Profitability of Small Domestically Owned Banks in Croatia

MARKO NOVAK

PhD student
Southern Taiwan University of Science and Technology
Email**:** marko.novak885@gmail.com
Tel: +886978646626

SU-YING HSU, PhD

Associate Professor, Department of International Business
Southern Taiwan University of Science and Technology
Email: suinghsu@stust.edu.tw
Tel: +88662533131

Abstract

This paper studies the profitability of small domestically owned banks in Croatia. Profitability indexes such as ROA, ROE, Net Interest Margin and Net Profit are employed in measuring profitability for the small domestically owned banks. This research shows that small banks need to have better business model and management in order to have more sustainable profitability results.

Key Words: Banks, NIM, Profitability, ROA, ROE.

Introduction

Banks want to spread their revenues in order to gain more profits. In that way, they want to satisfy their shareholders. Small banks have challenging business model in between cost in one side and profit on another. They are small in terms of their assets so they have smaller space for errors. Their bad loans can affect their profitability and sustainability and increase reservations, so it would question a bank existence on the market. In this research, attention is made on small banks in Croatia in domestically owned ownership.

Croatian big banks are considered to be with assets greater than 5% of all banks in the country. Medium sized banks are those with assets greater than 1% and smaller than 5% of all banks on the market. Small banks are considered to be the one with assets smaller than 1% of all assets in banks in Croatia. (Bilten o bankama, br. 26.)

According to ownership structure of banks, banks in Republic of Croatia are divided on banks in domestic ownership and on banks in foreign ownership. In the table are described numbers of banks and their share in Croatian market. Number of banks declined from 2012 until 2015. In 2012 were 31 bank and in 2015 were 28 banks. Number of foreign owned banks remain the same from 2012 until 2015, but number of domestically owned banks declined from 15 in 2012 to 12 in 2015.

Market share of foreign owned banks in year 2015 was 89.9%. At the same time market share for domestically owned banks was 10.1%. Croatia had in 2015 in total 28 banks, 12 of them were in

domestically ownership and 11 out of 12 were small sized domestically owned banks. Aim of this research is to count the profitability indexes of small sized domestically owned banks from the year 2012 until 2015. (Bilten o bankama, br.29.)
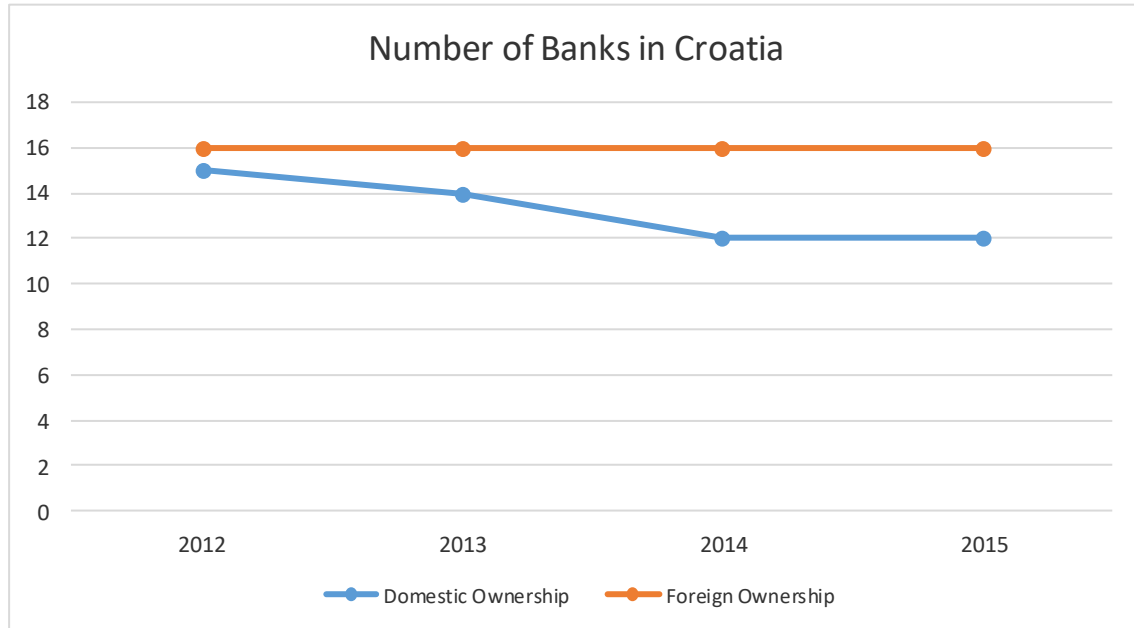
Source: the authors processed the data according to Bilten o bankama, br. 29. (2016, August).
Graph 1: Number of Banks in Croatia

In Graph 2 in alphabetic order are written all small sized domestically owned banks in Croatia in year 2015.
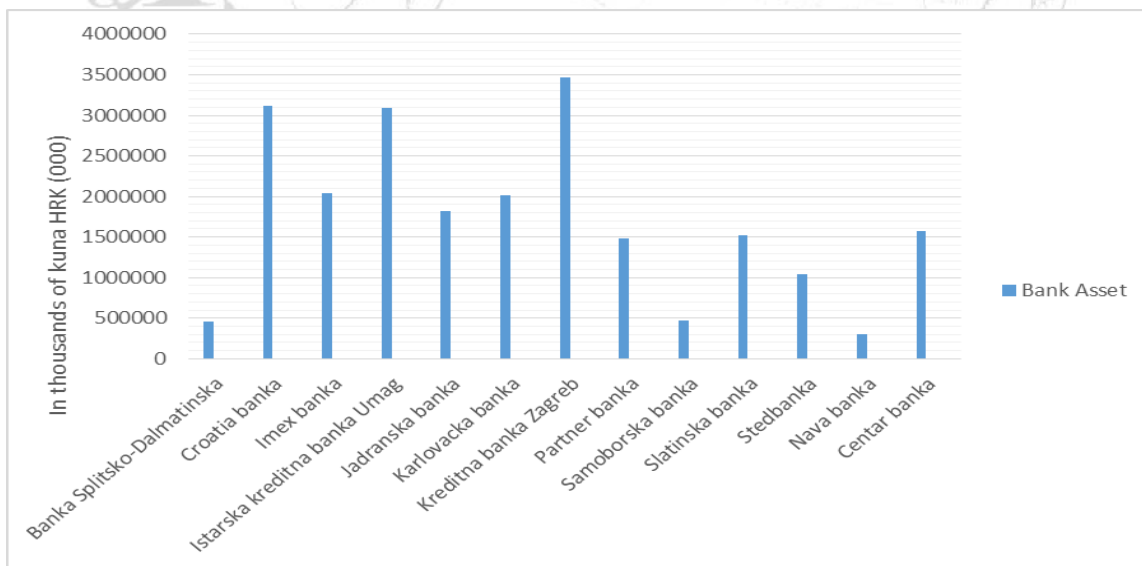
Source: the authors processed the data according to Bilten o bankama, br. 29. (2016, August).
Graph 2: Total Assets of Domestically Owned Small Banks in Croatia

Literature Review

Indexes of bank profitability are results of successful bank managing. Profitability indexes are indicators of bank achievement business policies of the bank. For any successful analysis it is necessary to use many different measuring indicators.

Rate of return on total bank assets is representing measure of profitability in banking sector. ROA puts in ratio net income and its total assets. This ratio is showing how good bank managers are using real investments resources of the bank. (Gul et al, 2011).

Rate of return of stock capital is representing the measure of bank profitability. ROE is measured as the firm's net income divided by stockholders' equity. This profitability index is showing the yield on bank stocks. This ratio reflects the fact that a portion of a firm's total assets are financed with borrowed funds. Bank management shows with ROE to the investors how much is the net profit for investments in bank stocks (Melicher et al, 1997).

Banking ratio analysis is showing feedback of bank management. The interpretation of historical financial data typically begins with ratio analysis. Ratios are constructed by dividing one balance sheet or income statement item by another. The value of any ratio depends on the magnitude of both the numerator and denominator and will change when either changes. It helps to the bank management to calculate sources and size of bank profit to according to the taken risks. Usage for it is for specific influence of bank risks and analysis bank profitability (Koch, 1992).

In economic added value are two popular ways of defining EVA. One is „accounting" way and other is „finance" way. From accounting perspective EVA is defined as the difference between the firm's net operating profit after tax (NOPAT) and its weighted-average dollar cost of capital. EVA is not the same as traditional accounting measures of corporate profit including EBIT (earnings before interest and tax), EBITDA (EBIT plus depreciation and amortization), net income, and even NOPAT because it fully accounts for the firm's overall capital costs.

From finance perspective, Eva is defined in terms of how it relates to the firm's„ market added value". In this context NPV (Net Present Value) is equal to the present value of the firm's expected future EVA. Advantages of this profitability index are that bank has to generate profit that will cover expenses, interest on debt and dividend for stockholders (Grant, 2003).

Internal factors of profitability in the study of (Pavković, 2004) are considered size of chosen bank, ratio of given loans to clients and short term bank financing with primarily deposits and ratio of stock capital and total bank assets. It is considered that greater bank market share means a greater profitability. According to relative market power hypothesis only enterprises that are in monopolistic position and have big market share and highly differenciate products can achieve above average profit margins.

Efficient structure hypothesis is coming from assumptions that the most efficient companies achieve greatest market shares. Profitability of bank's share capital (ROE) has to be in positive relationship with ratio of capital and bank assets.

Low capitalized banks because of prominent financial leverage in the period of successful management should show higher value of this index. Because of that they are also exposed to greater risk of insolvency. It is assumed that highly capitalised banks with greater ratio of share capital and total bank assets should be having lower ROE.

Net interest margin is showing reduction from total interest revenues and total cost of interests. It changes with modification of interest rates. Banks that have expansive business policy for revenue growth, often have lower interest rates so they could offer their clients lower interest rate of their products. And in that way to become more attractive on the market.

Mainly, size of net interest margin depends upon chances on the market, stability of the market and market's risks. Ratio of operational expenses and bank assets should be negatively connected with profitability, what would mean that growth of the ratio is reducing profitability of the bank and the opposite. (Pavković, 2004).

Factors that affect bank activity include GDP, inflation, average exchange rate, GDP per capita. Growth of GDP should have positive influence on bank profitability. Inflation can positively and negatively affect on bank profitability. Inflation can positively and negatively affect profitability, independently upon ability of the bank management. In the case of overestimation of domestic currency, enterprises will decrease export activities what will lower the GDP and with that scenario bank profitability will be also even lower (Pejić Bach et al, 2009).

Analysis

In the next chapter are described profitability indexes, ROA, ROE, Net Interest Margin and Net Profit. Those profitability indexes are calculated from 2012 until 2015 and are made from all domestically owned small banks in Croatia.
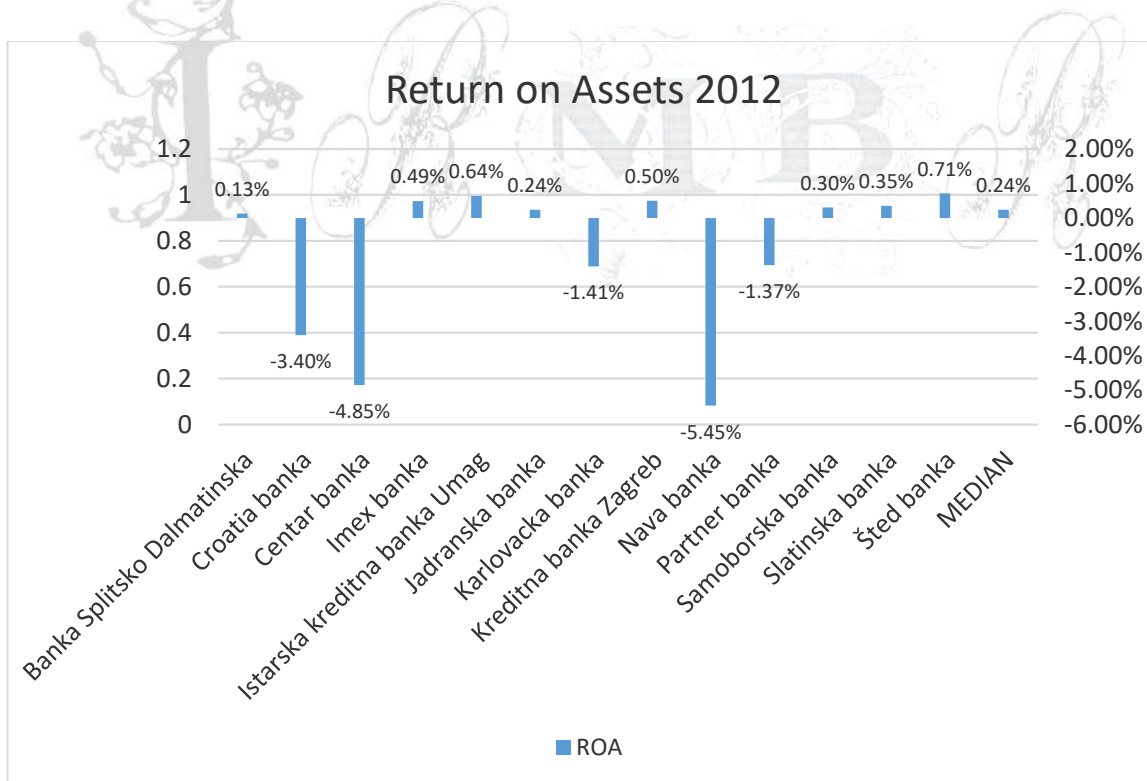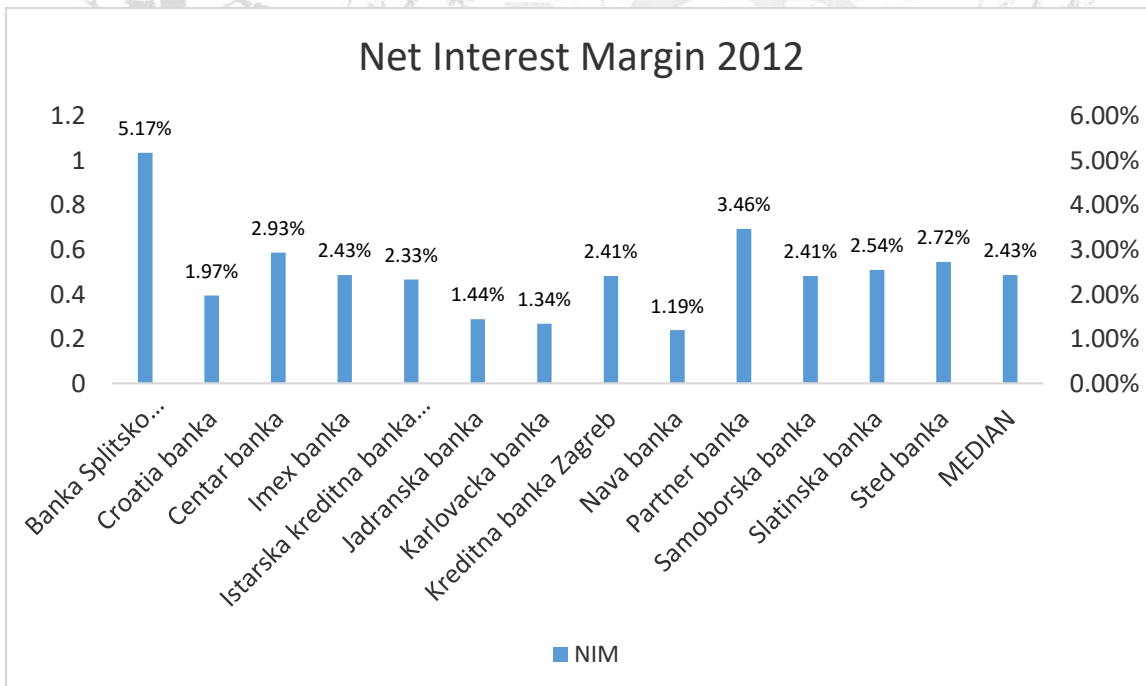

Source: the authors processed the data according to Bilten o bankama, br. 26. (2013, August).
Graph 3: Return on Assets of Small Domestically Owned Banks in Croatia in Year 2012
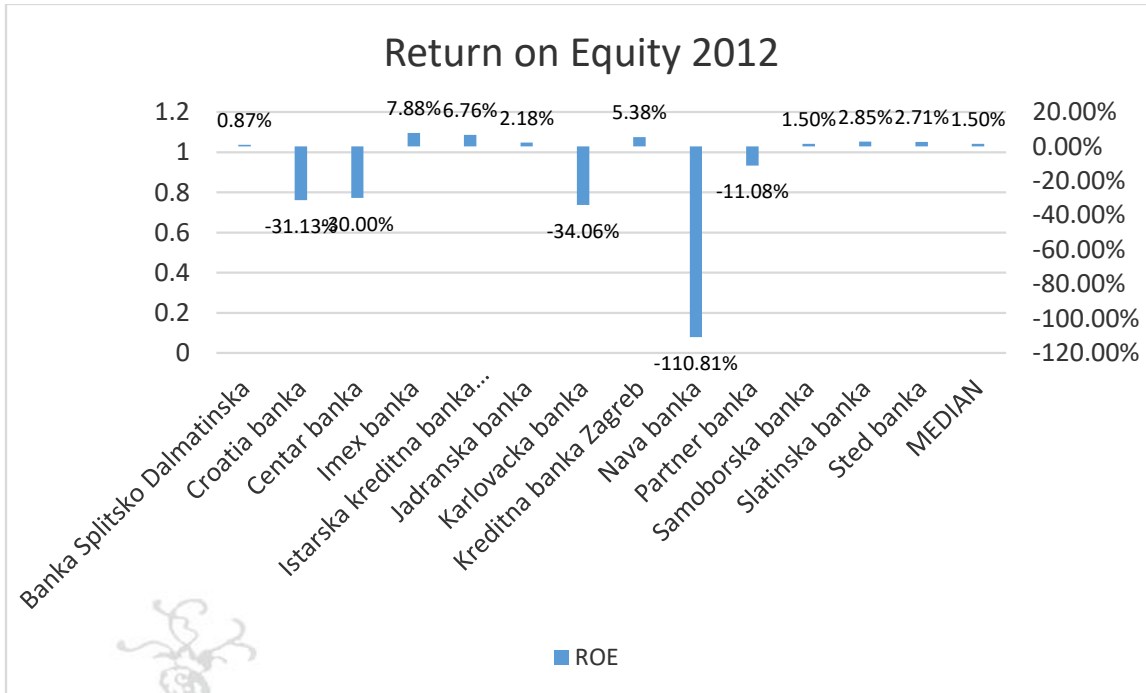
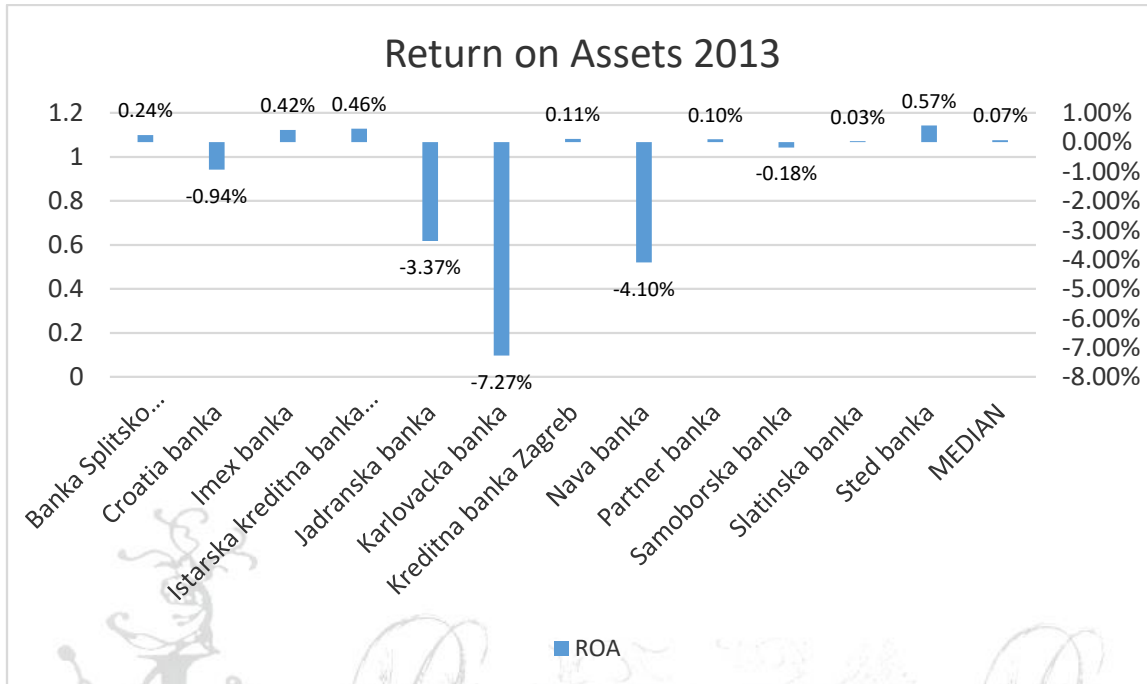Source: the authors processed the data according to Bilten o bankama, br. 26. (2013, August).
Graph 4: Return on Equity of Small Domestically Owned Banks in Croatia in Year 2012

Source: the authors processed the data according to Bilten o bankama, br. 26. (2013, August).
Gaph 5: Net Interest Margin of Small Domestically Owned Banks in Croatia in Year 2012

In following tables for year 2012 Croatian small banks in domestically ownership have ROA median 0.24%. ROE for the same year was 1.50%. Net Interest Margin median is 2.43%.
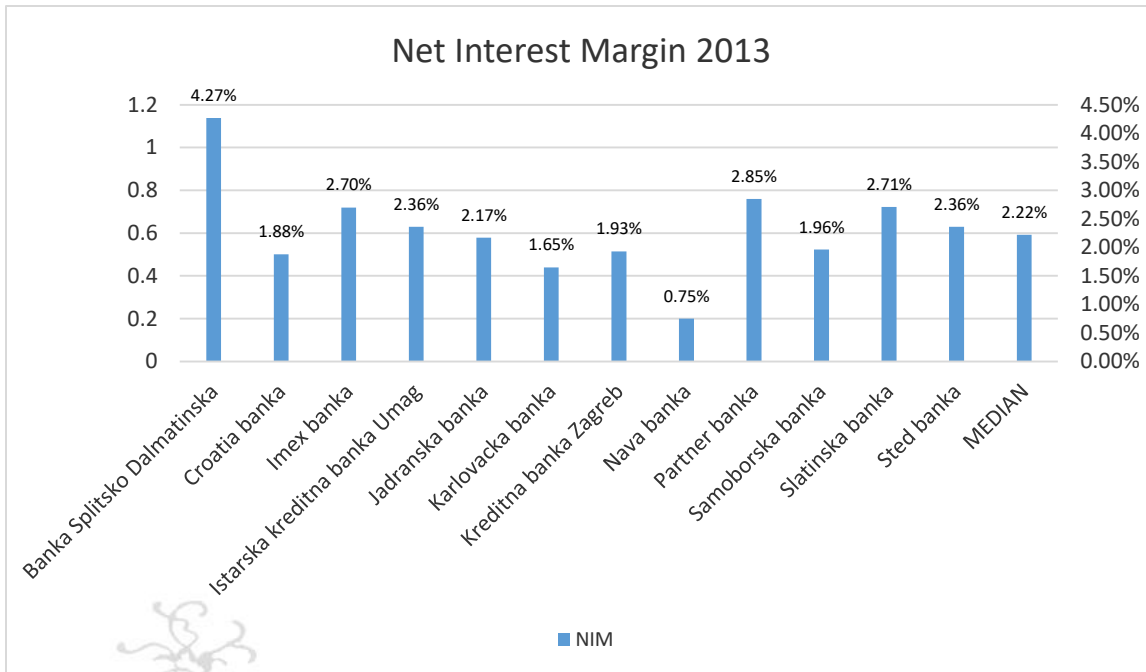

Source: the authors processed the data according to Bilten o bankama, br. 27. (2014, august).
Graph 6: Return on Assets of Small Domestically Owned Banks in Croatia in Year 2013
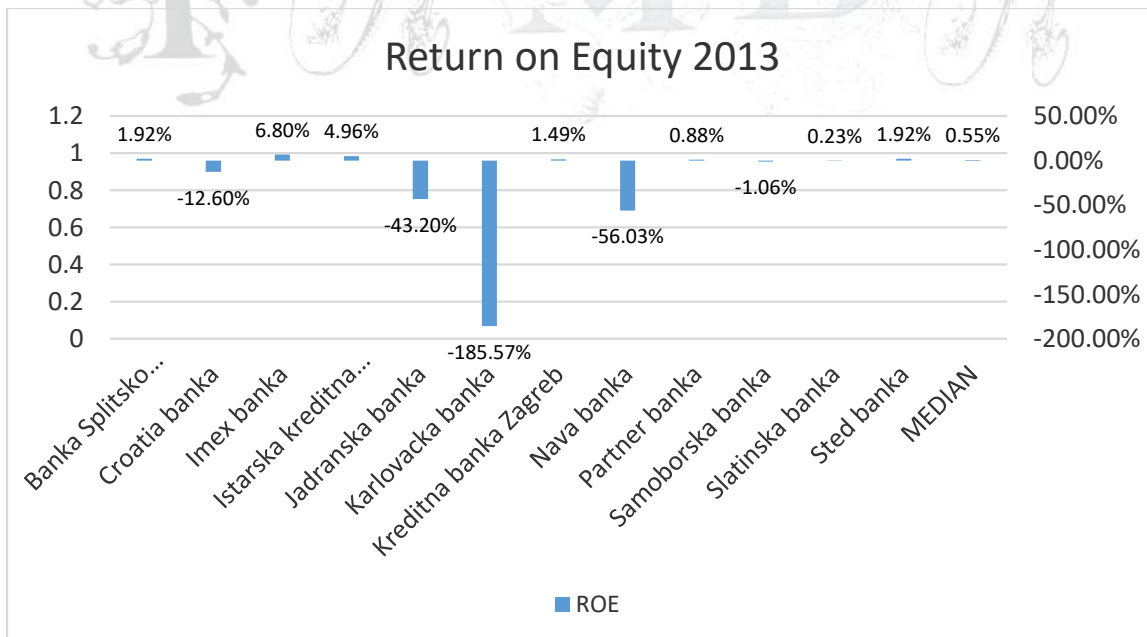
Source: the authors processed the data according to Bilten o bankama, br.27. (2014, August).
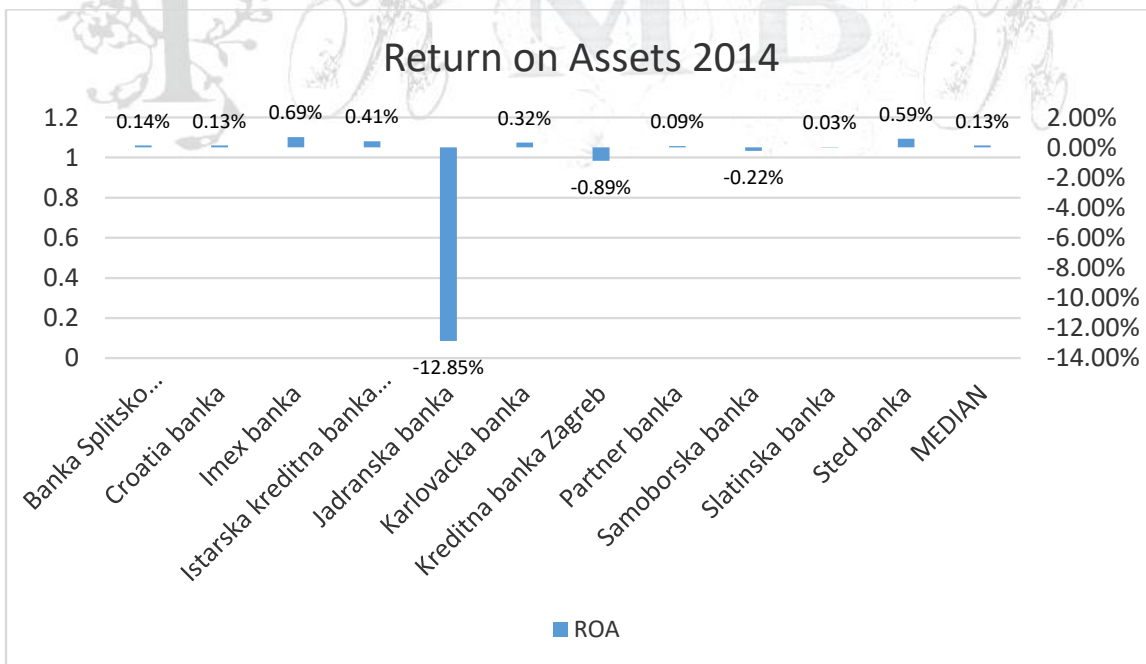Graph 7: Return on Equity of Small Domestically Owned Banks in Croatia in Year 2013

Source: the authors processed the data according to Bilten o bankama, br. 27. (2014, August).
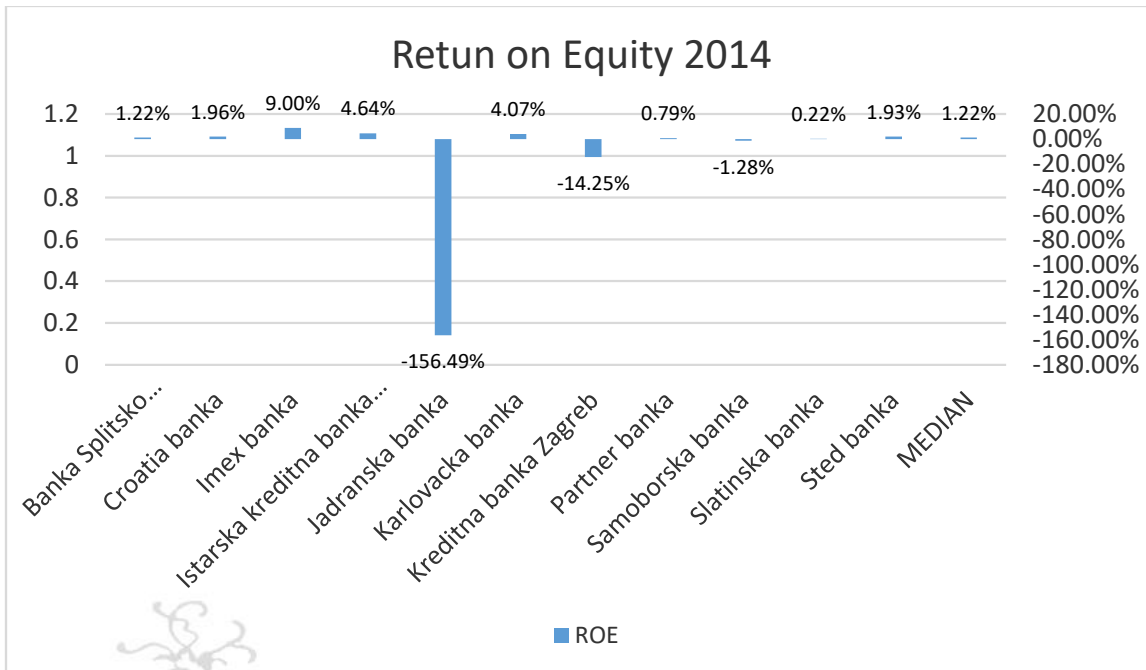Graph 8: Net Interest Margin of Small Domestically Owned Banks in Croatia in Year 2013

In year 2013 median ROA drop to 0.07%, ROE to 0.55% and Net Interest Margin to 2.22%
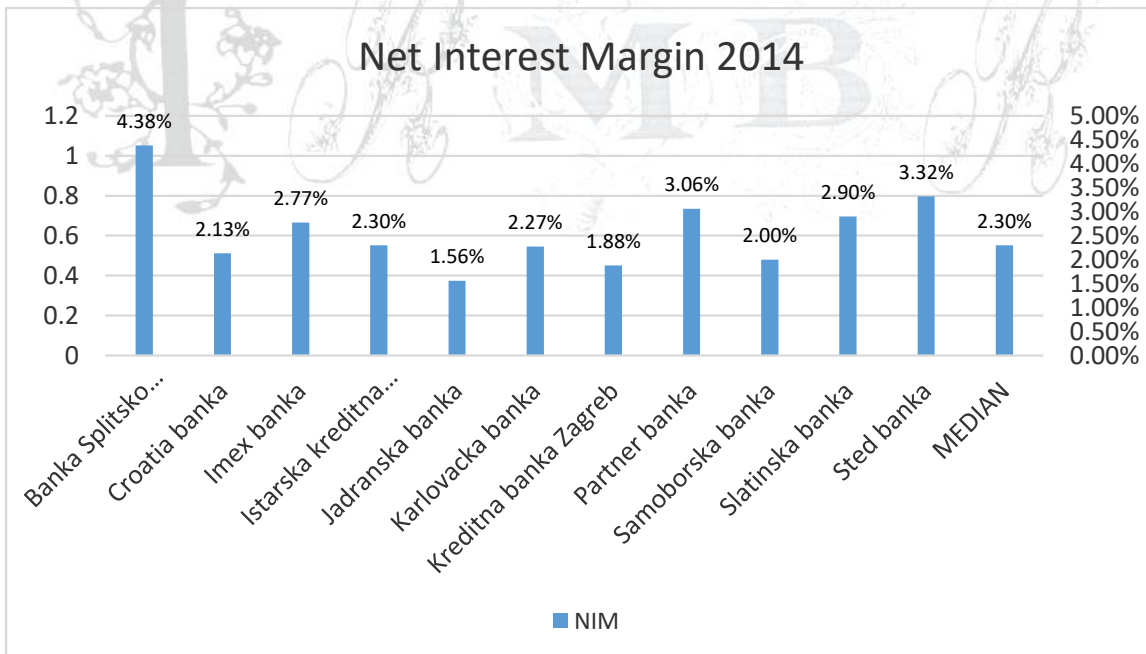

Source: the authors processed the data according to Bilten o bankama, br.28. (2015, August).
Graph 9: Return on Assets of Small Domestically Owned Banks in Croatia in Year 2014

Retun on Equity 2014

Source: the authors processed the data according to Bilten o bankama, br.28. (2015, August).
Graph 10: Return on Equity of Small Domestically Owned Banks in Croatia in Year 2014

Net Interest Margin 2014

Source: the authors processed the data according to Bilten o bankama, br.28. (2015, August).
Graph 11: Net Interest Margin of Small Domestically Owned Banks in Croatia in Year 2014

In year 2014 median for ROA recover to 0.13%. Also ROE went up to 1.22% and also the Net Interest Margin to 2.30%.

Source: the authors processed the data according to Bilten o bankama, br.29. (2016, August).
Graph 12: Return on Assets of Small Domestically Owned Banks in Croatia in Year 2015

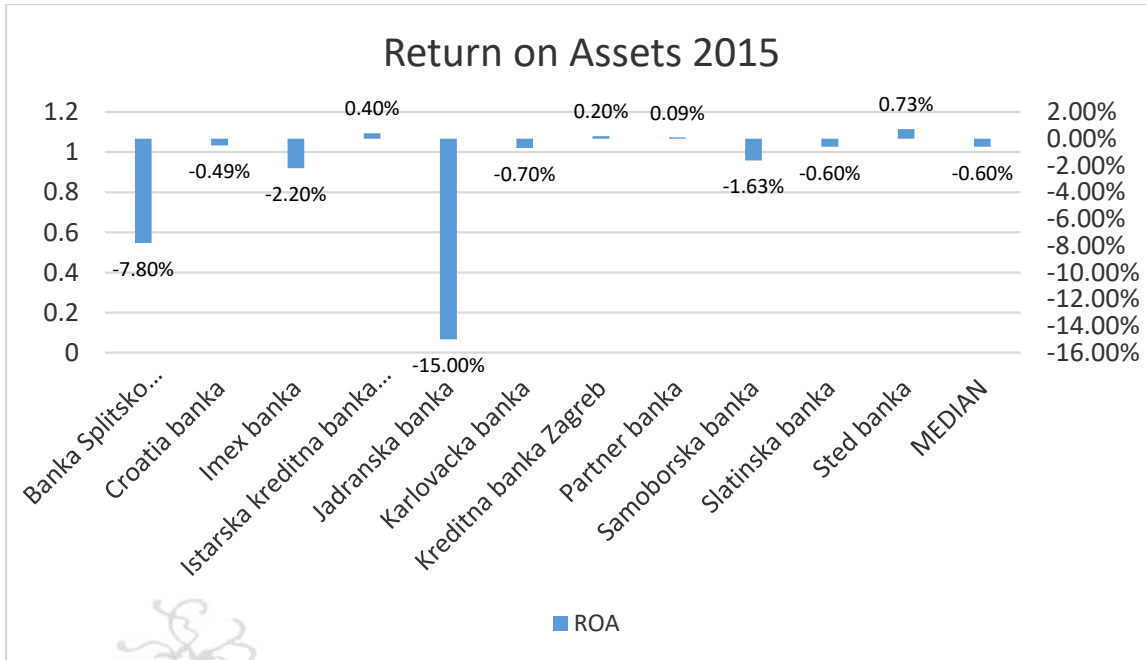Source: Bilten o bankama, br.29. (2016, August). and processed by authors
Graph 13: Return on Equity of Small Domestically Owned Banks in Croatia in Year 2015

Source: the authors processed the data according to Bilten o bankama, br.29. (2016, August).
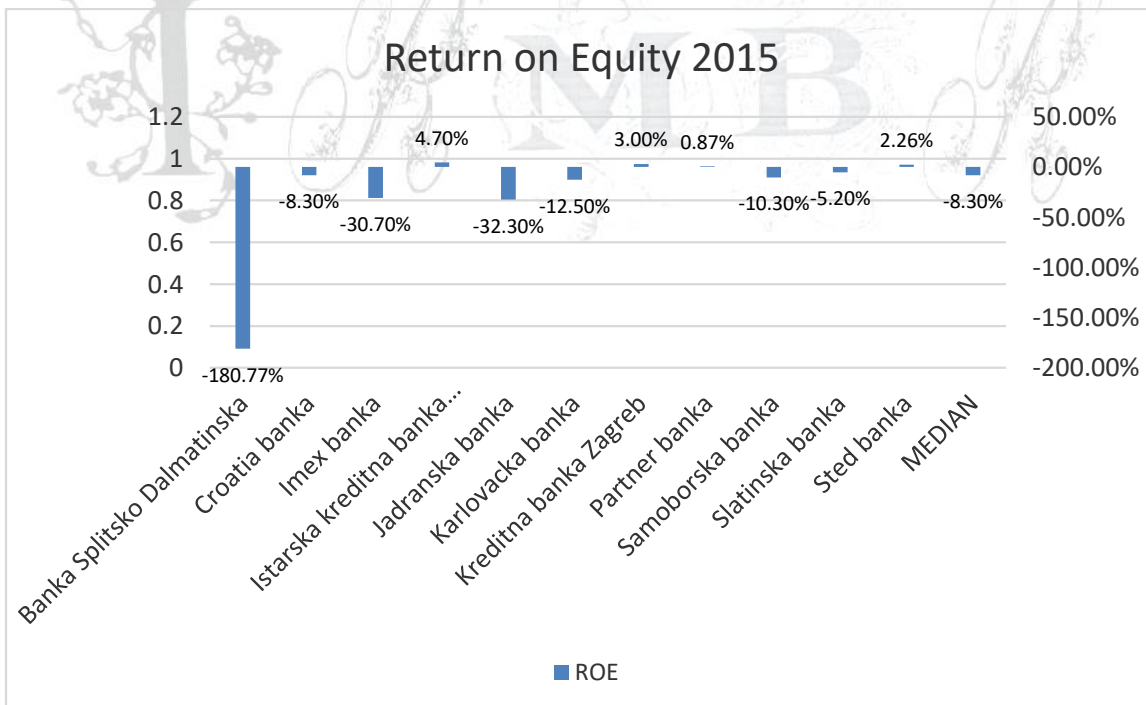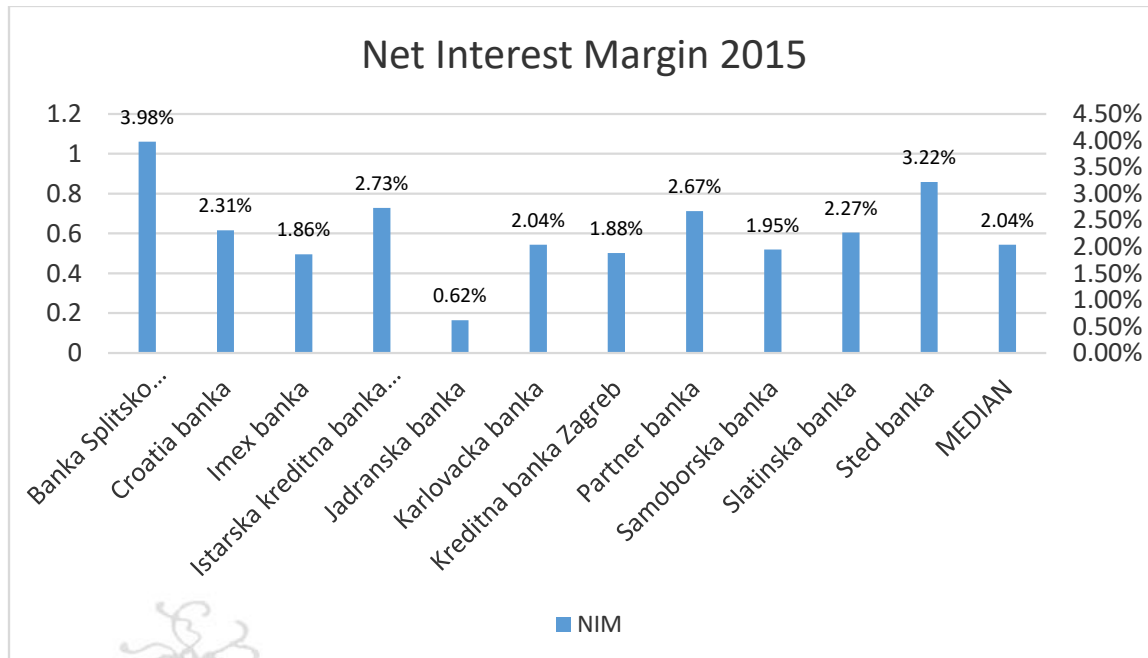Graph 14: Net Interest Margin of Small Domestically Owned Banks in Croatia in Year 2015

In year 2015 ROA was negative -0.60%. ROE was also negative -8.30%. Net Interest Margin was 2.04%.

Table 1: Net Profit of Small Domestically Owned Banks in Croatia in Year 2012-2015

BANK	NET PROFIT 2012	NET PROFIT 2013	NET PROFIT 2014	NET PROFIT 2015
Banka Splitsko Dalmatinska	455.000 kn	1.010.000 kn	642.000 kn	-35.503.000 kn
Croatia banka	-67.211.000 kn	-24.644.000 kn	3.919.000 kn	-15.134.000 kn
Centar banka	-76.250.000 kn	-	-	-
Imex banka	10.263.000 kn	9.488.000 kn	16.033.000 kn	-45.980.000 kn
Istarska kreditna banka Umag	17.246.000 kn	12.834.000 kn	12.068.000 kn	12.444.000 kn
Jadranska banka	7.249.000 kn	-99.373.000 kn	-314.261.000 kn	-271.989.000 kn
Karlovacka banka	-25.511.000 kn	-113.128.000 kn	5.436.000 kn	-14.529.000 kn
Kreditna banka Zagreb	16.090.000 kn	4.506.000 kn	-38.092.000 kn	8.349.000 kn
Nava banka	-15.130.000 kn	-12.383.000 kn	-	-
Partner banka	-17.706.000 kn	1.389.000 kn	1.288.000 kn	1.407.000 kn
Samoborska banka	1.299.000 kn	-896.000 kn	-1.065.000 kn	-7.768.000 kn
Slatinska banka	4.997.000 kn	398.000 kn	389.000 kn	-8.625.000 kn
Šted banka	8.643.000 kn	6.237.000 kn	6.382.000 kn	7.661.000 kn
MEDIAN	1.299.000 kn	704.000 kn	1.288.000 kn	-8.625.000 kn

Sources: the authors processed the data according to Bilten o bankama, 26.-29. (2013-2016, August).

Discussion

Banka Splitsko Dalmatinska is showing negative trend during 4 year period and from stable profitability results it shows results with strong declining profitability. In 2015 ROA and ROE were negative and net interest margin went 1.96% above median value with loss of 35.503.000 kuna. Even higher interest margin could not boost profitability and that is the next bank in Croatia that is avaiting monitoring from the central bank.

Croatia banka in observed years 2012, 2013 and 2105 had loss. Only in year 2014 there was a profit. Not very good signal for any future potential investor. Centar banka went bankrupt in 2012 with huge loss of 76.250.000 kuna.

Imex banka had from 2012-2014 three years of very stable and good business period. Last 2015 was generally very bad for all banks, so it also didn't avoid Imex banka. This bank is from second biggest Croatian city of Split. Bank has good management and good profitability indexes.

Istarska kreditna banka Umag is one of the best small private owned banks in Croatia. Bank has stable profitability ratios, average net interest margins what shows that bank management has good balance in attractive products they offer and stable profits.

Jadranska banka is also one more bank that is going to become monitored from Croatian central bank because of its poor profitability and management results. After last positive year in 2012, year from 2013-2015 were all with huge losses and negative profitability ratios. Karlovacka banka in researched 4 years have 3 years of negative profitability trends. From this point of view bank has unstable management and in the future it may reconsolidate in order to perform better.

Kreditna banka Zagreb is biggest small domestic owned bank in Croatia with total assets of 3.469.679.000 kuna. Bank has stable profitability indexes and stable profits with only one year of negative trends in 2014, but already in 2015 when most of banks were doing with losses, Kreditna banka Zagreb had net profit.

Nava banka was the smallest domestic owned private bank in Croatia with assets of just 301.582.000 kuna. In first two observed years with very negative profitability and losses, Nava banka went bankrupt. Partner banka is a stable bank in Croatia with only one year with negative profitability and loss. After that unstable 2012 year later from 2013 until 2015 bank were doing positive and stable.

Samoborska banka is one more bank in a row of unstable and not profitable banks in Croatia. Even though its profitability indexes do not go well under zero, after last positive year in 2012 those negative trend is continous and shows that there should be consideration for possible new management board in that small bank.

Slatinska banka shows from 2012-2014 positive trends in, even profitability is not well over zero, it shows stable management of the company. In lastly observed 2015 bank sank with high loss and that is not very good sign for potential investors. Šted banka is with Istarska kreditna banka Umag the best small domestic owned bank. Profitability ratios of the bank are positive and stable as well as net profit. Good signal for any potential investor.

Conclusion

From aforementioned results it is visible that the number small banks in domestic private ownership are getting lower. In year 2013 Centar banka went bankrupt and in 2014 Nava banka went bankrupt too. Just two banks were having positive profitability indexes in all 4 years, Šted banka and Istarska kreditna banka

Umag. If we take into consideration all the profitability indexes of small banks in domestically ownership, we can say that generally small domestically owned banks in Croatia need change in business model and better management.

The study of (Prga and Šverko, 2004) shows that lowering the number of small banks is worldwide trend and Croatia is not different from that issue. Also, small banks have many advantage comparing to big banks, they are more flexibile and they have to rely to their competitive advantages. Some of the competitive advantages are more flexibile working organization and easier managing with credit risk.

The study of (Šubić, 2009) shows expectation that small banks will merge. Dealing with big banks that are very well capitalized and have diverse supply of bank products is harder year by year. So in the study (Šubić, 2009) concludes that small banks in order to be stable has to have strong market niche for their products in order to have sustainable profitability and market share.

References

Bilten o bankama, br. 26. (2013, August). Retrieved from https://www.hnb.hr/-/bilten-o-bankama-26
Bilten o bankama, br. 27. (2014, August). Retrieved from https://www.hnb.hr/-/bilten-o-bankama-27
Bilten o bankama, br. 28. (2015, August). Retrieved from https://www.hnb.hr/-/bilten-o-bankama-28
Bilten o bankama, br. 29. (2016, August). Retrieved from https://www.hnb.hr/-/bilten-o-bankama-29
Grant, J. L. (2003). *Foundations of economic value added* (Vol. 99). John Wiley & Sons.
Gul, S., Irshad, F., & Zaman, K. (2011). Factors affecting bank profitability in Pakistan. *The Romanian Economic Journal*, *39*(14), 61-89.
Koch, T. W. (1992). *Bank management*. Harcourt Brace College Publishers.
Melicher, R. W., Welshans, M.T., Norton, E. A. (1997). *Finance: An Introduction to Markets, Investments and Management*. John Wiley & Sons.
Prga, Ivica i Ivan Šverko, 2004, "Značajke malih banaka i njihova budućnost", Računovodstvo i financije, (50)4, str. 81-87.
Pavković, A. (2004). Instrumenti vrednovanja uspješnosti poslovnih banaka. *Zbornik ekonomskog fakulteta u Zagrebu*, *2*(1), 179-192.
Pejić Bach, M., Posedel, P., & Stojanović, A. (2009). Determinante profitabilnosti banaka u Hrvatskoj. *Zbornik ekonomskog fakulteta u Zagrebu*, *7*(1), 81-92.
Šubić, Roman, 2009, "Uloga stranih banaka u okrupnjavanju bankovne industrije", Ekonomski vjesnik, 2009(2), str. 296-313.