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Some Challenges the Management Confronts with, in the Financial Institutions

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Abstract. *In this paper, we analyze some features and components of the management in general, and of the management in the financial area in particular. Special attention is given to how they cope with some risk which could affect their activity. Trying to find from practice what kind of difficulties the management faces in their work, for sure, we get to interesting conclusions and furthermore, to optimum solutions. We already have some data, result of some earlier preoccupations of the specialists (Dănilă and Berea, 2000 pp.39-48) while others can be foreseen as specific elements for the beginning of the 3rd millennium, that started with what the rating agencies seem to admit as the most important economic decline and prolonged recession risk within the post World War II history. We consider an evaluation of the challenges the management confronts with, lately - while subject to pressures and to the need for radical changes that come with an astonishing speed and that are enhanced by the shareholders' desperate need to protect their capital. Findings reveal that, in any business enterprise the shareholders' strategy and the management's objectives are earning new clients, enlarging the market share, creating added value and on these bases, maximizing the gained profits. We consider that the volatile and fluctuant nature of the raw material the banks operate with - namely the money – turn the management in this area into a particular one, depicted by some specific features, which we analyze in the following pages.*

Keywords: *management, financial-banking institutes, overregulation, loans securitization, monoline insurance*

Introduction

Any economic activity and especially banking, healthily develops and grows only while strictly and professionally respecting the laws and best practice rules in the respective area. In the banking field, there are premises for a new risk to occur, risk that, up to the present moment, was present mainly in the public institutions. This is the overregulation risk, meaning the risk of not being able to produce the targeted profit or to reach the aimed objectives due to so many rules imposed from inside by the administration and by issuing large and complicated internal norms and procedures, that risk to „strangle" both the employees and the clients. Based on our research, we found that, when the overregulation risk exceeds certain reasonable limits, the consequences occur and are perceived, first of all, by the clients (Clark, 1997). They cannot make a realistic comparison between the various banks regarding the business terms and conditions and the way the transactions will be processed. This way, the clients are forced even to try to understand in detail how the operations are developed in the different banks and to compare them with the way they were done with the bank they were used to cooperate with. The clients have their own expectations about the terms for transactions completion, the accounts they are operating with, the correspondent banks they should use and not last, with the involved costs (Levesque & McDougall, 1996). When we tried to found how this risk was possible to appear in some banks, one of the responses was a wrong decentralization. But, we also found that the decentralization and leaving the task of elaborating the internal norms and procedures up to every organizational entity had its supporters and arguments that, within other banks defeated the centralized model. As usually, people are driven by the will to change, some deciders in certain banks appreciated that, a welcome measure would be to reduce the area or department, that was in charge with creating all the internal norms, regardless the area in the bank. In the most cases, after canceling the area or department in charge with issuing and harmonizing the internal norms, there hasn't existed a certain preoccupation for developing a coherent and correlated process regarding the issuing of the internal norms. Thus, in the most banks but also in other financial institutions, it eventually happened that every department became in charge with issuing its own working rules: from the product data sheets - that describe the characteristics of the products and services sold to the clients, to the pricing and commissions' policy and to the operations registration modality. This particular situation was enhanced, in some cases, by the will of each entity that issues internal norms to promote, as visibly and aggressively as possible, the own products they worked with and „to cover" their responsibilities as much as possible, with documents that had to be requested from clients (Goyal, 2011).

If to all these, we are to add the difficult cooperation among the various departments in the separate functional lines, it is easy to understand why, sometimes, the internal procedures may become even contradictory, creating a real uncomfortable situation and even confusion, both to the internal and external clients. We started this analysis with a concrete example from which, the reader (be he or she accustomed with the way a financial-banking or insurance institution is organized and functions or be one that does not know these mechanisms from inside) may understand that, the manager's role and the his or her way to take actions and to make decisions is essential for the success or, on the contrary, for the failure of an organization (Sekaran, 1989).

Also, this example and especially the exposures and analysis that will follow, should succeed in convincing the interested readers that the features and the components of the banking management follow, in large, the ones of any other type of company's management. But, in the same time, they differ through certain specific characteristics that can make a difference and that, if known, can help a manager in his/her mission to administrate and lead a financial-banking institution or insurance company and to mitigate the risks. Another point of difference might be related with the organizational knowledge (Brătianu, 2013), which is "inclined" towards cognitive knowledge, less on emotional and spiritual ones. Maybe a more balanced approach from this perspective would be beneficial.

The Research Template

We acknowledged from the researches performed by the authors at several commercial banks that develop their activities in Romania, that many of them elaborated their own norms in a decentralized way. In general, the norms in the market risk area, for example, elaborated by the commercial banks, stipulate that, every position is strictly marked to the market, as we can see in the following table in which we explain how certain transactions are marked to the market, in their various development stages:

Table 1. Daily marking to the market, according to the transaction type

Transaction Type	Marking to the market
Open transactions	The treasury/capital investment department (depending of which department developed the transaction) calculates the difference between the settlement price of the accounts receivable or of the goods and its present market value.
Incomplete transactions (unfinished)	The Back-Office team offers a report regarding the market value of the due titles/goods, the risk management department.

Transactions of lending/borrowing titles/goods	- transactions of lending titles/goods – the back office team calculates the difference between the market value of the titles/goods and the borrowed value or market value of the warranty; - transaction of borrowing titles/goods – the Back-Office team calculates the difference between the lent value or the market value of the warranty and the market value of the received titles/goods.

Source: The table was elaborated based on the analysis and of the individual studies performed by the authors at some commercial banks activating in Romania.

For the transactions of borrowing titles, the Back-Office operations departments in banks may decrease the exposure calculated according to the above description, with the amount of the exceeding warranty, if the respective amount is covered by collaterals - fact that means that the bank is assured to receive the rest of the collateral in any situation, when the counterparty does not proceed to payment.

Based on the reports we studied in several banks, there were defined methodologies or rules for establishing the borderlines between the institutions that respect the Basel Directive regarding the Capital Adequacy and the banks that do not respect it, yet. The first methodological requirement verifies if, according to the prudential rules in the field, the followings are respected: the activities related to the trade book do not exceed for example 5% from the total own funds, the total open positions in the trade book do not exceed for example Euro 15 million. The second requirement is based on the alternative methodology for establishing the capital requirements for the market risk, with respecting The Directive 93/6/CEE and also stipulates certain limitations for the activities related to the trade book in relation with the total balance sheet and off - balance-sheet activities. When the two mentioned methodologies are applied, the lending institution must not exceed the specified limit that means that the banks accomplish 2 conditions in the same time. First, that the limits were not exceeded for more than 5 consecutive working days and secondly, that in the last 90 days, the limits were not exceeded for more the 10 cumulated working days.

The Value At Risk (VAR) models give us a high probable description of the future evolution for the value of a financial instruments portfolio, that uses standard statistic techniques and measures the biggest loss that can be registered by a financial instrument/instrument portfolio within a certain time horizon, in normal market conditions and with a pre-settled level of trust.

The probable loss, calculated according to the VAR methodology

For example, *10-days, 99%, RON, VAR = 10.000* for the „P" portfolio means that, the „P" portfolio can produce a maximum loss of 100.000.000 RON within a 10 day time frame, with a 99% probability.
The fundamental hypothesis of every VAR model is that, all the changes in the value of a portfolio can be explained by the variation of a limited number of factors, the market risk factors.

Figure 1. The probable loss, calculated according to the VAR methodology

Within the commercial banks where it is applied the research model, there are issued VAR reports by the risk management division, on daily bases, issued as follows:

The Historical Simulation Method, that depends on the capacity to build historic series of profitability measurements for various portfolios, within one year period. These numbers are, afterwards calculated in VAR, by using empiric formulas and on based on the variance - co-variance analysis. The system does not calculate volatilities and has its optimum utility in a bank where do not exist feasible hypotheses regarding the risk margins. In general, there is used/considered a level of trust of 99% and a 1% quintile for this simulation.

The Norma-Delta Method, that calculates the volatility of the portfolios and, for the big portfolios, it offers a feasible calculation of the risks. Moreover, for the portfolios in which there exist just a small number of risk factors, this method offers a high level of accuracy. Yet, in our opinion, the weak point of this method is that it assumes that, the variations of the risk factors are evenly distributed.

The Monte Carlo Simulations, case in which there are used minimum 10.000 random data seria, on an uncorrelated basis, on which there is built a variance – co-variance matrix. Measuring the difference between the present value and of the portfolio and a 1% quintile, offers to the bank the VAR for each portfolio. This is the reason why the Monte Carlo method is mostly used on the foreign exchange markets.

A report using VAR methodology, according to the Monte Carlo simulation, is presented within the Table no. 2. The figures have an example character, the main purpose being to show the modality in which a report of this kind is presented in some cases.

Table 2. The VAR Value on Portfolios (RON) and Their Weights (%), in the Total

	VAR Value -RON	Weights (%) in Total
The Capital Markets Entity	6.043.728	4,67%
Arbitrage Spot Transactions	393.518	0,30%
Fixed Incomes	35.022.946	27,04%
Interbanking and NBR* Foreign Exchange	6.801.331	5,25%
Money Market	36.153.400	27,92%
All foreign exchange transactions	6.387.111	4,93%
Treasury	38.701.966	29,89%
TOTAL	129.504.000	100%

Source: The table was elaborated based on the studies (Shrieves, 1992; Sensarma & Jayadev, 2009) and analyses performed within the banks where the research was developed. It has an example character, thus securing the confidentiality of the studied data within the commercial banks where the research was done.

Following the developed researches, we concluded that the actual format of the reports is not according to the main scope they are issued for – of providing the high level management with a clear image of the VAR value within a bank. The Table no. 2 is useful, but must be provided together with reports to reflect, beside other aspects, the overall VAR based on currencies and maturities. In addition, in the banking practice, testing the VAR system capacity is required, so that calculations and reporting can be done regarding the VAR value for loans.

For allocating the capital afferent to the market risk, in the authors' opinion, it is recommendable the banking institutions to settle, by using the VAR system, the economic exposure adequate to the market risks, at the bank's level as a whole, and also at the business lines and units' level. This requirement should be a best practice applied in each and every bank, and in our opinion, the absence of such information could be a huge managerial mistake.

We should mention also that in this area the regulator developed an extensive reports requested from each bank thus improving the methodology and the practice and awareness of the risk embedded in the day by day business of the banking sector. Another conclusion taken from the mistakes performed during the subprime lending in US (probably valid also for Europe) was that the awareness and understanding by the highest level of the management of a very complex and sophisticated statistical models used in the risk area (Danila, Anghel & Danila, 2002, p.267). In our days any top level manager from the banking sector understands (we assume) these figures shown in the Table no 2. Also, it is advisable to use different models and not only the model presented briefly above in order to be able to capture the unthinkable movements that could occur with only 1% probability but the impact could destroy the entire value of many financial services.

The quality of the management makes the difference

If we are to think beyond the area of activity, beyond the strict specialization – on products or on distribution channels (Wan, Luk & Chow, 2005) - regardless the business volumes and the areas in which the financial-banking institutions activate, in all the stories of success it is the same element that stands still: the quality of the management. And this is true, because in our vision, the management represents the process in which, the executive management in an organization, at all levels, administrates the material and financial resources he has and coordinates, manages and controls the human resources, so that, by their synergy, to achieve the best results with minimum costs and acceptable risks (Dănilă, Anghel & Dănilă, 2002, pp.11 - 12).

Judging through the practical experience we acknowledged that, lately, the management's banking philosophy changed, moving the focus from the profit targeting and maturities correlating, to the risk-profit duality for each banking asset. Reaching the optimum between profit and risk became the biggest challenge for the banking management. This finding is also confirmed by the authors of the book „The Analysis of the Banking Management", that, in their paper, accumulated and exposed the situations experienced by a large number of outstanding specialists in The World Bank.

All these appreciate that, the banking environment is in continuous change and, „...the traditional banking practice - based on deposit making and loan granting – is today just a part of the typical banking activity, often being the least profitable one, as well (van Greuning & Bratanovic, 2011). The new activities based on information...represent now the major sources for the banks profitability".

We fully understand the financial arguments that generated the extreme sophistication of the financial banking and insurance products (bank assurance included) prior to crisis. But we cannot entirely share the above mentioned opinion, because a bank's profitability cannot or, better said, must not be obtained by any means and especially, not by immoral means. Introducing some too complicated products for the regular consumer and even for the average and well informed in the respect of the financial-banking industry one, via „back-door" somehow, is, in our opinion, a dangerous tool, that proved that can generate a unexpectedly freak boomerang effect.

We consider that it is nothing wrong in maintaining and promoting the classical products and services furthermore (even if not particularly profitable), especially because they address to a large mass of clients, the ones representing the huge majority of consumers for the banking and insurance services. We also appreciate that the innovation process is necessary and welcome in every area and also in banking, just that it has to be done only if the innovation product (the resulted product or service) is created for serving the real consumption needs of the majority of clients. Even more important, the newly created products must be explained and understood by the consumer that has to be informed when buying and using them, being fully aware of their implications.

In any industry, launching new products that may be bought and consumed without a previous proper information and comprehensive understanding of the consequences, may have strong negative effects, both for the buyer and for the seller. We found here another risk, which should be addressed and mitigated by management, because it can turn into a dangerous weapon against the clients.

Or, the recent history proved us that, some financial-banking institutions so called „specialized" or „of niche", by these appellative willing to underline the elitist character of the customers they are targeting, introduced, like we previously said – via back-door - certain products that were not properly understood by the clients (Aspinall, Nancarrow & Stone, 2001).

Unfortunately, the reality proved that through an improper usage, once out of any control, neither the ones selling them nor the ones that created them knew how to avoid their negative effects. Some of these „innovative products" produced important financial losses both to the unaccustomed investors and also - result of the unleashed avalanche effect – to the financial institutions that took advantage of them. Here, we can offer several examples of complex financial tools or instruments with special purposes, that, by the way they were promoted and their wide usage among an improper targeted public, irremediably affected the financial situations for numerous clients and even „erased" several known banks and insurance companies from background (Morris, 2010). We are mentioning here some of these techniques and instruments:

- securitization (including the cash-flow on credit cards) and transforming them in bonds, that were sold on the secondary market but not at their true market value, thus refinancing the bank's loan granting activity and artificially increasing the liquidity of the long term portfolio. The securitization of the mortgage loans (incl. accrual bonding for non performing loans) by issuing bonds intended to be sold by the banks to various investors (thus the banks obtaining additional funds for granting loans and in the same time, trying to get rid of the consequent risk), was the main ingredient that generated the sub-prime crisis in the United States. Unfortunately some well-known rating agencies rated even with the best rating possible these issuance (AAA). In addition the investors relay mainly on the rating granted by rating agencies and did not scrutinized their judgment that was another huge mistake that increase dramatically the bill generated by the crises;
- monoline insurance (insurance companies specialized in overtaking the non-reimbursement risk for loans, within bonds issuing or securitization operations) also contributed to the market crush; the structured securitization showed that financial innovations that occurred during last years were mostly meant, not for a better administration and dispersion of the risk but for increasing the loan volume that were granted without having the corresponding own funds. The error made by the financial institutions was that the risk was not shared appropriately. The issuer of the loan in a wrong way consider that the whole risk will be taken by the insurer of the risk and loosen the risk filters. Also the monitoring the performance of the portfolio was not in the best shape and later decreased the probability of recovering the bad loans. Everything was hidden also by the booming economy and by the huge demand and fights between banks for the acquiring of the market share;
- multiplying the special purpose vehicles (SPV), registered in out of balance-sheet positions that, usually, do not need own funds, thus having an infinite „leverage effect". Today also due to capital requirement and regulation imposed on regulated financial entities it is a trend of developing the "shadow" banking entities. This trend is a reflection that always in the management of the financial sector the innovation never sleeps;

– derivative financial products based on loans (forward, futures, swap) and selling loan packages with asymmetric exposures, that lead, if correspondingly used, to diminishing the concentration risk and relieve capital. We should not blame all derivatives. There are also good derivatives for hedging the value of many SMEs business like hedging against foreign exchange risk (Danila, Anghel & Danila, 2002, p.295). Unfortunately in the way to delivering more and more profit the financial sector some time used in a wrong way the financial innovation. The conclusion is to understand what you are selling to your client, to teach him or her and to be sure that the client understand and need the product that you are selling. A good change after the crises was also to split the bonus pool for several more years in order to stimulate long term value creation and not on spot profits.

The practice brought enough arguments about the fact that innovative products do not necessarily bring long term benefits. For learning this lesson, it is suffice to analyze the way the American Investment Bank, Lehman Brothers initiated the bankruptcy procedures, and the Bank of America took over Merrill Lynch for 50 billion US, due to the rumors about the hidden losses, many of them determined by the innovative products" immorally used (Morris, 2010). On the other hand, our opinion is that we must not throw the classical savings and loan products away, „at the history's garbage can", just because they do not bring (in some specialists' opinion) good returns compared with the innovative ones. It would be advisable not to forget that these classical products resisted the test of time for hundreds years and even nowadays, the banks with the most solid business model are the ones that bet on „keep it simple" principle.

In our opinion, choosing the proper ones from the wide range of banking products and services is the management's task that has to prove determination, adherence to the moral principles and consistency. Defining the trustworthy person, J.P.Morgan said: „The consistency based on principles does not mean a blind acceptance of dogmas, but rather analysis, judgment and the sense of reality" (Morris, 2010, pp.7-10). All these virtues are, in our opinion, necessary to the managers, because the globalization, the new applicable techniques and technologies, the products sophistication as well as the changes that occur in the economic environment require the managers to extend their expertise area so, implicitly, to increase the quality of the management act.

Volume 1 (2013) no. 3, pp. 481-495; www.managementdynamics.ro

Conclusions

We appreciate that the last 5-6 years proved that, in the management of the financial-banking institutions (maybe more than in other industries), there are necessary serious qualitative mutations, able to become the engine of the recovery and, based on that, of the development in the financial – banking activity (Anghel, 2013). The necessary revival and re-launching of the financial-banking industry may be possible, first, by ranking the science of banking management as "golden law" and by an immediate transformation of the old hierarchical superior into a pre-eminent manager and even into a leader (Bartel, 2004). In the simplest manner, relying on people's elementary competences and abilities, we can state that the difference between a manager and a leader is that any leader can be a manager (by driving a business), but not any manager can be a leader. The feature that makes an unquestionable leader out of a very skilled manager is his or her native ability to develop relations and communicate with people, so as to succeed in transferring to them the obsession of breaking the own limits and of raising the maximum performance of today into the minimum performance for tomorrow, within the day-to-day working processes.

Maintaining a constant increased rhythm and an evolution based on solidity, trust and team spirit is a mandatory ingredient in the recipe of the success a leader creates. A leader must not impose himself or herself towards the team by the force given by the hierarchical position, neither by his power to control the activity and even the others' lives, as he decides the employments, salaries, bonuses or dismissals (Baker, 2002). The leverages a real leader uses in his mission, may be very often at hand, just waiting to be discovered, put into practice and refined in time, while in other cases they have to be obtained by sustained effort, by study and here we have to stress the fact that there exist certain situations in which specific features just exist in the person's genetic legacy or, on contrary, the person does not have these features and will never obtain them. Here show-up the role of the decision makers and shareholders to find and to appoint the proper people in corresponding position, avoiding this way the mismanagement.

We are aware that is not easy, because the experience of the last few years have obliged the managers everywhere to face the consolidation of the finance globalization process. This process was perceived both from geographical and also from the structural point of view, leading to the establishment of complex systems of financial-banking entities, groups, holding, concerns etc. This true „merger-mania” created, as a consequence, the integrated finance-banking services in areas as leasing, insurances, brokerage, pension funds, factoring, etc, bringing as strategic advantages the decrease of the operations costs, increasing the cross-selling and the efficiency, developing the common distribution channels, creating more visible brands. The importance of a professional management, able to manage the main banking risks with good results, was a major preoccupation of all times. But now, after the world-wide financial system acknowledged the destructive power of world crisis so strong, everything that was said, written or applied in the banking risk management area seems to be doubtful. And, this could be the major risk of our age. It is difficult to understand how, the techniques considered to be the most advanced in the world in the management area by the most of the experts, were not of any use, how some „guru” of the world financial-banking industry were wrong in their appreciations. And then, there occurs a natural thought namely, that it is possible to have come too far with the sophistication of the banking industry (at the entire world level, not only in Romania).

We appreciate that, even for this reasons, the financial managers’ role in our country, is essential in these crucial moments. The evolutions in Romania shows that the financial crises lead to a decrease in consumption, therefore accelerated the negative impact throught the society. This led to further impacts on the marketing and management strategies in all economic sectors (Pînzaru, Zbuchea & Galalae, 2010). Therefore, the banking system should be more responsible, and its management more aware of the weight it carries. The managers that activate in Romania must be able to learn from the experiences and even from the mistakes made on the mature, advanced markets, where the impact of the errors lead to extremely negative consequences. Based on our studies, we draw the conclusion that, the biggest risk that seems to have been reached, is that the financial products became so complicated that the majority of people cannot understand them anymore and the management risk techniques known up to now cannot keep up with the reality anymore. From one reason or another, certain limits, including the morality ones, seem to be overcome in some cases. This is why we express our opinion that it would be appropriate to focus on what can affect the national banking market today, respectively the major banking risks and especially, on identifying solutions for a better administration of these risks and for preventing a possible contamination with the „toxic” effects of some wrong „innovative products". In our opinion, the way in which we have to wish for changes is the one that brings progress and welfare for the majority of the people, in known or acceptable risk conditions. The financial innovations involve higher profits than regular, because the profit is a key motivational factor for innovation, but that can bring with themselves the same high risks. Within a highly competitive market environment, such as the banking is, the innovation puts an enormous pressure upon the competition (Chou & Chou, 2000), in the direction of engaging new activities for obtaining profit or for not losing market shares. It is understandable, up to a point, the desire to be the first that launches a new product on the market, one that nobody has yet, one to identify you as a "market maker" and to bring you bigger sales. Yet, the innovation sometimes involves for the banks, a special way of assuming risks, making some of them invest or deal a new instrument, even if the profitableness and the risk effects were not tested, or even if there does not exist an appropriate market for that new instrument yet. A prudent bank must dispose, in our opinion, of prudent policies for administrating the risk, in order to allow its presence on the new markets and dealing the new financial instruments in know and assumed risk conditions. Findings reveal that the limits regarding the presence on a new market must be periodically revised and adjusted, because the markets permanently evolve, together with the people and the companies that form the respective market. A super-dynamic market and in permanent change, on which the new product launching rhythm overcomes the average considered as normal statistically speaking, naturally attracts the competitors, fact that should lead to the price decreasing for all products and services. We also found, that the constant utilization of the new banking instruments may be benefic in controlled risk conditions, because it helps to the development of the width and depth of the additional secondary markets and to their liquidity increase. Once the market became stable and liquid enough, in our opinion, the bank must adjust the limits to levels applicable on mature and stable markets. One of our final conclusions is that the change for progress is necessary in the banking field, as well as in the other fields of activity, but, we consider it must be done after a preliminary period for verifying the new theoretical concepts and following certain risk measurements. All those risks illustrated by us in this paper should turn into as many challenges for the management to find mitigation solutions before being too late. Or, this is the decisive role of the management we discussed about…

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Volume 1 (2013) no. 3, pp. 481-495; www.managementdynamics.ro

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