
Assessment of the Balance Degree of Loan Companies Banking Policy

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Abstract:

Achieving a balance in the management of banking transactions in the crisis tendencies in the national banking system becomes a priority for bank management. The need for finding a solution to this problem is determined by the persistence in the national banking sector a number of dislocations caused by narrowing of the resource base of loan companies, by low efficiency of bank capital allocation, and high-risk credit policy. These dislocations determine the imbalance of the banks' policies and cause the strengthening of the financial sector of point defaults, which inevitably lead to the systemic risk of the entire banking sector activities. The solution of the designated problem requires the development of methodological tools and allows us to give a comprehensive assessment of the balance of the banking policy of loan companies and to take timely organizational actions.

In this article the authors proved the approach to assessing the balance of the banks' policies, based on a comprehensive analysis of the balance between active and passive banking operations, including liquidity, stability, profitability as well as risks and assets' quality. The assessment is made through calculating the coefficients and indicators for the above criteria groups that allows ranging loan companies depending on the actual value of the resulting final indicators in banks with: 1) high-balanced; 2) satisfactory-balanced; 3) low-balanced bank policy.

Key Words: *banking policy, balance, liquidity, profitability, sustainability, risks, imbalances, quality*

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1. Introduction

1.1 Introduction to the Problem

Modern Russian banking system is characterized by insufficient resource base of loan companies, predominance of short-term liabilities, persistence of high risk for funds placing, growth of bad debts and as a result, aggravation of financial results of loan companies. The appearance of the above-mentioned imbalances is explained by the behavior of commercial banks with unbalanced banking policy. Loan companies neglect the need to develop the bank portfolio, balanced on its main parameters: the volume of attracted and placed resources, terms, financial resources cost. As a result, banks face with liquidity shortages and reduce their financial stability that in crisis conditions leads to bankruptcies and revocation of the license. As a result, there is a need to make balanced banking policy based on a thorough, careful and continuous quantitative and qualitative structural and dynamic analysis of active and passive operations, early detection of interbank dislocations, analysis of their causes and their elimination in the future.

1.2 Exploration of the Importance of the Problem

The ways of assessing the activity of loan companies used in the banking practice showed the imperfection of the analysis methods of the balance of the banking policy. Currently, in the banking practice there is no unite approach to assessing the balance of banking policy of loan companies. They are independently developing methodological basis for assessing the balance and contingency of active and passive operations. This internal development of banks affects mainly credit activities, is based on an intuitive level, and doesn't have sufficient methodological support. So the research to develop methodological tools for its practical use in integrated assessment of the degree of the banks policies balance is relevant. It will help to aim the loan companies at the early detection and solution of problems appeared in their work.

1.3 Review of the Literature

Analysis of the survey results conducted by leading Russian and foreign scientists on banking activities indicates the presence of interest in the issue that we studying. Problems of formation of banking policy and assessment of its risks are studied in the works of Lavrushin (2014), Zhukov (2012). At the same time, as noted by Greuning & Bratanovic (2009), “changing environment in which banks operate, offers plenty of opportunities for them, but at the same time has complex and diverse risks, challenging traditional approaches to bank management”.

The following authors whose works address the issues of sustainability and balance in loan companies are worth noting: Evans et al. (2000), Carson & Ingves (2003), Lai (2002), Villar (2006), Fetisov (2003).

Alongside with this, the study of publications on the above mentioned topic of scientific research has shown that in the scientist's works there is no adequate

coverage of the issues related to the development of methodological tools for a comprehensive assessment of the balance of the banking policy. The solution to this problem will allow the loan companies to conduct constant monitoring in order to identify the degree of balance of the banking policy by its main parameters (volume, term, profitability).

1.4 Hypotheses and their Influence on the Research

Considering insufficient attention to this problem, the main target of the study is development of a comprehensive methodology for assessing the balance of banking policy, allowing risk management to timely detect the presence of structural imbalances in the resource activity of the loan company and adequately respond to emerging imbalances.

This target can be achieved by solution of the following logically related tasks:

- grounding the methodology for assessing the degree of balance of the banking policy;
- the definition of criteria to assess the degree of balance of the banking policy;
- testing the developed techniques on the loan companies: JSC-IB “KS BANK”, Interregional Industrial and Construction Bank, PJSC “AKTIV BANK” (the Republic of Mordovia);
- identification of the major imbalances in resource policy of the studied banks;
- summarizing the study.

2. Method

2.1 The Method of Mathematical Formulation and Economic Analysis

Substantiation of the methodology for assessing the degree of balance of the banking policy is achieved through selection of appropriate criteria, such as the balance of liquidity and stability; the balance of profits; the balance of indicators of banking risks and quality. Then the definition of the coefficients and indicators is made that most accurately characterize the balance of the banking policy. The final stage is the presentation of the formula of calculating the aggregated indicator for assessment the balance of the bank policy and establishment of the upper and lower thresholds for determining the degree of balance of the banking policy.

2.2. The Method of Qualitative Description

Based on this method the description of qualitative characteristics of banking policy is made, which will range the loan companies according to the degree of the balance of their policies as banks with: 1) high-balanced; 2) satisfactory-balanced; 3) low-balanced policy.

2.3. The Method of Analysis and Synthesis

Based on the developed methodology the authors analyzed three regional commercial banks of the Republic of Mordovia: JSC-IB “KS BANK”, Interregional

Industrial and Construction Bank, PJSC “AKTIV BANK”. As an information base for the analysis financial and accounting statements of the above commercial banks for the period 2007-2013 were used, as well as aggregates from rating agencies. The results showed that the commercial banks are characterized by a satisfactory degree of balance of their policy. This trend is observed throughout the study period, and is a consequence of the identified dislocations in the activities of loan companies.

2.4. The Method of Observation, Generalization and Logical Conclusions

The process of determining and marking of the imbalances in the activity of loan companies is characterized by the lack of balance between passive and active operations of banks on terms, structure, and efficiency. The recommendations are suggested, developed with the use of the method of logical conclusion and designed to provide a balanced banking policy.

3. Results and discussion

Methodology of comprehensive assessment of the balance of the banking policy is made on the basis of the analysis of passive and active banking operations in the following directions:

- 1) balance of liquidity and stability of loan company;
- 2) balance of profitability of the loan company;
- 3) balance of indicators of banking risks and quality.

Assessment is made by calculating the coefficients and indicators that most accurately reflect the degree of balance of the banking policy.

Assessment indicators of the balance of commercial bank policy are systematized and summarized in Table 1. Depending on the actual value of these parameters, they can be classified into one of three classes by an expert (for qualitative indicators) or, depending on the deviation of the optimal parameter to the negative side for the loan company (for quantitative indicators).

Consolidated indicator of bank balance policy (CAP) can be calculated by the following formula:

$$BBP = \sum_{i=1}^3 \frac{FAB}{3} \quad (1)$$

where BBP – balanced banking policy, in points;

FAB – the final assessment of the balance of the group of given indicators.

Thus, the average value for obtained classes on the above criteria will determine the degree of balance of the banking policy of the loan company. At the same time the value obtained is characterized as:

- 1) High, if the value of the consolidated indicator for all the criteria groups ranges from 1 to 1.5;
- 2) Satisfactory, if the final result is more than 1.5 and less than 2.5;
- 3) Low, if the consolidated indicator values are over 2.5.

We'll highlight the qualitative characteristics of banking policy, depending on the level of its balance. The high degree of balance of bank policy is characterized by the relevant indicators of liquidity, stability, profit, quality and risks of active and passive operations for their optimal values, or having a maximal deviation from the optimal values in positive or negative direction at a rate of 10%. This level of the balance of the banking policy proves the stability of the commercial bank and its effective activities in which there is a coordinated interaction of qualitative and quantitative connections of all the elements of the banking process and the matching between the volume of attracted and placed resources.

Management of any loan company must ensure a high degree of the balance of the banking policy in order to improve the efficiency and reliability of the banking activity, as well as reduce the negative effects of the crisis on the banking process as a whole.

Implementation of the balanced banking policy by commercial bank helps to improve the interaction between all the components of banking activities; qualitative growth of capital, placed and attracted resources; and timely response to the impact of negative processes and banking decision-making, increasing the stability, reliability and image of the bank.

To achieve a high degree of balance of the banking policy, each loan company should optimize banking processes through the implementation of innovative methods of active and passive operations management and by the formation of an adequate system of banking risks minimization. Ensuring a high degree of balance of the banking policy requires support of qualified staff at all the stages of the banking process.

The balanced banking policy can be achieved only through agreed actions on its implementation, aimed at improving the quality of the banking process, reducing the banking risks and increasing customer's satisfaction, while maintaining maximal profitability.

A satisfactory level of balance of the banking policy is characterized by the presence of significant deviations of the optimal balance from the performance values. These deviations may be more than 10% in both negative and positive direction. In that case the loan company's resource policy is characterized by the lack of liquidity and balance, stability, profitability, quality and high risks; incomplete qualitative and quantitative interaction between the elements of the banking process and relative

mismatch between the amount of active and passive resources and the need for them.

A satisfactory level of balance of the banking policy is a transitional stage on the one hand, to ensure a high degree of balance in the banking policy, and on the other hand, in the framework of strengthening of the imbalances in the banking capital to the crisis of values to low degree.

Reasons for compliance of a policy of significant part of the national loan companies with the satisfactory level are concluded in the strengthening of the crisis phenomena in the banking sector. The crisis phenomena are caused by the following macroeconomic problems:

- dominance in the national banking system of the state-owned banks, which determines their proactive support from the budget;
- high fragmentation and localization of competition in the banking market;
- weakness of the banking regulation and supervision, resulting in a high number of revoked licenses from banks under the growing crisis trends;
- existence of the risks associated with low transparency of owners of loan companies;
- instability of the resource base of commercial banks, including the reduction of the possibilities of borrowing on foreign markets;
- high concentration of loan risks.

Banks policy characterized by a satisfactory degree of balance is not able to overcome the deficit/surplus of liquidity, and effectively manage banking risks, smooth banking activity even in the crisis. The problems mentioned above caused stiffening of the banking policies, reduction of the resource base, while worsening the quality of loan portfolios, reducing the profitability of the banking business.

Solving these problems will help to overcome the lack of a balance in the banking policies for the majority of loan companies and move into a new and effective model of banking business. Careful analysis of the banking policy of the loan company and the identification of the problems of its implementation requires competent actions from the bank in line with the contingency and coordination of all business operations, sustainability and effectiveness of banking activities.

Low degree of banking policy balance is characterized by an imbalance on all its assessment criteria. At the same time there are dramatic deviations from the optimal set of values. This policy proves the high-risk activity done by the management of the loan company or inactivity on the risk management of the bank during the necessity for the solution of the problems in the management of passive and active operations.

Low degree of balance of the bank policy leads to an increase in bank risk, especially in the loan area, helps to reduce bank resources, and as a consequence causes inefficient activity of the commercial bank. By implementing this policy, the bank is faced with the threat of losing financial stability. Low degree of balance of

the banking policy requires from the management of a commercial bank to take a complex of measures to optimize the bank's portfolio, stabilization of the banking activities and minimization risks.

Based on the methodology developed by the authors the following three regional commercial banks of the Republic of Mordovia were analyzed: JSC-IB "KS BANK", Interregional Industrial and Construction Bank, PJSC "AKTIV BANK" (Tables 2, 3, 4).

As an information base for the analysis of the above mentioned loan companies accounting and financial reporting of commercial banks JSC-IB "KS BANK" (PJSC) (2014), Interregional Industrial and Construction Bank (2014), PJSC "AKTIV BANK" (2014) were used for the period 2007-2013; as well as aggregates of rating agencies presented on the portal of banking analyst (Banking analyst portal, 2015).

The results of the analysis showed that all three commercial banks throughout the study period were mainly characterized by a satisfactory degree of balance of their policy. In the PJSC "AKTIV BANK" in 2007 and 2010 there was a high degree of balance, however, impossibility of retaining a high degree of balance by a commercial bank in the long term should be noted due to the functioning of the loan company in the ever-changing market conditions.

Analysis allows the authors to state that there are significant imbalances in terms, time and efficiency of active and passive resources in the studied loan companies. This trend appeared throughout the study period, explained by the following factors identified in the activities of loan companies:

- 1) the studied loan companies didn't have banking policies to balance itself in the medium and long term. Management took short-term measures to stabilize the situation to ensure financial stability.
- 2) in the conditions of negative situation on the financial market (2008-2009) banks' risk management did not pay a sufficient attention to the implementation of anti-crisis measures, which determined the imbalance of almost all the indicators of the banking policy.
- 3) the lack of uniform growth rates of profitability, which suggests the absence of a balanced approach in operations.
- 4) conduction of high-risk loan policy, characterized by a high degree of concentration of loan portfolios of the studied banks.

According to the authors, the removal of the identified imbalances is possible by creation of permanent monitoring criteria of the balance of banking policy on the basis of the above mentioned methodology. Formation and implementation of the balanced banking policy by loan companies should consider the following measures:

- 1) providing the necessary proportions between owned and attracted funds by banks to comply with liquidity ratios;

- 2) commitment to the development of reliable and relatively cheap resources that have the possibility for long-term placement in the region's economy;
- 3) the creation of loan policy, taking into account the effective and rational distribution of resources, including the compliance with the terms and volumes of attracted and placed funds;
- 4) the formation of the optimal structure of assets with an increase in the share of liquid assets in it.

It worth noting, that the proposed method of determining the degree of balance of the banking policy of the loan company is a framework. On its basis for industrial (specialized) banks individually-oriented indicators can be developed that are included in the criteria for balance and aimed at ensuring a balanced banking policy in both short and long terms. Assessment methods of the balance of bank loan policy allow companies to find problem areas, determine the dislocations in the implementation of the resource policy based on performance. So, the consistent use of this technique and monitoring the criteria will allow the management of the loan companies to make timely decisions to establish and maintain high balanced activities of the loan company.

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Tables

Table 1. Method of determining the degree of banking policy balance of loan companies

Indicator		Formula	Notes	Points distribution		
				1 point	2 points	3 points
1		2	3	4	5	6
1. The analysis of the balance of liquidity and the stability of the commercial bank						
Acid ratio (A)		Indicator is calculated according to the Instruction of the Central Bank of the Russian Federation №139-I from 03.12.2012	Controls (limits) the risk of bank liquidity during one day	≥ 17	< 17 and ≥ 15	≤ 15
Bank-liquidity ratio (B)		Indicator is calculated according to the Instruction of the Central Bank of the Russian Federation №139-I from 03.12.2012	Controls (limits) the risk of bank liquidity during the nearest 30 calendar days to the date of calculation	≥ 55	< 55 and ≥ 50	≤ 50
Long-dated bank-liquidity (C)		Indicator is calculated according to the Instruction of the Central Bank of the Russian Federation №139-I from 03.12.2012	Controls (limits) risk of loss of bank liquidity as a result of placing funds in long-term assets	≤ 60	> 60 and ≤ 120	≥ 120
Liquidity ratio	In short term, up to 1 year (D)	Short-term assets/short-term liabilities *100%	The relative value, expressed as a percentage, shows the liquidity in the short term period	from 90 to 110%	from 80 to 89 % and 111 to 120%	Less than 79% and more than 121%
	In the medium term from 1 to 3 years (E)	Medium-term assets/medium-term liabilities *100%	The relative value, expressed as a percentage, shows the liquidity in the medium term period	from 90 to 110%	from 80 to 89 % and 111 to 120%	Less than 79% and more than 121%
	In long-term period, over 3 years (K)	Long-term assets/long-term liabilities *100%	The relative value, expressed as a percentage, shows the liquidity in the long term period	from 90 to 110%	from 80 to 89 % and 111 to 120%	Less than 79% and more than 121%
Indicator of capital adequacy (L)		Indicator is calculated according to the Instruction of the Central Bank of the Russian Federation №139-I from 03.12.2012	Controls (limits) the risk of insolvency of a loan company, and defines the requirements for the minimum amount of the capital of loan companies required to cover credit, operational and market risks.	≥ 13	< 13 and ≥ 10	< 10
Resource base stability factor (M)		The amount of term deposits/deposit portfolio	A high value of the indicator shows the stability of the resource base, which is essential for lending operations	≤ 25	> 25 and ≤ 50	> 50

Total assessment 1 is	$(A+B+C+D+E+K+L+M)/8$				
2. Assessment of balance in profitability indicators of commercial bank					
1	2	3	4	5	6
Growth rates of return on equity, % (A)	Return on equity of the current year/previous year	The relative value expressed as a percentage, reflects the change in return on equity during the study period	from 0 to $\pm 10\%$	from 11 to $\pm 25\%$	over $\pm 25\%$
Growth rates of return on assets, % (B)	Return on assets of the current year/previous year	The relative value expressed as a percentage, reflects the change in return on assets during the study period	from 0 to $\pm 10\%$	from 11 to $\pm 25\%$	over $\pm 25\%$
The growth rate of the interest margin, % (C)	Interest margin of the current year/previous year *100%	The relative value, expressed as a percentage, reflects the change in the margin interest rate on lending operations made during the study period	from 0 to $\pm 10\%$	from 11 to $\pm 25\%$	over $\pm 25\%$
Capital multiplier (D)	Total assets/owned capital	It shows the ability of a commercial bank capital to attract funds without endangering the stability and profitable operation of the loan company	≥ 10	< 10 and ≥ 6	< 6
Total assessment 2 is	$(A+B+C+D)/4$				
3. Assessment of the balance of indicators of risk and quality of a commercial bank					
Riskiness of loans coefficient (A)	Reserves for loans/loan portfolio	It shows the share of reserves attributable to one ruble of the loan portfolio and allows evaluating the risks of the loan portfolio of the loan company	≤ 10	> 10 and ≤ 25	> 25
Concentration ratio of large loan risks (B)	Indicator is calculated according to the Instruction of the Central Bank of the Russian Federation №139-I from 03.12.2012	Controls (limits) the aggregate value of the bank's large loan risks and determine the maximum ratio of the total amount of major loan risks and the size of bank's owned capital.	≤ 200	> 200 and ≤ 750	> 750
The share of overdue loans in the loan portfolio (C)	Loans overdue more than 30 days/loan debt	It shows the share of overdue loans over 30 days in the loan portfolio	≤ 4	> 4 and ≤ 18	> 18
Indicator to assess the quality of capital (D)	Additional capital/basic capital	It shows the quality of the capital of loan company	≤ 30	> 30 and ≤ 90	> 90
Total assessment 3 is	$(A+B+C+D)/4$				
Final result (Balance of bank policy), points	$(\text{Total assessment 1} + \text{Total assessment 2} + \text{Total assessment 3})/3$				

Table 4. Assessment of the balance degree of indicators of bank policy of PJSC “AKTIV BANK”

Indicator		Years						
		2007	2008	2009	2010	2011	2012	2013
1. Assessment of balance of liquidity and stability indicators of PJSC “AKTIV BANK”								
Acid ratio		1	1	1	1	1	1	1
Bank-liquidity ratio		1	1	1	1	1	1	1
Long-dated bank-liquidity		2	1	1	1	2	2	1
Liquidity ratio	In short term, up to 1 year	3	1	1	1	3	1	1
	in the medium term from 1 to 3 years	3	3	3	3	3	3	3
	In long-term period, over 3 years	3	3		1	3	1	3
Indicator of capital adequacy		1	1	1	1	1	1	1
Resource base stability factor		No data	No data	No data	No data	2	1	1
Total assessment 1		2,00	1,57	1,33	1,29	2,00	1,38	1,50
2. Assessment of balance of profitability indicators of PJSC “AKTIV BANK”								
Growth rates of return on equity, %		No data	3	3	1	2	3	2
Growth rates of return on assets, %			3	3	1	1	3	3
The growth rate of the interest margin, %			2	1	1	3	3	2
Capital multiplier		2	2	1	2	2	2	2
Total assessment 2		1	2,50	2,00	1,25	2,00	2,75	2,25
3. Assessment of the balance of risk and quality indicators of PJSC “AKTIV BANK”								
Riskiness of loans coefficient		1	1	1	1	1	1	1
Concentration ratio of large loan risks		2	2	2	2	2	2	2
The share of overdue loans in the loan portfolio		1	1	1	1	1	1	1
Indicator to assess the quality of capital		No data	No data	No data	No data	2	2	2
Total assessment 3		1,33	1,33	1,33	1,33	1,50	1,50	1,50
Final result		1,44	1,80	1,56	1,29	1,83	1,88	1,75
Balance level		High	satisfactory	satisfactory	High	satisfactory	satisfactory	satisfactory