A FRAMEWORK FOR ANALYZING THE ROMANIAN BANKING MARKET BY NEW ENTRY INSTITUTIONS

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Abstract. *The banks, as institutions that attract the saved resources for investments by mediating the relation between the savers and the investors, are essential for the proper functioning of the economy. However, for the newcomers, the entry on the Romanian banking market involves targeting the opportunities for corporate growth and achieving sustainable advantages compared to the competitors, particularly that, the entry of a newcomer on the Romanian banking market also means entering the EU banking market, as well. Based on this hypothesis, the current study proposes a perspective on the strategic options available to new entries, by analyzing the banking potential and the risks while taking into account the regulations, the local resources and the specific regional and global context. The paper takes into account the economic and social dimension of the banking business, given that, the pressure for democratization and improved living standards contributes to the emergence of new social guidelines. The analysis of past events for identifying a set of early warning indicators (namely the research method used in this paper) is only a starting point. So, we take into account the efficiency and profitability of some of the banks that went through periods of difficulty. In making the decision about if and how to enter the local banking market in Romania, the potential newcomers should analyze a large series of indicators and their evolution trends in time, this being possible with a help of a working instrument called Target Evaluating Model for avoiding the failure on a new banking market. But not only this, because the newcomers must understand the local perspectives of this market. The Romanian banking sector proved to be, over time, stable and strong enough, that was not deeply affected by the global financial crisis and even has a significant potential for growth nowadays. Nevertheless, in the current work we made a deep research upon the ratios that should have given early signs to the risk management systems in some banks that did not survive on the Romanian banking market in the past and, consequently, bankrupted. The competition among the banks is beneficial for the customers and also for the national banking system. It is equally beneficial for the regional or global competition among the national banking markets to attract the investors to the banks and to provide better services to the natives.*

Keywords: *risk management; banking analysis; target evaluation model; supervision; financial stability.*

Introduction

There are many models for analyzing the financial risks, models that can be used by the universal banks as institutions that attract the saved resources for investments, as it was demonstrated (Benink, 1995). In mediating the relation between the savers and the investors, the banks are essential for the proper functioning of the economy.

By using the financial intelligence, the banking analysts are responsible with providing an overview that is particularly tailored for the management of the risks. However, for the newcomers, the entry on the Romanian banking market, involves targeting the opportunities for corporate growth, achieving sustainable advantages compared to the competitors, but in the same time, risk taking.

This paper aims to complete the existing methodologies by establishing a comprehensive framework for the decisions assessment regarding the difficulties to be faced by the new entry banks, not only by using the financial data but also by considering the informational system for banking knowledge.

From the credit institution's point of view, the features of the banking success in relation with this subject also refer to depicting the factors that are specific for the banking activity, factors that contribute to the development of the banking risks. They also include an analysis from the perspective of the bankruptcy risks that are summarized by the elements of the economic cycle and of the economic crises that happened within the environment the banks activate in.

We argue that, even if the bank`s behavior is adverse towards risk, the costs that are associated with possibility of bankruptcy make them act against taking excessive risks that can increase the probability of failure.

This paper uses and promotes a series of methods and principles focused on the banking risk assessment methodologies, by using a synthesis of positive and negative experiences, as a result of the growing recognition of the capital adequacy standards importance. In particular, we recognize the utility and the importance the semiotic analysis has, as a decision basis in relation with the development of banks, because what really matters is making the best decision regarding the management of the banks. And this can be solved either by investing in development or by investing in solving the difficulties.

Macroeconomics banking awareness. Why do the banks fail, and how to avoid failure? Should we trust evaluation models?

We know that the traditional banking analysis is based on a range of quantitative supervisory tools regarding the liquidity, the solvency, the loan portfolio quality, the large exposures and the open foreign exchange positions (van Greuning & Bratanovic, 2009). Although these are extremely useful, they are not an adequate indication for the banking financial condition or about its perspectives. This particular contradiction we will clarify in the present work and by the new calculating model for forecasting the chances of survival for the newcomers on the Romanian banking market.

In the same time, the picture reflected by financial and prudential indicators also depends on the opportunity, the completeness and on the accuracy of data used for calculations (van Greuning & Bratanovic, 2009). On the contrary, an in-depth analysis as proposed by the current paper includes important qualitative factors and places the financial indicators within a broad framework for assessing and managing the risks as well as the changes or trends in evaluating if the bank environment is a viable one. Also, it allows us to know whether the bank`s operations are or aren't likely to jeopardize the safety of the banking system as a whole.

In order to respond to the public pressure, worried about the viability of one on another bank in a certain market, there was developed a system of technical methods for making a financial diagnosis of the lending and savings institutions, also to ensure compliance with the regulations in force for the general activity of the banking system.

Analyzing the economic opportunities and the circumstances that are typical to the banking activities, as well as the issues related to the transition, we may conclude that the research activity which was the basis of this paper leads towards the consideration that in fact, canceling the evaluation of certain parameters by the central financial-banking supervisory institutions, does not mean only that those parameters are not interesting from the bank's stability and viability point of view, anymore.

The diagnosis focuses on the role the analysis plays in detecting the signs of risk for the banks, starting from the necessary knowledge in the activity of a credit institution, including the use of the prediction models. For a better assessment of the possible risks associated with bank failure, we studied the cases of the banks that faced difficulties and the ways of solving them, for all such situations that occurred in Romania after 1990.

Since the space allocated for this presentation does not allow a dissemination of all the materials, we selected the part describing the evolution of the most important indicators in some of the analyzed cases, out of a paper which is in progress and prepared to be published in a scientific journal.

Practically, this work has as main objective creating a Target Evaluation Model (TEM), able to offer support to any bank that would like to enter the Romanian market. This new coming player on the local market will have the opportunity to use this TEM, meaning that it will introduce the indicators that are characteristic for its own activity in the last 5-10 years and will get an overall image and a perspective of how it will succeed in adapting itself to the Romanian business and banking environment. The TEM relies both on the statistical (historical) comparison and also on analysis and forecast. The calculation system used within the TEM is two-dimensional, combining the results of the analysis upon the new coming bank characteristics (prudential ratios) and the ones of the economic, business and banking environment in the host market. When it is ready, the TEM calculation system will rely on the multiple criteria analysis model as elaborated by Altman (1968), this being in fact a correlation function in which the value of the variable is determined in relation with the value of 13-14 independent variables and with the correlation coefficients that are assigned to each criterion. As we have previously stated, creating this TEM is the final objective of a wider research, that it is still ongoing. Presently, we are working on defining the quality of the business environment of the host country (Romania) and on identifying the most relevant indicators that will be used in the next research phase, for building the TEM matrix that will provide the users with information that help them avoid a potential bankruptcy or major difficulties in a banking market that is new for that player.

In what the Romanian banking system concerns, currently, it presents an increased liquidity degree and a corresponding level of capitalization (approximately 10 billion RON), with a tendency to withdraw and redirect some capital resources towards some mother-banks, particularly when it is acknowledged that, the withdrawn resources can be replaced/substituted. The Romanian banking system reflects a gradually diminishing volume of non-performance loans (NPL), from 21,9% (in December 2013) to 13,9% (in December 2014), with a reduction tendency of under 12% by the end of 2015, while, their coverage with provisions maintained, in time, to a weight of approximately 70%. In 2013, Romania got out from the excessive deficit procedure and, by the end of 2014 it was acknowledged that the national economy functioned within the parameters according the Maastricht Criteria, with an average annual inflation of 1,2%, the average annual long term interest rates of 4,1%, the maximum variation of the RON towards EURO exchange rate being between +2,1% and – 3,5%, the consolidated budgetary deficit under 1,8% from the GDP and the public debt being under the limit of 40% (39,8%). All these improvement and consolidation trends for some macroeconomic indicators encourage some new players on the international banking market to analyze the opportunity to enter the local market, that, slowly but surely, makes its path towards Euro (Isărescu, 2015a).

The evolution (in percentages) of the main efficiency and profitability indicators for some of the banks that passed through difficult periods are presented in the Tables 1 to 3. These indicators provided the respective banks' management with early warning signals, but were not considered. Introducing the following indicators into TEM will give solid clues to the risk managers in the banks that will use the TEM in the decision making process for correctly determining if the time is right for accessing a new banking market.

The minimum set of prudential indicators is the following:
1. ROA = Profit After Taxes / Total Assets (The Return On Assets)
2. ROE = Profit After Taxes / Own Capital (The Return On Equity)
3. Rr = Total Operating Income / Total Operating Expenses (The Profitability of the Main activity)
4. L = Total Loans Portfolio / Deposits From Clients (The Liquidity)
5. Lr = Net Assets / Total Debts (The Quick Liquidity)
6. E = Own Capital / Total Assets (The Leverage Effect)
7. C = Own Capital / Social Capital (The Capital Adequacy)

8. Ca = Total Loans Portfolio / Total Assets (The Quality of Assets)
9. Cr = Impaired Loans/ Total Loans Portfolio (The Impaired Loans Ratio in The Total Loans)
10. Cra = Impaired Loans / Total Assets (The Impaired Loans Ratio in Total Assets)
11. Crc = Impaired Loans / Own Capital (The Impaired Loans Ratio in Total Capital)
12. Pcv = Personnel Expenses / Operating Income (The Personnel Expenses Ratio in the Operating Income)
13. Rpc = Profit After Taxes / Personnel Expenses (The Profitability of the Personnel Expenses)

This minimum set of indicators can be extended with further relevant ones, we will think about along the analysis and research completing process, analysis that we have initiated in the current paper.

The set of indicators that will be the essence of the TEM, are considered to have proven their efficiency through the warnings they coud give, if the risk managers in those banks had owend a multi dimenssional analysis instrument, as we intend this TEM to be. Wishing to verify how relevant the early signals would have been if using the TEM in the case of some banks in Romania that bankruped in the past, we proceeded to the following analyses:

Table 1. International Bank of Religions

Year / Indicator	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
ROA	3.9	4.3	2.9	2.6	1.7	2.9	-58.3	-23.7	-256.2	-280.0
ROE	23.3	38.9	15.9	22.0	14.8	-54.6	x	x	x	X
Rr	164.6	184.6	126.1	672.5	491.2	115.1	309.9	170.9	129.9	80.9
L	222.5	540.9	2.928.7	102.5	63.7	81.1	34.7	23.1	31.5	32.3
Lr	89.8	106.7	90.4	93.6	90.5	92.9	87.4	100.0	-253.7	-232.9
E	16.9	10.9	17.9	11.6	11.8	5.5	-47.3	-103.2	-233.5	-215.1
C	144.7	393.4	477.3	207.9	341.5	0.9	-398.5	-518.4	-590.0	-590.0
Ca	13.7	21.6	36.6	56.5	38.4	54.4	82.0	54.5	125.7	125.2
Cr	18.3	12.9	17.9	21.0	53.6	32.4	39.2	99.9	100%	100%
Cra	2.5	2.8	6.6	11.9	20.6	17.6	32.1	54.4	125.7	125.2
Crc	14.9	25.6	36.6	101.9	175.0	323.3	-67.9	-52.8	-53.8	-58.2
Pcv	8.8	7.4	7.3	8.4	10.9	7.2	13.2	23.1	40.9	35.5
Rpc	443.9	615.9	226.1	107.3	66.8	-114.2	-1.048.9	-306.1	-2.117.1	-3.5

Table 2. Credit Bank

Year / Indicators	1995	1996	1997	1998
ROA	3,99	2,50	0,13	-18,18
ROE	38,70	31,90	1,56	-176,17
Rr	116,71	105,65	88,14	92,64
L	149,87	117,41	127,55	92,97
Lr	94,61	95,56	96,18	76,50
E	10,30	7,84	8,36	10,32
C	357,28	448,71	396,05	252,52
Ca	71,02	63,94	72,04	50,87
Cr	9,90	8,01	x	69,94
Cra	7,03	5,12	x	35,58
Crc	68,27	65,37	x	3,45
Pcv	7,96	8,42	7,96	12,37
Rpc	142,06	77,84	2,80	-427,10

Table 3. Turkish-Romanian Bank

Year / Indicators	1995	1996	1997	1998
ROA	7,11	0,56	-27,35	-195,85
ROE	28,95	30,47	-238,96	1490,99
Rr	6,52	3,17	189,65	115,92
L	93,40	48,06	117,52	1,11
Lr	93,18	88,71	59,77	6,73
E	24,55	15,64	11,44	-131,36
C	205,34	311,95	105,21	-214,29
Ca	2,86	21,42	25,03	0,52
Cr	0,01	0,98	14,00	1,96
Cra	0,002	0,003	3,50	0,38
Crc	0,09	0,18	30,62	-0,29
Pcv	8,06	17,12	23,93	36,86
Rpc	344,84	162,49	-275,18	-1.023,45

An efficient use of the banking risk analysis is essential and requires a good knowledge of all the elements of the controllable and uncontrollable activities, all the limitations and the possible outcomes, to provide control for the quality and quantity of the data and for the information management system used in the bank.

Basically, the entire banking system, from basic operations to decision making, relies on information that are structured in a certain form and for certain activities, after their volumes, the type of incomes and expenses, the potential occurrence of losses, the level and the quality of the assets, as well as on the information regarding the investments for development according to in the economic environment in which the bank activates.

The Romanian banking environment

Peng (2000) showed that in their attempt to enter into a new banking market and to design strategies to overcome challenges, an important barrier is the propriety of information about the clients, starting from the uncertainty of the environment they activate in. The bank must identify the greatest strengths for the lenders or investors and how the bank could use the money in order to develop the markets that are specific to these, in Romania.

The increasing competition on the banking market gives responsibility to the key actors to coordinate the focus on the identified areas, according to the institutional development plan and to manage all the categories of financial business and operational risks, together with event risks associated to these.

For planning and defining the risk tolerance levels, the management board, in their decision making process, analyze the major risks coming from the banking environment. Consequently, by analyzing the policies at the macroeconomic level, we acknowledge that Romania has a low inflation rate and a significant decrease in the fiscal deficit as, well as prudent monetary and financial policies.

The banking management mainly considers that an important result of the evaluation is given by ranking the major changes in the national economy (Tochkov & Nenovsky, 2011). The public infrastructure projects reflect a quality strategic priorities plan for a faster growth of the investments on a medium term, as Romania has the lowest infrastructure density in the EU.

On the other hand, the analysis upon the indicators illustrates why Romania still keeps the vulnerabilities to external shocks and also the internal and external imbalances although widely reduced, but not totally yet.

Based on this hypothesis, the study proposes a strategic perspective upon the available options for the new entries, by analyzing the changes towards the last year's evolution, for thus offering a dynamic view upon the banking potential and its risks, while taking into account the regulations, the local resources and also the specific regional and global context.

The paper takes into consideration the economic and social dimension of the banking activity, given that, the pressure for democratization and improved living standards contributes to the occurrence of new social guidelines. They can help the analysts to evaluate the trends and to project the structured activities and resources, to better respond to the development needs.

In addition, the analysis upon the past events is only a starting point. We can say that the advantages the banks that developed on the Romanian market have may change or disappear. Therefore, in addition to the modern marketing techniques used to get the necessary information for penetrating the local banking market, when choosing between the possible alternatives to entry on the market, the new entries must aim a fundamental understanding of the local perspectives.

Important structural reforms move the banking sector forward, to the market-based systems within the transition from socialism to capitalism and democracy. So, the process began with an environment transformation into a market economy, with prices liberalization, with building the private sector (many state-owned enterprises having been privatized) and also the necessary institutions to support a market economy (Pettis, 2001). But many state-owned enterprises only gave the illusion that were able to survive, due to the fact that their arrears were reduced with 1% from the GDP by the end of 2014, while the Romanian state-owned enterprises sector became profitable only after several years of loss producing, as stated in International Monetary Fund Country Reports (2015).

Romania widely reduced the internal and external imbalances, the inflation is well below its target and the incomes slowly convergence to the EU level. This was achieved by an impressive fiscal consolidation and by prudent monetary and financial policies. In the same time, Romania remains vulnerable to global and Euro area shocks, given its relatively high level of external debt, compared with its sustainable force of macroeconomic growth. While the fiscal gap and the foreign exchange reserves provide a buffer and the non-performance loans were substantially reduced, the financial and foreign exchange balance sheets in the private sector still need to be strengthened further on. Some of these macroeconomic environment indicators for Romania, as presented in the Table 4, were issued and published by the General Division for Economic and Financial Affairs (DG ECFIN) on February, the 5th, 2015 and revised by The International Monetary Fund within The Country Report No. 15/79.

Table 4. The Level of the Forecast for Romania 2013 – 2015 (Directorate General for Economic and Financial Affairs, 2015; IMF, 2015)

Indicators / **Year**	**2013**	**2014**	**2015**
GDP Growth (%)	3.4	2.9	2.7
Inflation Rate (%)	3.2	1.4	1.2
Unemployment (%)	7.1	6.8	6.7
Public Budget Balance (% of GDP)	-2.2	-1.8	-1.5
Gross Public Debt (% of GDP)	38.0	38.7	39.1
Current Account Balance (% of GDP)	-1.2	-0.5	-1.1
Gross National Saving (%)	21.6	21.2	24.3
Gross Domestic Investment (%)	24.5	23.0	23.7
Gross Official Reserves (%)	24.6	23.6	22.7
NBR Policy Rate (%)	4.0	2.7	2.2
Exchange Rate: RON per EURO (end of period) (%)	4.5	4.5	4.4

The GDP grew with 3% in 2014 and is foreseen to remain strong in 2015 as well, at a level of 2.8 – 3%. The annual inflation rate slowed down by the end of 2014, decreasing with/to??? 0.83%, and to 0.41% in January 2015. As stated by Isărescu (2015b), the inflation is predicted to remain low in 2015 as well,

reaching an average annual value of about 1%.
The external position was consolidated while the current account deficit was reduced to a historic level of 0.5 % of GDP, in 2014. As Timu (2014) demonstrated, Romania continued to improve its presence on the international capital markets, thus generating significant buffers. In May 2014, Standard and Poor's upgraded Romania's investor grade level to "investment grade" and the country continued to successfully activate on the international capital markets. The public deficit was reduced to 1.9% of GDP in 2014, due to the fiscal consolidation process. Romania's banking system is strong, the non-performance loans ratio decreased, adequate buffers were granted and no public funds were necessary to support the banking sector during the global financial crisis. But, in the same time, there persists the dramatic decrease in the respect of the lending activity for the private sector.

The Romanian Central Bank international reserves level was of 34.3 billion Euro by the end of January 2015 and exceeded the required standards for covering the imports on a period of 3 months. Yet recently, the growth of the economic activity led to an improvement in the respect of the labor force market, the unemployment decreasing to 6.8%. The improvement of the financial performance by sustainable macroeconomic policies needs fiscal adjustments for a good management of the public debt and for improving the UE funds absorption.

A special attention is given to identifying and ensuring the security of banking business cycle and to the level of correlation between the bank liquidity and the credit availability, for thus anticipating and preventing the information asymmetry. Even if we recognize that The Central Bank acted by adjusting and adapting the norms and consequently the market did not prove itself to be perfectly free, we can see that the banking investors were able to effectively monitor and respond to the imposed rules, even if the progress are only partially recognized. Moreover, under the exactness of the regulations and considering the possible changes of the market risks in the banking field, the depositors and the borrowers may be affected, as it will be impossible for them to renegotiate their contracts with the banks.

The Romanian banking sector proved itself in time, to be stable and strong enough, so that it was not deeply affected by the global financial crisis and even has a significant potential for growth. The competition among banks is beneficial to the customers and for the national banking system. It is equally beneficial for the regional or global competition between the national banking markets, in their aim to attract investors for the banks and to provide better services to the population.

The banking sector in Romania has prudential reserves of capital and liquidity to face a high intensity shock resulting from possible adverse internal and external macroeconomic developments. Within the Romanian banking system, there operate 40 banks, out of which 24 are with private foreign capital, 4 with private Romanian capital, 2 banks have the State as the majority stockholder, 9 are branches of foreign banks and one is a credit cooperative.

The bond between the Romanian banking system and the European banking system is strong, as demonstrated by the share of foreign capital in the total banking net assets, of 364.4 billion RON. Out of these, 91.2% are assets belonging to private capital credit institutions and 89.9% are assets belonging to institutions with foreign capital, more than 80% being of European origin.

The vulnerability of the Romanian banking sector, judged by a too strong dependence on the external financial resources, has significantly diminished. The mother-banks continued to reduce the volume of the financing lines granted to subsidiaries in Romania. The de-leveraging continued to manifest itself in a more methodic manner. The exposure of mother-banks towards their subsidiaries in Romania has decreased. In the same time, the ratio of customers' loans and the deposits related to the private sector in Romania has consistently adjusted to 92 % (which no longer generates a pressure level, from the macro-economic point of view).

The probability of default for the non-financial corporate sector remains on a downward trend (the average value for December 2014 was of 5.4% compared with 6.9 % in December 2013). The banking institutions in Romania continued restructuring the business by reducing the number of banking units (the number of banking units decreased with 229 units in 2013 and with some additional 142 units in the first half of 2014) and also by reducing the number of employees (the number of employees in the banking system decreased with 3157 in 2013 and with 603 in the first half of 2014), in an attempt to optimize the operational costs. Related to the development of territorial networks, the profitability rate of the bank's core business is of 181 % (calculated as the ratio between the operational income and operational expenses).

Conclusions and outlook

In conclusion, the activities that were the basis for the elaboration of the current paper point out that, to inform themselves about the risks, the credit institution evaluate the risk as being higher than the limit of the financial risks that is associated to the loss, as generated by an opposite evolution compared with the optimistic previsions (what we see in the sensitivity analysis). Consequently, for stimulating the capacity of the banking institutions to resist to shocks, we have to examine a series of parameters and to use the semiotic analysis model, for deciding accordingly. For this, it is necessary to have some correct information, including the financial inter banking arrangements regarding credit line for special and emergency situations.

The low level of the bank lending activity characterized the most of the Member States of the EU-28, the identified factors being both cyclical and structural. Thus, on the supply side, there were identified the capital constraints and the persistent financial market fragmentation. On the demand side, the influence factors were the gap in the relation with the business cycle and the credit risk adjustment within the current balances of the non-financial companies.

The paper may be used for highlighting and eventually solve a macroeconomic paradigm, for recognizing a good and appropriate environment for administrating the banking investments, for overcoming the difficulties and for improving the corporate governance. Another plus of the current paper is the construction of a new model that explains the national banking fluctuations, recesses and cycles. Therefore, taking into account the settled prerequisites, we propose a management framework model (TEM) for analyzing the complex banking risk and also the macroeconomic risk model that gives us a realistic solution and which indicates that, the substandard environment indicators can determine losses and distortions in terms of long-term competitiveness of the banking market.

The theoretical analysis upon respecting the capital adequacy standards is important because obliges the bank to take an as small as possible social risk in the host market. Generically, the new banks must seek new customers for loans, which are a category of borrowers with a higher degree of risk, which initially were not credited, resulting in a surplus of funds in the market (Dell'Arriccia, 1998). This is the motivation for which, a medium degree of caution in riskier conditions, may lead to a decrease of investment appetite. We can appreciate why, when the economy falls into recession, there is no clear presumption about the investors' decisions. Our future estimation model (TEM) could respond to the worries about the small interest of the newcomers in the Romanian banking market when the decrease of the lending activity is sure. But even if, it is necessary to grant the compliance with the capital adequacy standards, we have to realize that these are not perfect for thus to respond to the risk adjustments, the banks having an incentive to go for the riskiest assets within any risk category (Mishkin, 2001). This minus will be solved by the model (TEM) we created at the completion of this research.

The analysis driven by the TEM should not focus only on the macroeconomic variables that reflect the structure of the national economy but, in general, on the issues such as the degree of banks capitalization, the degree of concentration and the competition in the credit market structure, the market liquidity and the inter banking bond market, the shareholders structure (public or private) as well as on other regulatory aspects for supervising the quality of the banking activity, that can also be operatively forecasted and controlled.

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