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Spis treści

Wstęp.....	11
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Część 1. Procesy rozwojowe krajów i regionów Europy – konwergencja czy dywergencja?

Jan Borowiec: Konwergencja regionalna w Unii Europejskiej.....	15
Leszek Cybulski: Dywergencja rozwoju regionalnego w krajach UE po 2000 roku a polityka spójności.....	26
Zofia Hasińska: Regionalne zróżnicowanie zmian zatrudnienia w Polsce w okresie integracji europejskiej	39
Jarosław M. Nazarczuk: Kryzys gospodarczy a zróżnicowanie regionalne w UE.....	50
Pasquale Tridico: Ten years after the accession of Central and Eastern Europe countries in the EU: evaluation in comparison to the transition in former Soviet Republic.....	60
Zhanna Tsaurkubule, Alevtina Vishnevskaja: Some aspects of economic development of the Latvian market during 10 years of its membership in the European Union.....	82
Dilara Usmanova: Enhancement of the methodological and systematic founda- tion for monitoring socio-economic developments in Latvian regions..	94
Agnieszka Wojewódzka-Wiewiórska: Zmiany poziomu rozwoju społecz- no-ekonomicznego powiatów w Polsce a pozyskiwanie środków z UE....	102

Część 2. Polityka spójności społecznej, gospodarczej i terytorialnej jako narzędzie rozwoju Unii Europejskiej

Wojciech Bożek: Znaczenie i wysokość środków pochodzących z budżetu Unii Europejskiej jako kategorii środków publicznych.....	117
Krystian Heffner, Piotr Gibas: Polityka spójności UE a obszary funkcyjnal- ne centrów regionalnych w Polsce.....	127
Natalia Konopińska: Polityka spójności a obszary górskie na przykładzie programu „Alpine Space”.....	139
Joanna Kudelko: Nowy model europejskiej polityki spójności i jego możli- we konsekwencje dla rozwoju społeczno-gospodarczego w Polsce.....	150
Marek Pieniążek, Dominika Rogalińska: Statystyka publiczna w procesie monitorowania wymiaru terytorialnego polityki spójności	158

Magdalena Pronobis: Fundusze strukturalne w roli kapitału wysokiego ryzyka: skala i przesłanki interwencji.....	166
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Część 3. Beneficjenci polityki spójności

Adam A. Ambroziak: Prawne i ekonomiczne aspekty pomocy regionalnej w Polsce po akcesji do UE.....	177
Maria Bucka: Rozwój małych i średnich przedsiębiorstw w okresie realizacji polityki spójności w 2007-2013	189
Barbara Kryk: Rozwój przedsiębiorczości kobiet w Polsce jako wyraz realizacji unijnej polityki równości	197
Paweł Mańczyk: Opodatkowanie pomocy finansowej z Funduszu Spójności	207
Beata Skubiak: Czy fundusze strukturalne rozwijają województwo zachodniopomorskie?.....	215
Justyna Socińska: Rola i znaczenie Programu Leader w rozwoju obszarów wiejskich w latach 2007-2013 na przykładzie województwa opolskiego ..	225
Piotr Szamrowski, Adam Pawlewicz: Praktyczne aspekty wdrażania podejścia Leader na przykładzie Lokalnych Grup Działania i Lokalnych Grup Rybackich funkcjonujących w województwie warmińsko-mazurskim.....	233
Katarzyna Tracz-Krupa: Analiza wpływu Europejskiego Funduszu Społecznego na rozwój zasobów ludzkich w Polsce	245
Anna Tutak: Zmiany w podejściu do świadczenia usług szkoleniowych w ramach EFS w latach 2004-2013	256
Magdalena Wojarska, Izabela Zabielska: Samorząd lokalny jako beneficjent funduszy unijnych (na przykładzie gmin województwa warmińsko-mazurskiego)	266

Część 4. Wiedza i innowacje a polityka spójności Unii Europejskiej

Małgorzata Dziembala: Wspieranie inteligentnych specjalizacji regionów w Unii Europejskiej w warunkach globalizacji	279
Dorota Kwiatkowska-Ciotucha: Programy rozwojowe uczelni szansą wzbogacenia oferty i podniesienia jakości kształcenia w polskich szkołach wyższych	289
Dorota Murzyn: Innowacyjność w polityce spójności Unii Europejskiej.....	301
Aleksandra Nowakowska: Inteligentne specjalizacje regionalne – nowa idea i wyzwanie dla polityki regionalnej	310
Agata Surówka: Innowacyjność województw Polski Wschodniej na tle kraju	319

Nataliya Tyuleneva, Anastasia Lisnyak: Social and economic development of regions based on cluster programs: European and Russian experience .	327
Monika Zadrożniak: Wyrównywanie szans edukacyjnych w ramach polityki spójności jako kierunek poprawy jakości życia mieszkańców obszarów wiejskich w Polsce	334

Część 5. Problemy rozwoju regionalnego

Bernadeta Baran: Terytorialne odniesienie działań rozwojowych w Strategii Rozwoju Województwa Dolnośląskiego	345
Aranka Ignasiak-Szulc, Ireneusz Jaźwiński: Pozycja ustrojowa samorządu województwa w kontekście jego roli w polityce rozwoju w Polsce	356
Łukasz Olipra: Dostępność usług transportu lotniczego jako czynnik lokalizacji inwestycji zagranicznych na Dolnym Śląsku.....	368
Ewa Pancer-Cybulska: Europejskie Ugrupowania Współpracy Terytorialnej (EUWT) w pakiecie legislacyjnym na okres programowania 2014-2020	383
Ewa Szostak: Umowa Partnerstwa a Regionalny Program Operacyjny dla Dolnego Śląska na lata 2014-2020	394
Paweł Wacek: Rozwój gospodarczy a systemy transportowe regionów Polski.....	406
Alicja Zakrzewska-Półtorak: Wybrane aspekty rozwoju społeczno-gospodarczego i przestrzennego województwa dolnośląskiego po wejściu do Unii Europejskiej.....	416

Część 6. Rozwój społeczno-gospodarczy w Europie i problemy integracji

Iwo Augustyński: Struktura zadłużenia firm polskich na tle wybranych krajów europejskich na tle kryzysu z 2008 roku	429
Tetiana Girchenko: Formation of competitiveness of Ukrainian banks under the influence of foreign capital	443
Zbigniew Jurczyk, Barbara Majewska-Jurczyk: Model ochrony konsumentów w Unii Europejskiej	453
Danuta Kabat-Rudnicka: Orzecznictwo Trybunału Konstytucyjnego RP w kluczowych kwestiach integracji europejskiej. Uwagi na marginesie polskiego członkostwa w Unii Europejskiej	465
Lidia Kłos: Rzeczowy wymiar polityki spójności w rozwoju branży wodno-kanalizacyjnej w Polsce	472
Zbigniew Mikołajewicz: Bezpieczeństwo energetyczne w polityce spójności Unii Europejskiej	481

Danuta Milaszewicz: Jakość rządzenia a rozwój społeczno-gospodarczy w krajach UE	491
Anna Nowak, Katarzyna Domańska: Konkurencyjność rolnictwa Polski Wschodniej w aspekcie zrównoważonego rozwoju.....	501
Zhanna Tsaurkubule: Improving social policy of Latvia as a factor of sustainable development of the state.....	510
Grażyna Węgrzyn: Zmiany strukturalne na rynku pracy – modernizacja czy stagnacja?	525

Summaries

Jan Borowiec: Regional convergence in the European Union	25
Leszek Cybulski: Divergence of regional development in the EU after 2000 and Cohesion Policy.....	38
Zofia Hasińska: Regional differentiation of changes in employment in Poland in the period of EU integration.....	49
Jarosław M. Nazarczuk: Economic crisis and regional inequalities in the European Union.....	59
Pasquale Tridico: Dziesięć lat po przystąpieniu krajów centralnej i wschodniej Europy do Unii Europejskiej: porównanie z przemianami w byłym Związku Radzieckim	81
Zhanna Tsaurkubule, Alevtina Vishnevskaja: Wybrane aspekty rozwoju ekonomicznego rynku Łotwy w ciągu dziesięciu lat jej członkostwa w Unii Europejskiej.....	93
Dilara Usmanova: Udoskonalanie metodologicznej i systematycznej organizacji monitorowania rozwoju społeczno-ekonomicznego regionów łotewskich.....	101
Agnieszka Wojewódzka-Wiewiórska: Districts changes in the socio-economic development level in Poland and obtaining EU funds.....	113
Wojciech Bożek: Significance and amount of funds from the budget of the European Union as a category of public resources.....	126
Krystian Heffner, Piotr Gibas: EU cohesion policy and functional areas of regional centres in Poland	135
Natalia Konopińska: “Alpine Space Programme” as an example of implementation of cohesion policy in mountain areas	149
Joanna Kudelko: New model of the European cohesion policy and its implications for social and economic development in Poland.....	157
Marek Pieniążek, Dominika Rogalińska: Public statistics in the process of monitoring of territorial dimension of cohesion policy.....	165
Magdalena Pronobis: Structural funds as venture capital: scale and conditions for intervention.....	174

Adam A. Ambroziak: Legal and economic aspects of regional state aid in Poland after the accession to the EU	188
Maria Bucka: Development of small and medium-sized enterprises during the implementation of cohesion policy in 2007-2013	196
Barbara Kryk: Development of women's entrepreneurship in Poland as a form of EU policy implementation of gender equality and employment ...	206
Paweł Mańczyk: Taxation of the financial assistance from the Cohesion Fund	214
Beata Skubiak: Do the structural funds develop Western Pomerania?	224
Justyna Socińska: Role and importance of Leader in the development of rural areas in 2007-2013 on the example of the Opole Voivodeship	232
Piotr Szamrowski, Adam Pawlewicz: The practical aspects of the implementation of the LEADER approach on the example of the LAGs and Fisheries Local Action Groups operating in the Warmia and Mazury Voivodeship	243
Katarzyna Tracz-Krupa: Analysis of the European Social Fund impact on the human resource development in Poland	255
Anna Tutak: Changes in approach to training programs conducted under Europejski Fundusz Społeczny fund in years 2004-2013	264
Magdalena Wojarska, Izabela Zabielska: Local government as a beneficiary of EU funds (on the example of the municipalities of the Warmia and Mazury Voivodeship)	275
Małgorzata Dziembala: Supporting of smart specialization of regions in the European Union in a globalized market	288
Dorota Kwiatkowska-Ciotucha: Development programs of universities as an opportunity for developing educational offer and improving the quality of teaching at Polish universities	300
Dorota Murzyn: Innovativeness in EU cohesion policy	309
Aleksandra Nowakowska: Regional smart specializations – a new idea and a challenge for regional policy	318
Agata Surówka: Innovativeness of Eastern Poland voivodeships compared with other regions	326
Nataliya Tyuleneva, Anastasia Lisnyak: Rozwój społeczno-gospodarczy regionów na podstawie programów klastrowych: doświadczenia Unii Europejskiej i Rosji	333
Monika Zadrożniak: Equalization of educational opportunities within the framework of cohesion policy as a way to improve the quality of life for residents of rural areas in Poland	342
Bernadeta Baran: Territorial dimension in the development strategy for the Lower Silesian Voivodeship	355

Aranka Ignasiak-Szulc, Ireneusz Jaźwiński: Legal status of voivodeship self-government in the context of its role in the development policy in Poland	367
Lukasz Olipra: Accessibility of the air transport services as a determinant of foreign investments location in Lower Silesia.....	381
Ewa Pancer-Cybulska: European Groupings of Territorial Cooperation (EGTC) in the legislative package for the 2014-2020 programming period.....	393
Ewa Szostak: Partnership Agreement and Regional Operational Program for Lower Silesia for the years 2014-2020.....	405
Paweł Wacek: Economic development and Polish transportation systems.....	415
Alicja Zakrzewska-Półtorak: Selected aspects of socio-economic and spatial development of Lower Silesian voivodeship after joining the European Union	426
Iwo Augustyński: Comparison of the debt structure of Polish companies with selected EU member countries against the background of the financial crisis from 2008.....	442
Tetiana Girchenko: Kształtowanie się konkurencyjności banków ukraińskich pod wpływem obcego kapitału.....	452
Zbigniew Jurczyk, Barbara Majewska-Jurczyk: Model of consumer protection in the European Union.....	464
Danuta Kabat-Rudnicka: Polish Constitutional Court's jurisdiction on the key issues of the European integration. Remarks on Poland's membership in the European Union.....	471
Lidia Kłos: Material dimension of cohesion policy in the development of the water-sewage industry in Poland.....	480
Zbigniew Mikołajewicz: Energy security in the cohesion policy of the European Union.....	490
Danuta Miłaszewicz: Governance quality vs. socio-economic development in the European Union.....	500
Anna Nowak, Katarzyna Domańska: Sustainable development approach in agriculture competitiveness of Eastern Poland	509
Zhanna Tsaurkubule: Poprawa polityki społecznej Łotwy jako czynnik zrównoważonego rozwoju państwa.....	524
Grażyna Węgrzyn: Structural changes in the labour market – modernisation or stagnation?.....	534

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FORMATION OF COMPETITIVENESS OF UKRAINIAN BANKS UNDER THE INFLUENCE OF FOREIGN CAPITAL

Summary: The article provides an analysis of the impact of the global financial crisis on the processes associated with the movement of capital and the main trends of foreign banks in Ukraine. The author investigates the dynamics of the expansion of foreign capital in Ukraine over the last decade, structural changes in the competitive environment in the banking sector, banking market restructuring, distribution of banks with foreign capital by the country of origin equity, reasons of foreign capital outflow from the country in the post-crisis period. Moreover, the article provides a comparative analysis of the structure, level and rate of expansion of foreign bank capital in Central and Eastern Europe. As a result, the author determines the effects of the expansion of foreign banks due to the increasing levels of competition and efficiency of the banking system, the role of foreign banks in shaping the competitiveness of the domestic banking sector in Ukraine and suggests possible lines forming the competitiveness of domestic banks under the influence of foreign capital.

Keywords: banking system, foreign capital, competition, competitiveness of the bank, competitive environment.

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1. Introduction

The presence of large amounts of foreign capital in the economy of any country is a sign of macroeconomic stability and a high level of investor confidence. Over the last 2 years, the share of foreign capital in the banking system of Ukraine has decreased by 7.9%. Thus, at the beginning of 2014 according to the official data of National Bank of Ukraine the share of foreign capital in the authorized capital of banks was 34% as opposed to early 2012, when the share of foreign capital in the authorized capital of banks was 41.9%.

At present, the banking systems of foreign countries are characterized by the significant presence of foreign capital. The liberalization of financial systems in Central and Eastern Europe has meant that foreign affiliates have 60-90% of bank assets. For example, in Slovakia the vast majority of the national banking system

represented by banks with foreign capital today (the share of assets held by foreign owners is 96.72%) with the bulk of foreign capital comes from Luxembourg (30%) and Austria (29%)¹.

In Romania, the banking sector is characterized by a constant growth of foreign capital: in 2004, foreign banks owned 38% of the banking market, while in 2012, their share in the total assets of the banking system reached 50%. In the Czech Republic the share of foreign capital in the total capital of the banking system is 90%, of which 33% of the registered capital is owned by Austria, 17% by France and 8% by Germany².

The share owned by foreign banks in the total assets of the banking system of Estonia in 2005 was 98%. Almost the entire banking sector is controlled by foreign capital there. More than 80% of banking assets are controlled by the Swedish holdings today. Estonia managed to prevent the occurrence of excessive amounts of unreliable small banks, and as a result – to prevent a banking crisis, as happened, for example, in Lithuania, which focused on the development of domestic production, especially agriculture. As in manufacturing, the majority of lending institutions exist due to internal investments. One of important factors of investments increasing was the privatization of large state facilities, including the Lithuanian Savings Bank, which was bought by the Swedish bank “Swedbank”. The development of the credit system in Latvia is based on both local and foreign capital that comes from many European countries and the USA. In Latvia (like in Hungary and Poland) more than 2/3 of bank assets are under control of foreign capital. In Hungary, which has the most powerful banking system in Eastern Europe, foreign banks own 60% of all banking assets.

The example of Poland is noteworthy, as the banking system passed a difficult way of development and has achieved considerable success there. The country has no restrictions of foreign capital. The largest share in total banking assets is owned by banks from Germany (19%), Italy (15%) and the USA (9%)³. Banks with foreign capital constitute over 3/4 of the banking system in Poland.

The global financial crisis has affected the processes of movement of capital. As it is stated in the materials of the European Central Bank (ECB) on 01.01.2013, 511 financial institutions ceased to operate in the EU. The number of organizations decreased to 9076 and the number of financial organizations in the euro area fell by 6% to 7059 banks. In Luxembourg, in 2012, 124 banks ceased to operate, which is the maximum rate in the Eurozone. France (105 financial organizations) and Italy (55) are also in a group of top three countries in terms of the number of banks that have ceased to work. The ECB notes that the reason for the reduction of the financial sector is not only bankruptcy but also mergers and acquisitions. As a percentage Slovakia came first, as 30% of banks ceased to operate there. Luxembourg was the second (22%), and France third (9%). Since the beginning of the euro zone in 1999 the number of financial organizations decreased by 28%, i.e. by 2797 banks. The

¹ The official website of the Central Bank of Slovakia: www.nbs.sk.

² The official website of the Central Bank of the Czech Republic: www.cnb.cz.

³ The official website of the Central Bank of Poland: www.nbp.pl.

largest financial sectors remain in Germany and France, which together account for 42% of the banking sector across the Eurozone⁴

2. Foreign capital in Ukrainian banking sector

Table 1 presents the dynamics of the share of foreign banks in Ukraine for the period 2001-2014, which shows that the banking system of Ukraine was characterized by a significant increase in the share of foreign capital and the position of foreign banks on the domestic financial market has strengthened since 2012. In Ukraine the first representative offices of foreign banks opened in 1993, and in the middle of that year “Credit Lyonnais Ukraine”, the first bank with 100 percent of foreign capital, was created. In 1995, the share of foreign banks in the total banking institutions in Ukraine was 5.2%, while the share of foreign capital in the authorized capital of domestic banks at the end of the year was 1.1%.

The share of foreign capital in the authorized capital of banks on 01.01.2012 reached a maximum value of 41.9% (an increase of 28.6% from 13.3% recorded on 01.01.2001). The acceleration of the integration process by expanding the presence of foreign capital in the banking system of Ukraine is seen in the number of banks with 100% foreign capital which increased 3.14 times from 01.01 2001 to 01.01.2013.

On 01.01.2014, 180 banks, including 49 banks with foreign capital (27.22% of the total number of registered banks in Ukraine), of which 19 banks (10.56%) with 100% foreign capital, had the license on banking operations given by the National Bank of Ukraine.

The development of banking infrastructure (an increase in the number of banks with foreign capital, and an increase in the the share of foreign capital in the authorized capital of banks) in the period 2001-2014 has had a positive effect on changes in GDP of Ukraine and, as a consequence, on the development of the economy as a whole.

Analyzing the geographical distribution of banks with foreign capital by countries at the beginning of 2014, we observe some changes in comparison with the two previous years. In early 2014 Cyprus occupied the leading place. The capital of this country held the largest share in the total number of banks with foreign capital – 24.49% (20.34% – in early 2012), while 18.37% of banks with foreign capital in Ukraine were controlled by the Russian Federation. From the beginning of 2012 their share rose by 3.12% from 15.25%. The third was Austria (10.20%). Banks from other countries had less than 10% of capital share in the system.

⁴ Foreign banks recover from stress: http://www.epravda.com.ua/publications/2011/07/20/292399/_print/.

Table 1. Gross Domestic Product and the number of banks in Ukraine for the period 2001-2014

№	Indicator name	01.01.2001	01.01.2002	01.01.2003	01.01.2004	01.01.2005	01.01.2006	01.01.2007	01.01.2008	01.01.2009	01.01.2010	01.01.2011	01.01.2012	01.01.2013	01.01.2014
GDP of Ukraine, mln.hrn.															
1.	Gross Domestic Product (at current prices), mln.hrn.	170070	201927	225810	267344	345113	424741	388584	720731	948056	913345	1082569	1316600	1411238	1454931
Number of banks															
1.	Number of registered banks	195	189	182	179	181	186	191	198	198	197	194	198	176	180
2.	Number of banks with banking license:	153	152	157	158	160	165	167	175	184	182	176	176	176	180
2.1.	with foreign capital	22	21	20	19	19	23	32	47	53	51	55	53	53	49
2.2.	including 100% of foreign capital	7	6	7	7	7	9	11	17	17	18	20	22	22	19
3.	The share of foreign capital in the authorized capital of banks,%	13.3	12.5	13.7	11.3	9.6	19.5	22.9	35.0	36.7	35.8	40.6	41.9	39.0	34,0

Source: formed by the author on the basis of the National Bank of Ukraine data⁵.

The decision of some European shareholders to leave the Ukrainian market was justified under high competitive pressure from both domestic and systemic foreign banks, extremely high reserves that they had to form in order to fulfill the regulatory requirements of the National Bank of Ukraine, as well as uncertainty about the political situation and the consequences of the collapse of economy that strengthened the losses from generously given pre-crisis currency loans, which, after a catastrophic devaluation of *hryvnia* in 2008, borrowers were unable to pay. Financial support from the parent companies, in turn, was hampered by financial problems in Europe and the stringent requirements of the “Basel III” capital adequacy. Foreign banks leaving reduces competition in the banking market, resulting in a possible decline in quality.

Table 2 presents the role of the largest foreign banks in the economy based on the proportion of assets and liabilities in the system. Considering only a 5% or higher share of domestic banks in the assets or liabilities of domestic banks as important,

⁵ Basic indicators of banks in Ukraine: National Bank of Ukraine, http://www.bank.gov.ua/Bank_supervision/dynamics.htm.

“Prominvestbank” (owned by Zovnisheconombank) is the only important bank in terms of corporate lending among banks operating in Ukraine. In terms of lending to individuals, important systemic banks are “Ukrsotsbank” (UniCredit group), “Raiffeisenbank Aval”, “UkrSibBank” (BNP Paribas).

Table 2. The share of foreign banks that are members of the first group of assets and customer accounts of the banking system of Ukraine, as at 01.01.2014

Name of bank	The share of banks, %		
	In the assets of the system	In corporate lending, %	In individuals lending, %
Raiffeisen Bank Aval	3.4	2.9	5.4
Ukrsocbank	3.4	2.4	7.9
Prominvestbank	3.1	4.3	0.1
Sberbank of Russia	2.7	3.8	0.9
Alfa-Bank	2.3	2.4	3.3
VTB Bank	2.0	2.4	2.1
UkrSibBank	1.9	1.2	4.8
I group of banks	64.3	63.1	69.9
The banking system	100.0	100.0	100.0
	In customer accounts	In the capital of legal entities	In the individual's funds
Raiffeisen Bank Aval	3.8	4.5	3.3
Ukrsocbank	3.1	3.7	2.7
Prominvestbank	2.0	2.2	1.8
Sberbank of Russia	2.7	1.9	3.2
Alfa-Bank	2.3	2.5	2.1
VTB Bank	1.6	1.6	1.6
UkrSibBank	2.4	2.9	2.1
I group of banks	62.9	56.1	66.9
The banking system	100.0	100.0	100.0

Source: formed by the author on the basis of the National Bank of Ukraine data⁶.

The first group of banks has a crucial impact on the banking system of Ukraine: all foreign banks-members of the first group control 19% of customer funds and 18% of banking system assets. It is promoted by higher standards of risk management and requirements for the selection of borrowers.

Foreign banks affect the change in the competitive environment, and thus alter the level of competitiveness of individual banks and the banking sector as a whole. In Ukraine, banks with foreign capital, taking strong competitive positions, actually have the opportunity to choose which sector to lend, to vary interest rates in the domestic market, to displace weaker domestic banks.

Under the influence of foreign banks, domestic banks are under threat of loss of market share and deterioration of competitiveness, so they have to respond quickly to environmental conditions that will come close to the performance of foreign

⁶ Ibidem; <http://www.asconsulting.com.ua/articles>; Forum of Leading International Financial Institutions, <http://www.flifi.org.ua/>.

banks and, as a result, have a positive impact on the competitiveness of the domestic banking sector of Ukraine.

The research of indicators of competition in the banking systems of 50 countries between 1994 and 2001 suggests that banking systems with higher presence of foreign capital and fewer regulatory restrictions on its occurrence and activity were observed to compete⁷. A number of regional studies demonstrate the increased competitiveness of the banking system under the influence of foreign banks through:

- reduction in interest rates,
- efficient allocation of credit,
- system benefits (higher rates of foreign banks activity improve the total rates of the system).

To determine the effect of foreign banks on the competitiveness of domestic banks key indicators of their activity should be analyzed.

Let us conduct the research of the first group of banks by the parameters of return on capital and return on assets for the period 2006-2013. As shown in Fig. 1 and 2, average return on assets and own capital of domestic banks throughout the studied period, except for 2007 and 2012, was higher compared to banks with foreign capital.

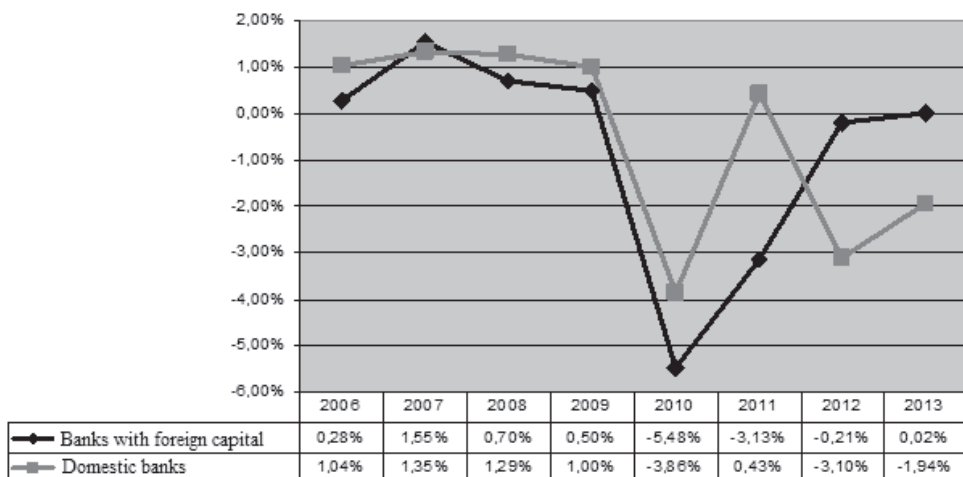


Figure 1. The average return on assets of Ukrainian banks of the first group

Source: formed by the author on the basis of the National Bank of Ukraine data⁸.

⁷ R.V. Kornelyuk, *Foreign banks in Ukraine: impact and adjustment: monograph*, eds. R.V. Kornelyuk, I.B. Ivasiv, O.M. Dyba, KNEU, 2012, p. 234.

⁸ Basic indicators of banks in Ukraine: National Bank of Ukraine, http://www.bank.gov.ua/Bank_supervision/dynamics.htm.

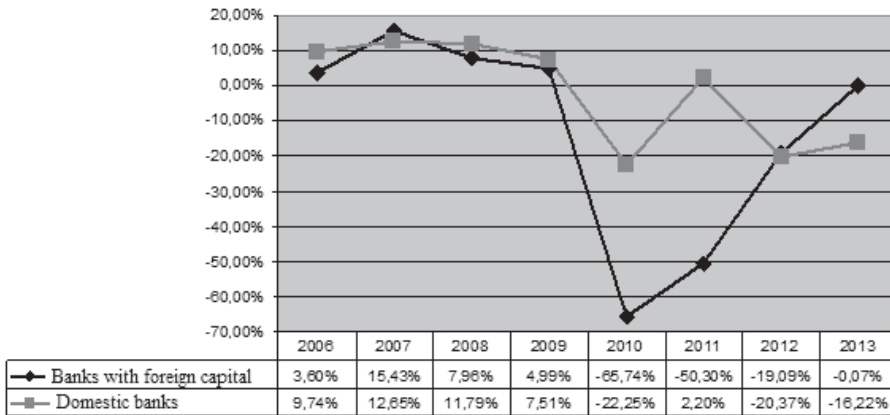


Figure 2. The average return on own capital of banks in Ukraine

Source: formed by the author on the basis of the National Bank of Ukraine data⁹.

It is advisable to analyze the distribution of own capital among banking institutions by groups (Fig. 3).

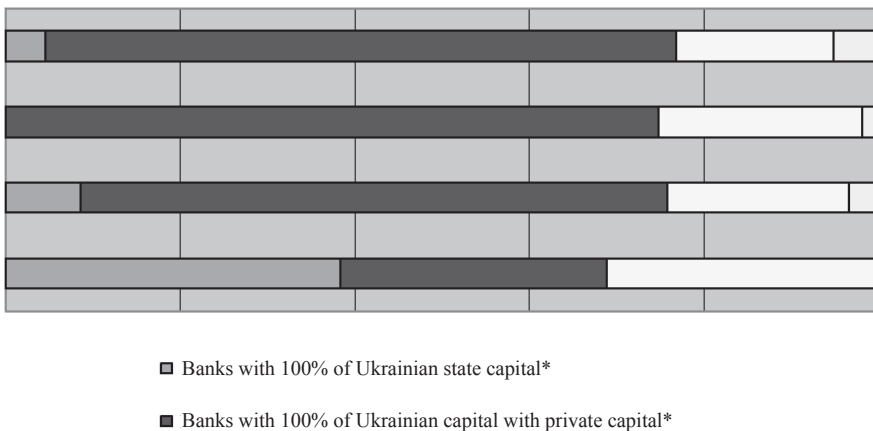


Figure 3. The distribution of own capital between banking institutions by groups as at 01.01.2014

Source: formed by the author on the basis of the National Bank of Ukraine data¹⁰.

It should be noted that the share of capital of foreign banks is 31.10% in the first group. In the second group – 24.2%, in the third group the figure is 25.3% and in the fourth group the amount of own capital of banks controlled by foreign investors – 23.2% (Fig. 3).

⁹ Ibidem.

¹⁰ Ibidem.

The amount of assets of banks with foreign capital of the first group is 29.2%, the third group – 38.1%, the fourth group – 30.9%. The highest figure is in the second group – 46.5% (Fig. 4).

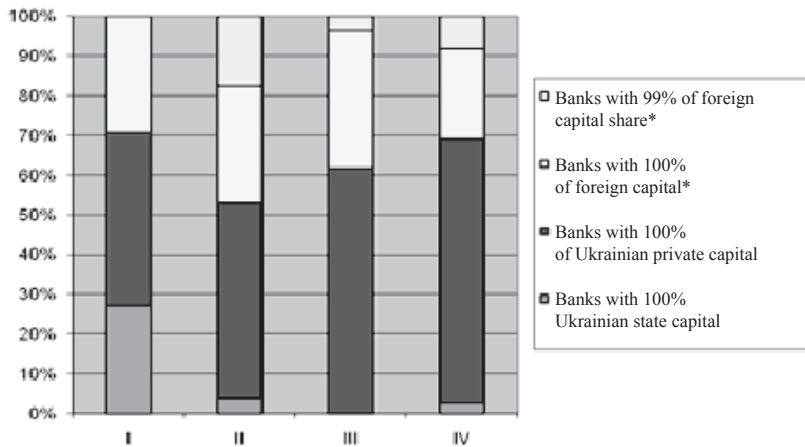


Figure 4. Distribution of assets between banking institutions by groups as at 01.01.2014

Source: formed by the author on the basis of the National Bank of Ukraine data¹¹.

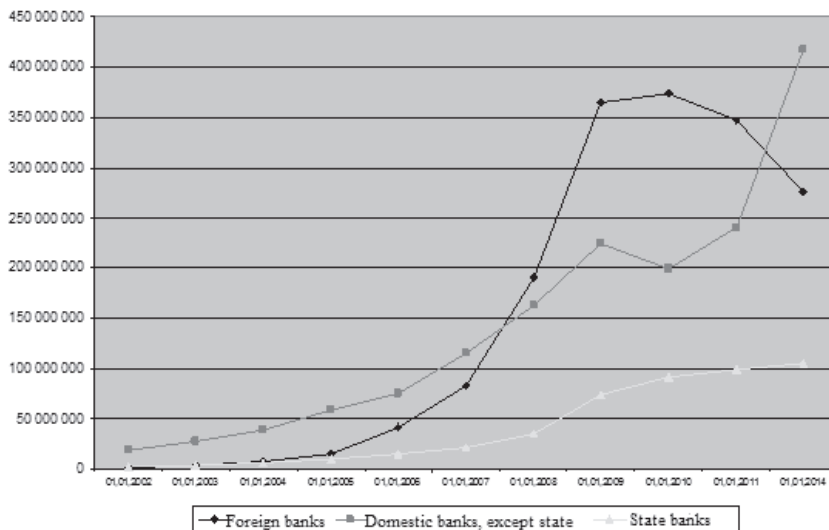


Figure 5. The dynamics of loans to banks for the period 2002-2014

Source: formed by the author on the basis of the National Bank of Ukraine data¹².

¹¹ Ibidem.

¹² Ibidem.

In the research of credit operations of foreign banks, it was found that access to international markets of cheap financial resources led to the tendency of foreign banks to boost lending activity in Ukraine during the period of growth (Fig. 5). During 2005-2010, foreign banks increased their market share in loans from 12% to 46%, while their share in the retail segment accounted for 60% of all loans to individuals. The main competitive advantage of banks with foreign capital over domestic banks is the opportunity of quick access to low-cost funding of parent groups.

3. Conclusions

In general, foreign capital has a positive impact on improving the competitiveness of the banking sector. The activities of foreign banks in the period of economic growth contributed to increasing capitalization of the banking system, increasing the rate of lending, expanding the range of banking services and improving the quality of banking services, which means they indirectly contributed to increasing the competitive position of domestic banks.

An important step in improving the competitiveness of domestic banks should be to support Ukrainian banks, helping in their competition with foreign banks that already operate in the domestic market. Competitive banking sector is a prerequisite for sustainable and balanced development of the national economy and its integration in the international financial sector.

The question of the foreign capital presence in the banking system and the preservation of the national banking system at a competitive level should be considered in the context of the economic development strategy of the state, ensuring equal rights for all market actors and accurate regulation and insufficient control over the activities of foreign branches, guaranteeing protection of Ukrainian banks that lend money to priority sectors at legislation level as well as further adaptation of the bank legislation of Ukraine to the European Union legislation, the fulfillment of the requirements of the FATF and the Basel Committee on Banking Supervision regarding customer identification and the prevention of using the banks for unfair financial practices.

Nowadays under the influence of foreign capital, domestic banks need to take a competitive position in the banking market and carry out work towards ensuring its competitiveness, leading to the formation of the competitiveness of the banking system as a whole. For this purpose, banks need to have a clear and effective competitive strategy, the components of which may include:

- a sufficient capital base of the bank;
- ensuring optimal management of bank assets and encouraging long-term investments;
- high business performance and business-processes – providing new approaches to doing business, based on the introduction of new information systems, to sup-

port the creation of banking products with the highest level of customer satisfaction and to lead to expansion and strengthen the market position of the bank;

- direction of sufficient investment in the development of information technology;
- providing high quality service, good personnel policy and the formation of an effective structure of the bank;
- determining the optimal number of banking units and establishing effective cooperation with a major bank as well as effective control over the activities of branches, taking into account the specifics of the market and business environment.

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KSZTAŁTOWANIE SIĘ KONKURENCYJNOŚCI BANKÓW UKRAIŃSKICH POD WPLYWEM OBCEGO KAPITAŁU

Streszczenie: W artykule przedstawiono analizę wpływu światowego kryzysu finansowego na procesy związane z przepływem kapitału i głównych trendów banków zagranicznych na Ukrainie. Autor bada dynamikę ekspansji kapitału zagranicznego na Ukrainie w ciągu ostatniej dekady, zmian strukturalnych w konkurencyjnym środowisku w sektorze bankowym, restrukturyzacji na rynku bankowym, udział banków z kapitałem zagranicznym z punktu widzenia kraju pochodzenia kapitału, powody odpływu z kraju kapitału zagranicznego w okresie po kryzysie. Ponadto artykuł zawiera analizę porównawczą struktury, poziomu i tempa ekspansji zagranicznej kapitału bankowego w Europie Środkowej i Wschodniej. Autor określa skutki ekspansji banków zagranicznych ze względu na wzrost poziomu konkurencji i efektywności systemu bankowego, rolę banków zagranicznych w kształtowaniu konkurencyjności krajowego sektora bankowego na Ukrainie, sugeruje możliwe profile banków krajowych, kształtujących konkurencyjność pod wpływem kapitału zagranicznego.

Słowa kluczowe: system bankowy, kapitał zagraniczny, konkurencja, konkurencyjność banku, konkurencyjne środowisko.