

## THE PERFORMANCE OF THE BANKING SYSTEM IN THE REPUBLIC OF MOLDOVA: THEORETICAL AND PRACTICAL ASPECTS

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**Abstract:** Bank performance is an analysis tool of great importance for bank managers, shareholders and, last but not least, for all participants in the financial markets, who, by the nature of their activity, have business relations with banks. In practice, the analysis of banking performance is outlined using a series of indicators, the size of which is given by the result of the comparison of balance sheet items. The profitability of a bank is given by attracting resources in the short term and placing them in the long term. Thus, the level of interest rates for investments would be much higher than that of short-term resources, which would generate a substantial margin between active interest and passive interest and, implicitly, a maximum profit.

**Key words:** performance, bank, profitability, profit.

### INTRODUCTION

The performance of the banking system reflects the efficiency of the mobilization and use of capital as a whole, but also in particular, for this purpose banks must mobilize internal savings, allocate funds for investments, which contribute to structural changes in the economy and increase productivity, facilitate payments so so that the market can operate at low costs and find the most fair correlations between efforts and effects, i.e. efficiency and effectiveness.

It is extremely important to develop realistic strategies, whose objectives should be realized in: increasing the bank's value, and implicitly its ability to generate profit; ensuring and consolidating an optimal ratio between resources and investments, by increasing own capital, increasing resources attracted from non-banking clients, active presence on the interbank market; increasing the efficiency of the activity carried out by banks by controlling costs, increasing revenues; strengthening the position on the market, which is achieved by diversifying the offer of integrated products and services, corporate banking and retail banking activities; the intensification of banking prudence.

### MATERIALS AND METHODS

The research methods focused on the analysis of the performance dynamics of the banking system. In the content of the article, I highlighted theoretical and practical aspects of the performance of the banking system, I performed qualitative and quantitative analyses, with the aim of analyzing the results of the banking activity. Quantitative analyzes were based on dynamic analysis of performance rates. The research carried out was based on the data processed from the balance sheet and the profit and loss account of 11 banks from the Republic of Moldova, for the period 2018–2022, with the aim of capturing the evolution of the respective indicators.

### RESEARCH RESULTS

The term "performance" has a Latin origin (performo, -are, -atum) and broadly represents the level of achievement of objectives. In a strict sense, performance is the result of an action, and in a broad sense, it represents a set of logical steps to achieve the proposed objective [7], [14].

The quantification of a performance should not be limited to an indicator, to a result, but to the entire set of actions taken to achieve the proposed objectives.

The concept of performance is used more and more for a wide range of activities, and depending on this it is associated with success, growth, effort, etc. As far as the banking activity is concerned, performance is associated with the creation of added value, an optimal ratio between cost and benefits. [4], [12], [15].

Performance can be defined as the measurable level of stability of a bank's activity, characterized by reduced levels of risks of any nature and a normal trend of increasing profits from one analysis period to another.

At the same time, the improvement of banks' performance aims at an increase in profit, satisfying customer requirements in the most realistic way possible, improving the level of capital adequacy and properly managing the risks specific to banking activity. [1]

The performance of a bank can be highlighted with the help of a financial analysis system, built with the help of rates and which takes into account the correlation between profit and risk, looking at the management of bank assets and liabilities. The most used indicators for evaluating banking performance and solidity are grouped into: indicators regarding asset quality, indicators regarding profitability, indicators regarding banking risk.

In the specialized literature, the concept of "performance" is associated with the notions of "profitability" and "efficiency". The profit is the main source on the basis of which the banks establish their reserve funds, thus contributing to the increase of the bank's capitalization and taking preventive measures against possible losses recorded in case of default probabilities following the lending process. [7], [11], [13].

Bank profitability represents the bank's ability to obtain profit from all its activities and is an index for measuring efficiency. In this sense, net profit is considered a better measure of a bank's performance. In addition to net profit, indicators such as net interest margin and return on capital employed must be considered for evaluating profitability. Another aspect concerned is the structure of the two components of the profit and loss account (revenues, expenses). [2]

The improvement of banking performances indicates a better allocation of financial resources and therefore an increase in investments favors an increase in institutional performances.

Performance management intersects with that of the banking management field, quality being reflected in banking performance, directly related to the management of banking assets and liabilities, and reflected in the balance sheet and the profit and loss account. [2]

Banking performance is a function dependent on three variables: two quantitative (risk and profitability) and one qualitative variable (bank management). The strategic objectives of a commercial bank are assumed by the management team, within a time horizon of three to five years, and must be subject to the approval of the general meeting of shareholders. [4]

Within the analysis indicators of the performances of the banks in the banking sector of the Republic of Moldova, the following particularities can be highlighted: [10]

*Return on assets (ROA)* represents the profit or loss related to the exercise obtained in the managed period (Pnet) divided by the number of reported months (N), multiplied by 12, divided by the average assets for the managed period (Am) and multiplied by 100:

$$(ROA = (((Pnet) / N \times 12) / Am) \times 100) \quad (1)$$

The average assets for the managed period is calculated by summing the average monthly value of the assets for each managed month (not taking into account value adjustments and reductions for impairment losses (loss of value) to the respective assets) and dividing this amount by the number of reported months.

*Return on capital (ROE)* represents the profit or loss for the year obtained for the period managed (Pnet) divided by the number of months reported (N), multiplied by 12, divided by the average capital for the period managed (Cm) and multiplied by 100:

$$(ROE = ((Pnet) / N \times 12) / Cm \times 100) \quad (2)$$

*Non-interest expenses / total income* represents the non-interest expenses obtained for the managed period divided by the total income obtained for the managed period and multiplied by 100;

*Interest income/average value of interest-bearing assets* is the interest income obtained for the period under management (VD) divided by the number of months reported (N), multiplied by 12, divided by the average interest-bearing assets for the period under management (ADm) and multiplied by 100:

$$((VD / N \times 12) / AGD) \times 100 \quad (3)$$

The average interest-generating assets for the managed period is calculated by adding the average monthly value of the interest-generating assets for each managed month and dividing this amount by the number of reported months.

*The net interest margin (MJDnet)* represents the net interest income (interest income minus interest expenses) obtained for the managed period (Vnet af.d) divided by the number of reported months (N), multiplied by 12, divided by the average generating assets of interest for the managed period (AGD) and multiplied by 100:

$$MJDnet = ((Vnet \text{ af.d} / N \times 12) / AGD) \times 100 \quad (4)$$

The average interest-generating assets for the managed period is calculated by adding the average monthly value of the interest-generating assets for each managed month and dividing this amount by the number of reported months.

*The efficiency index (Ief)* represents: net interest income (Vnet af.d) plus non-interest income (Vneaf.d) divided by non-interest expenses (Chneaf.d) and multiplied by 100:

$$Ief = (Vnet \text{ af.d} + Vneaf.d) : Chneaf.d \times 100 \quad (5)$$

In order to determine the efficiency of a bank's activity (taken as a whole or at branch level), the simple elaboration of indicators is not enough. These indicators must be compared with similar indicators in order to be able to determine the real position of the bank from the point of view of profitability. [6]

Three types of comparisons are generally practiced: [7]

1. comparison with the indicators of the same bank over the years;
2. comparison with the average indicators of other banks during the same period;
3. the comparison with the planned indicators, when the bank elaborates its strategies on various terms structured in plans aimed at obtaining certain levels of profit.

The financial situation of the banking sector during the analyzed period 2018-2022 was satisfactory. The banks are sufficiently capitalized, their own funds constituted 18394.66 million lei in 2022, 4776.5 million lei more than in 2020 when the value was 13618.08 million lei and 3215.72 million lei more than year 2021 when they constituted 15,178.94 million lei.

During 2021, the Executive Committee of the NBM approved the results of the process of supervision and evaluation of the banks' activity, with the imposition of specific capital requirements for each bank, depending on the individual risk profile, which were respected by all the banks.

According to the reports presented by the banks, all banks complied with the "Total equity ratio" indicator (the limit for each bank  $\geq 10.0\%$ ) and the additional requirements imposed by supervisory measures.

The structure of the total own funds is made up entirely of 9 banks from basic level 1 own funds (total per sector – 14,740.1 million lei), and 2 banks (B "MOLDOVA-AGROINDBANK" S.A. and B.C. "ProCredit Bank" S.A.) they also have level 2 own funds

(subordinated loans in the amount of 299.8 million lei and respectively in the amount of 118.5 million lei). [8]

The Equity/Total assets indicator shows growth in the analyzed period from 13.12% in 2020 to 13.99% in 2022. On the other hand, the Total liabilities/Total capital indicator is reduced from 4.8% to 4.64%, which indicates a reduction in debt and an increase in the share of equity.

During the analyzed period, the significant share of foreign investments in the banks' capital can be observed. The share of foreign investments in the share capital of banks increases during the analyzed period from 86.63% in 2020 to 88.87% in 2022, i.e. by 2.16 percentage points. Among the foreign investors participating in the capital formation of banks in the Republic of Moldova are: banks from Italy, Hungary, Romania, as well as the European Bank for Reconstruction and Development and corporate investors from Germany, the Netherlands, Bulgaria, Austria, the United Kingdom of Great Britain, Greece, Iraq, Russia. Out of the total number of banks, 4 banks have capital made up entirely of foreign investments (including 3 subsidiaries of foreign banks and financial groups: B.C."EXIMBANK"S.A., BCR Chişinău S.A. and B.C."ProCredit Bank"SA), 6 banks - of capital consisting of foreign and domestic investments and a bank – of capital consisting entirely of domestic investments. [9]

According to the Annual Report of the National Bank of Moldova for the year 2021, the increase in own funds was determined by the banks' reflection of eligible profits after holding general meetings of shareholders and after obtaining the NBM's permission to include in own funds the profits made in the total amount of 1,405 .2 million lei. In 2021, the NBM, considering that the effects of the COVID-19 pandemic persist, creating uncertainties on the banks' external economic environment, as well as in order for licensed banks to maintain an adequate level of own funds and liquidity to ensure viability and stability to them, in the context of the subsequent effects of the COVID-19 pandemic, recommended that banks apply a prudent approach regarding the decision to distribute dividends. [8]

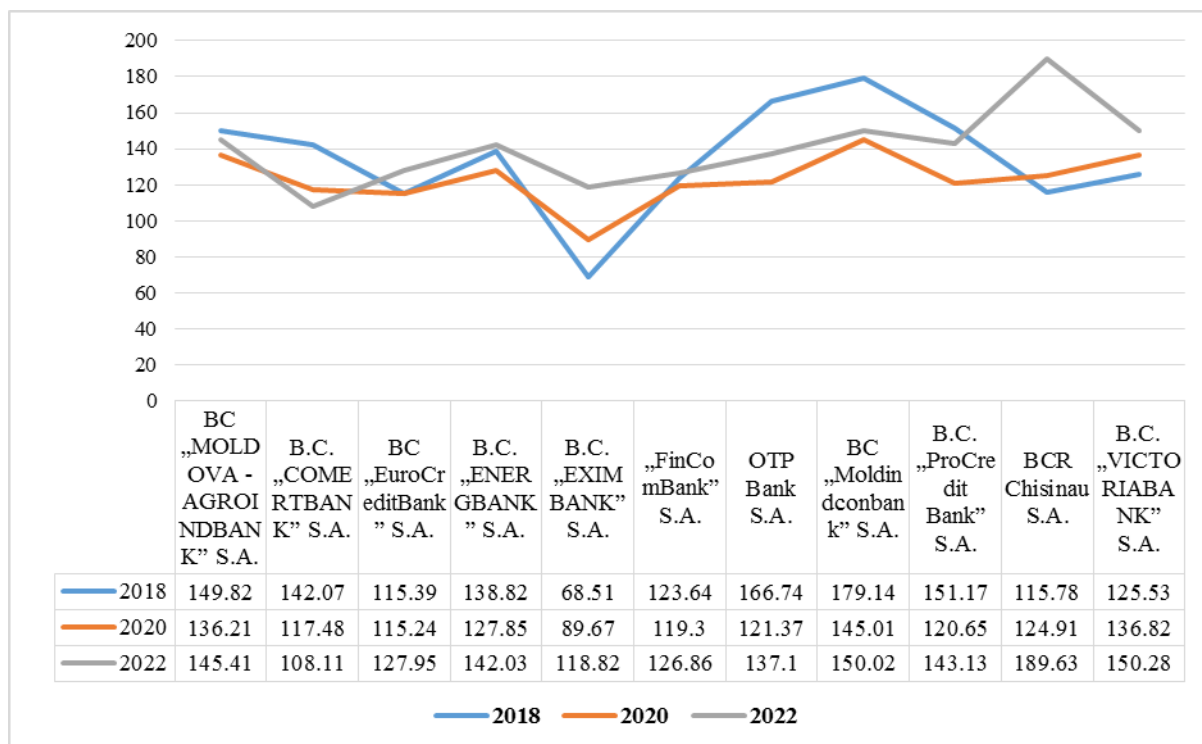
**Table 1**

**Revenues and profitability of the banking sector in the Republic of Moldova for the period 2018-2022, %**

	Years				
	2018	2019	2020	2021	2022
Return on assets (ROA)	1,90	2,47	1,53	2,00	2,89
Return on capital (ROE)	11,60	14,63	8,89	12,26	17,03
Net interest income / Total income	41,09	41,73	39,12	43,00	48,94
Non-interest expenses / Total income	55,36	51,06	63,56	60,69	57,54
Annualized interest income / Average monthly value of interest-generating assets	6,52	6,36	5,37	5,41	9,03
Net interest margin (MJDnet)	4,31	4,39	3,76	4,09	6,67
Efficiency index (Ief)	142,65	159,25	130,82	141,95	143,64

*Source: developed by the author based on the Information on the economic and financial activity of banks in the Republic of Moldova 2018-2022 [10]*

The return on assets in 2022 registers the value of 2.89%, the highest level in the analyzed period. The lowest value is recorded in the pandemic year 2020, of 1.53%. The return on capital was 17.03% in 2022, 5.43 percentage points more than at the beginning of the analyzed period. The lowest value is also recorded in 2020 and is 8.89%. The net interest margin increases from 4.31% in 2018 to 6.67% in 2022, registering a value of only 3.76% in 2020.



**Figure 1. Dynamics of the efficiency index of commercial banks in the Republic of Moldova, %**

*Sursa: developed by the authors on the basis of information on the economic and financial activity of banks in the Republic of Moldova [10]*

The efficiency index was 143.64% in 2022, 0.99 percentage points more than in 2018. The highest value of the indicator of 159.25% is obtained in 2019, and the lowest of 130.82 % in 2020.

From the data in figure 1, it can be noted that most banks register the same trend of the efficiency index: the lowest level in 2020 and a return or even the highest level of the indicator until the end of 2022.

## CONCLUSIONS

The performance of the banking activity, in the context of different banking business models, depends directly on the bank's managerial policy and the correct management of the bank's assets and liabilities. The banking performance measurement models are developed depending on the configuration of the banking business models, the market situation and corporate governance.

The evaluation of the activity of the banking units based on the performance criteria can contribute to the qualitative analysis of the results of the activity of each profit center, regarding the revenues, expenses and the results obtained compared to the activity of the other profit centers, as well as to the results obtained in its previous periods.

Any commercial bank in the Republic of Moldova aims to obtain high profit by entering the legal level of activity. The domestic banking system has experienced continuous changes in the establishment of business strategies, influenced by changes in the market situation, the high level of corruption, bank frauds, the management's desire to increase the banks' profitability, as well as crises in the context of the analyzed period (Covid-19, the energy crisis, the war in Ukraine). All this has caused the need to adapt and establish appropriate measures to ensure the achievement of performances.

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