

## ADVERSE EFFECTS OF BANKING COMPETITION IN ALBANIA

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### Abstract

Albanian banking system is relatively new and banks operate in a relatively new and small market economy with many country-specific features. Given these characteristics, and the fact that the new market in Albania with unconsolidated businesses and relatively big number of banks, with lots of cheap funds to lend, there has been room for a stiff and rather unfair competition among banks for market share, thus causing a low-quality loan portfolio and liquidity problems in the market. In the frame of too much cash, flowing in the country from sources other than banks, like FDIs, remittances, donations, etc., have conditioned banks in investing in risky projects, while the economic infrastructure is not yet consolidated and prepared to employ such considerable funds in a healthier effective way. Besides the global and Albanian financial crises, the Albanian economy it also suffering from mistakes on lending, especially during the first wave of banking activity expansion. Notwithstanding positive effects of banking competition during this phase, banks have adopted and seek for very high targets on lending, by funding risky projects which failed to produce success. When twinning this fact with the actual global and local financial crises, the situation is affecting the stability of the banking system in Albania.

The paper analyses the loan-making approach & practices of commercial banks in Albania, during the last decade, and provides some recommendations on improving lending practices, procedures, portfolio diversification and aggregating risk within tolerable and manageable limits, which all together aim preserving the stability of the banking system in Albania.

Keywords:

Credit portfolio, bank competition, NPL – Non performing loans, market structure,

### Introduction

Albanian banking system it is relatively new as the market economy is new. Many tries and initiatives to perform in this relatively new market undertaken by some very special actors like financial institution, government and other private businesses some times are considered not quite adequate. The long transition phase of the economy has affected the banking system by experiencing the so-called adverse effect of bank competition into the market.

Trying to find the correlation between the theoretical studies and the recent empirical researches, it become easier to understand that, there are contradictions between them. Stijn Claessens and Luc Leaven confirm that "competitiveness measure negatively relates to banking system concentration"<sup>1</sup>

The concentration of the market by few banks indicates the failure of the Bank competition and his role to prevent this kind of phenomena. This creates the miscarriage of the system, affecting negatively the normal operating of the Banks.

In the theoretical literature it is best analyzed the relationship between the competition and the banking system performance and stability.

Analyzing the historical data of the Albanian banking system in the scope of the actual and most recent research, we are trying to draw the right conclusion on the real adverse effect of the bank competition based on the country's specific conditions.

The recent development on the financial global market tend to be globalize like other business and despite the positive effect on that, this trend has pressed on opening too many foreign banks to open their branches and filial to Albania. As e result, out of 16 operating commercial banks, 98% of their total capital is coming

from abroad (100% foreign capital or less). Few of these banks start operating by 1996, and what is more significant all these banks started to be very aggressive in lending particularly by year 2004 and forward up to year 2008, before the blast of the global financial crises.

### Some evidence of the factors indicating to an adverse effect of bank competition in albania

Bank Competition in Albania despite the positive effect for creating a standard and fair market development has brought also some adverse effect and this is very much related to the banking sector.

"The banks and the banking system have a special status, mainly because they are regarded as most vulnerable to instability as other firms or sectors."<sup>2</sup>

Albanian local specific factors in connection with global factors are both indicating in the failure of the Bank Competition and its role in preventing the adverse effect in the market.

Many banks operating in a very small informal market, trying to get as quick as possible the access to a limited number of private businesses, which could reach the minimum requirement for the lending practices. This is typical for the bank competition in Albania especially during the first wave of the banking activity expansion.

Too much cheap funds need to be lent, in order to make profit out of cost deposit from the banks. While the economy was over funded enough from other sources coming from remittances, donations, which altogether were far beyond the capacity of the market to absorb in the most efficient way. In this situation many banks which already had cheaper funds, especially of the foreign capital, put high targets on lending by competing with low interest rate, and parallel neglecting the basic principal in the lending practices.

<sup>1</sup> Stijn Claessens and Luc Leaven "What drives Bank Competition, some international evidence" World bank Policy, working paper 3113, August 2003, pg8.

<sup>2</sup> Elena Carletti and Filip Hartmann " What special about Banking" European Central Bank, working paper no 146, pg 8, May 2002

This period of time coincides with the blooming phase of the Albanian market, where a lot of cheap foreign funds flow in. Banks with 100% western foreign capital experienced a strong advantage towards the other foreign and local banks at start.

All these mentioned above resulted in a poor credit portfolio and an increasing trend of NPL, mainly took place during years 2004-2008. As can easily noticed in the Tabs 1 and the Graphs 1 below, in this very short period of time, too much cheap funds were flowing to Albania from many sources like, remittances, FDI, lit is accompanied with an sharp increase of credit portfolio and NPL.

By the other side Albania as most countries in the region experienced a consistent trend of assets/collateral reevaluation, which influenced in additional appetite for the banks for gaining more market share, in a way of a severe or unfair competition, with the excuse that the value of collateral is the safety of repaying back even the low quality loan. In these circumstances Banks were careless about lending quality and didn't pay enough attention to the portfolio quality.

Other than the above mentioned factors, private businesses in Albanian were still unprepared to employ/absorb such huge funds in the good and long term profitable projects. Albanian businesses were typically focused on civil construction and imports of goods rather than industrial production and exports, so the market was not diversified.

As stressed, in the NPL trend in the banking sector in Albania causes, challenges and recommendations, as co author with Dr. Meka E "When it comes to commercial banks approach factors it should be noted that, the lending trend before financial crises, was perceived by strong competition between commercial banks, which brought poor portfolio quality, caused primarily by: - Financing risky projects, Financing underperforming entrepreneurs, Concentration of lending in construction and real estate sector.<sup>3</sup>

Before this period, especially before year 2003, Banks were mostly sleepy; their contribution to the economy was significantly low compare to other sources (FDI and Remittances). From the other side the figures of the market prosperity, like DGP were not justifying all the funds available.

Too many banks, with lots of cheap funds, operating into a relatively small market with limited number of businesses which were overloaded on loan exposure, it is the conclusion that we might consider at this stage. Again the no. of banks competing in the small market influenced on producing a low quality portfolio and soon in liquidity problems.

No of banks and branches in a country should be related to its productivity and concentration of banks.<sup>4</sup>

As you can easily notice in the table 2 and the Table 3 and chart 3 below, despite the fact that most of the banks has been already in the market earlier than 2000, they become very active in lending only after 2004 to 2008, by competing each other on intensified lending. Table 2, shows clearly the concentration of the banks in the market.

Based on the research that Christos Staikouras & Geoffrey Wood, on, "Competition and Stability in Euro Area, case of Greece and Spain, we can easily make comparison with the Albanian market structure. Greece, as closest neighbor to Albania, has lower no of branches, lower productivity and higher concentration compare to Spain, which has bigger no of branches, higher productivity and less concentration but also higher technology investments. While in Albania compare to those countries, there is a high concentration where the 5 banks have 75%, out of total no of banks only two, RZB and BKT have 47% of total assets, which is similarly to Greece with 83% versus Spain with 52%. No of branches in Albania is still under both these two countries with 0,17 branches per 1000 inhabitant, versus Greece with 0,24, and Spain with 0,97.

The structure of banking system in Albania it is similar to Greece, which experienced the most severe liquidity problems recently, still particularities of one country to another make difficult to draw conclusion about best market structure.

#### Conclusion

The regulation and procedures of lending in the Albanian banking system is far from being adequate and modern as it is in the western countries. While banks in the Euro zone are in the phase of implementing Basel III, in Albania we are still applying the Basel I, hence there is lot to say and the implementation of modern banking procedures is it something not only related to the banking system in itself but also to the level of the market standard applied.

The market structure, the concentration of commercial banks it is related to particularities of one country to another, and this make difficult to draw conclusion on the best market structure application.

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<sup>3</sup> Nazaj S. and Meka E on "The Trend Of Non-Performing Loans In Albania's Banking Sector - Causes - Challenges & Recommendations" November 12,

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<sup>4</sup> Christos Staikouras & Geoffrey Wood, the City University of Business School, "Competition and Stability in Euro Area, case of Greece and Spain.

Chart 1 Trend of total total inflowing funds towards the NPL trends during 2000 to Q1 2012 (ALL million)

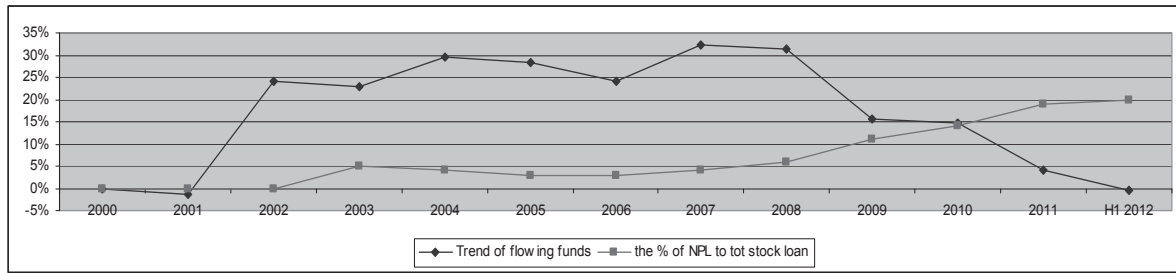


Table 2. List of the commercial Banks In Albania to their market share on total assets, as per Spetember 2012,

No.	BANKS NAME	Total Assets	in %	Total Loan	loan to asset
		In LEK	to total	in LEK	in %
1	Raiffeisen Bank – Albania	323,136,334	28%	134,136,033	42%
2	Banka Kombëtare Tregtare	227,102,744	19%	86,500,584	38%
3	Intesa Sanpaolo Bank – Albania	138,020,830	12%	50,097,011	36%
4	Tirana Bank	94,406,469	8%	56,515,232	60%
5	Credins Bank	92,605,448	8%	62,548,919	68%
6	Alpha Bank – Albania	73,379,976	6%	38,523,319	52%
7	Societe General Albania	60,604,226	5%	32,076,576	53%
8	National Bank of Greece Al	42,329,454	4%	27,523,373	65%
9	ProCredit Bank	41,161,734	4%	23,211,152	56%
10	Emporiki Bank – Albania	32,069,397	3%	23,883,626	74%
11	Veneto Banka	15,960,575	1%	11,485,324	72%
12	First Investment Bank – Albania	9,833,120	1%	5,049,551	51%
13	International Commercial Bank	8,620,359	1%	2,503,949	29%
14	United Bank of Albania	6,432,135	1%	1,741,423	27%
15	Credit Bank of Albania	1,808,965	0%	26,876	1%
16	Union Bank	n.a	0%	15,877,000	
<b>TOTAL</b>		<b>1,167,471,766</b>		<b>571,911,000,000</b>	

Table 3 and the Chart 3, about the no of banks in total and according to their lending activity, before and during the installment phase in the market and during the blooming phase.

years	2000-2002	2003-2005	2006-2009
No of Banks	11	13	16
no of Banks lending	9	10	16
No agresive lender	6	8	16
Portf in billion	3	3	31
NPI in billion	-	0	2

