

MANAGING NON-INTEREST INCOME AS PART OF BANK BUSINESS STRATEGY¹

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ABSTRACT

In order to obtain constant and stable sources of finance, particularly in the changed circumstances on the banking market, i.e. the global financial crisis, credit institutions in Croatia have changed their business strategy by focusing partly on the non-interest income segment. By this procedure credit institutions are trying to impact their market position.

In this paper the authors investigate the role and significance of non-interest income and its impact on business policies of credit institutions in the Republic of Croatia.

JEL classification: E5, G21, P17

Keywords: management, non-interest income, banks

1. INTRODUCTION

Performance of lending institutions, especially at the time of the global financial crisis, depends to a great extent on their business strategy and policy. A good business policy is characterized by well-defined goals and plans and successful adjustment of the policy to the environment. By accepting these principles lending institutions create preconditions for achieving competitive advantage and at the same time affect their own market position. In the Croatian banking sector, which

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is the dominant segment of the loan-providing financial system, orientation to non-interest income as a source of funding can be increasingly observed. This can be explained by the fact that non-interest income is increasingly more present due to its characteristics, abundance and the way clients respond to it (psychological reasons).

2. BANK STRATEGY VS. BANK BUSINESS POLICY

Bank strategy is defined as ability and art of utilizing particular bank resources in order to use advantages to create desired effects. This means that bank strategy is a means for achieving its essential goals and at the same time it represents the creative idea by means of which every bank wants to achieve the ultimate, usually a long-term goal. Bank strategy is closely related to bank's business policy. Business policy is a "set of principles and methods for making business decisions. They are based on scientific achievements, analytical methods and experience, with the aim of continuous improvement of business operation" (Kandžija, Živko; 2004, 285). Business policy defines goals and plans of a bank as well as ways of their realization, and it is the foundation on which business operations of the bank itself are based. Thus certain banks direct their business policy mainly to the population segment, while other banks are oriented to the sector of the economy.

3. MARKET OF BANKING SERVICES IN THE REPUBLIC OF CROATIA

Banking and/or financial services in the Republic of Croatia are provided by lending institutions. A lending institution is a legal entity that has obtained a banking licence from the relevant body, and its field of activity is to receive deposits or other repayable funds from the public and to approve loans for its own account (Credit Institutions Act, Official Gazette 117/08, 74/09, 153/09, Article 2). System of lending institutions in Croatia comprises: banks, savings banks and housing savings banks.

Among the above listed lending institutions, banks are dominant financial institutions in the Croatian territory. A bank is a financial institution that has obtained a banking licence from the Croatian National Bank (HNB) and that was founded as a joint stock company with the seat in the Republic of Croatia (Bank Act, Official Gazette 84/02, 141/06, Article 2). Banking services include receiving of deposits or other repayable funds from the public and approving loans for its own account (Credit Institutions Act, Official Gazette 117/08, 74/09, 153/09,

Article 4). In addition to banking services, banks can also provide both basic and additional financial services.

In terms of ownership structure, the banking system in the Republic of Croatia consists of: state-owned banks, private domestic banks and foreign-owned banks. (Table 1)

Table 1: The number of banks in the Republic of Croatia according to ownership structure and the share of their assets in the total bank assets in the period from 2006 to 2008

GODINA	2006.		2007.		2008.	
	Number	Share	Number	Share	Number	Share
State owned banks	2	4,2	2	4,7	2	4,5
Private domestic banks	16	5,0	15	4,9	16	4,9
Foreign owned banks	15	90,8	16	90,4	16	90,6
UKUPNO	33	100,0	33	100,0	34	100,0

Source: Croatian National Bank, available at <http://www.hnb.hr> (March 3, 2010)

Based on the data from the Table 1, a conclusion can be made that in the period from 2006 to 2008 most of the business in the Republic of Croatia was done by foreign-owned banks and private domestic banks. The largest share of assets in the total assets in the analyzed period belongs to foreign-owned banks (from 90.4% to as much as 90.8%).

The number of banks in the stated period, considering their size according to the classification of the Croatian National Bank (large, medium-sized, small banks), did not significantly change. So, in the period from 2006 to 2008 in the Croatian territory there were 6 large and 4 medium-sized banks. In 2006 and 2007 there were 23 small banks, while in 2008 this number increased by one.

4. CHARACTERISTICS AND CLASSIFICATION OF BANKING INCOME

Banking income consists of interest income, non-interest income and other banking income.

4.1. Interest income

According to a definition, interest income comprises active interest rates on loans as well as commissions and fees, for which calculation basis consists of loans that are stated in assets in the balance sheet, regardless whether calculation of these

commissions or fees is done on a one-off basis or based on a time period (Instructions for application of chart of accounts for banks, National Gazette 115/03, 39/04, 29/06).

Interest expenses include expenses of interest payable and other expenses that are directly related to received loans and deposits and other instruments through which banks collect their funding sources (hybrid and subordinated instruments), and those for which received loans and deposits and other instruments are used as the basis for calculation, regardless of the time dimension of the calculation, which can be on a one-off basis or time basis (Instructions for application of chart of accounts for banks, National Gazette 115/03, 39/04, 29/06).

4.2. Non-interest income

The same legal framework (source) defines non-interest income as all income that a bank generates by providing services to its clients, using human and technical resources of the bank, but without direct use of funds. By providing these services the bank's placements are not shown in assets. The most important types of non-interest bank's income are commissions or fees for:

- a) payment transactions,
- b) card transactions,
- c) issuing warranties and other forms of guarantee, including acceptance of a bill (acceptance credit), except income from due acceptance credits,
- d) loan management on behalf and for the account of other persons (mandated operations),
- e) care about securities and securities transactions on behalf and for the account of other persons,
- f) other (safe deposit boxes rental service and other off-balance sheet activities of a bank, other services that are provided without mobilizing bank funds).

5. COMPARATIVE ANALYSIS OF THE CROATIAN MARKET OF INTERMEDIATION BANKING PRODUCTS

Research included the entire Croatian banking market in the period from 2006 to 2008 and the efficiency of interest and non-interest income in the banking system of the Republic of Croatia. (Table 2)

Table 2: Efficiency of interest and non-interest income in the banking system of the Republic of Croatia

			Efficiency od 1 HRK income									
			net interest income					net non-interest income				
			2006	2007		2008		2006	2007		2008	
1.	ERSTE & STEIERMÄRKISCHE BANK d.d.	B	0,50	0,47	▼	0,42	▼	0,65	0,71	▲	0,71	■
2.	HYPO ALPE-ADRIA-BANK d.d.	B	0,46	0,34	▼	0,37	▲	0,81	0,81	■	0,81	■
3.	PRIVREDNA BANKA ZAGREB d.d.	B	0,56	0,52	▼	0,51	▼	0,60	0,64	▲	0,63	▼
4.	RAIFFEISENBANK AUSTRIA d.d.	B	0,49	0,41	▼	0,40	▼	0,62	0,67	▲	0,67	■
5.	SOCIÉTÉ GÉNÉRALE-SPLITSKA BANKA d.d.	B	0,51	0,48	▼	0,49	▲	0,78	0,76	▼	0,76	■
6.	ZAGREBAČKA BANKA d.d.	B	0,53	0,50	▼	0,50	■	0,79	0,83	▲	0,84	▲
7.	HRVATSKA POŠTANSKA BANKA d.d.	M	0,65	0,54	▼	0,49	▼	0,15	0,22	▲	0,29	▲
8.	OTP BANKA HRVATSKA d.d.	M	0,60	0,55	▼	0,54	▼	0,63	0,70	▲	0,73	▲
9.	SLAVONSKA BANKA d.d.	M	0,56	0,46	▼	0,45	▼	0,76	0,80	▲	0,83	▲
10.	VOLKSBANK d.d.	M	0,57	0,52	▼	0,50	▼	0,83	0,87	▲	0,79	▼
11.	BANCO POPOLARE CROATIA d.d.	S	0,57	0,52	▼	0,55	▲	0,85	0,79	▼	0,78	▼
12.	BANKA BROD d.d.	S	0,60	0,57	▼	0,51	▼	0,42	0,39	▼	0,42	▲
13.	BANKA KOVANICA d.d.	S	0,45	0,34	▼	0,33	▼	0,56	0,50	▼	0,73	▲
14.	BANKA SPLITSKO-DALMATINSKA d.d.	S	0,67	0,66	▼	0,65	▼	0,41	0,79	▲	0,57	▼
15.	BKS BANK d.d.	S	0,64	0,65	▲	0,59	▼	0,55	0,59	▲	0,60	▲
16.	CENTAR BANKA d.d.	S	0,60	0,59	▼	0,52	▼	0,67	0,74	▲	0,75	▲
17.	CREDO BANKA d.d.	S	0,48	0,45	▼	0,47	▲	0,78	0,79	▲	0,82	▲
18.	CROATIA BANKA d.d.	S	0,53	0,51	▼	0,54	▲	0,22	0,28	▲	0,42	▲
19.	IMEX BANKA d.d.	S	0,56	0,50	▼	0,51	▲	0,62	0,63	▲	0,67	▲
20.	ISTARSKA KREDITNA BANKA UMAG d.d.	S	0,63	0,63	■	0,62	▼	0,61	0,75	▲	0,79	▲
21.	JADRANSKA BANKA d.d.	S	0,46	0,52	▲	0,54	▲	0,56	0,59	▲	0,63	▲
22.	KARLOVAČKA BANKA d.d.	S	0,64	0,65	▲	0,60	▼	0,45	0,46	▲	0,49	▲
23.	KREDITNA BANKA ZAGREB d.d.	S	0,54	0,50	▼	0,46	▼	0,35	0,45	▲	0,57	▲
24.	MEĐIMURSKA BANKA d.d.	S	0,65	0,66	▲	0,60	▼	0,88	0,87	▼	0,86	▼
25.	NAVA BANKA d.d.	S	0,46	0,40	▼	0,20	▼	0,62	0,46	▼	0,22	▼
26.	PARTNER BANKA d.d.	S	0,65	0,60	▼	0,54	▼	0,59	0,60	▲	0,60	■
27.	PODRAVSKA BANKA d.d.	S	0,53	0,56	▲	0,52	▼	0,69	0,69	■	0,69	■
28.	PRIMORSKA BANKA d.d.	S	0,70	0,68	▼	0,62	▼	0,35	0,33	▼	0,09	▼
29.	SAMOBORSKA BANKA d.d.	S	0,60	0,64	▲	0,61	▼	0,27	0,16	▼	0,26	▼
30.	SLATINSKA BANKA d.d.	S	0,51	0,53	▲	0,52	▼	0,70	0,71	▲	0,72	▲
31.	ŠTEDBANKA d.d.	S	0,63	0,58	▼	0,58	▲	0,75	0,77	▲	0,80	▲
32.	VABA d.d. BANKA VARAŽDIN	S	0,35	0,44	▲	0,39	▼	0,21	0,76	▲	0,70	▼
33.	VENETO BANKA d.d.	S	0,72	0,50	▼	0,38	▼	0,78	0,71	▼	0,72	▲

B-Big banks, M-Medddium banks, S-Small banks

Source: Authors calculation based on banks Annually Report

Based on the calculation of net profit from interest and non-interest income, a decrease in the net interest income in the analyzed period can be observed for all bank groups. At the same time net non-interest income increased. (Table 2)

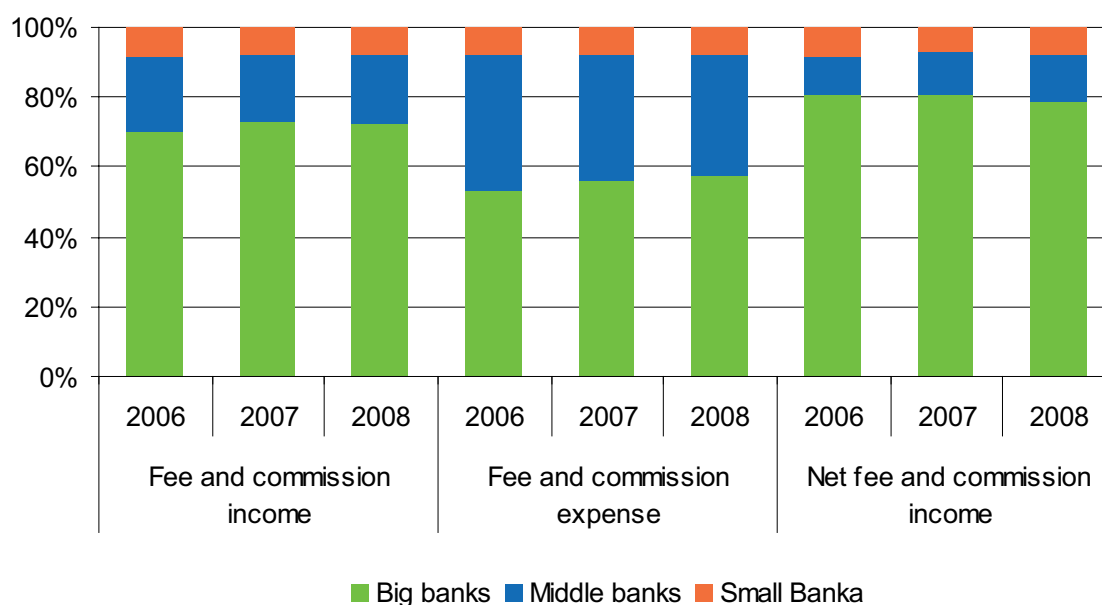
5.1. Types of intermediary banking products and their participation in non-interest income

The representation structure of non-interest income according to the types of banking products was analyzed in the researched period. (Table 3)

Table 3: The share of intermediary banking products in the Republic of Croatia and their percentage share in non-interest income according to the groups/types of banks

	payment transaction			credit card services			investment management, brokerage and consultancy fees, customer loans, guarantees given, customer services			other fee and commission income		
	2006	2007	2008	2006	2007	2008	2006	2007	2008	2006	2007	2008
Big banks %	65,03	71,34	72,61	80,89	81,71	80,16	76,60	81,94	80,92	75,49	61,41	61,44
Middle banks %	27,92	25,07	23,81	13,02	13,44	15,52	6,15	5,17	6,02	16,53	26,40	25,78
Small banks %	3,05	3,60	3,59	6,09	4,85	4,32	17,25	12,89	13,06	7,98	12,19	12,78
Total %	100	100	100	100	100	100	100	100	100	100	100	100

Source: Authors calculation based on banks Annually Report

Graph 1: Percentage share of non-interest income and expenses and net non-interest income per bank groups

Sources: Authors calculation based on banks Annualy Report

Based on the data from the Table 3 it can be concluded that the largest share in non-interest income of large banks is the share of card transactions in the period from 2006 to 2008 (as much as 80.71% in 2007). The most represented group of income in the group of medium-sized banks are payment transactions, while in small banks the largest share in non-interest income was represented by loans to clients, issued guarantees and client services.

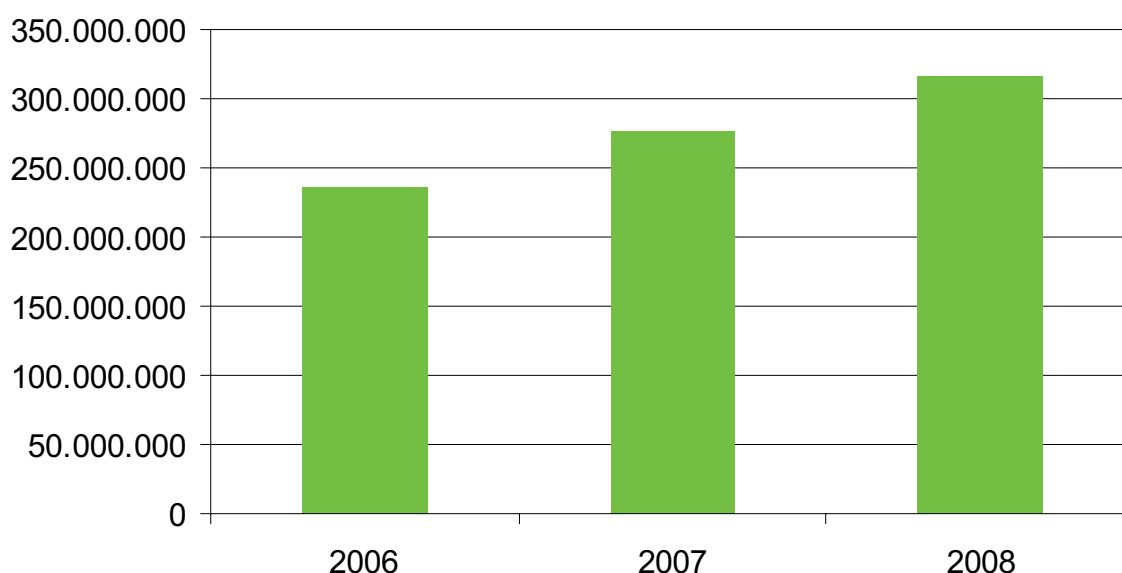
5.1.1. Payment transactions

Considering the pronounced representation of payment transaction as non-interest source of income in banks in the Republic of Croatia in the analyzed period, the value of payment transactions was analyzed as well as their number. (Table 4)

Table 4: Payment transactions in mil. HRK

	2006			2007			2008		
	income	expense	net	income	expense	net	income	expense	net
Big banks	1306	352	954	1418	314	1104	1489	285	1204
Middle banks	528	488	40	498	441	57	488	405	83
Small banks	146	93	52	72	42	30	74	39	34
	1979	933	1046	1988	796	1192	2051	730	1321

Source: Authors calculation based on banks Annualy Report

Graph 2: The number of payment transactions in the Republic of Croatia

Source: HNB (Croatian National Bank)

An increase in the number of payment transactions can be observed at the annual level in 2007/2006 and 2008/2007. The same trend can be observed in the net income from payment transactions, and increase of the net income is especially pronounced in large banks. (Table 4)

5.1.2. Card transactions

Card transactions have a very large share in the Croatian banking system. Therefore all commercial banks offer this banking product. (Table 5)

Table 5: Card transactions in mil HRK

	2006			2007			2008		
	income	expense	net	income	expense	net	income	expense	net
Big banks	497	274	223	596	328	268	670	359	311
Middle banks	80	21	59	98	29	70	130	34	95
Small banks	37	8	30	35	8	27	36	8	28
	614	303	312	729	365	365	836	401	435

Source: Authors calculation based on banks Annualy Report

Growth of income from card transactions can be observed in all bank categories in the analyzed period. The growth of net income of large banks in 2007 in relation to 2006 by as much as 45 mil. HRK is especially important as well as the growth of net income in medium-sized banks in 2008 in relation to 2007 by 25 mil. HRK. (Table 5)

5.1.3. Fees for property management, brokerage and consulting services, fees for loans to clients, fees for issued guarantees, fees for client services

Fees for property management, brokerage and consulting services, fees for loans to clients, fees for issued guarantees and fees for client services are analyzed by profusion for the entire banking system of the Republic of Croatia. (Table 6)

Table 6: The amount of fees for property management, brokerage and consulting services, fees for loans to clients, fees for issued guarantees, fees for client services in mil. HRK

	2006			2007			2008		
	income	expense	net	income	expense	net	income	expense	net
Big banks	484	30	454	884	40	844	774	44	730
Middle banks	39	5	34	56	6	50	58	8	49
Small banks	109	19	90	139	42	97	125	32	93
UKUPNO	631	54	577	1078	88	991	956	84	872

Source: Authors calculation based on banks Annualy Report

There are no significant differences within all three bank categories in net income trends for these banking products.

5.1.4. Other fees and commissions

Due to official data presentation methodology it was necessary to include all other types of non-interest income in this category. (Table 7)

Table 7: Trends in other types of non-interest income and fees by bank categories in the Republic of Croatia expressed in mil. HRK

	2006			2007			2008		
	income	expense	net	income	expense	net	income	expense	net
Big banks	229	84	145	179	93	86	185	104	81
Middle banks	50	27	24	77	26	51	78	24	54
Small banks	24	5	20	36	10	26	38	11	27
UKUPNO	303	115	188	291	129	163	301	139	162

Source: Authors calculation based on banks Annualy Report

Continuous growth of other types of net non-interest income in the analyzed period was observed in medium-sized and small banks, while decrease in such income was observed in large banks.

CONCLUSION

Based on the conducted research of non-interest income management of commercial banks in the Republic of Croatia in the period from 2006 to 2008, the following can be observed:

- Non-interest income is becoming an increasingly interesting area for commercial banks;
- Non-interest income management is gaining a growing share in business strategies and policies of Croatian banks in the first place as a reaction to the changed market circumstances (financial crisis);
- Banks perceive specific qualities of such income, for example, non-elastic demand by bank's clients for particular types of banking products, weak or zero reaction to the changed amount of fees for such services because they are relatively small, but frequent; absence of client reaction to relatively large changes of commissions; therefore such income is becoming increasingly interesting for banks;

- There is no positive correlation between the size of a commercial bank and the choice of non-interest income for the purpose of achieving better market positioning.

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