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## RESTRUCTURING OF BANKS IN POLAND AFTER 1989

Contained in this article (reports) are the results of a survey made on the implementation of the Polish Law on Financial Restructuring of Enterprises and Banks, as of 31 March 1994. The following nine banks have been included in the survey:

1. Bank Depozytowo-Kredytowy S.A. (The Deposit and Credit Bank) in Lublin
2. Bank Gdański (The Bank of Gdańsk) in Gdańsk
3. Bank Przemysłowo-Handlowy (The Trade and Industry Bank) in Kraków
4. Bank Zachodni S.A. (The Western Bank) in Wrocław
5. Pomorski Bank Kredytowy S.A. (The Pomerania Credit Bank) in Szczecin
6. Powszechna Kasa Oszczędności BP (The National Savings Bank) in Warsaw
7. Powszechny Bank Gospodarczy S.A. (The National Bank of the Economy) in Łódź
8. Powszechny Bank Kredytowy S.A. (The National Credit Bank) in Warsaw
9. Bank Gospodarki Żywnościowej (The Food Economy Bank) in Warsaw.

The data on the Law implementation were accessible from seven banks. No data have been obtained from the following two banks:

1. Bank Przemysłowo-Handlowy (The Trade and Industry Bank) in Kraków
2. Pomorski Bank Kredytowy S.A. (The Pomerania Credit Bank) in Szczecin.

For the first part of the report the data were available from a questionnaire prepared in advance and sent out to the banks to fill in. The questionnaire

comprised two parts. The first part contained a request for the provision of a list of borrowers (or the total number of borrowers) who are intended by the bank to be subject to a restructuring proceedings as provided by the Law on Financial Restructuring of Enterprises and Banks. We have also requested the banks to divide borrowers covered by the provisions of the Law according to the type of the procedure intended. As provided by the Law there are in general three ways of handling „bad debts”: the bank conciliatory proceedings, a public sale of borrowers' debts by the bank and a purchase by the bank of the Treasury of State companies in which the Treasury holds 100 percent of shares.

The second part of the questionnaire requested the banks to depict the structure of debts of the borrowers who are covered by the provisions of the Law, using the following two categories:

1. debts not to be reduced, capital and interest listed as separate items,
2. a separate part of the debt subject to the proceedings under the provisions of the Law.

As regards the second point, there was a further request to depict the structure of this debt listing as separate items the debtor's obligations to:

- a) the bank conducting conciliatory proceedings (capital and interest);
- b) the state budget (capital and interest);
- c) suppliers (capital and interest);
- d) other banks (capital and interest).

The nine banks addressed by the questionnaire have been selected upon the following basic criteria:

1. together they take control of over 90 percent of the currency flow in the economy. Also they are the chief participants in handling „bad credits”, absorbing a major part of them. Therefore, an analysis of their condition and the conclusions drawn are representative for the entire banking sector in Poland;

2. among these banks, seven (except for the National Savings Bank and the Food Economy Bank), by virtue of the Finance Minister's Resolution of 27 July, 1993, were supported by the Treasury of State restructuring bonds, the total value amounting to 11 trillion PLZ, to increase their own assets and reserves.

The following is a presentation of the results based on the questionnaire.

## 1. THE QUANTITATIVE ASPECT

The data contained in questionnaires received from the seven aforesaid banks show that there were 2963 borrowers covered by the provisions of the Law on Financial Restructuring of Enterprises and Banks (Table 1). If, as in the case of the Food Economy Bank, additionally 357 State Agricultural Farms were included, also covered by the Law but whose restructuring is not due for completion till 30 September 1994, the total figure would rise to 3320 entities.

These borrowers' total debt, as of 31 March 1994, amounted to nearly 33.7 trillion PLZ. The highest average debt level per one borrower was noted in the Food Economy Bank (20.6 billion PLZ) and the lowest in the Bank of Gdańsk (2.1 billion PLZ).

The Law affected the „bad debts” portfolio of individual banks in a different way (as shown in Table 1), ranging from 57 percent of the portfolio in the Deposit and Credit Bank, to 100 percent in the National Bank of the Economy in Łódź, the National Credit Bank in Warsaw and the Food Economy Bank in Warsaw.

Table 1. Implementation of the Law on Financial restructuring of Enterprises and Banks

Bank's Name	Entire number of the borrowers covered by the Law on Financial Restructuring of Enterprises and Banks	Total debt of the borrowers covered by the Law, to the Bank (in billion PLZ)	Average level of debt per one borrower covered by the Law (in billion PLZ)	Share of credits covered by the Law in the total sum of "bad credits" (percent)
Bank Depozytowo-Kredytowy S.A. (The Deposit and Credit Bank) in Lublin	319	3000.0	9.4	57
Bank Gdański S.A. (The Bank of Gdańsk) in Gdańsk	646	1340.5	2.1	70.7
Bank Przemysłowo-Handlowy S.A. (The Trade and Industry Bank) in Kraków	no data	no data	no data	no data

Bank Zachodni S.A. (The Western Bank) in Wrocław	392	2538.6	6.5	84
Pomorski Bank Kredytowy S.A. (The Pomerania Credit Bank) in Szczecin	no data	no data	no data	no data
Powszechna Kasa Oszczędności BP (The National Savings Bank) in Warsaw	294	3446.5	11.7	86.1
Powszechny Bank Gospodarczy S.A. (The National Bank of the Economy) in Łódź	63	1162.0	18.4	100.0
Powszechny Bank Kredytowy S.A. (The National Credit Bank) in Warsaw	276	2234.6	8.1	100.0
Bank Gospodarki Żywnościowej (The Food Economy Bank) in Warsaw	973 (1330)*	20,000.0	20.6 (15.0)*	100.0

\* Including the State Agricultural Farms

Source: The Author's own elaboration based on the contents of questionnaires answered by the banks.

## 2. THE RESTRUCTURING PATHS

The provisions of the Law on Financial Restructuring of Enterprises and Banks allow for several (aforesaid) restructuring paths. Besides these paths the banks have decided to apply still some other procedures. These most frequently included bankruptcy proceedings and settlements in court.

The Table 2 below shows a division of borrowers from the seven banks under consideration, covered by the Law, according to restructuring paths that have been applied to them.

Table 2

Bank's Name	Entire number of borrowers covered by the Law on Financial Restructuring of Enterprises and Banks	Number of borrowers included into:				
		Bank conciliatory proceedings	Public sale of the borrowers' debts by the bank	Purchase of shares of Treasury of State Companies in which the Treasury holds 100% of shares	Bankruptcy and liquidation proceedings	Settlement in court
1. Bank Depozytowo-Kredytowy S.A. (The Deposit and Credit Bank) in Lublin	319	17	36	no data	no data	no data
2. Bank Gdański S.A. (The Bank of Gdańsk) in Gdańsk	646	12	108	–	519	7
3. Bank Zachodni S.A. (The Western Bank) in Wrocław	392	40	10	6	no data	no data
4. Powszechna Kasa Oszczędności BP (The National Savings Bank) in Warsaw	294	20	69	–	191	4
5. Powszechny Bank Gospodarczy S.A. (The National Bank of the Economy) in Łódź	63	24	6	–	29	3
6. Powszechny Bank Kredytowy S.A. (The National Credit Bank) in Warsaw	276	16	93	no data	47	5
7. Bank Gospodarki Żywnościowej (The Food Economy Bank) in Warsaw	973 (1330)	152 (509)	71	no data	340	6

Source: The Author's own elaboration based on questionnaires answered by the banks.

As the data obtained from individual banks are incomplete, it is difficult to assess which of these paths prevailed. Considering the data from Table 2 one can assume that most probably it was the bankruptcy and liquidation proceedings which dominated in case of certain banks, and especially the Bank of Gdańsk, where over 80 percent of the borrowers were included in such proceedings.

In case of several banks, financial restructuring „techniques” listed in Table 2 and applied to respective groups of enterprises, do not include the entire number of enterprises covered by the Law. Besides incomplete information obtained, this is due to the fact that these banks included into their financial restructuring activities also these enterprises which at the end of 1992 had a „bad” credits portfolio and since the effective date of the Law have started to repay them or have already repaid them in full. Thus, in the case of the National Savings Bank there were respectively 1 and 9 such enterprise. As regards credits which were being repaid and which as of 31 December 1992 were qualified as „bad”, the total sum (with interest) amounted to 1.9 billion PLZ at the end of 1992. The total sum (with interest) due to already repaid credits which as of 31 December 1992 also were qualified as „bad”, amounted to 32.0 billion PLZ at the National Savings Bank.

In turn, in the National Credit Bank, within the period of the Law implementation, 80 credits with repayment delayed in time have been repaid completely, the total debt, as of 31 December 1991, amounting to 786 billion PLZ (i.e. 24.7 percent of a separated credit portfolio). In six cases the repayment was combined with a partial remittal of the debt and in the next three cases the repayment was combined with fixed asset take-over. The further 20 borrowers from this bank, the total debt amounting to 414.6 billion PLZ, as of 31 December 1995 (i.e. 13 percent of a separated „bad” credits portfolio) are currently repaying their debts.

A similar situation occurred in the Food Economy Bank. The credit portfolio, constituting the so called base group, included 1396 entities at the end of the first quarter of 1994. Within that period 66 entities have been transferred to the lower banking risk group (group I or II), by virtue of Ordinance No 19 of the President of the National Bank of Poland (NBP), because they reached a capacity for their debts being repaid in due time, as a result of an improved economic performance. Thus, the number of entities within group III and IV decreased to 1330 (cf. Table 1), i.e. by 4.8 percent. Also the debt level in both groups decreased by 891 billion PLZ. This sum amounted to 3.5 percent of the base group's total debt to the bank, at the end of 1993. In addition, in case of

404 out of the entire number of entities, the Food Economy Bank is going to recover its debts by means of a compulsory execution.

These entities' total debt, as of 31 March 1995, amounted to 4831.9 trillion PLZ, i.e. to 24 percent of the total base debt.

Also in the National Bank of the Economy part of the borrowers repaid their debts. As of 31 December 1991, 120 borrowers were separated, who constituted a base group for the Bad Credits Department. As of 20 March 1995, 57 borrowers fully repaid their debts to the Bank.

### 3. RESTRUCTURING PATHS – A QUALITATIVE APPROACH

The scope of application of the respective restructuring paths to the borrowers experiencing problems with their timely repayment of debts was different. This is indicated in Table 2 which depicts their structure according to various restructuring paths applied to individual borrowers.

In turn, the Table 3 below depicts a quantitative approach to the division of restructuring paths depicted in Table 2. The question is, what portion of the total debt to the banks has been covered by respective restructuring paths?

Incomplete data in Table 3 do not allow for providing a unequivocal response to this question.

Based on the existing data it can be said that in banks included into the „bad” credits survey, the scope of application of the aforesaid restructuring paths was different. However, it seems that the bank conciliatory proceedings path and bankruptcy and liquidation proceedings path prevailed.

As regards the first path it clearly dominated in case of the Western Bank (79.1 percent of „bad” credits), in the National Bank of the Economy (79.1 percent), the Bank of Gdańsk (71.3 percent) and in Deposit and Credit Bank in Lublin (40.2 percent). In turn, the bankruptcy and liquidation proceedings path dominated in the National Savings Bank in Warsaw (57.3 percent of unpaid credits) and in the national Credit Bank (24.6 percent).

Table 3

Bank's Name	Total debt of the borrowers covered by the Law (billion PLZ)	Portion of the debt (capital and interest) included into: (percent)				
		Bank conciliatory proceedings	Public sale of the borrowers' debts by the bank	Purchase of shares of Treasury of State Companies in which the Treasury holds 100% of shares	Bankruptcy and liquidation proceedings	Settlement in court
1. Bank Depozytowo-Kredytowy S.A (The Deposit and Credit Bank) in Lublin	3000.0	no data	no data	no data	no data	no data
2. Bank Gdański S.A. (The Bank of Gdańsk) in Gdańsk	1340.5	71.3	no data	–	no data	13.2
3. Bank Zachodni S.A. (The Western Bank) in Wrocław	2538.6	79.1	no data	no data	no data	no data
4. Powszechna Kasa Oszczędności BP (The National Savings Bank) in Warsaw	3446.5	21.9	19.6	–	57.3	1.2
5. Powszechny Bank Gospodarczy S.A. (The National Bank of the Economy) in Łódź	1162.0	71.9	0.006	–	19.7	2.5
6. Powszechny Bank Kredytowy S.A. (The National Credit Bank) in Warsaw	2234.6	14.4	17.8	–	24.6	27.2
7. Bank Gospodarki Żywnościowej (The Food Economy Bank) in Warsaw	20,000.0	36.0*	5.0	–	19.5	36.0**

\* jointly with settlement in court

\*\* jointly with bank conciliatory proceedings

Source: The Authors' own elaboration, based on questionnaires answered by the banks.



## FINAL REMARKS AND CONCLUSIONS

The implementation of the financial restructuring of enterprises and banks project begun in the mid 1992. The immediate cause was a growing volume of „bad” credits, estimated to constitute about 25-35 percent of all credits granted by all banks. Among them, within individual banks, the non-performing credits were estimated to amount to 15-60 percent of their credit portfolios, as stated at the conference at the Ministry of Finance in June 1992.

The restructuring programme implementation was also caused by the worsening of economic-financial performance of enterprises, which caused a drop in their credit worthiness, as well as by the developing payment bottlenecks, i.e. a mutual granting of credits by enterprises, outside the banking system. The next cause was the state owned banks privatisation programme, which comprised, as a vital element, a restitution of their financial performance through financial restructuring, in order to make them ready for privatisation.

For a certain period of time, the restructuring programme objectives were presented in mass media and also by part of the economists in their many publications and interviews, as a debts reduction programme, whose major objective was to cancel, generally and definitely, the enterprises' debts. As may be expected, the programme would most probably be financed by the state budget.

However, subsequent versions of this programme, elaborated by the Ministry of Finance in the mid of 1992, did not meet these expectations. The same applies to the final version of the programme, passed by the Parliament on 3 February 1993, as the Law on Financial Restructuring of Enterprises and Banks. No mechanism of automatic debt reduction of any economic entity has been introduced, which would cancel the existing debts of the state-owned enterprises. On the other hand, the example of Hungary is an illustration that such a solution may work only within a very short period of time and after that the volume of „bad” credits rises again and much more rapidly.

The absence in the Law of an option for automatic debt cancellation, which disappointed some of the economic operators (especially large state-owned enterprises), corresponds with the understanding of financial restructuring itself, because it cannot be reduced only to „bad” credits cancellation. It should be borne in mind that a basic task of the financial restructuring is to cause such changes in the borrower-bank relationship that would allow the bank to regain its money (in this case due to credits granted) and the borrower to repay its debts (at least partly), thus providing a sound performance basis.

The Law on Financial Restructuring of Enterprises and Banks should also be looked upon in the light of „bad debts” and payment bottlenecks which occur (and grow) in the Polish economy within the last few years. One should also think whether there is a chance for the Law to solve or at least to reduce this problem (in theory and practice). It is a generally accepted opinion that the scale of „bad” debts and payment bottlenecks is a negative phenomenon, because:

a) payment bottlenecks offer a privileged position to large, monopolistic enterprises and through a system of „free” prices consolidate a monopolistic structure of the Polish economy (e.g. within the last 4-5 years the fuel-energy sector's position strengthened). Such a situation has a direct impact on the competition between economic operators and the effectiveness level (as measured for the entire economy), which due to the above factors has to decrease,

b) it is due to the payment bottlenecks and „bad” credits that the allocation of the economic surplus in the economy is determined by enterprises' technical monopoly, and not by economic calculation,

c) it is impossible to select enterprises according to the effectiveness indicators. At present it is difficult to separate „good” and „bad” enterprises, as the financial assessment criteria do not correspond to the capital and technology criteria. Due to the existing mechanism of a mutual and forced financing of economic entities, a company's access to outer financing does not depend on its economic performance and internal structure efficiency,

d) the banking sector's role in the economy is becoming marginal, as a mutual granting of credits by enterprises through payment bottlenecks is an alternative to granting of credits by banks (or through capital market) and finally,

e) they are among the potential factors fostering the inflation growth, causing the „automatic creation” of currency, i.e. an appearance of additional currency flows beyond the central bank's control and influence.

Regarding the question of the Law's application to a general handling of „bad” credits and payment bottlenecks, the conclusions drawn in this respect would be those as may be drawn upon the data provided in the questionnaires filled in by the seven aforesaid banks and discussed in the first part of this chapter.

First, one should consider the total amount of „bad” credits, covered by proceedings by virtue of the Law on Financial Restructuring of Enterprises and Banks. In case of the seven banks included into our survey it amounted to almost 34 trillion PLZ, and constituted from 57 to 100 percent of the total value of „bad” credits in individual banks. Thus, many non-performing credits have not been covered by the Law at all. It also seems that the value of „bad”

credits subject to the restructuring procedures within the entire banking sector did not exceed 50 trillion PLZ.

Meanwhile, the total debt of economic entities in the non-financial sector amounted to 333.3 trillion PLZ, as of the end of March 1994 (including 301.0 trillion in PLZ and 32.3 trillion in hard currency, cf. Statistical Bulletin of Polish Main Office of Statistic - „Biuletyn Statystyczny” GUS - No 5, 1994, p. 51). If we estimated the share of „bad” credits in the total economic entities' debts to amount to 35 percent, then we would have the amount of about 116.7 trillion PLZ within the entire banking system. Thus, a conclusion may be drawn that the share of credits covered by the Law did not exceed 50 percent of total value of non-performing credits, as calculated within the entire banking system.

These considerations should also take into account mutual debts of enterprises (assets and liabilities), i.e. the payment bottlenecks, estimated to amount to 400 trillion PLZ. As it is known, the Law does not consider payment bottlenecks directly. However, in case of one of the restructuring paths, i.e. the bank conciliatory proceedings, the bank also has to take into account the interests of other creditors, including the liabilities of its own debtor to the suppliers, and these liabilities are also subject to financial restructuring. Since the data are incomplete it is impossible to estimate the portion of payment bottlenecks which is covered by the Law in this way. Using a very rough estimation, one can assume that most probably it did not exceed 15 trillion PLZ within the entire banking system.

To make a partial summing up here, it can be said that the Law on Financial Restructuring of Enterprises and Banks covered a small portion of the total sum of „bad” credits and payment bottlenecks (less than 10 percent). Therefore, it cannot be considered a means to solve entirely the problem under discussion (which on the other hand reflects the original idea while preparing this legal act).

One should also be aware of the fact that the causes of the phenomena described here are far apart from the economic reality which the Law describes and which it tries to influence. One can point to the elements of the economic system such as:

- a) high monopolisation of the production and financial sectors in the Polish economy,
- b) informal links established between banks and companies (especially large state-owned enterprises),
- c) a limited scope of transferability in the economy of the production means and knowledge to more practical applications and their insufficient share, together with technical skills, in creating the companies' profits,

d) shortcomings of the banking system regulation by the National Bank of Poland, especially as regards the rules of granting the refinancing and discount credits to commercial banks, the sources of money issue coverage, an impact of discount and lombard rates upon the market interest rates,

e) the problems of commercial banks while assessing the credit risk and managing their assets and liabilities.

A relatively high share of „bad” credits covered by the Law in case of the seven surveyed banks, proves that they give their due attention to solving this problem. Of course, from the very beginning these banks were to receive a sort of a reward in the form of restructuring bonds to increase their own funds and reserves, for their involvement into the restructuring project. This does not imply that all restructuring proceedings are to be a success and this statement is supported by an analysis at random of several cases (especially as regards the bank conciliatory proceedings).

It is also worth noting that experience gained by the banks and their borrowers at the restructuring stage (especially as regards the bank conciliatory proceedings) should bring about effects in the future. Within this process repair programmes of the companies have to be elaborated and presented and the banks have to evaluate these programmes in the context of the proposed solutions' adequacy and their feasibility within a specified period of time. Also the participants on both sides have to think and act in a long-term perspective and they become aware of the fact that they, as two types of economic operators, are mutually dependent. This aspect of the Law cannot be overlooked.

#### RESTRUKTURYZACJA BANKÓW W POLSCE PO 1989 R.

##### Streszczenie

Artykuł zawiera analizę realizacji Ustawy o Restrukturyzacji Finansowej Banków i Przedsiębiorstw, w wyniku której uratowana została płynność sektora bankowego w Polsce w połowie lat dziewięćdziesiątych. W tekście zamieszczono dane z tego zakresu (zebrane metodą ankietową), odnoszące się do największych banków komercyjnych, jakie wówczas funkcjonowały.

**Słowa kluczowe:** banki, przedsiębiorstwa, restrukturyzacja, płynność finansowa, „złe” kredyty.

**Key words:** banks, enterprises, restructuring, financial liquidity, “bad” loans.