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MANAGEMENT STRATEGIES IN THE BANKING SECTOR

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Abstract
The financial crisis that began in 2008 has had an impact on the way banks and financial institutions conduct their business. It's not just the financial situation of such institutions that has changed, but the market as well. The measures that should be taken involve the banking sector itself as well as the governments and central banks. In Romania the banking sector has remained quite stable and did not require bailouts from the government as in other European Countries. However the presence of European banks in Romania is expected to generate effects as a result of sovereign debt evolutions in the European Union.
Keywords: Management, Banking, Crisis, Strategies, Financial.

1. INTRODUCTION

Since the beginning of the crisis in 2008, the financial sector has taken measures in accordance to the new global economic situation. In Europe, many of the developed economies have slowed down due to the crisis. After the growth in the years prior to 2008, the banking sector has undergone substantial changes also from the marketing and management point of view.

Talking about the activity of lending money to private individuals, these changes refer to the fact that households have seen their revenues drop dramatically due to the changes in the economy. Furthermore, social welfare programs have been reduced by governments where possible, new taxes have been set and jobs restructurings have taken place: first in the private sector, then in the public sector. This has created an increase in unemployment levels. In EU countries that are not yet in the Euro zone, such as Romania and Bulgaria, the fluctuations in the currency exchange rates has had an additional impact on those individuals that have contracted financing in foreign currencies (Euro, USD and CHF).

The Romanian Government increased VAT (Value Added Tax) by 5% from 19% to 24% in 2010, after failing to increase tax on pensions. This measure was expected to fuel inflation and a decrease in consumption. However, according to the IMF delegation chief Jeffrey Franks, in November 2011, inflation is lower than expected. Certainly this achievement is not due to a single factor, but rather to a combination of factors such as: cutting public sector expenses and stepping up investments.

In 2011 Italy has increases VAT as well, from 20% to 21%. This increase is rather small but it has to be seen in context to be able to calculate its effects. Similar measures have been adopted by many countries struggling with large budget deficits.

Going back to the core of banking activity, we can see that economic policies have had quite an impact.

2. DEPOSITS AND OTHER SAVINGS INSTRUMENTS

Let's look for a moment how the measures mentioned above have affected the banking sector. First of all, if less money is available to the population, there is less available to live on, and thus even less is available for saving, if any. As a result, this produces a decrease in deposits, which in turn has a negative impact on the short to medium term banks' liquidity.

Granted that banks have many sources for raising funds, such as from their shareholders, from the stock exchange (if listed), from private deposits, some of them being from private companies.

Companies sometimes save their excess liquidity in bank accounts until they need it for various financial transactions such as for the payroll, paying suppliers and for raw materials. They keep those funds in deposits, current accounts and overnight deposits. Yet, we must keep in mind that while in 2009 interest rates were quite high, in 2010 they have dropped considerably.

The EURIBOR (Euro Interbank Offered Rate, meaning the rate at which euro interbank term deposits are being offered by one prime bank to another within the European Monetary Union zone) has dropped constantly from 2009 to 2010, and as a result banks are able to obtain financing more cheaply and apply higher spreads. On the other hand, the drop in interest rates did not influence so much the percentage that borrowers pay monthly, as it influenced the interest rates on deposits. As a result, the margin of the banks has increased due to the increase in the spread. However the banks are not necessarily able to cover in this way all their losses. We must remember that the number of late payments and non performing loans has increased as well. Accordingly, banks try to compensate for these losses in other ways.

In 2009, in Romania, the tax on the interest received on deposits (which accounted for 16%) was suspended. At that time this course of action was considered an anti-crisis measure, meant to keep liquidity to banks so that the banks would keep granting loans. Afterwards, granted that the situation got better, starting July 1st 2010 the Romanian Government decided to re-establish the 16% tax on revenue from deposits. My belief is that the re-establishment of this tax is not a good course of action on the part of the government due mainly to the fact that it encourages people to do other things with their money other than keeping it in the banks. As a result the short term liquidity of the banks is affected and anyway there would be no money to tax.

Of course the Romanian government is in need for more money to reach its budget targets. Yet it would have possibly made more of it from taxing economic activity alone through VAT. Instead, I would recommend to tax interest on deposits only when they are not renewed at maturity. The measure would be similar to not taxing the reinvested profit. This way, both parties would benefit: the depositors would be able to see their investments grow faster, the government would earn more on compound interest and the banks would have more liquidity for lending to the private sector. There are other measures that were adopted to help the banking sector, that are welcome.

One of those measures was adopted in 2009 by the Romanian government: to offer a state guarantee the deposits in case of default of the banks, up to 50.000 Euro. This encouraged people to keep their money in their bank accounts and avoid possible runoffs at the sign of danger. Even so, we might ask ourselves how many people have such large amounts of money to be covered by this measure? Not many, I presume. However, there are private firms that have more than 50.000 Euro in deposits and might not be covered by the government's decision for the whole amount. Anyhow, given the current financial situation, it's difficult to say to what extent the Romanian government would be able to cover the losses on deposits, should a critical event take place. Next we will look at what banks do with their liquidity: offer financing.

3. LOANS

If we look at the lending activity, (one of the roles of the banking activity - to allocate money from areas that have a surplus to areas that have a deficit), we see that this area has also been affected. From a marketing perspective, there has been a decrease in retail loans. This is due mainly to the fact that the defaults on retail loans have increased so much and in those cases in which the borrower had no real guarantees to be executed, the banks lost their whole exposure.

To better understand the phenomenology behind this we must take a look at the whole picture.

As a consequence of the fact that the households' revenues have dropped, eligibility for contracting home financing loans for instance has worsened. The main reason for this is that banks screen potential customers based on their earnings, age, credit record, their employers' solidity (the riskiness of the sector), the current debt level they have and their level of their expenses. It is not uncommon to hear politicians say that banks should restart the lending activity, but on the other hand the measures they adopt go against the functioning of the economy. And if the engine of the economy does not start, it will be difficult for banks to start lending again up to the levels of 2008, or even close to those. The very customers that should benefit from these loans see their sources of revenues diminish, maybe lose their jobs and as a result default on their mortgage or leasing payments. We have to keep in mind that the real estate business was doing great before the crisis began in 2008: banks were lending freely, people were being granted mortgages and the construction sector was doing great. On top of this, the exchange rate between the Romanian Leu and the Euro was very favourable. However, because access to mortgages was quite easy and the demand increased, prices were kept up.

Even in the US, home ownership was encouraged. In Romania (where the sense of ownership is strong), up until 2008, many were tempted to buy real estate quickly (mainly on credit) because prices were increasing at a constant rate. The availability of financing led to an increase in demand, and the supply of houses was lower than the demand, because the construction businesses could not keep up with the demand.

The economic and financial crisis has also had a major impact on the structure and allocation of banking products all over the world. Retail financing products have been blamed for defaults. The reason they were so widespread is because lessening borrowing requisites for customers has incentivised many to pile up substantial debt that they weren't able to repay. Until now the number of private individuals as well as private firms, have registered an increase in late payments or even non-performing loans.

Given the current market situation, banks have increased the activity of restructuring loans for those clients that demonstrated ability to still keep their businesses afloat even in hard times. The communication between lenders and borrowers has brought them to mutually acceptable terms and has given some of those clients a breath of fresh air until better times come back. One odd phenomenon is that support has shifted from the lender or creditor to the borrower. Such is the case in many European countries, including Romania. Bankruptcy procedures or just insolvency procedures or the reorganization of the firms, protects borrowers by law from payments to their creditors.

3.1 The competition between banks

Banks compete with each other by offering better financing conditions, better services, more varied services, cheaper fees, better customer support, flexibility and better conditions on saving instruments.

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They also use their brands, mission statements and advertisements to lure clients to their offices and agencies. However, each bank has a unique structure and is able to attract financing at better or worse terms than their competitors. The amount of liquidity and sources available to them determines their capacity to lend money at more competitive conditions. Banks make profits from the spread between the cost of raising funds and the costs of loans (paid back by clients) determined by their interest rates, fees on transactions, financial services, consultancy, credit cards, savings plans, investing in financial instruments on the capital market, brokerage services and so on. Even if banks would like to increase their profit margins let's say by increasing the interest rates on loans, they are subject to market competition, which ultimately sets the price. John Maynard Keynes regarded the rate of interest set by the market as the foremost 'unjust price' in the economic system and did not hesitate to use the medieval term 'usury' to condemn it (Skidelsky, 2009: 148).

Investors sometimes feel that the fees charged by banks do not reflect a correct competitive structure. One complaint is that fees have gotten fatter in a way that is not explained by any increase in banks' risks or costs. They think banks were overpaid for the risks they took. This is also true for banking markets of other countries. Banks try to make up for their losses due to provisions on bad loans. According to The Economist, a corporate adviser stated, "Our clients want the best, not the cheapest". Like other professionals, investment bankers tend not to compete on price because customers interpret low fees as a sign of poor quality.

Considering that it's desirable for the market as a whole to have a competitive banking market, banks should compete in innovation. Innovation is the result of research and understanding of the market and it does not come automatically (Estrin, 2009). Extensive efforts have to be made by banks if they want to stay competitive. The quality, but most of all the transparency of the services offered to consumers are very important. Right now is the time to disclose the information written in fine print so that those signing up for financial services know what they are signing up for. In this last part of this article we will see the results of Porter's five forces analysis.

4. PORTER FIVE FORCES ANALYSIS

Porter's five forces is a framework for the industry analysis and business strategy development developed by Michael E. Porter of Harvard Business School in 1979. It draws upon Industrial Organization (IO) economics to derive five forces that determine the competitive intensity and therefore attractiveness of a market. Attractiveness in this context refers to the overall industry profitability. An "unattractive" industry is one in which the combination of these five forces acts to drive down overall profitability. A very unattractive industry would be one approaching "pure competition", in which available profits for all firms are driven down to zero (Daft, 2008).

Three of Porter's five forces refer to competition from external sources. The remainder are internal threats.

Porter referred to these forces as the micro environment, to contrast it with the more general term macro environment. They consist of those forces close to a company that affect its ability to serve its customers and make a profit. A change in any of the forces normally, requires a business unit to re-assess the marketplace given the overall change in industry information. The overall industry attractiveness does not imply that every firm in the industry will return the same profitability. Firms are able to apply their core competencies, business model or network to achieve a profit above the industry average. A clear example of this is the airline industry. As an industry, profitability is low and yet individual companies, by applying unique business models, have been able to make a return in excess of the industry average.

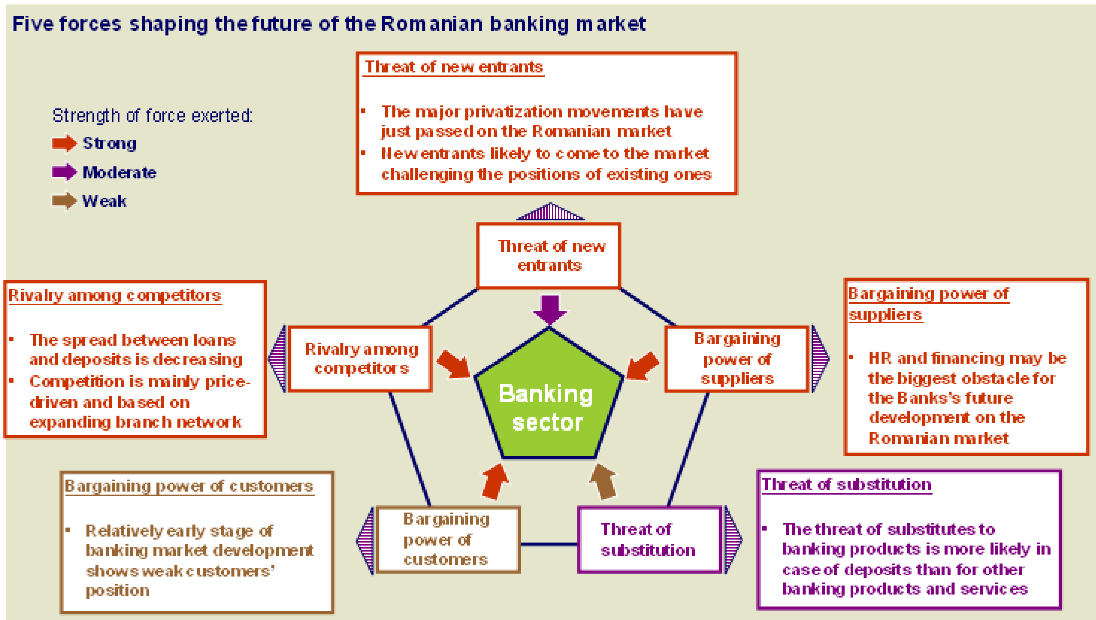

FIGURE 1 – THE BANKING MARKET IN ROMANIA

Porter's five forces include - three forces from 'horizontal' competition: threat of substitute products, the threat of established rivals, and the threat of new entrants; and two forces from 'vertical' competition: the bargaining power of suppliers and the bargaining power of customers.

This five forces analysis is just one part of the complete Porter strategic models. The other elements are the value chain and the generic strategies.

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The trends that will shape the future of the banking market in Romania can be analyzed within the five forces framework (figure 1).

Figure 1 reveals a chart for the five forces analysis applied to Romania's banking market as of today. As we can see there are strong risks coming from the Bargaining power of customers, the Bargaining power of suppliers (concerning the limited highly trained professionals on the market) and from the Rivalry among competitors (reduced spread between loans and deposits and high competition based on pricing). The threat of new entrants is moderate because the banking market in Romania has already undergone extensive privatization and because there are already many foreign banks on the market. As far as the threat of substitution is concerned, given the current market development in Romania, the risk is considered to be moderate because there are not many alternatives for financing to the banking – financial sector and of course European Funds.

5. CONCLUSION

In regards to HR resources, Romania needs to focus more on developing professionals for the most important sectors of the economy. This can be achieved through a close relationship between companies and universities so that students can enrol during the course of their studies in internship programs. Banks, as other companies should not be too closed to such initiatives. By being open, the relationships between future employees and the bank is established early on. Once students graduate, they can be hired and trained for key sectors of the bank.

Right now the banks in Romania are not expanding geographically as they were in 2008. Instead, they are rationalising their resources and eliminating those agencies and offices that are producing the least revenues. This is a time for restructuring problematic debt while trying to attract new customers. Keeping in mind that deposits are important for the bank's activity, they should be attracted as well. In Romania, many of the banks are subsidiaries of foreign banks. Given the current gloomy perspective of the European Banking Sector, it would be an achievement if the international subsidiaries maintain their local exposures in Romania for the time being. Possible increases of capital are possible only in extreme cases, but hard to achieve considering the pressures put on mother companies by the next Basel III accord.

The latest updates on the European debt crisis leads to the conclusion that the following years will be hard for the banking sector. Growth prospects are sluggish while sovereign debt is high in many EU countries such as Greece, Italy, Spain. If the referendum proposed by the Greek prime minister will take place and the Greek people will vote against the agreement signed with the EU and IMF, things will turn bad for the EU and the Euro currency as well. Already the news of this referendum spread panic in stock markets across Europe, bringing down especially the banking stocks. If the EU is to solve this problem, it has to move swiftly and take the right decisions, even if they are painful.

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