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# Efficiency of the Polish banking industry: Foreign versus domestic banks

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**Abstract**

The present paper investigates the efficiency of the Polish banking industry between 1997 and 2001. Our preferred methodology is Data Envelopment Analysis, which allows us to distinguish between cost, allocative, technical, pure technical, and scale efficiency. Additionally, we perform a number of tests to investigate whether domestic and foreign banks come from the same population. Finally, we attempt to shed light on the determinants of efficiency. Our results indicate that bank efficiency has not improved during the years analyzed. Whereas greenfield banks have achieved higher levels of efficiency than domestic banks, foreign banks that acquired domestic institutions have not succeeded in enhancing their efficiency.
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## 1. Introduction

There has been an ongoing debate as to the role of foreign banks in Poland. The initial ideological stance of the government was to keep the banking industry

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"national", because foreign capital was regarded as hostile to "Polish interests" (Balcerowicz and Bratkowski, 2001). Between 1993 and 1997 foreign banks were limited to greenfield operations or taking over distressed institutions, and were entitled to minority shares during the privatization process. As EU aspirations developed the restrictions on foreign bank entry and participation in the privatization process were repealed. Foreign banks have entered the Polish market either by establishing greenfield institutions or acquiring domestic banks. As a result the assets controlled by foreign banks[1] have increased from 15.3% of total banking assets in 1997 to 69.2% in 2001.

The literature on bank efficiency and the role of foreign banks is dominated by studies about the US, and to a smaller degree European, banking industries (Berger and Humphrey, 1997). Efficiency studies found that foreign banks in developed countries exhibited lower efficiency in comparison with domestic banks. However, banks from certain countries were able to operate more efficiently than domestic banks in other developed countries (Berger et al., 2000). Even though the research on transition and developing markets lags far behind, the findings support the conclusion that foreign banks in these countries succeeded in exploiting their comparative advantages and show higher efficiency than their domestically owned counterparts (Isik and Hassan, 2002; Grigorian and Manole, 2002; Hasan and Marton, 2003; Bhattacharyya et al., 1997). One of the proposed explanations is that foreign banks enter developing and developed countries for different reasons. In particular, foreign banks do not just follow their customers into developing markets, but seem genuinely interested in exploiting local opportunities (Clarke et al., 2001).

We would like to contribute to the above literature by providing evidence on the efficiency of the Polish banking industry with the emphasis on the domestic versus foreign banks debate. To do so, we employ Data Envelopment Analysis and estimate cost, allocative, technical, pure technical and scale efficiency. Then, we perform a number of parametric and non-parametric tests to investigate whether domestic and foreign banks come from the same population. Finally, we analyze how ownership structure and different bank characteristics, such as capitalization, problem loans ratio, assets growth, size, and volatility of returns, influence our efficiency estimates.

Our paper differs from the previous studies on transition economies in a few respects. First of all, our sample covers 95% of total banking assets, which makes it the most comprehensive database on the Polish banking system.[2] Second, unlike other studies that consider foreign banks as a homogeneous group, we distinguish between greenfield banks, which have been set up as new entities, and takeover banks, which have resulted from the acquisition of formerly domestic institutions during the privatization process. We are also interested to test whether foreign banks tended to pick more cost-efficient institutions, and thus their higher efficiency would be inherited, rather than gained. Finally, following Berger et al. (2000), we take into

[1] A bank is defined as foreign if more than 50% of its equity is owned by foreign investors.

[2] The traditionally used BankScope database employed by Grigorian and Manole (2002), for example, provides data on 25% and 45% of the total banking assets in Poland for years 1995 and 1998, respectively.

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