG S.A. to BIG S.A. whereupon BIG will transfer its shares to the shareholders of the acquired company. For every BG S.A share held its owner will receive 10 BIG S.A. shares in September 1997, all of them from an issue dedicated to the merger deal. In order not to contravene the provisions of the Commercial Code forbidding any joint stock company to acquire its shares, in June of this year – after the AGM adopted all the merger-related resolutions - BIG S.A. implemented measures targeted at transferring all the BG S.A. shares it legally owns to other members of the Group.

The origins of any merger decision can be traced back to a comprehensive analysis of key challenges posed by the intended deal and to a review of key similarities of the acquirer and the investee company. Each merger is after all the reflection of a necessity to improve the cost structure and stems from the will to expand and strengthen market presence by the creation of a new entity. Likewise, in this case the differences between the two banks, when an in-depth review is undertaken, in many aspects emerge as indeed complementary. Bank Gdanski S.A. is a universal retail bank and its market presence is in practice confined to northern Poland, whereas BIG S.A. is a wholesale bank with a nation-wide market penetration. The loan portfolios of the two banks pivot on borrowers from entirely different sectors.

The main objective of the new bank will be to cater for the needs of small savers and the SME sector. Given such a mission BIG Bank Gdañski plans to enlarge the network of jointly operated customer service outlets to 400 in the year 2000, which is to be achieved primarily through the split of the existing large service centres into a number of smaller ones, each of which will be dedicated to services targeted at a different market segment. Such a growth will also be made possible by the introduction of a new IT system. The merger should bring about savings in the order of PLN 80 to PLN100 million per annum, available to the Bank commencing from 1999, when the savings and the costs of effecting the merger will have been more or less offset.

The President of BIG S.A., Mr Bogustaw Kott, who in 1996 was awarded the title of the Banker of the Year by the Union of Banks in Poland, says "in the future growth of the banking system sector our focus will be on the retail sector. Our objective is to continue growth and stay among the top five Polish financial institutions" and concludes "this will crown the most important stage of my bank's transformation and I do not perceive any need to seek a strategic investor in the future, although small scale ventures with foreign partners cannot be ruled out."

Bank Gdañski SA.

Summary of Key Indicators

(all figures in thousands of PLN)

	31.12.93	31.12.94	31.12.95	31.12.96
Total Assets	2 368 249.0	2 857 024.0	3 987 149.5	5 427 500.3
Loans	495 889.0	503 716.0	1 048 018.3	1 776 354.7
Funds received from customers	1 404 773.0	1 855 482.0	2 521 254.8	3 255 269.7
Shareholder's equity	49 030.0	49 030.0	49 030.0	49 030.0
Interest income	477 432.0	579 699.0	658 588.3	740 109.7
Interest expense	323 339.0	375 446.0	367 232.8	433 052.5
Provisions	27 259.0	42 920.0	52 102.5	77 119.0
Net banking profit	198419	255 065.0	354 119.4	400 925.4
Income taxes	42 254.0	31 204.0	82 993.0	63 859.3
Gross profit	110 459.0	144 221.0	173 894.2	165 069.1
Net profit	59 288.0	111 869.0	90 901.2	101 209.8
Number of branches	49	56	58	58
Number of employees	3 477	4 022	4 495	4 690
Solvency ratio	34.1%	34.3%	17.0%	24.7%
Return on Assets (ROA)	2.5%	4.1%	3.1%	3.6%
Return on Equity (ROE)	38.6%	34.4%	23.2%	20.2%
Earning per Share	3.0	5.7	4.6	5.2
Price-Earnings Ratio	-	-	3.9	9.7
Price-to-Book Value Ratio	-	-	0.8	1.2
Market Capitalisation to Sales	-	-	-	1.0
Return on Investment	-	-	-4.2	62.2
Share price				
Peak	-	-	24.7	46.5
Trough	-	-	22.3	23.0

6.3. Bank Handlowy - the success of a self-managed pro-active privatisation concept

"I have always dreamed for Bank Handlowy to become a Polish JP Morgan", said Cezary Styputowski, the president of the Board of Directors of Bank Handlowy S.A., the oldest and biggest commercial bank in Poland in December 1995. Eighteen months later he had indeed many reasons to rejoice. His bank had evolved into the biggest bank listed on the Warsaw Stock

Exchange - a giant looming over the Exchange. Bank Handlowy, with the book value of PLN 2.2 bln. against 80 plus other listed companies with a mediocre PLN 14.4 bln. of the aggregated book value. Yet, in its original five-year strategic plan which the Bank adopted in 1992, privatisation was not to be found among the organisation's priorities. Now the President quotes several arguments to support the need for privatisation, such as: flexible access to capital market resources in an increasingly competitive environment and to cheaper finance available in the international financial markets. In the President's opinion, provided that strong shareholding groups emerge, the Bank will be capable of participating in privatisation sales of other SOEs, as the State Treasury will no longer exercise any control over the Bank. Even before the Bank was admitted to public trading, market analysts were in agreement and in concert highlighted the Bank's strengths: a steady growth, strong capital position, and a good and stable management team. These opinions seem to be confirmed by the bank's profile in foreign markets, in 1996 its investment rating was BAA3, whereas its financial strength earned a D++; indeed the best ratings any bank from Eastern and Central Europe has ever received.

Bank Handlowy w Warszawie is the biggest commercial bank in Poland with respect to the size of own funds. Its history dates back to 1870 when it was established as a private joint stock company, since then it developed its operations and - following significant growth achieved in the 1920s - in 1939, before the outbreak of the war, was the largest private commercial bank in Poland, with a nation-wide market presence and an extensive branch network.

Since 1945 - as part of the mass nationalisation programme affecting the whole economy - the State Treasury had gradually assumed the control over the bank and in 1966 it already held 100 per cent of its stock. This gradual change of the Bank's ownership was also reflected in the companion changes to the scope of its activities, which was consistently administratively reduced until eventually - in 1963 - Handlowy's role was limited to a simple provision of payment settlement related services for the needs of state-owned foreign trade offices. Soon thereafter the bank was forced to close down all of its branches. The 1970s and 80s witnessed a significant deterioration in the bank's financial position. In those days Bank Handlowy was made to finance burgeoning imports of consumer goods to meet the needs of an insatiable and imbalanced market and provide finance for giant investment projects of the communist government – whereas the volume of the country's exports continued to stagnate and the costs of foreign debt servicing continued to soar. This decline continued to exacerbate until 1981 when finally Poland's crisis in the balance of payments became so acute that the Bank was forced to temporarily suspend debt related payments and enter into negotiations on foreign debt rescheduling. Following negotiations with the London Club and the governments of the Western creditor countries and thanks to the Bank's own proactive measures, financial standing had finally started to improve toward the end of the 1980s.

Since 1990 the bank restored its "proper" banking business and extended its market offer to include general banking services targeted at businesses and commenced its investment banking activities. In addition, Bank Handlowy continued to actively market its services in order to extend its share in the growing business markets; initially it focused on large private corporates and SOEs and later went on to penetrate the SME sector. The President of the Bank is committed to the principle "nobody is capable of doing everything well enough so it is wise to focus on one's strengths." In keeping with this motto the Bank chose to focus on one market segment only – large and medium sized businesses. At present over 12 thousand Polish enterprises bank with it – including 300 companies from the Polish "Top 500". This secures Bank Handlowy a share of 8.9 per cent share in the total of loans extended by the Polish banking sector to businesses. The current strategy of the Bank does not envisage any heavy penetration of the retail sector and indeed lending to such customers accounts for a mere one per cent of Bank Handlowy's portfolio. The Bank's activity in the field of investment banking is quite noteworthy, as it directly acquires shares of ailing companies, administers restructuring measures required and a sound business is then sold at a profit. The Bank also operates an in-house securities brokerage – Centrum Operacji Kapitatowych – whose share in business transacted on the Warsaw Stock Exchange makes it the largest brokerage house in Poland.

At the end of 1996 the Bank had the largest gross own funds in the Polish banking sector - with a 11.2 per cent share in the sector's total. The value of its asset total accounts for 5.8 per cent of the sector's total (here the bank comes third after Pekao S.A. and PKO BP, this so called Big Three jointly holds 33 per cent of assets). Handlowy's share in the net lending business of the sector and in its deposit taking activity was 6.1 per cent and 3.1 per cent respectively. The Bank also enjoys supremacy in the Polish market for foreign trade financing and settlements - with the share of 27 per cent. In 1996 - thanks to the performance of its Centrum Operacji Kapitatowych - Handlowy also maintained its status as the biggest intermediary in business transacted on the Warsaw Stock Exchange and ranked first with respect to its share in the total business volume on all the WSE markets: 15.2 per cent share in the equities market, 16.7 per cent in the bond market and 11.9 per cent in the volume of new share floatations. In addition to its might represented by the share in the market for banking services, Handlowy also scores high with respect to its effectiveness. The record high net financial result totalling PLN 555.5 million generated in 1996 - when benchmarked against the average level of own funds - yields a ROE figure of 33 per cent. For the last three years Handlowy has continued to pay out fat dividends and still managed to enjoy a commendable growth rate with respect to own funds, while its solvency ratio has stayed in the region of 16.5 per cent.

Last year, 1996, was good for the Bank. Its balance-sheet total grew by 51.2 per cent and the volume of lending business went up by 45 per cent. Handlowy's loan portfolio is fundamentally sound – the share of non-performing loans decreased and now accounts for 12 per cent of its gross value (a year before as much as 23.4 per cent). It should also be noted that facilities in default and those serviced in irregular intervals accounted for 7 per cent of the bank's loan portfolio. In addition, the industry background of the Bank's borrowers is fairly diverse and so is the structure of its loan portfolio – lending to any sector is never in excess of 10 per cent of the aggregate loan portfolio. When Handlowy's income statement is examined, a steady growth in commission income is immediately visible. Net commission income in 1996 increased by 34 per cent against previous year's figures, while with respect to the net interest income a slight decrease of 1.3 per cent was recorded. Following the improvements in quality of loans and other assets, the Bank was free to release many provisions it previously established - this alone was the major driver of a significant increase in net profits - by 30.7 per cent.

In the programme of banking sector privatisation and consolidation - adopted by Poland's government in 1995 - the role of one of the key architects and at the same time actor in the process of administratively imposed consolidation was assigned to Bank Handlowy. Consolidation as such meant that Handlowy might need to wait long for privatisation. The reality was however different. President C. Styputkowski won on the strength of his vision of the bank's development, personal endurance and agility in overcoming objective set-backs and Bank Handlowy eventually managed to get out of the "consolidation incubator" by the back door. Its quick privatisation surprised the experts and the public offering of the Bank's shares was the feat of 1997 on the WSE.

The Bank's privatisation was meant to meet three objectives: increase the competitive edge of Handlowy over other players in the sector, boost the privatisation sale proceeds for the State

Treasury and increase the total capitalisation of the Warsaw Stock Exchange and thus further strengthen its position in Central and Eastern Europe.

Following the appointment of the adviser, Schroders, time was ripe to crystallise the privatisation strategy for Handlowy. Preservation of the Bank's "Polishness" was viewed as a priority, since if acquired by a major strategic investor, Handlowy would be reduced to but a branch of a multinational giant, which, in the opinion of the State Treasury and the Bank itself, was not desirable. Nor was a total dilution of ownership, as this could make Handlowy a bank without a real owner. Therefore identification of a group of major and stable investors was considered an optimum solution to the problem of bank's ownership. The emergence of such a strong lobby of committed owners would in actual fact even increase the Bank's value. Committed investors, in addition to pro-actively shaping the Bank's strategy, would ensure the diversification of the Bank's market offer and take care of its needs in the field of new banking technologies. Last but not least, in such a set-up of corporate governance the Bank would retain its identity and heritage becoming the oldest financial institution of the country.

In June 1997, the State Treasury floated 65,000,000 Bank Handlowy shares with the nominal value of PLN 4 each on the market. They were sold in the following tranches: Individual Investors Tranche (15 per cent of shares), Institutional Investors Tranche (30 per cent of shares, although the State Treasury reserved the right to claw back up to 7.5 per cent of shares to the Individual Investors Tranche), Stable Investors Tranche (42.86 per cent of shares and here again the State Treasury reserved the right to claw back up to 14 per cent of shares to the Individual Investors Tranche) and finally the Employees Tranche (7.14 per cent of shares).

The shares to be retained by the State Treasury, totalling 5 per cent of the Bank's equity, and constituting a contingency reserve for future re-privatisation claims were also admitted to public trading. In addition the State Treasury acquired the entire issue of PLN 112 million worth of zero-interest convertible bonds which upon conversion into stock ensure a share of approximately 30 per cent in the increased equity of the issuer. Those CBs were structured in such a way that they gave bondholders the same rights as those enjoyed by equity holders, save for voting rights. The government expects to use the State Treasury's shares of Bank Handlowy to support its reform of the pension system. Another important benefit which the government derived from the privatisation of Handlowy translates into approximately US$200 million which could be released from The Banks Privatisation Fund and used to repay interest accrued on restructuring bonds, as by privatising Handlowy the government was in keeping with the agreement made with donors of the Zloty Stabilisation Fund (part of which was used to set up Banks Privatisation Fund) and was in position to use up some of the money.

In keeping with the government's intentions, the major chunk of floated shares was offered to the so-called Stable Investors, which by definition were to be chosen from among reputable financial institutions. JP Morgan - the biggest American investment bank managing investments worth in excess of US$200 bln. - was among them and finally acquired a 14.8 per cent share in Handlowy's equity. In 1995, JP Morgan was the issuing agent placing the issue of Polish five-year Eurobonds, as well as was Handlowy's agent when it launched two issues of its own Eurobonds - in 1996 and 1997. The other Stable Investors included: Sparbanken (Swedbank), a Swedish retail bank, third in size in its local market, which acquired 5 per cent of Handlowy's shares; and Zurich Group, a Swiss insurance group with operations in over 50 countries and co-owner of over 250 insurance companies, including Zurich Ubezpieczenia Service sp. z o.o - to the Swiss 6.2 per cent of Handlowy's equity was allotted. After negotiations the sale price for stable investors was fixed at PLN 31.40 per share and payable in two instalments: PLN 20 per share due upon closing of the issue and the remaining PLN 11.40 due three years thereafter. In addition, stable investors were committed to pay - after three years since the closing of the issue but not later than 4 years thereafter - the amount equal to 10 per cent of the excess of stock carrying market price over the selling price they originally paid. Upon acquisition of shares the Stable Investors agreed and were contractually mandated not to sell their shares within 18 months since the closing of the issue, also for a period of another 18 months their transfer was subject to a number of stringent restrictions. The representatives of the stable investors in their statements published in *Financial Times* emphasised that the investment in Bank Handlowy is indeed sound given the growth potential of the Polish market. Those investors are to choose nominees for three - out of the total of twelve - members of the Supervisory Council (Board) of the Bank.

Individual investors were the most courted targets of Bank Handlowy's offer. To boost their interest in shares a special system of incentives - the most comprehensive ever in Poland - was devised. Those incentives were to a certain extend fashioned after the methods used in last year's privatisation of Deutsche Telekom and covered free bonus shares, rebates and preferential treatment with respect to share allotments; all of them - when combined - meant that private investors could pay approximately 9-10 per cent less for their shares than the institutional investors.

The public offering of Bank Handlowy shares was indeed a spectacular success. In the tranche for individual investors the number of shares subscribed for by the public was three times the available allotment, even despite the injection of 9.1 million extra shares from the Stable Investors Tranche. The issue's appeal to institutional investors was even higher – here the volume of orders received was 17 times the total available supply of stock.

It is also noteworthy that among subscription orders placed by the institutional investors, those lodged by the domestic entities accounted for less than 2 per cent of the total. Among foreign investors, investment and pension funds were in the majority. Given such big demand a decision was made to prefer domestic investors and the issue of GDRs was reduced from 40 per cent to 20 per cent of the tranche for institutional investors. Due to such a high demand the price of one share was fixed at the level of PLN 35 - the maximum in the price bracket fixed for individual and institutional investors. Such a price was translated into sale proceeds of over PLN 1.3 bln. to the Treasury (total bank privatisation revenues projected in the country's budget bill for 1997 amounted to PLN 1.45 bln. and rested on the government's plans which at the time when the budget was drafted did not envisage the privatisation of Bank Handlowy).

Handlowy's shares made their debut on the Warsaw Stock Exchange on 30 June 1997 and were traded at PLN 37.9; during the first day of trading PLN 55.8 worth of the bank's shares changed hands (this volume of trading being 40 per cent of the entire business transacted on the Exchange on that day). The price was 8.3 per cent above the issue price, which accounting for incentives available for individual investors meant a profit of 13.8 per cent.

After the public offering the following composition of Bank Handlowy's equity ownership emerged:

- Stable investors 28.86 per cent
- Institutional investors 30.00 per cent
- Individual investors 29.00 per cent

- The State Treasury 5.00 per cent
- Employees 7.41 per cent

The public offering being over, the Bank is now facing even greater challenges. Jointly with its stable investors it must define its future and develop its corporate strategy for the new millennium. It still however remains to be seen whether Bank Handlowy will eventually become a Polish J. P. Morgan.

Bank Handlowy S.A.

Summary of Key Indicators

(all figures in thousands of PLN)

	31.12.93	31.12.94	31.12.95	31.12.96
Total Assets	7 186 066.1	8 392 339.1	9 930 656.7	14 676 148.6
Loans	2 367 067.3	3 059 619.9	4 373 782.1	5 914 260.5
Funds received from customers	2 001 383.9	3 165 344.8	3 543 967.4	4 030 232.5
Shareholder's equity	260 000.0	260 000.0	260 000.0	260 000.0
Interest income	1 170 159.8	964 086.4	1 276 818.0	1 443 494.5
Interest expense	379 291.4	451 313.5	598 599.3	773 759.1
Provisions	99 711.6	120 173.2	116 199.9	137 197.1
Net banking profit	643 269.1	943 010.0	1 188 385.4	1 076 615.4
Income taxes	489 037.8	280 129.2	311 235.2	216 603.3
Gross profit	654 985.8	515 737.6	731 852.7	747 023.6
Net profit	165 948.0	232 419.8	420 617.4	530 420.3
Number of branches	25	31	38	50
Number of employees	3 577	4 005	4 206	4 300
Liquidity ratio	15.3%	15.2%	17.4%	16.5%
Return on A*ssets (ROA)*	2.2%	3.0%	4.6%	7.4%
Return on Equity (ROE)	19.4%	21.5%	30.6%	33.3%