ARGUMENTS ON THE LEVEL OF MINIMUM PAID-UP CAPITAL

I. WHAT DOES CAPITAL REPRESENT FOR BANKS?

Banks as any other business needs capital to exercise activity. Reverse from them, the commercial banks must always detain certain amount of capital ready to discount the unexpected losses at any time. Such obligation is resulted from the specific nature of banking activity.

Banks perform a number of functions via capital. To realize these functions, these must have structures or size to satisfy the regulatory authorities, shareholders and investors (including depositors).

To be mentioned amongst capital main functions are the following:

First, bank capital absorbs bank losses and its potential exposure to reverse risks it must meet throughout its activity.

Second, it makes other depositors and creditors feel protected not only for stable working periods of banking activity but also through crisis periods. This means that bank capital is the one that reinforces the public confidence at any bank and the entire banking system in general.

Third, it is the resource of long-term funds for a stable activity, banking technique and technology. Capital is the main resource financing bank's growth, which is very important to be competitive in the banking environment.

Fourth, it serves as an instrument controlling the extension of banking activity. If bank assets have a faster growth than needed, then banks will receive signals from regulatory authorities to restrain expansion or augment capital in accordance with the risks taken over.

Fifth, it helps bank licensing, organizing or operation before the deposit flows get started. In the early period, when the public confidence is relatively low to the bank the only financial resource the bank can resort to are its own capital or assets. Referring to all these functions, minimum capital assumes a special significance in view of amount.

II. WHAT FACTORS MIGHT BE INFLUENCING THE REQURED CAPITAL AMOUNT?

- **The macroeconomic situation** of the country. The more stabilized and healthier this situation will be the lower the risk at banks operating environment. This means that banks carry a little risk in their activity therefore similar conditions do not urge the augmentation of capital amount.

- **Are new banks needed or not.** This relates to market need to extend the system and the supply of services offered from it. If banks and banking services and competition are deficient this may urge the authorities to undertake new bank licensing through a more liberal requirement of capital. In the reverse case a high capital demand would mean a low return on equity to investors and vice-verse.

- Business leverage strength (in terms of capital), states business actual strength to enter the banking industry of a country. Frequently the national authorities are interested to add the number of banks founded on domestic assets or capital. To meet this preference are considered real business strengths in terms of capital or own assets. Referring to this criterion and the preference to establish banks on domestic assets or capital, this would not affect the further augmentation capital amount in any case.

- **Interested investors (domestic or foreign) to open a bank**. This factor underlines the idea that investors' strength or power to invest is equally important to the interest they show in this activity. The level of interest for domestic or foreign investors is directly related to profitability indicators (return on equity) and the risk taken over by them. If interest is low, it will be acted through holding own assets or capital amount at low rates and the reverse.

- **The need to meet international standards like different directives from BIS or EU, for example.** In the framework of signing association agreement to member EU, many countries of the region like Croatia, Rumania etc, have converged required minimum to directive no. 12 of year 2000. According to this directive, countries signing the association agreement must hold as required capital, not less than EUR 5 million or USD 4,7 million. Generally, member countries to EU have got EUR 18 million or USD 16,5 million as required minimum.

III. THE HISTORY OF THIS INDICATOR IN ALBANIA OVER YEARS.

Required capital in Albania is currently at Lek 700 million or nearly USD 5 million. The required capital has reflected a rising trend over the recent decade. EU criterion, USD, 16,5 million is 3.3 times higher than the current standard in Albania, nevertheless it meets EU criterion for countries that would be signing the association agreement. Knowing that we aspire membership in EU, converging legislation with EU member countries presents an important step to this and we naturally come to question: Is it necessary to augment the required capital amount? The answer is yes as we do not want to step away from the already started integration and moreover ensure benefits that accompany the augmentation of required capital amount as well. The second question is: Is it time to augment capital amount? For this we are going to analyze some facts.

1996). This year change was undertaken to maintain the same rate of required minimum sated in USD (USD 2 million). In fact this year we have a noticeable devaluation of Lek exchange rate to USD (from 100 Lek /USD to 170 Lek/ USD). This devaluation of Lek enforced the decision on the augmentation of the required capital from Lek 200 to 350 million. In 1998, it was established that for new banks requiring access in the banking system the minimum paid- up capital will be no less than Lek 700 million, whereas for current banks and those in the process of granting a license the augmentation take place in some stages. Initially it was deemed as rational that augmentation be met at the rate of Lek 500 million. Banks will meet this obligation in the framework of 18 months and later at Lek 700 million for other 18 months. From 1992 until now, we note four changes meaning that these changes have been already undertaken at the average of every two years and a half. However, if we refer to the western countries experience will note that

Table 1: Required capital in Albania year

Years	Required minimum (Lek million)	Banks no.
After 1998	700	14
02.12.1998	700	10
December 1996	350	8
28.06.1996	200	8
Year 1994	100 – 200*	6

Note: In 1994, there were two levels accompanying the required minimum for domestic investors Lek 100 million, foreign investors Lek 200 million.

From the history of the changing the required minimum, we can directly draw two important characteristics:

I. In Albania, the augmentation of the required capital has not restrained new bank licensing requirements and 4 banks are added from year 1998 (when the required minimum went up to Lek 700 million). This means that the interest of investors to open new banks is affected from other factors than the required capital.

II. In Albania, we note that the timeliness for changing the required minimum is already every two years. There are cases when the required capital has twice changed in a year (namely year

at the time it was established Basel accord on the criterion of capital adequacy in year 1998 it was assigned a date to the application and adjustment of this accord for about 4 years to year 2002. Meantime that in our banking system as above mentioned the period of the changing capital has been 2,5 years.

Conclusion 1: Only from a look at the history of changing capital it is concluded that the frequency of growing capital has been relatively high. For this reason, it has been assessed that it is still early to change the amount of required capital because the frequent change of sets banks in front of insecurity and pressure as well as hardens the application of their business-plans.

IV. REQUIRED CAPITAL IN ALBANIA AND IN SOME COUNTRIES OF THE REGION

in Albania is a bit lower than the average of the countries in the region (55.5), which means that the banking system needs to be expanded yet. This indicator underlines the fact that the augmenting the required capital would be desirable

Table 2: Comparing capital indicators for countries in the region.

Countries	Required minimum (USD million)	Minimum capital /GDP	Financial degree	Capital adequacy	Size of the banking system*
Albania	5,0	0.05%	6.7	42	50
FYROM	2,2- 8,3*	0.22%	23.3	36.7	38
Croatia	4,7	0.02%	11.2	21.3	71
Bosnia-Herzegovina	7,0	0.17%	25.7	32	67
Slovenia	4,0	0.02%	14	12.4	79
Bulgaria	5,1	0.04%	11.3	41.3	40
Romania	4,6	0.01%	8.6	23.8	29
Yugoslavia	5,0	1.87%	-	-	-
Turkey			11	-	70
Average	5,5		13.27	25.84	55.5

*Note: In the case of FYROM we have two levels of required capital for banks. USD 2 million is for banks exercising their activity inside the country, whereas those performing operations outside the country must meet the required minimum, USD 8 million.
* With the size of the banking system it is understood total assets of the system to GDP.
Source: Annual bank reports of the countries and the Annual Report of IFS.

Actually the required capital in Albanian is very close to the average of the region, at USD 5,5 million.

This indicator backs the idea that it is not the right moment to change the amount of minimally requested capital. The share of required capital as to the total of GDP is higher for Albania than in other countries of the region (like Romania, Bulgaria), meaning that changing the amount of minimally requested capital is inappropriate in these circumstances. Finacial average is actually low in Albania, meaning that own capital allotted to total assets is too small. The smallest of all the countries brought to comparison suggests the augmentation of this indicator that is the capital amount. The size of banking system for banks to be availed of expansive possibilities.

Conclusion 2: Comparing capital indicators we underline that the required capital amount and the size of the banking system are close to the average standard of the countries in the region, therefore the further augmenting capital is inappropriate. Even capital adequacy at 1.6 times higher than that of countries in the region does not support the augmentation of minimum capital. On the other side, the level of financial leverage is half the average of the countries in region and far off such country standards like Croatia and Slovenia (respectively 11.2 and 14 percent) bearing the most advanced system. This fact props the augmentation of the paid -up capital.

V. ANALYZING FACTORS THAT INFLUENCE THE REQUIRED CAPITAL AMOUNT IN ALBANIA

V.1. MACROECONOMIC SITUATION

Comparing the performance of macroeconomic indicators over years it is clearly evidenced that the macroeconomic environment in Albania has got a stabilizing trend. During the recent four years taken under analysis, Albania disclosed the best positive developments on macroeconomic indicators amongst countries in the region taken to comparison.

Referring to our problem means that it is not yet the moment to augment the capital for a similar action will restrict banking system further growth to a certain amount. If we refer to the attraction of foreign investments per capita we shall see that Albania is the last ranked in the region which means that it must create as much more favorable conditions in order to attract a larger number of investors, meaning that augmenting the capital amount is inappropriate. Inflation reflects the lowest rate of the region. Inflation indicators together with the stable exchange rate express a more favorable and safer macroeconomic situation, which necessarily does not appeal from more capital.

Table 3: The history of macroeconomic indicators performance.

Indicators	1997	1998	1999	2000
GDP in nominal value (USD million)	2,294	3,057	3,676	3,752
GDP per capita in USD	684	906	1,081	1,094
GDP growth rate (change in %)	-7	8	7.3	7.8
Direct investments (USD million)	47.5	45	41.2	143
Investments to GDP (in %)	2.1	1.5	1.1	3.8
Inflation (in %)	42.1	8.7	-1	4.2
Exchange rate Lek/USD (average)	148.9	150.6	137.7	143.7

From macroeconomic developments, Albania resembles more such countries like FYROM, Romania, Bulgaria, meantime that there is a lower inflation between these countries. Investments in percent to GDP are lower and the same can be mentioned for GDP per capita. As already known, the Balkan currently attracts a very small percentage of investments from foreign investors and this affects to a certain extent overall macroeconomic developments and those of the banking system. This has been as an aftermath of the extremely aggravated situation with wars and a noticeable disclosure of deficient political stability, as region.

Conclusion 3: from the above analysis we may say that the established macroeconomic situation does not unquestionably request the addition of minimum capital. Also the low level of foreign investments per capital backs the idea of unchanging capital.

V.2. ARE NEW BANKS NEEDED OR NOT

New banks need is generally decided from:

- The size of the banking system. With the size of the system, we refer to some quantitative indicators as for example

Table 4: Macroeconomic data on countries in the regions.

Countries	GDP indicators			Direct investments		Inflation (in %)	USD annual average
	GDP USD million	GDP/ per person	Real growth of GDP	Total in USD million	FDI/GDP (in%)		
Albania	3,752	1,094	7.8	143	3.8	4.2	143.71
FYROM	3,800	1,885	5.1	181.6	4.6	10.6	65.904
Croatia	18,977	4,227	3.7	827,9	21.9	6.2	8.3
Bosnia-Herzegovina	4,130.4	1,053	5	117	2.8	8	2.1
Slovenia	18,169	9,413	4.6	133.3	1	8.9	222.7
Bulgaria	11,950	1,459	5.8	999.6	8.4	10.1	2.1
Romania	36,691	1,636	1.6	1036	3	45.7	21,708
Yugoslavia	267	940	7	-	-	85.6	37.5
Turkey	77,484	1150	7.6	112	1.3	55	1644.5

Source: IFS Annual Report for year 2000.

Table 5: Albania and countries in the region at the size of the banking system.

Countries	Banks no.	Banks no. per 1000 km2	Banks no per 100,000 inhabitants
Albania	13	0.45	0.37
FYROM	22	0.87	1.08
Croatia	44	0.78	1.02
Bosnia-Herzegovina	63	1.23	1.61
Slovenia	97	4.79	5.03
Bulgaria	35	0.32	0.45
Romania	40	0.17	0.18
Average	45	1.23	1.39

the number of banks per 1,000-km2 presenting banks expansion to ever more aid the people with banking services.

- The structure of banking system related to the concentration of banking activity. This fact is underlined in view of an ever more efficient competition of the banking system[1]. Our country has the lowest number of banks compared to other countries in the region. Should this number be allotted to our country population or its surface area we will get a more real indicator. Even in this case, our country is ranked amongst the last three countries of the region, after Romania and Bulgaria and is generally far off the average of the region as per banks coefficient per 1,000 km2.

Conclusion 4: These indicators confirm that the banking system is not over saturated therefore we can say that it is appropriate to stimulate the introduction of new banks in the system. From this viewpoint, the augmentation of minimum capital would not help the attraction of investors.

Should we refer to the banking structure, Albania has a consolidated system to a single bank. In 2000, the largest bank assets in the country share nearly 65 percent of the total of the banking system assets. Meantime in Croatia, three largest banks in the country share 18.8 percent of banking system assets.

Conclusion 5: The more concentrated the banking system, the more indispensable the enhancement of competition and the introduction of new banks in the system will be. This fact once more backs the creation of more favorable conditions to get the access of investors in the banking market, thus it does not sustain the idea for the augmentation of the minimum capital.

V.3. DOMESTIC BUSINESS STRENGTH LEVERAGE (IN TERMS OF CAPITAL)

At the first steps of assigning this rate in our country, it was deemed as appropriate to differentiate the domestic or local investors from foreign. Assisting the domestic or local investors with half amount of foreign investors (Lek 100 million) was undertaken in that time when the Albanian businesses lacked real opportunities to invest in the banking system. This indicator was assessed as a stimulus of this activity. Further it was deemed reasonable to remove this criterion unless there were other reasons to keep Albanian businesses investments away from the banking activity.

Conclusion 6: Anyway, in the conditions when Albanian businesses are not fully consolidated and do not feel as retracted from the banking activity, the augmentation of the capital amount would be untimely.

V.4. ALBANIAN OR FOREIGN INVESTORS' INTEREST ON NEW BANKS

Actually, Albanian investors (according to some preliminary analysis) do not prefer banking as their investment alternative because of the low and gradual return on assets from this activity.

A bank investment is long term investment frequently accompanied with loss in the first years of activity meantime that similar investments like trade or construction harvest their profits since at the first years of activity.

There are also other factors additionally to the above mentioned supporting the preference of Albanian investors to rather invest in other

[1] At the lack of data on concentration coefficient for countries in the region, we are mentioning it as the only theoretic factor to be really considered when decided to set the minimum of required capital.
[2] Shih vrojtimin "Sistemi bankar shqiptar, probleme të zhvillimit të tij" të përgatitur nga Sh Cani, M. Muco, T. Baleta.

economy sectors than the banking system meantime that the attraction of foreign investors would request the creation of favorable conditions with respect to return on assets. Also the capital amount must be such like to maintain competition in the region. Establishing a high rate of minimum capital would make the foreign in investors to retract, investing their assets to other countries offering more facilities.

Conclusion 7: Albania remains in need of new banks and there are no interested investors in that. In this viewpoint, it must stimulate the introduction of new banks and not their restraint. On the other hand, in view of developing privatization of public banks, we note that interested investors are few. This once more strengthens the idea the actual amount of required capital will not augment.

V.5. COUNTRY AND BANKING RISK

The required capital is fairly associated with the risk rate. Currently, Albania as the other Balkan countries is a high- risk country. Banking activity from its relative significance requests for highly prudential and preliminary measures, which might be saving shocks to the entire banking and financial system, in general. Whether referred to the evolution of banking indicators (credit growth as lending represents the main activity) we will note significant improvements year-on- year.

Conclusion 8: Compared to the rest of the Balkans lending indicators state a high- risk position. Such fact is in favor of augmenting the principal amount laying the basis for a healthy banking system.

VI. SITUATION IN THE BANKING SYSTEM

Anyway, to be focused is banking system performance. Banking system profitability in Albanian is situated at relatively average rates or a bit higher than the average of the countries in the region (set as simple average through the countries taken under analysis). Return on equity is at the highest of the region (at least compared to countries having data available with this respect) indicating that banks net profit set against shareholders equity is high. Whereas for the other two indicators that its return on the total assets and net profit to GDP, Albania indicators rank second, indicating a satisfactory position again.

the country with the least developed credit to economy (private sector) of the region. Banks do not prefer lending activity as already known this is the main activity of a bank.

Credit portfolio at the moment remains at bad levels and far-off from the average of the region. From this banks must be drawing the conclusion that that the further growth of lending activity must be stimulated. In the conditions when lending is a high-risk activity we might say that it might be accompanied with the augmentation of the capital amount.

Should we refer to the evolution of capital adequacy or the leverage effect over years, we shall note that these indicators have been at

Table 6: Banking system profitability indicators by countries in the region.

Countries	ROE	ROA	Net profit/GDP
Albania	21.06	2.1	1
FYROM	3.8	0.8	0.3
Croatia	15.6	1.3	0.8
Bosnia-Herzegovina			
Slovenia		0.8	1.3
Bulgaria	18	2.4	0.9
Romania	12.5	1.5	0.4
Average	14.2	1.5	0.8

Table 7: The history of Albanian banking system profitability indicators.

Indicators	Years			
	1998	1999	2000	2001
ROA	-1.8	-0.56	2.1	1.46
ROE	-82.3	16.4	21.06	21.6
Net profit/GDP in %	-0.7	0.3	1.0	0.7

Table 8: Credit growth indicators comparable for countries in the region.

Countries	Problem loans /total credits	Credit to economy/GDP	Credit to economy/total assets
Albania	42.8	5.2	10.4
FYROM	34.8	19.5	33.8
Croatia	9.2	37.5	45.8
Bosnia-Herzegovina		49	73
Slovenia	5	39	53
Bulgaria	8.2	18.3	36.8
Romania	38.3	9.4	32.2
Turkey		22	32.1
Average	23	25	40

Looking at the historical performance of profitability indicators we will note an apparent improvement from year to year.

On the other hand, banking activity growth indicators compared to other countries in the region is far off the average. Albania represents

very low rates in the previous years. This has been as result of the high provisions for covering bad loans of the system. After 1999, we evidence the transition of bad loans to BART and the significant improvement of capital account. Capital adequacy discloses the highest rate from all the countries taken under analysis.

Table 9: The history of banking system performance indicators.

Indicators (in %)	Years			
	1997	1998	1999	2000
Problem loans to total credits	45.0	41.0	32.7	42.8
Credit to economy against GDP	4.5	7.9	8.1	5.2
Credit to economy against total assets	9.2	18	16	10.4
Size of the banking system (assets/GDP)	49.0	44.7	49.3	50.2
Financial leverage (own capital /total assets)	6.7	2.8	3.6	6.7
Adequacy ratio	-	-1.3	8.2	42

This fact confirms that either the banking system is extremely capitalized compared to the risk taken over from banks (there is more capital than requested) or that banks invest in very low risk activities. Regarding the share of banking system assets to total GDP, it is very close to the average of the countries taken under analysis but far-off the developed country standards (this ratio is at 250 percent in western countries).

Conclusion 9: Referring to profitability indicators we can say that they represent the most favorable rates the highest amongst of the region, whereas, banking system performance indicators remain at low rates. High-risk reality requests more capital.

It must be cared for setting a higher capital rate additionally to leaving investors as above-mentioned, it might lead to the added request for establishing other financial non-bank entities.

VII. ALBANIA AND NEIGHBOR COUNTRIES, MEMBERS OF EU

In the framework of Albania's association in EU, we refer to banking system indicators of the country members in EU. We have chosen Italy and Greece not only for the fact they are members of EU but also because they our main partners.

Bad loans to total credits clearly indicate their low rate and good performance of banking activity.

The above indicators show that the banking system in these countries is highly developed and consolidated, but anyway they show a some times higher standard of required capital compared to regional countries. The reason why we are providing a table of neighbor countries

Table 10: banking system indicators of EU country members in year 2000.

Indicators	Italy	Greece
Required capital in USD	16,500,000	16,500,000
Finacial leverage (in %)	6.7	12.3
Size of the banking system (in %)	153	128
Number of banks	846	
Capital adequacy	10.3	14.7
Bad loans to the total credits	8	
Total credits to total assets	51.3	45%
Total credit to GDP	78	53%
ROA	0.79	
ROE	11.6	

The required capital for both countries is determined from EU directives at the level of USD 16,5 million. Finacial leverage in Italy is higher than Greece. The size of the system stated in the ratio of banking system assets to GDP is some times higher than the average of the region and the size of the Albanian banking system. These countries size of the banking system is extremely large confirming for consolidated and advanced banking system.

is already known and refers to that whether we really want to augment the capital amount or is it the time to undertake such a change? Is our banking system really able to support and face this change? Our banking system remains at early (infantile) stage so it must be covering a long way to reach countries with advanced banking systems and unless the conditions are ripe it must change the amount of minimally required capital parallel to that.

VIII. CONCLUSIONS AND RECOMMENDATIONS

In conclusion we might stress that the factors on which basis it is reasoned to settle the amount of minimally required capital act on both sides. Anyway there much more factors that do not back the augmentation of minimally required capital.

Categories. For example it must be considered that our banking system profitability is higher than other countries in the region, the Bank of Albania may ask for more conservative on banks side with the appropriation of dividends

Reasons in favor or	Contrary to the augmentation of capital
Low level of financial leverage	Frequency of changing the capital amount
The risk of the banking system, bad quality of banks portfolio required capital	The size of the banking system are close to the average of the region
Country risk	Capital adequacy ratio is high
Convergence to EU criteria	Required capital is the same with EU criterion imposed on the countries requesting participating in EU
	The improved macroeconomic situation
	The need to improve competition at a concentrated banking system
	business strength in terms of equity
	The need for foreign investors
	The improved macroeconomic situation

1. From the above analysis we judge that the required capital remain unchanged momentarily.

2. We assess that it must be carefully estimated the risk of the banking system activity and if the risk rate is increased it might be acted through other capital.

leaving untouched capital principal amount.

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