Risk and Competition - the Largest Virtues of the Financial-Banking Market

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Abstract: The purpose of this research is to bring into attention a problem that affects not only the banks, the economy, but also the people, as the risk and competition of the financial-banking market are one of the most important challenges. As for the approach used to put into light the research evidence there were used observation, analyzing data and case-study. Thus, we tried to make a revue of the international aspects of the topic - resulted from the prior literature, together with a picture of the Romanian study-case, making a balance between theoretical concepts and practical activity in this area. The results of this paper could be useful both for groups of: academics, students, administrators and bank-stuff, and as for the common clients of the bank system.

Keywords: banks efficiency; costs; financial stability; clients

JEL Classification: D40; G21; 055; G390; G18

Motto: The bank is the place that lends you money, if you prove that you do not need it

Bob Hope

1. Introduction

Risk is a fundamental factor in business because you can not get profit without risk. That is why any company tries to maximize its profits by managing the risk specific to its field of activity and by avoiding or transferring the risk it does not want to take. It is obvious that a robust banking strategy should include both banking risk management programs and procedures that aim, in fact, to minimize the likelihood of these risks and the potential exposure of the bank. This results from the main objective of these policies, namely to minimize the losses or additional costs borne by the bank, and the central objective of the banking activity is to obtain a maximum profit for the shareholders. In banking, risk should be seen as a conglomerate or

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complex of risk, often interdependent, with common causes or the production of a type of risk generating a chain of other risks. The risk can have a considerable impact on the bank's value, both a self-impact (usually in the form of direct losses) and an induced impact caused by the effects on the bank's clients and authority.

The banking sector has a low degree of concentration, indicating a relatively high degree of competition. However, for a better interpretation of the degree of competition, we should analyze other indicators, such as the mobility of bank customers. Some experts consider that the banking system has a moderate level of concentration, reflected both by the market share by assets held by the top five banks in the system and by the Herfindahl-Hirschman index calculated by assets. The upward trend of this index shows a continuous decline in the concentration of the banking system and, implicitly, the increase in credit institutions, according to the most recent annual report of the central bank.

2. Related Work

Cade (1997) fills a gap in banking literature by providing a professional and sophisticated “risk” primer for bank directors, executives and staff at every level as well as students, analysts and commentators on the banking scene. The breadth of focus is exceptional in covering the full range of banking risks, rather than the customary specialist segment.

Northcott (2004) reviews the theoretical and empirical literature to examine the traditional perception that the following trade-off exists between economic efficiency and stability in the banking system: a competitive banking system is more efficient and therefore important to growth, but market power is necessary for stability in the banking system. That this trade-off exists is not clear. Market power can have positive implications for efficiency and the potentially negative implications of competition on stability may be manageable through prudential regulation.

Berger & more (2008) appreciate that more bank competition erodes market power, decreases profit margins and results in reduced franchise value that encourages bank risk taking. Under the alternative “competition-stability” view, more market power in the loan market may result in greater bank risk as the higher interest rates charged to loan customers make it more difficult to repay loans and exacerbate moral hazard and adverse selection problems.

Amidua and Wolfeb (2013) investigate how the level of competition affects diversification and stability using a sample of 978 banks in 55 emerging and developing countries over an eight year period 2000–2007. The authors shed further light on the competition-stability nexus by examining the complex interaction between three key variables: the degree of bank market power, diversification and

stability. The core finding is that competition increases stability as diversification across and within both interest and non-interest income generating activities of banks increases. Our analysis identifies revenue diversification as a channel through which competition affects bank insolvency risk in emerging countries. The results are robust to an array of controls including alternative methodology, variable specifications and the regulatory environments that banks operate in.

Mirzaei and Moore (2015) investigate whether the recent financial crisis has had any adverse impact on bank competition for 24 emerging and 25 advanced countries with large and small-size banks over the sample period 2001-2010.

Elyasiania and Zhangb (2015) examine the association between "busyness" of the board of directors (serving on multiple boards) and bank holding company (BHC) performance and risk. They estimate several simultaneous-equations econometric modelsemploying the 3SLS[1] technique and instrumental variables to account for endogeneity.

Léon (2015) has identified three reasons why competition in the financial sector is important: firstly, for efficient functioning of financial intermediaries and markets, secondly, for firms and households access to financial services and thirdly, for stability of the financial system.

Kaminski and Robu (2016) wrote about tighter compliance regulations have challenged financial institutions in a variety of ways. Yet those who adapt best may enjoy a distinct competitive advantage. They presented new topics that continue to emerge, such as conduct risk, next-generation Bank Secrecy Act and Anti-Money Laundering (BSA/AML) risk, risk culture and third- and fourth-party (that is, subcontractors) risk, among others. Even though a lot of work has been done to respond to immediate pressures, the industry needs a more structural answer that will allow banks to effectively and efficiently mature their risk-and-control frameworks to make them more robust and sustainable over time.

Alhassan (2016) after analyzing the activity of 26 banks and used to estimate technical and cost-efficiency scores by the data envelopment analysis while the Boone indicator is employed to proxy for competition. Controlling for bank size, lending, income diversification, tangibility, leverage and profitability, ordinary least squares, instrumental variables and fixed effects estimations are used to estimate the panel regression model. The authors also apply the growth convergence theory to examine the existence of efficiency convergence recommends that efforts at improving competitiveness of the banking industry will translate into lower interest rate spread through improved CE. This will ultimately improve access to bank credit and impact positively on economic growth. The study recommends that efforts at

[1] 3SLS technique = Three-Stage Least Squares: Simultaneous Estimation of Simultaneous Equations.

improving competitiveness of the banking industry will translate into lower interest rate spread through improved CE. This will ultimately improve access to bank credit and impact positively on economic growth.

Härle, Havas and Samandari (2016) analyze the change expected in the risk function's operating model which illustrates the magnitude of what lies ahead. Today, about 50 percent of the function's staff are dedicated to risk-related operational processes such as credit administration, while 15 percent work in analytical. McKinsey research suggests that by 2025, these numbers will be closer to 25 and 40 percent, respectively.

Problem Statement

Financial-banking market is a very sensitive one, depending on a lot of factors and conditions, about many specialists deal with. Some of the most important challenges of this market are the risk and the competence. That is why our endeavour to present some aspects of this matter.

3. Concept and Terms

Banking risk can be said to be a phenomenon that occurs during the course of banking operations and causes negative effects on the respective activities, by deteriorating the quality of the business, diminishing the profit or even recording the losses, affecting the bank's functionality. Banking risk can be caused inside the bank by customers or because of the external competition environment. In the banking risk management and oversight activity, it is recommended to use a methodology that includes several steps, namely identification, assumption and transfer of risk. Some risks are obvious to anyone, others can not be identified, regardless of the precautions taken, until their triggering and the loss of their activities. Under these circumstances, maximum caution is recommended to identify any possible risk, in order to limit unidentified risks to the maximum.

Competition is the guarantor of the efficiency of banking. A low level of bank competition allows banks to place on the shoulders of clients the costs generated by inefficiency in activity and the underestimation of the impact of certain risks. In the face of unfair behavior in relation to customers, the bank risks losing it and this is the biggest financial penalty that the banking institution can give itself. Banking competition ensures innovation and efficiency and the latter leads to "loyalty" to customers, because they receive what they want, why they need the price/price they are willing to pay for that banking service/product.

4. Solution Approach

Risk identification work becomes very important in a banking corporation, meaning it has to start from its main lines of business and the strategy it will adopt. Any new product or service also involves a new procedure in detecting and anticipating new accidental risks, in order to obtain the best methods of handling them. Identifying risks and locating them is the first stage of global risk management, with the risks associated with each type of product and banking being determined. In order to identify the associated risks, it is necessary to develop possible scenarios to determine the frequency and magnitude of each associated risk. Once the risks have been identified for each type of banking product and service, an aggregate picture of the influence of risk factors is required.

The importance of banking management is not just about minimizing spending. The permanent concern of management to minimize exposure to risk also has positive effects on the behavior of employees who become more rigorous and more intimidating in fulfilling their job duties; neither the psychological effect of discouraging fraudulent activities will be neglected. The existence of adequate programs for the prevention and control of banking risks also contributes to the institution's imposition within the banking community, with the few existence of such programs conditional upon the admission or participation of the bank in inter-bank associations or obtaining higher ratings from banking authorities.

Ultimately, effective bank risk management will also affects on the public image of the bank. Customers want a safe bank, as well as shareholders. The solidity of a bank attracts depositors in conditions where deposits are not necessarily secured.

Finally, because bank risks are a source of unforeseen expenses, their proper management can stabilize revenues over time, with the role of a shock absorber. At the same time, the consolidation of the value of bank shares can only be achieved through a real communication with financial markets and the implementation of appropriate banking risk management programs.

The success of a banking institution is guaranteed when it, once enrolled in the competition, manages to fulfill its economic role better than competition. The primary mission of banks is to attract customers and this requires innovation, quality, professionalism, products and services as close as possible to customer needs and as many competitive advantages as possible. Banks need to be focused on people and needs, not just on profit. Banks do not operate in an isolated environment, which is under the influence of environmental factors of economic nature, banking regulations and competition. The latter, however, has the most aggressive influence on bank performance. Banking competition takes place both in the field of attracted resources and in the field of credit. Deposit-related competition is limited to the interest rate offered and the ability to repay deposits at maturity. Credit competition

is a much more preoccupied concern for banks, which have to choose customers that have a risk of minimal loss.

A strong competitive factor is the presence of foreign banks on the market. When a foreign bank enters a state market, it brings with it the financial know-how acquired in its home country, new banking management techniques, innovative products and services. And so, foreign banks have the role of modernizing the banking system in the host country, increasing competition and increasing the efficiency of banking.

One of the indicators that can be a measure of the market power of players in the banking sector is the interest rate difference between loans and deposits, an indicator called interest spread. The difference between interest rates on loans and deposits is determined by such issues as country rating, financing cost etc., but depends to a large extent on the degree of bank competition existing in that state. A high degree of competition can improve a country's economic performance, open up business opportunities for its citizens and reduce the cost of goods and services across the economy. However, numerous laws and regulations restrict competition on the market. Many of them go beyond what is necessary to achieve the objectives of their own policy. Governments can reduce unnecessary restrictions by applying the OECD's "Compendium of Competitive Assessment Toolkits". The Toolkit provides a general methodology for identifying unnecessary constraints and developing less restrictive alternative policies that still achieve governance goals. One of the main elements of the Toolkit is a competition checklist that addresses a series of simple questions to identify laws and regulations with potential to restrict competition. This test focuses on limited government resources in areas where competition assessment is imperative.

5. Analysis of Results

The success of banking institutions is guaranteed when it once compete manages to fulfill the economic role better than the competition. The primary mission of the banks is to attract customers and this requires innovation, quality, professionalism, products and services closer to customers' needs and as many competitive advantages. Banks should focus on people and needs, not just profit.

In Romania there is a peculiarity, in which some directives on the consumer area are transposed or at least trying to transpose contrary to the provisions approved by the European regulators, which leads to unrealistic expectations of the clients. Promoting in the public space legislative initiatives or adaptations of European directives inconsistent with the text proposed at European Union level negatively affects payment discipline, image and confidence in the banking system. The comparative analysis of interest rate developments with the bank service charges that cover the largest number of clients indicates a stronger market power of banks,

versus debit card customers and a relatively low degree of competition generated by the uniform level of commissions. According to the Competition Council, an important cause of this situation is the high barriers to switching costs for consumers (especially debit cards) for consumers. Against this background, initiatives aimed at enhancing the pro-competitive nature of regulations, especially by removing barriers to switching providers (such as portability of bank accounts), are of particular importance from the perspective of the national competition authority.

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Debt collection market has entered into a mechanism is a more professional market, more competitive and much more with a growing number of collectors. The retail banks have sold largely in balance and therefore have balance cleaning and rehabilitation of retail receivables is deemed largely clean.

The main problem is liquidity Romanian market and this could be solved if the bank non-performing loans by specialized firms outsource debt collection. Competitors are represented bank institutions engaged in similar activities. These may crediting financial institutions, non-banking institutions, international financial organizations. Competitive relations are customized, on the one hand, due to the rigid nature of the offer banking services which excludes "exact approximation" of the products, on the other hand, because competition means used in the struggle. Since the degree of competition in the banking sector can influence the degree of risk incurred by players portrayed in this market, competition policy in this area must include a macroeconomic component.

The tightening of credit standards is not in itself a cause for concern regarding competition in the banking sector, but corroborating its high level of indebtedness of customers, interest rates and bank charges lead to the reduction of customer mobility. As is known, a high level of customer mobility degree of the effect of a normal competitive environment, competition law and order, is to just maintain and stimulate competition.

The first half of 2016 was marked by an increased nervousness about the future of global markets, driven by a decline in international economic exchanges, rising unemployment, the inflationary phenomenon, financial sector volatility and a decline in the price of natural resources, as well as a high of geopolitical risks. The extremely slow rhythm of the growth of the economies (especially the emerging ones) attracted the attention of the analysts, especially in terms of the comparison with the expansion period of the early 2000s, which brought these markets an

increase in the level of financial inter-mediation, integration regional and international levels, as well as access to major financial and strategic investors.

Nowadays, the emerging market area and beyond, is forced to aggressively adjust its strategies and policies to face the new realities and structural challenges (some analysts wonder if we are going through a new "Lehman moment") and provide the conditions for a sustained medium and long-term development. But few institutions or banking groups are implementing the necessary measures; it seems that many institutions refuse to accept the current situation as a new standard and prefer to use a wait or minimum effort strategy in the hope that we are dealing with a simple phenomenon of cyclicality. Even worse, there are examples of institutions that have accumulated financial resources due to the support of financial authorities, resources that have not been channeled to the credit process. And in the Central and Eastern European area, in many cases, the expectations about the sophistication and the capacity of Eurozone or even global banks with local presence to successfully deal with negative market developments compared to state banks in the pre-privatization continues to generate disappointment among the individuals and institutions involved. All these developments create the premises for increased volatility and vulnerability of financial markets, transposed in stock exchange terms, by dramatically decreasing the market value of banking institutions - this clearly reflects the increased sensitivity of the banking sector to the negative evolution of the economic situation local and international. The fall in market value for financial-banking institutions also reflects the investors' view of the magnitude of the short-term efforts by these institutions to adjust the business model to successfully meet the challenges of economic growth slowdown, interest rates, as well as tightening legal and regulatory requirements on the part of the authorities. In this context, the quality of the asset portfolio produces an important sense of concern for all stakeholders - regional and national authorities, clients, investors. Specifically, at the continental level, the European Central Bank's (ECB) efforts to control the phenomenon of bad loans that is non-performing loans (NPLs) are noted and we refer both to existing exposures and those that may occur in the future. This phenomenon has started to manifest at a dangerous level starting with 2008, joining the European level on a constant trend of growth, a trend that will continue in the coming years, with implications on bank liquidity and profitability and implicitly on the stability of the system financial banking.

The reaction of decision-makers and authorities has begun to be perceived as ineffective and illustrating the law of declining marginal utility. Many of the European Central Bank's initiatives are notorious for lacking the desired effect, such as Quantitative Easing (funds that have become available have not come to the real economy, but have returned largely to the ECB) or interest "marching" to the negative area.

However, positive initiatives have been implemented in combating the NPL phenomenon, new methodologies that allow accurate identification and quantification of NPLs, based on a set of common variables/definitions established by the European Banking Authority, together with tightening safeguards assessment regulations, reporting requirements, or provisioning level. It is necessary, in view of the configuration of the European banking system, to move from transactions with nationalized portfolios to cross-border portfolios, harmonized from the point of view of individual characteristics.

6. Why Big Banks have begun to Withdraw from some Markets?

The banking market is very volatile, sensitive not only to economic events but also to social, political and not only. For example, a few years ago there was a “off-risk” phenomenon: big banks are leaving risky markets. It is a preventive withdrawal from US regulations, said a senior executive from a large US bank. The decision is also embraced by its competitors, who give up inter-bank relations and retreat massively from some markets, countries and business lines, a measure that could attract the wrath of regulators or prosecutors. This practice is so widespread that a term for her has also emerged: “denial” (renunciation of risks). Thus, the links between the international financial banking system are degrading, which leads to increased financing costs for poor countries and for people.

One of the main victims of this withdrawal is even the correspondent banking institution. This is a bank in another country where a client of a banking institution can transfer money abroad, even if the bank from which the transaction does not have a representative there. The system is as old as the one of international finance itself, dating from the oldest bank notes and letters of credit issued by banks. This system is now threatened by the overwhelming interpretation and implementation of rules aimed at preventing money laundering and terrorist financing.

The number of bank relationships has been declining in recent years, largely because the industry has gone through a consolidation process. Now, however, the major international banks continue to give up such relationships. The exact size of this withdrawal process is difficult to assess, as recent global data are missing, but directors in these institutions say they are giving up one-third of their dealings with correspondent banks. A large institution said it was giving up about 1,000 inter-bank links; another at 1,800. Such “cruelty” will have a dramatic impact, as these institutions are the main knots by which banks in the world bind to each other. The four largest correspondent banks for euro transactions accounted for 81% of all transactions, for example.

The spark that sparked this fire of banking relationships was a series of criminal investigations against major US international banks as a result of the inefficiency of

money laundering controls and the financing of terrorism. The charges brought a fine of $ 1.9 billion for HSBC and substantial fines for Standard Chartered, ING and Barclays. BNP Paribas, the largest bank in France, appears to be fined up to $ 10 billion as a result of the violation of US sanctions against Cuba, Iran and Sudan. Here, bankers have learned two lessons. The first shows that US prosecutors and financial regulators apply unilaterally a more rigid standard than the one agreed by the Financial Action Task Force (FATF), an intergovernmental body that since 2001 oversees the implementation of international money laundering and terrorist financing rules. They essentially ask banks to know who their clients are and what they are going to do with their money. And US regulators ask banks to know what customers are. The most affected are banks in countries considered to be at high risk of FATF, including Ethiopia, Indonesia, Myanmar and Pakistan. Last year, J.P. Morgan Chase stopped its relationship with Al-Rajhi Bank, one of the largest banks in Saudi Arabia. Only one large Western bank still has significant retail banking operations in Pakistan.

In most cases, banks do not stop these relationships because they have evidence of illegalities committed by correspondent banks. The measure is simply applied because the costs and the effort to verify the correspondent institutions are higher than the profits that these transactions generate. The ambiguity of these rules is not helpful. The bankers say the stack has risen. Transactions with Cuba, for example, appear to be less problematic than those with Iran.

Applying tougher rules also brings positive results. Many banks in poorer countries have adopted control procedures in rich countries on money laundering to avoid being cut off from global funding. But it has a high price. The cost of business has risen sharply for Indonesian exporters and for cotton makers in Mali. The most relevant example comes from Africa. The costs here have fallen in recent years from around 8 euros ($ 11) per transaction to less than one euro. Now, taxes have returned to their previous levels in many markets, after local firms that broker banking transactions that have introduced competition that has led to lower prices have lost access to rich banking. And this situation is not only found in remote countries. In the UK, students from Iran, Sudan and Syria can not open bank accounts. In America, foreign diplomats and embassies complain that they are denied access to the banking system.

Charities also suffer. Some, such as Save the Children, the Red Cross and Christian Aid, have had to make great efforts to transfer money to some countries, such as Syria, because of sanctions. Even after obtaining approvals from US regulators, some organizations have come to the conclusion that it is difficult to persuade banks to send these funds.

Technology can offer a partial solution. Money transfer systems, like M-PESA, for example, provide clear evidence of the money's route, from receipt to spending. In

Afghanistan, it is used to pay police wages, which reduces corruption. However, the most important thing is that politicians will not only weigh the benefits, but also the costs of their rules. Left uncontrollably, the "dithering" process could leave some countries without any access to international finance, affecting the domestic industry. In turn, an affected economy will lead to worsening poverty and accentuate the feeling of exclusion, which will fuel terrorism and simply kill the rules designed precisely to prevent it.

Bank overdrawing seems to be a bad idea, because it does not achieve the stated purpose of punishing banks, but it punishes their clients (depositors and borrowers), because banks can easily pass those costs on them.

Whether we are talking about a tax on financial transactions (as in Austria) or a tax on financial assets (as in Poland), the effect is the same: those who ultimately suffer are banks' customers. At least, in Western Europe, these taxes (in the 11 states that introduced them) had a double motivation: the fact that banks were massively helped directly by states in the post-crisis period, and - where the financial transaction tax has been applied - discouraging the use of toxic assets, such as derivatives. It is true that none of these two motivations was made in Poland, but perhaps - dissatisfaction with the extension of Swiss francs (CHF). However, in the case of Poland, the number of debtors affected by CHF loans was much higher than in Romania: about 500,000 versus about 70,000.

Essentially, banks with foreign capital are an important player in Romania's economy. Their treatment has so far been similar to that applied in the states of the region. It would be a shame as a relationship in which both parties gain to transform into a relationship in which both sides lose.

7. Conclusion

In the current international financial context, it is recommended to maintain confidence in an investment climate favorable to the growth of financial intermediation to benefit the population, companies and the state, so as to contribute to the economic development of any country, and to increase the standard of living of each individual consume.

Paradoxically, we have competition between banks, but Romania's banking competition ignores the client! True bank competition should bring more into the Romanian banking landscape from the perspective of the domestic customer. Thus, interest and commission on loans should be "more seated" and lower; the client-bank relationship must not be a captive one for the latter but a loyalty; customer service needs to be prompt and more customer-centered; credit agreements should cease to

be cryptic and trappable for customers; banking products and services need to be diversified and improved; better-trained and trained bank staff.

All banks and financial institutions need to improve their banking risk management understanding and practice in order to successfully manage different product ranges. If the bank risk management process and global management system are effective, then the bank will be successful. Banks can successfully manage bank risks by recognizing the strategic role of risk management, by using the paradox of analysis and management to increase efficiency, by adopting precise measures to adapt performance to risk, and finally, by setting up performance reporting mechanisms based on risk, to ensure that investors understand the impact of risk management on the value of the bank.

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