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**Article**

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*Suggested Citation:* Hampel, Erich (2002) : Successful banking in an enlarged EU, EIB Papers, ISSN 0257-7755, European Investment Bank (EIB), Luxembourg, Vol. 7, Iss. 1, pp. 109-115

This Version is available at:

<https://hdl.handle.net/10419/44816>

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# Successful banking in an enlarged EU



**Erich Hampel**

## 1. Introduction

From the single-tiered banking system of the late 1980s, still ruled by the communist party, Eastern Europe's financial system has evolved towards one which EU countries have long been accustomed to. Central and Eastern European Countries (CEEC) are now on the brink of EU membership, and accession to the European Union requires the implementation of the *acquis communautaire*, the set of laws that underpin the common market. As a result of adapting to the *acquis*, the CEEC financial systems have already been transformed to such an extent that the supervisory and legal framework has more or less reached EU standards.

Other papers in this volume describe how the size and sophistication of the financial system in the CEECs has evolved over the past ten years, and how it remains underdeveloped today. Complementing these papers, this paper presents the mid-term strategy of a commercial bank that has established a strong presence in the region.

In the next section, I will discuss the growth scenarios for the banking sector in the CEECs. Following ten years of far-reaching reforms, it is clear that the region constitutes an extremely promising market on our doorstep. In Section 3, I will explain our strategy, and how we at the Bank Austria/Creditanstalt/HypoVereinsbank (1) group are going about exploiting these opportunities. In particular, the view that Central and Eastern Europe, our second core market has motivated the expansion of our banking group for more than a decade (2). In Section 4, I will briefly summarise our achievements to date and where we are positioned vis-à-vis our competitors. Section 5 concludes the paper with a summary of how we assess the banking market in the region.

## 2. The growth potential of Central and Eastern European banking markets

It is fair to say that the financial services sector in Eastern Europe is still largely under-developed, despite the considerable progress that has been achieved in the past ten years. The enormous supply gap is evident in the degree of monetisation, which is clearly lagging behind the EU standard. Money in circulation plus deposits in the CEECs (i.e. M2) as a percentage of GDP is roughly equal to two-thirds the level seen in the EU. Bank intermediation, as measured by the standard indicator of bank claims on the domestic sector as a percentage of GDP, is even lagging behind to a greater extent. As Riess *et al.*, document in this volume, bank claims in percent of GDP amount to roughly one third of the corresponding EU measure.

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*Erich Hampel is a member of the managing board of Bank Austria and Chairman of the managing board of Creditanstalt.*

*1) In 1997, Bank Austria acquired full ownership over the Austrian bank Creditanstalt. The group Bank Austria/Creditanstalt and the German HypoVereinsbank merged in autumn 2000. Within HVB Group, Bank Austria is responsible for Central and Eastern Europe. Erich Hampel is the responsible board member.*

*2) In the late 1980s, even before the collapse of communism, Creditanstalt was already present in Hungary, where the bank conducted, among other activities, offshore banking business. In the early 1990s, we were among the first banks to be established in the Czech Republic, and we were the first western bank in Slovenia. We also received the first full bank licence to operate in the Russian market.*

This low aggregate measure of bank intermediation is reflected in low credit supply and a low level of customer deposits. In more detail, loans in percent of GDP stand at around 14 percent in South-East Europe, about 40 percent in the Czech Republic, Slovenia and Croatia, and at 30 percent on average in the CEECs. This compares to a ratio of over 100 percent in the euro zone. The situation is similar in the case of deposits: in the CEECs they amount to some 43 percent of GDP, while the comparable figure for the euro zone is 85 percent. In individual CEECs, the share ranges from 20 percent in Romania to about 70 percent in the Czech Republic and Slovakia.

**There is a considerable growth potential for banking in Central and Eastern Europe.**

The underdeveloped nature of banking in the CEECs coupled with strong economic growth prospects implies a banking growth potential that is unimaginable for the over-banked and low-margin banking market in the euro zone. And growth potentials also exist in other segments of the financial market. For example, the stock market capitalisation for the whole of Central and Eastern Europe amounts to no more than the stock market capitalisation in Ireland. The combined annual turnover on the stock exchanges in Prague, Budapest and Warsaw equals the turnover registered on the Frankfurt stock market on ten trading days. CEEC bond markets, which are dominated by government bonds, are equivalent to 5 to 20 percent of GDP; this compares to a figure of approximately 50 percent in the euro zone.

**Table 1.** Indicators of the current state of development of the financial sector, in % of GDP

	euro zone = 100
Loans	28
Deposits	50
Market capitalisation	21
Government bonds	37

Table 1 provides an overview of where the CEEC financial sectors stand at the moment in comparison to their EU counterparts (figures in Table 1 are presented in percent of the euro zone average). This Table clearly reveals that the use of external finance sources, such as bank loans, bonds, and stocks - is relatively limited. Corporates in particular must use other means to finance their investment projects. Smaller firms are likely to rely more heavily on retained earnings. However, larger firms, and especially blue-chip companies, also tap financing sources outside the region.

Looking into the future, the growth potential for deposits and, in particular, for new loans is higher than that for total assets. This is due to improved regulations for corporate governance, and to better ways and means of dealing with old problem loans. As a result, deposits and loans will experience a surge in volume by 2005. Table 2 shows that we expect growth rates of 69 and 85 percent in these sectors between 2000 and 2005.

**Table 2.** Forecast development of the CEEC banking market, bn EUR

	2000	2005	Change	
Total assets	291	471	+180	+62%
Loans	124	229	+105	+85%
Deposits	168	281	+113	+69%

Table 3 presents financial sector developments in individual CEECs from another angle - the degree to which banking products are currently used. In Germany and Austria, broadly speaking, between 90 and 100 percent of the population aged over 15 years have an account with a bank. In Eastern Europe the use of bank accounts is less widespread although striking differences exist between the accession countries. The comparable figure for Slovenia is close to 80 percent, which is not much below the level in Austria. The middle range of 45 to 65 percent comprises the Czech Republic, Croatia, Hungary and Slovakia. At the low end we find Poland - the largest applicant country - where the share is as low as 34 percent, and Bulgaria and Romania where even less than 10 percent of the population have opened a bank account. Other examples of retail banking products that, in a number of countries, seem to be under-supplied include bankcards, savings books, time deposits, mortgages, loans and securities. This shows that the region offers a huge business potential for a universal bank, once the economic catching-up process has got under way.

Against this background, it is hardly surprising that CEEC financial markets have become a prime target for the international, especially EU, banking community. Towards the mid-1990s, CEEC governments stepped up the privatisation process in their banking industries. Furthermore, some countries opened up their banking markets to foreign "greenfield" operations. As a result, in most economies of the region banking business has become a domain of foreign banks. Except for Croatia, Romania and Slovenia, the banking market is firmly in foreign hands (see Figure 1). It is worth noting, however, that in countries such as Slovakia the dominance of foreign banks is only a very recent phenomenon.

**Central and Eastern Europe has become a prime target for the international banking community.**

**Table 3.** Use of banking products in 2000

Product	% of total population over 15 years who use this product									
	A	D	BG	CRO	CZ	H	PL	RO	SK	SLO
Account (any)	89	97	6	60	64	46	34	8	55	79
Bank card	57	n.a.	n.a.	30	49	35	21	3	36	57
Savings books	68	n.a.	10	45	38	16	13	13	58	53
Time deposits	29	n.a.	11	4	12	8	6	21	14	15
Mortgages	56	30	0	1	20	2	0	0	15	3
Loans	18	22	3	10	7	7	14	4	6	17
Securities	15	n.a.	0	n.a.	3	4	n.a.	2	4	7

Note: A=Austria, D=Germany, BG=Bulgaria, CRO=Croatia, CZ=Czech Republic, H=Hungary, PL=Poland, RO=Romania, SK=Slovakia, SLO=Slovenia.

Foreign ownership can make a positive contribution to the transformation of the CEEC banking sectors by more than just making capital available. Employees are also often offered training to become familiar with modern banking techniques. To stress the importance of Western knowledge in banking, in one of the smaller CEECs it was decided that the governor of the central bank must be a foreigner for a certain initial period.

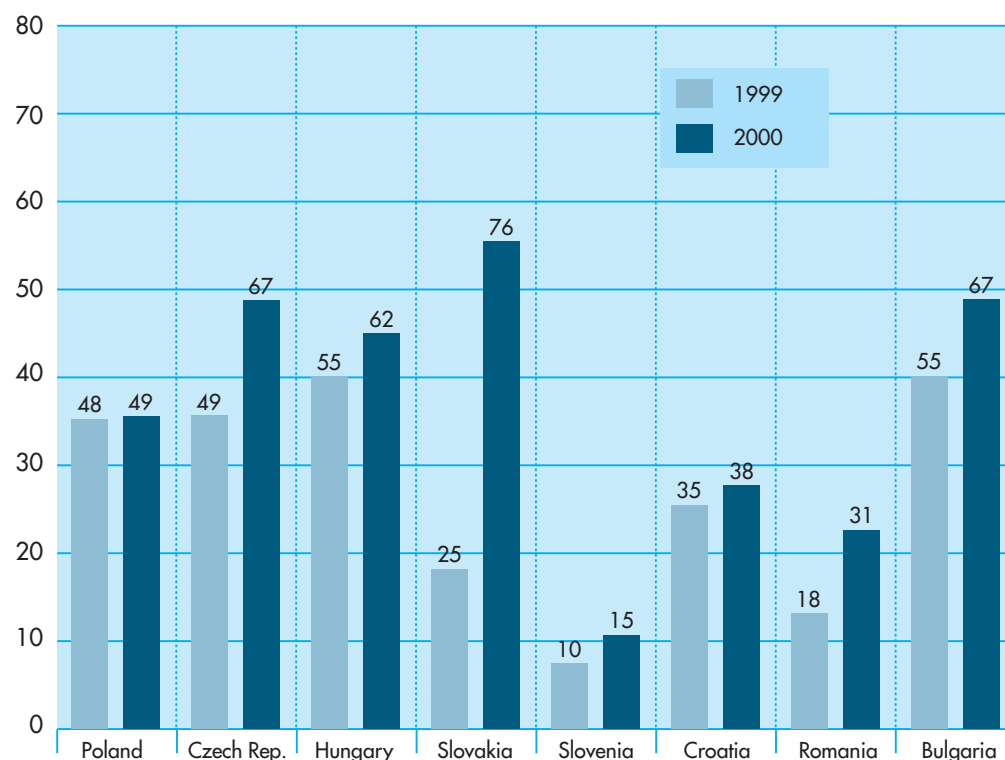
### 3. Our strategy

How is the HypoVereinsbank group going to turn this opportunity in the financial markets of the CEECs into a success story? What do we aim for?

**Our view is that the region's banking sector differs substantially from other emerging markets.**

An important point is that our starting position is excellent, as the businesses of Bank Austria, Creditanstalt and HypoVereinsbank fit together very well. Combined, they maintain a comprehensive network throughout the CEECs region in addition to the two home markets in Austria and Germany, a continuous region of 165 million consumers. Indeed, it is our view that the market in the CEECs differs significantly from other emerging financial markets in the world since it lies on our very doorstep. For our operations, we are not only taking advantage of our cultural similarities and generally good neighbourly relations, although such "soft" features are important. We are also taking advantage of the very close economic ties between the regions, both in terms of foreign direct investment (FDI) and trade.

**Figure 1.** Share of foreign banks in total assets, in %



Note: This Figure is based on equity interest reflecting the shareholder structure in 1999 and 2000, including holdings of the EBRD, IFC, and non-banks.

We also expect to benefit from an “early mover” advantage. All banks within our group became involved with this market at the very beginning. Such timing is highly significant. During the period in which this region found itself deep in a transformation crisis, we already maintained an office network there. Even though our business volume at the time was low, it now gives us an advantage in terms of know-how over competitors who remained absent. In addition, we succeeded at that time in establishing relationships with local customers which is essential to us today.

In the early stage of transition our philosophy was to commence activities in the region via “greenfield investments”. At that time we discovered a banking sector that was still far from the banking sector structure to which we were accustomed in the West. The restructuring of banking and financial markets had yet to begin in most countries. Privatisations were still in the distant future and the bad loan problem had not been solved. In several cases, balance sheets did not meet international accounting standards. Therefore, to start business operations successfully in these countries, there was no other choice but to establish our own branch offices or affiliates.

Today, more than ten years later, the situation has changed significantly. Bank legislation along the lines of the EU directives has been implemented everywhere. CEEC governments have also dealt to a large extent with the bad loan problem and, in all countries except Slovenia, major commercial and universal banks have been privatised. This led to new opportunities for foreign banks to enter the region’s market via the second route of purchasing existing “retail networks” on a large scale. Indeed, Bank Austria and the HypoVereinsbank purchased two major Polish banks, namely the Powszechny Bank Kredytowy (PBK) and the Bank Przemysłowo Handlowy (BPH). Following the merger of these two banks, the Hypovereinsbank group has actually become the third largest bank in Poland.

**Central and Eastern  
Europe is the second core  
market for the HVB  
Group.**

Our business focus has also evolved during the last ten years. Initially we focused primarily on commercial customers, participated in privatisations via our subsidiary Creditanstalt Investmentbank, and were active on the capital market. Recently the HypoVereinsbank group has established a strong foothold in the retail banking business. This leads to a key plank to our strategy - to be a universal bank throughout the entire region. This distinguishes our Eastern European strategy from other international activities. In other parts of the world, the group often only operates as a special-purpose bank. However, in the CEECs we wish to set up a true universal bank that differs from local banks only in that it has a foreign owner and that it is hopefully more cost efficient and profitable.

To achieve this last goal, we pay special attention to business organisation. The HypoVereinsbank group operates with the know-how and standing of Europe’s third-largest bank - but without forgetting the basic sales principle that “all business is local”. We are well aware that every transaction requires a healthy combination of both a decentralised and a supra-regional presence. Our banking strategy, on the one hand, means being aware of, and serving, the needs of local customers. Our banking subsidiaries should fulfil this task with entrepreneurial initiative and in a decentralised fashion, with short lines of operative decision-making. On the other hand, our strategy is founded on the supra-regional group - the reason why we have called our approach the *bank of the regions* - with a uniform strategy that involves centralised control and risk management, and binding corporate guidelines, which regulate all regional activities.

To conclude, what we are, and what we want to be in Central and Eastern Europe, is both local and international. The HypoVereinsbank group operates according to local needs by creating universal bank subsidiaries, but at the same time, these subsidiaries are an integral part of an international network that we place at the disposal of our local customers. Naturally, we believe this banking strategy is the one that is most likely to succeed over the longer term.

#### **4. Achievements**

That we feel confident about our approach to the region comes from our successes so far. Before the announcement of the merger with HypoVereinsbank, the Bank Austria/Creditanstalt group was already running operational units in nine CEECs. At the end of 2000, our bank was well ahead of its main international competitors such as Société Générale, Citibank, ING and the Raiffeisenbank by operating the largest banking network in Eastern Europe. At that moment, Bank Austria/Creditanstalt managed roughly EUR 15 billion in total assets. The merger with HypoVereinsbank brings in an additional EUR 6 billion of total assets. The group is currently active in thirteen countries in the region. Our latest subsidiary was opened on the 29th of October 2001 in Belgrade, and we will soon open a representative office in Sarajevo.

*The early involvement and achievements of the group in the region provides a sound basis for further extending its activities.*

The key figures presented in Figure 2 for the HypoVereinsbank group in Central and Eastern Europe speak for themselves:

- The combined total assets amount to EUR 21.3 billion.
- The banking network comprises almost 750 offices.
- The market share in individual countries stands at between 5 percent and 10 percent.
- The group employs 18 500 employees in the CEECs, which is more than in Austria.
- The group manages accounts for 2.6 million retail customers (also more than in Austria).
- The group serves 80 000 corporate customers.

At present, 25 percent of total income is generated in the CEECs. In nominal terms, our banking business is more profitable in Eastern Europe than in Austria. At the moment, the total return on equity in our subsidiaries in the CEECs is around 20 percent whereas in Austria this is about 10 percent. And we have set ourselves the mid-term policy objectives of increasing the return on equity to 30 percent and the share of income generated in the CEECs to 50 percent.

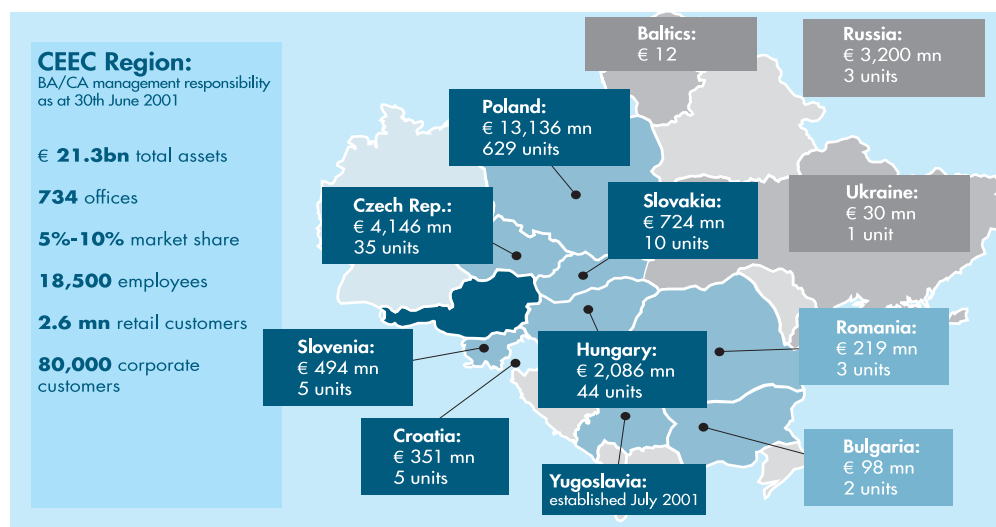
#### **5. Summary**

To conclude with a summary of how we assess the banking market in Central and Eastern Europe:

Firstly, despite the reforms and progress made in Central and Eastern Europe over the past ten years, the financial markets in the region are still largely under-developed. The aggregate total assets of the credit institutions in the CEECs stand currently at EUR 290 billion, which is roughly equal to the size of Landesbank Baden-Württemberg in Germany. This demonstrates that there is a truly fantastic potential for growth. Indeed, the prosperous outlook for the development of the CEECs banking industry has attracted the interest of many Western, especially EU, banks. As a result, the majority of bank assets are now in foreign hands.

Secondly, the expectation that the CEECs will soon be part of the Single Market is evidently one of the driving forces behind the decision of EU banks to enter the region's market. This includes the HypoVereinsbank group. With EU enlargement, it is also likely that part of the region will soon join the common currency zone of our two home markets of Austria and Germany.

**Figure 2.** HVB and Bank Austria/Creditanstalt in Central and Eastern Europe



Thirdly, from the very start many Western banks were active in corporate lending and some, like our subsidiary Creditanstalt Investment bank, were making important transactions on the capital market. Now, after ten years of transition, the time is ripe for exploring business opportunities in retail banking. Thanks to the policy achievements of CEEC governments, foreign banks could purchase large retail networks. With this background, the HypoVereinsbank group decided to consider the region as a core market in all its facets.

**A thorough understanding of the market is the key to success.**

Fourthly, the secret of success in the CEECs is not really a secret. It is simply what is always demanded of successful business people throughout the world. This is an understanding of the market, close proximity to customers, and competitively priced products and services. The "gold rush" is part of the past. But those seeking business opportunities - even if they do not have a gold rush mentality, or perhaps precisely for that reason - will find Central and Eastern Europe an attractive market that is certain to prosper over the long term.