

## DEVELOPMENT MILESTONES AND TENDENCIES OF BANKING IN THE CZECH LANDS IN THE CONTEXT OF FINANCIAL LITERACY DEVELOPMENT

Zdeněk Hruška, Lilia Dvořáková

### INTRODUCTION

In the context of the financial literacy development the bank literacy represents its specific part which focuses on the banking sector and related topics like e.g. insurance, stock market, investment etc. Banks represent one of the basic pillars of market economy functioning because they operate mainly in the role of financial agents and enable a fast cash flow. In market economies these are corporates which differ in some features from common business entities, the most significant difference can be the disposition of high sums of entrusted financial funds (Revenda, 2000). In the historical context the banking sector has gone through dynamic development worldwide. The development tendencies of banking in the territory of today's Czech Republic closely correspond with the historical development and important events which often influenced also the government system and the state territory. At first banking developed in response to the world development. North Italy had a significant influence on the form of banking systems of individual European states because **the genesis of banking is dated there in the 12th – 13th century** (Polouček, 2006). The Czech lands were part of the Austro-Hungary until 1918 therefore an independent Czech or Czechoslovak banking system cannot be identified until that year. A significant milestone was the year **1918** when the **independent state Czechoslovakia** is established. Related to the establishment of a new state it was necessary to form a banking system which should have consisted of two stages. At the same time it was necessary to create currency for the new state. In the Czech lands the banking has gone through significant changes from 1918 until 2015. The crucial change can

be considered the transfer from one-stage banking system to two-stage system in 1990.

### THE RESEARCH TARGETS AND METHODOLOGY

In the paper the results of the qualitative research in the banking area with a specific focus on the history, present and development tendencies of banking in the Czech lands in years 1918 – 2015 are presented. The main target of the paper is to identify, analyze and evaluate the milestones and development tendencies in the banking area in the Czech lands since the establishment of an independent Czechoslovak state, i.e. since 1918. In the paper the historical connections in the banking development are related to the political and economical development in the world because they are closely related factors. In the paper the historical development in banking is divided into **7 stages** which are bordered by significant milestones and changes which happened in the current Czech Republic territory. These changes were of a political or economic character. The authors of the paper based the qualitative research by the desk research method on critical literary search of mainly domestic literary sources, especially of monographic publications and scientific studies. Secondary information was further obtained from papers in professional magazines and professional internet servers.

#### 1. DEVELOPMENT STAGE 1918 – 1939 (PERIOD BETWEEN THE WORLD WARS)

A significant milestone which preceded the development stage in 1918 – 1934 was the year 1751 when the first private banking house was founded in the Czech territory. This

banking house was founded in Brno at the time of Marie Terezie reign and it was focused especially on textile manufactures (Ježdík, 2002; Šenkýřová, 2005). As Polouček (2006) states after the formation of the independent Czechoslovakia there were 301 commercial banks, however, their number was reduced by the economic crisis influence. Živnobanka gradually became a significant bank which gained considerable strength especially before the Second World War (Polouček, 2006). The year **1919** can be considered the key year in the history of especially central banking in today's Czech Republic because the **Banking Office** was formed and it operated at the Ministry of Finance (Czech National Bank, 2015; Revenda, 2001). The head of this office was the minister of finance, while the first Czechoslovak minister of finance was Alois Rašín. The Banking Office had the role of the central bank (e.g. it issued state notes, determined the primary interest rates, provided the foreign exchange activity of the state or managed the state debt), however, because of the subordination to the Ministry of Finance it was not completely independent, as the current Czech National Bank is. Until the formation of the Banking Office the Land Bank temporarily held the functions of the institute of issue (Šenkýřová, 2005). Cashless payments were provided by the Postal and Check Office at that period. Already since 1920 there was a direction towards formation of a separate and independent institution in the form of the central bank. Everything resulted in **1925** by establishing the **National Czechoslovak Bank** which started its activity on the 1st April 1926 and by that moment the activity of the Banking Office was finished (Czech National Bank, 2015; Polouček, 2006; Revenda 2001). This bank had a form of a joint-stock company and the chief statutory body of this institution was the bank board of nine members (Vencovský, 1999). The first governor of the National Czechoslovak Bank was Vilém Pospíšil who was followed in 1934 by Karel Engliš (Šenkýřová, 2005). This central bank had the exclusive right to emit banknotes, to manage the circulation of currency and to look after its right function in Czechoslovakia at that time. As

Revenda states (2001) the bank could provide loans also to business entities. By formation of the **Protectorate of Bohemia and Moravia** its functions were reduced, branches were closed and also the name of this bank was changed to the **National Bank for Bohemia and Moravia** (Czech National Bank, 2015). Regarding commercial banking, as soon as in the first development stage the banking system went through a big crisis which lasted in years 1923 – 1926. After overcoming the crisis there were in total 114 banks operating in Czechoslovakia in 1929 which means a decrease compared to the number at the time of Czechoslovakia formation. The most important banks were Živnobanka, Česká banka Union, Česká eskontní banka or Česká průmyslová banka (Šenkýřová, 2005). The banking market showed a dominance of **universal banks** because it was very difficult for specialized banks to find their use at that time and their development started at the end of the 20th century. Over the time banks extended their offer of services by new products which were for example transactions with state bonds (Pátek, 1992). Also institutes of public banking whose target client groups were especially farmers, tradesmen and public had a significant role.

## 2. DEVELOPMENT STAGE 1939 – 1945 (THE SECOND WORLD WAR PERIOD)

In the period between the 15th March 1939 – 8th May 1945 a part of the Czechoslovak territory was occupied by the nazi Germany which was reflected in the banking system too. The central bank was completely subordinated to the **banking of the German Reich** and its new name was the **National Bank for Bohemia and Moravia** and a German representative was appointed in its management. In Slovakia the Slovak National Bank was established. In the Czech territory the legal currency was the Czech crown and the Reich mark. When the exile government in London was formed there was started also a new bank of issue called the **Czechoslovak Currency Office**. It was opened in 1944 in London too (Czech National Bank, 2015). In October 1945 the activities of this office were

started to be executed by the National Czechoslovak Bank which started to work entirely as the central bank of Czechoslovakia (Czech National Bank, 2015). The period of Protectorate also effected the second stage of the banking system when there was a **reduction of commercial banks number** (Polouček, 2006). Most of the banks were expropriated and were directly under the Reich influence. Some banks were even deliberately destroyed (Šenkýřová, 2005). During the Second World War banking was **centralized** which was assisted by the Central Banking Union for Bohemia and Moravia established in 1941. This central union was divided in three economic groups which were further divided in professional groups. Each group was linked to a certain office in Germany. This way the protectorate banking was directly connected to the reich organization. The banking reorganization resulted in reduction of a lot of banking houses, in 1944 there were only six (Vencovský, 1999).

### 3. DEVELOPMENT STAGE 1945 – 1989 (COMMUNISM PERIOD)

Even after the end of the occupation of the Czech territory the number of banks decreased because of the presidential decrees and then all the banks were nationalized (Polouček, 2006). At that time the Czech banking system consisted of the National Czechoslovak Bank, joint-stock banks, private banking houses, land banks, reexcont and lombard institute, cooperative banking institutes, cooperative savings banks and post and municipal savings banks (Vencovský, 1999). After October 1945 the National Czechoslovak Bank became an exclusive institute which had the right to emit banknotes and coins and it made currency reform (Šenkýřová, 2005). The National Czechoslovak bank was involved in the **national economy centralization** in 1948. In 1948 two operating banks were formed, they were Tatrabanka for Slovakia and Živnostenská banka for Bohemia. In that year there were only five banks operating on the banking market. (Revenda, 2001). Long-term loans were financed by Investiční banka. Another key milestone in the central banking area was the

year **1950** when the **banking system reform** was made and the **State Bank of Czechoslovakia** was established. This bank worked as the central bank and took over the functions from the National Czechoslovak Bank. The main tasks of this institution were to emit banknotes and coins, to provide operating loans to economic and business institutions and since 1958 also to provide investment loans – since that year the State Bank of Czechoslovakia was the only universal bank, also labeled a monobank (Czech National Bank, 2015). Another function was to perform settlement and payment operations. The State Bank of Czechoslovakia was subject to the government powers, therefore it lacked the basic feature of a central bank which is independence. More changes came in **1953** when all public banking institutes were transformed into **state regional savings banks** and those fell within the influence of the Ministry of Finance (Šenkýřová, 2005). In 1967 they were united in the Czechoslovak State Savings Bank which was supposed to provide banking services to the Czechoslovak citizens. The Czechoslovak State Savings Bank was divided in two institutions in 1969. They were the Czech State Savings Bank and the Slovak State Savings Bank. There was also the Czechoslovak Commercial Bank operating in Czechoslovakia which was founded in 1964 and started its operation in 1965 (Revenda 2001). This bank focused on monetary relations with foreign subjects. In the researched period in Czechoslovakia except the mentioned banks there operated also the mentioned Živnobanka which focused especially on the monetary contacts with abroad (Šenkýřová, 2005). The key savings product for citizens in this stage were passbooks which were opened on a name or a bearer. Further on the citizens were offered budget accounts or accounts for young citizens and from the passive banking products especially housing loans.

### 4. DEVELOPMENT STAGE 1989 – 1993 (DEMOCRATIC CZECHOSLOVAKIA PERIOD)

The Velvet revolution and the transition from centrally planned economy to **market economy**

meant a number of changes also in the banking area. Since the 1st January 1990 two laws came to force and they significantly influenced the banking system and then the banking reform which meant the decline of the one-stage banking system was started. It was the Law no.130/1989 Col. about banks and savings banks. At that time the **two-stage banking system** was started in Czechoslovakia when the first stage is represented by the central bank and the second stage by commercial banks. In the same year the central bank stopped providing loans to the corporate sector (Revenda, 2001). In 1990 a few banks appeared which was supposed to contribute to the development of market economy. The **State Bank of Czechoslovakia was divided** into central bank, Commercial Bank (Komerční banka) and General Loan Bank (Všeobecná úvěrová banka). Furthermore the Czech State Savings Bank was transformed into Czech Savings Bank Inc. (Česká spořitelna a.s.) (Šenkýřová, 2005). Because of the establishment of market economy and rapid development in the business area it was reflected in the banking sector too. However, at that time the legislation had a number of weaknesses which showed later. Regarding the banking supervision, which is now done by the Czech National Bank, at that time it was performed by the **Ministry of Finance**. As Platscheková (2013) states in 1991 so-called small privatization was carried out and it used 80% of financing from bank loans. Platscheková (2013) further states that in that year 16 new banking licences were granted. The year 1992 meant the beginning of so-called big privatization and the number of banks grew further. Also during the big privatization banks played an important role by their loans. Another significant event of this stage of banking development in Czechoslovakia was the start of the **CERTIS** system (Czech Express Real Time Interbank Gross Settlement System) on the 8th March 1992. It became the only system for interbanking payments (Czech National Bank, 2015). In this stage the Consolidation Bank Prague (Konsolidační banka Praha) was also established (Businesscenter.cz, 2015). In 1992 The Bohemian-Moravian Guarantee and

Development Bank (Českomoravská záruční a rozvojová banka) was founded to support small and medium businesses (Českomoravská záruční a rozvojová banka, 2004).

## 5. DEVELOPMENT STAGE 1993 – 2004 (PERIOD BEFORE JOINING THE EUROPEAN UNION)

High demand for loans was typical for the period of the 90s and the banks took inappropriate risks in a lot of cases (Mejstřík, Pečená, & Teplý, 2008). The year **1993** can be considered the most significant milestone in the history of the Czech Republic in terms of central banking because together with the formation of the separate Czech Republic also the **Czech National Bank** was formed as an independent institution. The main target of the Czech National Bank is to look after price stability (Mejstřík, Pečená, & Teplý, 2008). As Platscheková (2013) states there were measures approved which included strict rules for granting banking licences for new banks. Adopting the Law no. 96/1993 Col. about building savings and the state support of building savings was an important event. Adopting this law led to forming new banking institutions which are called **building societies** (stavební spořitelny). These societies belong to specialized banks (Association of Czech building societies, 2014). In the following year 1994 the requested basic capital for banks was risen to minimal **500 million CZK**. The year 1995 meant the beginning of operation of the **Czech Export Bank** which became an important tool of the pro-export politics. (Šenkýřová, 2005). Platscheková (2013) labels the year 1996 as the black year because the Czech banking was characterized by a lot of frauds which were followed by filing criminal charges. In 1997 small and medium banks were revitalized which resulted from making the Stabilization program where the main role was played by a specialized institution Czech Financial Ltd. (Česká finanční s.r.o.). Then in 1998 the first big bank was privatized, it was the Investment and Post Bank (Investiční a poštovní banka) and further steps were made towards privatization of other big banks. Since 1998 the Czech National Bank switched to

**inflation targeting** (Czech National Bank, 2015). In 1999 new products and services especially for clients from the business area started to emerge on the Czech banking market. At the same time the majority share of ČSOB (Czech and Slovak Commercial Bank) was sold. Some banks lost their banking licences and negotiations about selling the Czech Savings Bank (Česká Spořitelna) were started. The critical situation of cooperative savings banks further influenced the Czech banking market. Since 2000 the Czech National Bank started to use the **Central register of loans** which was focused on information about loan commitments of natural persons and legal entities in business (Czech National Bank, 2015; Platscheková, 2013). In the same year the privatization of the Czech Savings Bank (Česká spořitelna) was finished, it was sold to Austrian Erste Bank. The group Soci t  G n rale became the majority owner of the Commercial Bank (Komer n  banka) in the following year. The year 2002 meant the stabilization of the Czech banking system. Since 2003 the Law no. 124/2002 Col. has been in force, it is about financial funds transfers, electronic payment means and payment systems. In the same year the Union Bank Inc. (Union banka, a.s.) and the Pilsen Bank Inc. (Plzeňsk  banka, a.s.) lost their banking licences. Regarding the most significant product for public clients in terms of conservativeness and profitability it was still **building savings**. However, the state support for this product was reduced from 25% to 15%.

#### 6. DEVELOPMENT STAGE 2004 – 2008 (PERIOD BEFORE THE WORLD ECONOMIC CRISIS)

The year 2004 is considered to be the year of Czech banking stabilization and the number of loans for clients from public grows (Platscheková, 2013). On the 1st May 2004 the Czech Republic joined the **European Union** which effected also the Czech banking because the Amendment to the Law about banks no. 126/2002 Col. and other laws influencing the banking business came into force. During the year 2005 the legislation adjustments continued especially the European Union directives were

implicated into the Czech legislation. In the banking sector a new system was created which enabled to measure and monitor loan risks. Together with the economic growth in 2006 there was also positive development in the banking sector. The banks operating on the Czech banking market then started to closely focus on public and the number of mortgage and consumption loans grew. Furthermore banks started to extend their portfolios of offered products by e.g. insurance or investments. In 2007 banks introduced automated systems of individual clients checking.

#### 7. DEVELOPMENT STAGE 2008 – 2015 (PERIOD OF OVERCOMING THE WORLD ECONOMIC CRISIS)

In 2008 the **world economic crisis** hit the Czech Republic which had an impact also on the financial sector. The Czech banking system did not notice significant interferences in spite of the growth of clasified loans, because it was characterized by its stability. Also for this reason the Czech banking system is considered to be a stable sector with further growth potential. As Platscheková (2013) states the **loan market was stopped** especially in relation to the enterprise sector. The year 2009 was characterized by the growth of risk margins for business entities loans and by toughening the conditions for their providing. In 2010 Fio Bank, Inc. started to operate on the Czech banking market, it can be considered to be a pathfinder in the area of reduction of common banking services fees. In the same year the Czech National Bank presented its inflation target of 2% which was valid until entering the eurozone (Czech National Bank, 2015). As Platscheková (2013) says, since 2011 there has been growth of business entities loans. Other small banks entered the Czech banking market that year and they presented themselves by low fees. They were Equa Bank, Inc. and Air Bank, Inc. In 2012 the banking system of the Czech Republic was characterized by a strong link to other financial institutions such as insurance companies and pension funds. Among other small banks operating on Czech banking market in that period belongs ZUNO BANK.

Also Sberbank entered the Czech market and conversely Citibank limited its operations. In 2014 in the Czech republic an innovative Ferratum Bank started its business too, it focused on providing minimal loans with maturity up to three months. Except this bank Expobank started to work in the Czech Republic (Janda, 2014). In 2015 there are 46 banks and foreign banks' branches in the Czech Republic according to the statistics of the Czech National Bank. On the Czech banking market there are mainly **universal banks**. According to the balance sheet total the **three biggest banks** are ČSOB (Czech and Slovak Commercial Bank), Česká spořitelna (Czech Savings Bank) and Komerční banka (Commercial Bank). Among the significant specialized banks belong building societies. The banks with the state participation also belong among specialized banks. These are the Bohemian-Moravian Guarantee and Development Bank (Českomoravská záruční a rozvojová banka) and the Czech Export Bank (Česká exportní banka). For the current banking market is typical high competition and continuous reduction or cancelling of selected fees. Smaller banks try to get new clients especially by the no-fees policy and lower interest rates e.g. for loan products refinancing. New trends can be identified also in **cashless payments** which is still going through a dynamic development. A great boom was noticed especially by contactless payment cards or chips. Payments by mobile phones are so far at the beginning. A significant development is also seen at electronic banking which can be done not only on computers but also on mobile phones. Even in future we can expect further development in the area of payments and bank products and especially in the area of electronization and reduction of cash payments. In the last development stage there was noticed an attempt of banks to reduce the number of branches, however, according to performed researches the Czech clients are not ready for this step and therefore in the last years banks have taken the opposite direction and open new branches and contact places (e.g. in shopping centres). The year 2015 also meant achieving a new **minimum of**

**average interest rate for mortgage loans** which is 2,05% (Hypindex.cz, 2015). A negative news for the public clients in this stage was mainly the reduction of state support for building savings from 15% to current 10%. The continuous reduction of interest rates for savings accounts and term deposits still goes on. Concerning the future outlook in terms of the state measures, according to the statement of the deputy of the minister of finance we can expect transformation of the Bohemian-Moravian Guarantee and Development Bank (Českomoravská záruční a rozvojová banka) into Czech Investment Bank. It will still be in the property of the state (Houdek, 2015). In terms of central banking the year 2014 was significant especially by the **interventions** performed by the Czech National Bank for the reason to keep price stability and to revive the economy (Janda, 2014). The average interest rate for mortgage loans stays on its minimum as well as the key interest rates declared by the Czech National Bank. The Czech banking sector is currently resistant, stable and profitable according to Pavel Štěpánek (2015). The above-average profitability is identified especially in comparison in Europe. Another feature of the current banking sector in the Czech Republic is the sufficient capital resources. The resistance of the Czech banks to risks was proved also by stress tests performed by the Czech National Bank. The news in 2015 was considering the introduction of so-called reverse mortgage on the Czech financial market. However this kind of loan has not been offered by any banking house in the Czech Republic yet, but the insurance company NOVIS considered its introduction (Střecha, 2015).

## CONCLUSION

The Czech banking has gone through a dynamic development since the formation of the independent Czechoslovakian state till the present while the biggest influence on its form was the political situation and economic development not only in the domestic but in the worldwide context. The banking system form was changing during the time and great

differences can be found. During the monitored period there was the one-stage and also the two-stage banking system in the territory of today's Czech Republic. Since 1989 there has been the two-stage banking system in the Czech Republic which consists of the central bank and other banks. The banking market is characterized by high competition and by targeting on certain client groups. Nowadays banks try to adjust to the clients' needs and they bring innovations in the area of banking products as well as supplementary services to the market. Even in the future we can expect a dynamic development in this segment of national economy. According to the present knowledge and development cash payments will be continuously reduced and they will be substituted by non-cash payments. Further innovations will probably come in product portfolios because banks bring new products in a reaction to clients' demands (as examples can be presented re-loans, re-financing of mortgages, reverse mortgage etc.). A significant development will continue especially in the cashless payment area on the national and international level. Another important milestone for the Czech banking market will indisputably be the acceptance of the unified European currency Euro and therefore the limitation of competences and functions of the Czech National Bank.

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## DEVELOPMENT MILESTONES AND TENDENCIES OF BANKING IN THE CZECH LANDS

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### Abstract

In the paper there are presented the results obtained in the qualitative research in the area of banking with a specific focus on the history, present and development tendencies of banking in the Czech lands. The main target of the paper is to identify, analyze and evaluate the milestones and development tendencies in the banking system area (central banks and commercial banks) in the Czech territory since the formation of the independent Czechoslovak state in 1918 until the present, i.e. 2015. The historical development is divided into seven stages when each stage is bordered by important events of a political and economical character which had a significant influence on the form of the banking system. The stages are dated in the years 1918 – 1939, 1939 – 1945, 1945 – 1989, 1989 – 1993, 1993 – 2004, 2004 – 2008 and 2008 – 2015. In the paper important milestones regarding the banking development are described and prediction of the expected banking system development future periods is performed. For each historical stage of banking development the key events which influenced the character of the banking system and the portfolio of offered services on banking market are identified in the paper. Also the main changes in the first stage of the banking system, namely in the central bank, are documented and analyzed.

**Keywords:** banking; banking system; central bank; commercial banks

**JEL Classification:** G21, N24