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COMPARATIVE ANALYSIS OF PERFORMANCES IN BANKING SECTOR

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ABSTRACT: *Financial crisis had a major impact on economic development worldwide and the banking system as well. The main purpose of the paper is to present a comparative approach of the key drivers of bank performances. Discussions are related to banks profitability based on the literature review and researches related to drivers factors who may affects the activity in banking sector, and about trends of the profitability in banking system in European Union based on main profitability ratios: return on assets and return on equity.*

KEY WORDS: *performance, bank profitability, performance banking system; return on assets; return on equity.*

JEL CLASSIFICATION: *G21.*

1. INTRODUCTION

The financial sector plays an important role in economic life due to financial intermediation and the banking system is crucial in achieving economic growth.

In terms of the performance, efficiency of the banking system has a major importance both in terms of macroeconomic and microeconomic perspectives. From microeconomic perspective of the bank, the aspect of efficiency is important in the competition in the banking sector, so, the increase in performance have been somewhat imposed:

The efficiency of the banking system has influences on the financial intermediation and stability of the entire financial system, as long as the banks are the backbone of the financial markets in the European Union. Banking performance improvement implies a better allocation of financial resources, an increase in investments, overall an increase in institutional performance.

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While well-functioning banks accelerate economic development, poorly functioning banks are an obstacle to economic growth. Many researchers argue that the international financial crisis led to a prevailing inability of borrowers to pay back their loans, as more companies and people faced payment difficulties and even bankruptcy. Thus, the deterioration of loan portfolios quality became a common characteristic all over the world, including Central and Eastern European banking systems. (Drigă, 2017)

Performance banking management quality, together with other areas of banking management are reflected in banking performance. The essential aspects of this field are:

- performance analysis and assessment, based on the financial situation, using indicators of profitability, liquidity, solvency, as well as norms and standards of comparison;
- strategic planning and banking performance policy.

In Romania, performance banking management was developed by many researchers, who studied the particularities of the banking system and banking performance (Basno C, Dardac N., Trenca I., Bătrâncea I, Cerna S., Isărescu M, Roșca T, Rotaru C., Nițu, I., Stoica M., Oprițescu M.).

2. DRIVERS OF BANK PERFORMANCE

What does performance mean? In business dictionary, to perform means; "to do a task"; "to do an action or piece of work"; "to do something in a satisfactory or expected way"; "to overcome a problem".

Performance is usually mean: "the act of doing something"; "how well an activity is done"; "how successful investment/business/company is and how much profit it makes".

Performance in the banking system can be defined as the measurable level of bank financial stability, characterized through low levels of risk, of any kind, and a normal increasing trend of profit from one period to another (Bătrâncea, 2010).

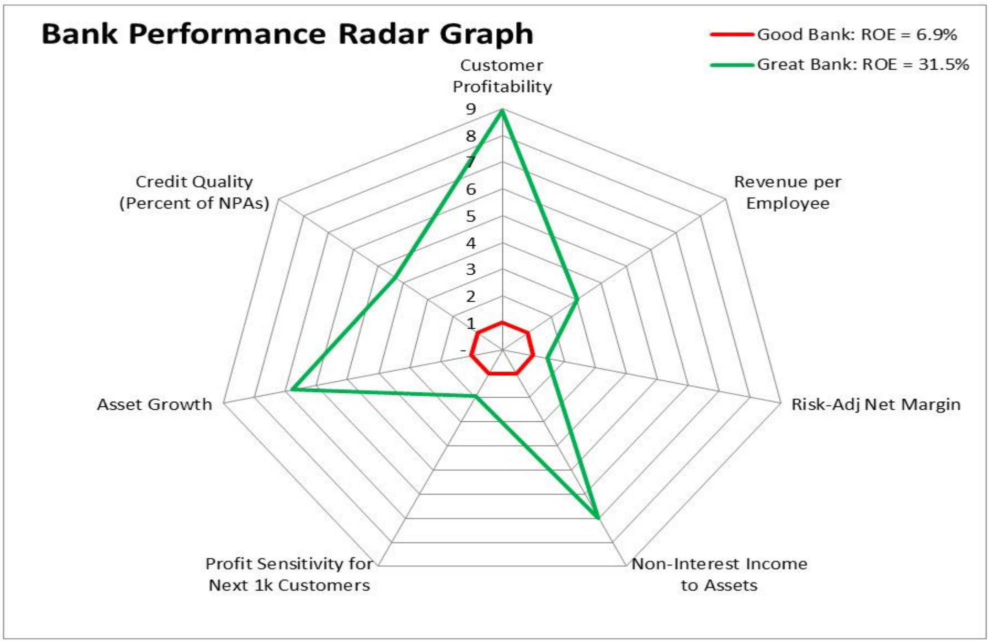
There are many approaches in order to assess bank performance. The issues regarding bank performance and the drivers of bank performance is for most researchers and business professionals from banking system an important topic. Also, due to importance of banking system into the economic growth, to assess and manage bank performance is on the current agenda of the governmental authorities in each state of the European Union.

Many approaches focus on the key drivers of bank profitability, and the difficulties are facing banks in attempting to turn these drivers into positive drivers of profitability.

The chef strategy officer at Center State Bank (Davenport, Florida, USA), Chris Nichols, studied bank performance and based on statistical data, from last five years, related to bank performance has identified the following drivers of bank profitability, in the article entitled "*The drivers of bank performance*, 2016":

- customer profitability;
- revenue per employee;

- risk adjusted net interest margin;
- net interest income to assets;
- assets growth;
- low cost infrastructure allowing scalable growth;
- credit quality,



Source: https://csbcorrespondent.com, October, 2016

Figure 1. The drivers of bank performance (USA commercial banks)

Since the financial crisis, European banks have struggled with low profitability. Low profitability of the European banks is influenced by a range of factors, such as (KPMG International, 2016).

- economic environment in Europe;
- low net interest margins
- non-performing loans (high level);
- high cost to income ratios high cost to income ratios;
- regulatory reform;
- banking business model.

A great impact on non-performing loans had generated by the financial crisis all over the world. The increase in NPLs has a negative impact on profitability through (KPMG International, 2016):

- unpaid interest on loans;
- raising provisions against impaired assets;
- losses when assets are sold or restructured.

Source: KPMG International, The profitability of EU banks: Hard work or a lost cause? October 2016

Figure 2. Drivers of bank profitability (EU banks)

According to the research conducted by KPMG International, a particularly impact on banks has had downward pressure on interest margins. Financial innovation and technological progress may offer opportunities to reduce costs over the longer term, but for many EU banks this appears to be a distant and uncertain horizon.

Business models could be an important driver of profitability. Regulatory reform has had a major impact on banks' funding costs through higher capital requirements, with additional cost and income pressures through liquidity requirements. The price of the greater resilience and resolvability achieved through these reforms is a large deadweight impact on banks' return on regulatory capital (KPMG International, 2016).

3. TRENDS ON THE PROFITABILITY OF THE EUROPEAN BANKING SYSTEM

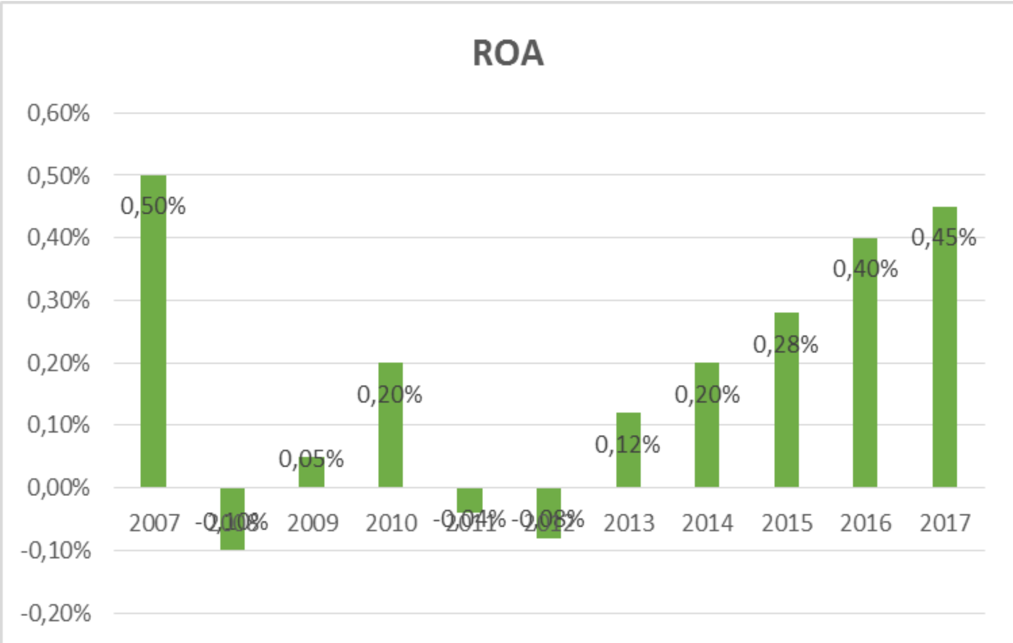
Performance of the banking system is focussed on bank profitability ratios.

Bank profitability is a major issue and indicates whether a bank is able to provide basic financial services and properly function. Besides, banks need to offer a viable business model and the efficiency of the banking system is a key determinant of sustainable growth (Drigă, 2017).

The main profitability indicators of the banking sector include:

- the return on assets ratio (ROA);
- the return on equity ratio (ROE).

The first key indicator, ROA, is used for bank profitability since it measures the bank's return on investment in a format that is easily comparable with other institutions, pointing out how efficiently a bank can manage its assets to produce profits. The other ratio to assess the bank sector's attractiveness, ROE, is commonly used by shareholders as a measure of their return on investment and it measures the amount of a bank's income that is returned as shareholder equity (Drigă et al, 2016).



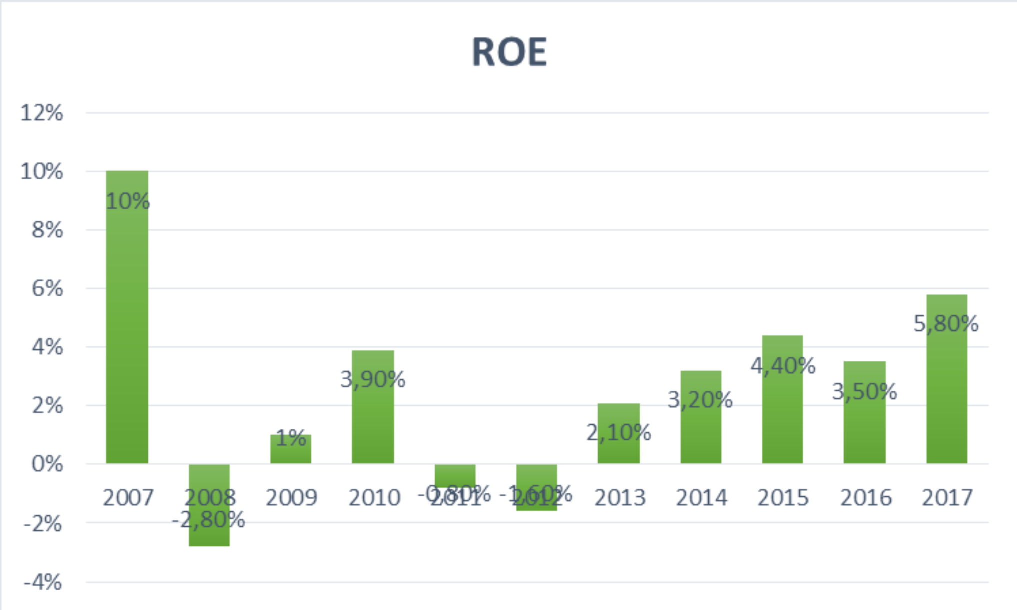
Source: based on data from Eurostat, https://ec.europa.eu/eurostat/data/database

Figure 3. Return on assets for EU-28, 2007-2017

Across European Union countries, financial crisis has deteriorated the profitability of banking sector through the two main indicators used to assess that aspect. The evolution of the ROA and ROE for EU-28 is presented in Figure 3 and Figure 4).

In terms of ROA, at the beginning of the financial crisis the level of ROA of European banks was 0,50% and decreased to negative levels in the following years. An improvement of the level of ROA was recorded after 2013, when reached a level of 0,12%. Between 2013 and 2013 have presented a constant increase up to 0,45% in 2017. Negative levels of profitability were significantly higher in some countries from European Union such as Estonia, Bulgaria, Cyprus, or Slovenia. After, 2013-2014 ROA of European banks had started a slowly recover.

In terms of ROE, at the beginning of the financial crisis the level of ROA of European banks was 10% and also decreased to negative levels in the following years. Improvements were recorded starting with 2013, when the ROE of EU-28 recorded a level of 2,10%, and still increased up to 5,80% in 2017 but far from 10% recorded in 2007.



Source: based on data from Eurostat, https://ec.europa.eu/eurostat/data/database

Figure 4. Return on equity for EU-28, 2007-2017

In case of Romania, the global economic crisis with enormous negative effect on the overall economy had serious impact on the Romanian economy, and also on the banking system. The Romanian banking system began to experience the effects of the crisis starting with 2009 due to low credit and higher funding costs with a negative impact on financial intermediation and bank profitability (Drigă, 2013).

4. CONCLUSIONS

In last 10 years, performance of banking sector became a current issue for researchers and business professionals from this sector.

At the beginning of the financial crisis, weak performance of banking system in European countries was recorded through non-performing loans, loans quality, bank profitability ratios), but improvements in last years have demonstrates a slowly recovering process in banking sector, a very significant one for the economic growth.

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