PERFORMANCE INDICATORS FROM BANKING SYSTEM

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ABSTRACT: *The purpose of the paper is to present the main aspects related to bank performance through the traditional measures which are expresses the profitability and bank efficiency, and also, the trends of the profitability in banking system in Romania and European Union based on the return on assets, return on equity, bank capital to assets ratio, or nonperforming loans.*

KEY WORDS: *performance, bank profitability, return on assets, return on equity, nonperforming loans.*

JEL CLASSIFICATION: *G21.*

1. INTRODUCTION

Financial sector is dominated by banks. Banks are a key component and support business environment development through services and products offered.

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. The main goal of a commercial bank is profitability or profit maximization in order to minimize risk exposure. Profitability express banks position on banking system highlighting banks management quality (Bătrâncea, 2010).

Bank performance is a continuous issues for bank managers, researchers, academicians and other business profesionals. Due to importance of banking system into the economic growth, to assess and manage bank performance is also, on the current agenda of the governmental authorities in each state of the European Union.

According to the European Central Bank "bank performance refers to the capacity of generating sustainable profitability" (ECB, 2010).

Financial performance in banks are revealed through income statement and balance sheet, where there are the assets, liabilities, incomes, expenses and also are

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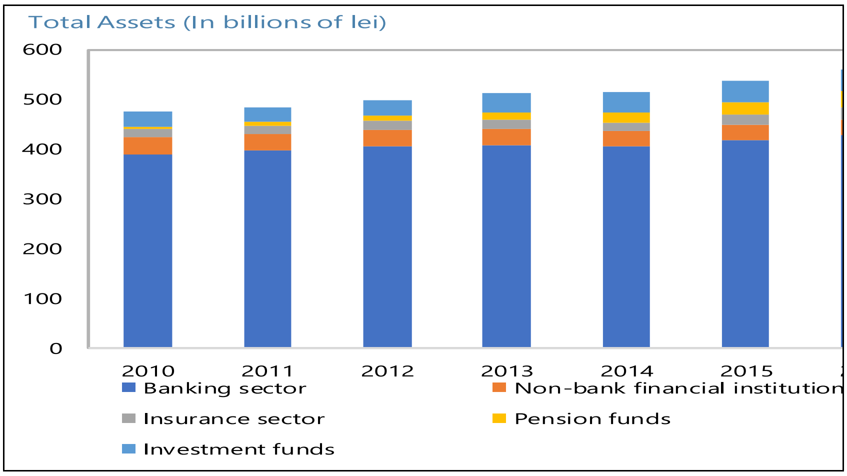
explained the results. The lack of performance is, ussualy, easy to detect mainly through non performing assets, because those assets does not generate revenues. We can say that bank performance is related to the main concepts of profitability and efficiency.

In Romania financial sector is dominated by banks, a large share of which is foreign-owned. The banking system as a whole holds around 80 percent of financial sector assets. Concentration is moderate, with the largest five banks accounting for about 60% of total deposits and 57% of total loans.



Source: National Bank of Romania https://www.bnr.ro/

Figure 1. Structure of financial sector in Romania

According to the Financial Stability Report of the Natinal Bank of Romania, banking sector profitability rebounded to positive territory in 2015.

2. KEY INDICATORS TO ASSESS PERFORMANCE FROM BANKING SYSTEM

Performance from the banking system is focussed, mainly, on bank profitability ratios, but could be assess through the level on non-performing loans or the bank capital to assets ratio.

Profitability, also, indicates earning capacity of the banks. It highlights the managerial competency of the banks management. Profitability is the most important and reliable indicator as it gives a broad indication of the ability of a bank to raise its income level. (Dasgupta, 2001)

Profit is the reason for the continued existence of every commercial organization. The rate of profitability and volume of profits are considered as indicators of efficiency in the deployment of resources of banks.

Profitability indicators are also used in order to determine the global risk position of a commercial bank. (Drigă, 2009).

Efficiency and profitability analysis in banks is based on a set of ratios:

- bank capital to assets;
- return on assets;
- return on equity;
- gross profit margin;
- net assets margin;
- expenses to income ratio;
- equity multiplier;
- solvency ratio;
- liquidity ratio.

Profitability allow to a bank to increase capital, in order to support the growth of assets, to absorb loan losses and also to provide a return to investors.

Bank capital to assets is the ratio of bank capital and reserves to total assets. Capital and reserves include funds contributed by owners, retained earnings, general and special reserves, provisions, and valuation adjustments. Total assets include all nonfinancial and financial assets.

$$K/A = \frac{\text{Capital} + \text{Reserves}}{\text{Total Assets}} \times 100 \qquad (1)$$

Return on Assets (ROA) is a ratio between net profit and total assets. In American literature the ratio is known as Return on Total Assets or Return on Investment (Halpern, 1998) and measures the profitability of the invested capital in bank or the efficiency of the assets management.

$$ROA = \frac{\text{Net profit}}{\text{Total Assets}} \qquad (2)$$

This ratio depends on profit margin and assets efficiency.

$$ROA = \frac{\text{Net profit}}{\text{Total Income}} \text{ X } \frac{\text{Total Income}}{\text{Total Assets}} = \frac{\text{Net profit}}{\text{Total Assets}} \qquad (3)$$

ROA indicates how much net income is generated per monetary unit of assets. The higher is ratio, the more profitable is the bank. In case of a decreasing trend of the ratio we can say that the bank has some difficulties in obtaining incomes, and an increasing trend signify good results, but in conditions of excessive risk assumed by the bank.

Return on Equity (ROE) is a ratio between net profit and total equity measuring the profitability of the shareholders' investments. This ratio depends on profit margin, financial leverage and speed assets (Bătrâncea, 2010).

$$ROE = \frac{\text{Net profit}}{\text{Equity}} \qquad (4)$$

$$ROE = \frac{\text{Net profit}}{\text{Assets}} \text{ X } \frac{\text{Assets}}{\text{Equity}} = \frac{\text{Net profit}}{\text{Equity}} \quad (5)$$

Gross Profit Margin measures how efficiently a bank controls for its costs.

$$GPM = \frac{\text{Profit before tax}}{\text{Total Income}} \quad (6)$$

Net Assets Margin in banking is a percentage of net interest income and total assets. Net interest income is calculated by subtracting interest expense from interest income.

$$AM = \frac{\text{Net Interest Income}}{\text{Total Assets}} \times 100 \quad (7)$$

Expenses to Income Ratio measures the income generated by a monetary unit of cost. That is how expensive it is for the bank to produce a unit of output. The lower the E/I ratio is, the better the performance of the bank (Kumbirai & Webb, 2010).

$$E/I = \frac{\textit{Total Expenses}}{\textit{Total Incomes}} \times 100 \quad (8)$$

Equity Multiplier is a ratio between total assets and equity revealing the degree of banks business development starting from a certain amount of equity, and how additional resources use generate an increase in return on equity.

$$EM = \frac{\text{Assets}}{\text{Equity}} \quad (9)$$

Solvency ratio measures the long term ability of the bank to meet its obligations. This involves understanding the capacity of the bank to meet its obligations.

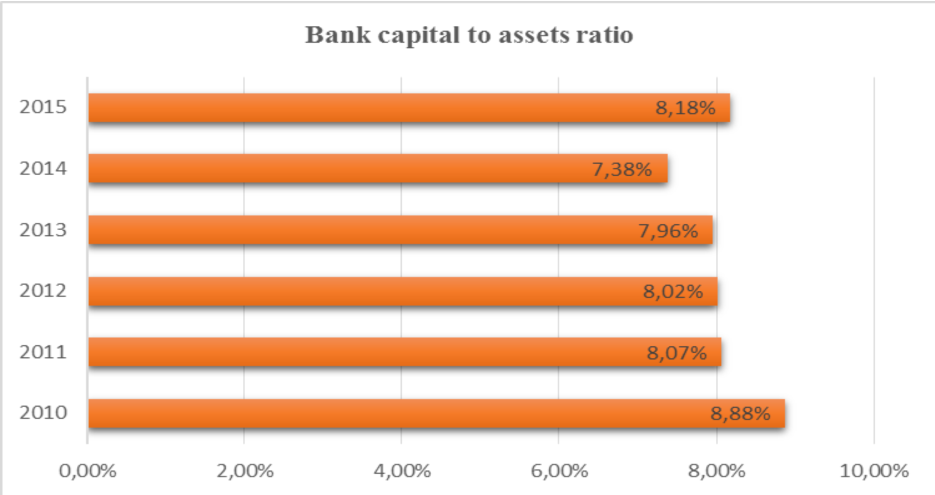
Liquidity ratio measures the short-term ability of the bank to operate and function.

3. TRENDS ON PROFITABILITY FROM ROMANIAN AND EUROPEAN BANKING SYSTEM

After years of losses, Romanian banking system returned to profit, 2015 being the best year after the beginning of the global financial crisis which affected financial institutions' shareholders.

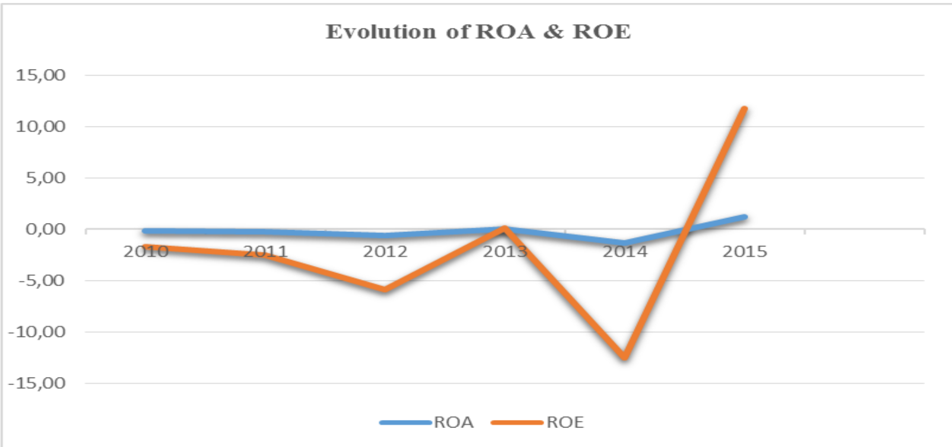
According to the data of National Bank of Romania, the assets of the Romanian banking system increased to over 377 billion lei, the maximum level of the last eight years.

Bank capital to assets in Romania from 2010 to 2015, is prezented in Figure 1. It can be seen that the bank capital to assets ratio fluctuated overall during the period under observation, with a decreased trend from a value of 8,8% in 2010, and reaching a value of 8,18 at the end of 2015. The ratio decresed from the begining of the global financial crisis. In 2007 was the largest ratio of bank capital to assets, when a bank capital to assets ratio of 10,68% was recorded.



Sources: based on data from Business data platform - statista.com

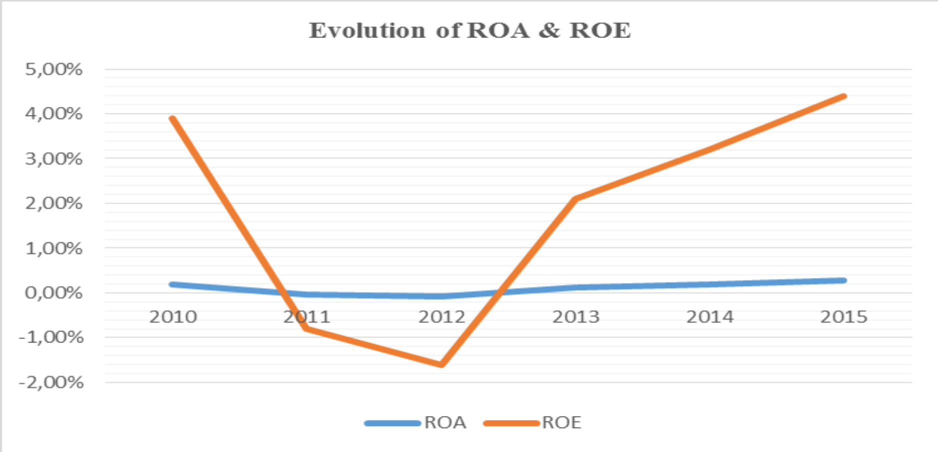
Figure 2. Bank capital to assets ratio in Romania (2010-2015)



Source: based on data from NBR, https://www.bnr.ro/

Figure 3. Evolution of return on assets and return on equity in Romanian banking sector (2010-2015)

At the end of the 2015, the Romanian banking system recorded a net profit of 2.25 billion lei. Return on equity (ROE), was 11,77%, while return on assets (ROA) was 1,24%. Compared to 2014, the figures turn from minus to plus, but still far from the glory years of the banks.

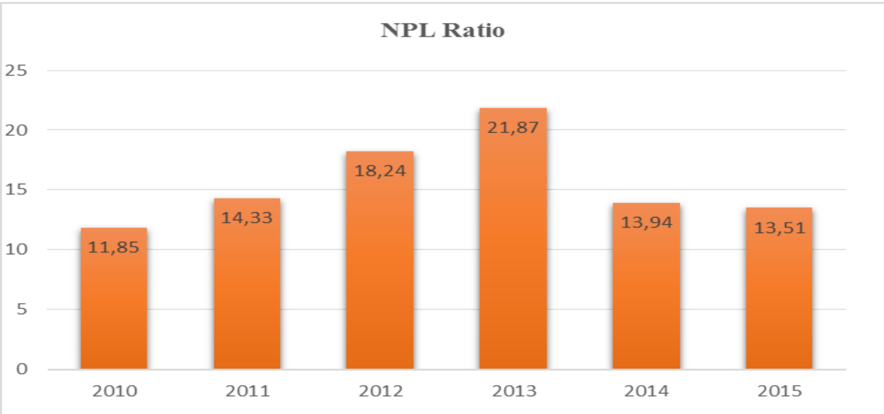


Source: based on data from Eurostat, https://ec.europa.eu/eurostat/data/database

Figure 4. Evolution of return on assets and return on equity for EU-28 (2010-2015)

The level of ROA of European banks was 3,90% in 2010 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 2015 have presented a slowly recover up to 0,28% in 2015.

The level of ROA of European banks was 0,20% 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 4,40% in 2015.



Source: based on data from NBR, https://www.bnr.ro/

Figure 5. Evolution of the NPL ratio in Romania (2010-2015)

The ratio of NPLs was 11,85%, in 2010 and reached 21,87% at the end of 2013, a high value compared to the value recorded at the end of 2010. The large volume of non-performing loans still remained a major concern, in 2014 and 2015 when Romania recorded a level of 13,94% at the end of 2014 and 13,51% at the end of 2015.

The solvency ratio – one of the most important indicators monitored by BNR, which shows capacity of the bank to meet its obligations reached to 17,5%, at the end of 2015, above the minimum required of 10%.

4. CONCLUSIONS

To assess performance of banking system is a difficult task because of the multitude of aspects to take into account and, mainly, because the complexity of this assessment process. The analysis of the performance of banking system is useful to different users such as: shareholders, creditors, customers and managers. In these context, in order to improve bank performance is useful to consider and measure the more significant indicators which can be considered key performance measures. The indicators discussed in the paper indicate that the overall performance of the banking system from Romania and European banking system has been improving after 2013 up to 2015, in the studied period between 2010 and 2015.

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