

Reorientations of the Bank Management Induced by the Banking System Globalization

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Abstract

The article presents the implications of globalization for the activity within the banking sector, as a result of the new economic context in which banks are currently evolving. An increasing competition has obliged banks to orientate towards diversifying their activities. Nevertheless, such a reorientation leads to the increase in the number and dimensions of the risks which banks are exposed to and are to undertake. These aspects impose the continuous renewal of the methods to manage the activity of bank entities, methods that are partially presented and analyzed in this paper.

Key words: *globalization, banking system, corporatist governing, portfolio management, risk management*

JEL Classification: *G21*

Introduction

During its history, mankind has witnessed profound transformations in the structure and functioning of the economy.

In the contemporary period, analysts have proposed two concepts, internalization and globalization, in order to characterize these changes. Most of the analysts have opted for the term “globalization” taking into account the fact that the main beneficiaries of the transformations have been manufacturing multinationals.

In its evolution, the process of globalization has covered several stages, the most recent starting in the 1990's when there were synthesized the transformations that world economy had suffered.

Globalization is considered in the present the final point of a process of integrating economic, financial, social and cultural forces, process that takes place at all levels of the contemporary society.

By its nature, globalization has both positive and negative effects. The valorisation of the positive effects has contributed to the technological development and to the actual integration of the states in the world economy, in the context of the increasing economic potential of some countries. On the minus side of globalization, one can mention the marginalisation of the less technologically developed countries.

At the world level, globalization has produced dramatic mutations in the structure and functioning of the main economic subsystems, especially in the financial one.

The financial subsystem, that encompasses flows of capital and investments, has registered, in the context of globalization, the highest rate of growth in the volume of activity. Such a rate was favoured by the post war monetary arrangements (Breton Woods, USA, 1944) and by the founding of several international organisations – International Monetary Fund, World Bank, European Central Bank – initiatives that contributed to the formation of an integrated financial system.

As a result of turning to account the opportunities offered by globalization, the circuits of capital increased in volume, and there was founded a highly institutionalized infrastructure. The vigorous development of these factors generated a global financial market, whose evolution rapidly affects the national markets.

In spite of the distortions accompanying its evolution, the current world financial space, including the globalization of banks, capitals and financial markets, has become an essential component of the globalization of economic activity.

In its turn, the banking system, as a component of the economic and financial system, lies under the influence of the changes determined by the current economic juncture in which it develops – the instability of the interest rates, the increasing competition, states capitals concentration and so forth.

An increasing orientation towards the market and, implicitly, towards the client, has led to the development of the international financial markets, of financial flows and transfers. Initially created as highly specialized financial institutions, banks have been forced to diversify their activities as a result of fierce competition. Such a tendency aims at meeting the financial needs of different geographical areas and fields of activity. This new orientation has materialized in diversifying services portfolio by including more and ore complex operations, such as derivatives (futures, swap, options) and new types of obligations that are now used either in speculative purposes, or as instruments to cover currency risk.

Recent acceleration of economic changes induced by globalization has determined banks to create complex products considering various economic sectors involved. As a result, there appeared merges of the banking sector with the insurance field, of commercial banks with investment ones, of the banking sector with real estates and the markets of real value titles, the use of financial and operational leasing. Another consequence of globalization and the development of foreign trade is the thriving multinational banks sector, materialized in subsidiaries and branches that are opened in countries others than the country of origin.

In the present, the evolution of the banking systems is oriented towards satisfying the needs of an economic environment in which competition is getting harsher and harsher, with regulations imposed by both national and international organisations, and with phenomena that manifest at the local and international level influencing their activity.

Intense competition, as a result of banking globalization, has led to the increase in the number and dimensions of the risks banks are exposed to and are to undertake in their activity. The current economic context has obliged banks to take these risks, concepts such as risk and uncertainty being currently included in the structure of the decisional process. Insufficient knowledge of risks, their incorrect estimation or lack of protection against the induced effects directly affects the results of banks' economic activities. These aspects have imposed the continuous renewal of the methods and techniques used to manage bank portfolios and the activity of bank entities, so that risks may be rigorously controlled in order to sustain competitiveness, and even banks' existence on the market.

Under these conditions, a competitive bank strategy implies the existence of both programmes and procedures to manage financial risks and to minimize the probability of risk occurrence and of potential exposure of the bank

Therefore, one can consider that the qualitative level of the bank management, and especially that of risks management, along with bank surveillance in the context of corporatist governing, are essential for guaranteeing the security and stability of banks as individual entities, and of the entire banking system.

Corporatist Governing and Risk Management

In their activity, banks are exposed to various financial, operational or business risks or to risks determined by unpredictable events.

The competitive, yet volatile market environment in which banks are currently evolving has accentuated the difficulty and complexity of the bank evaluation process. This environment implies a permanent dynamics and update of the evaluation methods so that they comply with the changes occurred in the banking sector or those imposed by the international standards and surveillance practices imposed by the Basel Committee on Banking Supervision.

Traditionally, bank analysis refers to the determination of liquidity quantitative indicators, capital adequacy ratio, indicators of portfolio credits, exposures and opened positions of foreign exchange. To these, one should add an analysis of qualitative factors of risks management, of corporatist governing and of management, of bank policies and procedures, of informatic systems.

The diversification of bank assets portfolio, imposed by the accentuation of competition in the context of banking globalization, has imposed that risk management activity, traditionally focused on credit risk management, should also consider and manage other types of exposures to operational and financial risks.

The banking system globalization has made necessary that the analysis of the financial risk to which a bank is exposed, imply its detailed revision, both as an independent entity and as a consolidated bank, considering risks exposures of local or foreign branches and of other companies within the group.

The analysis shall indicate the behaviour of the assessed entity in comparison with the group tendencies of the sector. It shall indicate the nature and reasons for possible deviations and, also, the causes which may have or not an impact on that particular entity or on the entire banking sector.

The increasing number of risks and their determinants force banks to develop new abilities of management and to carry forth periodical determination of each bank's institutional profit. The institutional profile of a bank is usually determined annually, by means of external evaluations run both by surveillance authorities and by external auditors.

Surveillance authorities analyze the compliance with reglementation and control requirements, as well as the impact of bank operations of one entity on the banking system as a whole.

External auditors focus mainly on the financial reports at the end of a financial exercise, as well as on assessing the bank's management and the carrying out of the proposed objectives.

The determination of the banks' institutional profile is periodically completed with financial evaluations, portfolio analyses or revision commitments realized by third parties when evaluating the credit risk.

The globalization of the banking system, in the context of economic globalization, has determined surveillance authorities, central banks respectively, to adopt new measures in order to maintain monetary stability in the general context of price equilibrium and stability.

The evolutions of the market conditions have determined, lately, changes in the activity of the reglementation and supervision organisations. These institutions have, therefore, modified the reglementations regarding the structure of the portfolio, namely the requirements that portfolios should contain certain amounts of liquid assets or with low risk, and have established new requirements in order to increase the immunity of the banking system to shocks.

In our country, the main actions to improve the activity of credit institutions' supervision have focused on avoiding the deterioration of their situation, as a result of the evolutions in the current economic environment. Similarly with the actions initiated by the European authorities, The National Bank of Romania has acted in the direction of diminishing the vulnerabilities in providing liquidities and capital adequacy. Therefore, in order to supply liquidities, The National Bank of Romania has intensified the operations destined to the injections of liquidities, thus becoming a creditor for the banking system.

This position changed in the second quarter of 2010, when the net position of liquidity turned from deficit to surplus.

In order to avoid disfunctionalities, The National Bank of Romania has monitored, on a daily basis, the existing liquidity on the interbank market by solliciting credit institutions to elaborate alternative plans of financing, to frequently analyze their liquidities, to diversify their resources. The surveillance authority has also asked credit institutions to ensure the structure and level of the capital in accordance with their risk profile.

These measures have determined some credit institutions to increase their corporate funds, fact that maintained a solvability indicator above 10%, the maximum reglemented limit being 8%.

The measures taken by the National Bank of Romania, as well as the rather reserved attitude of several banks towards some activities of high risks are reflected in the level of prudentiality indicators (Table 1).

Table 1. Main indicators of prudentiality (percentage)

Period	Solvability indicator ($\geq 8\%$)	Lever effect (Own funds of level 1/ Total average assets)	General rate of risk	Investments and interbank credits (brute value) Total assets (brute value)	Credits lent to clientele (brute value) Total assets (brute value)	Arrears or questionable credits (net value) Total of credits portfolio (net value)	
2007	13,78	7,32	56,94	29,98	59,09	0,22	
2008	13,76	8,13	50,73	26,01	62,50	0,32	
2009	14,67	7,55	47,29	23,03	59,13	1,45	
2010	15,02	8,11	44,61	19,58	58,64	2,23	
2011	14,51	7,87	42,97	16,91	59,30	2,40	
2011	Mar	14,88	7,96	44,80	17,75	59,02	2,59
	April	X	7,93	x	16,96	59,68	2,51
	May	X	7,89	x	16,46	59,69	2,47
	June	14,19	7,79	44,82	16,58	59,86	2,51
	Iul	X	7,79	x	15,50	60,60	2,50
	Aug	X	7,75	x	15,64	60,30	2,55
	Sept	13,43	7,50	44,66	15,77	60,45	2,45
	Oct	X	7,36	x	15,27	61,32	2,58
	Nov	X	7,57	x	14,74	61,58	2,61
Dec	14,51	7,87	42,97	16,91	59,30	2,40	
2012	Jan	X	x				

Period	Total arreas and questionable credits (net value) Total assets (net value)	Total residual and questionable claims (net value)/ Own funds of level 1	Total residual and questionable claims (net value)/ Total debts	Rate of credit risk (The gross exposure of the non-banking loans and interest classified as doubtful and loss / Total classified loans and interest, non-banking loans, exclusive the off-balance sheet items)	Indicator of liquidity (actual liquidity / necessary liquidity)	Rate of negative credits (The gross exposure of the non-bank loans and interest classified as loss second category, for which the debt service > 90 days and / or where they were initiated or towards the debtor / Total loans and interest afferent to the non-banking loans, exclusive the off-balance items)	
2007	0,17	2,28	0,19	4,00	2,13	X	
2008	0,29	x	0,32	6,52	2,47	X	
2009	1,01	x	1,10	15,29	1,38	7,89	
2010	1,47	x	1,62	20,82	1,35	11,85	
2011	1,57	x	1,72	23,28	1,36	14,05	
2011	Mar	1,72	x	1,90	22,00	1,37	12,71
	Apr	1,69	x	1,86	22,40	1,37	13,04
	May	1,67	x	1,83	22,33	1,36	13,55
	June	1,70	x	1,87	21,89	1,37	13,35
	Jul	1,70	x	1,90	22,20	1,30	13,60
	Aug	1,68	x	1,85	22,66	1,35	13,91
	Sept	1,64	x	1,80	23,03	1,34	14,18
	Oct	1,75	x	1,92	23,50	1,36	14,42
	Nov	1,78	x	1,95	23,62	1,35	14,39
	Dec	1,57	x	1,72	23,28	1,36	14,05
2012	Jan						

Source: The National Bank of Romania, Monthly Bulletin, March 2012, Statistics Section, Year XX, no. 221

The ultimate goal of the banking activity is to make a profit. The changing environment in which banks currently operate supposes adapting their activity to new risks, more complex than those taken in consideration for the traditional bank management.

In these circumstances, the risk management of a bank is provided by the components of the corporatist governing.

In the case of the banking entities, the corporatist governing means the set of working relationships established between the bank management, shareholders and consumers of the banking products and services.

The key elements of the corporatist governing in the banking system include the existence of a certain strategy and of some corporate values that should allow the organization of a financial risk management and of some effective systems of internal control.

The financial risk management requires a special monitoring of the exposures at all the risk categories. It must be conducted in compliance with the banking regulations elaborated by the regulation organisms, regulations aimed at improving risk management.

These regulations refer to the full range of risks and suggest principles concerning the evaluation system and the risk management in the banking entities.

The recent changes in the international banking, the increase of the off-balance sheet transactions, the segregation of the types of risk, the emphasis of the contagion effect have made the bank management to become more difficult. Its essential component, the risk management has become a part of the daily activity of each bank manager. He should always ensure that the

risk management systems are properly applied, and that the procedures and the internal bank policies and standards are fully followed and that control systems work properly.

The role of management in identifying, evaluating and managing the financial risks is established and described by the Basel Committee on Banking Supervision. According to this organism "any corporation using new financial instruments needs acutely that all the management levels know and understand the inherent risks and adapt the internal accounting systems, so that to ensure adequate control"¹.

It is therefore evident that the banks profit maximization involves monitoring the risks meaning to know, prevent or even reduce them.

The term "monitoring" actually refers to managing the assets responsibly. In the banking practice, according the monitoring requirements and the risk typology, there can be defined two specific methods of risk management:

- overall management or the balance sheet management;
- internal management on responsibility centers.

According to some authors (we agree to their opinion) the balance sheet management has a dual function: on the one hand, the overall management of risks of the interest rate, of the liquidity and solvency of the bank, and on the other hand, fixing the conditions of profitability of personal funds of operations profitability².

The balance sheet risk management requires a holistic approach, taking into account that by focusing on the bank operations there is a risk mitigation due to their diversity, some engaging in a sense, the other in another way, such multiple phenomena of risk compensation taking place.

Since many banks run operations with various customers - individuals or businesses – the risks of these operations become in their amount the risks amount of the respective clients or the a portfolio risk.

A portfolio of transactions supposes a lower risk than the one determined by adding the individual risks, and a portfolio of risks makes possible to restructure it in order to optimize it.

Since risks are unavoidable, they need to be managed so as to be maintained at an acceptable level, on the condition to maintain the proposed level of profitability in the budget.

In these conditions, efficient management of risk involves anticipating the changes, structuring and restructuring the activity to obtain the profit or to minimize the losses. Such management requires a globally specific group and management of risks, according to which it should be delimited the general conduct at the banking entity level that it runs (interest rate risk, currency risk and liquidity risk).

In practice, the risk profile of a banking entity emerges, among other factors, through the manner of establishing the balance sheet. Its structure represents the core activities of management of the assets and liabilities.

The changes in the balance sheet structure have an impact on the risk management, the change of the balance sheet components could suggest the evolution trends of the respective entity.

The asset-liability management is a strict accounting method based on periodic accounting reports that provide the needed data to assess the responsibility centers, allowing to establish

¹ Von Greuning, H. Bratanovic Brajovic, S., *Analiza și managementul riscului bancar: evaluarea guvernantei corporatiste și a riscului financiar*, Irecson Publishing House, București, 2004.

² Basno, C., Dardac, N., *Riscuri bancare. Cerințe prudențiale. Monitorizare*, Editura Didactică și Pedagogică, București, R.A. 1999.

costs for each department. These costs include the financial costs for the interest payment, the management costs for the payment of various expenses (with the administrative staff, with computing) the costs for the provisions to avoid and cover risks.

The asset-liability management involves operations leading centered on the control levers, flows, trade and interrelationships between assets, liabilities and capital. In this way, it aims to establish a bank optimal behavior.

The globalization has generated multiple banking system changes and updates to the classic model of the balance sheet of banks. They were determined by the change of the activity and of the customers, of the competitive environment, of the regulatory environment, of the economic and political model. In these conditions, a slight general increase of the balance will be accompanied by the change of its individual components, in response to changes in the economic or regulatory environment. This change in structure of the balance will bring changes of risk levels.

The analysis of the elements contained in the bank balance, of the structure and composition of debt and assets, allows the managers to evaluate the specific risk elements that characterize each balance-sheet and off- balance-sheet position (liquidity, market risk, credit risk, interest rate etc.) as well as the interaction of the different types of risk.

We therefore believe that the balance sheet structure is the mirror of the effectiveness of policies and procedures of managing the risk exposures.

In practice, the analysis of the bank balance job allows drawing conclusions of interest for the banking entity as well as for the national economy.

So, the analysis of the loans portfolios granted by the banks of a national economy can provide information concerning the propensity for economic competitiveness.

On the other hand, depending on how the central bank achieves its minimum reserve policy, in order to control the volume of loans that may be granted by banks, they can adjust their product portfolio, respectively, their portfolio assets. They can focus on creating and promoting tools that are not covered by the compulsive requirements, but can generate a satisfactory income.

In our country, the financial crisis led the credit institutions to switch targets. This shift was facilitated by the austerity measures taken by the authorities in the second half of 2010 (reducing wages, increasing by five percent the standard VAT) and the effects of rising the unemployment and the depreciation of the national currency. The same effect was the application of the Government Emergency Ordinance no.50/2010 concerning the credit agreements for consumers. These provisions were aimed at tightening lending standards and the loan conditions, having a significant impact on the bank profits. In these circumstances, in 2010 the aggregate net assets in the banking system in Romania has increased only by 3.6%, but the cautious attitude of the banks towards the risks provided a good level of the solvency ratio - 15%.³

The analysis of the main indicators of the banking system activity clearly points out the factors specific to the environmental impact in which the system is evaluated.

The domestic economic environment characterized by high uncertainty, measures of austerity, determined a reduction of the loan activity in 2010. The share of loans in total assets, the gross value, decreased from 59.1% in 2009 to 58.6% in 2010. To observed the increase with 4.7% of the loan lent to private sector, mainly in foreign currency.

The developments on the international financial markets and the uncertainty specific to the internal economic determined the worsening of the assessment indicators of the credit risk. Thus

³ Banca Națională a României, *Raport Anual 2010*, București, 2011.

the average gross exposure appropriate to the loans and interests of "doubtful" and "loss" categories from the total loans and interest increased from 13.5% in 2009 to 13.4% in 2010.

In the same period, the share of overdue and doubtful loans in total loan portfolio, the net value, rose from 1.50% to 2.28%. These developments have forced the banks to increase the volume provision, which had negative effects on their profit.

The increased expenditure with the provisions negatively influenced the profitability indicators of the banking system. In 2010 these indicators were negative (-0.18% rate of economic return, respectively - 1.73% rate of financial return).

The current competitive environment that encouraged the financial innovation led to the emergence of some products such as bank guarantees, letters of credit and derivatives. They have exposed banks to some risks sometimes greater than those who accompanied the classical lending activity, being classified as off-balance sheet instruments, and they are not considered either active or passive.

The risk management for these tools is relatively difficult, mainly due to difficulties in quantifying the volume of debt or rights.

This activity involves assessing the nature and the volume of credit commitments, guarantees, contingent liabilities and other off-balance sheet items and estimate their sensitivity at the market changes.

In these conditions, the risk management has become the central preoccupation the in financial management. It must establish its main and continuous objective the identification, quantification and balancing of all components of the financial system.

These issues require that policies and procedures of managing risk exposures also cover the analysis of the balance sheet structure and its changes. In practice, the efficient risk management requires a static analysis of balance sheet posts combined with their dynamic analysis, i.e. determining the growth of rates and types of structural changes that occur during their activities.

To this end, we discuss separately the global increase of the balance-sheet from the off-balance sheet.

The increase of the balance sheet is analyzed both as a general increase of the banking assets and capital. There will be analyzed the consequences that may occur as a result of a too rapid expansion, especially those related to the maintenance of the capital adequacy, respectively of the increase of assets weighted by the risk.

A too fast increase indicates, usually taking undue risks, which is also indicated by the registration of margins increase - due to the expansion of loan portfolio.

The dynamic of the balance-sheet items is also important, whereas these elements expose the banks to additional risks, without always being a precise relationship between the efficiency of those operations generating additional risk and the level of the risk.

Conclusion

The liberalization, the volatility and the globalization of the financial market, the increased competition and the deepening struggle for growth of the market share have determined the increase of the number and size of risks to which banks are exposed in their work.

These aspects have required continuous renewal of methods and techniques of the portfolio management banking, of the business banking entities in order to control the risks.

Concerning the banking portfolio management, its primary objective should be to maintain a reasonable risk profile on a profitable basis.

Under these circumstances, it is clear that a banking management performance requires through its activity to notice, to group and to manage the specific overall risks. According to them, there will be defined the general conduct of the banking entity.

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Reorientări ale managementului bancar induse de globalizarea sistemului bancar

Rezumat

În articol se prezintă, în partea introductivă, implicațiile globalizării asupra activității sectorului bancar, determinată de noua conjunctură economică în care băncile evoluează. Accentuarea concurenței a obligat băncile să se orienteze către diversificarea activităților pe care acestea le desfășoară. O asemenea orientare a fost, însă, însoțită de creșterea numărului și dimensiunilor riscurilor la care se expun, băncile fiind obligate să-și asume aceste riscuri.

Aceste aspecte au impus înnoirea permanentă a metodelor de gestionare a activității entităților bancare, unele dintre acestea fiind prezentate în lucrare.