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CONSULTANCY REPORT NUMBER ONE ON
THE REGIONAL BANK OF WROCLAW
FOR THE
POLAND COOPERATIVE DEVELOPMENT PROJECT
Contract No. EUR-0024-G-1069-00
Cooperative Bank Development Project

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LIST OF ACRONYMS

1. NBP -- National Bank of Poland
2. KZBZ (Kezibez) -- National Union of Cooperative Banks
3. RCBs -- Regional Cooperative Banks
(Currently)
BUG -- Warsaw
GBW -- Poznan
Wroclaw -- Wroclaw (Vrotzloff)
4. LCBs -- Local Cooperative Banks

SCOPE OF WORK

The scope of my work was to analyze the situation, determine the steps needed to get BUG fully operational, and counsel with BUG officers about what needs to be done and where priorities should be placed.

METHODOLOGY USED

I spent a full measure of time with BUG president Dr. Roman Rak, each of his senior staff members and key junior staff members. I also attended a day-long BUG board meeting, attended a day-long BUG shareholders meeting and visited four local cooperative banks, speaking with either the LCB president or vice president for at least three hours in each instance. I also spent two full days during weekends in social contact with Roman Rak. I was provided with an interpreter (Beata Serwacka) who performed admirably. With this excellent assistance and with the solid background provided by Jon Greeneisen and his staff I have been able to form what I believe to be an accurate impression of the current situation in BUG and its shareholder LCBs and to make informed decisions as to what needs to be done to bring the bank fully operational as quickly as possible.

FINDINGS

BUG has already made great strides in becoming a fully operational regional cooperative bank. From only a concept in early 1991, President Roman Rak has put together a staff of 35 people and developed basic operating procedures to get the bank functioning (and meeting NBP's requirements). The senior staff includes Dr. Rak as well as Mr. Wierzbicki and Mr. Mackiewicz. All have good experience in banking or finance as well as a good knowledge of the governmental, agricultural and cooperative situations in Poland. The contacts of the senior staff members are obviously very valuable to BUG.

With great challenges they initially sold shares to 117 local cooperative banks. I learned this initial effort would have been larger but BUG had initially required that all BUG board members be non-management people from LCBs. This concept did not fly because many LCB managers consider the LCB to be "theirs". Eventually BUG backed off and said half of the board could be LCB directors and half managers. It was also found that some LCBs would not come with BUG because they felt BUG was tied too closely to Rural Solidarity.

BUG finally received approval from the National Bank of Poland to begin operations on March 3, 1992. NBP approval was given to carry out additional activities (financial training, consortium agreements, kantors and use lines of credit to settle debts) in May.

The immediate challenge is to increase the bank's capital to the minimum levels established by NBP by early 1993. They are working to do this by going back to the initial stockholders and asking for more investment and by asking all other LCBs in the region to buy shares in BUG. The initial step in this effort was accomplished at the shareholders meeting held on July 17. All of this has far more chance for success than it would have several months ago because LCBs can now apparently see that BUG has a foothold and a chance to "make it". In addition, it appears that BUG's competitor (the former state-run central bank for local cooperative banks) is losing ground and may not be able to serve LCB needs in the future. Also BUG is beginning to get the word out to LCBs about the types of services and programs which it will be providing. At the same time BUG is becoming assertive in that it is telling LCBs that they must now make a decision (sign a formal affiliation agreement with BUG), cut all old ties and make a purchase of BUG shares which is substantial in relation to the LCB's capital. If these things are not done, the LCB should look elsewhere for services. BUG's capital also stands to improve because of outside injections. In fact, during my visit, BUG received 35 billion zl from the Polish Capital Fund (these are funds from the U.S. and Polish governments which had been delayed for several months). All of this indicates

that the airship has become airborne. But much remains to be done in order to gain some altitude.

In relationship matters I observed that some BUG support from LCBs comes because of BUG's initial ties to the Rural Solidarity movement. It seems these LCBs have simply said "we trust BUG because we know who started it". As noted earlier, the Rural Solidarity ties have also worked against BUG. The Solidarity ties have been primarily responsible for BUG having shareholder LCBs far outside what could reasonably be presumed to be its territory. Dr. Rak realizes this situation and tells those LCBs that, at some point in the future, they may be asked to move to a more logical relationship with an RCB. This could be a bothersome point at some time in the future.

One other problem is that BUG has 7 or 8 large shareholder LCBs near Warsaw and about 110 smaller ones elsewhere. The large shareholders want completely different services than the small ones and they are not keen about spending stockholder funds to set up things like branch clearing offices. This is a problem in view of the one stockholder/one vote rule.

In my visits with LCBs I found a reasonable level of competence in management staffs as it relates to accepting deposits but borderline competence in making even small short term loans (the average loan to farmers and individuals is about \$1000). There is a pride in their local cooperative banks, but they look down their noses at other cooperatives (because of their feelings toward the state-owned cooperative farms and food processing plants of the past--most of which are now bankrupt). LCB staff members generally have a simplistic view of credit and most don't seem aware of collateral aspects. More than once I heard that foreclosure would be unthinkable. They use co-signers on questionable loans but don't usually get financial information on the co-signer. And in several instances there was an indication that they do not look to the co-signer for payment of nonperforming loans.

LCBs do not generally have very high expectations for types of services they want from BUG. Most seemed only to want BUG to provide a cash clearing branch operation for them (and to pay competitive rates for deposits). The mention of possible new services, common forms, common computer programs, new loan types, etc. seemed to baffle all but one of the four presidents I met with. They all thought that BUG-sponsored training holds real promise, but said that the initial sessions were far too expensive.

Most of them don't envision much new demand for credit in the farm sector, but a couple of them felt there may be some future demand in the agribusiness and general business sectors. They seemed doubtful as to whether farmers would ever have big enough operations to justify sizable amounts of debt. They indicated that farmers as a whole consider farming as a way of life (not a

business) and most farmers show little interest in changing this. Three of the four LCBs said they had few problems with bad loans (one of those did have a large alcohol plant loan which had gone bad). The other LCB said that 60% of its loans were "hopeless".

This area is suffering from drought and prices on their farm commodities are low, but I question whether this LCB might be angling for loan restructuring (through a new government program) for many of its borrowers.

Near the end of my consultancy, I learned that BUG was considering leasing new office space in a suburb of Warsaw. The positives of the situation are

1. More modern space than BUG presently occupies.
2. It would separate them from Rural Solidarity (the primary tenant in BUG's present building) and this appearance of partnership hurts BUG in some quarters.
3. The new space has flexibility for expansion (even with only 35 employees, people are stacked on top of one another in the present quarters).
4. The proposed new space is less than half as costly per square foot as the current space.

One negative:

1. Telephone communications probably won't be as good initially because the needed modern cable is just being laid.

July 20, 1992

Dr. Roman Rak, President
Bank Unii Gospodrczej SA (BUG)
Pl Dabrowski Ja. 3
00-057 Warsaw, Poland

Dear Roman,

This letter will summarize the discussions we have had relative to my consultancy with BUG. First, I wish to thank you and your staff and board for the courtesies shown to me during my visit. Second, let me say that I am impressed with the abilities of you and your senior staff. Those abilities and the obvious effort being put forth should allow BUG and the cooperative credit system to make continued progress in the months ahead. However, as we discussed, it is a challenging situation which you face and it will be important to direct the organization's resources to critical areas during this period.

At the beginning of my consultancy you asked me to give you

1. Recommendations for development of a strategic planning system for BUG.
2. Ideas for a BUG communications plan.
3. Suggestions for carrying out an audit of LCBs.

You and I have discussed these subjects in depth and I have presented you with papers on each subject outlining my recommendations. In addition, I have given you my ideas for prioritizing the strategic plans so as to attack the critical areas right away. Copies of the above-mentioned papers in both Polish and English are attached.

In addition, I discussed with you how cooperative bank board meetings are held in the United States. You and I agree that, for the time being, it would be preferable for your board to meet once every three months. I believe that the board meeting which I at-

tended on July 9 was quite productive and I do not have recommendations for improvements other than the use of a monthly board report as a communications tool as outlined in an attached paper.

I am hopeful that I have presented you with some ideas that will be valuable to BUG, particularly in the area of strategic planning. I suggest that you and your senior staff discuss the strategic planning outline further and make changes you feel are necessary. Then, if you think I could be helpful, I could come back to Poland in a few months for several weeks to serve as a facilitator in guiding you and your senior staff through development of a strategic plan for BUG. I recommend that I spend two full days with you and your senior staff away from the bank and interruptions to facilitate the strategic planning. I would suggest one full day at planning, a day back at the office for you and your officers, and then a final day to complete the plan. I could stay a while longer if you and Jon Greeneisen had other areas in which you wanted my help.

Again, it has been a pleasure working with you and I want you to know that I wish only the best for you, your staff and BUG in the months ahead.

Sincerely,

Dean Raber

7'

SUMMARY OF RECOMMENDATIONS

At our first meeting, Roman Rak asked that I counsel with them as to how BUG could develop a strategic planning program. He also asked that I develop a list of suggested services which BUG could provide to LCBs. Both of these requests fit well within the scope of work initially given to me. Thus, I prepared a recommended process for development of a BUG strategic plan (including all of the subject areas to be dealt with in the plan and encompassing my list of suggested services for LCBs). I placed priorities on each subject area so as to direct attention to those areas demanding immediate attention. A copy of the Strategic Plan Development paper is attached. It has been discussed fully with Dr. Rak. A copy of my letter summarizing our discussion is also attached.

Dr. Rak also asked me to recommend how BUG should communicate with its various audiences. A suggested plan of communication with the BUG board, bank management staff and LCBs is attached.

Dr. Rak also asked me to give ideas on audits of LCBs. In my visits to shareholder LCBs, I found that in at least one instance there may be problems with the loan portfolio which had not been made known to BUG. I suggested to Dr. Rak that an audit of all LCBs signing affiliation agreements is needed in the near future. He said that he doesn't see how BUG could possibly audit all LCBs. He proposed auditing some of them with auditors on site, but doing the rest with LCBs sending some completed forms to the bank. I told him that such a procedure should be discussed to determine if accurate information would be received. I also reminded him of the possibility that EC would pay for such audits. I submitted to him my rudimentary ideas for a process whereby BUG would do the audits if necessary. That paper is also attached.

We talked in depth about services BUG could provide to LCBs. Most of the ideas for those services are included in the outline for strategic planning. I did encourage them to carry out what we call brainstorming as to how BUG could become a player in the business of privatizing state farms and agribusinesses. I encouraged them to think not only about financing sales of those farms and businesses but to think in the terms of devising a way BUG could provide appraisal services and/or real estate services in the selling of these properties. This would of course be a method of providing income to BUG.

I also concurred that BUG should move ahead with all due speed with plans to work with the other RCBS in getting approval from NBP to sell bonds in order to get additional lending funds. This was an idea which Mackiewicz brought back from the U.S.

I related to Dr. Rak that in the U.S. we had some success in getting farmers to keep better records by providing farm record

books to them free of cost. I promised that when I got back to the U.S. I would get a copy of such a record book, make suggested modifications in it and provide it to Jon Greeneisen. I further stated that I would encourage ACDI to print a quantity of the record books for distribution by RCBs/LCBs to Polish farmers at no cost.

In another area, I said that it seems that the time demands on the senior staff members of BUG are so great that I am amazed that they have time to give proper attention to high priority items. In this regard, I suggested that a determination be made as to whether the greatest possible delegations of authority have been made to various BUG staff members. I pointed out that it needs to be decided who should meet with individuals from LCBs, NBP and the Ministries, etc. The point being that Dr. Rak, Mr. Wierzbicki and Mr. Mackiewicz need to control their schedules and not let them be interrupted constantly by outsiders.

STRATEGIC PLAN DEVELOPMENT

- I. Determine the duration of a strategic plan for BUG.
 - A. Three years is suggested because of the amount of change which is taking place.
- II. Establish assumptions on external factors (those factors over which BUG has no control).
 - A. Inflation rate in Poland during the three-year period.
 - B. Typical deposit interest rates in Poland during the period.
 - C. Typical loan interest rates in Poland during the period.
 - D. Demand for Polish agricultural products and prices received by Polish farmers during the period.
 - E. Logical boundaries for BUG (assuming there will be four RCBs).
- III. Determine BUG's strengths and weaknesses.
 - A. Strengths
 - 1.
 - 2.
 - 3.
 - 4.
 - B. Weaknesses
 - 1.
 - 2.
 - 3.
 - 4.
- IV. Selecting subject areas to be covered by a strategic plan. Following is a recommended list of strategy areas. Items D through N constitute subject areas which are also services to be provided to LCSs. An * (asterisk) is placed by those strategies which are felt to be high priority.
 - *A. Attracting shareholder LCBs.
 - *B. Meeting capital requirements.
 - *C. Obtaining additional operating funds.
 - *D. Carrying out loan restructuring.

- *E. Attracting deposits.
- *F. Establishing clearing branches.
- *G. Making loans through LCBs.
- *H. Developing new products and services which BUG can offer to LCBs (possibly insurance, record keeping, farm record books, legal services, kantors, real estate appraisal services, real estate sales services, stock and bond sales windows, etc.)
- *I. Training BUG and LCB employees.
- *J. Communicating with BUG directors and staff members and LCBs.
- *K. Carrying out audits of shareholder LCBs.
- L. Developing model operating procedures for LCBs and encouraging their use.
- M. Developing model forms for LCBs and encouraging their use.
- N. Developing model computer programs for LCBs and encouraging their use.
- O. Staffing up to carry out approved strategic plans.
- P. Locating cost effective housing for the bank which provides the desirable degree of flexibility and attractiveness.
- Q. Working through KZBZ to coordinate activities with other RCBs and to meet national expectations as a team.
- R. Developing a new image for the cooperative banking system.

V. Sample strategy.

ATTRACTING SHAREHOLDER LCBs.

We shall have a minimum of ____ shareholder LCBs working closely with BUG in three years. We shall accomplish this by maintaining an attractive package of services and economic advantages for LCBs and making personal contact with each non-shareholder in our region at least once each year to explain the benefits we can offer and our record of operation to date.

COMMUNICATING WITH BUG AUDIENCES

In an emerging organization, communications between all levels and all parts of the organization is important in order to keep everyone feeling a part of the team. Good communications is a protection against serious problems arising because people are uninformed.

For the above reasons, it is suggested that BUG immediately begin to communicate with its main audiences:

1. the Board of Directors.
2. the Bank management staff.
3. BUG's shareholder LCBs.

I suggest that the communication be carried out through two different documents issued monthly. One document (probably called "Monthly Board Report") would be provided to members of the Board and the bank management staff at board meetings or would be mailed to the board members on months when there is not a board meeting. The other printed piece (probably a typed newsletter) would be mailed monthly to shareholder LCBs with encouragement that it be discussed at a LCB board meeting held in the near future or mailed to members of the board. The newsletter can be transmitted to LCBs by computer as soon as a network including all LCBs is completely operational.

Following are subject areas which could be covered in the two documents. Please note the areas where it is suggested that information not be included in the LCB newsletter. Other than those few areas, it is suggested that the information be the same in both documents.

- A. A brief article covering the actions in the following areas which could affect BUG or LCBs.
 1. Government
 2. NBP
 3. KZBZ
 - 4.
- B. A listing of shareholders since the last publication.
- C. A table showing BUG capital levels.
- D. A table showing deposits held by BUG (broken down by term).
- E. A table similar to the one above except showing the information for each LCB. (For the monthly board report only.)

- F. A table showing loans made in the BUG region (broken down by term, borrower type, and whether direct or participation).
- G. A table similar to the one above except showing the information for each LCB. (For the monthly board report only.)
- H. A table showing credit quality in the BUG region.
- I. A table similar to the one above except showing the information for each LCB. (For the monthly board report only.)
- J. Training activities carried out by BUG and announcement of forthcoming training activities.
- K. A brief article telling of successful marketing programs carried out by individual LCBs.
- L. A message from a bank officer outlining positives and negatives facing the cooperative system.

AUDIT OF LOCAL COOPERATIVE BANKS

First, let me reiterate to you that Mr. Greeneisen and his ACDI staff continue to work with KZBZ toward getting the EC to provide funds to assist RCBs in carrying out initial audits of local cooperative banks. If this attempt fails or is too late to provide BUG with needed information on a timely basis, I recommend the following as a general approach to be used in determining the financial condition of individual LCBs.

A widely dispersed group of banks can afford a degree of financial safety not provided by a single bank. This is particularly true in agricultural areas where weather conditions and prices for various agricultural commodities can raise havoc in a single bank territory. But to accomplish group strength, there must be a regular determination whether each unit in the group is operating according to established laws/regulations/procedures and is making sound financial decisions. For BUG to make such a determination, regular audits of LCBs should take place. Such audits are provided for in the Affiliation Agreement and thus should be expected by each shareholder LCB. It is my experience that local cooperative bank managers and board members eventually come to appreciate audits themselves because they recognize that audits can serve as an early warning device for them too.

I. Carrying out audits.

- A. Teams of auditors (probably two people per team) should be trained to examine LCBs. Their training should start by gaining an understanding of NBP laws and regulations and BUG procedures. The auditors will also need to become familiar with LCB accounting practices and forms in both the deposit and lending areas.
- B. In on-site examinations determinations should be made as to the soundness of actions being taken in the following areas:
 1. Deposits (perhaps all deposits during a selected period of time).
 - a. Appropriate documentation and records.
 - b. Appropriate and timely handling of funds.
 - c. All laws/regulations/procedures followed.
 2. Loans (probably a sampling of all loans on the books).

- a. Appropriate documentation and records.
 - b. Study a sampling of all loans to determine if credit decisions are arrived at in a professional manner.
 - c. Study problem loans to determine what mistakes, if any, were made and whether there will likely be a loss on the loan.
 - d. All laws/regulations/procedures followed.
 - e. Determine the percentage of loans (both by amount and by number) which are unsound in the eyes of the auditor.
3. Other financial activities of the LCB.
- C. After the audit, a report is written and given to the LCB. The LCB is given the opportunity to raise questions, and after the report is accepted, the LCB is asked to put in writing what will be done about any serious problems found.

LIST OF CONTACTS MADE BY DEAN RABER

July, 1992

Roman Rak, BUG president

Stanislaw Mackiewicz, BUG vice president (deposits, investments,
and loans)

Zbigniew Wierzbicki, BUG vice president (accounting, EDP,
administration, and shareholder acquisition)

Adam Mroczek, BUG department head (accounting)

Ryszard Atamaniuk, BUG department head (EDP)

J. Swiader, BUG department head (credit)

Jolanta Balcerkiewicz, credit officer, BUG

Waldemar Wojciechowski, chief attorney, BUG

Inga Podolak, department head, Bureau of BUG board

Jan Klimkiewicz, chairman of BUG board

Marek Siniarski, member of BUG board, Prof. Ag Econ. Warsaw School
of Economics, to be BUG credit trainer.

Sojka Emilian, vice president of LCB in Miedzyrzecz Podlaski (also
met briefly with president)

_____, chief of deposits, and _____, chief
of credit, of Galancz LCB (also met briefly with president)

Mrs. Marcinkowska, president of Biala Rawska LCB (also met with
chief of credit)

Jolanta Malicka, president of Czervinsk LCB (also met with chief of
credit)