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Corporate Governance in Banking System Case Study Albania

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ABSTRACT

The financial sector in the Balkan countries, especially the banking sector is having gradual improvement on the last years. The Corporate Governance in banks is one of the most important discussions overall the world, being reinforced especially after the crises period. Recently, it has been noticed a fast reaction and total focus from all banks on building and improving their structures of Corporate Governance. This study aims to analyze the corporate governance policy in the major banks of Albania. The research methodology used is mainly empirical through researches in the annual reports and websites of the banks, information published in the websites of banks in Balkan countries especially in Albania.

KEYWORDS : corporate governance, banking system, Albania

1. Introduction

Corporate governance is defined by the OECD as involving a set of relationships between the company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set. In the banking sector, corporate governance was addressed at the international level by the BCBS long before the recent financial crisis. Effective corporate governance practices are essential to achieving and maintaining public trust and confidence in the banking system, which are critical to the proper functioning of the banking sector and economy as a whole. The corporate governance regime in a jurisdiction often consists of rules adopted at several levels: company law, securities markets legislation/ listing rules, corporate governance codes, and sector-specific banking laws and regulations (e.g., adopted by a national central bank). Corporate governance in banks differs from the "ordinary" corporate governance of companies. This is due to the nature of the banking business (i.e. dealing with money), the need for protection of the weakest party in the chain (i.e. the depositor) and the systemic risks that a bank failure might cause.

The research on the subject for the Balkan area is limited enough and there are only a few working papers performing several analyses. OECD, Organization for Economic Co-Operation and Development has been the most active in publishing frequently topics and raising discussions through different panels considering as very important the role of Banks in corporate governance system. The objective of our research is to analyze the corporate governance in Balkan countries and how important is its role in the banks' performance especially in terms of sizing, expansion and profitability, as well as the role of international groups in improving the corporate governance of the banking system.

2. Corporate Governance in Balkan countries

The research methodology used is mainly empirical and qualitative. It is combined with the desk research of the annual reports of banks, the evaluation of their structures, interviews with the contributors in this research, completed in the main part the results of the analysis. Not all banks are obliged to publish data on their organizational structures and the composition or functioning of their committees. There were only a few banks having corporate governance policy published in sites and/or in their annual reports.

Finally, a deep review on the different working papers mentioned above, as well as the different publications in the EBRD and OEDC websites, was performed in order to complete the research and analysis. Considerable information has been downloaded from the websites of banks in Albania regarding banking system situation and development.

Corporate Governance in banks in Balkan countries is a new concept introduced gradually in the respective banking systems. It is part of the European Integration process and imposed through the OECD and Basel Committee principles. The fast expansion of the banking system mainly performed during the last 15 years, was not associated by a fast establishment of structures to support good corporate governance. Especially after "post-socialist" period, Balkan countries are experiencing different growth trajectories. The banking sector in Balkan countries is comparatively more advanced than the securities markets. In the large majority of countries in the region, stock exchanges are illiquid or characterized by limited trading and continuous changes. Taking into account the necessity of the local economies for new fund injected in order to support the development and evaluating the important positioning of banks in their development prospects, the local governments become the major support for these fast expansion and growth of the banking system.

3. Corporate Governance in Albania

The banking system in Albania is one of the newest in the area, being established on the last 15 years, starting with the privatization of one of the first state owned banks in 1994. In 2000 was the start of the banking system for Albania that currently is composed by 16 Banks. The presence of the foreign capital is dominant in all banks, such as in Intesa San-Paolo Bank, Raiffeisen Zentrale Bank, Societe Generale, and Credit Agricole. As common characteristic of Albanian banks, the Board of Directors is composed by the managers of the group and only two or three members are executive directors of the subsidiary. The presence of the local management though is quite invisible since mainly the top management of subsidiaries of foreign groups is not local staff, but expatriates. There are efforts from the central bank recommending in increasing the presence of the local staff in the Top Management level of banks, as well as in the Board of Directors composition. The Board of Directors is convoked on frequent basis (usually on monthly basis) according to a preliminary approved schedule depending on the size of the bank and according to the development stage of it.

From the other side, referring to the subject, a total indifference from the local government side is noticed despite the efforts performed in the framework of joining the European Union. The legal environment is not covering important issues for building the grounds of the corporate governance structure in the country. Issues like shareholders' right protection, agreements' enforceability, managers' and employees' rights are lacking in the system by not providing for a healthy business in the proper corporate governance environment. Moreover the frequent reports of deposits insurance is not compulsory for all banks, it is requested in specific cases and mainly during the yearly inspection by the respective Agency for Deposits' Insurance.

Albanian banks are governed in an insider model fashion, like other general firms in Albania. However, the model consists of different patterns due to banking regulation and highly concentrated ownership. We find that parent banks have beyond reasonable influence in setting long-term performance objectives of their affiliated banks in Albania. Therefore, we argue that, apart from economic slowdown and shortfalls in collateral execution, the current high and increasing level of NPLs in Albanian banking might partially be a result of low independence of Boards and quality of Board membership in general. In addition to independence, a crucial determinant of good Board per-

formance is their collective knowledge and education, which depends on the harmonization of their qualifications, skills and professional experience.

4. Corporate governance and banks' performance

It is a fact that in the Balkan countries the Banks, especially the penetration of foreign groups was very aggressive during the last 10 years. Different researchs shows at a great extend that along with the expansion in the local markets, banks were giving importance to the internal control policies as well and the establishment of corporate governance policies. It was noticed that the expansion of the bigger banks, having well established structures and strong corporate governance was strongly related with the growth rate of this banks in the Balkan region. The existence of fixed organizational structures and clear definition of reporting lines and accountability provides for an improvement of the internal control, as well as a very efficient operational activity with clearly defined roles and responsibilities.

Therefore the commercial performance of banks in the Balkan countries despite the short period of expansion is at very satisfactory levels. A special case remains Albania that has no corporate governance structure and still the performance of the banking sector is one of the best in the region. One explanation may be the fact that 15 out of 16 banks in Albania belong to foreign banking groups and their corporate governance policy is propagated in the country's subsidiaries as well. Another explanation is that apart from the good performance of the banking system, the size of it compared to the other countries remains still as low level due to the current potential of the local market. In Albania, Raiffeisen Bank is the leader of the market in all aspects, followed by Intesa San Paolo and Alpha Bank (in terms of assets and profitability). The steady structure of the above banks seems to be autocratic in most of the cases but it fully complies with the principles of the good corporate governance.

Conclusions and Recommendations

The banking sector in Albania is well organized from a regulatory and institutional view point, disposing regulations, internal procedures and practices, elements of good governance. The majority of banks in the region are subsidiaries of international banking groups. Corporate governance codes require listed companies – and banks – to disclose their structure under the so-called comply or explain mechanism, but the monitoring of such practices is weak in all countries in the region. Further, the quality of information included in annual reports is very different among jurisdictions. In some cases the reports only provide a superficial description of the bank's business and assets portfolio, providing only little valuable information. A simplification of the annual report's structure would be welcome. On the other hand, the definition of independence and the composition, role and functions of the committees vary. In some cases, board committees can include persons not sitting on the board, while there is no test for their independence. Above all, the recent crisis evidenced a crisis of knowledge and competence in the banking sector. There is much need for both a constructive dialogue on corporate governance with authorities and training of directors.

From the analysis, it was seen that a strong corporate governance structure has a positive impact on the banking system performance. Another result of the research was the intensification of efforts from the local governments and the central banks with reference to corporate governance subject, especially after the world wide crises in 2008. Effective practices of corporate governance are essential for achieving and maintaining public trust and confidence in the banking system. Poor corporate governance leads to bankruptcy of the bank, which may cause public costs and consequences considering the impact on the deposit system.In addition, weak corporate governance can lead markets to lose confidence in the bank's ability to manage its assets and liquidity, including deposits, which may in turn lead the bank toward a liquidity crisis.

In terms of recommendations, the most important one is addressed to the enhancement of the corporate governance principles in the Balkan countries complying fully with the OECD principles and instructions. In addition, frequent monitoring tools for controlling the application of such principles in the countries should be in place. A better definition of reporting and accountability is needed and as well the transparency is required. The application of the corporate governance principles will ensure a better economical environment for companies and especially for banks.

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