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Credit Risk Management in Albania - Analysis of Factors Affecting It

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Abstract:

Credit, a concept so important for the banking system, but is also an important source of financing for businesses, to provide assistance in their investments, for beginning or to expand their activity. When companies are involved in business, it is obvious that they will be exposed to a risk, or to another, which in most cases is uncertain time that it will happen. Banks are one of such businesses, which risk is very safe because they do not operate in isolation, given the dynamic environment in which they operate, the volatility of the financial markets in which they participate, diversification and competitive environment in which it is located. So in lending it is very important risk management process. Regarding Albania, lending over the past two decades has been a help to businesses that began to grow with the launch of a new democratic system. Rapidly developing banking system during these years gave a significant step Albanian financial system. 2008 was a shock year to the financial system and countries manner, the worldwide economies, which led to the crisis in the banking system that was later reflected in the wider financial system. Since 2008 after lending performance had downward trend for businesses and families, due also to the increase of non-performing loans. This is one of the issues that will be addressed during the development of the subject, who they were factors that led to increased credit risk. The methodology used in this paper is a connection between theoretical analysis, analysis of the real situation, as well as graphical *analysis and the factors to draw accurate conclusions. At the end of the paper made a comparative analysis with countries in the region, in terms of credit risk.*

Key words: credit risk, management risk, credit process, financial crisis

1. Introduction

The last two decades in Albania brought fundamental changes in the economy passing path from a closed economy to an open economy brought progress in creating private business number of business before the business began to grow year after year, making it necessary and their classification in small, medium businesses and big businesses. Developed and increase the number of businesses came in parallel with the development of the banking system in Albania, as the banks served as the main sources of financing for businesses by providing credit .Business is a markedly important for the economy of a country and therefore is required to be funded to give breath to country . But course's developments beyond their importance are focused businesses and problems that hinder their development. In Albania, businesses and families have problems with getting credit, as the year progressed last are tightening credit conditions, but also another problem is the difficulty you have entities on repayment of loans taken.

Risk Management of credit is closely linked with lending, should therefore study parallel the risk management concept which can be defined simply as the act of planning, management, control, monitoring and testing to obtain desired results. Or is it simply the act, manner, or practice management, treatment, supervision or control (AIRMIC, ALARM, IRM: 2010). Risk in turn can be defined as something unpleasant or dangerous that may occur (Macmillan Dictionary, 2002). When companies are involved in business, it is obvious that they will be exposed to a risk, or to another, which in most cases is uncertain time that it will happen. Banks are one of such businesses, which risk is very safe because they do not operate in isolation, given the dynamic environment in which they operate, the volatility of the financial markets in which they participate, diversification and competitive environment in which they find themselves (Williams & others. 2006: 69). Although it is certain that the risk will occur, it is not always possible to eliminate, reduce or ameliorate (Keith, 1992: 16). So the best option for companies is to try to manage the risk in order to reduce the likelihood of occurrence or to reduce the consequences. These opportunities could range from "do nothing" to do "all" in an effort to cancel the effects of any risk identified (William & others 2006: 67). But due to the nature of banking, a bank cannot find itself in a position to do anything, or to nullify the danger. So what does all that she is living with, but require tools to manage it. Given the volatility of its activities, a bank does not expect to introduce risk management in a certain stage of its activities, but does this since the beginning. This is because its activities are linked in such a way that if not well treated, the effect of consequences can even lead to bankruptcy. To reach decision makers must first identify the risks involved, to measure its intensity, to assess it, to monitor and then to see the extent to check it out. Risk management act is called RM (Risk Management). RM is a planned course of action to reduce the risk of an event that is happening and to minimize or restrained subsequent effects will bring to the event (Keith, 1992: 14). This course of action related, RM creates a process involving a number of stages. RM is very important and constitutes a major part of the activities of any organization, because his main goal is to help all other management activities to achieve the goals of the organization directly and efikase.RM is a process constant that depends directly Identification Analysis Measurement Monitoring Control.

Figure 2.1

Identification – Analysis – Measurement – Monitoring – Control

Source: Keith (1992: 15)

Viewing stage as a process seen before managed risk must be identified. Once the risk is identified, we made measure the measure it is for intensity or to assess the impact of risk. After evaluation of the effects is done, taken control measures to avoid or reduce its intensity and thereafter made a good monitoring to see if the outcomes are desired (Keith 1992: 15) .In the following paragraph we are analyzing some of the factors that influence the risk of credit by literature. They analyzed factors regarding the Albanian banking system.

2. Management of credit risk in banks

Although the effects of all types of risks could cause negative impact on bank credit risk has been identified as the main risk associated with negative consequences in terms of its effects on the performance of the bank (Sinkey, 1992: 279). This means that if credit risk is not well managed, it can lead to failure. Thus, for each bank to succeed, its credit management should be dealt with very seriously. If there is a loss, the bank would have to "take their hands" to get funds by other means to meet or losses. One obvious reason why a correct management of credit risk is very important is that the banks have a limited capacity to absorb credit losses and this loss can be covered only by using income generated from loans or other income the capital of the bank (Boffey & Robson, 1995: 66). If the incomes from these two sources are used to cover a loan that is not paid, the move will affect the long time the bank's capital adequacy, its liquidity and even its benefits. Seeing the consequences or effects of credit risk, it is important that before a bank gives a loan, she should try as much as possible to have a concrete picture of the borrower. According to (Greuning & Bratanovic, 2003: 136), "because of the potentially serious effects of credit risk, it is important to carry out a comprehensive assessment of a bank's capacity to assess, manage, supervise, implement and to recover loans and other credit instruments. "The bank must have the ability on how recover a loan from a client by examining its policy of credit risk management and practices as determined by the board. This means that the process of credit risk management should be followed in order to ensure that loans granted can be recovered in time and if not, good collateral can be taken in place of credit. Every bank obviously needs to develop strategies it, in order to fight competition in the same industry to be successful. Banka should assess the value of the borrower's credit after the loan is granted, temporary monitoring is required until the borrower has completed the repayment of monitoring credit .this It is very important because the uncertainty in the future, every possible event that could cause a borrower cannot write quickly identified or a mechanism can be implemented in time to reduce the frequency and intensity of loss that will occur. Early identification of at-risk borrowers is good because it determines the most cost effective type of information to customers, and begin repayment plans before the borrower's financial situation to deteriorate to the point at which execution is imminent (Focardi, 2009: 73).

3. The policy of credit risk management

Banks like any other corporation have formal policies defined and principles that are approved by the board of directors how to manage loans and it must be implemented carefully by supervisors or managers leader .this prevent managers and over seers to take action. They should do this by looking at the policies set to know if they are doing the right thing at the right time. Maness & Zietlow (2005: 139) specifies that a crediting policy has four main components which include: credit standards, credit terms, credit limits and collection procedures.

- Standards credit - This is the profile of the minimum acceptable confidence client.
- Credit conditions -This is where the credit period determines how long the customer must pay by cash receipts and deductions (if any).
- Limitations credited- This is the amount in dollars that cumulative credit purchases could reach for a client if the credit extended.
- Procedure collection - These are detailed statements about when and how the company will carry out the collection of overdue accounts.

Despite the rules, it does not mean that credit policies are stereotyped. "A good policy of not lending is limited, but allows presentation board credits that officers believe are worthy of consideration, but that do not fall within the parameters of written instructions" (Greuning & Bratanovic, 2003: 137). Since the future is uncertain, flexibility should be allowed for an easy adaptation to change state (perhaps internal or external). That a sound management to achieve, since the risk in lending activity is identified, policy banks credit risk management and philosophy should be used in the right way to control credit risk (Greuning & Bratanovic, 2003: 151) . These policies of credit risk management must constantly change with the changing banking environment activities, as these activities may come with many changes of risks.

According Greuning & Bratanovic (2003: 151) Specific measures of risk management include three types of policies:

- Policies aimed to limit or reduce credit risk (concentration and exposures, adequate diversification, lending to related parties or on exposures)
- asset classification policies (the collateral mandate periodic evaluation of the loan portfolio and other credit instruments, including any interest accrued and outstanding, which exposes a bank to credit risk).

- Policies positioning loss (taking supplements at a level sufficient to absorb projected losses).

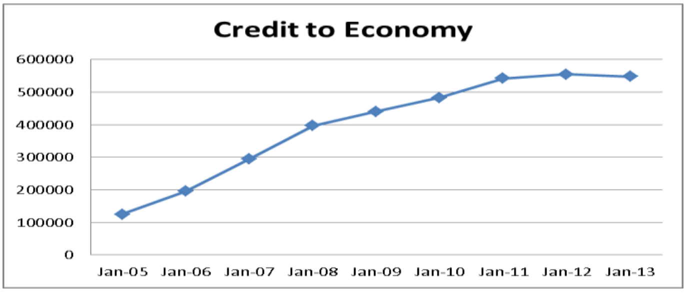
4. A brief analysis of the credit and the factors impacting Albania

The banking system in Albania has experienced growth after 1990 and mainly more rapid development has been after 2000, when many foreign banks began to open their branches in our country or privatized existing banks with Albanian capital. The opening of these banks were allowed great Albanians for financing and lending by them, but on the other hand the large number of banks in Albania brings marketing campaigns "aggressive" in order to overcome the competition between other banks and to absorb As more borrowers. Approval and disbursement of loans certainly more increases the risk of these loans. Given that there are many banks that offer various payment options and interest installments, credit supply growth leads individuals and businesses to make more loans. On the other hand and banks make more loans, aiming to capture most of the market; it carries significant increase in the risk of return of these loans by the borrowers.

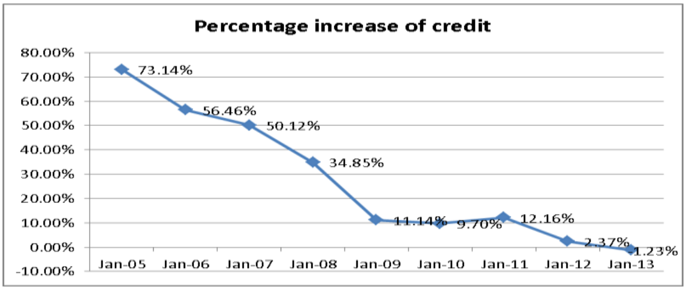
Risk management is one of the key and most important for banks, which pay a special importance to creating a special department and using different techniques and procedures to prevent losses and eliminate as much risk you loans. This risk arises from fluctuations in interest rates or random events that can ocur borrowers and that can cause failure of timely payment or non-payment of loan installments by his side. Risk it considered problematic if it passed a certain level on the objectives of the bank. Regulation of the Central Bank of Albania defines the criteria, categories and methods for classification of loans and other bank assets, calculating the appropriate level of reserve funds to cover potential losses as a result of inability to recover or return to full value them. Bank of Albania may request at any time from banks, additional data and analytical on how credit risk management and the creation of reserve funds to cover loan losses. Credit risk is called the inability of the borrower and the guarantor or other party to fulfill its financial obligations to the Bank under the terms of the agreement between the parties. Banks should definitely take the analysis and review all credit characteristics and determine which makes part of the loan category to determine also the degree of risk that carries this loan.

The banking loan portfolio at the end of the first quarter of 2013 represented 39.1% of gross domestic product (GDP) 1, being 1.7% lower than last year. Reduce the use of financial leverage in the economy began in the second half of 2012 and continued throughout 2013. The cumulative growth of the loan portfolio by 12% during the period 2011-2013 is significantly lower than the growth of 55 % in 2008-2010. The slowdown observed in all levels of lending. Thus, lending to households has stopped increasing in 2010, and has remained at the same level for years other developments have come as a result of mortgage credit contraction. Meanwhile, the same downward trajectory has followed the growth rate of credit to businesses since 2012, reflecting both the slowdown of lending for investment as well as that for liquidity (Monitor, 2014) .More below are presented for the economy Loan the period 2005-2013.

Chart 2. Credit to the economy during 2005-2013 in domestic and Loan growth in%



Source: Bank of Albania



Source: Bank of Albania

In recent years, in large sectors of the economy have been credited to the industry and services, which have provided added value to the economy. Services, which have given an average contribution of 2.4% economic growth in the past three years, have received 56% of business loans granted in the period. While the industrial sector has averaged 0.5% economic growth in recent years and this has absorbed about 35% of business loans. Credit to the construction sector increased slightly in 2010 and 2011, but contracted in 2012 and in 2013 to -1.5%, showing poor economic performance of this sector. Meanwhile, the agricultural sector, although with a contribution of 1.1% in economic growth remains sub credited again due to the high risk that carries the lending process in this sector economy (Annual Report 2013: 44).

Business demand for funding has been directed mainly towards financing the working capital needs, especially in the last two years. But, the demand for financing investment has been steadily declining since the year low 2008.Kërkesa for investment loans has resulted in the contraction of credit in foreign currency, as this loan has traditionally been associated with the financing of investments. According to the Bank of Albania (Annual Report 2013: 44), the main reasons for falling demand for credit are the general economic slowdown and in particular the decline in new investments.

Unlike businesses, personal loans demand has declined in both segments, as the consumer, as well as the mortgage, despite those banks have tightened credit conditions less for individuals. Having suffered a slight increase in 2011, decreased again in leading 2012.Faktorët by banks for the decline in demand for loans to households have been situations in the real estate market and the presence of informal sources of funding. The Bank of Albania has reduced the base interest rate by providing a positive impact on demand for loans and ensuring price stability, as an anchor of stability for economy. The individual's behavior affected by uncertainties about the future of their financial, as the slowing real disposable income. Family members reflect this uncertainty following in maintaining their tendency to save, which is reflected in the steady growth of deposits and other savings vehicles, such as securities issued by the government (Monitor, 2014). Regarding supply, the survey results indicate that banks offer is tight, although banks have sufficient capital and liquidity to conduct mediation in the economy.

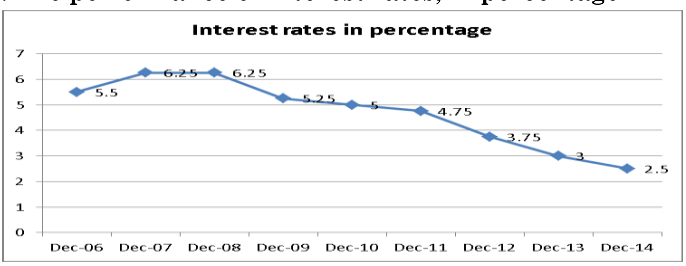
5. Lending Standards

Analysis of lending conditions shows that banks have always been more restrictive since 2009. Later in the years 2010 and 2011 there was a tendency easing credit conditions for businesses, for loans and for liquidity purposes they investment. This was in line with improving macroeconomic conditions, as well as the confidence to further improve them. While after 2011, the deepening of the crisis in the Euro zone and in particular the return of a second recession situation in the countries of Central and Southeastern Europe, back to a tightening trend, and in particular conditions for investment credit. Mitigating factors are estimated to have been good competition and liquidity situation in the bank. Meanwhile, the demand for capital is reduced, especially after 2011, reflecting the application of new regulatory standards of the European Banking Authority (Annual Report, 2013: 6).

Meanwhile, in the segment of personal lending, developments in credit standards are different from those for businesses. Borrowing conditions for households have been tightened significantly by 2009 and then had a tendency easing; especially mortgages, by 2011 and standards still remain at the same levels today. Lending market for individuals, banks have followed the policy easing compared with business this was in line with the strategies of major banks, to enhance this market position during this period main factors that determine the performance of these conditions, banks cite the performance of the housing market, the financial situation of individuals and the performance of the rate of loans to total loans (NPL) From the other side, liquidity, competition between banks and the Bank of Albania decisions have helped to ease lending conditions for individuals. Overall, the analysis above, the Central Bank determines that tight lending conditions, alongside concerns that banks macroeconomic performance of the country, reflecting the deteriorating situation of non-performing loans portfolio (Credit Analysis Report Financial, 2013: 4).

Bank of Albania, as a result of the crisis, followed the easing monetary policy, with the aim of promoting credit, whose rates, they slowed sharply in 2008 and then in 2009-s. Once intervened several times during the period July 2006 - November 2007, increasing five times the base interest rate to a level of 25.6 percent, as a result of increasing inflationary pressures, the Bank of Albania kept unchanged this level in 2008 However, the reduction of credit during 2009 tells made her go back to the Central Bank's decision to reduce the key rate twice, in January and October of the year, reducing it to 5.25% from 6.25% at the end of 2008. This policy was followed even further until February 2011, which aims to stimulate the demand for credit from consumers and stressed Albania business. Banka easing monetary policy nature. After two cuts carried out in February and May, the base interest rate is brought down to 2:50%. Also, the Bank of Albania has continued to guide the public on the direction of monetary policy expected in the future and its continued operations of injecting liquidity into our political bank monetary system has proved successful in calming financial markets, mitigated liquidity pressures and to control inflation expectations for the medium term. Bank of Albania reduced by 0.5 percentage point interest rate during the fourth quarter, by reducing it to the level of 3.0% at the end of 2013. The Supervisory Council of the Bank of Albania decided to cut by 0.25 percentage point interest rate by reducing it to the level of 3.75% in 2012.

Chart 3: The performance of interest rates, in percentage

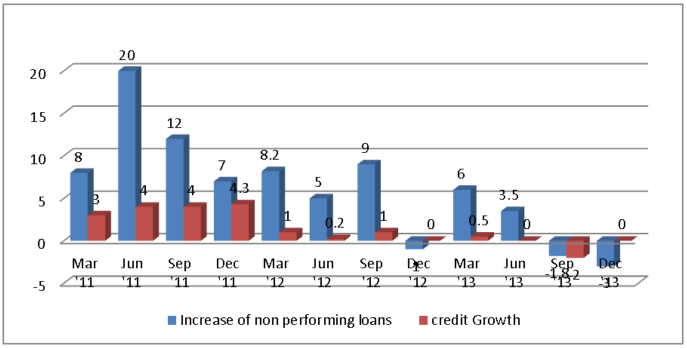


Source: Bank of Albania

As we know the volatility of interest rates affects the demand for loans, as well as the cost of credit, but must be taken into account the fact that loans received from customers are fixed or stated interest rate, interest rate fluctuations increase the cost of credit for borrowers, by following the deterioration of their solvency. The result in increased non-performing loans portfolio to the bank

The deterioration of portfolio quality of banks affects the intermediary role they perform, in two important directions. On the one hand, increase the need for capital to meet regulatory requirements of the supervisory authority and in turn, signal directly to various risks that certain sectors of the economy. Regarding the latter, it notes that the portfolio of individuals characterized by a somewhat lower ratio of non-performing loans, of 17.8% of the total, compared with 27.4% that is to businesses. Within sectors of the economy, shows that loans have increased regularly since the year almost all sectors, remain problematic while the construction sector and the trade. As the financial crisis turned into a real economic crisis worldwide, which did not leave untouched even Albania, its effects were felt and loan portfolio has entered a slow trend of deposit , strong contraction in lending because of liquidity volatile situation in the last months of 2008, have led to an increase in the volume of loans problems is also associated with increased bank reserve funds to cover potential losses by loans. Performing loans marked the largest increase at the end of 2009 with 10.5% of total loans, down from 6.6% in 2008. Delay in loan rates, problems encountered businesses and individuals cope with the economic crisis, the price increase in foreign loan installments due to currency depreciation were some of the main reasons that led to this deterioration in loan portfolio quality. Despite ongoing measures taken by the banking sector for the management of non-performing loans, their level continued to rise in 2010, which was estimated at 13.9% .In September 2012 it runs at 9% for the fallen December 2013 to 3 percent.

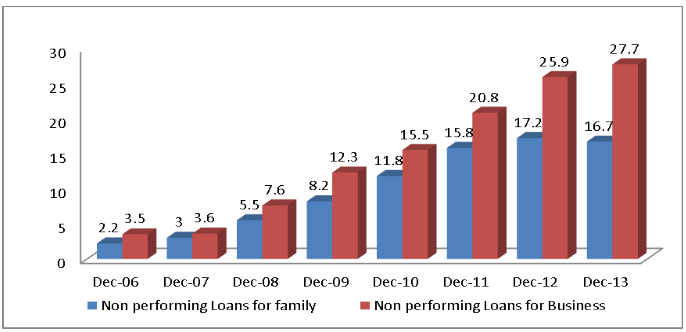
Chart 6: The performance of the portfolio growth rate of non-performing loans and loan portfolio.



Source: Bank of Albania

has declined relatively high starting from 2008 onwards, for both businesses and above Figure, the highest increase of problem loans appears in the fourth quarter of 2008, that given the fact that at the same period there was also a significant decline in deposits. According to groups of users, the quality of the loan portfolio individuals. The ratio of non-performing loans to outstanding loans at the end of 2009, for businesses and individuals is estimated at 12.4% and 8.2%, compared with 7.6% and 5.5% at the end of 2008.

Chart 7: The performance of non-performing loans according to user groups



Source: Bank of Albania

Credit to the economy during 2013, was reduced by 7 billion or 1.2% in comparison with ALL 2012.Kredia slowed compared to the previous year and its annual growth to 2.2% go of 3.4% over the year has recorded foreign currency loans to poor credit is reflected in its supply and demand. In terms of weakening the economy and increasing uncertainty about future demand for credit by businesses and individuals has declined. On the other banks were more selective in lending, showing caution in assessing the financial health of clients this is one of important rule of the bank's which have emerged as to other conditions imposed on lending, as well as through price credit those demand mainly addressed to the collateral and the size of loans (Annual Report 2013: 42).

Central Bank lowered the key interest rate, but is reflected in the second 6-month period of years 2013. This has to sit down interest rates on new loans to about 10% for the lek.

6. Credit Ratings

Albania's Central Bank classifies loans into five categories as follows:

- standard loans
- loans in pursuit
- substandard loans
- doubtful loans
- Loan loss

Loans classified in the first and second group loans constitute quality, while loans classified in the category of third, fourth and fifth constitute the group of non-performing loans (Official Bulletin 2004: 3).

In the group of standard loans entering all loans, unless installment is not paid for a period of 1 to 30 days .on this case but unpaid installment is included in the section of the outstanding advances in the pursuit period of credit means all those loans when the borrower's situation is thought to have potential weakness of the financial situation in the future, or when interest is not paid in full for a period of 31 to 90 days. In the group of loans substandard loans that make part of the above features and also the financial condition of the borrower is evaluated as unsatisfactory. Loans classified doubtful loan when the borrower's situation deemed insufficient to pay the total obligation to the bank, or when the loan was restructured twice and still not settled. Loss loans called those loans when the borrower is bankrupt and the bank has initiated legal proceedings for the execution of capital (Supervisory Council 2011: 9).

Table1. Classification of loans as a percentage of total loans.

Loans Classification	Dec. 2010	Dec. 2011	Dec. 2012	Jun. 2013
Standard	79	73.8	69.2	66
loans in pursuit	7	7.4	8.3	9.5
substandard loans	6.2	9.3	9.7	9.8
doubtful loans	3.7	3.9	5.2	5.3
lost credit	4.1	5.6	7.6	9.23

Source: Bank of Albania.

Analysis of loan portfolio quality groups highlights the decline in the share of loans to first-grade and second, so quality loans. Credit grade "standard" in the first six months of 2013 continued the downward trend of recent years, while loans "in pursuit" are easily grown. Meanwhile, the portfolio of problem loans has increased to three classes the most problematic loans in less time lost which doubled as the weight of the total loan.

7. A comparison of our country compared with other countries in the Balkan region

Bad loans have turned the Balkans from "economic paradise" with high returns in "purgatory" corrosive profit international banks, to shake their ability to lend and weighing on the region's economic potential. Before the crisis, banks with foreign capital usually borrow from their parent banks at low interest rates, and then to lend to corporate clients in the Balkans. Capital markets were only the beginning of the activity, and had very little capital funding. But the 2008 crisis hit the corporate sector in the region difficult, and foreign banks cannot take more loans from their parent. Everything had won, mainly by investing in securities of government; he went to repay the debt to the group (Reuters).

Problems in the Balkans taken individually are too small to have a material impact on international banks, but taken as a whole, the region's difficulties can make their presence felt. Raiffeisen Bank International, as the lender of the second largest of Europe for the development, in September had predicted for 2013 that the provisions of the bad loans were more than one-fifth, to cover problems with borrowing in Albania, Bulgaria and Slovenia (RBIV.VI). It is a similar story for the whole region. Bad loans account for more than 24% of lending in Albania, nearly 15% in Bosnia, 17% in Montenegro and 14% in Croatia, the newest member of the EU, such as the World Bank figures show.

Chart 5: Bad loans in the Balkan Countries

Source: World Bank

World Bank figures show that the rate of problem loans in the Balkans have been consistently above the EU average over the last decade. On the other hand, Balkan banks tend to have higher capital than the EU average, in order to have greater capacity to absorb losses on loans in the future.

EBRD owns shares worth about 4.1 billion € in Balkan banks. As a result, bad loans in Central and Eastern Europe have become a top priority of its policy. (EBRD, 2013: 103) low growth rates, the lack of a legal framework to move more aggressively to bad loans and that the loans, mainly indexed in euro , had sensitivity to fluctuations of exchange that contribute to high number of bad loans. According to the bank it is important to treat the cleaning of balance sheets.

Conclusions and Recommendations

The performance of lending to the economy has been decreasing since after the global financial and economic crisis of 2008. This means that many factors contributed to this performance has been negative rates. Factors affecting credit negative performance factors from the demand side and supply side, the macroeconomic situation in the country, slowing the overall economy, the decline in the level of new investments, the macroeconomic situation in the country, sector specific issues economy, the performance of loans.

Factors affecting the growth of bad loans during the period 2008-2013 in Albania have been the consequences of the global financial crisis and its impact on the economy, the continued decline in remittances, the decline in growth rate of GDP, payments Late government and the inability to pay bills to business public affairs, issues of liquidity, liquidity problems in the construction sector.

Based on the problems and challenges faced by banks, but also in the process of lending businesses may make some recommendations.

Banks in Albania should start as soon as the process of restructuring of loans to businesses by giving preference to those businesses that has financial difficulties who can recover. The restructuring process should start evenly throughout the banking system.

- Banks should be careful in lending, not to reduce lending but to strengthen the analysis of credit before the credit go to the hands of businesses. The banking all system should select qualified about credit analyst train or credit analysts in order to reduce the risks on lending.
- Reducing interest rates will bring motivation in lending, and assistance in financing businesses.
- Banks should not execute the collateral immediately after the deadline to return the loans by businesses.

Banks must first analyze business activity and try to find a solution between them for the execution of the procedure takes time collateral and which exhibit many problems and may not be more effective than business recovery and then the return of the loans.

- ❖ Banks should encourage and special sectors of business in order to expand the demand for loans and to allow the development of businesses in the country.
- ❖ Distribution of bank branches must be distributed as much in place so that businesses have the opportunity to negotiate with the banks, for all the problems we may have.
- ❖ Banks must constantly inform the business and financial culture spread to businesses, because really in Albania most businesses, especially micro and small businesses, they lack the financial and economic culture

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