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THE ROLE OF BANKS IN PERFORMANCE OF THE REAL SECTOR IN SELECTED EU MEMBER STATES*

ZNACZENIE BANKÓW DLA FUNKCJONOWANIA SEKTORA REALNEGO W WYBRANYCH KRAJACH UE

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Summary: The purpose of the paper is to analyse the role of the banking sector in financing the real sector of the economy in the selected old (France, Germany, Italy, Sweden) and new (the Czech Republic, Hungary, Poland) EU member states. The specific objective is identification of differences in the ownership structure of banking sectors and their linkages with the provision of loans to the real sector. In order to accomplish this target, differences in the ownership structure of the banking sectors and lending activity in the selected EU member states are recognized and analysed, as well as their implications for the regulatory environment. One of the most important remarks is that optimum regulatory structures should be aimed at the protection of the diversity within the harmonization of banking sectors. Less oligopolistic market structures within the framework of prudential regulation should enforce stability of banking sectors in analysed countries.

Keywords: credit activity, banking sector, ownership structure.

Streszczenie: Artykuł ma na celu analizę roli sektora bankowego w finansowaniu sektora realnego gospodarki w wybranych starych (Francja, Niemcy, Włochy, Szwecja) i nowych (Czechy, Węgry, Polska) krajach UE. Celem szczegółowym jest identyfikacja różnic w strukturze własnościowej sektorów bankowych i ich powiązań z dostępnością kredytu dla sektora realnego. Aby osiągnąć ten cel, rozpoznano i zanalizowano różnice w strukturze własnościowej sektorów bankowych i w akcji kredytowej w wybranych krajach UE, a także ich skutki dla środowiska regulacyjnego. Zgodnie z jednym z najważniejszych wniosków, optymalne regulacje powinny umożliwiać ochronę różnorodności w ramach harmonizacji sektorów bankowych. Mniej oligopolistyczne rynki poddane nadzorowi ostrożnościowemu powinny wzmocnić stabilność sektorów bankowych w analizowanych krajach.

Słowa kluczowe: akcja kredytowa, sektor bankowy, struktura własnościowa.

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1. Introduction

Structural changes of forms of ownership of banks observed in the EU member states have reshaped not only the structure of the banking sector, but also influenced the real sector of the economy. In order to identify the scale and background of this process it is necessary to examine the structure and functioning of monetary financial institutions in the EU countries. Taking this into account, the role of the banking sector in financing the real sector of the economy in the selected old (France, Germany, Italy, Sweden) and new (the Czech Republic, Hungary, Poland) EU member states. The specific objective is identification of differences in the ownership structure of banking sectors and their linkages with the provision of loans to the real sector.

2. The structure of ownership of banks and its importance for the economy – literature review

The analysis of the impact of the banking sector on the real sector of the economy can be conducted in two dimensions: state or public ownership versus private ownership, and foreign versus domestic ownership.

Some authors underline that the higher the state ownership in the banking sector, the slower the financial development, the stronger the financial instability and the higher concentration of bank lending. Opponents to the state ownership claim that state-owned monetary financial institutions generate lower profits and reveal lower cost efficiency [La Porta, Lopez-de-Silanes, Shleifer 2002; Beck, Demirgüç-Kunt, Maksimovic 2003]. According to them, such institutions often fail to screen out good projects. This reduces their profitability and limits interest margins [Sapienza 2004].

Despite these concerns, government ownership of banks remains prevalent in many countries. There are two main motives for the presence of the state in the banking sector. According to the proponents of the political view, the state ownership is driven purely by political motives [Andrianova, Demetriades, Shortland 2008]. On the other hand, proponents of the development view underline that the state ownership of banks responds to institutional deficiencies and external effects [López-Puertas Lamy, Gutierrez 2012; Schmit et al. 2011]. They argue that taking into consideration financing the needs of real sector it can be assumed that domestic state-owned institutions are able to provide loans to customers that would be excluded by privately owned institutions.

While analysing the implications of foreign ownership, it is often assumed that this ownership results in a positive influence on financial sector efficiency and stability [Cull, Martinez Peria 2010; Demirgüç-Kunt, Huizinga 2000]. The dominance of the foreign ownership in the banking sector may have negative consequences, however.

Foreign institutions can import disturbances from their home countries and spread shocks from other countries in which they operate. Moreover, when home country conditions improve, the opportunity costs of limiting home country lending increase and parent institutions may therefore allocate less capital to their foreign subsidiaries [Molyneux, Seth 1998; Moshirian 2001]. Foreign institutions may be also less inclined than their domestically owned peers to provide financing for domestic companies [Detragiache, Tressel, Gupta 2008], having difficulties in lending to borrowers that lack the hard information to prove their creditworthiness. This stems from the fact that domestic banks tend to be better at relationship-lending that is based on “soft information” [Berger, Hasan, Klapper 2004]. Therefore, although the foreign ownership may have a positive influence on the banking sector efficiency and competition, at the same time it may limit access to loans, especially for SMEs and individuals, and import economic disturbances from the host country.

3. Banking sector and its interactions with the real sector in the selected EU countries

In Europe, the share of banks in credit intermediation remains within the range of 70–75% of debt financing to households and enterprises [European Banking Federation 2012]. In such “bank-based” model, as opposed to “capital markets-based” model, banks dominate. They are free to engage in all forms of financial services. This model is dominant in all the analysed countries.

Analysis of Tables 1 and 2 reveals that foreign private ownership is very strong in the new EU member states. Unlike the old EU member states, private domestic investors are almost absent among shareholders of Hungarian, Polish or the Czech banks. In the Czech Republic, banking sector is almost completely dominated by foreign capital, whereas in Hungary and Poland only some specialized agencies remain under the control of the state. At the same time, foreign institutions are almost absent in France or Germany.

Particularly high level of foreign ownership in the new EU member states raises concerns regarding the degree of concentration and competition. In Hungary and Poland, the four or five largest banks are all foreign-controlled. In the Czech Republic, all five biggest banks are foreign-owned. As a result, the outburst of the global financial crisis proved the new EU member states’ banking sectors vulnerable because of high levels of foreign ownership. Supervisory authorities in these countries – not without reason – have become increasingly concerned that foreign-owned banks, despite their declared long-term interest in the region, would seek to cut their losses and run [Schoenmaker 2011]. However, this last view can be called into question while analysing changes in assets of banks in analysed countries.

The growth trend of the total assets of banks was interrupted in the second half of 2008 [European Central Bank 2010]. Among seven analysed countries the

positive pace of assets growth in 2013 was registered only in Poland and the Czech Republic. By contrast, Germany registered the deepest decline in the asset base (11.0%). This can be a bit surprising as it undermines the common assumption of the possible reduction of activity of foreign-controlled monetary financial institutions in the new EU member states as a result of the liquidity tensions of parent companies.

Table 1. Total assets of credit institutions in the old EU member states, 2007–2013

Country	Year	Total assets of credit institutions in the sample (EUR billion)					(5)/ (1 + 5)	(5) in % of GDP
		Domestic credit institutions (1)	Large (2)	Medium (3)	Small (4)	Foreign-controlled subsidiaries and branches (5)		
France	2013	6,154.2	6,041.9	111.3	1.0	188.7	3.0%	8.93
	2012	6,583.5	6,313.6	268.4	1.4	227.0	3.3%	10.86
	2011	6,155.0	5,888.4	264.2	2.4	225.4	3.5%	11.29
	2010	6,172.7	5,914.5	253.9	4.4	212.2	3.3%	10.98
	2009	6,101.4	5,849.1	248.6	3.7	214.8	3.4%	11.26
	2008	6,874.4	6,666.8	203.8	3.8	276.1	3.9%	14.17
	2007	5,876.0	5,811.4	58.8	5.9	544.0	8.5%	28.70
Germany	2013	6,456.9	3,287.2	2,436.8	741.9	278.5	4.1%	9.91
	2012	7,257.1	4,103.4	2,394.8	758.9	309.2	4.1%	11.24
	2011	7,282.1	4,021.1	2,531.6	729.5	392.3	5.1%	15.26
	2010	7,517.5	4,482.4	2,315.1	720.0	379.3	4.8%	15.18
	2009	7,767.1	5,056.5	2,099.1	611.6	861.0	10.0%	35.92
	2008	9,004.7	6,281.5	2,092.6	630.6	1,005.1	10.0%	40.51
	2007	6,625.0	4,279.8	1,749.0	596.3	n/a	n/a	n/a
Italy	2013	2,404.6	1,591.8	795.5	17.2	238.5	9.0%	14.82
	2012	2,602.7	1,750.5	834.8	17.5	246.7	8.7%	15.27
	2011	2,532.7	1,739.4	780.9	12.4	237.9	8.6%	15.05
	2010	2,535.6	1,768.7	757.9	9.0	229.2	8.3%	14.80
	2009	2,474.9	1,746.8	718.0	10.1	236.3	8.7%	15.55
	2008	2,521.6	1,863.6	645.8	12.2	236.2	8.6%	15.07
	2007	2,422.0	1,729.3	680.6	12.1	265.0	9.9%	17.14
Sweden	2013	1,561.6	1,384.4	160.2	17.0	102.4	6.2%	23.84
	2012	1,626.4	1,450.9	161.1	14.3	102.4	5.9%	23.47
	2011	1,416.8	1,273.7	132.0	11.1	n/a	n/a	n/a
	2010	1,391.9	1,250.7	131.3	9.9	n/a	n/a	n/a
	2009	1,222.0	1,104.8	109.0	8.2	n/a	n/a	n/a
	2008	1,165.1	901.1	259.2	4.8	n/a	n/a	n/a
	2007	1,100.0	1,002.1	95.7	2.2	n/a	n/a	n/a

Source: own preparation based on Eurostat and European Central Bank Consolidated Banking Data.

The state appears to be more involved in smaller banking institutions from outside of the 10 largest banks in each country. Analysis of the whole banking sector

in the sample of seven countries reveals that the public ownership of banks in terms of number of institutions is the highest in France and Germany. In terms of share in total assets of the banking sector such an ownership is the highest in Germany. Poland takes the second place, what can be a bit surprising if one forgets about unfinished privatization process and the state involvement in the largest commercial bank. On the other hand, country of the lowest public stake in the banking sector is the Czech Republic. It results from complete sell of the domestic banks to private investors in this country because of the accomplishment of the privatization process [Jurek 2014].

Table 2. Total assets of credit institutions in the new EU member states, 2007–2013

Country	Year	Total assets of credit institutions in the sample (EUR billion)					(5)/ (1 + 5)	(5) in % of GDP
		Domestic credit institutions (1)	Large (2)	Medium (3)	Small (4)	Foreign-controlled subsidiaries and branches (5)		
Czech Republic	2013	13.8	0.0	10.9	2.9	165.4	92.3%	10,52
	2012	13.0	0.0	10.8	2.2	165.0	92.7%	10,25
	2011	8.1	0.0	7.6	0.5	161.4	95.2%	10,42
	2010	7.4	0.0	7.1	0.4	154.5	95.4%	10,65
	2009	5.9	0.0	2.4	3.6	144.3	96.1%	10,52
	2008	6.0	0.0	2.8	3.2	141.4	95.9%	9,56
	2007	4.0	0.0	1.9	2.1	135.0	97.1%	10,60
Hungary	2013	46.2	0.0	37.1	9.1	57.7	55.5%	57,39
	2012	45.0	0.0	36.6	8.3	62.4	58.1%	63,22
	2011	47.5	0.0	39.1	8.5	75.6	61.4%	75,21
	2010	46.2	0.0	37.7	8.5	73.5	61.4%	74,66
	2009	66.4	0.0	44.0	22.4	67.1	50.3%	72,20
	2008	52.1	0.0	41.0	11.1	82.1	61.2%	77,18
	2007	43.0	0.0	35.8	7.2	66.0	60.6%	65,51
Poland	2013	133.0	0.0	104.2	28.8	210.7	61.3%	n/a
	2012	127.6	0.0	101.8	25.8	207.5	61.9%	54,46
	2011	109.8	0.0	87.2	22.6	201.4	64.7%	54,43
	2010	99.4	0.0	77.6	21.8	200.6	66.9%	56,72
	2009	83.4	0.0	64.9	18.5	180.2	68.4%	58,04
	2008	69.9	0.0	51.8	18.1	184.4	72.5%	50,78
	2007	70.0	0.0	52.2	17.8	152.0	68.5%	48,87

Source: own preparation based on Eurostat and European Central Bank Consolidated Banking Data.

The concentration of assets among the main five banks is different in analysed countries (Table 3). Markets are concentrated because the number of banks decreases and the skewness of the size distribution of banks rises, manifesting itself in the growth in the number of large banks. However, the concentration in 2007–2013 increased only in Italy and Germany, owing to intra-group reorganisation. Despite

that process, in these two countries the scale of the market concentration remained well below EU average. Instead, the level of the concentration appeared to be the highest in the new EU member states (except for Poland), dominated by foreign institutions.

While analysing the EU member states separately, it can be noticed that larger countries such as Germany and Italy have more fragmented markets, encompassing strong savings and cooperative banking sectors, whereas smaller countries, especially new EU member states, are characterised by concentrated banking sector [European Central Bank 2005, 2010, 2013a]. Consolidation increases the market concentration because of the decline in the number of credit institutions. This allows large institutions to obtain market power as they are in a better position than smaller institutions due to established reputation and economies of scale. As a result, banking sectors in the Czech Republic, Hungary, and Sweden tend to be characterised by growing oligopolistic competition.

By extending credit to the real sector, banks facilitate economic growth. However, in the aftermath of the global financial crisis, credit activity is unfavourably shaped by both cyclical and structural developments. The share of total loans in assets of banks dropped due to unfavourable macroeconomic conditions and transfer of distressed loans to special purpose asset management vehicles, at the same time institutions increased their debt securities holdings (mainly government bonds) aiming at building up liquid asset buffers in order to be able to pass stress tests conducted by the European Central Bank [European Central Bank 2013a].

Table 3. Share of the five largest credit institutions in total assets, 2007–2013 (%)

Country	2007	2008	2009	2010	2011	2012	2013
Czech Republic	65.7	62.1	62.4	62.5	61.8	61.5	62.8
France	51.8	51.2	47.2	47.4	48.3	44.6	45.9
Germany	22.0	22.7	25.0	32.6	33.5	33.0	30.6
Hungary	54.1	54.4	55.2	54.6	54.6	54.0	51.9
Italy	33.1	31.2	31.0	39.8	39.5	39.7	39.6
Poland	46.6	44.2	43.9	43.4	43.7	44.4	45.2
Sweden	61.0	61.9	60.7	57.8	57.8	57.4	58.3

Source: own preparation based on European Central Bank, Statistical Data Warehouse, http://sdw.ecb.europa.eu.

Credit activity in this respect appears to be divergent in different countries due to disparities in developments in banks' cost of funding and overall credit risk. Reduction in the volume of loans by European banks was caused by an onset of the credit crunch; at the same time, credit institutions registered a high growth in deposits. A decline in the credit activity caused a reduction in the on-balance sheet financial sector leverage vis-à-vis the real economy and the fall of the financial sector dominance over the real sector.

In the period 2007–2012 the reduction in loans in terms of the GDP, reflecting putting a halt on overall credit activity in the banking sector, was the strongest in Germany. It should be emphasized, however, that credit activity in terms of the GDP (65–70% in 2012) in the three new EU member states is well below levels observed in the selected old EU member states (150–220% in 2012), allowing two of them to reach exceptionally fast pace of credit growth due to catch-up process (Figure 1). The pace of growth of volume of loans was the fastest in the Polish banking sector, which is less concentrated and dominated by privately owned foreign financial institutions.

Undoubtedly loans, which are crucial for the recovery of the European economy, are loans to non-financial companies. EU companies rely heavily on banks for external funding: ca. 75% of corporate financing in the EU is obtained from banks. Other market sources of financing such as venture capital, mezzanine finance and equity markets, have been relatively weaker developed. As a result, the supply of a bank credit is the main source of matching the companies' demand for financing. This is especially relevant for SMEs [European Banking Federation 2012].

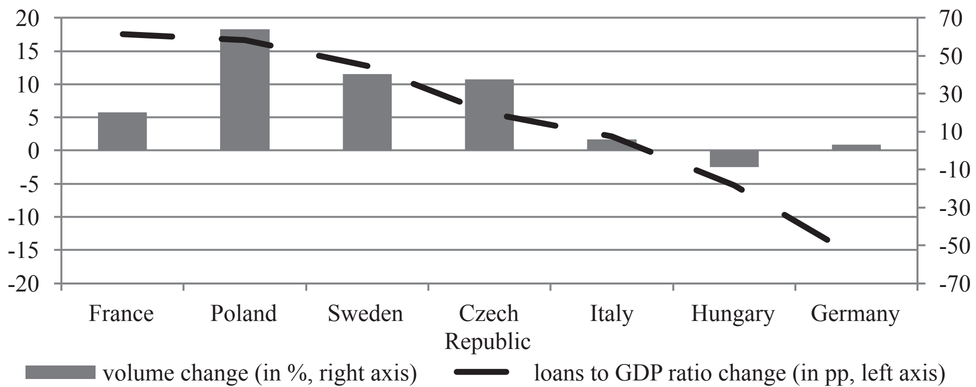

Figure 1. Change of the volume of loans and ratio of loans to GDP in 2007–2012 (MFI excluding ESCB, in pp)

Source: own preparation based on [European Banking Federation 2013].

The volume of loans to non-financial corporations in seven analysed countries fell by 0.21% y/y in 2012 as compared with 2011 (Table 4). Over the period 2007–2012 the volume of loans to non-financial corporations in terms of the GDP fell in four countries: Germany (by 293 bp), Sweden (by 56 bp), the Czech Republic (by 122 bp) and Hungary (by 450 bp). Strong countercyclical reaction can be found only in Italy, Poland and France, as only in these countries the ratio of loans to households to GDP increased over the complete analysed period (by 86, 104 and 141 bp, respectively). These divergences cannot be explained only by differences in the ownership structure. Instead, they are the result of differences in demand for and

access to credit across EU member states, reflecting differences in the economic outlook, deleveraging pressure, costs of funding and domestic sovereign risk.

Table 4. Loans to non-financial corporations, outstanding amounts at the end of period, 2007–2012 (MFI excluding ESCB)

Country	2007	2008	2009	2010	2011	2012
EUR million						
Czech Republic	27,992	31,641	29,603	31,249	32,224	33,414
France	712,644	781,218	769,091	778,920	815,015	815,722
Germany	781,101	834,966	794,249	787,366	797,294	802,447
Hungary	28,704	30,036	28,288	27,312	24,579	23,678
Italy	814,485	869,430	849,024	867,122	894,016	864,669
Poland	48,258	53,896	52,763	53,970	56,855	63,084
Sweden	168,653	162,642	163,268	190,091	204,224	215,306
% of GDP						
Czech Republic	21.98	21.40	21.58	21.54	20.80	20.76
France	37.60	40.09	40.33	40.30	40.82	39.01
Germany	32.11	33.65	33.13	31.51	31.01	29.18
Hungary	28.49	28.24	30.44	27.74	24.45	23.99
Italy	52.68	55.45	55.87	55.99	56.58	53.54
Poland	15.52	14.84	16.99	15.26	15.37	16.56
Sweden	49.91	48.80	56.12	54.83	52.80	49.34

Source: own preparation based on Eurostat and European Banking Federation [2013].

The financial crisis has influenced also the interest rates. It appears that dispersion of interest rates on new loans to non-financial corporations has even intensified since the outburst of the global financial crisis, achieving peak values in 2009. Differences in interest rates, even among euro area members, depend on demand and supply-side factors, such as market differences (credit and interest rate risk, industrial structure, business practices, degree of capital market development), institutional differences (fiscal framework, regulation and supervision, consumer protection), structural differences (degree of bank market financing, competitiveness) and last but not least – clients' risk appetite. However, since the outburst of the global financial crisis banks in distressed countries have to offer better conditions and compete more strongly to fund themselves with retail deposits. This process has dampened lowering of costs of financing the real sector needs, despite low policy rates observed in almost all countries and low interbank rates [European Central Bank 2013b].

4. Discussion

As noted in Section 2, the analysis of the impact of banking sector on the real sector of the economy can be conducted in two dimensions: state or public ownership versus private ownership, and foreign versus domestic ownership. While analysing

the first dimension it can be observed that the seven countries under consideration have different banking sectors. Some of them are populated by strong domestic state-owned as well as by strong cooperative or savings institutions. In other countries, notably in the new EU member states, state ownership is almost completely abolished in favour of commercial, purely profit-motivated foreign institutions and mutual ownership is of insignificant influence on the real economy. This raises concerns on the possibility of sustainable financing the real sector of the economy, of contributing to systemic stability and preventing financial exclusion by institutions, which do not have strong relationships with their clients and recognition of local needs.

There are important differences in the structure of the ownership of monetary financial institutions in analysed countries. While analysing banking sectors it occurs that they are constrained by national borders, with the exception of the new EU member states, where a vast majority of banks are foreign-owned, mostly due to privatisation of former state-owned institutions. These institutions tend to focus almost exclusively on large local corporate clients, neglecting lending to small and medium enterprises.

Banking sector in the analysed countries has been confronted with the second wave of the global financial crisis, including a weak economic environment in many countries. This has led to a deterioration of asset quality, which in turn has negatively affected profitability. Significant funding pressure on banks, most notably in the euro area, continued to constrain the supply of credit to the real sector of the economy, exerting a negative drag on consumption and investment. The global financial crisis has led to reduction in the on-balance sheet financial sector leverage vis-à-vis the real economy. Since outburst of the crisis banks, striving for survival, have intensified consolidation. Therefore, the proper regulatory environment is crucial to prevent negative influence of further consolidation on the real sector of the economy. Public authorities should be more proactive and consist in creating a financial sector able to reconcile the private financial institutions striving for profit with interests of the real sector and of general public ones. To achieve this target public authorities should, on the one hand, effectively regulate and supervise all financial institutions, and, on the other, create favourable conditions for development of other than private-owned profit-oriented financial institutions.

Policy goals should include promoting both competition and plurality. Competition is necessary for efficient functioning of financial institutions. Plurality, by protecting diversity of banking sectors, builds up systemic trust and helps maintaining the stability of this sector. Less oligopolistic market structures within the framework of prudential regulation should enforce stability of banking sectors in the analysed countries. Therefore, optimum regulatory structures should be aimed at the protection of the diversity within the harmonization of banking sectors.

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