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## PECULIARITIES OF THE COMMERCIAL BANKS FUNCTIONING AS A PART OF THE CREDIT SYSTEM

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*Анотація. В статті розглянуто сутність, структура та етапи формування кредитної системи. Проаналізовано особливості функціонування комерційних банків та вплив на розвиток сучасної кредитної системи України в умовах ринкової трансформації національної економіки.*

*Аннотация. В статье рассмотрены сущность, структура и этапы формирования кредитной системы. Проанализированы особенности функционирования коммерческих банков и влияние на развитие современной кредитной системы Украины в условиях рыночной трансформации национальной экономики.*

*Summary. The article reveals the essence, structure and stages of credit system formation. The peculiarities of commercial banks functioning*

*and their influence on the development of Ukraine's modern credit system in the national economy market transformation period have been analyzed.*

**Ключові слова:** кредитна система, спеціалізовані кредитно-фінансові інститути, банківська система, парабанківська система, центральний банк, комерційні банки, страхові компанії, недержавні пенсійні фонди, ломбарди, фінансові компанії, кредитні спілки, активи, зобов'язання, прибуток, ринкова трансформація економіки.

**Ключевые слова:** кредитная система, специализированные кредитно-финансовые институты, банковская система, парабанковская система, центральный банк, коммерческие банки, страховые компании, негосударственные пенсионные фонды, ломбарды, финансовые компании, кредитные союзы, активы, обязательства, прибыль, рыночная трансформация экономики.

**Key words:** credit system, specialized credit and financial institutions, banking system, para-banking system, central bank, commercial banks, insurance companies, non-state pension funds, pawnshops, financial companies, credit unions, assets, liabilities, profit, market transformation of the economy.

**Statement of the problem.** Market transformation of the national economy has opened a new stage in the development of credit system. It has led to the actualization of the problem of scientific study of new phenomena in the sphere of lending, understanding their meaning, nature and essence, developing effective schemes and credit process technologies and their practical application. Implementation of credit relationship occurs through the functioning of the credit system. When considering a credit system one must take into account that it is based on the realization of complex economic relations that have long history and play a consolidating role in the structure

of all economic relations. There are two concepts of credit system:

- a set of credit relations, forms and methods of lending (functional form);
- a set of credit and financial institutions that accumulate temporarily free money given as a loan (institutional form).

In the first case, the credit system is represented by the banking, consumer, commercial, governmental and international credit. All of these types of loans are characterized by specific forms of relationship and methods of financing. A credit system is also implemented by the second (institutional) form. Banks

serve as the main link in the institutional structure of the credit system. However, the credit system is a broader concept than the banking system, which includes only a set of banks operating in the country. Credit and banking systems shouldn't be confused, as banking system is a part of the credit one. There is no single point of view in defining the credit system. But despite the existence of different wordings, all authors agree that the credit system can be considered in terms of a set of forms and methods of loans as well as from the institutional point of view.

**The analysis of the recent publications and research.** Many Ukrainian scientists and professionals focused their attention on the problem of credit system development: O. I. Baranovski, O. V. Vasiurenko, O. D. Vovchak, A.V. Demkivski, V. V. Kovalenko, S. V. Naumenko, V. M. Oparin, M. I. Savluk, T.S. Smovzhenko, V. M. Fedosov etc. Their research dealt with the general problems of credit market development, its constituting parts and relations arising here.

Modern research has many problems that need to be solved during the period of economic transformation.

**The aim of the article** lies in clarifying the essence and the stages of formation; in analyzing the special role of commercial banks functioning as a part of credit system in the national economy market transformation period.

**Ground of scientific results.** The credit system of modern Ukraine is a system in transition. According to its ideology, it is a market model, but the elements of some credit institutions are not well-developed yet and it belongs to the credit systems that are under development. Having made a significant step in the development of new philosophy of lending activity, Ukrainian credit institutions do not possess the entire set of tools that ensure the interaction of credit system elements. Obviously, after the financial crisis there will be fundamental changes not only in the architecture of the global financial system as a whole, but also in Ukrainian credit sector in particular.

The term "system" can be applied not only to money and the arranging of money circulation. It is also used to determine the credit relationship, banks and organizing their activities. Referring to the system enables us to link the individual parts and make them work as a whole. Thus, the credit system is a set of elements, which is aimed at implementing features specific of the loan. A loan is the main element in the credit system; its essence determines the functioning of all the other elements of the system.

The evolution of the credit system is defined by the economic situation in the country, dominant

forms and mechanisms of management. Each stage of economic development has its own credit system; in Ukraine it covers banking and non-banking sectors. The banking sector is represented by the National Bank of Ukraine and commercial banks.

The non-banking sector includes specialized credit and financial institutions; they are distinguished by a focus on maintenance of certain types of customers or a particular type of service.

In a more general sense the credit system is a set of credit relations and credit institutions that organize them. According to the hierarchy degree, the credit system is a structure of a larger order in comparison with the banking system. The banking system is rarely treated as an integral part of the credit system.

The term "credit system" has no definition in the legislation of Ukraine, and its concept is revealed only by naming the components, identifying the terms "credit system" and "credit sector". Meanwhile, if the credit system is a set of credit relations, forms and methods of credit, then the credit sector is a quantitative component of the credit system.

The principal features of the credit system are: the elements of the system, the relationships between the elements of the system, the functions of individual elements of the system, external relations of the credit system.

In accordance with national peculiarities, credit systems of different countries differ in specific composition of its elements.

Ukraine's modern credit system consists of three main parts:

- 1) banking system;
- 2) specialized non-banking financial institutions;
- 3) credit unions.

The banking system of Ukraine, being a part of the overall economic system experienced a difficult way of market relations growth and development. In the period of the transformation of economy, its transition from the distribution to the market economic system, the destruction of traditional economic ties between economic entities, economic crisis and inflation had a considerable influence on its evolution.

The concept of the banking system should be distinguished from the concept of the credit system, which unites all market participants to the extent in which they are involved in the credit relations. Credit system unites both professional and non-professional members of the credit market, while the banking system unites only professional participants.

The banking system of each country develops under the influence of general economic principles and specific factors peculiar to this country and the his-

tory of its development. General economic principles are:

- hierarchy, the division of the banking system into equal hierarchies, or subordinates. No organizational system can exist without the correlation between the whole and its parts.

- competency (professionalism), functioning of credit institutions only on a professional basis.

- versatility, which means that all existing (possible, necessary) activities in the credit market are covered by credit institutions.

It means that, taken together, credit institutions are to perform all necessary actions in the credit market. Specific factors that affect banking in the country usually include:

- history of the country;
- political system;
- mentality of the population (attitudes, habits);
- current market structure;
- the interests of the ruling elites, etc.

The main features of the market banking system are:

- diversity of the forms of ownership;
- the absence of state monopoly on banks, any legal bodies and entities can set up a bank;
- a two-tier banking system;
- decentralized management;
- the nature of banking policy is a policy of numerous banks;

- the State is not responsible for commitments of the banks, and banks are not responsible for commitments of the State;

- the Central bank is accountable to Parliament, commercial banks are accountable to their shareholders and the Supervisory Board;

- emission activities are done only by the Central bank;

- lending operations to enterprises and individuals are done only by commercial banks;

- the Governor of the Central bank is approved by Parliament. The Chairman (President) of the commercial bank is appointed by its Board.

The banking system is not isolated from the environment; on the contrary, it is closely connected with it. It is a subsystem of the economic system. As a part of the whole, the banking system operates within general and specific banking laws, is subject to the general legal norms of the society. Its acts, expressing the features of the banking sector, can be included into the general system, like the banking system itself, only if they correspond to the general principles and make it possible to build the overall system as a whole.

The banking system is the basis of the credit system. Depending on the subordination of its constituting entities one-tier and two-tier systems are distinguished.

One-tier banking system is based on a set of horizontal relations between banks universalization of the conducted operations. Within the one-tier system, all banks, including the Central Bank, perform similar functions concerning loan and settlement services for customers.

A two-tier banking system consists of the Central Bank as the highest governing body and non-state banks. Its operation is based on the principles of vertical and horizontal connections. All elements of Ukraine's banking system have a two-tier structure:

- 1<sup>st</sup> tier – the National Bank of Ukraine;
- 2<sup>nd</sup> tier – all the other elements of the banking system: commercial banks, banking infrastructure.

The National Bank of Ukraine has authorized capital being the state property, is a legal entity and the issuing center of the country, that carries out single monetary policy, regulates the exchange rate, public debt, credit, activity of the banking system as a whole, organizes and implements interbank payments. It is accountable to the President of Ukraine and the Verkhovna Rada of Ukraine according to their constitutional powers and authorities [5, p. 219].

The NBU is not a commercial organization. The goal of its activities is not for profit; its actions are guided only by the public interest and applicable legislation.

The National Bank of Ukraine provides commercial banks with cash settlement on their request; exercises settlement and credit servicing of banks. The necessity of providing credit services to commercial banks appears when they need to increase cash flow, particularly for loans.

Commercial banks operate on a commercial basis for profit. They can be of different forms of ownership, specialization and fields of activity.

The analysis of the history of banking, the nature and mechanism of banking activity enables us to consider the bank's core activity as the complex with three intermediary operations:

- attraction of deposits;
- giving loans and creation of the means of payment;
- providing settlement for clients.

Carrying out of this set of operations can be considered to be a determining economic feature of the bank. The above mentioned operations are basic, they provide primary sphere of banking activities. In case some of these operations are not carried out,

the relationship between supply and demand in the money market is broken, or it must take the form of direct contacts between money buyers and sellers [1].

Thus, a set of three basic operations – deposit, credit and settlement – creates primary sphere of banking activities, and the financial intermediary performing them is a banking institution, a bank in the economic sense.

In fact, bank intermediaries, except the basic ones, can perform a number of other transactions which are non-core but necessary for the money market. However, they do not cease to be banks, as they provide a set of basic operations [1].

According to Article 2 of the Law of Ukraine “On Banks and Banking Activity” a bank is a legal entity, which has the exclusive right, on the basis of the license of the National Bank of Ukraine, to perform the following banking operations in aggregate: deposit-taking activity in respect to the funds of individuals and legal entities, and placement of these funds on its own behalf, own conditions and at its own risk, opening and servicing of the accounts of individuals and legal entities [14].

Commercial banks act primarily as credit institutions which, on the one hand, involve temporarily available funds, and on the other, satisfy credit needs of businesses and individuals through these borrowed funds.

The purpose of commercial banks is to be the most reliable universal (or specialized) bank in the country, focused on the interests of customers; be the leader in providing a full range of quality services to all segments of the financial market, promote integration of the international money markets and capital [14, p. 254].

Therefore, the banking system is a legally defined set of different banks operating in the country at a particular historical period.

Under present conditions there can be associations of banks as well as associations of various participants on a voluntary basis or by right of ownership, control, centralized control, direct subordination. Their main purpose is coordination of actions, protection of professional interests, the development of ethics and rules of conduct.

Non-banking financial and credit institutions play an important role in the development of the national

economy. Their complex forms a parabanking system that has its own characteristic features:

1. the system does not affect the dynamics of money supply in the country;
2. credit and financial institutions exercise non-deposit raise of funds in two ways – on a contractual basis or through the sale of securities;
3. narrow specialization of carrying out certain types of operations that are clearly regulated by law;
4. subordination of non-banking financial institutions, as a rule, to different regulatory bodies;
5. all risks connected with changes in the value of assets and liabilities are shared by shareholders [5, p. 220-221].

Non-banking financial and credit institutions are financial intermediaries. These are insurance companies, non-state pension funds, pawnshops, financial and leasing companies and credit unions.

Domestic banks are taking a test of time in the period of constant economic transformations. Rapid changes of operating conditions, the impact of the environment, and the need for internal reforms lead to the improvement of the banking system. The level of economic development is largely dependent on the banking system [1].

According to the NBU, as at 01.01.2013, the license for banking operations in Ukraine was given to 176 banks. 22 institutions were under liquidation. Assets of the banking system have increased by 6,9 % over the past year and amounted to 1127,2 billion hryvnias at the balance sheet date [10].

According to the size, banks in Ukraine are divided into four groups depending on the value of assets. This classification is applied to conduct a comparative analysis of banks' activities and division of supervisory roles and responsibilities between the central office and regional branches of the National Bank [15].

In 2013 the National Bank of Ukraine increased the maximum level of assets to banks belonging to group I (major banks) to more than 20 billion UAH (previously 15 billion UAH). The limiting amount of assets remains at the level of 2012 for the other groups [9].

Let us examine the structure of the key indicators of the banking system (Table 1).

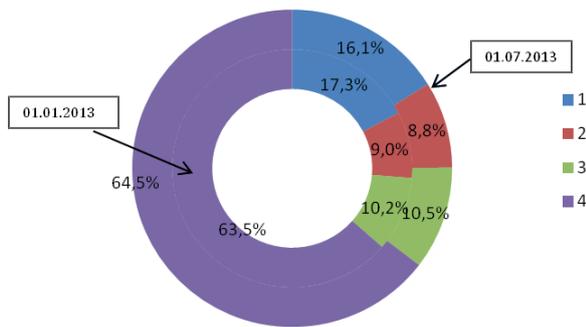
**Table 1**

*Structure of Key Indicators according to the Groups of Banks of Ukraine by 01.01.2013*

Indicators	I group (the largest banks) 15 banks	II group (large banks) 20 banks	III group (middle- sized banks) 25 banks	IV group (small banks) 115 banks	Total in Ukraine
Assets, thousands of UAH	716 233 404	194 678 701	101 572 707	114 761 819	1 127 246 631
Share in total assets of the banking system, %	63,54	17,27	9,01	10,18	100
Liabilities, thousands of UAH.	611848593	163461438	90039481	91633601	956983113
Share of liabilities of the banking system, %	63,94	17,08	9,41	9,58	100
Profit (losses), thousands of UAH	5 461 404	-51 125	-837 733	450 265	5 022 811
Profitability (losses) in assets, %	0,76	-0,03	-0,82	0,39	0,45

*Calculated by the authors with the data of www.bank.gov.ua.*

The share of the assets of the largest banks at the beginning of 2013 made up 63,54 % in the total assets of the banking system, the share of liabilities – 63,94 % of the liabilities of the banking system. Profit was shown only by groups I and IV: profit of group I was 5461,4 mln UAH and of group IV – 450,3 million UAH. Groups II and III showed flawed results. The dynamics of the assets is shown in the picture.



*Picture. The distribution of assets of the banking system by groups of banks [9]*

For the first half of 2013 the distribution of the banking system of Ukraine by groups has not undergone any significant changes. The share of bank assets, which belong to group I, has increased by 1 percentage point to 64,5 %, the share of banks in the second group has decreased by 1,2 percentage points to 16,1 %, the share of banks in group III has de-

creased to 8,8 %, the share of banks in group IV has increased to 10,5 % [9].

Insurance companies occupy the leading positions in the credit system after commercial banks in terms of assets and value as providers of debt capital. The total amount of assets according to the results of the first half of 2013 has increased by 7638,9 million UAH (+13,5 %) to 63,863,6 million UAH [9]. The activities of the insurance companies are connected with the mobilization of substantial funds, which are able to become credit resources for a long period of time. Banks that rely on attracting short-term funds don't have such opportunities.

Summing up the results of credit unions activities we can state that they have not completely overcome the effects of the global financial crisis, but in 2012 there were some positive trends for the restoration of credit unions to the level of pre-crisis period. [9]

The total amount of assets, the existing private pension funds amounted to 1 660,1 million UAH at the beginning of 2013, which appeared to be 19,7 % more than at the beginning of 2012 [11].

The banking system and a set of non-banking financial institutions as two parts of the credit system, have common features as they act as financial intermediaries. However, they have some differences that are related to the fact that they operate in different sectors of economy, have different functions, having their own instruments of influence on credit relations.

**Conclusions.** Thus, the current credit system of Ukraine is formed by the banking and para-banking systems. Banks serve as the main element of the credit system. The modern banking system of Ukraine has a two-tier structure, a clear hierarchical subordination and performs important functions in the national economy. Non-bank financial institutions occupy a prominent place in the credit system. They are promising investors, make an alternative to the banking sector and ensure the development of competitive

environment in the market of credit resources.

International experience shows that the development of the banking system gains strategic importance for the state as a factor in ensuring economic and political sovereignty.

The effective functioning of human capital and high-tech industries, providing quality public housing and meeting consumption needs depend on the competitiveness of the banking system

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