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THE EFFECTS OF THE COMPETITION IN THE ROMANIAN BANKING SYSTEM

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Abstract

The present study is structured as follows: in section 1, it is enhanced the gap and in the same time the potential to growth in the Romanian banking system, compared with the EU ones; it is analysed the impact of EU integration on bank products' prices, taking into account the two approaches concerning the evaluation of the competition: „the Structure-Conduct-Performance Hypothesis" (SCP) and the „Efficient Structure Hypothesis" (ESH); it is approached the competition problem in the Romanian banking system, as result of the integration process, including aspects concerning the marketing strategies, the corporate and retail banking and the financial non-bank institutions.

Key words: competition, banking system, challenges, European integration

1 Introduction

In the post-transition period, the Romanian banking system suffered a series of legislative, structural and operational transformations which changed the financial environment in a substantial way, becoming thus a more stable and mature one.

Now, the challenges are to prepare the banking sector for the EU integration, to insure that it will be able to continue the sustaining of the economic development, in the European environment, a more competitive and demanding one. The main consequence of the European integration will be the increasing competition on the internal banking market; after the euro zone integration, the transparency provided by the single currency is expected to strengthen the competition. The accentuated competition on the internal banking market will have as effects: the development of the retail sector; the appearance of new types of banks and banks' orientation towards new activities (including financial consulting); the bank concentration; the reorientation of banking marketing policies; the banks' penetration in unexplored areas, including rural ones; the decreasing interest rates and, the most important one, the degreasing margin between the active and passive interest rates.

2 The Romanian banking environment in the market economy

A benefit from the massive presence of foreign (European) banks in the Romanian banking system will be probably visible after the EU integration: some specialists [Vosganian, 2005, 25] worry that after the EU integration moment, the credit costs will

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raise, together with the expenditure raise for investments, determined by the Basel II standard implementation. On the other hand, Steven van Groningen, chairman of Raiffeisen Bank Romania, argues that costs will be smaller for some products and services, due to the fact that *banks can process transactions in a foreign centre and the European banks will offer services in Romania without the special authorization of the NRB*; *some banking transfers as well as some card operations will be cheaper, as a follow up of using the branch networks and ATMs that function in the EU territory*.

Nowadays, *the concentration* in the Romanian banking system is very high: the top five banks according to the market share (BCR, BRD-GSG, Raiffeisen Bank, HVB Bank Romania, BancPost) in September 2005, concentrated 59.4% from the total assets, 61.2% from the credit market, 57.7% from the deposit market.

3 Competition theory and the banking system

In the literature, there are two approaches concerning the evaluation of the competition: „the Structure-Conduct-Performance Hypothesis” (SCP) and the „Efficient Structure Hypothesis” (ESH). The first approach, SCP, supposes that *the concentration in the banking sector generate market power, allowing the obtaining of greater profits* for banks through attracting deposits with low interests and offering credits with high interest rates [Bain, 1951, 293–324]. This is why it is necessary that the governmental authorities issue anti-trust regulations and supervise mergers and acquisitions in the banking sector. The second approach, ESH, suggests that the positive relationship profitability and market concentration is not a consequence of market power, but of the *greater efficiency of firms with larger market share* [Demsetz, 1973, 1–22]. The superior performance of the market leaders determines the market structure, implying that higher efficiency produces both higher concentration and greater profitability.

In the Romanian case, *the privatisation of the largest bank, BCR, will have a huge impact on the market, especially from the competition point of view.* The change in the bank’s management will impose an increase in the quality of products and services and competitive prices *and even a more coherent policy*. For example, at the beginning of January 2006, BCR decided to charge for clients (natural persons) the equivalent of 15 euros per month, for each inactive current account (without operations in the last three months), no matter the dimension of the credit balance. Only three weeks later, they publicly announced that retract the decision (forced probably by the new-declared major stockholder, Erste Bank, that conscience the important of each client and considered that clients with relative important amounts of money in current accounts, with virtually no interests, must not be removed).

Main benefits of foreign entry are higher competition in banking sector, leading to high quality, more variety of services at cheaper prices; this will benefit consumers of banking services. In addition, efficiency of banking services lead to more efficiency of resource allocation and risk management in the economy as a whole, resulting in more efficient and competitive economy. Levine specifically mentions that *foreign banks may improve the quality and availability of financial services in the domestic financial market* by increasing bank competition and enabling the application of more modern banking skills and technology; serve to stimulate the development of the underlying banking supervisory and legal framework and enhance a country's access to international capital [Levine, 1996].

Using data of national banking market from 80 countries, Claessens, Demirguc-Kunt and Huizinga finds that *foreign banks operate differently from domestic banks* [Claessens, Demirgüç-Kunt, Huizinga, 1998]. Larger foreign ownership share in banks indeed reduce the profitability and the overall expenses of domestically owned banks. These results suggest that foreign bank entry improves the functioning of national banking markets, with positive welfare implications for banking customers. The relaxation of restrictions regarding the foreign banks entry may similarly reduce domestic banking profits, but with positive overall welfare implications for the domestic economy. In addition, they find that the number of entrants matters rather than their market share. This indicates that *foreign banks affect local bank competition upon entry rather than after they have gained substantial market share*.

Taking into account this literature review, it could be for Erste Bank two alternatives: to make the efforts for recuperating very rapid the investment (the biggest price paid in Central and Eastern Europe in a privatisation, more that 3.5 billion of euros for taking the control, at the end of 2005), that is higher prices for their products and services, with impact on the entire banking system, or, to make efforts to improve its position on the market and promoting competitive prices. Probably, due to the fight for a major market share and very rapid changes in the Bank Top 5 and Top 10, Erste Bank will be forced to preserve its position and this will have a favourable impact on the entire market.

4 Evidence of competition in the Romanian banking system after year 2000

The increasing competition for a bigger market share takes into account both the expansion of bank agencies and ATMs, the developments of on-line services (bank cards, e-banking, call centre) and also a phenomenon of banking specialization on market niches.

Although the on-line services are much cheaper both for the bank as well as for the clients, the activity expansion strategies of retail banking will be grounded on the "net of branches made of bricks and cement", as the general manager of UniCredit Romania, Mr. Giuseppe Merlo said. Thus, the banks which will develop their retail sector in Romania will have no other solution, but to invest tens of millions of euros (only for creating a new branch the costs are between 100,000 and 300,000 euros) for the expansion and modernization of bank branches.

At the same time, a change in the model of bank branches is expected; this means smaller and much more fashionable ones. Thus, banks will open new branches dedicated for some population segments and in zones which have not been explored up to now, the rural area being the main target.

Nowadays, the number of banks in the territory is low enough and the specific indicator shows that there are only 0.13 banks for one thousand of inhabitants, which is almost four times less than the European Union average (EU 15), where there are 0.5 banks for one thousands of inhabitants; but the last year's evolutions as well as the expansion plans of some Romanian banks are very encouraging.

Another good sign for the competition is that some banks introduced *alternative channels of distribution*, such as the bank franchise (ING Bank or Volksbank); salesmen (ABN AMRO Bank) or sales consultants (Citibank).

The marketing policies will be oriented towards a service quality improvement and a *reconsideration of the client relations*. Thus, the complexity of products and integrated service packages will raise, banks will give more and more credits and in more and more varied and flexible forms, for longer and longer periods of time.

From the client relations improvement perspective, banks will make big efforts in order to increase the implementation degree of the banking ethics' principle, will develop private banking services (services for important clients) and will develop networks of independent financial advisors.

The financial market in Romania is still emergent and thus, *banks continue to have the monopoly in financing*. Statistics show that the alternative for the bank credit is insignificant (either the capital market, the leasing, or the microfinance (in the case of the firms), or the credit companies, credit cooperatives or mortgage societies (for personal loans) does not represent an real option, so *virtually there is no competition for banks*; luckily, the signs of competition between banks, at least in some areas, are visible, besides the estimations that *there is enough room for a few more banks*.

Being possible for the consumer credit institutions to offer credits with higher interest rates comparing with those offered by the banks for the consumer credit, sustains the idea that *the competition is still at the beginning*. Having a better understanding of the clients' needs, flexibility in the credit activity, working on a larger scale with persons with lower revenues and being where the needs are (in shops, in hypermarkets), makes the difference.

Those financial non-bank institutions "woke up" the banks; they enlighten a virgin area and now *the banks' credit policy for the retail market must be reconfigured*. Opening new agencies for being nearer to the potential clients, offering "express" credits, trying to tell you in less than a half of hour if you are eligible for a credit, are just a few signs that banks realise the market consistence and the huge potential gains.

The bank activity oriented towards the corporate segment will generate increasing competition especially on cash management services, enabling their clients to obtain comparative advantages and an efficient management of liquidities. The fight between banks will be in offering more sophisticated (complex) services, including transactional financing, capital market related services, risk management etc.

In the last two years, the Romanian banking system registered *substantial progresses having as result the improvement of services for the corporate sector*, including the introduction of the IBAN code or the implementation of the National Electronic Payment System operated by TransFond (with an RTGS system and ACH) and contributing to an increased speed in settlement, in reducing the gap between the intra and inter-bank transfers and the introduction of new bank products, such as direct inter-bank debit.

The relative new firms' *behaviour to use products and services from different banks* will determine from the banks' part to *develop and consolidate the relationship with the clients*, enhancing the competition in the system. Some studies underline that the companies that collaborate with one bank could be captive from the informational point of view, and eventually changing the bank will lead to increased costs [Machauer, Weber, 2000]. Nevertheless, in the case of the Romanian banking system, the first sign of competition was *the fight for the corporate clients*. Generally, at the local level, when a new bank branch appeared, the main mission for the local manager was to attract corporate clients (that he already knew and worked with, in another bank), promising for them at least the same credit facilities, but regularly making a better offer – a lower interest rate or smaller bank charges. Of course, in this case the offer to change the bank came from another bank and it was addressed to selected clients, but it shows that, *at least sometimes, changing the bank could bring advantages for the firm*; also, on the long run, *this behaviour determine the banks to be more competitive and to offer better products and services, at lower prices*.

There are also opinions in the literature, that the bank capital concentration will determine restrictions as regarding the corporate sector. Beck, Demirguc-Kunt and Maksimovic [Beck, Demirgüç-Kunt, Maksimovic, 2003], using data from 74 developed and developing countries, proved that, *in the conditions of the bank concentration*, the companies' access to financing is reduced. The correlation between the degree of banking concentration and the firms' access to finance in tempered in those countries where there are mature financial institutions and markets and a consistent proportion of foreign owned banks, allowing to offer viable alternatives; in countries with restrictions, state interference in the banking activity, with state-owned banks detaining large market shares, this correlation is more evident. Taking those aspects into consideration, the BCR's privatisation will determine *the elimination of last doubts and fears about state's intervention in the banking system,* besides an increasing competition in the system, as well as it will probably determine a more accessible credit for companies.

The nongovernmental credit growth rate was very important since 2000, especially due to the retail credit. Thus, the credits granted to the population in 2006 represented 42.51 % from the total nongovernmental credit, comparing with the level of 5.68 in 2000.

It must be highlighted that the *retail banking segment is increasing very fast*, continuing to have a huge potential to growth; this is due to the fact that, besides the fast development pace, the weight in the GDP is very low (5% in 2004), for 2006 being estimated at 7%.

This bank behaviour is determined by the certainty that they still have in the retail sector "captive clients", because:

- the dolarisation or "euroisation" is no more attractive since more than two years, the USD and EUR registering continuous depreciation comparing with the national currency (Romanian new leu - RON);
- the capital market investments, in shares and bonds suppose a minimum financial culture, a minimum capital and the need to assume the risk of potential losses, aspects which an important part of the bank clients (natural persons) does not agree;
- the placements in investment fund titles, even if there were less risky comparing with the direct investment in shares and bonds, did not regain completely the confidence of investors, after the substantial losses supported a few years ago, occasioned by the Mutual Fund of Business Men and more recently the National Fund of Investments' fall down.

As a consequence, viable alternatives available for the small savings did not existed; meanwhile those with important amounts of money oriented some part of their savings to real estate investments until the prices increased to prohibitive levels.

The credit expansion, especially in the last three years, allowed banks to continue to operate with a big interest gap, under the circumstances of the diminishing inflation rate, which made credit more accessible. This indicates a *still reduced competition in the Romanian banking system, which attracts an increased cost of the financial-banking intermediary*.

Thanks to the beginning of competition (between large European banks), the results for the clients, *especially on the retail segment* were more than satisfying in 2005 and there are good foundations for improvements this year. We could highlight some of the benefits, consequence of the fight between the biggest actors on the market and the struggle of some smaller (also mainly foreign owned) banks to survive, or find an uncovered market segment: the appearance of refinancing credits, the issue of smart cards, the development of credit cards and co-branded cards, the appearance of saving accounts (functioning as current accounts but with higher interests, close to the deposit ones), the important drop-down in interest rates for credits (sometimes even below 10%, but unfortunately still followed by increased charges), the development of saving-before credit system, the development of specialised banks.

The appearance of refinancing credits in 2005, an innovative product for the Romanian bank market, taking into account that there were a lot of credits granted with fix interest rates over 20-25% or more, in a moment when, on average, the interest rates dropped below 15%, is a sign that *the Romanian banks started the fight on the retail market*.

In the Romanian banking system, besides some areas where we could feel at every step the competition (especially on the corporate market), *we still expect a lot of retail products and services to appear or develop*; banks do not need to invent them; just to "remember" that they offer those products on other markets, more mature, competitive, in Europe especially.

The competition on the bank market is many times brought by the smaller credit institutions, for which a few clients could mean the difference between profit and loss. Such banks fights for their clients, search for uncovered market segments (or undiscovered), offer new products and services, are forced to be innovative, to meet the clients' needs.

In Romania as well as in other states, *not always the biggest banks offer the best products and services*; for example they can afford to lower much more the interest rate for deposits, for offering credits with lower interest rates, without endangering their position and being in a position to face a liquidity crisis; the smaller banks, more "dependent" on clients, are more cautiously.

5 Conclusions

In the last few years, the Romanian banking system became a mature one; after "surviving' the transition period, with more that ten bankruptcies and more than 50% in bad credits (in 1998) in the system, correlated with the economic environment' improvement and companies' sudden change (for the better), the state-owned banks' privatisation, foreign banks' involvement and adopting the EU banking directives, the banking system offer better products and services and is a normal one for an market economy.

Besides the fact that there are still some areas where the competition in the next years will have to bring consistent improvements, *the Romanian banking system, as it is, is better prepared for EU integration, comparing with other sectors of the national economy*, especially taking into consideration that, on the retail market, where the most important shortcomings are, even at European Union's level the integration is only at the beginning, cross-border deposits and credits being rare. However, we must keep in mind that the competition eliminate, in the conditions of an single banking market, the weak participants and, as a consequence, the financial sector must receive an special attention, both on regulation, for sustaining the development, and on supervision.

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