

CORPORATE GOVERNANCE AND BANK PERFORMANCE IN ROMANIAN BANKING SYSTEM

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Abstract:

The article aims to provide an analysis of Romanian bank performance in the context of corporate governance. In order to complete the research the authors used financial indicators such as ROA, ROE and others for 2003-2009 period and each financial institute's status regarding good governance practices. The study consists in establishing an econometric correlation between the appliance of sound corporate governance principles and economic performance. We consider the comparative analysis of Romanian banking system performance a secondary result of the research.

Keywords: bank performance, corporate governance, Romanian banking system

JEL Classification: G21

INTRODUCTORY NOTIONS

The main supplier of financial services in Eastern European countries is considered to be the banking system (European Commission [EC], 2004). This fact is possible due to the underdevelopment of the capital markets and national culture. Romania is no different; the economy bears the burden of over 40 years of communism and its centralized system.

The goal of this research is to study bank performance in Romanian banking system in the context of corporate governance. Profitability can be considered an important indicator of a financial system's stability and the quality of bank management. A healthy economy it's based on profitable banks adequate capitalized. [Hennie van Greuning, Sonja Brajovic Bratanovic Analyzing Banking Risk]

Banking activity has a number of features which differentiate it from enterprises which activate in other areas of business. The most important characteristic of financial institutions is the extreme volatility of the majority of services and products, fact that determine economists to consider very important the link between profitability and risk behavior. The specific activity of banks, credits, imply prudential risk attitude. Like any commercial enterprise financial institutions pursue financial profitability; in order to obtain a high level of remuneration bank executives must manage specific risks. Literature review classifies financial risks in three categories credit risk, operational risk and market risk.

Given the special nature of banking, bank performance is a term which includes diagnosis of profitability as well as diagnosis of risk.

Nowadays, during the economic crises authorities pay even higher attention to prudential regulation and the adequate capital. Economists have studied for over 30 years how corporate governance mechanisms influence risk decision.

The bank governance process is a very complex activity which implies a high degree of efficiency. For a better understanding of the bank management we

CORPORATE GOVERNANCE PRINCIPLES IN BANKING ORGANIZATION

The reason for which banking institutions are subject of analysis for corporate governance is the fact that banks are corporations and function in the same manner as societies which activate in different areas of business. Banks have

- shareholders,
- debt holders,
- boards of directors,
- competitors

Banking corporations are characterized by a number of special features such as opaqueness and high regulation. These features have strong impact on bank management strategies and on corporate governance codes.

Table 1. Corporate governance in banking

| Key players | Responsibility for risk management | Importance | |
|----------------------------------|---|-------------------------|-------------------|
| | | Policy level | Operational level |
| Systemic | | | |
| Legal and Regulatory Authorities | Optimize | Critical | n/a |
| Bank supervision | Monitor | Indirect monitoring | Indirect |
| Institutional | | | |
| Shareholders | Appoint key players | Indirect | Indirect |
| Board of directors | Set policy | Critical implementation | Critical |
| Executive management | Test compliance with board policies and provide assurance regarding corporate governance, control systems and risk management process | Indirect compliance | |
| Internal audit | Evaluate | Indirect | |
| External audit | Evaluate and express opinion | Indirect | |
| Consumer | | | |
| Public | Act responsibly | n/a | Indirect |

Source: Hennie van Greuning, Sonja Brajovic Bratanovic Analyzing Banking Risk

“Corporate governance relates to the manner in which the business of the bank is governed. It is defined by a set of relationships between the bank’s management, its board, its shareholders, and other stakeholders.

This includes:

- setting corporate objectives and a bank’s risk profile,
- aligning corporate activities and behaviors with the expectation that management will operate the bank in a safe and sound manner,
- running day-to-day operations within an established risk profile and in compliance with applicable laws and regulations, while protecting the interests of depositors and other stakeholders”.[Hennie van Greuning, Sonja Brajovic Bratanovic Analyzing Banking Risk]

Corporate governance in transition economies is of even greater importance given the dominant position of banks as suppliers of credit. In spite of this aspect, little attentions was paid to

the research of corporate governance in less developed economies. Economist Ross Levine analyzed the appliance of corporate governance in banking in developed economies such as the United States and Western Europe.

This situation can be explained through difficult access at actual databases and the lack of detailed mandatory reports.

In this article we try to fill this gap and analyze corporate governance in Romanian banking system in the context of corporate governance.

The fact that the Romanian banking system has a number of weak points such as a high degree of foreign exposure makes our study of even greater importance. During the present crisis the government tried to minimize the possibility of withdrawing foreign capital and imposed restrictive regulatory measures.

BANK PROFITABILITY

Bank profitability leans at the base of a healthy economic system; it usually constitutes the most important modality of capital formation. A sound financial system it's based on profitable and adequate capitalized banks. Profitability can be considered a quality management index. The traditional role of banks, credit supplier, has suffered important mutations, in the era of globalization, the banking sector is considered to be both consolidating and diversifying.

The diversifications of services lead to increase volatility and changes in bank income structure. For example incomes from capital investments and commissions represent more than 50% of total income.

As we noted above, banks are special institutions highly regulated and opaque, reason for which their profitability is strongly affected by monetary policy decisions. The government, by implementing different taxations for each category of income, determines bank managers to invest in the most rentable actives and/or activities.

Many factors can influence profitability; the most actual one is competition: many banks have invested in informational technologies, fact that influenced their profitability indexes.

As we can see in table 1 corporate governance must address a large range of activities within a financial institution.

As we stated above profitability represents the main purpose of any business, banking corporations are no exception. Its values are the reflection of good both operational and political strategies.

The most used profitability indexes are ROA and ROE.

ROA measures the profitability of a firm's assets.

$$ROA = \frac{Net_income}{Total_assets}$$

ROE measures the net income returned as a percentage of shareholders equity, more precisely much profit a company generates with the money shareholders have invested.

$$ROE = \frac{Net_income}{Shareholder's_Equity}$$

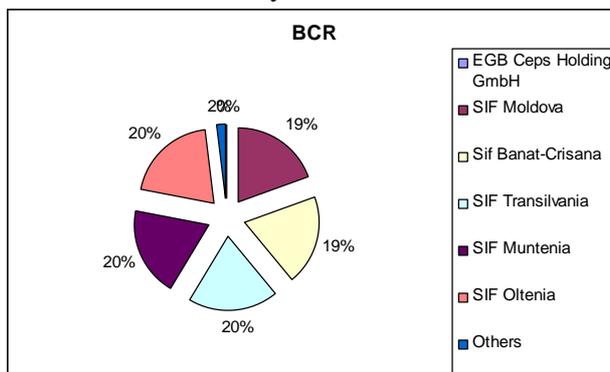
CHARACTERISTICS OF SAMPLE BANKS

Romanian Commercial Bank

Romanian Commercial Bank was founded in 1990 having over 5000 employees; nowadays it's the largest Romanian bank and the most responsible one according to international ratings.

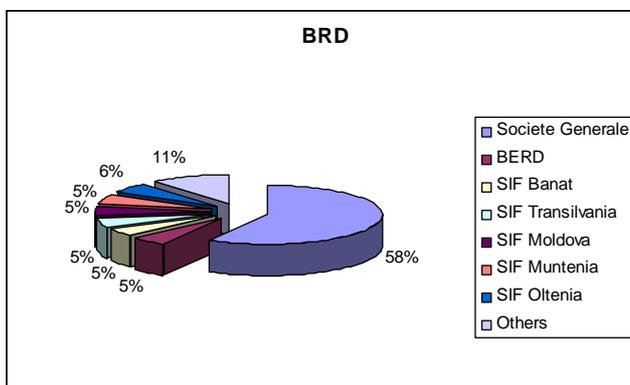
Braun Partners Network awarded the Romanian Commercial Bank for the best short corporate social responsibility report in 2009; the prize was based on 28 indexes GRI (Global

Reporting Initiative). The jury considered that BCR has transparent corporate social responsibility practices and is actively involved in community life.



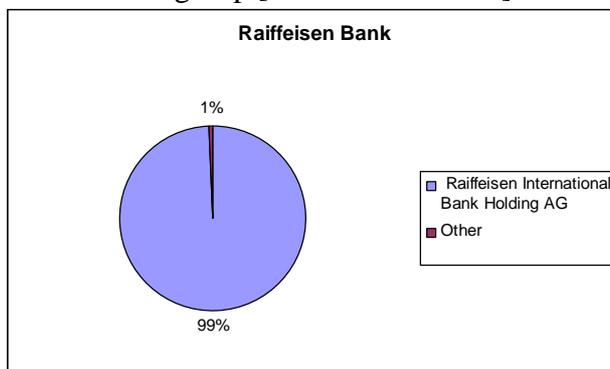
BRD- Groupe Société Générale

BRD - Groupe Société Générale is the second bank in terms of banking assets in Romania. This financial institution is very involved in corporate social responsibility projects and uses corporate governance codes.



Raiffeisen Bank Romania

Raiffeisen Bank Romania is one of the largest banks that operate in Romania; it has resulted from the merger in June 2002 of the two banks held by Raiffeisen Group on the local market: Raiffeisenbank (Romania) S.A., established in 1998 as a subsidiary of RZB Austria, and Banca Agricol` Raiffeisen S.A., established in April 2001 after the takeover of the Romanian state-owned Banca Agricol` by the Austrian group.[www.raiffeisen.ro]



Emporiki Bank Romania

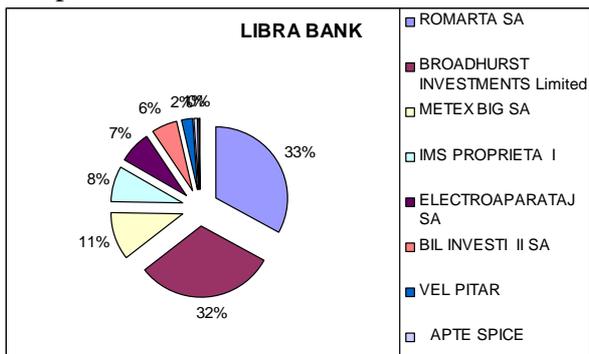
Emporiki Bank entered on the Romanian market in 1996, owning 99,54 of Emporiki Bank Romania. Starting with august 2006 Credit Agricole Group is the main shareholder of Emporiki Bank with 82,48% auction share.

Even though the most important shareholder of Emporiki Bank is a very well known financial institution for corporate governance practices, we don't consider that the Emporiki Bank

Romania 2009 financial report provides enough corporate governance information. [http://www.emporiki.ro/FinancialStatements/IFRS%20Financial%20Statements_31.12.2009.pdf]

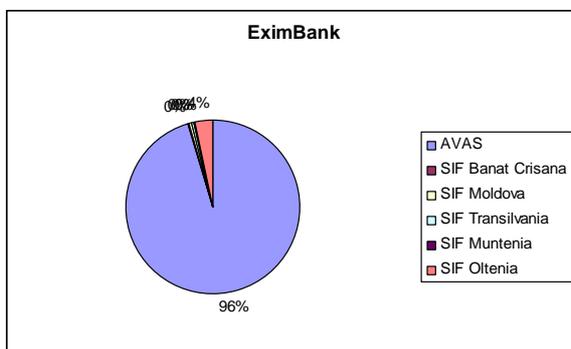
Libra bank

Libra Bank was founded in 1996 and from mai 2003 is member of New Century Holding; it is considered to be the “liberal profession bank”.



Eximbank

EximBank S.A. was founded in 1992 and it’s considered a state owned bank.



DESCRIPTIVE STATISTICS

For the econometric study we considered two categories of financial institutions: that implement strong governance codes and those that play less attention to corporate social responsibility. In order to obtain the classification we analyzed each bank’s financial reports, corporate governance codes and international awards. We used the financial results published on Bankscope database for 2005-2009 periods.

The sample includes both well known banks as well as banks with small market share. We can draw the conclusion that larger banks had the means for investing more in corporate governance, meanwhile high costs act as an impediment in implementing corporate governance in banks that are not characterized by large market share.

| <i>Sound corporate governance practices</i> | <i>Less developed corporate governance mechanisms</i> |
|---|---|
| Romanian Commercial Bank | Emporiki Bank Romania |
| BRD- Groupe Société Générale | Eximbank |

| | |
|-------------------------|------------|
| Raiffeisen Bank Romania | Libra bank |
|-------------------------|------------|

NIM * CG**NIM**

| CG | Mean | N | Std. Deviation |
|---------------------------|--------|----|----------------|
| weak corporate govnrance | 6,1660 | 15 | 2,34948 |
| good corporate governance | 6,3953 | 15 | 1,56507 |
| Total | 6,2807 | 30 | 1,96493 |

NIM

| Year | Mean | N | Std. Deviation |
|-------|--------|----|----------------|
| 2005 | 7,1717 | 6 | 3,10600 |
| 2006 | 6,0867 | 6 | 2,66570 |
| 2007 | 5,9333 | 6 | 1,01882 |
| 2008 | 6,3450 | 6 | ,89261 |
| 2009 | 5,8667 | 6 | 1,56600 |
| Total | 6,2807 | 30 | 1,96493 |

ROAA * CG**ROAA**

| CG | Mean | N | Std. Deviation |
|---------------------------|---------|----|----------------|
| weak corporate govnrance | -1,8687 | 15 | 5,21302 |
| good corporate governance | 2,3280 | 15 | ,75368 |
| Total | ,2297 | 30 | 4,23654 |

ROAE

| Year | Mean | N | Std. Deviation |
|-------|---------|----|----------------|
| 2005 | 4,2900 | 6 | 28,09825 |
| 2006 | 11,3617 | 6 | 16,46002 |
| 2007 | 10,6717 | 6 | 18,13259 |
| 2008 | 9,3633 | 6 | 30,47583 |
| 2009 | 4,3700 | 6 | 34,60123 |
| Total | 8,0113 | 30 | 24,81636 |

ROAE * CG**ROAE**

| CG | Mean | N | Std. Deviation |
|---------------------------|---------|----|----------------|
| weak corporate govnrance | -9,5607 | 15 | 22,93698 |
| good corporate governance | 25,5833 | 15 | 9,37695 |
| Total | 8,0113 | 30 | 24,81636 |

The statistical correlations reveals the fact that our sample banks which have implemented corporate governance principles have better financial results than the ones which are less preoccupied with this aspect of the activity.

Report

| ROAA | | | |
|-------|---------|----|----------------|
| Year | Mean | N | Std. Deviation |
| 2005 | -1,1933 | 6 | 7,17980 |
| 2006 | ,7783 | 6 | 2,35500 |
| 2007 | 1,0267 | 6 | 2,13523 |
| 2008 | ,4033 | 6 | 3,60709 |
| 2009 | ,1333 | 6 | 5,08266 |
| Total | ,2297 | 30 | 4,23654 |

Correlations

| | ROAE | ROAA | NIM | CG |
|--------------------------|--------|--------|-------|--------|
| ROAE Pearson Correlation | 1 | ,904** | -,062 | ,720** |
| Sig. (2-tailed) | | ,000 | ,743 | ,000 |
| N | 30 | 30 | 30 | 30 |
| ROAA Pearson Correlation | ,904** | 1 | -,271 | ,504** |
| Sig. (2-tailed) | ,000 | | ,148 | ,005 |
| N | 30 | 30 | 30 | 30 |
| NIM Pearson Correlation | -,062 | -,271 | 1 | ,059 |
| Sig. (2-tailed) | ,743 | ,148 | | ,755 |
| N | 30 | 30 | 30 | 30 |
| CG Pearson Correlation | ,720** | ,504** | ,059 | 1 |
| Sig. (2-tailed) | ,000 | ,005 | ,755 | |
| N | 30 | 30 | 30 | 30 |

**Correlation is significant at the 0.01 level (2-tailed).

CONCLUDING REMARKS

As we can see above there are significant differences between the financial results of banks that have implemented sound principles of corporate governance and the rest of the sample used in the present research; therefore we encourage banking activism regarding social responsibility. We consider a vicious circle between the appliance of corporate governance and profitability: high cost of good management constitute an impediment for smaller banks and the lack of sound corporate governance principles may lead to lower profitability.

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