# The improvement of bank infrastructure of Ukraine

P. Maciaszczyk
*State Higher Vocational School Memorial of Prof. Stanislaw Tarnowski in Tarnobrzeg, Faculty of Technical and Economic Sciences, Tarnobrzeg, Poland*

V. Stoika
*Uzhhorod National University, Faculty of Economics, Uzhhorod, Ukraine*

I. Britchenko
*State Higher Vocational School Memorial of Prof. Stanislaw Tarnowski in Tarnobrzeg, Faculty of Technical and Economic Sciences, Tarnobrzeg, Poland*

ABSTRACT: The article is devoted to the prospects of creation and functioning of cooperative banks and development banks in Ukraine. The article deals with the peculiarities of cooperative banks and development banks. Scientists analyzed the views on the activities of banks and their impact on economic development. The article deals with the peculiarities of development and operation of the cooperative banks of developed countries: Germany and Poland. A three-tier model of national cooperative bank system has been suggested.
The influences of developments banks operations on the national economy are defined. The main grounded differences between development banks and commercial banks are defined. The problems of creating development banks in Ukraine are analyzed.

## 1 INTRODUCTION

The article considers the ways for improving the current Ukrainian bank infrastructure through the creation of cooperative banks and development banks. International experience confirms that such banks are stable and remain financially stable in times of crisis. In addition, the direction of their activity and functions are of great importance for the further development of Ukraine. Cooperative banks have a significant impact on the stimulation of the development of the agrarian sector, rural areas and farmers, they also receive a high level of trust from the population. Development banks also have a positive impact on social and economic development of the country. During the period of Ukraine's independence, several financial institutions, referred to as development banks, have been created but the principles of their activity did not differ from commercial banking. The authors have considered the main problems in the process of creating both cooperative banks and development banks in Ukraine. The need for developing an appropriate legislation in order to regulate the activities proposed for the creation of banking institutions has been concluded by the authors.

Over the last decade, the Ukrainian economy along with the banking sector have been affected by the most profound crisis since gaining independence. This was due to armed conflicts in the eastern part of the country and internal economic imbalances. Last year, the banking system of Ukraine was under the influence of negative transformations, whose result was a decline in the number of banks and equities, outflow of deposits, high level of bad debts, and decreased financial stability, among others. This situation requires the development and implementation of effective measures aimed at eliminating such negative effects not only for the financial sector but also for the economy as a whole.

Building a competitive advantage on the EU market in cooperation with Ukraine is possible mainly through the development of the agricultural sector, as well as through the development of science and technology in the area of innovation. This strategy requires modernization of the banking sector as the main supplier of financial and credit resources. In modern economic conditions, a possible solution to this problem lies in the creation of cooperative banks and the so-called development banks in Ukraine.

Cooperative banks occupy a significant place in the banking system in developed countries, especially in Western Europe. During the financial crisis, their activities were of great importance because these institutions contributed to maintaining the financial stability of the sector and its economic effectiveness as well as strengthened their position on the market.

The first cooperative banks in Western Europe were established in Germany. Throughout almost

150 years of development history, they have evolved into a powerful financial system, that plays an important role in the banking sector in Germany. Nowadays, local cooperative banks are independent financial institutions whose activities are governed by cooperative and banking law. At the beginning of their operation, their main members were craftsmen and farmers. These days, most of the more than 13 million members belong to the middle class society. Approximately 75% of all enterprises, 80% of farmers and 60% of craftsmen in the country are members of cooperative banks.[1]

The basis for creating the cooperative credit sector in Germany was the idea of self-help through mutual help, which originated more than 125 years ago and was based on the principles of self-management and co-liability. At present, credit cooperatives offer a wide range of financial services due to the fact that their activities are focused on accepting savings deposits and providing short-term and medium-term loans to their members. In this case, it is worth noting that the volume of long-term loans is constantly increasing. The business activity of Volksbank and Reiffeisenbank is to carry out traditional banking services and other operations such as: product and service operations, acquiring savings deposits, involvement of other types of deposits, providing various types of loans, membership guarantee, payment transactions and international operations, including the purchase and sale of cash and non-cash means of payment, counseling, mediation, assistance in managing the family budget, protection and management of securities and other assets, mediation or sale of construction contracts, insurance, etc., collective purchase of essential goods, aggregate sales of agricultural products, and delivery of goods to members. In addition, cooperative banks in Germany lead active pro-social charitable activities. On average, every bank spends around 5% of its profit on charitable purposes, as well as support for culture and sport.

It should be noted that due to the increasing competition in the banking market, the number of regional cooperative banks in Germany (and other countries) is gradually decreasing through combining them in order to increase competitiveness. There were about 60 regional banks in Germany after the Second World War, 8 in the 80s and 3 in the 90s (SGZ-Bank in Frankfurt, WGZ-Bank in Düsseldorf and GZB-Bank in Stuttgart) and now – 1 (WGZ-Bank) (Бойчук 2009). This trend does not mean refining the role of regional cooperative banks. On the contrary, thanks to them, the German cooperative system has acquired significant stability and financial strength. Regional cooperative banks play a key role in creating a cooperative credit system. In Germany (as opposed to other countries – and this is also a feature of the German system), they have fulfilled their historic mission – strengthening bottom-up capitalization. Credit cooperatives have been transformed into large independent financial institutions, while cooperative financial structures at regional level have ceased to be important.

Cooperative banks in Poland are important for stimulating rural and agricultural development. They were founded in 1861, and their main customers were farmers and members of rural communities. The activity of cooperative banks was limited geographically (within the territorial community where the bank was located) and in terms of the scope of services (opening and running of accounts, deposits, loans and guarantees, acceptance of securities, and execution of term deposits in subsidiaries). By the end of 2010, there were 646 banks in Poland, of which 576 were cooperative banks[2]. In modern conditions, cooperative banks in Poland operate as universal banks but place a strong emphasis on maintaining the agricultural sector and rural areas. In years 1997 – 2007, the share of agricultural loans was 74% in the structure of investment loans and 59% in the structure of current loans (Siudek 2010).

The development of cooperative banks in Poland has led to the provision of preferential loans for agriculture by these institutions, and additionally, through these institutions, payments are made to farmers from the European Union resources and the state budget. Some researchers noted that privileged loans have played an important role in creating a stable, well-functioning system of cooperative banks that provide financial services to rural entrepreneurs. The granting of preferential loans to agricultural enterprises in Poland in 1990 was carried out on a large scale. From the beginning of 1995, the volume of preferential loans was about $ 1 billion a year, and the share of credit debt of rural households accounted for around 80%.[3]

The experience of EU countries confirms that the presence of cooperative banks and their service activities have become an effective tool for updating and developing socio-economic development. It is undeniable that these financial institutions are able to function effectively not only in the territory of the given country but also to establish a strong network of institutions in other countries and, in addition, they may be one of the largest banks in the world. Cooperative banks benefit from a high level of public trust and have a high share in the financial services market. These institutions operate as universal

[1] http://minfin.kmu.gov.ua/control/uk/publish/article.htm retrieved: 10.02.2017

[2] http://www.pu.if.ua/depart/Finances/resource/file/%D0%97%D0%B1%D1%96%D1%80%D0%BD%D0%B8%D0%BA/2012-1/09.pdf, retrieved: 10.02.2017.

[3] http://www.pu.if.ua/depart/Finances/resource/file/%D0%97%D0%B1%D1%96%D1%80%D0%BD%D0%B8%D0%BA/2012-1/09.pdf

ones but what is characteristic is that they are oriented toward supporting agriculture and rural areas.

Cooperative banks have several advantages in comparison with commercial ones and are characterized by the following features:

1) adequate level of capitalization and financial stability,
2) specificity of a business model that consists in creating ownership of the membership contributions in the bank, thus they are less sensitive to changes in the economy,
3) emergence of counter-cyclical behavior and national deposit guarantee schemes,
4) effectiveness of the control mechanism (in line with the "bottom up" principle),
5) democratic governance, which is based on the active participation of their members in making management decisions.

During the independence of Ukraine, cooperative banks were not formed. In this regard, W. Goncharenko (2012) emphasizes that such a situation affects the national economy and that the banking system is very sensitive to internal and external financial crises. The reason for this was the lack of understanding of the place and role of cooperative banks in the national economy by the National Bank of Ukraine and politicians, which is reflected in the imperfection of the legal regulation of the formation and operation of cooperative banks.

In Ukraine, the procedure for the establishment of cooperative banks is regulated by the Law "On Banks and Banking Activity"[4]. Article 8 of this law provides for the procedure for the formation of cooperative banks. In particular, it is assumed that cooperative banks are created on a territorial basis and will also be divided into local and central cooperative banks. Minimum number of members of a local cooperative bank is at least 50 people. The members of the Central Cooperative Bank are local cooperative banks.

It should be noted that the Bill on Amendments to several Legislative Acts of Ukraine regarding Operation of the Credit Cooperation System was drafted in Ukraine in 2008[5]. It envisages, among others, the scope, powers and functioning of cooperative banks, but these amendments have not been accepted so far.

An important issue, which also requires legal regulation, is the organizational structure of cooperative banks in Ukraine. Some researchers[6] believe that this model should be based on a "bottom up" principle and consist of three levels, each of which has corresponding functions. At the first, local level of the system of credit cooperatives should be local cooperative banks, which will provide services to their members and will have a savings and credit nature. They will participate in proposing appropriate changes in legislation. They will be sovereign in creating financial policies at the bank level and will be able to provide other financial and non-financial services to small businesses, farms and small farmers. The second, regional level of the cooperative system should be created by regional cooperative banks, aimed at providing effective support to the functioning of local cooperative banks. The main task of these organizations should be to support first level institutions in the provision of additional services (in the area of liquidity, development of new financial products, internal payments, currency, payment, investment and other operation collaterals). The third, national level consists of a central cooperative bank, which complements the structure of a full system of cooperative banks. This institution cooperates and is composed of the second level organizations and aims to provide them with additional financial services (improving performance in the context of international banking operations in the area of equities, international payments, foreign exchange and exchange markets, leasing, etc.). Thus, a central cooperative bank will combine all cooperative banks into one system that will give them a competitive advantage in relation to large system banks without losing their independence and autonomy.

Contemporary conditions for the development of the banking sector in Ukraine and the observed qualitative changes indicate the need to establish cooperative banks. The formation of a cooperative banking system is linked to the provision of financial and credit support to small businesses, the agricultural sector, the financing of investment projects aimed at stimulating the development of the regional economy as well as financial and credit services in rural areas. Periods of economic crisis require greater state influence in the investment process, by supporting the involvement of credit institutions. In the structure of the economic system of almost every developed country in the modern world, a special financial institution, for instance, development bank, can be found. Often these banks are part of a large network of branches in the country and have a special tool for implementing state economic policies in different sectors or directions of development. Such a bank performs additional functions to ensure long-term financing of social projects whose implementation should contribute to economic growth, economic modernization and more. W. Diamond (1957) draws attention to the fact that in many countries development banks have been created as a tool for financing specific projects. They played a key role in the postwar reconstruction of Western European economies, and also helped in the "big leap forward", which led to the development of newly industrialized countries. The author states that the adopted bank's development objectives may differ signifi-

[4] http://zakon2.rada.gov.ua/laws/show/2121-14
[5] http://zakon5.rada.gov.ua/laws/show/- 673-vi
[6] http://www.pdaa.edu.ua/sites/default/files/nppdaa/spec/19.pdf; http://www.economy.nayka.com.ua/?op=1&z=4720; http://nbuv.gov.ua/UJRN/**Pav**_2014_25_8

cantly from country to country in terms of ownership, activity, policies and the institution's activities. W. Diamond generalizes that government-backed financial institutions primarily aim at providing long-term loans in the context of stimulating the economy.

At the end of the 20th century, there were about 750 development banks, 32 of them regional and about 700 national, including special export development banks and small business support banks in 185 countries. In summary, one country has three Development Banks on average: 95.8% of them are national development banks and 4.2% are international and regional development banks. In developing countries there are on average 3 or more banks, whereas in developed countries there are much fewer of them (Ковалев 2016). The trend is that development banks are mostly created in emerging economies because they are designed to "revive" the economy of a country, which is supposed to contribute to its long-term economic growth.

In emerging countries, unconditional governmental economic development occurred through the creation of mechanisms to mobilize investment capital, in particular in the Republic of Korea, where the creation of the banking system resulted from the need for economic growth. In order to finance economic development projects in the industrial and agricultural sectors, the Korean Development Bank was established as a public credit institution. Subsequently, the entire system of specialized banks was created to provide financial support for both the strategic and industrial sectors (Korean Bank of long-term loans, Export-Import Bank of Korea, commercial and banking corporations that provide medium- and long-term loans to non-financial corporations and activate the inflow of foreign capital).

The main differences between development banks and commercial banks are as follows (Емельянов 2009):

- firstly, development banks use a special mechanism for mobilizing credit resources, they tend not to perform deposit operations, because the source of their funding is primarily the state budget, and partly government loans received from international financial organizations. This is the main difference between development banks and commercial banks and other financial institutions,

- secondly, development banks in their business activity are guided by the state's interests in the socio-economic development of the country, and receiving profits is not their goal. One of the most significant development banks' operations, with the exception of the refinancing of other banks, is the provision of guarantees from financial institutions on the repayment of the granted loans. Of course, development banks implement commercial principles, striving for positive performance, but in the case of losses, their coverage is at the expense of public funds,

- thirdly, development banks do not create competition for commercial banks, because they have their own spheres of business – investing and lending to core industries that have a long return on investment and high risk,

- fourthly, operations of development banks, as a trusted agent, are carried out by commercial banks.

During the period of Ukrainian independence, there were several financial institutions, known as development banks. One of them is the Ukrainian Bank for Reconstruction and Development (UBRD). It was created to develop innovative infrastructure, as well as strengthen the position of financial support for innovative activities, in accordance with the Regulation of the Cabinet of Ministers of Ukraine № 655 of 05.05.2003[7]. The mission of the bank is to create favorable conditions for the development of the Ukrainian economy by supporting domestic producers and the development of investment activity[8]. The bank should specialize in medium- and long-term financing of legal persons with a focus on reconstruction and production development loans. However, within 12 years of its existence, UBRD has failed to become a significant financial institution. The reason for this was the lack of a distinct specialization of the bank, which functioned as a counterpart to a traditional commercial bank. The UBRD's activity, as opposed to other countries, is governed by general banking laws, so the conditions for loans are not different from those of other commercial banks. The scale of activity and the main UBRD indicators show that it is one of the small banks in Ukraine apart from the head office in Kiev.

UBRD has no other branches and, at the end of 2015, it had assets of PLN 120 million. (0.0069% to GDP). Actual lack of macroeconomic efficiency and ineffective management led UBRD to take a decision in 2016 on the privatization of the bank.

Another private Ukrainian Development Bank is also now in liquidation. This decision was taken in December 2015. This financial institution was initially actually an analogue to a commercial bank and provided a wide range of banking services for both natural and legal persons. From 2014, the existence of the bank was largely linked to the political process and its owner was a representative of the ruling elite[9]. During its activities, the bank failed to become a financial institution for development as its activities were based on the general principles of commercial banking. Another attempt to create a Ukrainian Development Bank was made in 2013, when the Verkhovna Rada of Ukraine was introduced to the bill on the establishment of a new Ukrainian Devel-

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[7] http://zakon3.rada.gov.ua/laws/show/655-2003-п

[8] http://ubrr.com.ua/node/63

[9] http://ipress.ua/ru/news/nbu_reshyl_lykvydyrovat_bank_aleksandra_yanukovycha_1492 09.html

opment Bank[10]. It was supposed to be created on the basis of UBRD with the transfer of all its assets under control. The purpose of establishing this bank was planned credit support for structural changes in the economy, the development of the banking system and long-term domestic and foreign investment in priority sectors for the Ukrainian economy. The bank was also to promote the development of public-private partnership and serve as an agent of the Ukrainian government. The bill received the support of the Cabinet of Ministers of Ukraine and the National Bank of Ukraine, but it was subjected to a series of critical remarks of the chief scientific and expert leadership of the Verkhovna Rada of Ukraine, and as a result was sent back to the revision, which has never been realized. As a result, on November 27, 2014, the bill was withdrawn from consideration.

One of the comments concerns the concept of the need to adopt such a law. In Ukraine, all the relationships resulting from the registration, servicing, reorganization, and liquidation of banks are already regulated by the Law "On Banks and Banking Activity". It should be noted that, because of the lack of a special law determining all aspects of the development bank, as a special Institute in the structure of the Ukrainian economy, the activity of these banks previously failed and was ineffective. World practice proves that the effectiveness and scope of banking activities can be achieved by adopting a special law that exists in many countries (Canada, India, Korea, and Brazil, among others). Ukrainian scientists Y. Kindzersky (Кіндзерський 2015), A. Aborci, A. Mitusin (Матюшин & Аборчи 2016) also point out the need to adopt a special law that will define all the characteristics of the future Ukrainian Development Bank. Another problem that needs to be addressed is shaping of the development bank's liabilities. Among the researchers[11], there is a conviction that the capital of development bank created in Ukraine should be at the level of 3-4 billion dollars; moreover, it is necessary to raise funds in the same amount from external sources. Banks in their activities attract various sources of funding, in particular state budget funding, loans from other financial institutions, attracting funds on local and international financial markets, and attracting funds from international and regional development banks. In particular, 89% of development banks attract international funds, financial institutions and issues securities (Ковалев 2016).

The area in which the development bank's activity may be concentrated should be "... based on the neo-industrial paradigm of the need to issue high added value products and the creation of innovative infrastructure. On this basis, it is possible to draw up an indicative list of strategic industries for the Ukrainian economy, where the most needed resources of the bank are" (Матюшин & Аборчи 2016, p. 41). The promising areas for the development of Ukraine are: machinery, transport, energy, electronics, environment, nanotechnology, agriculture, and also the military-industrial complex.

Therefore, the formation of a development bank in Ukraine can not only improve the infrastructure of the banking system, but also solve important economic development problems and long-term financing of priority sectors, public investment, infrastructure projects, and small and medium enterprises. To do this, first of all, it is necessary to meticulously draw up the relevant laws regulating the activity of such a bank and carry out an in-depth study of international experience in the functioning of development banks as well as the main problems of the Ukrainian economy such as bureaucracy and corruption. The solution to these problems requires the involvement of representatives of the government, the National Bank of Ukraine, experienced bankers-practitioners, and leading academic economists in the study of this problem.

## 2 CONCLUSIONS

On the basis of the study of experience of developed European countries concerning the formation of cooperative banking sector the main lines of development of cooperative banks in Ukraine have been suggested.

The expediency of creation of cooperative banks in Ukraine has been substantiated. The attention is focused on the problems of legislative and organizational nature regarding the operation of such financial institutions in Ukraine. A three-tier model of national cooperative bank system has been suggested. It should be based on a "bottom-up" principle and consist of three levels, each of which must perform the relevant function. The first level of credit cooperative system should be represented by local cooperative banks. The second level should be formed by regional cooperative banks. At the third, national level, should be the central cooperative bank, which logically completes the construction of a full-fledged cooperative system. The result of the activity of these institutions should be a rational financing of small businesses and a rapid response to their needs, as well as the reduction of loan costs to farmers and the promotion of agriculture in general.

In the structure of the economic system of almost every developed country in the modern world, a special financial institution, for instance, development bank, can be found. Often these banks are part of a large network of branches in the country and have a special tool for implementing state economic policies in different sectors or directions of develop-

[10] http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=48717

[11] http://forumkyiv.org/uk/press-center/press-releases/chi-potriben-ukrayini-bank-rozvitku

ment. The main differences between development banks and commercial banks are as follows: 1) development banks use a special mechanism for mobilizing credit resources; 2) development banks in their business activity are guided by the state's interests in the socio-economic development of the country, and receiving profits is not their goal; 3) development banks do not create competition for commercial banks; 4) operations of development banks, as a trusted agent, are carried out by commercial banks. The formation of a development bank in Ukraine can not only improve the infrastructure of the banking system, but also solve important economic development problems and long-term financing of priority sectors, public investment, infrastructure projects, and small and medium enterprises.

The experience of developed countries clearly suggests that the solution to the strategic tasks of the national economy, by increasing the investment activity of credit institutions, requires the effective participation of the state. The effectiveness of close cooperation between the government and banks, as well as non-financial corporations, is essential for the realization of common national interests, which is particularly important at the stage of exiting the economic crisis and also in the process of European integration of Ukraine.

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