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## DETERMINANTS OF SUCCESS IN MANAGING CONSOLIDATION IN THE BANKING SECTOR IN POLAND\*

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**Słowa kluczowe:** fuzje, banki, analiza ilościowa

**JEL classification:** G34, B23, G21

### Introduction

Uncertainty and risk are inherent in all the domains of economic, social and political life. Risk is a combination of a number of constantly changing conditions.<sup>1</sup> The last decade has been a period of dramatic process of globalization, which is particularly noticeable in the area of highly-developed economies.<sup>2</sup> These tendencies have also been observed in the sector of banking services.<sup>3</sup> A number of factors, both internal and external, have contributed to ‘the increased demand’ for huge, international banking institutions that might meet the ever-growing demands of the customers.<sup>4</sup> Consequently, the number of acquisitions and mergers has risen dramatically in the banking sector, both in the individual countries such as Poland and in the international markets.

Consolidation of the banking system is a process of strengthening of the strategic potential of the<sup>5</sup> banks, which might include credit institutions, investors and insurers.<sup>6</sup> With

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<sup>1</sup> A. Zachorowska: *Ryzyko działalności inwestycyjnej przedsiębiorstw*, PWE, Warszawa 2006, p. 56.

<sup>2</sup> *Bank mergers and acquisitions handbook*, American Bar Association. Section of Antitrust Law, ABA 2007, p. 70.

<sup>3</sup> *Ewolucja systemów bankowych w Europie Środkowej i Wschodniej*, ed. H. Żukowska, Wydawnictwo Uniwersytetu M. Curie-Skłodowskiej, Lublin 2003, p. 51.

<sup>4</sup> D. Wielgórka: *Analiza finansowa działalności banku w okresie globalizacji*, Wyd. Nauka i Oświata Dniepropietrowsk 2008, Ukraine, pp. 4–8.

<sup>5</sup> J. Revell: *The Changing Face of European Banks and Securities Market*, St. Martin’s Press, New York 1994, p. 62.

<sup>6</sup> Z. Rezaee, W.D. Miller: *Financial institutions, valuations, mergers, and acquisitions: the fair value approach*, John Wiley and Sons, 2001, pp. 15–20.

the present system of property and organization in Poland, consolidation is likely to occur through natural expansion of commercial banks.

Capital consolidation in a banking sector means any initiatives that consist in combining two or several banks into a single organizational whole or creation of a capital-bound group of banks that cooperate with each other and implement joint policies.<sup>7</sup>

### Consolidation in the Polish banking sector

Consolidation processes in banking are usually associated with a number of positive effects, connected with diversification of portfolios, better opportunities to respond to technological advances, improved competitiveness and extended range of services in the market.<sup>8</sup> The most spectacular example of consolidation in Poland (although administrative) was the creation of the Pekao SA Group. Obviously, there are also other examples, such as the merger of BIG SA with Bank Gdański SA, Kredyt Bank SA with PBI SA, Bank Rozwoju Eksportu SA with Polski Bank Rozwoju SA, Bank Zachodni SA with Wielkopolski Bank Kredytowy SA, Powszechny Bank Kredytowy SA with Bank Przemysłowo-Handlowy SA, Bank Handlowy SA with Citibank Polska, or PEKAO SA z BPH SA.

The main reason for consolidation of Polish banks is the necessity of increased assets and equity funds as the total of the assets in Polish banks is much lower than the total of the assets in one large bank in a country of the European Union.<sup>9</sup>

The following years saw continuation of privatization through selling the shares in individual banks through offers addressed to both foreign strategic investors and national investors.<sup>10</sup> The establishment of the Pekao SA Group in 1996 was a step forward towards the strengthening of the position of Polish banks. The decline in the number of banks observed in the following years was mainly due to the consolidations initiated by Polish banks in order to reinforce their market position (see Tab. 1). A good example of the use of instruments of consolidation is Kredyt Bank SA, which included in its structure: Bank Ziemski SA, Powszechny Bank Handlowy Gecobank SA, Bank Regionalny SA in Rybnik, Poland, Bank Depozytowo Powierniczy Glob SA, and, finally, Polski Bank Inwestycyjny SA. In 1999, Pekao SA merged with Powszechny Bank Gospodarczy in Łódź, Bank Depozytowo-Kredytowy in Lublin, Pomorski Bank Kredytowy in Szczecin, and adopted the name of Bank Polska Kasa Opieki SA.

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<sup>7</sup> See B. Kosiński: *Bankowe ABC – Konsolidacja kapitałowa w sektorze bankowym*, “Bank i Kredyt” 2000, No. 10,

<sup>8</sup> T.J. Gough: *Building society mergers and the size efficiency relationship*, “Applied Economics” 1999, No. 11.

<sup>9</sup> D. Wielgórka, Z. Ostraszewska: *Zarządzanie procesem konsolidacji w polskim sektorze bankowym*, [in:] *Nowe wyzwania w zakresie ekonomii i polityki gospodarczej po kryzysie subprime*, ed. J. Ostaszewskiego, SGH Warszawa 2010, p. 456.

<sup>10</sup> See A. Wójcik-Mazur, K. Rusek: *Rozwój polskiego systemu bankowego na tle wybranych krajów w latach 2005–2009*, Zeszyty Naukowe Politechniki Częstochowskiej, „Zarządzanie” 2011, No. 2, pp. 139–140.

Table 1

Selected consolidations, not forced by a bad standing of the acquired bank

The Acquiring Bank	The Acquired Bank	Year of Merger
Kredyt Bank SA	Polski Bank Inwestycyjny SA	1997
Bank Inicjatyw Gospodarczych BIG SA	Bank Gdański SA	1997
Bank Polska Kasa Opieki SA	Pomorski Bank Kredytowy SA	1999
Bank Przemysłowo Handlowy SA	HypoVereinsbank Polska SA	1999
Powszechny Bank Kredytowy SA	Bank Austria Creditanstalt Poland	2000
BIG Bank Gdański SA	BIG Bank SA	2001
Bank Handlowy w Warszawie SA	Citibank Poland SA	2001
Bank Zachodni SA	Wielkopolski Bank Kredytowy SA	2001
Powszechny Bank Kredytowy SA	Bank Przemysłowo Handlowy SA	2002
Nordea Bank Polska SA	LG Petro Bank SA	2003
GE Capital Bank SA	GE Bank Mieszkaniowy SA	2004
Pekao SA	BPH SA	2007
DnB NORD Polska SA	BISE SA	2008

Source: Author's own study based on the data from the National Bank of Poland (NBP).

In recent years, bank consolidations were an additional outcome of connecting the daughter companies and branches of foreign banks. Examples include the merger of Austria Creditanstalt (Poland) SA with Powszechny Bank Kredytowy SA, Bank Handlowy in Warsaw with CITIBANK (Poland) SA, HypoVereinsbank Polska SA with Bank Przemysłowo Handlowy SA, and ING Bank NV with ING Bank Śląski SA.

An important date in 2007 (last quarter) was the acquisition of a part of BPH branches by Pekao bank and, consequently, increased share capital of the Pekao bank. The merger of BPH with Pekao SA was the greatest merger in the history of Polish banking. Pekao acquired 285 branches throughout the country and approx. 300 partnership branches with 1.7 million customers. Other 200 branches and 650 thousand customers were included in mini-BPH. Banking analysts and practitioners believe that this is not the end of the transformation and predict further concentrations in this sector. Therefore, more mergers are expected in the Polish banking sector.

### **Determinants of the processes of consolidation in the banking sector: analysis of study results**

A statistical analysis was carried out on a population of 60 commercial banks that operated in Poland as of 31 October 2008 (almost 100%). The observation unit was commercial banks. With respect to the specific characteristics that affect the efficiency of the processes of consolidation and the specific nature of banks' operation, it was found that the most suitable type of the study to achieve the study aim would be a questionnaire survey, which is

a primary source of data. The information about consolidations (their motivations, supporting factors, barriers) was collected by means of a questionnaire in almost all the commercial banks in Poland. The response rate in the survey was 40%. Analysis of the effect of consolidation processes on the efficiency in the sector of commercial banks in Poland revealed that a more noticeable effect is observed in bigger banks. This improvement in the efficiency through processes of consolidation in the Polish banking sector by medium-sized, large and very large banks results from the fact that the banks from these groups actively participated in the processes of consolidation in the sector of commercial banks in Poland.

Table 2

Effect of consolidation on the efficiency in Polish commercial banks

Motivation	Bank size*				Total	Share %
	1	2	3	4		
Need for increased value of the bank	38	67	35	24	185	14,86
Cost reduction	28	63	36	24	165	13,25
Economies of scale	22	59	35	23	158	12,69
Improved know-how	31	55	27	18	149	11,97
Entering into new markets	19	52	33	22	142	11,41
Combating the intensifying competition	24	41	20	15	110	8,84
Reduction in the cost of capital	23	33	24	16	104	8,35
Protecting markets of the bank	18	32	18	14	102	8,19
Fiscal benefits	16	19	15	8	70	5,62
Private motivations of the managers	14	18	8	5	54	4,34
Other	0	0	0	0	6	0,48

\* 1 – small (assets up to 5 billion zlotys); 2 – medium sized (assets from 5 to 12 billion zlotys); 3 – large (assets from 12 to 30 billion zlotys); 4 – very large (assets over 30 billion zlotys).

Source: Prepared by the author based on the author's study.

It should also be noted that the majority of the population of the banks studied consider the consolidation processes as improving their efficiency (87.50% of the banks studied). Problems with the determination of the improvement in the efficiency in the Polish banking sector through consolidation were reported by four banks, which constitute 12.50% of the banks studied.<sup>11</sup>

Globalization of financial markets is the main factor in the reinforcement of the processes of consolidation and was given 180 points, which constitutes 29,56%. Another important factor that is conducive to consolidation is increased competition, which forces banks to create bigger and more resilient banking structures. The economic crises were reported

<sup>11</sup> D. Wielgórka, A. Zachorowska: *Zarządzanie procesem konsolidacji a efektywność połączeń w polskim sektorze bankowym*, Wyd. WZ, Częstochowa 2010, pp. 87–99.

as the third factor that stimulated the processes of consolidation according to the respondent banks. Its importance was recognized by 18.88% of the respondent banks studied. A tendency can be noticed among large and very large banks where the process of globalization of financial markets as a factor conducive to the processes of consolidation is even more essential and as many as 38% of the respondent banks considered it very important. In the group of small and medium-sized banks, a dominant factor that affects consolidation is increased competition (this factor was confirmed by 24% of the respondent banks).

The study revealed that the main motivation behind the consolidation in the Polish banking sector was the need for increased value of the bank (14.86% of the respondent banks). Cost reduction is another factor conducive to consolidation of commercial banks in Poland.

The need for economies of scale takes the third place among the motivations studied. The three motivations outlined above behind consolidation account for 40.8%. Better know-how and entering into new markets are other motivations indicated by the banks, getting 11.97% and 11.41% of answers, respectively. The five main motivations account for 64.18% among the factors studied. It is remarkable that the motivations behind consolidation listed in the questionnaire were adequately selected since another motivation, concerning the state intervention in the process of consolidation, appeared only once.

Eleven banks used consulting services during the process of consolidation, which accounted for 53%. It was observed that larger banks used consulting services less frequently and, conversely, smaller banks were provided these services more often. This results from the fact that larger banks have their own specialized divisions that perform consulting functions, whereas smaller banks do not establish such units for financial reasons. Therefore, they are "forced" to use the outside consulting services.

The analysis of the results of the survey concerning the phases of consolidation revealed that the most difficult phase was phase 1 (Preparation). It was given 87 points out of the total of 96. Preparation of the process of consolidation is the most essential phase from the standpoint of the successful consolidation. The phase of the implementation of consolidation was the second difficult phase indicated by the banks studied. It obtained 79 points. According to the banks studied, post-implementation phase is the third difficult phase in the processes of consolidation. It was given 74 points. In general, the whole process of consolidation is difficult as the study showed that 248 points was assigned to that factor, out of the total of 288 points, which accounts for 86.11% of the difficulties (100% = maximum difficulties). No additional phases were found in the banks studied; this means that the presented three phases in the process of consolidation represent the process optimally.

The process of consolidation was necessary or essential according to 86.67% of the respondent banks. It can be observed that the processes of consolidation bring positive effects for banks.

Table 3

## Determinants that affect the success in consolidation processes

Determinants	Total	Share %
Preparation of the detailed plan for the implementation of consolidation	94	7.69
Proper evaluation of the assets in the consolidated bank	90	7.36
Proper information policy	88	7.20
No or insignificant cultural differences between partners	86	7.04
Cleared property issues in the bank	86	7.04
Large financial potential of the bank	81	6.63
Fast rate of the process of consolidation	81	6.63
Choice of a partner that operates in the international market	79	6.46
Positive attitude of staff to the process of consolidation	74	6.06
Positive attitude of managers to the process of consolidation	72	5.89
Size of the banks that take part in consolidation	68	5.56
Compatibility of the IT systems in the banks	61	4.99
Involvement of governmental institutions	59	4.83
Clearly defined legal system	55	4.50
Choice of a partner that operates in another market	53	4.34
Choice of a partner that operates in the same market	48	3.93
Difficult financial standing of one of the entities that take part in the process of consolidation	41	3.36
Other	6	0.49
Total	1222	100

Source: prepared by the author based on the author's study.

None of the banks provided the answer concerning the lack of the need for the processes of consolidation. Neutral effect of the process of consolidation on banks in the sector of commercial banks in Poland was reported by 6.67% of the banks.

The most important determinant of the process of capital consolidation in the Polish sector of commercial banks is preparation of a detailed plan of consolidation. This determinant was given 94 points out the total of 96 points. 97.92% of the banks studied reported this factor as the most important. Adequate evaluation of the assets of the consolidated bank was the second factor (90 points) that affected the success of the processes of consolidation in the Polish sector of commercial banks.

Proper information policies significantly affect the success in consolidation, reaching 88 points out the total of 96 points (91.67%). Both external and internal information is conducive to consolidation between the banks. Lack of cultural differences between partners and cleared property issues in banks positively affect the process of consolidation. These factors were given 86 points each. The fact that the banks gave high scores to 'clearly de-

financed property issues in the banks' is the result of the experience with privatization of the Polish banking sector.

Table 4

Positive effects of consolidation processes

Positive effects	Total	Share %
The effect of the improved scale of operation	94	9.54
Cost efficiency obtained through cost reduction	94	9.54
Increase in the market value of the bank	92	9.34
Increased abilities to finance bigger investments	90	9.14
Reduction in the cost of capital	89	9.04
Diversification of business risk	85	8.63
Extended list of services offered	80	8.12
Improved trust among the customers	78	7.92
Increased bank security	76	7.72
Finding new areas of business activity	75	7.61
Implementation of a modern system of management	72	7.31
Combating competition	60	6.09
Total	985	100

Source: prepared by the author based on the author's study.

The banks that carried out the process of consolidation faster obtained the positive effects of this process sooner. In the banks where this process took longer, a variety of social, organizational and financial problems arose, which caused increased negative effects of the consolidation. As is evident from the study, the choice of the partner that operates in the international market is an important determinant of the process of consolidation (79 points). Polish banking sector, compared to the American, Japanese or West European sector, is characterized by a relatively high number of small, undercapitalized banks with poor chances of entering into the international markets on their own. Therefore, the choice of the partner that operates in the international markets helps banks exist in at least European markets. Foreign capital also exhibited „the liking” for the Polish market of commercial banks, successively rising its share in the Polish banking sector through consolidation. In order for the process of consolidation to be successful, the staff in the consolidated banks must show positive attitudes to this process (74 points). The study showed that selected determinants that yielded positive effects of consolidation will allow for drawing attention to the most important ones during preparation of the process of consolidation so that only positive effects of this process can be emphasized, avoiding the difficulties in consolidation. Using the effect of increased scale of operation and cost efficiency are the two basic positive effects demonstrated in the study. Over 95% of the banks studied exhibited an increase in the market value of the bank after the process of consolidation. Over 93% of

the commercial banks studied improved their ability to finance larger investments (e.g. building motorways). In over 92% of the banks, consolidation allowed for reduction in the cost of capital, which had a positive effect on their financial results. Operation of banks is inseparably connected with the risk; the process of consolidation stimulates diversification of the risk of bank's operations (85 points out of 96 points in total). Another positive effect of consolidation in the sector of commercial banks in Poland is extended list of services offered. The bank size changed after the process of consolidation also positively impacts on the increased trust among the customer (78 points). The above effects account for 71.27% of all the positive effects of consolidation processes in the sector of commercial banks in Poland. Processes of consolidation are not only connected with positive effects but also with the negative ones. Proper process of consolidation intensifies the strength of positive effects and reduces the strength of the negative ones. The banks studied indicated that there are negative effects of the processes of consolidation in the sector of commercial banks in Poland. They concerned mainly the costs connected with operations of changes in human resources, technologies and organization. It is impossible to eliminate the negative effects of consolidation. However it is possible to limit them considerably. Elongation of the decision process, decline in the profitability of the bank, formation of the inflexible structure with delayed market response time or creation of informal structures are negative effects of consolidation processes, which, under conditions of the sector of commercial banks in Poland, show insignificant intensity. The causes of this phenomenon can be found in the scale of consolidation in the sector of commercial banks in Poland. Polish consolidations are much smaller (in value) compared to those in American, Japanese and West European banks, and therefore the new banking organizations which are established are resistant to the above negative effects of consolidation processes.

## **Conclusions**

Analysis of the research material leads to the conclusion that the process of consolidation in the sector of commercial banks in Poland takes on average from one to two years. Only in two cases was the consolidation finished within one year. Two to three years was necessary for five banks studied to complete the consolidation process. Fast process of consolidation positively affects achievement of the planned goals.

The majority of the banks answered 'yes' to the question regarding planning of the process of consolidation. The banks perceive consolidation as a chance for improvement of their market position. In most cases, the banks chose the period up to three years or from three to six years as a period of the planned process of consolidation. The vision of the open competitive market in terms of financial services will stimulate the formation of a future model of the banking sector in Poland. The expected changes allow for the assumption that the Polish banking sector will develop towards universal banking, similarly to the countries of the European Union. Globalization and liberalization of financial markets, combined



with the revolution in IT technology leads to the competition “without borders and beyond borders”. Pressure from competition is so big that traditional forms of organization (such as legally independent small bank) have become insufficient. Banks must establish strategic alliances, take over other lending institutions and seek the synergy effect in combating competition. For this purpose, they can establish capital groups, associations, holdings or financial conglomerates. The Polish banking sector, due to its capital size, does not play a significant role in the European market. It is a passive participant in the process of globalization; one of the effects of this process is consolidation. Considering the degree of concentration in the sector of commercial banks in Poland, the number of banks and market opportunities, it is likely that the processes of consolidation will be progressing and, in many cases, they will be the effect of the combination of foreign banks with the capital involved in the Polish banking sector. Consolidation of banks in Poland positively affects the efficiency of the banks, improves their competitiveness, allows for the economies of scale and improves the capital strength of the banks.

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### Summary

The process of consolidation in the banking sector positively affects the capital structure through increased lending capacity of the banks and improved ability to finance development and modernization initiatives. The goal of the present study, carried out on a group of commercial banks, was to identify and verify the determinants that affect the process of consolidation. An essential element of the analysis was identification of the main motivations behind Polish banks making decisions on consolidation. The analysis of the results of the study also emphasized the determinants used in management that provide a precondition for successful consolidation processes.

### **DETERMINANTY „SUKCESU” W ZARZĄDZANIU PROCESAMI KONSOLIDACJI POLSKIEGO SEKTORA BANKOWEGO**

#### **Streszczenie**

Proces konsolidacji sektora bankowego pozytywnie zmienia strukturę kapitałową, wpływając na zwiększenie możliwości kredytowych banków, zdolności do finansowania przedsięwzięć rozwojowych i modernizacyjnych. Celem badania przeprowadzonego w grupie banków komercyjnych była identyfikacja i weryfikacja determinant wpływających na procesu konsolidacji. Istotnym elementem analizy stało się także wyodrębnienie głównych motywów, skłaniających polskie banki do podjęcia decyzji o konsolidacji. W opracowaniu wyników badań zwrócono również uwagę na determinanty warunkujące powodzenie procesów konsolidacyjnych.