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Abstract

In the process of market liberalization, i.e. transition from non-market into market economy, a large number of foreign banks enter the market thereby increasing the inter-banking competition in financial markets. The emergence of other financial institutions (insurance companies, pension funds, building societies...) contributes to the outflow of savings from the state-owned banks as well. The establishment of a great number of financial institutions owned by foreigners, and the sell-out of the state-owned banks, transferred the management of the entire national savings potential to foreigners. Being aware of this, the expected development and growth of the indigenous economies is not possible. It is necessary to retain the existing state-owned banks and by applying the proper business strategy and concepts to channel financial flows into the national economy, and thereby improve its development and growth.

Keywords: Banking system, economic development

1. INTRODUCTION

As it has already been well known, banks in transition countries constitute the biggest and the most important part of the financial system. In the Republic of Croatia the banking sector represents 88.4 per cent of the financial system.

As the fundamental driving force of every economy, banks are an unavoidable object in researching and setting the right course for financial flows. Properly targeted financial flows directly influence the development and growth of all economies.

The basic functions of a bank are collecting funds by managing payment accounts (transaction accounts), receiving sight and time deposits, issuing shares, treasury bills, bonds and other promissory notes, and investing these funds into various development, business, consumer and other credit lines. Out of all business activities of the banks, the following chapters discuss the areas of the research dealing with the citizens' pros-
posibility to save and the factors to choose a bank, as well as the structure of banks’ in-
vestments according to institutional sectors. The primary research was a field research,
conducted in March 2000, on a sample of 189 interviewed in all regions of the Republic
of Croatia, the number being in proportion to the size of each region. The results of the
research indicate the unavoidable need to develop marketing in the state-owned banks,
which, if properly implemented, would exploit the comparative advantages over for-
ign banks and make the state-owned banks retain the leading role in the Croatian
banking system.

Apart from the market liberalization and transition from non-market to market econ-
omy, the establishing of private banks and foreign banks entering the market, as well
as the new financial institutions that emerge, have a huge impact on the outflow of sav-
ings from state-owned banks (life insurance, property insurance, pension funds, build-
ing societies, brokers, investment funds, etc.).

Definitely, the condition for the state-owned banks to survive and succeed in the in-
creasingly demanding and competitive financial market is to accept marketing princi-
pies, techniques and instruments as the basis of market business. These are discussed
in the chapters to follow.

2. ECONOMIC ENVIRONMENT AND STATE-OWNED
BANKS

By the mid 1980s, the main characteristics of the banks in the Republic of Croatia (i.e.
in the federation at that time) were approving loans to companies which established
these banks and under whose direct supervision they were. This kind of long-term pos-
tion and the management from the self-management control of power subsequently
brought about big financial difficulties and regular financial rehabilitation at the tax-
payers’ expense. The economic giants of the self-management used their daughter-
banks as financial services to “mend” operating and other losses. Such an environment
contributed to the creation of the poor inter-banking competition as well as to mutual
deals on setting conditions for doing business on the market.

It was at the end of 1980s that the changes in legislation started the banking system re-
form. Banks were transformed into joint stock companies in which their founders par-
ticipate in the decision-making process proportionally to their equity share. The law
regulated the maximum exposure of one debtor to a bank in order to decrease the pos-
sibility of one over-indebted company to drive the bank into bankruptcy when collapse-
ing itself.

In the first half of 1990s there were two financial rehabilitations of state-owned banks.
During the first one in 1991, the biggest part of banks’ bad investments were written
off at the expense of the state budget without influencing the business policies. Already
in 1996, such a concept resulted in the need to financially rehabilitate three out of four
biggest state-owned banks. Until then, the banks recorded losses amounting many
times over their share capital. These losses originated from bad loans to the state-owned companies (90 per cent of the three financially rehabilitated banks' bad investments were related to only a few state-owned companies). Very soon, the last banking crisis followed appearing as a consequence of the market liberalization and the establishment of a larger number of banks that attracted depositors with high interest rates. Such a competition conditioned higher and higher exposure of banks to credit risk and in the end it drove the biggest number of them into insolvency. Bankruptcy proceedings and financial rehabilitations were conducted in 1998, but the principle was to financially rehabilitate only state-owned banks, while private banks went bankrupt. This biggest banking crisis had an immense impact on the outflow of savings from state-owned and private banks (of Croatian owners) into foreign banks established in the Republic of Croatia. While depositors of the bankrupt banks lost their savings beyond the amount of insured savings, at the same time the depositors of the state-owned banks were refunded the full amount of their saving out of the state budget. As a result of these events, it was easy for the depositors to make a decision where to deposit their savings in the future when realizing that under all those difficulties that in the state-owned banks they are protected by the state budget.

The biggest problem for the outflow of savings from the state-owned banks was the existence of several foreign banks attracting savings with their tradition and image. Instead of changing the management structures and business concepts of the state-owned banks, the state responded with repressive measures. The new Banking Law was enacted at the end of 1998. It stipulates that newly established banks are not allowed to perform banking transactions of collecting deposits and savings of citizens within the first three years upon receipt of the decision on bank operating license. After that no more foreign banks were established. However, foreign banks found their way even in this unfair competition and made a back door entry into the Croatian market by acquiring small regional banks. By doing business successfully through small acquired banks, they realized that the acquisition of a few leading Croatian banks would secure them the monopolization of the market. Now, as a consequence, foreigners own more than 90 per cent of the banking sector.

3. STATE-OWNED BANKS AND ECONOMIC DEVELOPMENT

In the previous chapters, changes in the economic environment in the last ten years were outlined. The most important ones are transition from non-market into market economy and changes to the legal framework in the banking sector. The legal framework was based on the legislation of the developed European countries contributing to entering foreign banks at the Croatian market. The authorities, instead of recognizing the necessity when a reconstruction of the state-owned banks' business was needed, turned to selling these banks providing the denominated state budget with

1. Pobrana banke, Splita banke, Riječka banke
short-term revenues. This tax policy regarding the main driving force of the state economy resulted in foreigners owning 90 per cent of the banking sector. The smaller banks owned by Croatians and one state-owned bank, for which the transfer into foreign hands is being prepared, represent the remaining 10 per cent of the banking sector.

Picture 1: Banks in which the interviewed would deposit their money.

Picture 2 shows the survey results regarding potential depositors in different banks. The four leading banks are perceived as state-owned banks although they are privatized, i.e., sold to foreigners. The majority of the interviewed, 75 per cent and 25 per cent respectively, is willing to deposit their money into the two leading banks. Taking into consideration the fact that the interviewed perceive these banks as state-owned, it should be enough for the authorities to stop selling state-owned banks and even establish new ones.

Picture 2: Savings risk assessment
When reading the survey results on savings risk assessment and having in mind the fact that the interviewed are favouring saving in the state-owned banks, one should not forget the previous banking crisis. As already mentioned, out of all banks in difficulties only the state-owned banks were financially rehabilitated and only their deposits did not lose their savings. The fact that the state-owned banks have such a comparative advantage, it reconfirms the hypothesis that these banks should not by any means be sold in order to fill in the budgetary bases on a one-time basis.

By surrendering the whole banking system to foreign owners a great move was made only to the benefit of their owners while the Croatian economy suffered a big blow. The main business strategy and goals of the foreign owners is the profit exclusively while the development of the Croatian economy is being neglected. The economy is financed only to the limit of existential survival and servicing the approved loans. In the last few years, the increased concentration of the foreign banks has significantly expanded citizens' credit financing, i.e. consumption, while corporate loans have been constantly decreasing. These facts are shown in the following graphs:

Foreign banks obviously prefer loans to citizens stimulating consumption over production what slowed down an already slow economic growth. Consumption support stimulates trade and domestic trade is based mainly on imported goods. Having this in mind, the conclusion can be drawn that the foreign banks in the Republic of Croatia are stimulating and increasing the sale of goods originating in their home countries, are slowing down our economy and indebting citizens through loans.
4. CONCLUSION

The fact that the entire national savings potential is in the hands of foreigners is not only worrying, it is tragic.

Surely, the above-mentioned surveys showed that the Croatian citizens are far more ready to deposit their money into the banks behind which is the state rather than in foreign banks of whatever size, tradition and power. That is why the academic pressure on all political and governing levels must be continued on every possible occasion.

Therefore, it can be stated responsibly that the appropriate economic development and growth can be reached only by means of the state-owned banks, with proper and professional management which would adopt marketing principles, techniques and instruments as the market economy fundamentals.

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