DEVELOPMENTS IN THE ROMANIAN BANKING SYSTEM

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Abstract

The evaluation of the present offer of banking products and services in the developed countries as well in the emerging ones shows the extent to which they fulfill or not the principles specific to social responsibility and ethics in economics. The Romanian banking system, currently one of the markets with the lowest penetration in EU has posted sustained growth for the past years. Client confidence in financial institutions is increasing, and the system's dynamics is attracting new foreign players, which have an easier market access since Romania's EU entry. Competition is expected to heat up, resulting in pressure on margins and diversified product portfolios, which ultimately benefit the end consumer.

Key words: banking system, banking strategies, distribution channels.

Clasificare JEL: G20, G21, G24,

Introduction

The main objective of the research is to identify the new distribution channels and to increase the efficiency of the existing ones, in order to improve the relation between bank and customer, as a starting point to increase profitability of banks. In our economy are many different ways for a bank to make money. Some of them are focused on the traditional banking strategies such as: attracting house-hold deposits in exchange for interest payments and transaction services and lending those funds to business customers at higher interest rates and other are focused on the non-traditional strategies such as mortgage banks. These approaches to banking business strategies are focusing on local markets or serving customers nationwide; catering to house hold customers or business clients; using an internet delivery system. These business strategies are relatively new development in the Romanian banking system. The studies which were made in this area have performed on systematic analysis of the profitability, risks or long term viability of these banking models.

Structure of the banking system

The worsening of the economic environment in 2009 left its mark on the Romanian banking system as well. The general factors that led to the global economic crisis also affecting the performance of credit institutions were associated with the rise in unemployment and the uncertainties surrounding the

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labour market, the drop in household incomes, the contraction in exports, the higher exchange rate volatility, the drop in direct equity investment, as well as the fall in the market value of land and real estate.

In 2009, the Romanian banking system underwent the following structural changes (Financial Stability Report 2010 http://www.bnro.ro):

- the change in the statute of Citibank Romania which turned from a Romanian legal person into a foreign bank branch, starting January;
- the closure of the Bucharest branch of Depfa Bank;
- the establishment of Feroviara Bank an institution with majority domestic private capital;
- the merger of Raiffeisen Bank for Locuinte and HVB Bank for Locuinte through the absorption of the latter.

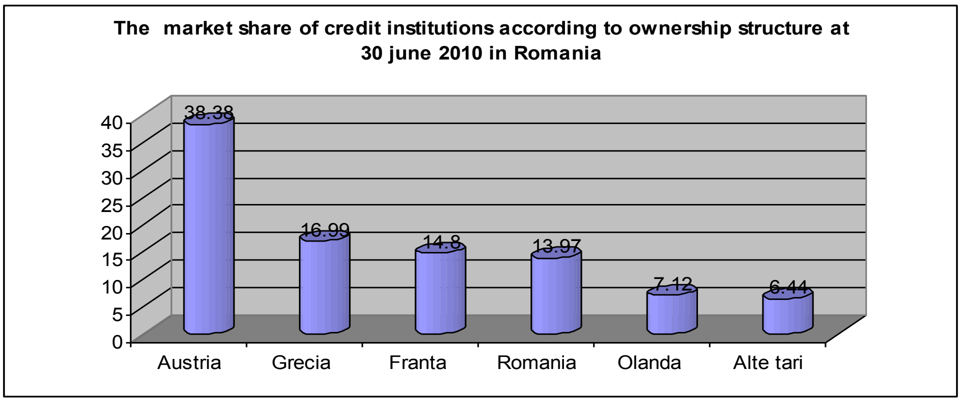
As a result, the number of foreign bank branches in 2009 was unchanged from a year earlier, 10 entities, while the number of domestic banks dropped from 33 to 32 entities.

By ownership, in 2009, the structure of the banking system was as follows:

- 2 banks with fully or majority state-owned capital (CEC Bank and Eximbank);
- 4 banks with majority domestic private capital (Transilvania Bank, Carpatica Bank, Libra Bank and Feroviara Bank);
- 25 banks with majority foreign capital;
- 10 foreign bank branches.

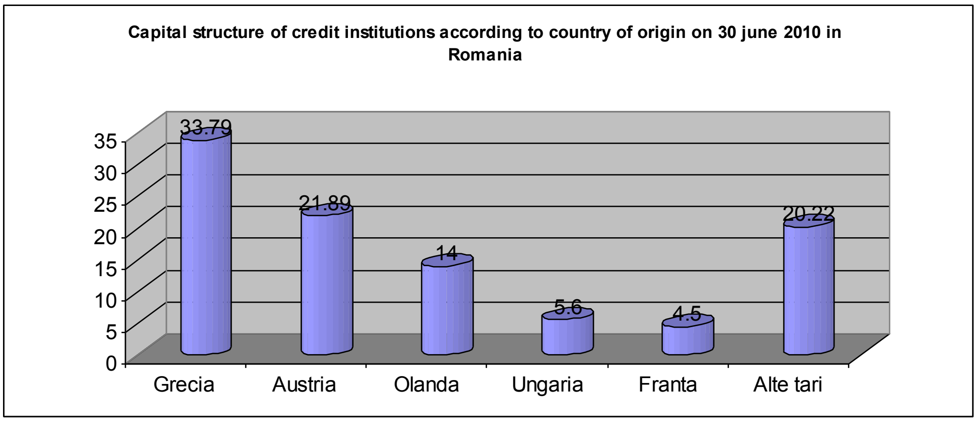
Furthermore, the Romanian banking system also included an authorised credit cooperative organisation, Central Cooperatist Bank CREDITCOOP with a network including 17 agencies and 50 cooperatives. It is to be mentioned that once Romania joined the EU and services were liberalised, 207 foreign institutions expressed their intention to perform direct banking activities on the territory of Romania, of which 192 banks, 3 NFIs and 12 electronic money institutions (Financial Stability Report 2010 http://www.bnro.ro).

Figure 1 The market share of credit institutions according to ownership structure at 30 June 2010 in Romania



Source:Financial stability report 2010 (Romania , BNR, 2010

Figure 2 Capital structure of credit institutions according to country of origin on 30 June 2010 in Romania



Source:Financial stability report 2010 (Romania , BNR, 2010)

Banking products and distribution overview

Competition is heating up in the Romanian banking system. A simple method for comparing the performance of different banking strategies is to separate banking companies by size. Scale is clearly important (DeYoung et al., 2004) a large bank company give it access to low-unit-cost marketing and production techniques; a small bank company allows it to build person-to-person relationships with its customers.

The 40 banks registered in Romania compete for a highly fragmented market with modest financial insight which supports the on going consolidation trend. The top 10 banks accounted for over 80% of the banking assets at the end of 2007 (http://rbd.doingbusiness.ro).

The concentration ratio for top 5 exceeded 62% already fairly high and expected to increase further, as the main banks will continue to strengthen their position. The stability of the economic environment, the downward inflation trend, a higher average salary and increased business opportunities in various industry sectors, together with the fall of the BNR interest rates, have all contributed in the last years to shift the banks focus from a cautionary approach, targeting operations, towards financing the real economy. As Romania is still an emerging financial services market, banks tailor their offer to a less sophisticated demand for retail and corporate products using a mass market approach, as opposed to mature markets where banks differentiate their offer and customize per specific customer segments. Most Romanian banks are clustered in the services area that means broad products range distributed via various channels. The major banks in this area have capitalized on various strengths.

- BCRŠ and BRD-GSG are examples of the universal bank concept, with clear scale benefits and cross-selling potential;
- Raiffeisen Bank developed an aggressive corporate and retail acquisition strategy;

- UniCredit has emerged as a strong universal bank, combining the strong Tiriac retail operations and HVB's corporate profile.
- In the opposition Transilvania Bank and OTP Bank are mostly oriented towards the retail segment while ABN AMRO's traditional focus is on the corporate segment.
- Porsche Bank, Raiffeisen Bank and HVB Bank, are examples of niche players that focus on specialized products, distributed via different channels including own agents, branches, car dealerships, brokerage companies.

At retail banking level, products are developed for retirees, young people, and affluent clients. The drop in interest rates in the course of a few years has opened up the opportunity of refinancing loans, now offered by almost all banks and used especially for previously contracted long-term loans, such as mortgage. On the other hand, SME clients are now in focus of many banks, such as Transilvania Bank or BRD-GSG, those are actively developing products for this particular segment. The bank's corporate portfolio is also being extended – for example derivatives, currently offered by banks such as ABN AMRO, UniCredit Bank or BRD-GSG. The accumulation of wealth has also prompted the development of private banking services for high net worth individuals, offering special relationships and investment services. ABN AMRO has been one of the pioneers of private banking in Romania; several other international banks have subsequently entered this segment. CEC has the largest branch network, but it lacks alternative distribution channels, that are successfully embraced by other banks. Although traditionally focused on the retail segment, CEC still has a limited product range offer for retail customers and has begun its development into the corporate segment and bank cards.

Distribution channels of the banking products

The development and expansion of electronic payment channels and instruments have permitted banks to offer their customers a higher level of convenience, often at lower costs (about 34% of household pavements are made using electronic channels like debit cards, credit cards and automated bill pay) (http:// rbd.doingbusiness.ro). For those who wish to make classical cash transactions, ATM networks has made access to cash more convenient, while generating fee income for banks and creating an new financial service sector for owners of ATMs. Banks have invested heavily into the expansion of their branch networks, which is still the major distribution channel, and plan to do so even more aggressively.

These new technologies have broken the paradigm of branch banking. Customers, whether individual consumers or business corporales, no longer have to go to the bank to do their business. It can be done from home, using the PC or the telephone, or at the shopping markets, using plastic money.

Some banks have now also started door to door delivery of services. As a result, it is now possible to order cash or demand drafts to be delivered at home.

Consumers wishing to open accounts with banks or to apply for durable loans can call up Direct Sales Associates (DSAs) of banks and their representatives will complete the necessary documentation at the customer's convenience, at his desired place und time. These are the elements of the new flexible financial supply chain.

Rohlwink (1991) explains how this form of banking is becoming a competitive advantage. According to him, "distribution channel strategies are particularly important because many new types of channel for financial services are emerging and rapidly gaining importance. For example, technological advances have made home, office and telephone bunking more effective and efficient as a means of selling and delivering products, and these channels are gradually gaining more acceptance among customers. At the same time, the rapidly rising costs of operating a physical branch network, particularly in terms of staff and premises, are making this traditional channel less attractive. Such developments are changing the relative competitive advantage of various distribution channels. They can thus pose a major threat to established competitors with extensive branch networks while creating specific opportunities for new entrants to improve their competitive position with respect to this key success factor."

Overall, banks increased their branch networks by 35% in 2006 compared to 2005, subsequently reaching more than 4,850 units by the end of 2007.

Several top 10 banks invested heavily in expanding their networks, such as BRD-GSG is now second in terms of number of units. The largest branch network belongs to CEC. Further growth prospects remain solid, although the gap to CEE branch density has shrunk: the current average in Romania is approximately 22 bank units per 100,000 inhabitants. However, severe discrepancies remain between branch density in Bucharest and the rest of the country, especially in the rural areas. These are signs that banks are prepared to invest in developing all distribution channels in an attempt to foster penetration and improve customer services and convenience. In this direction, banks support their investments with specific products to encourage their clients to use cards and to reduce the number of cash payments. The traditional distribution channels seem to be challenged by a few players which adopted different distribution strategies that are meant to maximize the efficiency of the customer interfaces:

- ING Bank started to address the retail segment, via an innovative “Self Bank” concept that is further supported by a franchising network of over 120 franchisees;
- ABN AMRO Bank pioneered a retail banking practice consisting of mobile banking agents, quickly adopted by a large number of players for selected products;
- Citibank started in 2004 the implementation of its retail arm - CitiFinancial, via a network of retail agencies;

- Volksbank set up its first franchising outlet in 2005, and is now offering basic bank products, as well as insurance and leasing services, in 75 franchised units.

Large banks, such as BCRŠ, BRD-GSG, Raiffeisen, and UniCredit have developed their own leasing, insurance, asset management or consumer finance companies, benefiting from group synergies and leveraging on their extensive branch networks. Cross-selling is an efficient way to leverage the traditional banking network. To mention just a few examples of financial entities that promotes and sells, besides banking products, various other financial products: (Annual Report 2009 http://www.bnro.ro).

- Insurance products: BCRŠ, ING, UniCredit, Volksbank;
- Mutual fund products: BCRŠ, BRD-GSG;
- Leasing: BCRŠ, BRD-GSG, UniCredit, Raiffeisen.

Competition will prompt banks to focus even further on innovative sales techniques and look at long-term strategic planning trends. Overall, banks will have to decide whether they will develop their products in-house or will acquire from third parties. Mature market distribution models rely on the insourcing/ outsourcing of products with direct benefits on the cost side. In addition, along with an increasingly sophisticated demand, banks will have to decide on how much of nonbanking products the customer expects to be offered by banks.

Things may work the other way too, with banking products that are sold via non-banking financial entities. For the time being, the proportion of loans intermediated by brokerage companies is insignificant. However, as competition on the maturing retail segment intensifies and banks begin to pay more attention to the costs entailed by an extensive branch network, financial intermediation will increase. In addition to credit brokers, some banks have already tapped into partnerships with retailers, real estate developers, real estate agents, car dealers etc. Banks such as OTP, Raiffeisen or Alpha Bank have partnerships with credit brokers; BCRŠ, BRD-GSG and Volksbank are examples of banks that use real estate agents to attract mortgage clients. One main challenge consists in the need for accelerated expansion of the bank’s distribution network in order to tap into the full potential of different geographic areas, but with increasing efficiency. Therefore, channels such as e-banking, m-banking, are expected to become standard distribution channels in the future. All these alternative distribution channels will lower the expansion and operational costs of banks.

Conclusion

We can define a variety of banking business strategies that are based on differences in product mix, funding sources, geographic focus and other dimensions. In conclusion we can make some notice (DeYoung et al., (2004).

- In the studies of banking business strategies it was find substantial differences in profitability and risk across the various banking strategies. Low profitability does not necessarily doom a banking business strategy. High average strategies like corporate banking generate high amounts of risk, while low average return strategies like community banking generate less risk. However both banking strategies may be financially viable.

- During the studies it was find some evidence that banks without a competitive strategy perform poorly, as do banks which are focused on the traditional banking strategies without embracing efficient new banking products and distribution channels.

Beside the strong growth in mortgage loans, Romanian financial institutions should look at an entire spectrum of attractive growth options such as new products or new distribution channels. The long term driver for the Romanian banking system is the low financial penetration that should continue to fuel double digit growth over at least the medium term. The average Cost Income Ratio for the banking system, calculated by BNR at 67.7% is well above the best practice ratios for banks in mature banking environments – 45%-50% – indicating opportunity for cost improvement (Barbu & Vintilã 2007). However, for the moment the focus is still on growth.

The 2008 is expected to bring further pressure on margins, driven by intensifying competition from both banks and nonbank financial institutions and possibly by BNR's policies.

Thus profitability will be closely watched in order to survive as competition becomes ever more intense. On the other hand, a favorable cost base compared to other countries could be used by international banking groups to relocate regional back office processing to Romania. To sum up, the banks' market positioning is the key for success. It makes sense to position as a universal bank if the bank has a significant market share, while it may be more appropriate for smaller banks to pursue a niche strategy. The increasing competition and sophistication of the market, along with this pricing pressure should gradually result in cheaper, more convenient and more diversified banking services for Romanian consumers, as well as alternative delivery channels.

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