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Evolution of Banking Sector Structures within Central-European Countries during Transition

Ko TAKATA *

* *Graduate School of Economics, Kyoto University, Japan*

Abstract: In recent years, the financial systems of Central-European countries evolved to a stage where they are regarded as having the common characteristic of amplifying the dominance of foreign capital in the banking sector. Within this study, I will compare banking sector structures and bank privatization policies in Hungary, Poland and Czech Rep. during transition, and attempt to examine the causes that generated the dominance of foreign capital. Firstly, I will make a comparison between banking sector structures and show evidence for an increase in the foreign-owned banks dominance in these countries. Next, I will make a comparison between privatization policies, which are considered as significantly responsible for the increased dominance of foreign-owned banks, and will show that privatization policies in recent years have been converging towards a method involving sell-out to foreign capital. Then, I will attempt to examine the causes of this convergence of privatization policies, from the perspective of ownership and achievement, the relevancy of EU accession, and foreign bank business strategies.

Keywords: Central-European countries, Transition, Banking sector, Privatization, Foreign bank, EU accession

JEL Classification Numbers: G21

1. Introduction

From the late 80s to the early 90s, the socialist planned economy regimes in Eastern Europe and the former Soviet Union collapsed, prompting a transition of economic systems aiming to establish capitalist market economy systems similar to those in advanced Western European countries. Within the reforms in each country, liberalization and stabilization were prioritized rather than problems concerning financial systems. Nevertheless, due to repeated experiences of financial crises occurring in the countries in transition, alongside the progress of research into the relationship between financial development and economic growth, as well as that into problems of corporate governance, there has been ever-increasing awareness of the importance of financial systems during transition.

On the other hand, the transition of Eastern European and former Soviet Union countries towards market economies is progressing amidst a worldwide trend toward globalization and regional integration. Together with individual national transitions to market economies, each country must also take international commercial and financial outreach into consideration. Moreover, with regard to Central-European (CE) countries, along with the rapid amplification of commercial relationships with Western European countries, system preparations have also been targeted with EU adherence in mind.

Under such conditions, it has become clear that certain characteristic transformations in financial systems are apparent in the countries in transition, especially the three Central-European countries, namely: Hungary, the Czech Republic and Poland (hereinafter called 'the 3CECs').

According to the studies on changes in the financial sector in transition economies, such as Anderson and Kegels (1998), Bonin *et al.* (1998), Helmenstein (1997), Blejer and Škreb (1999) etc., during the initial period of transition within the 3CECs, numerous similarities in the initial conditions inherited from the socialist period and of reforms lead to many common characteristics apparent in financial system structures. With regard to the relative degree of development within the banking sector and securities market, banking sectors that inherited assets from the socialist period took precedence (Table 1). Banking sector structures were quite similar in each country: national banks retained an oligopoly position, while there were also many incoming new small banks. Subsequently, as due to differing policies governing reforms within the banking sector—namely those concerning bad loan processing and the privatization[1] of state-owned banks[2] or the regulation of new entrants—diversity also became apparent in banking sector structures; in aspects such as the degree of banking sector concentration or the influence of foreign-owned banks.[3]

In recent years, the financial systems of CE countries have evolved such that they are uniformly considered to increase the dominance of foreign capital in the banking sector, hence the characterization of the region as having 'the strongest capital domination in the whole world' (*The Banker*, May 2000).

With regard to the causes of the amplification of foreign capital dominance, the relevancy of privatization policies is illustrated in case studies performed in each country. As will later be revealed, bearing in mind the initial oligopolistical tendency for the banking sector based on several national banks, and the fact that the selection of means of privatization had a direct and significant impact on the financial composition of national enterprises and banks, privatization policies may be considered the most important factor having influenced the capital composition of the banking sectors in each of the CE countries. This suggests that the primary cause for increased foreign capital dominance within the banking sectors in CE countries was the selection of privatization methods, by which foreign capital gained ownership of the main banks within the mid 90s privatization measures.

Table 1 Outlines of the 3CECs' economies and banking sectors in comparison to advanced countries

	Population (million)	GDP per capita ($)	GDP (billion $)		Banking sector Domestic lending (% of GDP)		Stock market Capitalization (% of GDP)	
	1999	1999	1990	1999	1990	1999	1990	1999
Czech Rep.	10	5,474	35	56*	n.a.	65.1*	n.a.	20.9*
Hungary	10	4,788	33	48	105.5	52.2	1.5	33.7*
Poland	39	3,983	61	154	18.8	36.5*	0.2	19.2*

	Population (million)	GDP per capita ($)	GDP (billion $)		Banking sector Domestic lending (% of GDP)		Stock market Capitalization (% of GDP)	
	1999	1999	1990	1999	1990	1999	1990	1999
Germany	82	25,381	1,720*	2,081*	108.5	146.9*	20.6	68.8
Japan	127	34,700	2,970	4,393	266.8	142.4	98.2	103.5
U.S.	273	31,912	5,554	8,709	114.7	170.1	55.1	191.0

* Due to data limitations, other years' data were used.

Sources: The World Bank (2000)

Nevertheless, there are currently no studies that make a detailed comparison between recent privatization policies in the CE countries, nor any that focus on the inter-relationships of the latter and the characteristics of financial system structures, such as the amplification of foreign capital dominance in banking sectors. Buch (2002) makes an analysis focusing on the comparison of policies towards new entrant banks and although stating the significant influence of privatization policies in increasing the dominance of foreign-owned banks, there is scant reference to privatization policies. Krawczyk (2003) shows that in Poland, foreign bank shares expanded rapidly due to the opening of domestic banking business to foreign capital. This was due, in turn, to deregulations for new entrants and bank privatization, and also to the momentum of the 'Europe agreement'. However, since this deals solely with Poland, this cannot be termed a comparative study. Yoshitake (2003) analyses the influences of financial reforms, privatization and the participation of foreign banks, summarizing privatization policies in each country, but avoiding any specific comparison between privatization policies.

With regard to the causes that generated changes in privatization policies during recent years, although those mentioned by Krawczyk (2003), referring to EU accession, are quite important, other factors must also be considered, such as the effects of previous bank privatization and business strategies of foreign banks. Nevertheless, no studies exist explaining these factors comprehensively.

Within this study, I will make a comparative analysis of bank privatization policies in the 3CECs (Hungary, Poland, Czech Rep.) within the period between the beginning of the transition (1992) to 2001. Moreover, by examining the power of the influence of foreign capital within the banking sector structures in each country, I will clarify the influence generated by privatization policy changes and exerted on national financial system structures. In addition, I will examine the causes that generated changes in bank privatization policies.

In the first section, I will make a comparison between banking sector structures in each of the 3CECs and show that the dominance of foreign-owned banks has increased during recent years in each country. In the second section, I will make a comparison between privatization policies, which are considered to have significantly influenced the increased dominance of foreign-owned banks in each of the 3CECs, and will also show that recent privatization policies have shown an increasing tendency toward sell-out to foreign capital. In the third section, I will attempt to examine the causes of national privatization policies converging towards a sell-out to foreign capital, from the perspective of ownership and achievement, the relevancy of EU accession, and foreign bank business strategies.

2. Banking sector structures within CE countries

With regard to the increase in foreign-owned banks within the bank sector structures of each of the 3CECs, here I will review changes in terms of the number of banks as well as the foreign capital share ratios, alongside ownership conditions within the top banks viewed from the perspective of each country's owned assets.

2.1. Initial conditions of banking sectors during the transition period

In the banking sectors within socialist planned economies, national banks cumulated central banking and commercial banking (mono-bank system). National banks, together with affiliated specialized banks, were no more than passive institutions that executed assets distribution under instruction from central planning centres, and absolutely guaranteed by the state. Top state-owned banks during the transition period were either part of national or specialized banks, and therefore during the initial move towards transition, they differed markedly from capitalist banks. Around the beginning of the transition towards capitalism and market economies, two-tier systems were implemented in several banking sectors; Hungary in 1987, Poland in 1989 and Czechoslovakia in 1990, thus separating commercial banking from national banks and prompting the founding of several state-owned commercial banks. In addition, commercial bank licenses were granted to extant specialized banks and to new entrant banks.

Speaking of banking sector structures during the initial transition period in the 3CECs, although the number of banks increased rapidly due to new entries of private banks, composition was still oligopolistic, state-owned top banks occupying the bulk of markets. Examining the degree of concentration in the banking sector from the perspective of asset shares, in Hungary the largest five banks held 93.8% of assets in 1987 and 82.6% in 1990. In Czech Rep., the largest four banks held 82.7% of assets in 1992. In Poland, in 1992 the largest four banks (former specialized banks) occupied 52% of assets, and nine regional commercial banks held 29%, totalling a comparatively low proportion of 81% for thirteen banks, despite a higher degree of regional concentration (Anderson and Kegels, 1998).

2.2. Banking sector structures during the transition period

With regard to the increase in foreign-owned banks within banking sector structures in the 3CECs, I will review: the evolution in the number of banks (Table 2), foreign capital shares in the banking sector (Table 3), shares of assets in foreign-owned banks and the ownership conditions of the top banks (Table 4).

The total number of banks peaked in the mid 90s, then started to decrease in each country, although the opposite was true for foreign-owned banks. The amount of foreign-owned banks as a proportion of the total was three quarters in Hungary, and two thirds in Poland and the Czech Rep. at the end of 2001 (Table 2).

Looking at foreign capital shares in the banking sectors of the 3CECs, the end of 2001, saw the proportion of foreign capital exceed two thirds in each country's banking sector (Table 3). Looking at shares of assets in banking sectors, at the end of 2003, foreign-owned banks reached over 70% in Poland, over 80% in Hungary, and over 90% in the Czech Rep. (*The Banker*, May 2002, April 2003, November 2004). Thus, the majority of the banking sector in CE countries has now been taken over by foreign-owned banks. Looking to the top-ranked banks from the perspective of owned assets, in 2001, six of the seven top-ranked banks in each country were foreign-owned, and with two or three exceptions, all the largest banks were owned by foreign banks (Table 4).

As observed above, the banking sector structure in the 3CECs converged; resulting in a situation where foreign-owned banks hold the majority of each country's banking sector.

Table 2 Number of banks in each country

	1991	1993	1995	1997	1999	2000	2001
Hungary :							
Total number of banks	35	40	43	45	43	42	41
Number of foreign banks	8	16	21	30	29	33	31
Ratio of foreign banks (%)	22.9	40.0	48.8	66.7	67.4	78.6	75.6
Poland :							
Total number of banks	74	87	81	83	77	74	72
Number of foreign banks	6	10	18	29	39	47	48
Ratio of foreign banks (%)	8.1	11.5	22.2	34.9	50.6	63.5	66.7
Czech Rep.:							
Total number of banks	24	52	55	50	42	40	38
Number of foreign banks	4	18	23	24	27	26	26
Ratio of foreign banks (%)	16.7	34.6	41.8	48.0	64.3	65.0	68.4

Note: ‘Foreign bank’ means a bank in which foreign capital ownership is over 50%.

Sources: EBRD (2002) (2003), Buch (2002) and Czech National Bank homepage, http://www.cnb.cz/en/bd_ukazatele _ tab01.php

Table 3 Comparison of foreign capital shares within banking sectors (ratios to total capital in %)

	1993	1995	1997	1999	2000	2001
Hungary	11.6	34.7	60.6	65.0	66.6	n.a
Poland		18.1	39.6	53.1	53.8	n.a
Czech Rep.		22.8	29.3	48.3	54.5	70.0

Sources: Hungary: Data for 1993 to 1996 are from OECD (1997) (2000);
Data for 1997 to 2000 are from National Bank of Hungary (1998) (1999) (2000)
Poland: National Bank of Poland (2001)
Czech Rep.: Czech National Bank (1997) (2000) (2001)

Table 4 Ownership conditions in main banks of Hungary, Poland and the Czech Rep.

At the end of 1994

Hungary				Poland				Czech Rep.			
		Bank name	Home country			Bank name	Home country			Bank name	Home country
1	S	OTP		1	S	PKO BP		1	D	CS	
2	S	MHB		2	S	PeKaO		2	D	KB	
3	S	K&H		3	S	BH		3	S	CSOB	
4	F	MKB	GER	4	S	BGZ		4	D	IPB	
5	S	Postabank		5	S	PBK		5	S	KoB	
6	S	BB		6	F	BSK	NED	6	D	Agrobanka	
7	F	CIB	–	7	S	BPH	–	7	F	Zivnostenska	–

At the end of 1997

Hungary				Poland				Czech Rep.			
		Bank name	Home country			Bank name	Home country			Bank name	Home country
1	D	OTP		1	S	PeKaO		1	D	KB	
2	F	MKB	GER	2	S	PKO BP		2	D	CS	
3	F	K&H	BEL・IRE	3	D	BH		3	D	IPB	
4	S	Postabank		4	D	PBK		4	S	CSOB	
5	F	CIB	BEL	5	D	BIG bank		5	F	Creditanstalt	AUS
6	F	ABN Amro	NED	6	F	BSK	NED	6	F	Zivnostenska	–
7	F	BB	USA	7	D	BPH		7	D	Union banka	

At the end of 2001

Hungary				Poland				Czech Rep.			
		Bank name	Home country			Bank name	Home country			Bank name	Home country
1	F	OTP	–	1	S	PKO BP		1	F	CSOB	BEL
2	F	K&H	BEL	2	F	PeKaO	ITA・GER	2	F	CS	AUS
3	F	MKB	GER	3	F	BPH-PBK	GER	3	F	KB	FRA
4	F	CIB	–	4	F	BH	USA	4	F	HVB CZ	GER
5	F	GE Capital	USA	5	F	ING-BSK	NED	5	F	Raiffeisen	AUS
6	F	HVB HN	GER	6	F	BZ-WBK	IRE	6	F	Zivnostenska	–
7	F	Raiffeisen	AUS	7	F	BRE	GER	7	D	Unionbanka	

Note: 'F' indicates foreign-owned banks. 'S' indicates state-owned banks. 'D' indicates domestic private capital (made by the author from references). At the end of 2001, OTP ownership composition was dispersed ownership of foreign capital, the state owning priority stocks (one-third of the decision-making right). Bank names (abbreviations not appearing within the text): GBTC: General Banking and Trust Co., KOB: Consolidacni Banka. Home country: –: Dispersed ownership or unknown, GER: Germany, NED: Netherlands, BEL: Belgium, IRE: Ireland, AUS: Austria, ITA: Italy, FRA: France

Sources: Yoshitake (2002), *The Banker*, each edition, Bonin *et al.* (1998), Anderson and Kegels (1998) and National Bank of Poland (2001)

3. Privatization policies in CE countries

The measures considered most influential in terms of increasing the number of foreign-owned banks within the banking sectors of the 3CECs are bank privatization policies. In the following section, I will compare methods used to privatize the state owned commercial banks in each country.

3.1. Privatization methods

The main privatization methods used for the privatization of top banks in the 3CECs were sell-out towards strategic foreign financial investors (SFFI method), the initial public offerings (IPO method) and voucher method. Within actual privatization, there were cases involving the use of multiple methods, while the employee buyoff (EBO) method was also adopted as an auxiliary method. The contents of every method, together with their respective likelihoods of heeding transferred shares towards foreign or domestic capital are described below:

The SFFI method is the method used to sell stocks directly to foreign specified investors interested in long-term ownership (strategic investors), through negotiations and tenders. Banks privatized by the SFFI method become foreign owned. Foreign investors regarded as strategic investors are mainly foreign private financial institutions (banks, etc.), although cases when international financial institutions, such as EBRD, became temporary strategic investors have also surfaced.

The IPO method sells stocks to ordinary investors in the form of public market offerings. In the case of the IPO method, since the sell-outs are effectuated in domestic markets, privatized banks become domestic owned. However, there have been cases where they were subsequently purchased by foreign financial institutions, as well as those when the stocks were sold in a foreign market from the start and the banks became foreign-owned.

The voucher method involves distribution in the form of population vouchers (coupons), which are certificates devised specifically for privatization in order to be exchanged for stocks.

The employee buyoff method (EBO) gives enterprise's employees the right to buy their employer's stock. Enterprises privatized by voucher or employee buyoff methods then become domestic -owned.

In what follows, I describe the formation of state-owned commercial banks and the evolution of policies in each country, focusing on the privatization methods actually used.[4]

3.2. Privatization policy in Hungary

Bank privatization in Hungary (1987-1997)

In the Hungarian banking sector, before the transition of the system in 1989, a two-tier system was implemented in 1987. Commercial banking was separated from the National Bank, and for each industrial sector, three state-owned commercial banks were founded. In addition, pre-existing specialized banks affiliated with the National Bank were granted licenses.

In Hungary, the Bank act of 1992 declared that the nationally-owned share of banks should be reduced to less than 25% by 1997 (with the exceptions of OTP and Postabank). Privatization was pursued after bad loans processing.[5]

Magyar Kulkereskedelmi Bank (MKB—The Hungarian Bank for Foreign Commerce) was, from the start, a commercial bank designed for international commerce. It had few bad loans, minimizing the number of capital injections required and was hence the first state-owned commercial bank to be privatized; being sold to the German Bayerische Landesbank (BL) through tender. Immediately after privatization (around July 1994), MKB's ownership share ratios were: 25.01% to BL, 16.68% to EBRD, 21.32% to domestic investors, 8.22% to foreign investors, 1.78% self-owned and 26.99% in nationally-owned shares. Afterwards, BL acquired the latter and took single majority of stock ownership by 1996, meaning the transfer of MKB's management rights to foreign hands.

With regard to Budapest Bank (BB), although the privatization process became entangled in repeated tender disorders, etc., BB was eventually sold to the American GE Capital in 1995, under a state guaranteed indemnity agreement. Immediately after privatization, at the end of 1995, ownership ratios were: 27.5% to GE Capital, 32.5% to EBRD, 18% to domestic investors, and 22% in nationally-owned shares. Afterwards, GE Capital acquired management rights to BB by applying the buyoff clauses specified in its contract with the Hungarian state.

Originally a savings-specialized bank, Orszagos Takarekpenztar es Kereskedelmi Bank (OTP—National Savings Bank) is the largest of the domestic banks in Hungary. Considering the importance of OTP, the Hungarian government declared that it should remain domestic-owned and during its privatization, limited foreigners' decision-making rights to a maximum of 5% per person with a maximum of 49% of shares, and Hungarian decision-making rights to 10% per person. In addition, it decided that the Hungarian state should preserve 25% of the property rights (34% of decision-making rights). The privatization process continued after 1995, and thus from the state-owned 58.4%, 20% of shares were sold out to foreign markets, 5% of shares to employees and 8.4% to the internal market.

For the privatization of Magyar Hitel Bank (MHB—Hungary Credit Bank), after tenders in 1996, 89% was acquired by the Dutch ABN Amro, following which the latter bought the shares of employees, leaving an ownership ratio of 94% to ABN Amro and 6% to other investors.[6]

With regard to Kereskedelmi es Hitel Bank (K&H—Commercial and Credit Bank), following tenders in 1997, the decision was made to sell to a consortium made up of the Belgian Kreditbank (in 1998 they merged and became KBC) and the Irish life insurance company Irish Life. Soon after acquiring its share of 10%, the consortium increased its capital, so that, immediately after privatization, K&H's ownership ratio was 47% to the consortium, 18% to EBRD and 34% nationally-owned share, with more than half owned by strategic foreign investors. Later, KBC bought the shares of Irish Life, domestic investors and the Hungarian state, and became its own subsidiary.[7]

Thus, the method adopted within the privatization of the Hungarian main banks was mainly the SFFI method. As for MKB and BB, the privatization method was an amalgam centring around the SFFI method, meaning half of the capital was privatized by the SFFI method and one quarter by the IPO method, with the rest remaining nationally-owned. As for the MHB, since more than half was made up of strategic foreign investors' share from the beginning, no nationally-owned shares were left. With regard to K&H, the strategic foreign investors' share totalled two thirds immediately after its acquisition, with the last third remaining in state ownership, although a substantial part of the shares left to the state within MKB, BB, K&H were later bought off by strategic investors. The only exception from these top banks was OTP, the largest domestic bank, which remained under domestic ownership; dispersed among a circle of investors.

3.3. Privatization policy in Poland

Bank privatization in Poland (1984-1994)

In Poland, a two-tier system was implemented in 1989. Commercial banking was separated from the National Bank and nine nationally-owned commercial banks were founded; one per region. In addition, licenses to function as commercial banks were granted to specialized banks affiliated to the National Bank.

Bank Rozwoju Eksportu (BRE—Bank for Export and Development), a comparatively small-scale, state-owned bank, was the first to be privatized: with 85% of shares sold by the IPO method and 15% left under state ownership. Later, in 1995, the German Commerzbank acquired 21% on the market, increasing to 48.7% in 1997 thanks to the purchase of capital increments. In 2000, Commerzbank's share increased to 50%.

For the privatization of Wielkopolski Bank Kredytowy (WBK—Credit Bank of Wielkopolska) a combination of the SFFI, IPO and EBO methods was adopted. Nevertheless, in the absence of strategic investors required to apply the SFFI method, 28.5% of the stocks were temporarily acquired by EBRD. Another 27.2% was distributed by the IPO method, 14.3% sold to employees and 30% was left as state property. By March 1995, a capital increment of 16.26% was acquired by Allied Irish Bank (AIB) from Ireland. By 1996, AIB increased its shares to 36.3% in 1996 and by 1997 to 60.14%, thus acquiring majority ownership.[8]

A combined method was also applied with regard to the privatization of Bank Slaski w Katowicach (BSK—Bank of Silesia). Likewise, in this case, the absence of the strategic investors required to apply the SFFI method prompted cancellation of tenders in October 1993. As tender stock prices were intended to become the criterion for the IPO method initial price setting, confusion arose regarding these settings. Eventually, the 'Bank of Silesia issue' developed until it became a political problem. Apart from the 30% sold by the IPO method, and 10% sold to employees, in December the Dutch ING raised its bidding as a strategic investor and acquired 25.9%, with 33.2% left as state property.[9] By 1996, ING acquired majority ownership with a share of 54.98%.

Thus, the first privatization took place using the IPO method, while the following two, concerning regional commercial banks, involving combined methods (the SFFI, IPO and EBO methods working side by side). The proportions in which each method was applied were: at least 25% for the SFFI method, the same for the IPO method, 15% sell-out to employees, and 30% left as property of the state.

Bank privatization in Poland (1995-1997)

After the 'Bank Slaski issue', privatization policy was subject to modifications, hence the privatization of four banks between 1995 and 1997 by the IPO method, rather than seeking foreign investors.

With regard to the privatization of Bank Przemyslowo-Handlowy (BPH—Bank for Industry and Commerce), although 50.2% of the stakes were sold out by the IPO method, scarce demand saw 15.06% of the stocks go into the property of EBRD, the stock-issuing undertaker. Thus, ownership dispersed, with 43% remaining nationally-owned. Afterwards, a proposal to re-nationalize the BHP and merge with BH was raised by the Bank Integration Project of the Polish government, although this was eventually turned down. By 1998, the German Hypo-Vereinsbank (HVB) acquired 36.72% of the state-owned stocks, followed by the stock held by EBRD in the next year, 1999, thus obtaining majority ownership with 60.14%.[10]

With regard to the privatization of Bank Gdanski (BG—Bank of Gdansk), the IPO method was divided into two stages, 31.8% being sold to the domestic market and 25% to foreign markets as depositary receipts in 1995. Apart from this, 4% was sold to employees, hence the share left to the state was 39%.[11] Within the domestic market, the Polish domestic bank Bank Inicjatyw Gospodarczych (BIG) acquired 24.1% by the IPO method. Subsequently, BIG raised its share to 31.23% by 1996, then to 63.42% in 1997.[12]

As for the Powszechny Bank Kredytowy (PBK—State Credit Bank), 51.7% of shares were sold by the IPO method, 15% to employees and 33.3% was left as the state's share.[13] Afterwards, Austrian Bank Austria-Creditanstalt (BA-CA) acquired 15% in 1988, and then increased its share to 43.5% in 1999 and to 57.13% in 2000, thus obtaining majority ownership.[14]

Bank Handlowy (BH—Commercial Bank of Warszawa) was privatized in 1997 by the IPO method. According to the bank integration project of the Polish government, BH was to be restructured, and thus expected to become Poland's 'flagship bank'; one able to stand firm against the competition expected from the foreseeable international opening. Eventually however, the expected merger with BPH was rejected and the bank was privatized under the IPO method. It became a dispersed ownership bank, with 7.9% remaining under state ownership until in 2000, the American group Citibank acquired 87.83% of the bank.[15]

Bank privatization in Poland (after 1998)

After 1998, privatization was pursued using the SFFI method.

Bank Zachodni (BZ—Western Bank) was the last of the nine regional commercial banks; privatized in 1999, when 80% of its stocks were sold to the Irish AIB. The Polish state retained a share of 4.3%.[16]

With regard to Pekao SA (Foreign Currency Savings Bank), a share of 15% was sold in 1989 to the domestic market. According to the bank integration project, issued by the Polish government around fall 1995, restructuring on a higher scale was planned, and it was expected to become Poland's 'flagship bank'. By 1996 Pekao SA absorbed three comparatively small regional commercial banks: Pomorski Bank Kredytowy (Credit Bank of Pomorska), Bank Depozytowo-Kredytowy (BDK—Credit-Deposit Bank) and Powszechny Bank Gospodarczy (PBD—General Economy Bank), becoming Pekao Group. Nevertheless, the group was eventually sold to foreign rather than domestic investors: in 1999 the whole group was integrated into a single bank and sold under the SPPI method. The Italian bank Uni Credito and German Insurance Company Allianz jointly acquired a share of 52.09%. 5.25% was sold out to EBRD, and 13.9% was left under state ownership.

At the end of 2002, of the largest banks, Powszechna Kasa Oszczednosci BP (PKO BP—Domestic Currency Savings Bank) and Bank Gospodarki Zywnosciowej (BGZ—Bank for Provision and Economy) still remained to be privatized, although the sale of PKO BP and BGZ stocks is projected in future.[17]

Thus, in Poland, the first bank was privatized under the IPO method, while that of the next two was done by a combined method. In other words, at least 25% was privatized by the SFFI method, at least 25% by the IPO method, 15% was sold to employees and 30% was left under the state's ownership. After the 'Bank of Silesia issue', from 1995 to 1997, the privatization of four banks was done exclusively by the IPO method. Since 1998, however, privatization was pursued under the SFFI method.

3.4. Privatization policy in the Czech Republic

Bank privatization in the Czech Republic (1989-1997)

Concerning commercial banking of the Czechoslovakian National Bank, due to the implementation of the two-tier system, loaned assets corresponding to enterprises' operating capital were split between Czech and Slovakian parts, while those corresponding to investment funds were taken on by Investicni Banka (IB - Investment Bank). At the same time, pre-existing specialized banks, together with Ceskoslovenska Obchodni Banka (CSOB—Czechoslovakian Commercial Bank), Zivnostenska Banka (ZB—Medium-Small Merchants' Bank), Ceska Sporitelna (CS—Czech Popular Savings Bank) etc., were licensed to function as commercial banks.

In 1992, privatization took place by the voucher method (vouchers to be exchanged for stocks were distributed to the population), and hence, state-owned banks and large enterprises were privatized. Among the four large banks from the Czech part, 53% of Komersni Banka (KB—Bank for

Commerce), 37% of Ceska Sporitelna (CS—Czech Popular Savings Bank), and 52% of Investicni a Postovni Banka (IPB—Investment and Post Bank) were privatized by the voucher method. After this privatization, banks and large enterprises' stocks were dispersed mainly towards privatization investment funds, themselves founded mainly by bank subsidiaries.[18] Within the ownership composition, a relatively large number of shares were left under state ownership: 44% for KB, 40% for CS [19], 45% for IPB; hence the state's control continued to be strong.

In 1993 the Czechoslovakian Federation was dismembered into the Czech Republic and the Republic of Slovakia. On this occasion, among the state-owned large banks, KB, IPB, CS and CSOB were taken over by the Czech Rep..[20]

Bank privatization in the Czech Republic (after 1998)

In November 1997, after the currency crisis, the Czech government decided to sell shares retained by the state within three large banks: KB, CS and CSOB. With regard to IPB, the same decision had already been made, meaning most of the state's share within all of the large Czech banks came to be sold and the relevant privatization method used here was SFFI.

As for IPB, the 36% nationally-owned share was sold to the English subsidiary of Nomura Securities in February 1998, but afterwards, Nomura subsidiary retreated from IPB due to deteriorating management conditions. In June 2000, IPB was absorbed by CSOB.

Agrobanka (Bank for Agriculture), although originally a private bank, was placed under state administration due to management deterioration over a period of two years and subsequently sold out to American GE Capital.

CSOB was sold in July 1999. 66% was acquired by Belgian KBC and 4.3% by International Finance Corporation of World Bank Group.[21]

As for CS, a share of 52% (56% of the administration rights) was sold to Austrian Erste Bank in May 2000. After two capital increments, KB was re-nationalized, then as a result of tenders in 2001, 60% was acquired by the French bank Societe Generale.

In this way, privatization of the largest banks in the Czech Rep. was done by the voucher method, whereby three of the four largest banks were sold. Voucher method privatization sparked a complicated ownership composition in which privatization investment funds founded by large-bank subsidiaries owned not only the stocks of their mother banks, but also those of a multitude of large enterprises. Afterwards, from 1998 onwards, bank privatization, including that of banks initially privatized by the voucher method and then re-nationalized, was done by the SFFI method. Consequently, all the large banks in the Czech Rep. are presently foreign-owned.

3.5. Review of privatization policies in CE countries

Before the advent of privatization, banking sector structures in the 3CECs were under the oligopoly of large banks, and large banks were state-owned. The property structure within the banking sectors was largely determined by the privatization methods adopted.

There were three main methods of privatization applied to large bank privatization in the 3CECs: the voucher method, initial public offerings method (IPO method) and selling to strategic foreign financial investors (SFFI method).

A summary of bank privatization in the 3CECs is presented in Table 5.

Looking at privatization methods adopted in the 3CECs, major changes were apparent around 1997 (hereinafter, privatization before 1997 will be referred to as 'first stage privatization' and privatization after 1998 as 'second stage privatization').

During the first-stage privatization, the main methods used differed in each country: the SFFI method in Hungary, the IPO method in Poland and the voucher method in the Czech Rep.. In addition, fixed shares were retained by states in each country.

During second-stage privatization, privatization methods changed to the SFFI method in all three countries. In addition, almost no state shares were retained, while those retained after the first-stage privatization were sold by the SFFI method.

Therefore, despite the initial 'diversity' of privatization methods adopted for bank privatization in each of the 3CECs, in recent years methods converged to the SFFI method. This explains why large national banks—which once formed oligopolistic structures in each country—were sold to foreign investors directly to increase foreign-owned bank dominance in the banking sectors.

Why was diversity seen within the privatization methods of each country during the first-stage privatization?

Firstly, the effects of limitations resulting from the various situations in each country could be considered. One such limitation appears in the shape of large state debts, which render privatization profits highly necessary. With this in mind, the SFFI and IPO methods would be preferred, since they allow profits to be made (as in Hungary and Poland).

Secondly, political situations were a significant influence. SFFI may be difficult to apply in countries where there is significant opposition to foreign capital (as in the Czech Rep.). In addition, in countries with strong populist tendencies (such as the Czech Rep.), the voucher method is more likely to be adopted.

Thirdly, changes in the privatization method also took place due to various problems during its actual implementation, i.e., cases in which the SFFI method could not be performed due to the lack of strategic investors (as in Hungary and Poland), and cases where, due to the lack of domestic capital or limitation of the stock market processing capabilities there were limitations in the execution of the IPO method (as in Poland).

Thus, the diversity of privatization methods adopted in each country can be presumed to be down to the applicable limitations caused by differences in each country's situation, and on the other hand, following successive trials and failures, due to problems occurring during the actual privatization processes.

Table 5 Privatization policies in 3CECs: privatized big banks and methods (1992-2001)

	Hungary	Poland	Czech Rep. (-1992: Czechoslovakia)	SFFI method in other CE countries
1992			KB (V: 53%, St: 44%) CS (V: 36.7%, St: 40%) IPB (V: 52%, St: 45%)	
1993		WBK (SFFI: 28.5%, IPO: 27.2%, EBO: 14.3%, St: 30%)		
1994	**MKB** (SFFI: 41.7%, IPO: 29.5%, St: 27%)	BSK (SFFI: 26%, IPO: 30%, EBO: 10%, St: 33.2%)*		
1995	OTP (IPO: 28.4%, EBO: 5%, St: 47%) **BB** (SFFI: 60%, IPO: 18%, St: 22%)	BPH (IPO & EBO, St: 43%) BG (IPO: 56.8%, EBO: 4%, St: 39%)*		
1996	**MHB** (SFFI: 89%, EBO: 6%) **MKB(2)** (SFFI)	**BSK(2)** (SFFI)		**Hansapank** (Estonia)
1997	**K&H** (SFFI: 20%; St: 34%)	PBK (IPO: 51.7%, EBO: 15%, St: 33.3%)* BH (IPO) **WBK(2)** (SFFI)		
1998		**BPH(2)** (SFFI)	**Agrobanka** (SFFI) **IPB(2)** (SFFI: 36%)	
1999		**Bank PeKaO** (SFFI) **BZ** (SFFI, St: 4.3%)	**CSOB** (SFFI: 70.3%, St: 19.6%)*	**Express** (Bulgaria) **BDR** (Romania)
2000		**PBK(2)** (SFFI)	**CS(2)** (SFFI: 52%)	**SS** (Slovak Rep.) **PBZ** (Croatia) **Bulbank**, **UBB**, **Hebros** (Bulgaria)
2001			**KB(2)** (SFFI: 60%)	**Banka Slovenska**, **VUB** (Slovak Rep.)

Note: In bold: banks that became 'foreign-owned' by 'privatization' (banks become foreign-owned 'after privatization' are not emphasized). (2) indicates transformation to 'foreign-owned' at the second privatization (by sell-out of state-owned shares or privatization succeeding to re-nationalization). Herein, 'privatization' means reducing state ownership under 50%; 'foreign-owned' means that foreign capital ownership is over 50%; 'foreign capital' includes foreign financial institutions, such as foreign banks, together with international financial institutions, such as EBRD. Privatization methods: V: voucher, SFFI: sell-out to strategic foreign financial investors, IPO: initial public offerings, EBO: employee buyoffs, St: state ownership. Parentheses contain each method ratios. * indicates estimates due to data limitations.

Sources: Yoshitake (2002), *The Banker*, each edition, Bonin *et al.* (1998), Anderson and Kegels (1998) and National Bank of Poland (2001)

Now, why did bank privatization methods converge during the second-stage privatization in each country? In the next section, I will examine the reasons why governments opted for SFFI privatization during second stage privatization, from the perspective of domestic and international situations. In other words, the relevancy of ownership and results on the one hand, and that of EU accession on the other. Another perspective to be examined concerns the strategies of foreign banks: that is, even in cases when the SFFI method was adopted from the first stage of bank privatization, bearing in mind that there were cases when tenders failed to function due to the very fact that foreign banks hesitated to offer tenders, why did foreign banks warm towards participation during second-stage privatization?

4. Causes determining the convergence of privatization policies towards the method of selling to foreign investors

4.1. Relationship between ownership and results

Relation between ownership and results

One of the most important purposes of privatization is strengthening incentives for efficient management by transferring enterprises from state to private ownership. However, the actual experiences of countries in transition show that merely transferring the majority ownership to private enterprises does not necessarily guarantee improved management.

Megginson and Netter (2001) carried out a survey of evidence-based research on enterprise privatization and indicated a few characteristics that can be observed concerning the relationship between ownership structure and enterprise results:

1. Enterprise results are better in the case of private rather than state ownership, and better in the case of concentrated rather than dispersed ownership.
2. Results are better in the case of foreign rather than domestic ownership, and also better in the case of external rather than internal ownership.
3. Results are better in the case of new rather than original managers.

EBRD (1998) considers the following three aspects with regard to ownership structure from the perspective of corporate governance and efficiency within the privatization of transition countries:

1. Concentrated ownership vs. dispersed ownership
2. Insider ownership vs. outsider ownership
3. Domestic resident ownership vs. foreign resident ownership

With regard to the first aspect of ‘concentrated vs. dispersed’, it must be emphasized that, although dispersed ownership is usually desirable, in situations when governance functions cannot be expected due to the immaturity of stock markets, concentrated ownership has the advantage of efficient management supervision of core investors.

With regard to the second aspect of ‘insider vs. outsider’, ‘insider ownership’ permits swift privatization, while 'outsider ownership' is liable to involve technological and management challenges alike, such as the examination and supervision of financing.

With regard to the third aspect of 'domestic vs. foreign', 'foreign-owned' strategic investors provide many advantages, such as capital injections and access to international markets (EBRD, 1998).[22]

Concerning these two studies, although the limited nature of the assessments; to a comparatively short interval of several years after privatization, must not be forgotten, indications seems to suggest that, within privatization during transition, optimal results come when the post-privatization ownership composition fulfils the following three conditions. As it turns out, ownership composition is largely determined by the method of privatization, and the method that best matches the three conditions of 'concentrated', 'outsider' and 'foreign' is the SFFI method, which presumes the sale of specific share allocations to foreign financial investors.

Privatization methods and their advantages

To continue, why are enterprise results most positive (according to comparatively short-term assessments) when privatization carried out under the SFFI method fulfils the three conditions of 'concentrated', 'outsider' and 'foreign'?

Meyendorff and Snyder (1997), when concluding about privatization methods and their effects in their case study on several privatized banks in the 3CECs and Russia, affirm, with regard to the effects of privatization carried out under the SFFI method, that the advantages consist of the acquisition of new capital and expert technology, and also of the introduction of independent corporate governance (Table 6). The effects of bank privatization made under the SFFI method, by Meyendorff and Snyder, are considered extremely important for solving the problems that burden banking sectors during the transition period.

Reordering the problems pointed out by Krawczyk (2003), with regard to nationally-owned banks prior to transition, are as follows:

(A) Problems inherited from the old regime:

1. Bad loans inherited from the old regime ('old' bad loans)
2. Pressure from the state (continuation of loans towards former national enterprises)
3. Issues referring to management/employees (insufficient experience/ technology; lack of financial discipline)
4. 'New' bad loans occurring due to points 2 and 3 above
5. Equipment issues (necessity to modernize infrastructures)

(B) Problems appearing during the process of bank formation:

1. Insufficient self-owned capital
2. Territorial and specialty biases (deviations towards financing particular regions or sectors)

Table 6 Privatization methods and their effects

Ownership transfer method	Representative countries	Potential economic advantages	Potential economic disadvantages
Voucher scheme	Czech Republic	Fast Politically expedient	No new capital raised No new expertise Diffuse ownership
IPO	Hungary and Poland	New capital raised	No new expertise Diffuse ownership Slow
Strategic foreign investor	Hungary and Poland	New capital raised New expertise New corporate governance	Slow

Source: Partially revised after Meyendorff and Snyder (1997).

The positive effects of privatization made under the SFFI method and pointed out by Meyendorff and Snyder respond to many such problems relating to national banks and raise the hope of a solution. This would involve issues concerning a lack of self-owned capital being solved by the introduction of new capital; whereby foreign capital would most likely send a management team, and would also proceed to implement new technology and new equipment, as well as educating employees; thus, allowing management and employee issues to be solved. Moreover, during the execution of the SFFI method, governmental assistance may also be expected. Governments normally process bad loans in order to stimulate buyoffs from outside the country and sell-out most of the state shares in order to dissipate concerns of management interference. These procedures would solve issues concerning 'old' bad loans and state pressures.

Thus, it is believed that one of the factors that determined the convergence of privatization policies to the SFFI method is the recognition of the desirability of the SFFI method, which creates premises for wiping out problems of old national banks, improving management conditions and bringing stability.[23]

4.2. Relevancy of EU accession

EU accession is widely thought to have constituted a strong impulse towards the opening of CE countries' banking sectors to foreign capital.[24] Considered as a return to Europe, accessing the EU became the ardent wish of former socialist countries, and among CE governments there was a strong competition to enter the first group of countries who would access the EU in its eastward expansion. I will consider herein how the EU accessing process constrained the domestic policies of CE countries and how it influenced the appeal of the CE region in the eyes of foreign financial institutions, together with the relevancy of these aspects to privatization under the SFFI method.

As a first step towards EU accession, Hungary, Poland and (then-named) Czechoslovakia signed the Europe Agreement in 1991. This advocated 'staged integration' (Osabe, 2001). Hungary and Poland ratified the Agreement in 1994 and The Czech Rep. in 1995.[25]

According to EU Agreements, banking sectors in 3CECs must abort restrictions with regard to new entrants from EU territories after a five-year moratorium period, and fully open their domestic markets to foreign capital. Furthermore, the EU formulated an accession strategy at the European Council in Essen in 1994 (the White Book of May 1995), implying that each candidate country must accept the entire *acquis communautaire* and the regulations of the internal market (Buch, 2002). EU Banking directives are 'part of a broader mandate to create a single market for service. In banking, a single market means that any provider of banking services can establish itself (or acquire banks) across the Union, and that customers can bank with any credit institutions legally established in the Union' (Gual, 2004). Due to this, in order for domestic banks to be able to rank in the competition against other banks it was necessary to reinforce their competitiveness, so that governments proceeded to restructure financial institutions in each country (Krawczyk, 2003). The main methods used to reinforce banks competitiveness were mergers to increase the scale and acceptance of foreign banks. In Poland, a huge bank grew out of mergers, and thus, the concept of leaving a flagship bank under domestic ownership became known. Also, in both the Czech Rep. and Poland, medium- and small-scale banks were first adjusted and integrated, then sold to foreign banks.

Table 7 Outlines of the course of events prior to EU accession

Europe Agreement (1991)	Pre-accession to EU
Signing (1991)	'Staged integration'
Ratifications (Hungary, Poland: 1994, Czech Rep.: 1995)	
Copenhagen standards (1993)	Declaration of acceptance of CEE countries to EU
	Proposal of accession conditions to CEE countries
Agenda 2000 (1997)	Decision of the first group to begin EU accession negotiations
	Hungary, Poland and The Czech Rep. proceed to accession negotiations.
EU accession negotiations (1998-2002)	Introduction of EU legal system
	Decision of EU accession of ten countries
EU formal accession (May 2004)	

Sources: Buch (2002), Tanaka (1999), Shimada (2001) and Cremona (2003)

The acceptance of CE countries to the EU was first announced at the European Council in Copenhagen in 1993 (Osabe, 2001). In addition, three conditions (Copenhagen criteria), namely political standards, economic standards and introduction of the EU legal system (*acquis communautaire*) were agreed upon as conditions that CE countries had to fulfil in order to access EU (Table 7).

Following the economic standard of the Copenhagen criteria, it was stipulated that countries should have functional market economies and be able to respond to competitive pressures and various market effects within the EU. With regard to banking sectors, factors such as heavy budget limitations, more efficient fund distribution, and reinforced corporate governance were considered as principal conditions in order to restructure enterprise sectors and create a functional market economy (ECE/UN, 1998). It was also specified that in order for the banking sectors of countries in transition to be able to perform such roles, a swift switch from banking activity held by national banks during the former socialist period and the initial transition periods, to activity under a capitalist system was necessary.

After the ratification of the EU agreement, competition began among the CE countries to enter the first group to start negotiations in view of the EU accession. Eager to receive positive assessments of their progress towards reform, governments proceeded to revise legal standards and domestic reforms in an effort to meet EU standards. With regard to the banking sector, Hungary and Poland enacted new bank laws in 1997, and the Czech Rep. largely reformed its bank laws in 1998.

Subsequently, the Europe Commission's report 'Agenda 2000', presented in July 1997, recommended that accession negotiations should start with an initial group of six countries: the Czech Rep., Estonia, Hungary, Poland, Slovenia and Cyprus. In December 1997, this was formally settled by the European Council in Luxembourg (Tanaka, 1999; Cremona, 2003).

Negotiations for EU accession started in 1998. Within the EU accessing process, it was settled that the progress of the introduction of the EU legal system (*acquis communautaire*) into domestic legal systems should be supervised and reported in each field, and that in order to settle EU accession, the EU legal system introduced in each field would have to pass the minimum standards.

Banking sectors of each of the CE countries had to face challenges to stabilize themselves and, at the same time, to adapt their systems swiftly to EU standards. In this context, privatization was believed to have been promoted in order to rapidly enhance the business conditions of large banks and also to transform the whole banking sector into one able to perform steadily under the EU standards. In particular, the SFFI method was preferred as a means of privatization. In addition, as EU accession became more and more certain to CE countries, and their legal systems grew better adjusted, foreign capital started to change the attitude towards this region and manifested itself in the shape of additional participatory interest, facilitating the location of strategic investors, and the implementation of the SFFI method.

In June 2002, at the European Council in Seville, it was stated that accession negotiations would be finalized with ten countries, including eight of the CE countries, and in December 2002, EU accession for the ten countries was formally settled.

In this way, until the decision of the first group of countries to enter EU accession negotiations in 'Agenda 2000' from 1997, conditions to enter the EU had a strong influence on domestic policies in CE countries. This decision generated hope in each country for 'returning to Europe', and also become an impulse for reform during this period. Moreover, as EU accession became more and more certain, the degree of risk of the region decreased in the eyes of foreign investors, who grew more and more interested in the region.

4.3. Foreign bank strategies

Why should a foreign bank buy a state-owned bank?

With reference to expansion overseas and to business development of banks within the country of destination Tsurumi (1988) proposes a 'staged promotion model' in the following order: 1. Data collecting performed by representative offices; 2. Branch office openings, beginning loans to clients from bank's home country; 3. Transactions with top and public enterprises of target country, savings businesses; 4. Participation in retail transactions with enterprises and private persons.

Foreign bank entrance conditions during the initial period of transition within CE countries mainly took the form of comparatively small-scale participation as joint-ventures, and their activity was limited to niche markets, such as providing services to clients from the same countries targeted for foreign direct investments. This situation was due to the fact that foreign banks were averse to increasing their risk in this region, due to various problems concerning each country's macroeconomics, political instability and international loans (Matousek and Taci, 2000). Under the conditions of the first steps of transition caused by strong oligopolies of state-owned banks, many foreign banks chose to limit investment to levels 1 to 3 of Tsurumi's 'stage promotion model'.

Tsurumi (1988) states that, in order for foreign banks lacking sufficient information to gain enough examining capability to overcome the high risks involved by retail transactions in the destination country, it is necessary for them to adapt their capital, personnel and management direction to follow those in the destination country, and points out further that expansion into markets where large banks retain nationwide branch networks, and have already gained strong infrastructures is difficult. An exception is the case when a foreign bank makes a new entry by buying an extant domestic bank.

For a foreign bank, buying a domestic bank and transforming it into its subsidiary means saving the time and cost of building branch office networks. However, when such a national bank is burdened by a multitude of problems inherited from the socialist period, management reforming costs may be quite expensive, considerably accentuating any risks.

With that in mind, why do foreign banks accept such high risks and proceed to build retail networks within CE countries? In what follows, bank strategies toward competition in Europe will be examined, beginning with the situation of foreign bank expansion towards the CE region.

Foreign bank expansion in CE countries and European banks competition strategies

Examining the conditions of foreign bank expansion towards CE countries as of July 2000, looking at the top-share asset holders,[26] the following characteristics can be observed (Table 8):

Table 8 Presence of foreign capital in CEE region and main acquiring banks (June 2000)

	Bank name (Home country)	World rank	Europe rank	Share (%)	Acquired banks in CEE
1	Hypo-Vereinsbank (GER) plus Bank Austria-Creditanstalt (AUS)	7	3	11.2	BPH, PBK (POL)
2	KBC (BEL)	60	37	9.3	ČSOB (CZE) KreditBank (POL) K&H, CIB (HUN)
3	UniCredito (ITA)	51	32	8.9	PaKeO (POL)
4	Citibank (USA)	2	–	7.6	BH (POL)
5	Erste bank (AUS)	102	57	6.5	ČS (CZE), SLSP (SLVK)
6	ING (NED)	25	14	5.1	BSK (POL)
7	Commerzbank (GER)	20	12	4.7	BRE (POL)
8	Raiffeisen Zentralbank (AUS)	180	79	4.1	
9	ABN Amro (NED)	13	7	3.6	MHB (HUN)
10	IntesaBCI (ITA)	30	19	3.5	
11	Allied Irish Bank (IRE)	92	53	3.0	WBK, BZ (POL)
12	Bayerische Landesbank (GER)	34	20	2.3	MKB (HUN)
13	GE Capital (USA)	–	–	2.3	BB (HUN), Agrobanka (CZE)
14	Societe Generale (FRA)	22	13	2.1	
15	BNP-Dresdner (FRA/GER)*	–*	–*	1.9	

Note: Share means the share of assets within CEE region. World ranking and Europe ranking are the assets rankings at the end of 2000. BNP-Dresdner had dissolved their partnership by the end of 2000. BNP-Paribas is ranked Europe's number five, while Dresdner is Europe's number 11.

Sources: *The Banker*, April 2001, July 2001

(1) Most of the banks are from the EU region (12 banks from a total of 14).

(2) Looking at the home countries of the foreign banks, the expansion of banks coming from medium and small countries is conspicuous: Austria, The Netherlands, Belgium, and Ireland.

(3) As for bank sizes within Europe, there are a comparatively high number of medium and small banks: only two of them are in the European top 10 in assets value order. As for the others, five are ranked within 11-20, two within 31-40, two within 51-60 and one 71-80.

Thus, not only giant banks from large countries such as Germany or France are expanding into the CE region, but also those from small countries. Moreover, comparatively small European banks are catching up with them. Let us examine this situation from the perspective of European banks competition strategies.

With regard to the situation of restructuring and competition within the EU region finances (retailing banking), generated by the formation of the EU integrated market prior to EU westward expansion, Iwata (1996) concludes the following: 1. Large-scale banks tend to transform themselves into 'European general financial institutions', through buyoffs across frontiers and types of businesses; 2. Medium-scale banks tend to build alliances across frontiers; 3. In medium and small countries, as well as marginal countries, they try to adapt to competition by domestic mergers. There are also cases of scale magnification and shifting to the first or second category.

Tables 9 through 12 were composed by corroborating the trends of domestic and international restructuring of financial institutions within EU territory by country and period (only buyoff sums over five billion USD were considered). Mergers and acquisitions between banks of the same country in each country of Europe (Table 9) increased temporarily during the late 80s and the early 90s, and after they stabilized once in the mid-90s, increased again steeply in the second half of the 90s, in 1998 and 1999 rising by over 30 cases per year. As for countries, after Great Britain, predominant in international finances, Italy and France, follow with many contracts, Germany following them. In recent years, many mergers and acquisitions may also occur in smaller countries, such as Belgium, and marginal countries, such as Spain, Portugal and Greece. According to Iwata (2001), restructurings include top-class financial institutions from each country; reducing the number of top banks from each country to two or three, and in smaller countries such as Sweden, The Netherlands, Finland, Portugal, Denmark or Greece, the assets of the top five banks account for more than 70% of each country's total.

International restructuring over the European region is also being pursued. Restructuring of international financial institutions occurred every year through the nineties, and particularly intensified after 1998, with more than ten events per year. As for the number of expansions per country (Table 10), apart from large countries as Germany and France, the number of cases in the Netherlands was remarkable. As for acceptances per country (Table 11), they were many in England and France, followed by the Netherlands and Belgium. Looking at the relationship between home countries and destination countries (Table 12), restructurings made between Germany and France, The Netherlands and Belgium, Northern European countries are conspicuous.

Table 9 Financial service sector acquisitions within Europe (1986-2001) (1): domestic consolidation (exceeding $500 million)

Nation	86	87	88	89	90	91	92	93	94	95	96	97	98	99	00	01	Total
UK		3	1		1		1		1	2	7	3	4	5	7	6	41
Germany		1							1	1		2	2	2	1	6	16
France				2	2						2	2	7	5	3	3	26
Italy				1	1	4				1		2	5	11	4	3	32
Netherlands				1	1	1								1	1	1	6
Belgium													6	1		1	8
Austria						1						3			1		5
Swiss*					1			1	2	1		1	1	2			9
Luxembourg																	0
Denmark					1	1				2			1	1		1	7
Sweden					2							3				2	7
Norway*						1					1			1			3
Finland										1					1		2
Ireland					1									1			2
Spain			2			1	1		1				2	1	1	1	10
Portugal											1		1		4		6
Greece													1	2	3		6
Total	0	4	3	4	10	9	2	1	5	8	11	16	30	33	26	24	186

Note: * denotes a non-EU country. Spain and Portugal joined the EU in 1986. Austria, Sweden, and Finland joined the EU in 1995.

Source: Walter (2004, pp. 146-256)

Table 10 Financial service sector acquisitions within Europe (1986-2001) (2): cross-border, acquirer nation (exceeding $500 million)

Acquiring nation	86	87	88	89	90	91	92	93	94	95	96	97	98	99	00	01	Total
UK									1					1	1		3
Germany	1			1	1					1			2	1	2	2	11
France	1			1	1		2	1		1	1		3		2	3	16
Italy										1			3	1	1		6
Netherlands					1	1		1		2		2	2	2	2	3	16
Belgium										1		1		2	1	2	7
Austria															1		1
Swiss*										1	1	1	1	1	1		6
Luxembourg				1													1
Denmark														2	1		3
Sweden													1	1	2		4
Norway*																	0
Finland															1	1	2
Ireland												1					1
Spain															2		2
Portugal																	0
Greece																	0
Total	2	0	0	3	3	1	2	2	1	7	2	5	12	11	17	11	79

Note: * denotes a non-EU country. Spain and Portugal joined the EU in 1986. Austria, Sweden, and Finland joined the EU in 1995.

Source: Walter (2004, pp. 146-256)

Table 11 Financial service sector acquisitions within Europe (1986-2001) (3): cross-border, target nation (exceeding $500 million)

Target nation	86	87	88	89	90	91	92	93	94	95	96	97	98	99	00	01	Total
UK					1					5	1	1	2		3		13
Germany				1			2						2	1	2	1	9
France				1					1			1	2	2	2	1	10
Italy	2			1											1		4
Netherlands								1		1		1	1		2	3	9
Belgium					1			1			1	2	2	2			9
Austria																1	1
Swiss*										1			1			1	3
Luxembourg														1	1		2
Denmark															1		1
Sweden														1			1
Norway*														2	1	1	4
Finland													1		1		2
Ireland																	0
Spain					1	1								1			3
Portugal															2		2
Greece																1	1
Czech														1	1	1	3
Poland													1			1	2
Total	2	0	0	3	3	1	2	2	1	7	2	5	12	11	17	11	79

Note: * denotes a non-EU country. Spain and Portugal joined the EU in 1986. Austria, Sweden, and Finland joined the EU in 1995. Czech and Poland joined the EU in 2004

Source: Walter (2004, pp. 146-256)

Thus, with regard to European finances, it is considered that, due to the formation of the EU integrated market, in all of Europe and also in particular regions, the main tendency is to pursue 'economies of scale and scope'. With regard to the countries forming the nucleus of the EU, together with domestic restructuring and integration, expansion towards marginal countries can be also observed. In addition, in mid- and small-size countries, restructuring and integration is advancing in order to allow institutions to face the intensifying competition within European territory and buyoff over frontiers. With regard to European retail banks, top-bank strategies are oriented to international restructurings meant to create branch office networks through the whole territory, while medium and small-scale banks tend to favour restructurings centred on the domestic market in order to maintain specialized branch office networks in specific regions.

Within these conditions, it can be said that for medium- and small-scale banks, CE countries constitute some of the few new-frontiers prone to expansion and subject to allow scale magnification. While the markets of EU countries—large, medium or small—are already saturated, offering few perspectives for future growth, CE countries' markets represent untapped resources in comparison, promising future high growth. Moreover, CE markets are currently smaller than occidental markets and even smaller-scale occidental banks can hope to acquire large shares in their markets at comparatively low buyoff prices. Thus, it could be said that markets of the newly EU accessing countries due to EU expansion are highly interesting, especially for banks from smaller EU countries.

Based on these facts, it is believed that a few medium- and small-size banks, aiming for their own survival within the EU region, marked the CE market as quasi-domestic and expanded into it more actively than large banks. In addition, in order to provide a concentrated branch office network in these new regions, they took the risky step to bid during privatization made by the SFFI method and bought the branch networks of the pre-existing state-owned banks.

Also, from the perspective of target countries, after Krawczyk (2003, p. 321), there were cases when the governments that decided to sell shares under the SFFI method, fearing the possibility that their countries' banking sectors might be completely taken over by banks of powerful countries, preferred to select banks originating from smaller countries in the course of the tenders under the SFFI method.

Thus, bearing in mind bank strategies envision EU competition and EU expansion, it is believed that the present characteristics of foreign capital expansion towards CE countries are due on one side to the fact that foreign banks—in particular medium and small-scale banks originating from smaller countries of the EU—participated actively within the privatization of CE countries under the SFFI method, and on the other side to the tendency of each CE government to prefer banks from smaller countries.

Table 3 Socioeconomic differences between growing and stagnant companies in 2003

Enterprises	Percentage of companies making investments (%)	Size of investments (mln. US dollars)	Size of investments needed during the last 2-3 years (mln. US dollars)	Percentage of companies where state order was increased (%)	Percentage of new civilian goods in overall production (%)	Percentage of new military goods in overall production (%)	Percentage of companies with outdated technology (%)
Growing	48	0.9	63	51	38	28	54
Stagnant	29	3.4	18	26	31	17	46
In average	42	1.5	50	43	36	25	51
Difference is statistically significant (+)	+	+	-	+	-	-	-

Enterprises	Percentage of companies at the threshold of bankruptcy (%)	Balance of overdue debts (thousand rubles per 1 employee)	Percentage of exports in overall sales (%)	Size of enterprise (number of employees)	Average monthly wages (rubles)	Percentage of employees satisfied with labour relations (%)	Percentage of directors satisfied with their work (%)	Labour productivity of 1 employee (sales in thousand rubles per 1 employee)
Growing	20	-2.6	18	2,700	5,161	80	63	174
Stagnant	33	+9.1	19	1,882	4,729	54	66	189
In average	24	+1.1	18	2,454	5,032	72	63	178
Difference is statistically significant (+)	-	-	-	-	-	+	-	-

5. Conclusion

In the initial transition period, Hungary, Poland and the Czech Rep. adopted different bank privatization policies, but in recent years, due to the fact that bank privatization methods have converged to sell-outs to foreign financial investors, banking sectors in each country came to the common characteristic of being largely occupied by foreign capital.

Within the general progress of globalization and territorial integration, such situation occurring within the banking sectors of CE countries during transition were observed in the process by which banking sectors of the countries in transition were integrated into the EU international financial market. As a result of the situation within which governments had to attempt to swiftly adapt their countries' banking sectors—burdened by the socialist inheritance—with a view to EU accessing, privatization policies gradually tended to converge to state-owned banks selling to foreign banks, while foreign banks, in turn, pushed this tendency further, as it matched their strategies towards globalization and territorial integration.

Notes

[1] Within the present study, 'privatization' is defined as reducing state's share to less than half (from the perspective of property rights) within a state-owned enterprise or bank.

[2] Within the present study, 'state-owned banks' are defined as banks in which state's shares constitute the majority.

[3] Within the present study, 'foreign-owned bank' is defined as a bank in which more than 50% of the shares belong to foreign investors, such as foreign banks or international institutions. 'Foreign bank' means a bank from another country than the CE country in question, and in concrete terms, it refers mainly to European and American banks.

[4] Mentions hereinafter regarding privatization have as references: Anderson and Kegels (1998), Bonin *et al.* (1998), Helmenstein (1997), *The Banker* (quoted numbers), Neale and Boznik (2001), Dedek (2000), Matousek and Taci (2000), Abarbanell and Bonin (1997), Bonin and Leven (1996), Meyendorff and Snyder (1997), NBP (2001).

[5] After the transformation of state-owned commercial banks into corporations, stocks were at first dispersed among state and state-owned enterprises, but, following the limitations imposed by 1992's bank law and through bad loans processing, shares detained by state-owned enterprises were reduced, so that state-owned shares reached to 90% of the stocks of the state-owned banks (Anderson and Kegels, 1998).

[6] Afterwards, MHB merged in 1998 with ABN Amro and became ABN Amro Hungary Bank. In 2001 it was incorporated by K&H, affiliated with Belgian bank KBC'.

[7] By 2001, it incorporated MHB, affiliated with ABN Amro.

[8] WBK merged in 2001 with BZ (also owned by AIB), and became BZ-WBK.
[9] Due to limited data, calculations include also author’s estimations.
[10] Afterwards, as a consequence of the fact that HVB bought Bank Austria-Creditanstalt (BA-CA), in 2000 BPH merged with BA-CA’s subsidiary PBK.
[11] Due to limited data, defalcations include also author’s estimations.
[12] Then, BG merged with BIG and became BIG Bank (Gdansk).
[13] Due to limited data, calculations include also author’s estimations.
[14] Afterwards, as a consequence of the fact that BA-CA was bought by HVB, PBK, in 2000, PBK merged with HVB’s subsidiary BPH.
[15] Afterwards, it merged with a subsidiary of Citibank.
[16] In 2001, it merged with WBK, owned by the same AIB to become BZ-WBK.
[17] At the time of October 2004, privatization of PKO BP was being performed by the IPO method (Internet data).
[18] Since banks were forbidden to settle up investment funds directly, these funds were founded by bank subsidiaries. Ownership was dispersed owing to the rule under which privatization investment funds ownership was restricted to a maximum of 20% per enterprise.
[19] The 40% of CB owned by the state does not include regional government’s 20%.
[20] IPB was founded by merging Investicni Banka (Investment Bank) with Postovni Banka (Post Bank) made from post savings sector.
[21] Afterwards, it merged with IPB in June 2000.
[22] On the other hand, the risk of fraudulence in the case of government’s selection of strategic investors was also pointed out (EBRD, 1998).
[23] Nevertheless, Stiglitz (2002) points out financing discriminations: in Argentina, which is under the control of foreign-owned banks, similarly to CE countries in recent years, foreign-owned banks finance multinational firms and domestics top-class enterprises, financing of medium and small scale banks is insufficient, hence inhibiting economic growth.
[24] Moreover, after it joined OECD and agreed to the clauses concerning liberalization of capital transfers, limitations with regard to founding branch offices were abolished (Buch, 2002).
[25] After its separation from Slovakia, the Czech Republic again signed the Europe Agreement.
[26] Due to the fact that market shares of BNP-Dresdner after its alliance dissolution are unknown, herein it is excluded.

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