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SUSTAINABILITY OF FINANCIAL INTERMEDIATION - THE MAIN CHALLENGE OF THE BANKING FINANCIAL SYSTEM IN ROMANIA

Associate professor PhD. Anisoara Niculina APETRI
Stefan cel Mare University of Suceava, 720229, Romania
anisoarad@seap.usv.ro

Abstract
The main objective of the financial system in an economy is to ensure long-term economic growth through the efficient financing of the economy. Thus the purpose of this research is to analyze and evaluate the level of financial intermediation at the level of the financial-banking system in Romania in the post-crisis period. The objectives set to be achieved through this research refer to identifying the level of the degree of financial intermediation and formulating measures to improve it. In order to achieve these objectives, we have used a series of statistical methods of centralization and graphical representation of the data regarding the evolution of credit granted to the private sector and GDP, data available on the National Bank of Romania's website. The conclusions of the study highlight a low level of financial intermediation in Romania and propose a set of measures to improve its level.

Key words: *financial-banking sector; financial intermediation; non-performing loans (NPL); sustainability of financial intermediation.*

JEL Classification: *E51; G21.*

I. INTRODUCTION

In any modern economy, the financial-banking sector plays an important role due to financial intermediation, namely the channeling of funds from depositors to investors, which they provide. A solid and efficient financial sector encourages the accumulation of economies and allows their allocation to the most productive investments, thus supporting innovation and economic growth. The study "*Economic and social impact of the banking system in Romania"*, conducted by Price waterhouse Coopers, shows that the banking system in Romania contributed 4.2% to the cumulative GDP of Romania from 2012-2016, with approximately 30 billion euros, when taking into account the direct, indirect and induced effects on the economy. The positive impact on the GDP is created by the banking services (direct effect), the higher production of the banks' suppliers in Romania and of their suppliers, as a result of the purchases of goods and services made by the banks (the indirect effect) and the additional consumption of the employees from the banking system and the employees of all the suppliers along the value chain, generated by the spending of wages received in the economy (the induced effect).

In Romania and in Europe, the main financial intermediaries are banks. For this reason, we considered in the present study the analysis of the data regarding the non-governmental credit available on the website of the central bank of Romania.

The aim is to analyze the evolution of the degree of financial intermediation in Romania, especially in the post-crisis period and not only. The objectives pursued were:

O1: The identification of the level regarding the financial intermediation degree;

O3: The identification of the causes of the low level of financial intermediation in Romania;

O2: The formulation of measures to improve it.

Depending on the availability of the data, we used a series of statistical methods of centralization and graphical representation of the data regarding the evolution of credit granted to the private sector and GDP, and we calculated the ratio credit / GDP to identify the level of the financial intermediation degree.

The present paper is structured in three parts. Thus, the first part of the paper presents the main articles of recent years that have addressed this topic and which constitute the state of knowledge. The second part of the paper highlights the structure of the financial system in Romania, and the third part presents the results of the research.

The study shows that during the analyzed period the degree of financial intermediation is low, Romania being the last place in Europe. Based on these considerations, the increase of financial intermediation represents the main structural challenge in the medium term, which is manifested at the level of the financial-banking system in Romania, although the banking sector has resources for increasing the exposure to the real economy.

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II. Literature Review

In the last decades, the issues regarding the financial system and financial intermediation have been widely debated both in the specialized literature and by specialists and practitioners in the financial-banking field. Several authors have tried to formulate the definition of the concept of financial system.

Thus, in the opinion of Văcărel and Bistriceanu (2007: 70), the financial system is analyzed from a quadratic point of view: as a set of financial relations; as a set of financial funds; as a set of financial plans and as a set of financial institutions.

Other authors consider the financial system as a set of interrelated institutions (Dragota, 2011: 8), as a set of markets, instruments and intermediaries whose objective is the mobilization and efficient use of financial funds (Corduneau, 2006: 10). Andrieș, (2010: 15) defines the financial system as an ensemble of markets, intermediaries and infrastructures through which individuals, legal entities and public authorities finance their activity and invest their economies. The financial system plays the role of financial intermediary between those who have surplus resources and those who need funds.

Based on this aspect, the specialists from the economic field have identified and attributed a number of functions of the financial system, the most important of which is to facilitate the transfer of funds (Boot & Thakoor, 1997) between the participants in the financial system. Andrieș (2010: 17) identifies three ways to make transfers:

• direct transfer between those who make surplus and those who lack financial funds;
• transfer through financial markets;
• the transfer with the help of financial intermediaries also called indirect transfer.

Freixas and Rochet (2008: 15) define financial intermediaries as those financial institutions specialized in the sale-purchase activity of financial assets and financial contracts. Other authors support the idea that financial intermediaries also have the role of creating financial assets (Howells & Bain, 2005: 6). One of the author (Andrieș, 2010: 24) classifies the financial intermediaries according to how they finance their activity in:

• financial deposit institutions: commercial banks, savings and lending institutions, credit cooperative organizations.
• non-depository financial institutions: investment banks, investment funds (monetary funds, diversified funds, equity funds, fixed income instruments funds), pension funds and insurance companies.

The role of the financial system is not only limited to the intermediary role, it also performs other functions or roles such as (Apetri & Mihalciuc, 2019): ensuring the functioning of the payment system, managing the portfolios of financial securities, offering diversified financial services, ensuring risk management.

In Romania, the following financial institutions operate within the financial system: credit institutions, non-banking financial institutions, insurance companies, private pension funds and investment funds.

III. The Financial System In Romania And Financial Intermediation

The most important component of the financial market is the banking sector. The banking system in Romania is considered the central pillar of financial intermediation (Apetri, 2018: 14), both because of the importance of lending in the financing of the economy and also because of its role in managing the payment systems and in transmitting the monetary policy impulses of the central bank.

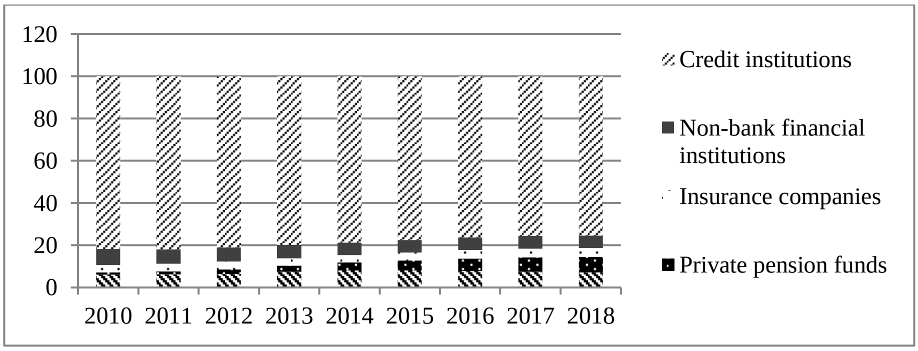

Figure 1 – Structure of the financial system in Romania (weight of assets in total assets) during 2010-2018
Source: elaborated by authors based on data from: www.bnr.ro

The credit institutions hold a dominant position but in decline, in the structure of the Romanian financial system in relation to the other financial institutions. From the market share point of view held by each category of institutions in the structure of the financial system it can be observed (Figure 1), that the largest share is held by

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the credit institutions, with a share of approximately 75% followed by the investment funds and private market funds.

The efficiency of the activity carried out by the credit institutions implies the substantial and sustainable increase of the degree of financial intermediation. The data published by the National Bank of Romania show that the banking sector in Romania has the lowest degree of financial intermediation in the EU, the ratio of assets in GDP being 49.25 percent in June 2018, a value significantly below the median level observed within the EU (9%) (Figure 2).

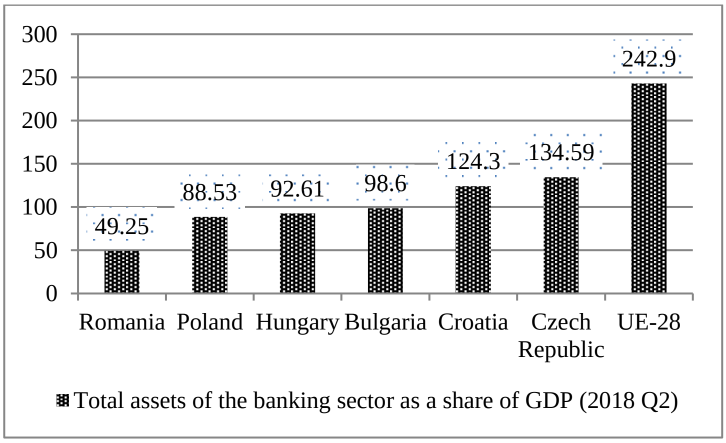

Figure 2 – Weight of banking sector assets in GDP (Q2 2018)
Source: elaborated by authors based on data from: www.bnr.ro RSF, 2018

IV. CONSIDERATIONS REGARDING FINANCIAL INTERMEDIATION IN ROMANIA - EVOLUTIONS AND PERSPECTIVES

As the official figures published by the NBR show that the financial intermediation is maintained at low values, significantly below those recorded at European or regional level. Capturing the sustainable potential of increasing financial intermediation, especially the one existing at the level of non-financial companies, remains the main structural challenge in the medium term of the banking sector. Credit institutions have solvency and liquidity resources to increase exposure to the real economy (Isărescu, 2018). The information in the Financial Stability Report for 2018 shows that the sustainable lending potential of companies amounts to about 115 billion lei, which would allow, in time, the doubling of the stock of loans. About 80 percent of the potential for debt is found in private sector companies. Improving the ability of credit institutions to turn potential solvable demand from firms into actual demand could almost double the stock of loans granted to companies. The special theme of the Report for 2018 studies in depth the analysis of the consequences from the very low degree of financial intermediation in Romania. It is estimated a limited capacity of the Romanian banking sector to sustain adequate profitability in the long term, if current business conditions are maintained.

The solutions for increasing the degree of financial intermediation are different (RSF, 2018: 14):

- The cost of financing and the cost of capital could be reduced if the tensions related to the macroeconomic framework will improve and the legislative predictability will improve.
- Increasing the degree of financial education among the public and improving the professional training of bank employees who interact in particular with companies are other solutions that will support long-term financial intermediation.
- Bringing into balance the performing loans outsourced in previous years could increase the banks' portfolio by almost 6 billion euros.
- Increasing the payment discipline in the economy and improving the financial health of companies could greatly increase the solvency demand as a whole.

Companies resort to a small number of bank lending, the most common forms of financing being (RSF, 2018: 28):

- reinvesting the profit or selling assets from the assets;
- loans from shareholders or capital increases commercial credit. Among the products offered by banks and IFN, overdraft is the most accessed product.

A situation of the number of companies that have applied for loans to banks can be seen in the Table 1:

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Table 1. Number of companies with loans to banks and IFN

	Number of companies		Total weight of companies - %-	
	2017	2018	2017*	2018**
Number of debtors (banks and IFNs)	93.624	105.002	14,8	16,1
Banks - total	66.111	72.244	10,4	11,1
IFN - total	49.383	57.532	7,8	8,8
Common - Banks and IFN	25.842	30.696	4,1	4,7
Only from banks	50.110	50.825	7,9	7,8
Only from IFN	25.499	31.029	4,0	4,8

*for 2017 there were considered 652.1 thousand companies that submitted financial statements at the end of the year;
**for 2018 were considered 634.5 thousand companies that submitted financial statements at the end of the year;
Source: elaborated by authors based on data from: RSF, 2018, www.bnr.ro, https://www.bnr.ro/Publicatii-periodice-204.aspx

The number of companies that have loans to banks and IFN has evolved positively, from 92.5 thousand in August 2017 to 105 thousand in August 2018, accounting for 16.1 percent of total active companies. Several companies focused on bank loans (11.1 percent of the total), while IFN turned to 8.8 percent. Nearly 31 thousand companies hold loans to both banks and IFN, rising compared to the same period last year.

The main difficulties encountered by the non-financial companies sector in accessing the financing are considered to be the following: the too high level of interest and commissions, as well as the requirements regarding the value or the type of guarantee requested by the financial institutions. Improving these aspects as well as improving the financial health of the companies will be able to lead to an increasing share of the companies eligible for sustainable financing.

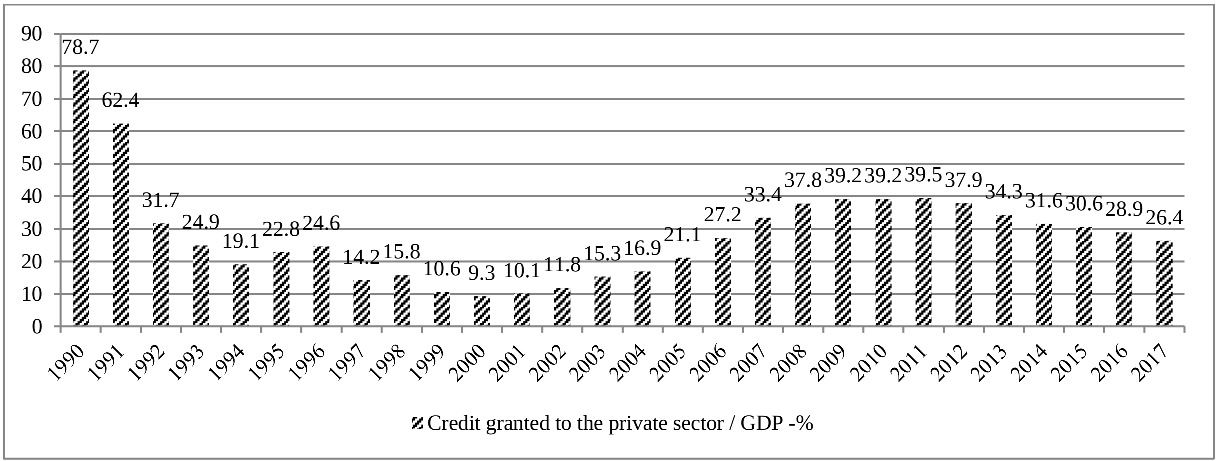

Figure 3 – Evolution of the income granted to the private sector in GDP (1990-2017)
Source: elaborated by authors based on data from: www.bnr.ro

The degree of financial intermediation has an oscillating evolution during the analyzed period, and from 2018 it started to continue its decreasing trend, a trend that has remained until the first half of 2018, the dynamics being mainly determined by the increase in a faster rate of gross domestic product, which could not be matched by the upward evolution of the assets of the financial system. Thus, the financial intermediation was reduced by about 10 percentage points in the period 2011 - 2017, reaching a value of 26.4% (Figure 3) (RSF, 2018: 61).

The low level of credit of the private sector in Romania has historical roots (1990s), being influenced by the slow and hesitant nature of the reforms associated with the transition to the market economy (Apetri & Mihalciuc: 2018).

After 2000, the financial intermediation recorded an increasing evolution, registered evolution from other states of Central and Eastern Europe, but on a lower level. Starting with 2010, there was a tendency to decrease financial intermediation, a decrease that was generated by a combination of factors, the most important being the volatility of the legislative framework and the precarious economic situation of SMEs (negative capital, profitability and declining liquidity). The process of cleaning up the balances of bad loans also contributed to the decrease of the financial intermediation. According to a PWC study, in 2018 Romania (25.7%) is below the EU average of 83%, in terms of financial intermediation, but also below that of countries with emerging economies (i.e. Poland and Czech Republic - 52%, Bulgaria 51%) (PWC, 2019).

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In the presentation of Lazea (n.d) are identified and can be consulted a series of obstacles that impede the growth of credit. A summary of them is presented in the table below:

Table 2. Structural obstacles to increasing lending

International factors	Internal factors
The phenomenon of creditless recovery (the financing of companies is mainly internal in nature.)	The very easy call of the companies to the law of insolvency
The phenomenon of reducing non-performing loans (NPL)	Large number of negative equity firms (non-bankable)
The phenomenon of financial disintermediation (deleveraging) - the decline of external liabilities.	The absolute and relative poverty of households
	Financial inculture of the banking public
	Issues related to the National Credit Guarantee Fund for SMEs (FNGCIMM)
	Laws regarding the payment and the conversion of credits in CHF

Source: elaborated by authors based on data from: Lazea, www.bnr.ro

In Romania, (Figure 4) the rate of non-performing loans (NPL) decreased from 21.5% (in September 2014) to 5.6% (in September 2017). The banks started an extensive process of cleaning the balance sheets of non-performing loans (Vlad, 2018: 204), given that Romania had one of the highest rates of non-performing loans in the EU. The objective of this process was to create the premises for relaunching credit on sound foundations, in order to achieve sustainable economic development.

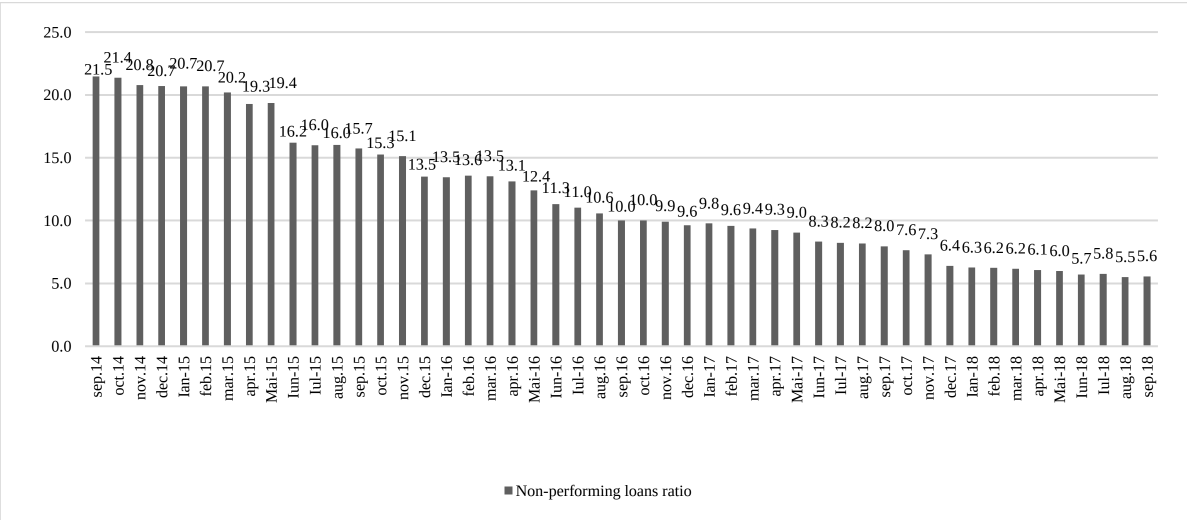

Figure 4 - Evolution of the NPL rate (2014-2018)
Source: elaborated by authors based on data from: www.bnr.ro

As of December 2017, the NPL rate is no longer in the "red" area (Figure 4), as alarmed, as defined by the European Banking Authority (respectively, over 8% of the total credits).

The National Bank of Romania (BNR) has set as a goal the sustainable growth of financial intermediation and the improvement of financial inclusion, "in order to achieve the objective of safeguarding the stability of the financial system."

A potential source of sustainable expansion of domestic credit is the external debt of non-financial companies. This could be achieved through two channels (www.bancherul.ro):

- transfer of loans granted Romanian companies from non - resident banks to Romanian credit institutions members of of the group, or through;
- substitution of external loans with loans offered by the local banks.

In the last Report on financial stability published by the NBR, a special topic is presented on the issue of external financing of non-financial companies in Romania, in which the following are shown:

- External debt is one of the important forms of financing for non-financial companies in Romania, accounting for 15 percent of total corporate debt. Cross-border financing involves a number of risks that are additional to those related to local market lending.

- External lending is more likely to be targeted at economically inefficient firms due to the lower capacity of non-resident credit institutions to monitor lending firms.
- The use of foreign loans exposes the sector of non-financial companies to risks such as currency risk (most of these flows being in foreign currency) and to the risk of non-refinancing.

According to BNR publications, lending non-financial companies by banks in Romania at a value similar to the financing attracted by companies from non-resident institutions would determine: an increase in the ratio between bank debt of firms and GDP from 12,2 percent at present time to about 18 percent, respectively an increase of the indicator the share of bank credit granted to non-financial companies and the population in GDP from 26.4 percent to 32.2 percent.

We consider that in the future period the new legislative regulations (Ordinance 114/2018 regarding the tax on bank assets), will have negative effects on the lending capacity and thus on the potential for increasing the financial intermediation.

V. CONCLUSION

The paper analyzes the degree of financial intermediation in Romania and its role in economic growth. The main finding is that at the level of Romania there is a low level of financial intermediation, which requires taking measures that will lead to its improvement.

The sustainable increase of the financial intermediation implies both the granting of loans to the real sector, oriented mainly to the non-financial companies, as well as the diminution of the structural imbalances accumulated at the level of the non-financial companies, a solution without which the credit demand of the loans will remain at modest values. Increasing the role of the banking sector in financing the economy, while maintaining the capacity to cope with potential adverse developments, is also important in the context of Romania's plans to join the euro area. The sustainable contribution of the Romanian banking sector in the process of accession to the euro area can be supported by the fulfillment of the measures stipulated in the "Basel Core Principles for Effective Banking Supervision" within the Program of evaluation of the financial sector in Romania realized during the period 2017-2018 by the Monetary Fund International and World Bank, but also by strengthening the framework for crisis management and bank resolution (conforming the bank resolution framework to the changes brought in by joining the Banking Union).

Stimulating the sustainable growth of the intermediation degree on the lending channel of the non-financial companies has the potential to contribute to the decrease of the interest margins currently applied by the credit institutions while supporting a healthy growth on a sound basis.

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