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Constructing the crisis - The case of local Savings Bank in Finland 1987 – 1993

Introduction

The Finnish banking system has been changing from the beginning of the 1980's. The financial market had been regulated for several decades from the beginning of the 1930. In the 1980's the financial market was deregulated during several years. The deregulation caused overheating of the market which led to banking crisis and worst depression in decades.¹ The overcapacity of the banking sector decreased through the numerous mergers of bank groups in the 1990's.²

The monetary deregulation from the beginning of 1980's gave banking sector chance to increase credit granting. After these institutional changes the banking system in Finland was reorganized. One of the key events was the diminishing of the largest retail banking group, the Savings Bank Group in the year 1993. There were similar but not the same kind of changes in other Nordic countries³.

Savings bank ownership differs significantly from commercial and co-operative banks. Savings banks don't have precise shareholders since they usually were based on public initiative or initiative of socially committed individuals who established savings bank. Depositors are committed to act together for social reasons than holding share in saving bank rather. For old savings bank in Finland there was idea or thought behind the establishment.

As the non-executive board typically has controlling role controlling body. The non-

¹ For depression in Finland in the 1990's see for example Kiander, J (ed.) 1990s economic crisis: the research programme on the economic crisis of the 1990s in Finland: the projects. Helsinki: Valtion taloudellinen tutkimuskeskus, 1999.; Kiander, J.; Vartia, P. Suuri lama : Suomen 1990-luvun kriisi ja talouspoliittinen keskustelu. Helsinki, ETLA-Taloustieto Oy; Hyytinen, A., Kuosa, I., Takalo, T.; Rahitusmarkkinoiden kehitys Suomessa 1980 – 2002. Kansantaloudellinen aikakauskirja. vol 99. no. 3, 2003.

² For the development of different banking group in Finland see: Kuisma, M. Kahlittu raha, kansallinen kapitalismi. Kansallis-Osake-Pankki 1940 – 1995. Suomalaisen kirjallisuuden seuran toimituksia 973. Hämeenlinna, Karisto Oy, 2004.; Kuusterä, A. Lähellä ihmistä. Osuuspankkitoiminta 100 vuotta. Helsinki, Otava, 2002.; Soukola, T.: Sallitun riskinoton rajat : STS-pankki ja sen edeltäjä 1980-1992. Vantaa: Kellastupa, 2008.; Vihola, T. ; (translation) Humphreys, P. The direction of money : Union Bank and Merita Bank. Helsinki: MeritaNordbanken , 2001

³ About Nordic banking crisis see Jonung, L, Kiander, J., Vartia, P. (ed.)The Great Financial [Crisis](#) in Finland and Sweden: The [Nordic](#) Experience of Financial Liberalization. Edward Elgar publishing, 2009.

executive board is not working full-time and it is regarded positive that they have distance to bank and should be able to be analytical and critical. Non-executive boards are regarded as non-active or as “rubber stamp”. They are regarded to have passive role in governing the boards. Typically board represents shareholders but as the savings bank lack formal ownership and owners is regarded as reason for passive role of the boards. How does the mode of ownership affect the reactions on banks operations? According to Myllys⁴ CEO and board of directors in savings bank has important role when changing the future of local savings bank.

Boards are regarded to be active in crisis but also they have importance in strategy process. Although board could have potential in strategy formulation there is limitations due lack of time, attention and information.

The aim of this paper is to analyze the decision making of the non-executive board directors in the case bank and how it was linked to the mode of ownership and structure in the local savings bank in Finland before and during recession in the years 1987 – 1993. Focus is on one local Savings Bank, TYPbank (established 1913) and especially in the years 1987 – 1993 when the bank adopted expansive strategy for increase its market share and. The main question is how the role of the non-executive board and CEO's was connected to the strategy and lack of ownership of the savings bank.

All the board members who was elected between 1987 – 1993 were interviewed. Also the vice executive officer who was responsible of credit granting were interviewed. All the interviews were taped and transcribed. Interviews were theme oriented in a way that there were no structured questions. Data is based on vast archive material, namely minutes of the board, strategy documents of the bank.

The research on the development of the Savings Bank Group in Finland

In case of Finland it is quite clear that some of Savings Bank chose aggressive market

⁴ Myllys, K., The Role of the Non-Executive Board and the CEO in Managing the Change: a survival battle in Finnish Banking. *Corporate Governance*, vol. 7, issue 4, 1999.

strategy. Still, there is inadequate research what happened at local level especially at local Savings Bank. According to Vihriälä⁵ who has studied the role of Finnish deposit banks in Finland's credit cycle during the years 1986–1995, stated that the additional information about the bank crisis is needed, especially why the individual Savings Banks operated as they operated.

The central reason for the banking crisis of the 1990's Finland was the operational policy of the Banks and especially credit granting policy after deregulation of financial market. This caused the massive capital import which led to the uncontrolled growth of the credit granting. In the Savings Banks this was especially seen as a possibility to expand the corporate credit granting. The unsuccessful strategic choices and the poor level of risk bearing capacity and lacking risk control systems were considered furthermore as the reason for the problems of the Savings Banks.⁶ On the other hand Halme⁷ came to that conclusion that, in spite of the differing administration and ownership structure of the savings banks compared to the commercial banks the restrictions concerning savings banks did not hinder enough the expanding of the risk-taking. Lehtiö stated that the Savings Banks had the weakest situation of bank groups mainly because of the ownership structure, the demand of own capital and in regard to risk bearing capacity. In any bank group one did not know how to prepare for the fact that several risks would come true simultaneously.⁸

One key episode on the development of the Savings bank Group was the establishment of the the national savings bank, the Savings Bank of Finland (SBF), established in the spring of 1992. Significant is that small group of Savings bank resisted the merger and stayed out of SBF. After splitting of SBF in 1993 the small number of local survived. Mylly studied the strategies and roles of board of directors in local Savings Bank. Conclusion is that local Savings Bank in its current form has ideologically come back to roots of savings

⁵ Vihriälä, V.: Banks and the Finnish Credit Cycle 1986 – 1995. Bank of Finland Studies E:7.

⁶ Kuusterä, A. Aate ja raha – säästöpankit suomalaisessa yhteiskunnassa 1822 – 1994 (The Ideology and Money – Savings Banks in the Finnish Society 1822 – 1994). Helsinki. Otava 1995.

⁷ Halme, L. Pankkisäätely ja valvonta. Oikeuspoliittinen tutkimus säästöpankkien riskinotosta. Bank of Finland Studies E:15. Helsinki 1999.

⁸ Lehtiö, S. Suomen pankkikriisin taustatekijät, luonne ja kriisinhoito erityisesti säästöpankeissa. TSE publications. A 1:2004.

banking.⁹

Structure of Savings bank group

As a part of the Finnish banking system, the Savings Bank Group consisted of a large number of independent local and regional banks with the common central bank SKOPbank (established 1908) and cooperation association, Finnish Savings bank association (established 1906). The structure of the bank group deviated from the structure of other bank groups and it had a significant effect on the operation of the whole Savings Bank Group. Even though Group had similar organizations, common central bank and common trusteeship the local and regional savings banks were able to operate very independently. The disconnectedness of the savings bank group is well described also by an example in case city Turku in which there was three savings banks, which regarded each other as the worst competitors.

Even though the savings banks may have competed with each other, they had a joint responsibility as being a member of Finnish Savings Bank Association and to the insurance fund of savings banks. The membership fee was justified as a payment of the trusteeship of the group, of the additional resources and of the improvement of operational preconditions. When the difficulties begun in the early 1990's SKOPbank was financed with 1,8 billion marks through the cooperation of the Savings Bank Group.¹⁰

Non-executive board of directors role in governing savings bank were considered essential from the beginning of the savings banking history in Finland. They were responsible of the management of the banks. When personnel of banks increased and operations became more professional, trustees and board of directors were the controlling body. The traditional role of the board was to control banks operations with passive attitude. In corporate world ownership is usually related to the controlling role of the board. Also representing shareholders is important task. In the savings bank the situation is different as

⁹ Myllys, K. (1995) Bank Managers' Agendas: Thoughts and Actions in a Crisis Situation. University of Tampere, School of Business Administration, series A 1: studies 42.; Myllys, K. (1999) Itsenäisiä ja itsepäisiä. Institutionaalinen näkökulma paikallisten säästöpankkien selviytymiseen pankkitoiminnan muutoksissa, Publication of the Turku School of Economics and Business Administration, Turku, 1999.

¹⁰ Partanen, R. Sata vuotta säästöpankkien yhteistoimintaa (Hundred years of cooperation of Saving Bank in Finland) Lappeenranta. Finnish Savings Bank Association, 2006.

the depositors of the savings banks elect the trustees in the annual meeting of the depositors to represent them. The board of directors is elected by the board of trustees. The lack of ownership is considered to be one reason for the passive role of boards.¹¹

During the institutional changes in 1980's in Saving bank the role of non-executive board were weakening when decision making became more complicated than before. Also board of directors lost their power, instead management from group level gain more important role in administration. In Spanish comparative study between commercial and savings bank conclusion was that the dispersed ownership structure and the lack of corporate control would appear to give managers freedom of action, which encouraged Savings banks to take more risk.¹²

Case description

Construction phase

The case bank was grounded (est. 1913) ideologically as social movement, namely to offer banking services for working class. The Case bank had several competitors from the start. There were main commercial banks, two other savings bank and co-operative bank. As the savings bank group owned its central bank, the SKOPbank, the case bank was significant owner of the central bank and had therefore access to Savings Bank group level decision making. The bank was also significant lender of house loans and the bank had developed accounts for home saving bonus.¹³

TYPBank went through several negotiations with other savings bank connected to labour movement. In negotiations in 1970's to form national level working class TYPbank denied to merge with other banks. Executives and board of directors did not find the good reasons to merge to a National level saving bank with working-class ideology embedded. The main reason may have been a fear of losing banks independency.

¹¹ Myllys, K., The Role of the Non-Executive Board and the CEO in Managing the Change: a survival battle in Finnish Banking. *Corporate Governance*, vol. 7, issue 4, 1999.

¹² Teresa Garcia-Marco, T.; Robles-Fernandez, M. D.: Risk-taking behaviour and ownership in the banking industry: The Spanish evidence, *Journal of Economics and Business*, Volume 60, Issue 4, 2008.

¹³ Paavola, R. Apukassoista miljardikerhoon. Turun Työväen Säästöpankki 1914 – 1989. Jyväskylä.

The bank chose its strategy to move away from an ideological emphasized bank. The case bank moved from its basic idea and traditional motto, "Saving first, then loan", towards to the strategy which was based on the credit sales and real estate refining. The purpose of the choice was to separate from the so called conservative savings bank which emphasizes the savings bank movement. Still, in strategic documents some of the central values of the strategy were the capital adequacy and the independence of the bank. However, all the savings banks in Finland did not choose an expansive strategy, because part of the banks continued on the more moderate growth.

The expansion of operations

When a long-standing CEO left the bank in 1987, the new leader's choice became difficult. The choice was made between two candidates: bank manager A was characterized as the banking professional, while bank manager B had a suitable political background and know-how in the real estate investments. The board did not reach an agreement about the candidate. As a final result Candidate B became CEO and candidate A deputy managing director. The relationship between the two leaders led to the situation that the discussions of the board were not open and confidential any more. This setting developed competitive position between managers where both leaders try to expand their own sphere of responsibilities.

The objective of the expansive strategy was to get new target groups and volume as the customer of the bank. The management of the bank set the acquisition corporate customers as a special target. For this purpose the bank founded affiliated companies as which purpose to offer financial services and investment services. Due these actions the bank achieved a progressive reputation within the Savings Bank Group.

For the investment services the stock exchange centre of Turku was established 1987. The purpose of the operation was to grant credit to the investments and to manage the investments. The bank got financing from the SKOPbank financing and at the same time

paid the commission of the financing. The bank founded the finance company (Master-rahoitus) in order to be saved from the commission of the credit limit financing that has been paid to the SKOPbank. For the corporate customers Eurobank was established in 1989. Members of the board did not understand completely new financial products. They relayed on executives on the matters and did not question the initiatives.

The member of the government talks about the decision-making in the government as follows: *"The members of the board were acceptors and in many matters givers of the direction of the final decision of course, but it usually took place according to the leaders' presentation."* The interview strengthens the picture of the government which accepted the managers' initiatives. The managers were making sure that the decisions were as expected. The board did not give any direct actual initiatives about strategic matters of the bank but accept the prepared matters.

The representative of the board talks about the attitude: *"We (the board) saw the cases after thorough preparation (...) we did not have any spontaneous ideas (...) in the board of the bank many matters, even big matter passed almost with the nod and we accepted them"*.

The chairman of the government had an active and strong role in the development of the bank. The chairman had been one candidate as the managing director of the bank. The chairman thought that the board of the bank was interested from more or less important matters. There was a more important one in his opinion for the representatives the advantages brought by the position of trust all.

Savings banks were traditionally independent in their actions, but in steadily increasing competition, the progressive resources and expertise provided by the Group level (consisting of the Finnish Savings Banks Association and the central bank of Savings Banks, SKOPbank) was important aid. Following quote of board member describes how they reacted to central bank support: *"The board tried to operate unanimously and trusted the initiatives of the operative management. Even though the matters were discussed, the decisions were unanimous. The instructions and recommendations of SKOP also were*

accepted because it was believed in the expertise of the central bank. We did not argue any ideas or orders from group level.”

Deconstruction phase

The bank faced the crisis after the downturn started from the 1988 on the security markets and the decrease in the value of real estates since the beginning of the 1990's. Savings bank group were one of the first whose problem became public. In the end of 1991 Bank of Finland took over SKOPbank. This affected especially to the capital and reserves of the TYPbank, the subsidiary companies of the bank, especially the financing company Master-Rahoitus and to the companies credited by the bank. It was at this stage when it was clear and shocking to all board members that TYPbank was middle of crisis.

The Bank of Finland intervened 1989 in the actions but in the savings banks instructions were not followed. However, all the savings banks did not choose an expansive strategy but the part continued on the line of the more moderate growth. TYP belonged to the expansive banks which tried to reach a significant position both in the administration of the Savings Bank Group and as an exemplary breeder of the operation in the savings bank group. The state supported significantly and invested capital to SBF. Public discussion raised led by other bank groups and politicians. The pressure to reorganize Finnish banking system were strong and SBF was splitted between other bank groups in 1993.

After realizing that the crisis was serious and it seemed that it was not possible to save the bank any more as the independent institution, conflicts were created inside the board. The deputy managing director disclaimed and the managing director stayed on the sick leave. Only possibility was merging to Savings Bank of Finland (SBF).

One reason for the crisis was the competition between the bank groups but also within the Savings bank group. In this relation, the savings banks were a conflicting group because the savings banks were the biggest bank group also in case town. The competition for the credit customers incurred especially fateful because the chosen strategy is a good example of how the worst customers started moving from the other banks.

The administration model of the savings bank can also be considered as one reason for the failure. The board had responsibility for the banks operation and for the made decisions but the members of the board did not have enough time to study operation and preparation of the decisions demonstrated by the management. In the case of TYPbank competition between CEO and a deputy managing director, was disadvantageous. The board members were chocked when they realized the crisis had hit the bank. They believed that the real estate property would not lose its value. After negotiations start of merging SBF the board tried to find a way to remain independent.

Conclusions

The aim of this paper was to analyze the decision making in the board of one local Savings bank in Finland. The case bank values were based on savings bank and labour movement. Bank also emphasized independence as its core value. After selection of new CEO's bank started to compete with other savings bank and commercial banks on credit market. Central bank of the Savings Bank, SKOPbank led the way in new thinking. On operational level some Finnish Savings banks tried to transform to and act like commercial bank. The Saving bank Group formulated new strategy in mid 1980's after financial difficulties.

Tainio et al. (1997) conclude that winners in the Finnish banking competition were the banks that balanced the creative and conservative practices and balanced their changes with the wider social context. The losers of the game were banks that either chose radically new strategies or stayed strictly in the old-fashioned retail banking.

Between the savings banks it was competed for which bank had the most significant SKOP property and that way affecting station in the savings bank group in among others. In this relation the savings banks were a conflicting group because the savings banks were the biggest bank group also in Turku added up. Even though the competitors were found in other bank groups, the savings banks also competed also with each other. The competition for the credit customers is a good example of how the problem customers started moving from the other banks.

The most important reasons for the deceiving of the strategy of the bank are 1988 on the security markets the decrease which has begun and a decrease in the value of real estates since the beginning of the 1990's since. These reasons affected especially to the own capital of the bank, the affiliated companies of the bank and to the companies given credit by the bank which have concentrated on the placing.

The board of non-executives was chosen by the board of trustees. The board worked part-time and did have little time to prepare themselves on complex credit granting decisions. The board of non-executives thought that they did not have enough information on decisions and relayed on executives preparation. Relationship between managers and the board were based on thought that executives lead and board enjoy the refreshments. Afterwards members of the board did not understand and disagreed some of operations. Passive role of the board was due group level expertise and resources offered. Threat of losing independence activated board but it was too late. Chair of the board was in favor of growth strategy and probably had strong influence on decisions. Chair of the board was member in SkOPbank board of governors and also Member of Parliament.

Executive officers regarded service for depositors unprofitable and therefore seek new financing products. In time of crisis board was chocked that they did not understand the scale of risks they had accepted. Depositors did not understand and disagreed especially the real estate operations.

The administration model of the savings bank also can be considered as one reason for the failure of the bank. The board of the bank had a responsibility for the operation of the bank and for the made decisions but the members of the government did not have enough time to study operation and preparation of the decisions demonstrated by the management. Furthermore, in case of TYP was fateful, the fact that both a managing director and a deputy manager were chosen to the bank, because the situation which was disadvantageous for the development of the bank was created between the leaders.