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Analysis of Financial Performance in the Banking System in Kosovo - the Period 2006-2012

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Through this paper we analyse the performance indicators of banks in Kosovo Banking System. According to the works of different authors worldwide, more accurate measurement of bank performance based on accounting data, in the application of coefficients leading financial banks are: Return on assets - ROA, return on equity - ROE and Cost Report to revenue - C / I.

This paper describes the analysis of financial indicators for the period 2006 – 2007 – 2008 – 2009 -2010 - 2011 and 2012.

The paper is organized as follows:

- Section 2 provides literature review on the performance of banks in other countries;

- Section 3 provides an analysis of the banking sector in Kosovo and macroeconomic indicators during the period analysed;

- Section 4 presents the results of analysing the financial coefficients. While section 5 presents financial analysis and provides key conclusions.

Keywords: *ROA – Return on Assets; ROE – Return on Equity; C/I – Cost to Income; Performance; Profit.*

Introduction

In 2007 and early 2008 in Kosovo, could be considered further stage of sector consolidation characterized by entry and fusion of commercial banks, thus contributing further to the dynamism of competition in this sector (Luboteni 2013). In the Republic of Kosovo commercial banks have undergone major changes since 2000, so that by the time of their establishment. These changes are a result of the entry of foreign banks, changes in the regulatory environment, technological change, but also from increased competition. As a result of the submission of the last financial crisis in 2008, and as a result of changes in the banking system, commercial banks are faced with increased operating costs, which may have affected banks' credit quality and performance the banking sector in Kosovo.

Stability and liquidity of a bank among others depends largely on credit, and then credit should actually be true, on the basis of sound that could maintain stability and liquidity of their entire banking system. Another feature of the overall financial sector in Kosovo is that it continues to be dominated by the banking sector, with a share of 70-75% percent of total financial system assets (RSF 2010-CBK).

Literature Review

In this part (section) is presented and evaluated previous literature used in the performance of commercial banks in different countries which are taken as a basis for analysing the performance of commercial banks in the Republic of Kosovo. With the introduction of the global financial crisis of 2008 and the bankruptcy of many popular global financial institutions (e.g. Bank of America, Bear Stearns, Merill Lynch, Citigroup, Lehman Brodhers, etc.), research by professors, industry analysts, researchers’ independent investigations in connection with the performance of banks, are added to a large extent.

Measuring the performance of banks in general and commercial banks in particular has been the subject of much research recent years, many famous authors. A large number of these surveys are empirical research on the performance of commercial banks around the world (Quey-Jen Yeh 1996; David Gregorian 2002; Muhittin Oral and Reha Yolalan 1990, John P. Bonin 2005; Ash Demirguç-Kunt 1999;). As part of the CAMEL (capital adequacy C, A Riches, M-management ability, E-Earnings, Liquidity, S-sensitivity) coefficients apply bank regulators to assess the financial performance of banks. Empirical evidence concerning the application of financial coefficients to evaluate the performance of banks, these authors included research (Beaver 1966), (Altman 1968), (Maishanu 2004) and (Mous 2005).

Based on the literature review of these authors can conclude that in general there are two general approaches to measuring the performance of banks. The first approach is based on accounting data, is the main financial coefficients applying to banks while the second approach is based on econometric techniques. Authors (Salkhan and Gulf 2004) investigated the performance of seven commercial banks of Denmark during the period 1994-2001.

Financial coefficients are applied to evaluate the quality of loans, profit-flow and liquidity. The authors applied the student t-test to measure the weight (significance) these statistical measures of performance. Results showed that the tested commercial banks are relatively less profitable, more liquid and are exposed to credit risk in the banking industry compared with Denmark.

The banking sector in the Republic of Kosovo

In recent years, growth in international financial markets has given banks the opportunity to design new products and offer wide range of services, but on the other hand there is an increased risk associated. If until now, the greatest danger was the risk that a bank customer or any other party could fail to settle the obligation for full value, known as credit risk, nowadays banking environment has changed and market has become more complex. It appeared the need to manage exposure to risks and other operational and financial.

Kosovo banking sector consists of commercial banks activity. During the analysed period, the number of banks has increased gradually. In 2006 the total number of commercial banks was 6, while in 2013 the number of banks has reached 9, which are: ProCredit Bank (former MEB - Micro Enterprise Bank), Raiffeisen Bank (former American Bank of Kosovo), Bank for Business (former Private Bank for Business), Nova Ljublanska (NLB), Pristina (established with the acquisition of two banks earlier Kasa Bank and

New Bank of Kosovo (BPK)), Bank of Commerce, National Commercial Bank Kosovo Branch (NCB), Turk Ekonomi Bankasi (TEB), and a branch Ishbank Komercijalna Banka AD Belgrade that exerts its activity in Mitrovica (northern) and Gracanica. Seven of these banks have their branches spread in an organized network of subsidiaries across Kosovo. Should be noted that only two banks in Kosovo are local capital (Bank for Business and Economic Bank), while other banks are foreign-owned banks. It appears as a new trend in the Kosovo market.

Depending on the numerous services that offer commercial banks in Kosovo, lending will remain their main activity, as should consider the fact that the demand for money in a country in transition is significantly larger than the money supply, so the importance of credit remains large. As the main sources of financing banking sector deposits and borrowings are local, this represents about 70-80% of all liabilities. This represents a great advantage for the banking sector, since they are not directly related to the international financial markets, and this has contributed to reducing the impact of global financial crisis.

Variables analysed

Analysis of the leading coefficients of profit-flow (performance)

Based in numerous works of different authors, we come to it that one of the best measures to measure the performance of commercial banks profitability analysis. Leading coefficients for measuring the performance of profitability (profit-flow) are: Return on Assets (ROA - Return on Assets) - net profit / total assets. Regarding banking perspective this ratio indicates management's ability to attract deposits at a reasonable cost and their investment in for-profit form. This ratio shows how much net profit is generated for every € 1 of real bank. The higher the ROA, the bank is profitable. This ratio indicates how well the bank's assets are managed in order to maximize returns. Return on equity (ROE - Return on Equity) - net profit / total equity. Regarding the banking perspective, this ratio is the best indicator of profit-flow and potential for growth. Represents the rate of return to shareholders of the bank, is the percentage of profit for every € 1 invested in the bank by shareholders.

The ratio of costs to income (C / I - Cost to Income) - Total cost / total revenues. Regarding the banking perspective, this ratio shows how much the bank is costly to produce a unit of output (revenue, profit). As low coefficient C / I, the high performance of the bank.

Results of analysis

Analysis of ROA, ROE and C/I

The main coefficients of profit-flow obtained from published financial statements in web pages each commercial bank in Kosovo, and are calculated as a percentage. The values of the coefficients are not manipulated value because every financial statement of banks which are published in advance is audited by audit companies, and the risk of manipulation can be considered 0%. Regarding the concept of risk and return are quite present in the banking industry. According to studies done by audit companies, lending to higher margin, high-risk customers, can increase profits (in the short term), but it increases the risk of bank creditors and potential future losses.

Table 3 presents the coefficients that make the profit-flow measurement in the banking sector in the period 2006-2012. Coefficients are: ROA, ROE and Cost to Income (C/I).

Table 3: Flow trend of profit in the period 2006-2012 (%)

Years	2006	2007	2008	2009	2010	2011	2012
Average ROA	-1.1	3.4	2.3	1.4	1.7	1.6	1
Average ROE	-25.3	25.4	20.1	13.1	18.6	17.3	9.6
Average C/I	106.9	74.4	78.5	86.2	88.6	90	96.2

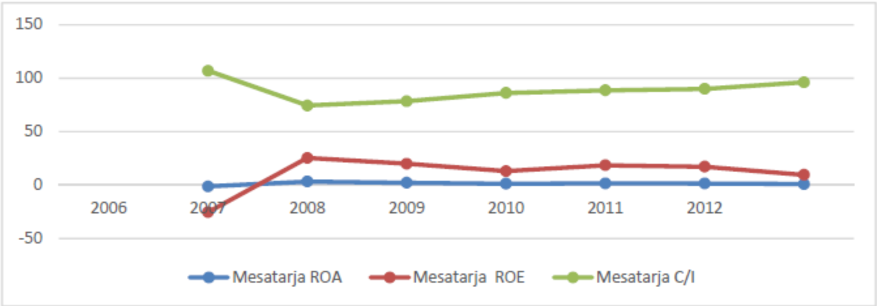

Figure 3: Trend-flow profit in the period 2006-2012

Figure 3 shows an increase in the trend of profit-flow from 2006 to 2007. ROA increased from - 1.1% to 3.3%, while during 2008-2012 continued to fall at a slower trend, reaching 1.0% in 2012. ROE increased from -25.4% to 25.5%, while during 2008-2012 continued to fall at a slower trend reaching 9.7% in 2012. The main reason for profit-flow growth during the period 2006-2007 as a result of the increase in total assets of the banking sector, mainly on the account of loans given to customers.

Analyses 2006-2012

Direct reflection of the profit made by commercial banks as a result of the reduction in the lending activity of the banking sector during the period 2008-2009. Year 2006 recorded a decrease sufficiently large ROA coefficient, see figure 4. Compared to 2006, that rate increase has been only in 2007, while all other years following record net profit dips in the banking sector. Reducing the profit of the banking sector represents negative implications for the level of efficiency in this sector. In this context, the average return on assets (ROA) of the banking sector for the years 2009, 20010, 2011 and 2012 was reduced significantly which could be interpreted as lower efficiency of the banking system during this period to realize a profit from the use of assets available.

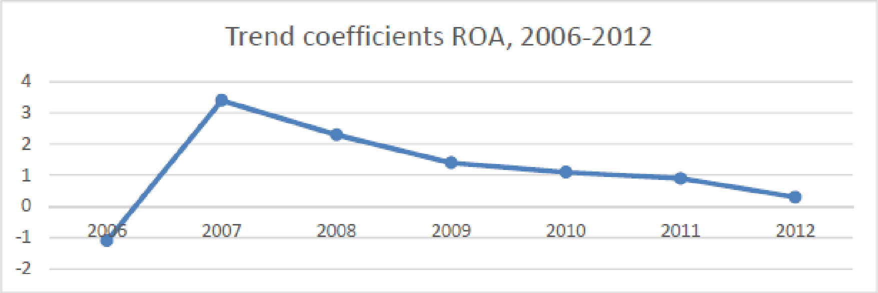

Figure 4: Coefficients trends of ROA

The profit decline was mainly due to lower growth in income levels of commercial banks. As a result of decreased profitability profit reduction appears at Figure 5, the banking sector that is expressed through the ROE indicator for 2009 was reduced significantly compared to previous years, except for the Business Bank, which has seen a decline apparent that rate in 2006. The main contributor to the profit decline was slowing the flow of interest income.

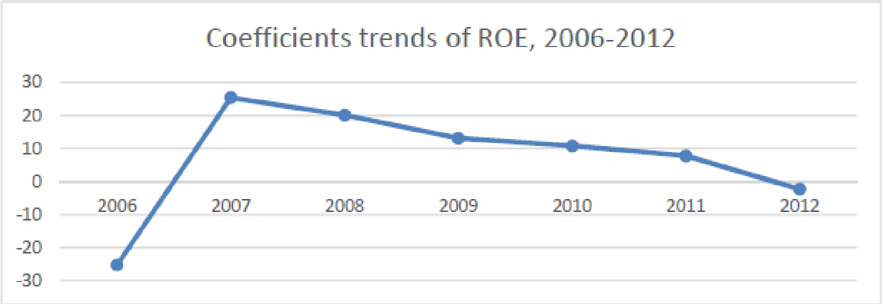

Figure 5: Coefficients trends of ROE

Increased spending quickly compared to total revenues of the banking system led to a decrease of net profit. This can be explained by the trend of costs to income (C / I) presented in Figure 6.
Here there is an obvious decline trend of this ratio in 2007 compared to 2006, while the constant increase observed from 2008 to 2012. This ratio was 74% in 2008 and is up over 90% in 2012.

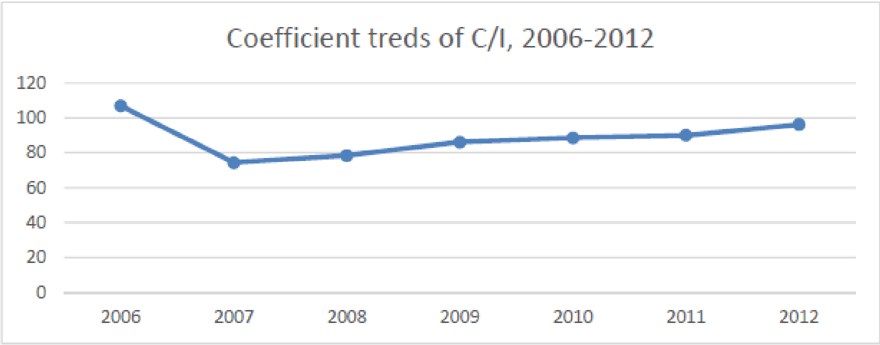

Figure 6: Coefficient trends of C/I

Banking system in 2012 reported profit of 10.2 million euros, which is 31.2 percent lower compared to 2011. While faster growth in spending compared with total revenues of the banking system led to a decrease of net profit. See the trend C / I in Figure 6. The decrease of net profit in 2012 was reflected in the deterioration of the profitability indicators of the banking system (ROA, ROE, C / I). In 2012, ROA declined, dropping to 1.0 percent from 1.7 percent in 2011.
With the decline was characterized ROE rate, which dropped to 9.7 percent compared with 17.4 percent in 2011. The more rapid growth of expenditures compared to revenues in the banking system in the country has also contributed to the deterioration of efficiency indicators for the banking system. The cost and revenue rose 96% in 2012 from 90% in 2011.

Conclusion and discussion

The main purpose of this paper was:

Analysis of financial performance in the Banking System in Kosovo, including the 2006, 2007, 2008, 2009, 2010, 2011 and 2012.

So, in this paper is realized measuring the quality of financial indicators to profit-flow and profitability of the banking sector commercial banks in Kosovo during the period 2006-2012, and is statistically tested, the level of influence of one financial indicator in changing other indicators. Results showed that in general, profit-flow, liquidity and profitability have been

ongoing improvement from 2006 to 2008 and from 2008 began to deteriorate.
According to the financial analysis that was done for the period 2006-2012, we can conclude that there was no difference statistically significant overall performance of banks, including the measurement of determinants that are taken into account. Such a result may be caused by the fact that Kosovo faced with the global financial crisis has had good position macro-fiscal, allowing less sensitive effects.
We can conclude that the banking sector has remained stable despite the appearance of disorder and crisis in the global financial markets during 2008-2009, although seen by financial analysis of indicators of the banking sector, the trend of profit-flow is going we drop. Regarding capital adequacy and liquidity acceptable level, banks have continued to meet all regulatory requirements.

To give a final conclusion regarding the performance of banks in Kosovo, by placing them in comparison with CAMELS ranking, we can conclude that:

C - Capitalization (capital adequacy) - Banks in Kosovo is a high level of what the second rule requires Basel - (ranking is in the first category);
A - Assets (property) - according to financial indicators and financial statements, shows that most banks have a healthy balance sheet with a low level of reserves for loans , low delay gives a high ranking in this indicator (the second);
M - Capacity Management - information taken in this paper is observed that banks, especially local ones, lack of management controls which will ensure the right information and a possible deviation from fraud, evasion of procedures and policies bank. While some of these deviations are evident, then rank 3 corresponding to this level;
E - Earnings - earnings points indicates a high level, which in most cases exceeds projections and at this point most of the banks assessed the level of ranking first;
L - Liquidity - in most banks in Kosovo, especially foreign ones estimated at very high level (in they have excess liquidity) , the management of the bank has also developed products that will provide them with risk reduction interest and financing.

Based on the results of individual ranking points CAMEL, we see that the level of banks in Kosovo is the second ranking that represents fairly stable safe sectors which require adjustment in certain spots. Also, the high level of capitalization represents an important indicator of bank performance and stability.

At the most basic level, performance measurement can help banks improve performance management; identify best practices and worst low efficiency and high.

Finally the results showed that the tested commercial banks are relatively few for-profit (not a significant difference) in comparison with previous years, and are more exposed to credit risk which is considered as the biggest risk of the banking system in Kosovo.

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