

UDC 336.71(497.7:497.5)
Professional paper

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COMPARISON OF THE MACEDONIAN AND CROATIAN BANKING SYSTEM

Abstract

The Republic of Macedonia and the Republic of Croatia have both been federative republics in the ex-SFRY federation until 1991. Both countries received their EU candidate status in 2007 and Croatia approached the European Union in July 2013, whereas Macedonia has retained the candidate status. This is why many people believe that both countries have so much in common. Considering this fact, it is a great challenge to try and elaborate on their differences in the banking systems, besides the first impression that there are many shared similarities of both countries.

The subject of this research are the banking systems in both countries, their performances, profitability, and efficiency during the past decade. The banking sector in each country is a very specific and crucial segment in the economy, especially in such bankocentric economies present in both analyzed countries.

The main objective of this paper is to stress the fact that even though originating from the same country, both republics have developed under different circumstances and thus, there are inevitable differences in their banking systems and their (under)development.

Other objectives of this paper are to emphasize the differences in order to clarify the areas and the reason why the Republic of Macedonia (or, its banking system) shows lower performance, and where the performance is better and could be used as an example in other countries further on in the future.

The main hypothesis in this study is: Even though both countries seem to be relatively similar regarding all the sectors of the economy,

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their banking sectors are showing differences in performance, efficiency and structure of the financial systems. Is the Macedonian banking system efficient compared to the Croatian? What lessons could be learned?

The methodology used in this research is historical, comparative and analytic method.

The findings were consistent with the hypothesis. Both banking sectors have similarities, but they also differ in their structure as well as the structure of the financial systems. The Macedonian banking system has not showed extraordinary results in the past decade, and has better performance than the Croatian one *only* in the past 2 years. However, the performance indicators do not indicate that the banking system has developed. It rather shows the struggle the Croatian banking system is facing due to the 7th year of recession. The main conclusions of this research have shown that the Macedonian banking sector has not been efficient enough, and a consolidation of the sector is needed in order to stimulate more efficient operations.

Keywords: Republic of Macedonia, Republic of Croatia, banks, banking system, comparison.

JEL Classification: G21, O57

Introduction

In this paper, the main goal is to objectively analyze the two countries' economies, with a special accent of the banking systems in order to come to a conclusion which both Macedonian and Croatian banks could benefit from, regarding the best practices in the sector.

Both Republic of Macedonia and Republic of Croatia share quite many similarities regarding the economy and the financial institutions.

The comparisons could be started with the fact that Republic of Macedonia participates in the world GDP with 0,01%, whereas the Republic of Croatia with 0,06%.²

When analyzing the financial system of a country, it should be outlined that it comprises the currency, the payment systems, the financial markets, the financial institutions and the supervising

²<http://www.nationmaster.com/country-info/compare/Croatia/Republic-of-Macedonia/Economy>

institutions and regulators.³

In Croatia, the commercial banks hold the dominant position in the financial system. Same as in the Republic of Macedonia, the supervision and regulation of the commercial banks is done by the Central bank - Croatian National Bank and National Bank of the Republic of Macedonia, respectively. However, the difference in this segment is that the banks in Macedonia have almost absolute domination over other financial institutions on the market, which points out the underdevelopment of the financial system. Nonetheless, both countries could be classified as bankcentric countries.

The Croatian National Bank (HNB) as well as the other central banks of the EU members do not hold legal mandate and authorisation to *directly* affect the financial stability of the country. However, the achievement and sustaining of the stability of the Croatian financial system is number one priority in the operations in the same system. In this sense, the strategy of the National Bank of the Republic of Macedonia includes sustainment of price stability and economic subjects' expectations of a stable inflation. Therefore, they both share the same objectives and they have the same interest - financial stability.

Banking systems in the Republic of Macedonia and the Republic of Croatia

At a first glance, it seems that the Croatian system consists of more banks than the Macedonian: there were 29 Croatian commercial banks and 15 Macedonian commercial banks in 2014. However, the difference is much bigger in this segment when the number of mergers and acquisitions on the Croatian market is considered. According to the Croatian National Bank, the Croatian banking sector has started with 43 banks in 1993, creating 60 banks in 1998 and 1999, thereafter starting and embracing consolidations in this sector.

The data in table 1 show a relatively similar situation in the Macedonian banking sector, where the decrease of the number of commercial banks started from 20 banks in 2005 to 15 banks in the previous 2014.

However, further consolidation of the banking sector is to be expected due to the fierce competition on the market, the globalized

³ http://www.hnb.hr/financijska_stabilnost/hfinancijska_stabilnost.htm

market and the high growth of the technological developments. The consolidation of the banking sector would enable banks to gain higher efficiency through economies of scale and diversification of the assortment of products and services offered.

Table 1: Number of banks in Republic of Macedonia and Republic of Croatia

Number of banks	Republic of Macedonia	Republic of Croatia
2005	20	34
2006	19	33
2007	18	33
2008	18	34
2009	18	34
2010	18	33
2011	17	32
2012	16	31
2013	16	30
2014	15	29

Source: Data from NBRM's and HNB's annual reports

The number of employees in the banking sector has also shown differences in both analysed countries. The Macedonian banking sector holds dramatically lower number of employees when compared to the Croatian banking sector, considering the fact that the number of banks active on the market is relatively equal. Thus, it could be concluded that the Macedonian banks offer smaller range of services, thereby have lower need for human capital in this sector.

Table 2: Number of employees in the banking sector in the period of year 2007-2012

Number of employees in the banking sector	Republic of Macedonia	Republic of Croatia	Number of employees in the banking sector as % of total population	Republic of Macedonia	Republic of Croatia
2009	6084	21730	2009	0,29451502	0,51057331
2010	6052	21770	2010	0,29296596	0,51151316
2011	6011	21865	2011	0,29098123	0,5137453
2012	6026	21639	2012	0,29170735	0,50843515

Source: Data from NBRM's and HNB's annual reports

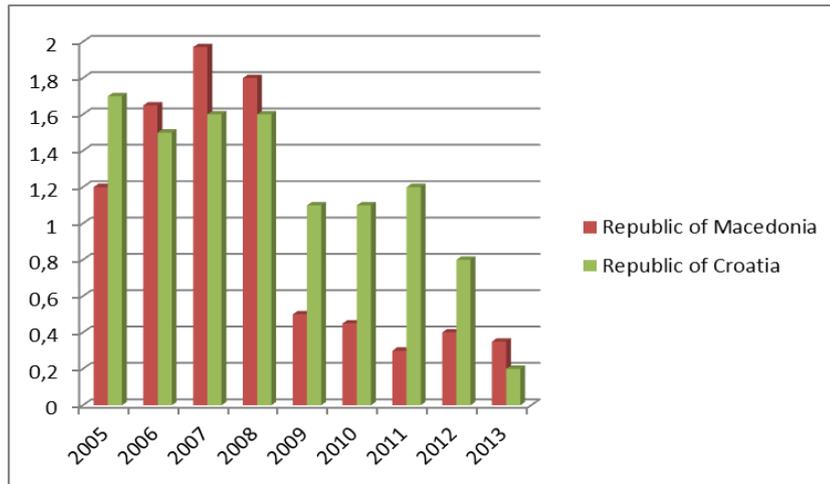
The most crucial difference between the financial segments of the two countries is actually the regimen and the maintenance of the exchange rate of the Macedonian denar and the Croatian kuna. The Croatian National bank pursuits a fluctuating regimen of the exchange rate of their kuna, whereas the National Bank of Macedonia has been using a strategy of targeting the stable nominal exchange rate of the denar regarding the euro, which is the biggest difference in the way the monetary policy is led.

When actually analysing the performances and the efficiency of the banking sector of a country, it is inevitable to analyze the ROAA (Return on Average Assets) and ROAE (Return on Average Equity) parameters. They give the most objective evaluation of the profitability of the banking sectors all around the world. The analyzed data have shown some very interesting facts regarding the profitability of the banking sectors in Macedonia and Croatia.

According to tables 3 and 4, as well as graphs 1 and 2, the ROAA rate has been increasing and showing higher efficiency in the years 2005-2008. The year 2007 is considered to be the “golden year” for the Macedonian banks due to the best performances of the banks. However, as a result of the Global financial crisis and the time lag, it has manifested its consequences – ever since 2009, the ROAA rate has decreased dramatically. Even though Croatian banks have shown higher ROAA until 2013, the long recession of the economy has had a

consequence of itself. So, even though the ROAA of the Macedonian commercial banks is currently higher than the one of the Croatian, it does not give an objective and neutral evaluation of the performances and efficiency of the banking sectors.

Graph 1: ROAA for both countries from 2005-2013



Source: Data from NBRM's and HNB's annual reports

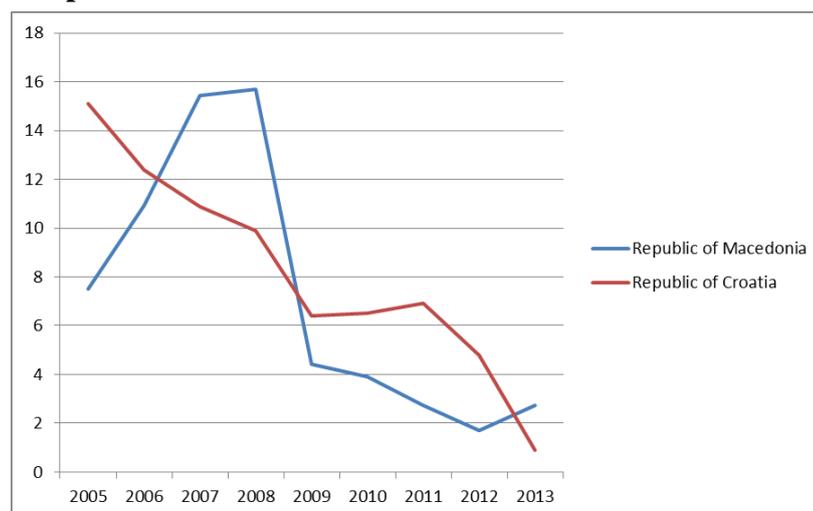
Table 3: The ROAA of Macedonia and Croatia in the period of 2005-2013

ROAA	Republic of Macedonia	Republic of Croatia
2005	1,2	1,7
2006	1,65	1,5
2007	1,97	1,6
2008	1,8	1,6
2009	0,5	1,1
2010	0,45	1,1
2011	0,3	1,2
2012	0,4	0,8
2013	0,35	0,2

Source: Data from NBRM's and HNB's annual reports

When analyzing the ROAE, the data of the Croatian banking sector was decreasing ever since 2005, starting with 15,1 and closing 2013 with 0,9. In the Macedonian case, the ROAE was increasing until 2009, when the consequences from the global crisis appeared. The first sign of improvement of this ratio for Macedonian banks came in 2013.

Graph 2: ROAE for both countries from 2005-2013



Source: Data from NBRM's and HNB's annual reports

Table 4: The ROAE of Macedonia and Croatia in the period of 2005-2013

ROAE	Republic of Macedonia	Republic of Croatia
2005	7,5	15,1
2006	10,92	12,4
2007	15,45	10,9
2008	15,7	9,9
2009	4,42	6,4
2010	3,9	6,5
2011	2,75	6,9
2012	1,7	4,8
2013	2,75	0,9

Source: Data from NBRM's and HNB's annual reports

The profitability of the banking sector in Croatia has been decreasing in the past few years due to the recession of the economy, *but* also due to the significant cost of regulations, followed by the growth of the interest rates on the global market. Many economists and academics are worried that the recession would take its toll on the profitability and efficiency of the banking sector in the country, which has actually happened. This effect is seen through the fast growth of bad loans and the growing risk premium because of the lower creditworthiness of the companies in the economy. Banks are left with no other solution than to write-off the due-to-default loans, to allocate more and more reservations and to do impairment.

This analysis gives the answer of the main reasons of the decrease of the profitability of Croatian banks, which is a decrease of the net-interest revenues (as a result of the higher increase of interest costs rather than interest revenues) and an increase of the reservations for the due-to default loans.

Even though the ROAA and ROAE rates are still positive, and despite the recession the country is facing, it is expected that these rates will continuously decrease as a result of the difficult operating conditions and the small opportunities to invest in state securities. However, the decrease of the absolute numbers of these ratios does not affect the stability of the Croatian banking sector, taking in consideration the fact that the profit is not the main buffer of the crisis, but the high level of capitalisation of the Croatian banks.⁴

The data shown in table 5 regards the capital adequacy rates of both analyzed countries. This data leads us to a very interesting conclusion: the Republic of Croatia has a very high capital adequacy rate and according to the press release issued by the Croatian National Bank on 26.10.2014⁵, the whole banking sector has a high rate of capitalization, which enables banks to have a sufficient and adequate security against potential losses, and resistance to stress.

In comparison, the banking sector of Macedonia has also successfully maintained its stability and security according to the stress-tests and analysis made by the National Bank. This decreases the potential risks of overflow in the other segments of the financial system.⁶

⁴ http://www.hub.hr/sites/default/files/hub_analize_broj_19_-_profitabilnost_banaka.pdf

⁵ <http://www.hnb.hr/priopc/2014/eng/ep26102014.pdf>

⁶ NBRM, Financial stability report for the Republic of Macedonia in 2013, July 2014

Macedonian banks have retained their liquidity and solvency thanks to their conservative approach in the operations and their aversion to risks. They are still very cautious when applying different politics, especially with their corporate clients. However, the effects of the prolonged crisis on the quality of the loan portfolios were inevitable and inescapable. In July 2013, the NPL's rate of Macedonian banks reached its maximum. In the first few months of 2014, this rate was slowly decreasing, but it is still quite high.

The NPL's rate of the banking sectors in 2014 was 13,2% and 15,4% for Macedonia and Croatia respectively.⁷ The logic behind these numbers is the following: Macedonian banks have a lower rate of non-performing loans in their portfolios when compared to the Croatian banks. It is due to the relatively conservative approach of the banks and their aversion to risks and financing projects without sufficient collateral.

Table 5: Capital adequacy rate in the period of 2005-2013

Rate of capital adequacy (%)	Republic of Macedonia	Republic of Croatia
2004	23	15,33
2005	21,3	14,62
2006	19,4	13,98
2007	17,52	16,36
2008	15,67	15,16
2009	16,45	16,43
2010	16,45	18,78
2011	16,7	19,55
2012	17,275	20,89
2013	14,6	21,05

Source: Data from NBRM's and HNB's annual reports

⁷ Data from www.nbrm.mk and www.hnb.hr (Annual, semi-annual publications of the National banks)

Comparison of the main aspects of the financial and banking sector

A real overview of the differences and similarities of both financial and banking sectors in the analyzed countries could be achieved through a grid depiction, such as the following table.

Table 6: Main characteristics of the banking sector in the Republic of Macedonia and the Republic of Croatia

CHARACTERISTICS	REPUBLIC OF MACEDONIA	REPUBLIC OF CROATIA
Banking sector (depository institutions) consists of:	Commercial banks and saving houses (whose importance and number was decreasing during 2013 as a result of changes in the Banking Law)	Commercial banks, saving houses, saving banks, credit union and housing saving houses
Non-banking sector (non-depository institutions) consists of:	Insurance brokerage companies, leasing companies, investment funds, pension funds, companies intermediating in insurance, brokerage houses, financial companies	Insurance companies, leasing companies, investment funds, pension funds
Number of licensed banks on the market	15 banks (3 of which belong to the big banks' group, 7 are middle-sized and 5 are small banks), 11 of which are in dominant foreign ownership.	35 credit institutions, 29 of which are banks, 1 saving bank and 5 housing saving houses. Out of the 29 banks, 15 are in dominant foreign ownership, 12 in domestic private ownership, while 2 are in domestic state ownership. Six of them belong to the big banks' group, three to the middle-sized banks and 20 to the small banks' group.
Employees in the banking sector	6.048 employees until 31.12.2013	21.454 employees until 06/2013

CHARACTERISTICS	REPUBLIC OF MACEDONIA	REPUBLIC OF CROATIA
National currency and exchange rate policies	<i>Macedonian Denar (MKD)</i> Strategy of targeting stable nominal exchange rate of the denar in relation to the euro. This strategy is usually used in small and open economies, that are dealing with high dependence on import of primary products. In this sense, this strategy enables upkeep of the price stability and the inflation expectations.	<i>Croatian Kuna (HRK)</i> Regime of pegged float exchange rate of the Croatian kuna, where HNB occasionally gets involved in the Forex market in order to prevent big oscillations and to keep the exchange rate relatively stable.
Capital adequacy	16,9% (30.06.2014)	21,1% (data from the end of 2013)
Profitability of the banking system	ROAA 0,6% (30.06.2014) ROAE 5,4% (30.06.2014)	ROAA 0,2% ROAE 0,9% (data from the end of 2013)
Population and GDP per capita in USD	2.065.769 inhabitants, GDP per capita 4800 USD	4,256 million inhabitants, GDP per capita 13.330 USD, according to the data from the end of 2013
Other institutions active in the financial markets	Deposit insurance fund, investment funds (which participated with 0,2% of the total assets of the financial institutions in 2013)	HANFA (Croatian Financial Services Supervisory agency), Ministry of finance – Republic of Croatia, DAB (State agency for deposit insurance and bank rehabilitation), CDCC (Central Depository & Clearing Company Inc.), FINA (Financial agency), REGOS (Central Registry of Affiliates), HBOR (Croatian bank for reconstruction and development), TNZ (Money Market Zagreb), ZSE (The Zagreb Stock Exchange).
Rate of NPL (Non-performing loans)	13,2%, in the second quarter of 2014	15,4% in year 2013

Source: NBRM, HNB, World Bank and www.stat.gov.mk

The analysis and the collected data show very interesting facts, such as the relatively low development of the Macedonian financial markets, the limited number of instruments on the primary market and the illiquid and unattractive secondary financial market. The lower stage of development of the Macedonian financial system in comparison with the Croatian financial system can be confirmed when analyzing the number and types of depository and non-depository institutions active on the market. There are larger number of institutions operating on the Croatian financial market.

There are also more employees in the banking sector in the Croatian financial system when compared to the Macedonian. Even though Croatia is more populated than Macedonia, the relative ratio is still much higher.

The number of banks in Macedonia is much lower. The capital adequacy of the banking sector is lower than Croatia's (16,9% as opposed to 21,1%), but they are both quite high.

As previously elaborated, the underdevelopment of the Macedonian economy could also be confirmed with the comparison of the GDP per capita of the both countries. Macedonian's GDP per capita is quite lower than the Croatian's.

However, the data also show the better economical circumstances of the Macedonian banks at the moment due to the 7-th year of recession Croatia has been facing. This explains the better results of the ROAA and ROAE indicators of Macedonian banks at the moment, and the lower rate of NPL (Non-Performing Loans). Croatian banks are now in an unfavorable position due to the stage of economic cycle the country is in.

Has anything changed after the accession of Croatia in the European Union?

When analyzing the two economies, the two financial and banking sectors, one must take into account that both countries did get their negotiation dates for accessing the EU in the same year – 2005, but the Republic of Croatia went through all the reforms and formally and officially accessed the European Union at 01.07.2013, as the 28th member of the Union. The Republic of Macedonia still has the status of candidate country for accession in the EU.

According to this, Croatia and all of the Croatian institutions (especially the financial and institutional segment) are subject to both national and European legislative and regulation. This is a crucial difference between the two countries.

By accessing the EU, the Croatian National Bank has become a part of the European System of Central Banks. Like the other central banks, it is proceeding operations and tasks that are in accordance with the rules, instructions and guidelines adopted by the governing bodies of the ECB.⁸

However, Croatia will not adopt the euro as a national currency yet, as it will have to fulfill some preconditions beforehand. The European Central Bank and the European Commission issue a convergence report every two years, which shows the progress of the country and these reports contain a suggestion if the EU member country should or should not yet introduce the euro.

In the future years, on the day when the euro will be adopted in Croatia, the Croatian National Bank will become a part of the Eurosystem, therefore, it would transfer its whole authorisation in monetary policies and exchange rate operations onto international (EU) institutions, as a part of the functioning of the payment system of the ECB. At the same time, the Croatian National Bank will take part in the proceeding of the monetary and exchange-rate policies, together with the other central banks of EU countries. Furthermore, the tasks of the National central banks (that are part of the Eurosystem) will also conduct the monetary policy, but only as agents of the ECB.⁹

Until that time, the Croatian National Bank will not face many changes in its operations and policies. Thus, it is not to be expected that many changes will arise from the EU membership of the Croatia. However, its effects on the financial, banking and economic system as a whole will occur later on, especially after adopting the euro and officially entering the EMU (European Monetary Union).

⁸ http://www.hnb.hr/medjunarodna_suradnja/h-institucionalni-ustroj.htm (10.02.2015)

⁹ http://www.hnb.hr/medjunarodna_suradnja/hmedjunarodna_suradnja.htm (09.02.2015)

Conclusion

As shown in the grid depiction (in table 6) and the comparison of the two financial systems (and the banking sectors as a part of those systems), it can be concluded that, even though very similar, the two observed countries have been differentiating in many areas.

At the moment, the financial state of the two countries differs significantly. Republic of Croatia has been facing negative growth of the economy in the past 7 years, whereas Macedonia has been lately recognized as the most perspective country on the Balkans.

The Croatian financial system (and the banking sector) is much more developed when compared with the Macedonian, judging by the number of institutions on the market, the number of employees and the total assets of the banking sector. Furthermore, the number of employees in the banking sector as a percentage of the total population in Croatia is quite higher than the one in Macedonia.

The main conclusions of this research have shown that the Macedonian banking sector has not been efficient enough, and a consolidation of the sector is needed in order to stimulate more efficient operations.

Namely, the analysis has shown that the ROAA and ROAE ratios for the banking sector in Macedonia are not as favorable in the analysed period, with exception of the last few years when changes in the Croatian legislative and regulation occurred and in conditions of a recession of the Croatian economy. Therefore, the better ratios in the past few years noted by the Macedonian banking sector should not be attributed to the better efficiency of the banks, rather than to the unfavorable conditions in which Croatian banks operate.

The positive characteristic and the current advantage the Macedonian banks should exploit is the more beneficial conditions they operate in at the moment. All the benefits Macedonia's economy growth offers must be exhausted. Furthermore, the efficiency of the sector should be also encouraged by the implementation of new technologies and innovations in the banking.

With this paper, we have tried to elaborate on the most important issues in the financial and banking sector regarding Republic of Macedonia and Republic of Croatia. The EU membership has had no effects whatsoever. However, it is still very early to say due to the accession of Croatia in July 2013. Furthermore, the 7th year of recession

that Croatia has been facing inevitably leaves its consequences and no analysis could be made without its elaboration.

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