
Position of Low-Cost Banks on the Financial Market in the Czech Republic

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Abstract:

In addition to insurance companies, pension funds, cooperative banks, investment companies, investment and share funds, and leasing companies, banks represent the most important segment of the financial sector with a stake of nearly 80% of total assets. The balance sum of the banking sector of the Czech Republic amounted to 5,476 billion CZK as of 1.3.2015. Innovative, low-cost players have become the latest trend on the banking market, presenting an alternative to traditional banking. They enforce a business mode of retail banking based on an internet platform. This paper defines and evaluates their activities compared to transnational companies in terms of business success and clients' perception.

Key Words: *banking, innovation, financial market, small and medium-sized enterprise.*

JEL Classification: *G21, G23, O16*

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1. Introduction

In addition to insurance companies, pension funds, cooperative banks, investment companies, investment and share funds, and leasing companies, banks represent the most important segment of the financial sector with a stake of nearly 80% of total assets. The balance sum of the banking sector of the Czech Republic amounted to 5,476 billion CZK as of 1.3.2015. The balance sheet shows that main assets are represented by loans provided to residents (3,235 billion CZK) and main liabilities are represented by deposits made by residents of the banking sector (3,513 billion CZK) (Czech Banking Association, 2014).

Banking in the Czech Republic is an integral part of the financial market of the European Union, and just like anywhere else in Europe, there are multinational players here (Unicredit, KBC, Erste Bank, Société Générale and Raiffeisenbank International) that define the product and pricing policies on the banking market. Innovative (and often low-cost) players have become the latest trend on the market, presenting an alternative to traditional banking. Small, low-cost banks can be classed as a "new type" competition; the business model of low-cost retail banking is based on an internet platform. This model focuses on young and innovative clients who want from their bank low costs and a change. Compared to abroad, the Czech banking system is stable, profitable and well capitalised. Czech banks have been showing a very good liquidity position for a long time since the volume covering all their clients' deposits with fast liquid assets exceeds 45%. From the point of view of capital adequacy, the Czech banking sector is well equipped. In 2013, capital adequacy ratio Tier 1 (CAR Tier 1) grew by 16.9 % and all banks reached the minimum value of 8% CAR Tier 1 which, for the Czech banking sector, is nearly identical with the newly required Common Equity Tier 1. The banking sector complies with the new capital rules under CRD IV/CRR with sufficient reserves, which is supported by the fact that as of the end of 2013, banks representing more than 83% of assets of the sector had a capital adequacy ratio Tier 1 higher than 15%. (Czech National Bank 1, 2015).

2. Literature Review

Only a few authors in the Czech Republic focus on the issue of financial markets and service marketing at a general level in the Czech Republic, apart from the co-author of this paper [e.g., Jílková, P., 2015, "New Retail Banks in the Czech Republic" (VŠERS, České Budějovice) or Jílková, P. and R. Říha, 2014, "Marketing Communication Strategy And Product Policy for New Retail Banks in the Czech Republic" (Kremenchuk Mykhailo Ostrohradskyi National University, Kremenchuk)]. We can mention, for example, doc. Ing. Hesková Marie, CSc. and her paper in Foret, M., 2013, "Service Marketing" (Mendelov University, Brno) or a publication by Vaštíková, M., 2014, "Efficient and Modern Service Marketing" (Grada, Praha). A theory of financial markets is discussed by prof. Mejstřík, M.,

Pečená, M. and P. Teply, 2014, in their publication "Banking in Theory and Practice" (Karolinum, Praha).

To name some foreign publications, we can mention a Slovak publication, Lakowski, S., 2012, "Disruptive Innovation in Banking. A Business Case in Low Cost Finance. How to Win Against the Leaders by Creating Competitive Advantage and Real Value for Customer" (Wydawnictwo Studio Emka, Warszawa, Poland), which discuss the issues of low-cost banking. The role of the rating companies describes an article by Thalassinos *et al.* (2014).

3. Material and Methods

The professional objective of the paper is to focus on the collation, processing and interpreting of secondary data concerning the position of low-cost banks on the financial market in the Czech Republic in terms of their pricing policies. The research focused on relatively new and innovative small banks on the Czech financial market, such as Air Bank a.s. (hereinafter "Air Bank"), Equa bank a.s. (hereinafter "Equa Bank") and Fio bank, a.s. (hereinafter "Fio Bank"). Internet banks such as mBank, a.s. and ZUNO BANK, A. G. have not been included in the research, despite the fact that they are viewed as new, low-cost banks of the new generation, as in terms of their organisation they form a part of large, traditional foreign banks so they cannot be compared to small, independent banks. The paper was based on data published as of 1.4.2015. Information for 2015, 2016 had not been published as of that date. The methods of analysis, synthesis, time comparison and product strategy comparison of large and small banks were used.

3. Results and Discussion

The development of clients' portfolios, the management of relationships with clients and their emotions, maintaining and increasing client satisfaction is crucial for banks in order to maintain their long-term profitability and growth, considering the growing competition in the banking sector. Competition pushes for a diverse product portfolio, putting emphasis on an individual approach, pricing strategies, modern technologies, development of alternative distribution channels, and a targeted communication mix supported by customer information management. From the perspective of the ownership structure, the Czech banking sector is international, mainly formed by four big banks (Česká spořitelna, a.s. – hereinafter "ČS", Československá obchodní banka, a.s. – hereinafter "ČSOB", Komerční banka, a.s. – hereinafter "KB", UniCredit Bank Czech Republic and Slovakia, a.s. – hereinafter "UNI"). The structure of the entities operating here has not changed for a long time; as of 13.4.2015 there were 46 banks and branches of international banks. Since 2013 4 branches of international banks have entered the local market (MEINL BANK Aktiengesellschaft, Western Union International Bank GmbH, Sumitomo Mitsui Banking Corporation Europe Limited and in 2015 BNP Paribas Personal Finance SA) (Czech National Bank 2, 2015).

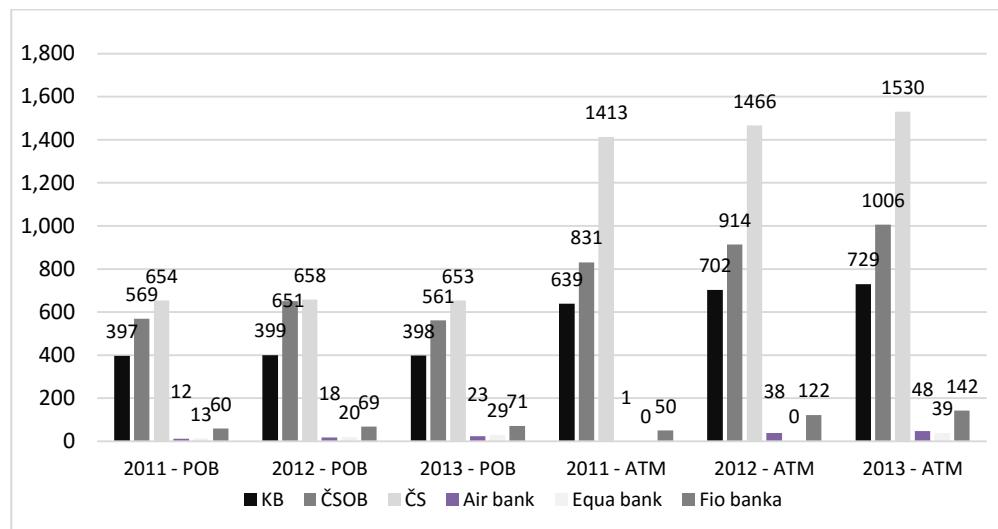
Due to the high concentration of banks, the level of competition is high, and medium sized-banks constantly strengthen their activities and represent a real competition in the individual market segments. Small low-cost retail banks have been on the Czech market since 2007 when the first of the still active entities, mBank, started its operation in the Czech Republic and introduced a banking model focusing on direct banking. It can be said that for its time this was a very innovative concept, contrasting with the approach of the big, well-established banks. Fio Banka, a.s., has been on the Czech market since 2010 and it has gained 460,000 clients as of 25.5.2015. Fio Banka is, so far, the first and only bank that has survived the transition from a cooperative bank (Hospodářské Noviny, 2015). In 2011, two new banks started operations, Air Bank a. s., which has 318,000 clients as of 01. 02. 2015 (Air bank, 2013) and Equa Bank a. s., which has 116,000 clients (Equa Bank, 2013).

In 2010 the concept of low-cost banks entered the banking market in the Czech Republic and, to a large extent, changed the market, creating a segment of low-cost banks. The new banks responded to the demands of retail clients in the Czech Republic in 2010 since they came with a revolutionary change for that time - low-cost, responsiveness, aggressive communication and simplicity. The term "low-cost bank" can be defined from a theoretical point of view as follows: a business model of low-cost retail banking based on the use of an internet platform. This model mainly focuses on young and innovative clients who prefer to communicate with their bank over the internet instead of visiting the actual bank in person, who like to actively examine product offers available on the market and who can search for essential information themselves (Lakowski, 2012).

In their marketing campaigns in 2010-2013, low-cost banks determined as their objective to differentiate themselves from standard traditional banks by focusing on creating a spontaneous awareness of their brand and getting onto the "consideration list" of dissatisfied clients who were thinking about changing their bank. In the first step, there was brand communication, followed by a comparison product campaign using the following key comparison criteria: deposit products, loan facilities and services for businesses. The aim of the campaign was to get the clients to think about their old bank and the products they did not need. In the marketing communication, the campaigns emphasised product disadvantages of the traditional banks (fees for everything) and proposed specific changes. It was expected that the key to success was an interesting, creative and communication concept that would intrigue clients and not be boring. The target group was a young person aged 25-45 with internet access.

All of the mentioned low-cost banks succeeded in getting new clients. At the end of 2013 Air announced that it had gained 126,000 new clients in the last year. Equa Bank gained 33,000 new clients and Fio Bank managed to attract 103,000 new clients in 2013 (Equa Bank, 2013; Air Bank, 2013; Fio Bank, 2013).

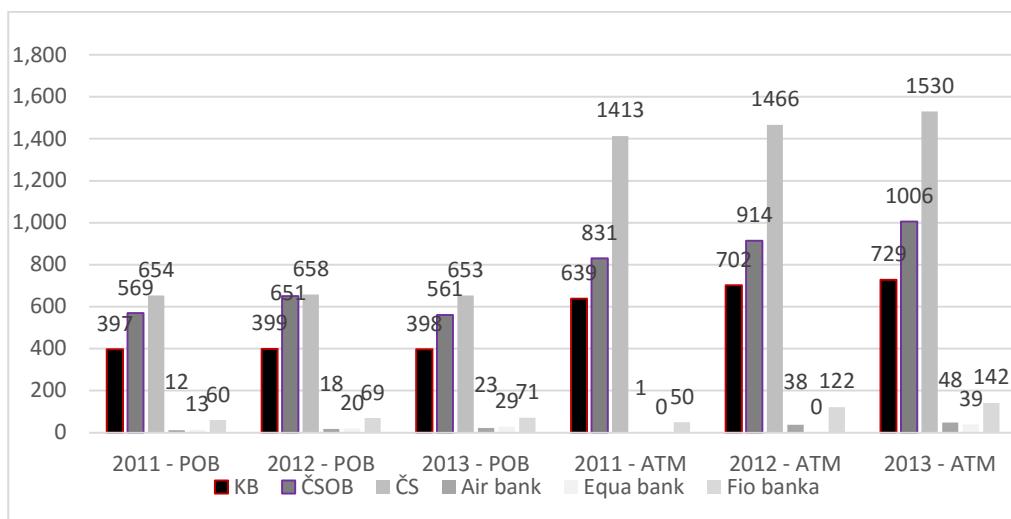
Graph 1 shows that the number of clients of low-cost banks constantly grew in the monitored period and the banks managed to meet their objective to widen their client base. On the other hand, big banks recorded a decline and it can be stated that some of their clients left them for small, low-cost banks.



Graph 1. Development of the number of clients of monitored banks (years 2011 – 2013, in ths.)

Source: Author according Annual Reports (2011 – 2013)

The number of branches and ATMs brings a certain level of comfort to clients during their standard administration of finances. The existing big traditional banks have a wide base of branches and ATMs throughout the Czech Republic. The attitude of low-cost banks is different. Air Bank enables their clients to withdraw cash from 4,300 terminals of Sazka a.s. and ATMs are only installed in Air Bank branches. Equa Bank opted for a pricing strategy offering cash deposits and withdrawals from any ATM in the Czech Republic free of charge. The only bank which owns and operates its own ATMs on a wider scale is Fio Bank. Fio Bank, as a low-cost bank, is the only one that decided to expand the business network of its branches, and as of 31.12.2013 it was operating 71 branches. This number cannot be compared to the big banks since Česká spořitelna operates 653 branches, Komerční banka 398 and ČSOB 561. The last bank mentioned also uses a network of branches of Poštovní spořitelna, a.s., i.e., 3200 points of sale, of which 150 are specialised banking counters in post offices throughout the Czech Republic (Československá obchodní banka, 2013; Česká spořitelna, 2013; Equa Bank, 2013; Fio Banka, 2013; Komerční banka, 2013).



Graph 2. Development of the number of own ATMs and branches of the monitored banks (2011 – 2013)

Source: Author according Annual Reports (2011 – 2013)

3.1 Pricing Policies of Low-Cost Banks

The price of a banking service has different forms and the price can be defined as an interest rate, commission and a fee. The price for services is often determined as an indirect fee included in the price of another product (for example, in the price for a "product package"). In order to evaluate the pricing policies of the monitored banks, it is essential to analyse their product strategy. In the first phase, low-cost banks offered their clients current accounts with no fees (in the Czech Republic, accounts are standardly subject to a fee). Lower operational costs and lower prices of products also resulted in a significantly smaller portfolio of services than those provided by the traditional big banks. In 2011, low-cost banks added to their portfolio savings accounts offering higher interest (introductory rates have decreased over time), followed by other product innovations, a wider portfolio of products, consumer loans, mortgages and business advisory services. However, they always waived their fees and offered an "initial" yield that was above standard. The offer was communicated to clients in an interesting manner and it was supported by a trendy, modern advertising campaign, highlighting these innovations and gaining the attention of both the professional and lay public. Nowadays, it can be stated that none of the low-cost banks has completed its journey to a comprehensive portfolio of banking products and services, and none of them has made their product portfolio complete. Each of the low-cost banks focuses on a different client segment and offers other "key" advantages which make it different from other low-cost banks and the big traditional banks. However, despite the incomplete product portfolio and non-comprehensive services of low-cost banks, it can be stated that low-cost banks

compete with the established, traditional banks and they are interesting for clients. Based on the analysis of the product lists of the stated banks, it can be stated that, compared to its competitors, the widest product portfolio is offered by Fio Bank (2014) which also offers specialised services for businesses and offers a wide network of its own ATMs. Another advantage of Fio Bank is the selection of foreign currency accounts it offers (EUR, USD, GBP, PLN, HUF), and standard or American-style mortgages. When comparing the product strategy of a low-cost bank to the original banks, we can see there is a significant difference in the scope of their product portfolio.

Table 1. Product Policies of Low-Cost Banks

	Air banka, a.s.	Equa banka a.s.	Fio banka a.s.
Account and debit card	x	x	x
Savings account/term account	x / n	x / x	x / x
Contactless technology	x	x	x
Consumer account	x	x	x
Credit card	n	n	x
Mortgages	Pilot, refinancing	x	x (standard, American)
Internet/mobile banking	x	x	x
Business account	No special account	n	x
Foreign currency account/SEPA payments	x (eur, usd) / n	x (eur, usd) / n	x (eur, usd, gbp, pln, huf) / x
Investment	n	n	x (e-broker)
No. of ATMs/deposit ATMs	48 + 4,300 (Sazka terminals) / x	0 (free withdrawals from all Czech ATM's)	142
No. of branches	23	10 + 8 kiosks	72

x – yes, n – no

Source: Author according price lists (2014)

In order to further evaluate the pricing policy of low-cost banks in the context of the existing players, it is advisable to analyse the development and profit structure of individual parties. It can be stated that low-cost banks threaten the client portfolio of big and medium-sized banks. They make their pricing so interesting for the client that of the monitored low-cost banks, only Fio Bank achieved a net profit of 36.2 million CZK in 2013. On the other hand, Air Bank and Equa Bank showed a loss.

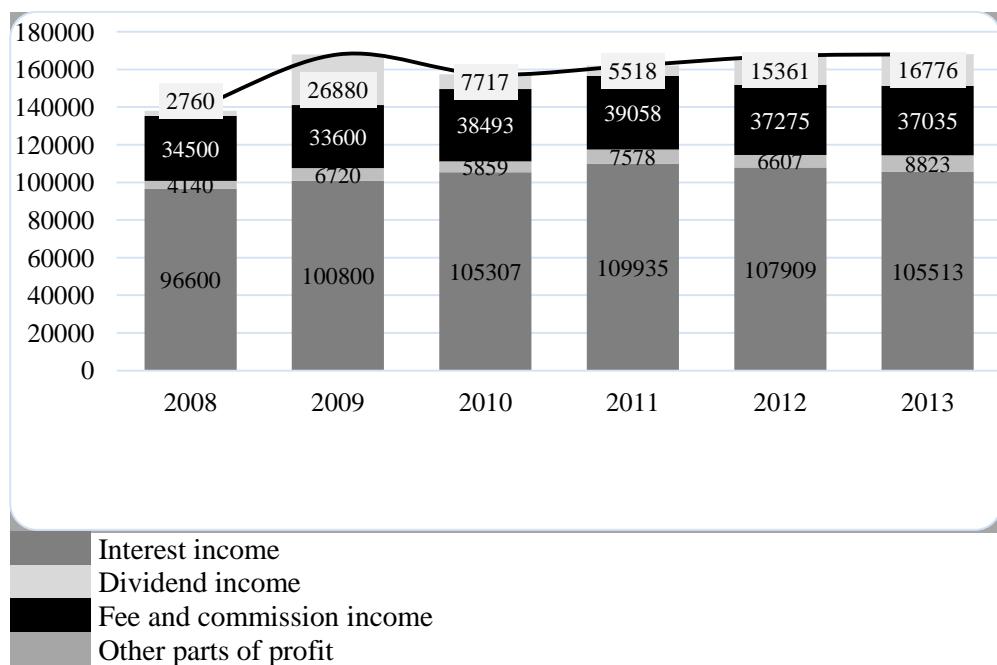
Currently, the acquisition tool of low-cost banks is their fee policy for standard and deposit accounts. The monitored low-cost banks were quick to grasp this fact and they offer a free of charge current account as standard. The pricing strategy is shown in Table 2 and is based on data valid as of 1.1.2015. Table 2 clearly shows that simplicity is a priority.

Table 2. Pricing policy of new banks - current account

Bank	Air bank	Equa bank	Fio banka
Product	Small tariff	Large tariff	Standard account
Opening an account	0	0	0
Interest rate	1.10 % p.a. (up to 100 thou. and min 5 card payments per month)	1.10 % p.a. (up to 100 thou. and min 5 card payments per month)	0.01 % p.a.
Monthly fee	0	100	0
Monthly electronic statement	0	0	0
Monthly statement by post	25	0	29
Sending a reminder	300	300	499
Cancellation of an account	0	0	0

Source: Author according price lists (2014)

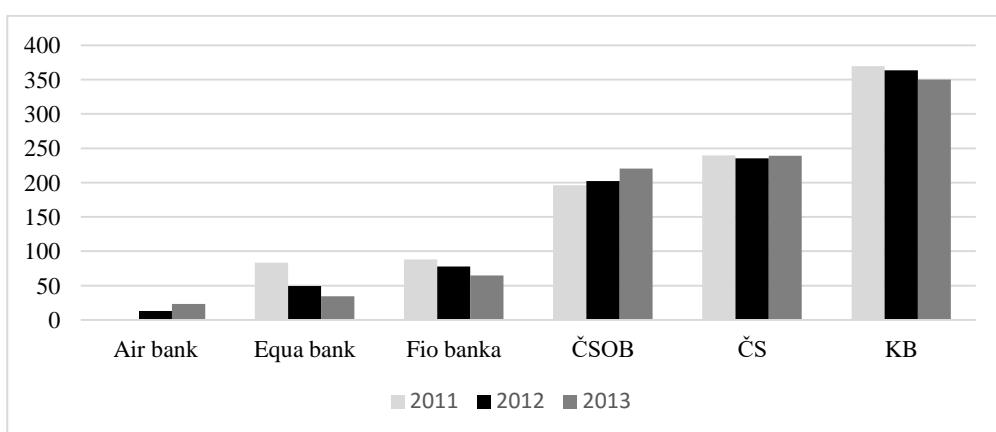
The Czech banking sector showed a profit of 168,147 million CZK in 2008 – 2013, which was largely created by interest income of 105,513 million CZK and income from fees and commissions of 48,845 million CZK. The biggest share was generated by the group of the four big banks, which produced 65% of the total net profit of the banking sector of the Czech Republic. Graph 3 depicts the development of profit from financing and operating activities of the entire banking sector of the Czech Republic in the last six years (the six-year period was selected due to the crisis on the financial market in 2009), divided into parts (profit from financial operations, fees and commissions, interest and dividends). It is clear that the fee policy and setting up the interest margin is critical for the banking sector since the revenue from interest income represents the biggest share of profits from operating and financial activities (2013) (63% of the total value, calculated as the difference between interest income and costs). The rest is represented by profit from fees and commission (22%), income from dividends (5%) and other profit from financial operations (10%) (Equa bank, 2013; Fio banka, 2013; Komerční banka, 2013; Air bank, 2013; Česká spořitelna, 2013).



Graph 3. Development of profit from operating and financial activities (banks in total for 2008-2013, in million CZK)

Source: Author according Annual Reports (2008 – 2013)

Another criterion for comparing low-cost banks with traditional big banks is bank income, i.e., the development of income from fees, commissions and interest income. In order to validate the fee policy when low-cost banks undertake not to impose fees for the administration of currents accounts and other services, we must compare the development of income from fees and commissions in both monitored segments, i.e., low-cost banks and established banks. For Equa Bank and Air Bank, the income from fees was around several million crowns but in 2013, in relation to the growing number of clients, both banks achieved higher income, circa 50 million CZK. Fio Bank runs commercial and investment banking, which increases the income from fees and commissions. However, even this bank, compared to traditional banks, showed in this regard a very low level of income of circa 250 million CZK. In 2013, all the big banks showed a decline in this part of income. In order to avoid the impact of the number of clients on income (increase or decrease), this indicator can be recalculated per one client, i.e., income from fees and commissions of the bank per client per month. Big banks generate on average 200 - 350 CZK per client per month, whilst low-cost banks generate on average 50 CZK per client per month; this confirms their low-cost concept (Effie Awards, 2015).



Graph 4. Development of income from client fees (per month in CZK)

Source: Author according Annual Reports (2011 – 2013)

Conclusion

In conclusion, it can be stated that the presented concept of new retail banks caught clients' attention. The question is how many clients decide to stay with new low-cost banks when the acquisition advantages, in the form of low fees, cease to exist. Furthermore, the banks do not state how many clients transferred to them all their funds from traditional banks, in other words, if they are their first or their second bank where they enjoy a specific advantage of having a current account free of charge, higher interest for savings account and lower fees for a loan. If low-cost banks manage to maintain their format and acquisition advantages, it is clear that their position on the banking market in the Czech Republic will strengthen and they will be able to compete against the big standard banks.

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