

Asset Quality: Benchmarking Armenian Banks

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Ակտիվների որակ. հայկական բանկերի համեմատական վերլուծություն

Տնիկյան Մարտին Գ.

3-րդ կուրսի սասպիրանտ, Տնտեսագիտության և քիզնեսի ինստիտուտ

Ռուս-Հայկական (Սլավոնական) համալսարան (Երևան, ՀՀ)

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Ամփոփագիր. Հայտնի է, որ երկրի տնտեսական աճի ապահովման գործընթացում մեծ դերակատարություն ունի բանկային համակարգը, և, որպես հետևանք, կարգավորվում է առավել ուժգին, քան այլ կազմակերպությունների աշխատանքը: Ֆինանսական կազմակերպությունների և բանկերի վերլուծության համար կիրառվում է այսպես կոչված “CAMEL” մեթոդը: Տվյալ մեթոդի արդյունավետությունը հաստատվել է բազմիցս և ամբողջ աշխարհում լայն կիրառում ունի ֆինանսական վերլուծաբանների շրջանում: Վերոգրյալ մոդելում բանկը կամ ֆինանսական ինստիտուտը դիտարկվում է տարբեր տեսանկյուններից՝ ներառյալ որոշակի ցուցանիշների քանակական վերլուծությունը և կազմակերպության կառավարման որակական վերլուծությունը: Այդ գործոններից է ակտիվների որակը: Ֆինանսական ինստիտուտների, և, մասնավորապես, բանկերի ակտիվների որակը մատնանշում է պոտենցիալ ռիսկի գոյության վրա, որը կապված է տրված կրեդիտների, ներդրումային պորտֆելների, անշարժ գույքի և այլ ակտիվների հետ: Բանկերի կառավարման համակարգում պետք է իր կարևոր տեղը զբաղեցնի ակտիվների կառավարումը, հատկապես կրեդիտների և ներդրումային պորտֆելի որակը, որոնք մեծապես մասամբ կազմում են կազմակերպության ակտիվների մեծ մասը և շահույթի հիմնական աղբյուրը: Հայտնի է, որ հայկական բանկերի ներդրումային պորտֆելները կազմված են պետական պարտատոմսերից և Հայաստանի հանրապետությունում գտնվող այլ ֆինանսական ինստիտուտների պարտատոմսերից: Սակայն, հաշվի առնելով աշխարհի ներկայիս տնտեսական և քաղաքական իրադրությունը՝ Ուկրաինայի և Ռուսաստանի միջև բախումները, արևմտյան երկրների պատժամիջոցները Ռուսաստանի հանդեպ, ինչպես նաև գորբալ ինֆլյացիան, համաշխարհային գնաճը և հիմնական տոկոսադրույքների աճն ամբողջ աշխարհում, վարկային պորտֆելներն ավելի մեծ ռիսկի տակ կլինեն, քան նախկինում: Սա կհանգեցնի NPL-ի (չաշխատող վարկերի) ավելի բարձր տոկոսի և, համապատասխանաբար, շահութաբերության անկման: **Հանգուցարաներ**՝ Ակտիվների որակ, NPL, բանկեր, ֆինանսական հաստատություններ

Качество активов: сравнительный анализ армянских банков

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Актуальность. Финансовая система и банковская система, в частности, являются жизненно важными элементами экономики страны. Банковская система формирует ядро финансового сектора экономики и помогает удовлетворять все потребности, необходимые для торговли и производства товаров. Качество активов является одной из наиболее важных областей для определения общей ситуации банка. Главным фактором, влияющим на качество активов, является кредитный портфель банков, так как он доминирует баланс банков. Качество активов – это общий риск, связанный с разными активами, которые компания или частное лицо держат на своем балансе/ в своем портфеле. Мы будем использовать термин «Качество активов» в случае армянских банков в контексте только качества кредитов, выданных банками. Банк имеет активы высокого качества, если кредиты, которые он выдал погашаются и погашаются вовремя. В то же время, плохое качество активов значит, что кредиты, выданные банком, не выплачиваются вовремя или вовсе из-за банкротств клиентов. Основным показателем, используемым банками для описания качества активов является NPL (Non-Performing Loans), которая учитывает все кредиты, по которым есть опоздание погашения более определенного количества дней. **Ключевые слова:** Качество Активов, NPL, банки, финансовые институты

Relevance\Issue

The financial system and the banking system, in particular, are vital elements of the country's economy. The banking system forms the core of the

financial sector of the economy and helps to meet all the needs necessary for trade and production of goods. Asset quality is one of the most important areas for determining the overall situation of the

bank. The main factor affecting asset quality is the loan portfolio of banks, as it dominates the balance of banks. Asset quality is the overall risk connected with different assets that a company or an individual holds on its balance in its portfolio. We will use the term "Asset Quality" in the case of Armenian banks in the context of only the quality of loans issued by banks. A bank has high-quality assets if the loans it has issued are repaid and repaid on time. At the same time, poor asset quality means that loans issued by the bank are not paid on time or at all due to customers' bankruptcies. The main indicator used by banks to describe asset quality is NPL (Non-Performing Loans), which takes into account all loans for which there is a delay in repayment of more than a certain number of days.

There are a large number of factors affecting this indicator at present - sanctions against Russia, global inflation, an increase in percentage rates around the world, which leads to a deterioration in the economic situation and, consequently, a drop in the paying capacity of the population and businesses.

A drop in economic activity and/or the currency exchange rate can also have a negative impact on the quality of assets throughout the banking system, especially in countries where many loans are given in foreign currency. In most cases, bank customers do not hedge this risk. The next factor that may have an impact on the assets of banks is the dynamics of the stock market. This may affect banks through the following:

1. Direct investments of banks in the stock market.
2. The effect of money loss among bank debtors.
3. Reduction of the value of the mortgaged property.

And, obviously, the percentage rate on the loan, which, in its turn, is closely related to the key rate of the central bank, is a factor affecting the paying capacity for loans.

The Degree of Development of the Problem

Arpita Ghosh (2014) proposed a method to reduce NPA (Non-Performing Assets) in banks – to take preventive measures at the stage of credit evaluation or calculation [1]. Preventive measures, in his opinion, can also be in the form of restructuring, early sale/deduction of stressful assets of companies. In this article, the author also proved that in the post-crisis period, the decline in bad assets slowed down, especially for OPS. According to the Global Financial Stability Report published by the IMF (2009), asset quality has a strong positive impact on the profitability of banks and other financial institutions. Thus, we can confidently state, that in order to improve

profitability, banks should improve the quality of their assets along with other determinants of profitability. The growing number of cases of poor asset quality in banks around the world shows the need for a new approach to assess asset quality and the factors affecting it.

Chilukuri noted in his work (2016) that there was a huge increase in advances during 2001-2012 [2]. Success in improving the quality of assets can be accredited to the management of these banks, which also complied with all regulations - prudential standards, income recognition and provision of norms. In order to reduce the threat and intensity of NPL, banks should develop effective management of the information system and should use specialized and well-trained personnel who can use their experience and handle situations carefully.

R. Saluja (2010) studied the growing NPA indicators in the banking sector of India and noted his deep concern about current situation in the country [3]. His research also shows that there is a huge difference in non-operating assets depending on whether the bank is public or private. The Gross and Net NPLs of public sector banks have greatly improved over the years under review. The author linked these changes with strict political initiatives and the application of various legal and non-legal measures.

In their work S. Purnima and M. Teivanyaki (2015), the authors noticed that the number of stressful assets is rapidly increasing in public sector banks [4]. The authors concluded that public sector banks should create a methodological framework, have a clearly defined goal, flexibility and sufficient financial support from the states to solve the problems of stressful assets.

In his work, V. Swami (2015) noted that favorable macroeconomic conditions facilitate the management of stressful assets and leads to an improvement in asset quality. This research also showed that private banks have advantages in terms of the efficiency of credit management, which once again confirms the inefficiency of public administration of such large organizations in the financial sector [5].

Goal

Our goal in this paper is to understand the average risk indicators of Armenian banking sector and compare the asset quality of several Armenian banks.

Methodology

The statistics was taken from the websites of the Central Bank of Armenia and the relevant banks for further analysis.

The Situation in the Banking System

At the beginning of our analysis, we will consider statistics on the banking system at the end

of 2021, published by the Central Bank of Armenia [6]. Let's first look at the regulatory indicators of the banking system in general (H1(2), H2(1), H2(2)). It is Obvious, the published statistics shows a pretty good image for the banking system. Standard H1(2), which shows the ratio of total capital to risk-weighted assets, is 17.2%, which is about 50% more than the minimum ratio determined by the Central Bank of the Republic of Armenia (12%). The second interesting indicator is the liquidity indicator H2(1), which shows the ratio of liquid assets to total assets of the banking system. This indicator is 32.03%, which is again significantly higher than the minimum required 20%. The last normative indicator that we are interested in is again related to liquidity (H2(2)) – highly liquid assets of the banking system/demand liabilities. This indicator is at a very high level – 122.67%, which exceeds the minimum (60%) by more than 2 times. At first glance, these numbers show a very good image, but we should take into account the fact that many loans are refinanced throughout the world only in order not to be included in the NPL and deducted from the bank's assets, thereby reducing the amount of assets. It is here that we should note the importance of asset quality assessment.

Other interesting indicators are Financial Leverage and Return on Equity. On average, the

banking system has a Financial Leverage of 7.7, and a Return on Equity of 6.73% at the end of fiscal year 2021.

Further, let us consider already defined banks and their financial indicators more thoroughly. First, you need to decide which banks to choose for this purpose. We have settled on three largest banks by assets – Ameriabank, Ardshinbank, Armbusinessbank, as well as Inecobank and HSBC.

Having considered the assets and their composition in banks (See Fig.1), we see that the largest part of the assets in all cases are loans of customers. They occupy from 52% to 69% of all assets of these banks. The following are cash assets and cash equivalents or investments in debt securities. Taking into account the fact that cash equivalents are still debt securities only with a shorter duration, here we can observe which securities banks invest in. Armbusinessbank has the most long-term and, accordingly, risky portfolio, where investments in bonds account for 18.9% of assets, while cash equivalents are only 6.6%. Among these banks, only Inecobank has investments in bonds that exceed cash in assets, but it is Inecobank, that has the smallest share of loans in relation to the bank assets.

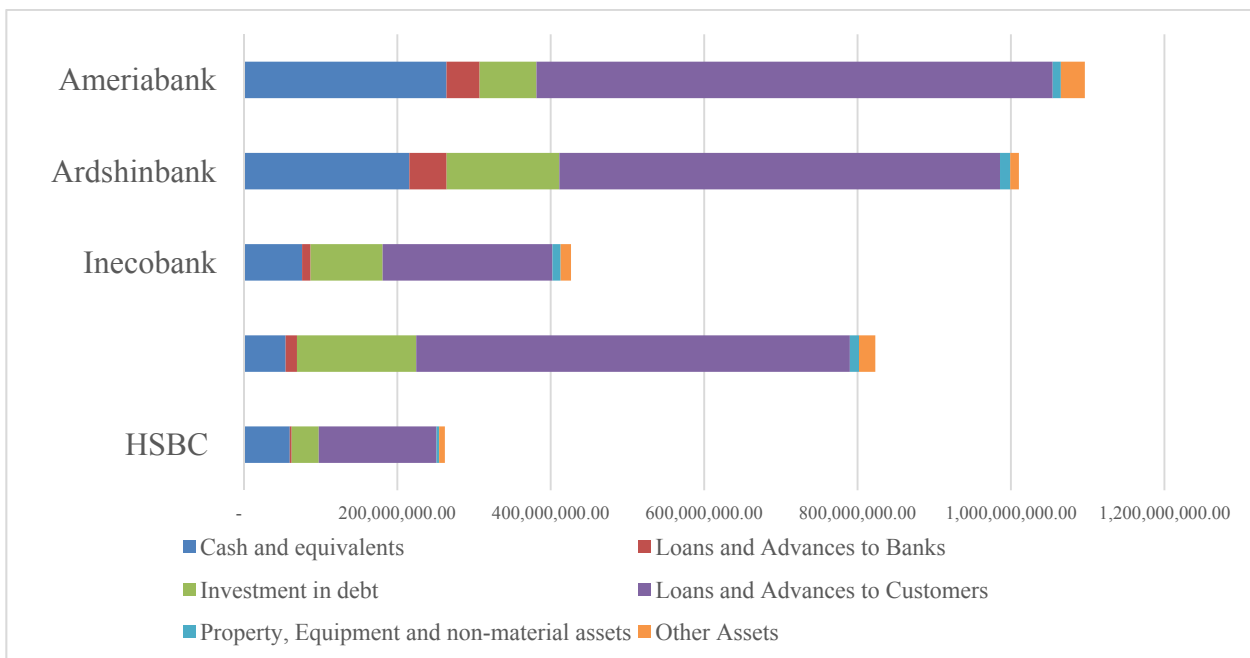


Fig.1 Assets of Companies

Next, let's examine the other side of the balance sheet - the obligations of these banks, in more detail. In the case of HSBC, we see that almost all liabilities are current accounts, deposits and issued bonds, and there are almost no funds from other banks. All other things being equal, this may indicate that this bank does not inspire confidence in

the rest of the banking sector due to high risks, however, in this case it may indicate the small size of the bank and not very close ties with the rest of the banking sector. We also see that Ameriabank also does not accept a large amount of funds from other banks, as well, which is quite interesting. This, in its turn, may be due to the incompetence to invest

this money in more profitable instruments, given the large amount of money accepted from customers

and other banks.

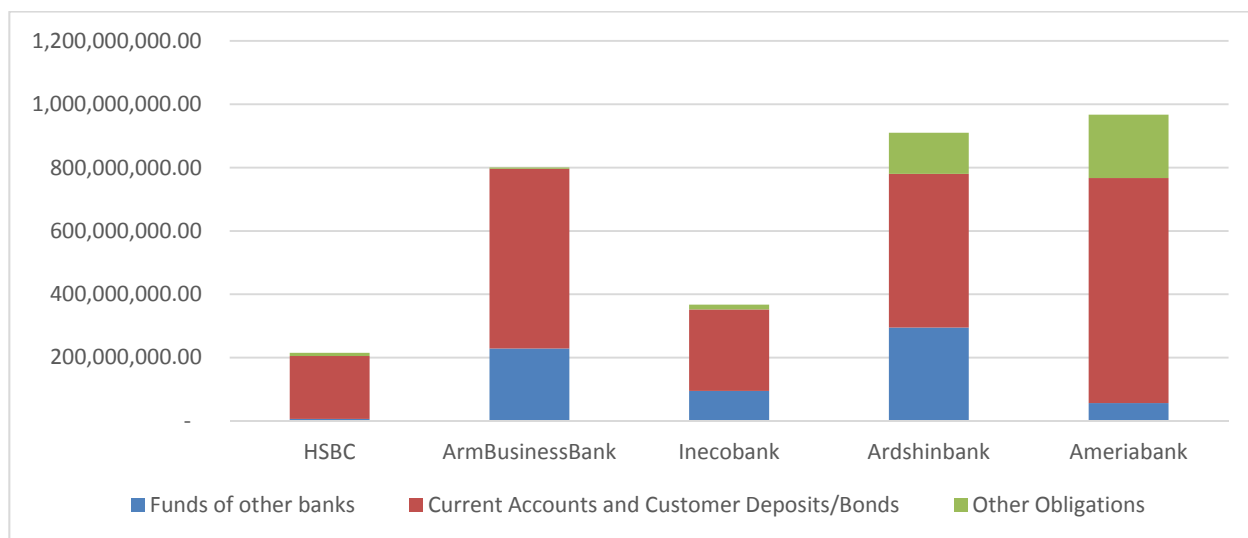


Fig.2 Obligations of companies

Among the banks considered, Ameriabank has the largest capital with amount of about \$ 128 million, and Armbusinessbank has the smallest – about \$ 22 million. The latter fact is quite surprising, considering the fact that Armbusinessbank is one of the largest by assets.

If we consider the equity in disassembled form, we can notice another amazing fact – the retained earnings of Armbusinessbank are negative and in a rather large amount – \$ 19 million. This means that the bank works with loss and is losing equity. (See Fig. 3).

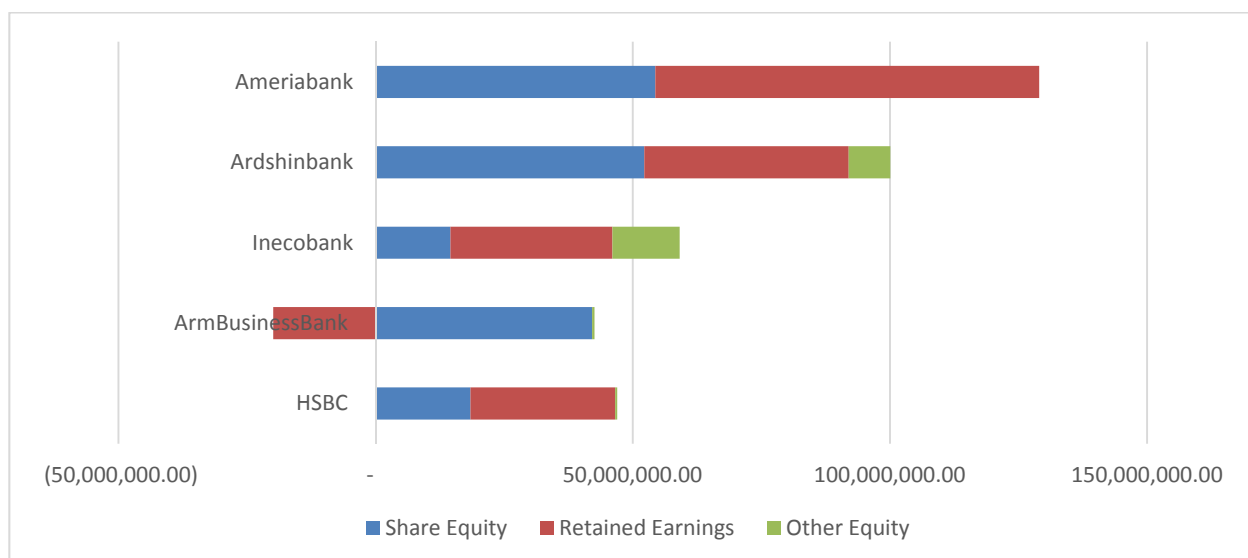


Fig.3 Capital of Companies

For a better understanding of the situation in the examined banks, let us observe the financial leverage indicator (See Figure 5). If in the case of the 4 banks it is comparable to the average for the banking system, then as we have already mentioned above, Armbusinessbank has serious problems with risk management. Such use of financial leverage is very dangerous, taking into consideration that the loss of only 3-4% of assets will lead to the bankruptcy of the bank, and such volatility is quite common among financial companies around the

world and especially for financial institutions in developing countries, where the economy and financial companies are highly dependent on exogenous factors. To struggle with the decline in the value of assets, the bank may be motivated to refinance insolvent loans in order not to write off the assets and declare bankruptcy, having lost all the money of the shareholders.

On the other hand, the bankruptcy of such a large player in the market may lead to the crisis of the financial system in Armenia. We may say that

Armbusinessbank has become one of the examples of “Too big to fail” companies for the country, and both the regulator and the state have their own motivation to support the company even in such situation. It should also be mentioned that with better management of the bank and comparable retained earnings with other banks (about 30 million for 3 banks and 74 million for Ameriabank), the

company would have a financial leverage equal to 10, which is a bit more than the average banking indicator. In addition, as we have already spoken above, it is the quality of assets, that affects the profitability of the banking sector, and such losses are possible only with initially poor quality of assets and their write-off with time.

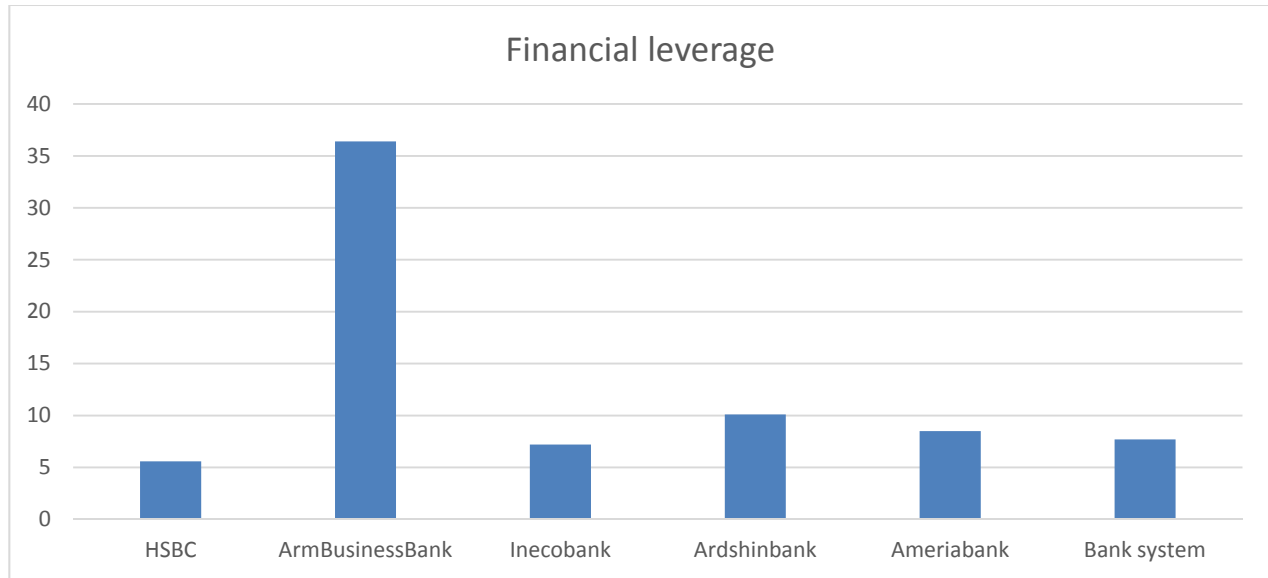


Fig.4 Financial Leverage

Conclusion

In this paper, we reviewed the literature showing the impact of asset quality and regulations on the profitability of companies, and came to the conclusion that this influence is certain and obvious. Further, we found that, if in the case of the banking system as a whole, the situation in Armenia is quite terrible, and then there are banks under a big question about their solvency in the future. To understand the ways to restore the financial situation with this bank, it is necessary to make a more detailed analysis of assets, in particular loans issued, and the share of refinanced loans. However, such data are not public and, accordingly, this kind of analysis can be carried out either by the Central Bank of the Republic of Armenia or by the bank itself internally.

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