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АНАЛИЗ И ОЦЕНКА НА СТРАТЕГИЧЕСКО УПРАВЛЕНИЕ В БАНКОВИЯ СЕКТОР НА ГЪРЦИЯ ПРЕДИ И ПО ВРЕМЕ НА ИКОНОМИЧЕСКАТА КРИЗА (2000-2015 г.)

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ANALYSIS AND EVALUATION OF STRATEGIC MANAGEMENT IN THE GREEK BANKING SECTOR BEFORE AND DURING THE ECONOMIC CRISIS, 2000-2015.

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Abstract

The banking industry has undergone significant growth in recent decades. These changes are in progress and are expected to continue in the future. Regarding the current study, one of the major elements of the analysis is the conditions and the development of the banking environment in Greece and the Balkan countries.

Having examined the external factors of the banking environment in Greece and the other Balkan countries, the current study examines three hypotheses: H1: GDP growth rate has a positive effect to banks' profitability. H2: A higher capital adequacy ratio has a negative effect to banks' Return on Assets and Return on Equity. H3. Total liquidity has a negative effect to banks' Return on Assets and Return on Equity.

In the study, there is a regression analysis, for the four banks in Bulgaria and Romania – subsidiaries of Greek banks- in order to identify the relation between the performance of the banks. As indicators of performance are, in one case the Return on Assets (ROA) and in the other case the Return on Equity (ROE).

One key conclusion of the research is that Bulgarian and Romanian banks have higher efficiency than the Greek banks, which are the parent companies. Another key point that resulted in the financial problems of Greek banks was the fact that they were increasing their loans provided to the Greek governments.

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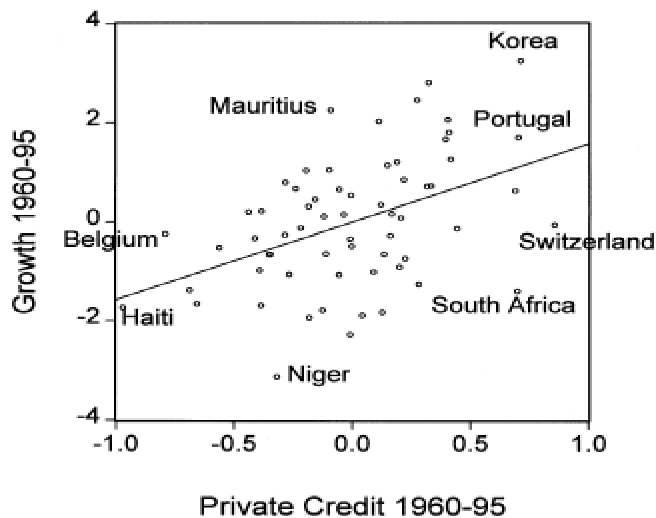
1.Introduction

First of all, as noted, capital is necessary in the production process. Therefore, the channeling of capital towards productive units,is helping them to develop their production, to strengthen their position and expand their activities. This results in the increase of GDP (Beck et al., 2000; Levine et al, 2000; Adrian & Shin, 2009). The supply of credit is positively linked with economic growth, as recorded in the following diagram.

Figure 1. *Credit to private sector and growth.*



Source: Levine et al., 2000, p. 48

2. Literature review regarding the functions and the risks of the banking system

The existence and proper functioning of banks as parts of the financial system development has been shown to enhance the economy and that the strengthening of the banking system supports the growth rate of real GDP, as well as the GDP per capita recorded (Jayaratne and Strahan, 1996). Also, as noted by Bencivenga and Smith (1991), the functioning of the banking system ensures not only the productive activity, but also limits the socially unnecessary liquidation of assets, which enhances the efficiency of investment and enhances the formation of new capital. Also, in his analysis Gertler (1998) shows that the expansion of activities of banks has been a major cause of the

increase in economic activity and also increases the criteria of quality borrowing of banks, thereby strengthening the most competitive firms.

For all these reasons, the banks, as part of the development of the financial system is extremely important, as it put the base of economic development (Ohno, 2011), increase the productive capacity of the economy (Mishkin, 2007), create a more stable business environment and have a positive effect on innovation (King & Levine, 1993) and specialization (Romer, 1987).

According to Jude (2010), growth is connected to financial development, but this relation is nonlinear: in fact, inflation rate, openness to trade and government consumption are influencing the relationship between these two variables, since they affect both the financial development and growth, but the degree of affection is not the same for these two variables. As Amano (2013) notes, capital formation varies among countries, since the countries which have the most developed financial system have the greater opportunity for higher capital formation. As Aghion et al. (2004) note, in order to be a convergence with the growth rates of the United States, countries should increase their financial development.

On the other hand, as Deidda (2006) notes, financial development might be unsustainable, since enterprises tend to be more capital-intensive, so they will need more and more capital, which the economy might not be able to provide. Also, as Bond et al. (2011) note, the development of the financial markets could boost speculation.

A major issue has to do with the failures of the financial system and their consequences to the economy.

The issue of the operation of the banking system is a main pillar of economic activity, as banks are the establishments for transmission of the monetary policy of central bank to the economy, but also have the institutional role of safeguarding depositors / savers, as well as to transmit funds to enterprises and the overall economy. Therefore, governments should have articulated a prudential framework for banks in order to ensure their efficient operation and, above all, to maintain unwavering trust of depositors and other stakeholders about the stability of the financial system.

Apart from the above, as banking activities are now globalized and banks form an interconnected web, an extra dimension of banking supervision, relates to the overall stability of the global economy. The phenomenon of contagion has become one of the most important primary causes of the deepening of the crisis of 2007 (Allen and Gale, 2000).

After the enormous crisis of 1929, USA had established a legal framework for banks (Glass-Seagal Act), which gradually had been abandoned and eventually there was a deregulation. As a result of this deregulation, the number of Savings and Loans Banks which declared bankruptcy during the 1980s increased sharply, as shown in Table 1.

Table 2. *Savings and Loans Banks failure, 1980-1988 (in thousand USD)*

Year	Number of Failures	Total Assets	Estimated Cost	Supervisory Mergers	Voluntary Mergers
1980	11	$ 1,348,908	$ 158,193	21	63
1981	34	19,590,802	1,887,709	54	215
1982	73	22,161,187	1,499,584	184	215
1983	51	13,202,823	418,425	34	83
1984	26	5,567,036	886,518	14	31
1985	54	22,573,962	7,420,153	10	47
1986	65	17,566,995	9,130,022	5	45
1987	59	15,045,096	5,666,729	5	74
1988	190	98,082,879	46,688,466	6	25

Source: FDIC, 1997

Precisely because of this, it was necessary to ensure a satisfactory level of functioning of financial institutions. This need was reflected in the creation of the Committee for Banking Supervision. The Basel Committee on Banking Supervision (Basel Committee on Banking Supervision) was founded in 1974 with the participation of central banks of thirteen countries (Belgium, France, Germany, Italy, Luxembourg, Netherlands, Spain, Sweden, Switzerland, Japan, Canada, United Kingdom and the USA).

The financial crisis of 2007 highlighted the enormous importance of the financial system for the economies of countries (Blundell - Wignall et al., 2008). Before 2007 it was believed that a larger financial sector has positive effects on an economy, as it enhances the circulation of money, increased multiplier is created, businesses find the necessary funding at favorable terms and consumers have the option of obtaining consumer and durable goods, thereby stimulating demand and therefore production.

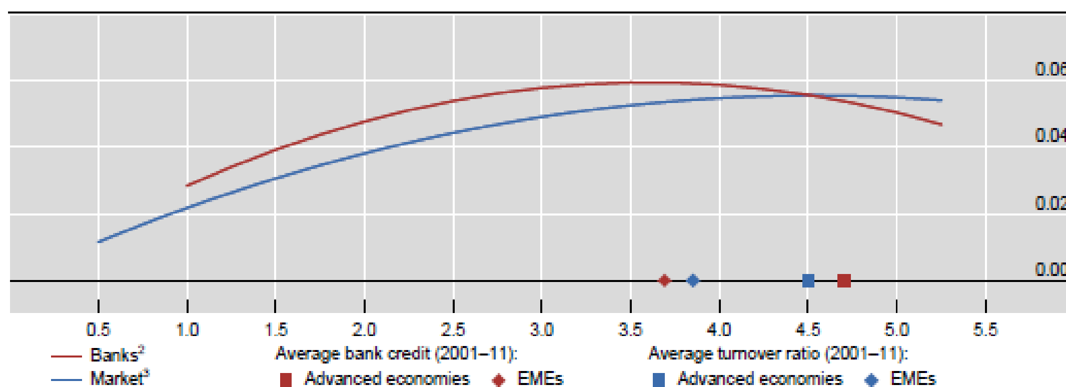
With the onset of the crisis, it was found that, to a significant extent, many of these above elements did not function as expected. The phenomenon of "bubble" on real estate has been triggered by investment firms, with the method of securitization. Also, the direction of capital to speculative markets, such as, derivatives on market indices, on currency market (forex), or in bonds of other countries with higher yields (carry-trade), «broke» the chain of transmission of monetary policy in the economy.

Apart from the above, according to the study of Cecchetti, and Kharroubi (2012), the growth of the banking function enhancers in an economy, only below a certain level. Above this level, the further expansion of the banking sector does not increase the economy of the country.

According to Gambacorta et al. (2014) the existence of banks substantially promotes economic development, but it happens to a point, beyond which the expansion of banking

reduces the growth rate. Analysts point out that, as the economies are growing, the banking sector should operate in parallel with the development of other sectors, such as investment funds, mutual funds and insurance companies.

Figure 2. *Correlation of GDP growth, banks and capital markets*



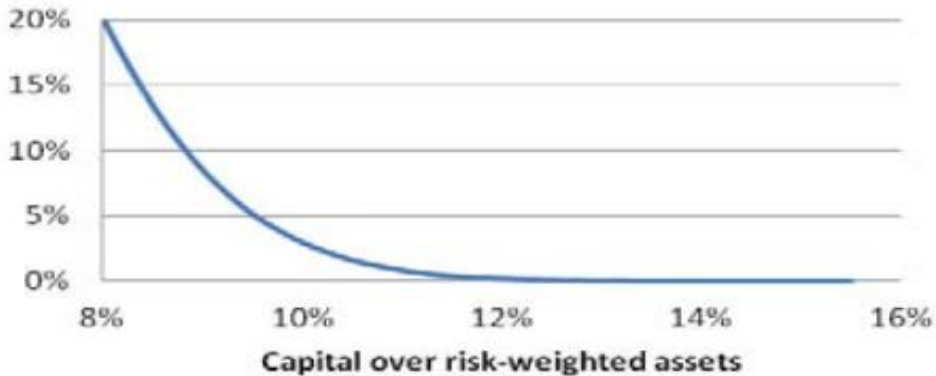
Source: Gambacorta et al., 2014, p. 30

One of the key points highlighted by the crisis is the phenomenon of contagion of the crisis, from country to country. Indeed, one of the main problems of Basel II is about the pre-cyclicality created, since there was lack of evaluation about the broader consequences that a major bank failure would cause to the whole system. Ben Bernanke, chairman of the FED, respondent from the Inquiry Commission on whether the crisis could be foreseen, it answered negatively. But when asked if measures could have been taken, he replied that indeed these measures could and should have been taken and that the FED took the worst decisions (FCIC, 2011).

The whole context of the deregulation of the banking market has been demonstrated as the primary source of the crisis (Blundell – Wignall et al., 2008). An extra dimension is that the problems of the banking sector were automatically transferred to the budgets of countries, which, in their efforts to maintain the sustainability of the banking system, they recapitalized and rescued the banks, increased the deficit and the debt, which, in turn, resulted in an increase in interest rates bonds, reducing credit rating and increased the difficulty in finding buyers of their bonds. In order to cope with the debt and deficits, some countries have taken restrictive fiscal policy measures, thus reducing overall demand, and, as a result, there were -and in some cases, still are- recession and rising unemployment. Therefore, the tighter control of banks as to the risk that they can take also has a positive effect on the economy. In their analysis regarding UK banks during 2007, Schanz et al. (2001) find when banks have a capital ratio of 8%, then there is probability of systemic crisis –defined by the authors as “the joint default of at least two

banks" (Schanz et al., 2011, p. 77)- of 20%, while with a capital ratio of 10% the probability falls to 3% and with capital ratio of 12% and higher, the probability of a systemic risk is zero percent, as shown in the next figure.

Figure 3. *Probability of systemic crisis regarding bank's capital.*



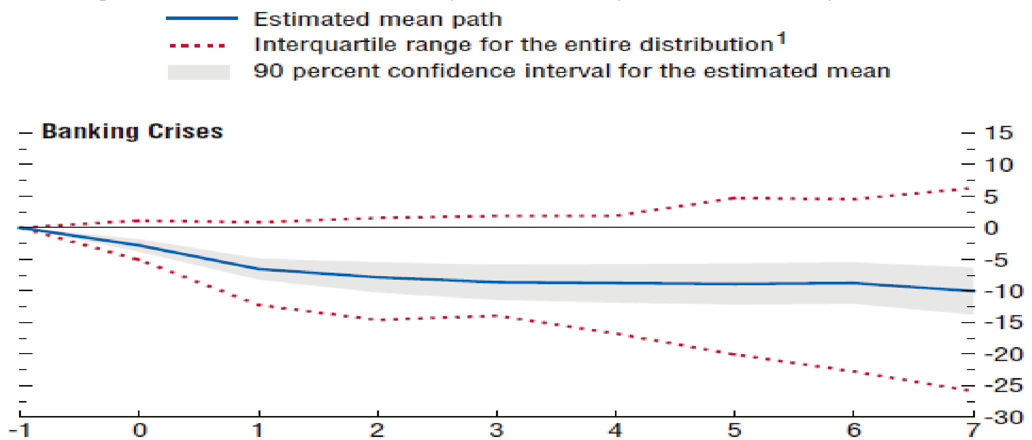
Source: Schanz et al., 2011, p. 77

As Elsinger et al. (2006) and Webber & Willison (2011) note, except the risk of a contagion of a bank's failure to other banks, the other source of the systemic risk of a bank's failure is because the asset values of the defaulted bank have positive correlation with the asset values of the other banks.

IMF (2009) notes that, even after 7 years of the begging of a banking crisis, as part of a financial system crisis, GDP is in resección

Figure 4. *Output Evolution after Banking Crisis*

(Percent of precise trend; mean difference from year t = – 1; first year of crisis at t = 0; years on x-axis)



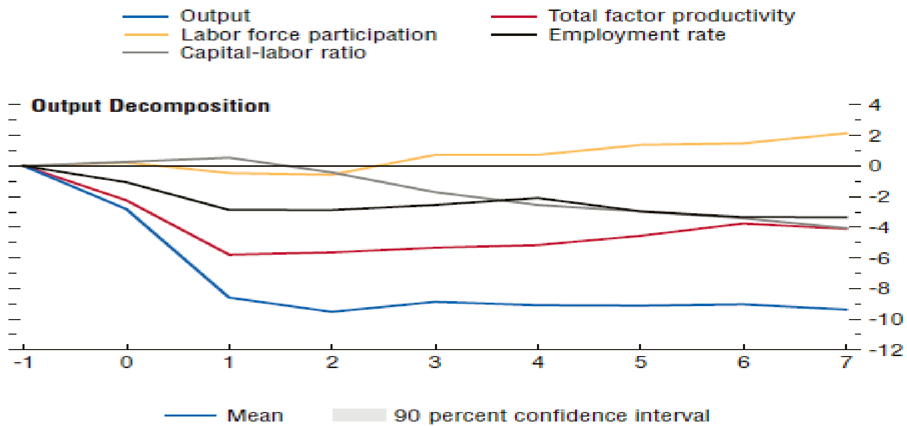
Source: IMF, 2009, p. 126

According to IMF, a crisis in the financial markets affects both the supply side and the demand side.

Regarding supply side, there is a lower output, lower total factor productivity, lower capital/labour ratio and lower employment rate, as shown in the next figure.

Figure5. *Output Decomposition*

(Percent of precise trend; mean difference from year t = – 1; first year of crisis at t = 0; years on x-axis)

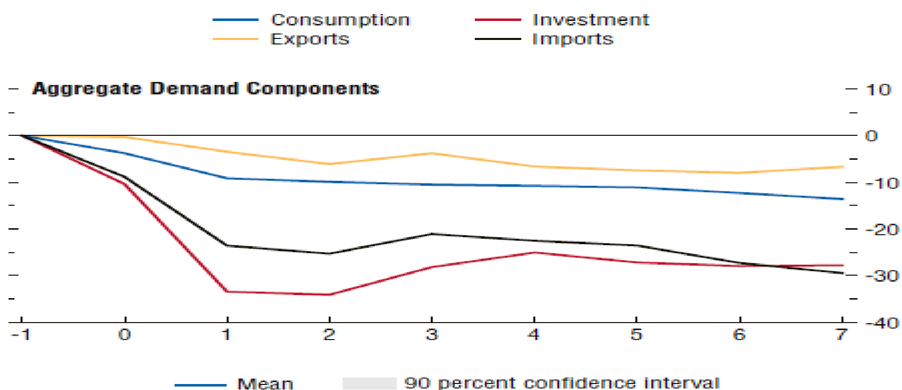


Source: IMF, 2009, p. 132

Regarding demand side, after a crisis in the financial system there is lower consumption, lower exports and imports as well as lower investments, as presented in the next diagram.

Figure6. *Demand-Side Decomposition*

(Percent of precise trend; mean difference from year t = – 1; first year of crisis at t = 0; years on x-axis)



Source: IMF, 2009, p. 133

Conclusion

From all of the above, it can be concluded that with a safer financial market there is a healthier link between the financial institutions and the real economy. Due to the interconnection of the financial markets and the economy, a financial failure can bring the economy to recession, while a stable and growing financial system can boost growth and capital formation.

In order to avoid the occurrence of a recession and a banking crisis, the major elements which have been pointed out by the international literature are:

- The level of trust, and
- The Central banks' policy

People and businesses engage in the act of saving in order to obtain revenue, however, they have as given that, at any time, can withdraw their money.

This element of faith of depositors need to be highlighted, since loss of depositor confidence is a key risk for the stability of the financial system, leading to increased risk of banking institutions.

Confidence in the broad sense - which involves confidence in the exchanges, the contractor, the functioning of markets, colleagues etc. is the necessary operating condition of any economic system. Thus, the decline in confidence may lead to a significant deterioration in overall economic activity.

Guiso et al. (2006) in their analysis are considering the influence of culture in the development of the size of the economy, defining culture as beliefs and values that ethnic, religious and social groups have, with substantially unchanged content, from generation to generation. They, also, indicate the importance that the element of trust has for economic activity, and they study whether trust varies according to nationality, registering significant differences between nationalities

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