MANAGING THE ETHICAL ISSUES AFFECTING LENDING PRODUCTS PERFORMANCE IN ALBANIAN BANKING SYSTEM

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Abstract-The recent Albanian banking system profitability fluctuations in a fragile economy slowdown context are actually oriented toward lending in real economy and money-market activities when from the other side non-performing loans trend is increased while deposits and basic interest rates have demonstrated the contrary. Hence, the weighted regression linear analysis toward return on equity ratio with other quarterly explanatory variables such as: Deposits/Assets, Loans/Assets, Placements/Assets, GDP growth and interest rates (pertaining to 16 second level banks for the time period Q3/2007-Q4/2010) is used to identify the determinants of non-performing loans in the market in question. The analysis results points out ethical issues in lending products affecting the quality of most crucial activity for the banks survival own selves, borrowing customers welfare and their social responsibility by revealing new standards in their credit risk management and future strategic goals.

I. INTRODUCTION

The slowdown of Albanian economy (see Fig.1) followed also from banking system performance during the last four years represented subsequently from non–performing loans to respective assets ratio significant growth (see Fig.2) are clearly translated in fear signals regarding its development.
The latest, being mainly a commercial system acts accordingly to borrowing and lending market conditions and simultaneously is highly exposed to economic changes of the market in question that's the reason why it flexibly respond to them in confront to any other sector.

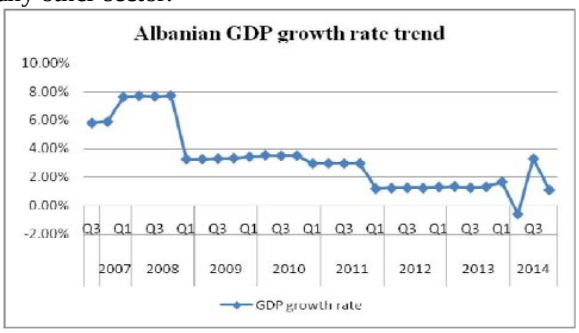


Fig.1-Albanian GDP growth rate trend
Source: World Bank data

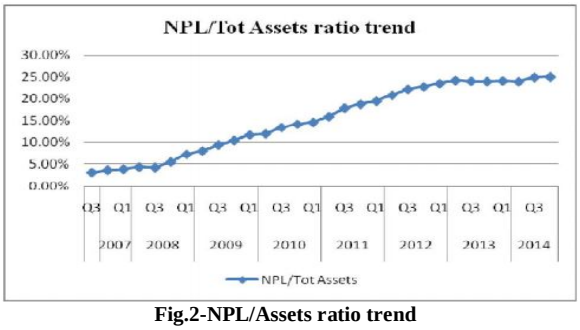


Fig.2-NPL/Assets ratio trend
Source: Albanian Banking Association data

But the matter is as through the past years and moreover current system's more consistent profits are generated from lending activity (refer to Fig.3) when bank themselves haven't maintained the same profit levels in confront of the previous periods and above all they have been restructured in terms of lending personnel (concretely the number of business branches is reduced).

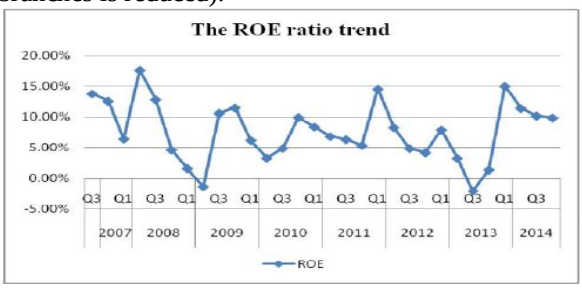


Fig.3-The ROE ratio trend
Source: World Bank data

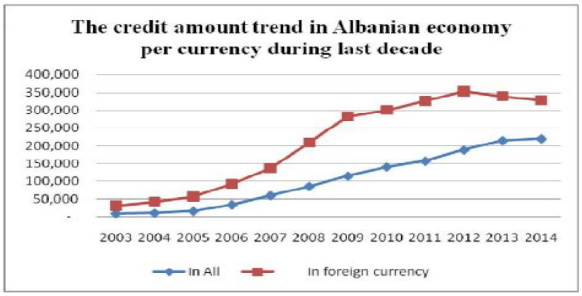


Fig.4- The credit amount trend in Albanian economy per currency during last decade
Source: Albanian Banking Association data

Under this point of view, seems that they simultaneously tried to solve respective loan inefficiency problems by avoiding as much as possible their severe impact on country's economy according to Kwan and Eisenbeis (1996), Hughes and

Moon (2000) and Resti (1995). And obviously this leaded to a more conservative approach (see Fig.4&5) which decreased lending activity mainly in domestic currency independently from the tenor (short-medium-long term loans) by acting in controversy of basic interest rate reduction as a consequence of an expansive monetary policy (see Fig.6) by generating turbulences regarding the forecasted macroeconomic scenarios. Therefore the main target activity in the system for the time being is loans collection even through the help of bailiff offices.

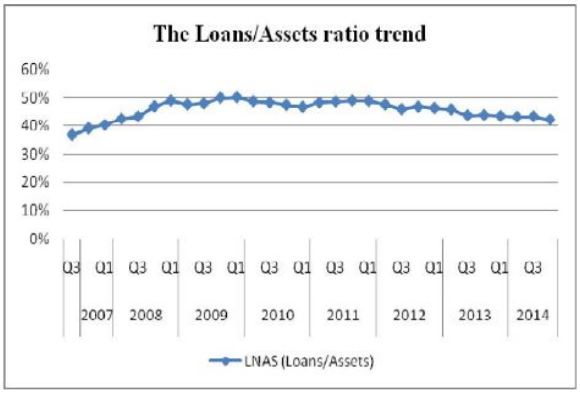


Fig.5-The Loans/Assets ratio trend
Source: Albanian Banking Association data

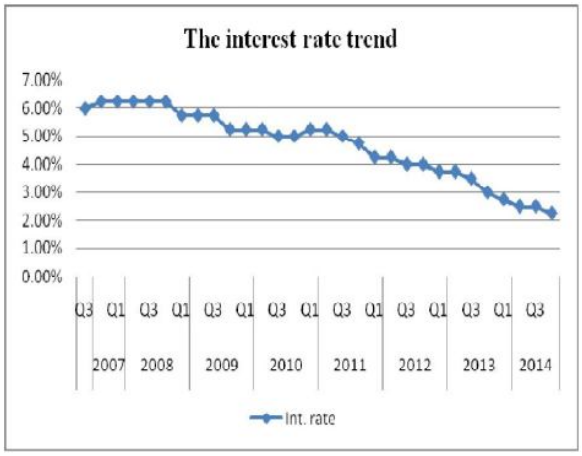


Fig.6-The interest rate trend
Source: Bank of Albania data

Meanwhile is observed that Deposits to Assets ratio (DPA) has maintained a constant trend in contradiction with Loans to Assets ratio (see Fig.7). The vice-versa occurred in 2009 when Loans to Assets ratio reached it maximal value on behalf of the exploitation of loans products. And this important element frequently explored in literature regarding NPL is named "the unnecessary lending" of commercial banks by referring to Salas and Saurina (2002), Jimenez and Saurina (2005), Keeton and Morris (1987), and Keeton (1999) argumentations. But it also refers to other internal local banking factors affecting NPL/Assets ratio particularly in developing economies like the Albanian one. And empirically there is evidenced an inverse relationship between non-performing loans and normal lending activity growth and the results are compliant to this in our case (see Fig.8) and maybe this stands for an alternative increase of money-market investments in the sector.

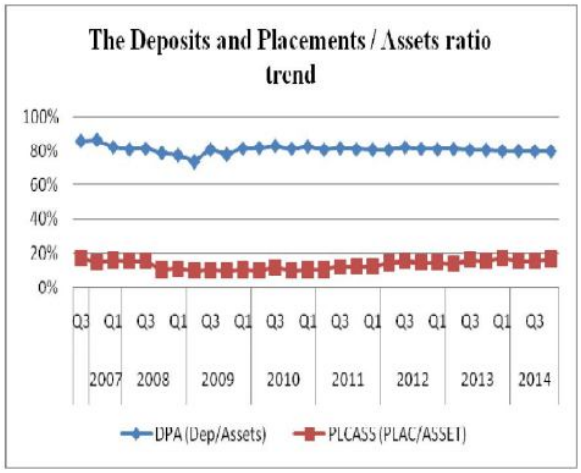


Fig.7-The Deposits & Placements/Assets ratio trend
Source: Albanian Banking Association data

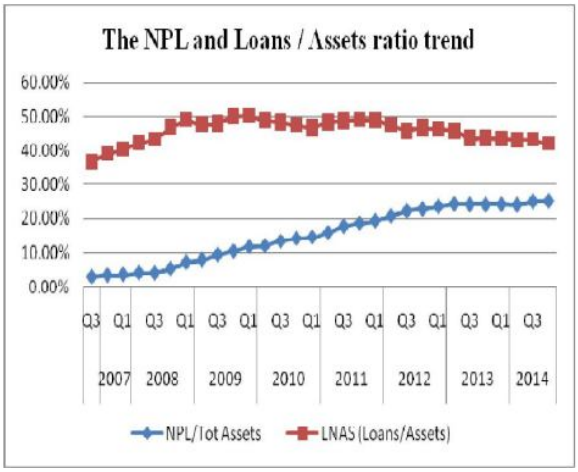


Fig.8-The NPL and Loans/Assets ratio trend
Source: Albanian Banking Association data

Therefore becomes more than interesting to understand which factors affect NPL ratio growth in Albanian market. Different empirical works, such as of: Beck T., Demirguc-Kunt, A., and Levine, R.,(2005), Stiglitz., J and Edlin A., (1995), Gourinchas, V., and Landerretche, O., Valdes, R., (2001) have concluded that macroeconomic and endogenous factors impact non-performing loans by establishing the bank failure limit to a NPL/Assets ratio at 75%. While, Kassim (2002) highlighted as the major causes of NPLs : inefficient management, poor credit banking policy, poor credit risk analysis and monitoring, focus on profit rather than quality of loan, fraud, economic decline, un-ethical competition, inconsistent policies and regulation, unstable real sector, undue influences (social and political) etc. In fact, Minsky (1992) named this phenomenon "euphoria" by evidencing the over-investments and over-lending problems as a major cause of financial crises. From the other side, Corsetti et al. (2012) posed the role of implicit and explicit bail out guarantee and moral hazard problem in sales

managers which has caused banks excessive risk accompanied from insufficient monetary capacity, asymmetric information and deposit insurance schemes as the main causes of over lending problem. That's why Schall and Halley (1980) opted out for the risk management which is the basis of lending and represents a challenging task for the general banks management. They also highlighted capacity, collateral, capital condition and banking character as key indicator for loan analysis improvement process by evidencing that the a/m factors may vary.

II. DATA COLLECTION METHODOLOGY

The present research analyzes the quantitative data collected from Albanian banking sector (pertaining to 16 second level banks on behalf of respective monthly report in Albanian Association of Banks).
Namely, the above mentioned data analyzed are: NPL/Assets, Deposits/Assets, Placements/Assets and ROE ratios as well as country's GDP growth and basic interest rates. Precisely, the dataset used refers to quarterly data pertaining to the time period Q3/2007-Q4/2014 which are analyzed with the support of weighted linear regression model toward ROE (in correspondence of the highest explanatory variables standard deviation) at 95% confidence level by using SPSS-16 version aiming to identify the determinants factors on non-performing loans trend in the a/m banking sector.

III. THE DETERMINANTS FACTORS OF NON-PERFORMING LOANS TREND

As previously mentioned the linear analysis of NPL determinants in Albanian banking sector is weighted according to ROE which is the most fluctuant explanatory variable referring to the time period taken into consideration. The analysis results are satisfactory in terms of R square determinant coefficient, because the latest confirms that the 96.9% of NPL/Assets variability (refer to Tab.1) can be explained from the a/m explanatory variables. Additional positive results in terms of overall model significance displays also the ANOVA table data (refer to Tab.2) as Fisher's statistic (138.42) is higher than its critical value 3,808 (6,30) by leading to the understanding of NPL determinants in Albanian banking sector.

Model Summary

Multiple R	.984
R Square	.969
Adjusted R Square	.962
Std. Error of the Estimate	.005
Log-likelihood Function Value	76.640

Tab.1-Weighted Linear Regression summary
Source: Author's elaboration through SPSS.

ANOVA

	Sum of Squares	df	Mean Square	F	Sig.
Regression	.015	5	.003	138.423	.000
Residual	.000	22	.000		
Total	.015	27			

Tab.2-ANOVA Table
Source: Author's elaboration through SPSS.

IV. CONCLUSIVE REMARKS

Despite, this study has several limitations related to research data sample, country banking characteristics, etc it should be highlighted the importance of the above mentioned analysis results on determining the factors affecting non-performing loans trend in Albanian banking sector. Namely, the factors that statistically affect non-performing loans trend at 95% confidence level result (see Tab.3) to be: deposits/assets, loans/assets and placements/assets ratios as well as interest rate (which even demonstrates the highest statistical impact than the other explanatory variables taken into consideration) cannot affect the non-performing loans trend in foreign currency.

Coefficients

	Unstandardized Coefficients		Standardized Coefficients			
	B	Std. Error	Beta	Std. Error	t	Sig.
(Constant)	-.767	.305			-2.515	.020
DPA	.725	.268	.187	.069	2.705	.013
LNAS	1.087	.232	.499	.107	4.684	.000
PLCASS	.625	.283	.194	.088	2.211	.038
GDP	-.153	.349	-.046	.106	-.438	.666
INT	-5.285	.696	-.877	.115	-7.592	.000

Tab.3-Weighted Linear Regression coefficients table
Source: Author's elaboration through SPSS.

While the second highest statistical impact on non-performing loans trend represents the loans/assets ratio. In other words, all this means that Albanian economy GDP slowdown trend isn't a crucial factor in non-performing loans trend in the market in question. And deeply the issue seems to be an unethical approach on behalf of banking sales managers risk moral issues or just their negative choices which as a consequence, doesn't implies only obstacles for loan repayment and credit deterioration but also increase the credit provisioning in both standards (NUS and IFRS) by transmitting troubles in the banking profitability, capital adequacy and ultimately threaten the entire lending process. Subsequently, under these circumstances the a/m system should resize its lending process under an alternative approach, the ethical one, in parallel

accordance with customer care, lending evolution prospective and future strategic goals by implementing the advanced measurement approaches on behalf of risk profile nature but in compliance within respective Head-Offices guidelines which from the other side must be frequently validated under the strong surveillance of Central Bank of Albania Supervision department.

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