Non-Financial Value Drivers: Case of Latvian Banks

Jelena Titko*, Inga Shina
The University College of Economics and Culture, Riga, LV1019, Latvia

Abstract

Non-financial performance is considered to be as much important, as financial results. The significance of non-financial measures will grow, considering the new requirements of the European Parliament regarding the corporate reporting. The goal of the current paper was to identify the most important non-financial bank value drivers, and to investigate the relationship between bank value and non-financial value factors. Research period covered 2012-2015. To achieve the research goal, the authors used expert survey method and statistical data processing, in particular, correlation analysis and multiple regression analysis. The most important value drivers from the viewpoint of banking experts are competence and operating efficiency of bank employees, and effective remuneration and motivation system. Correlation analysis yielded a statistically significant correlation between bank value and all analyzed non-financial bank value indices.

Keywords: bank performance, non-financial indices, Latvian banks

1. Introduction

Non-financial performance is considered to be as much important, as financial results, in the value creation process. Non-financial value drivers involve company’s reputation, customer satisfaction and loyalty, staff competence, employee satisfaction and turnover, and innovative potential (Sledzik, 2013; Larsen and Tan, 2015).

* Corresponding author.
E-mail address: jelena.titko@inbox.lv
A large amount of studies were devoted to the investigation of the link between company’s financial performance and corporate responsibility performance, trying to find out whether responsible behavior contributes to the shareholder value (Allouche and Laroche, 2005; Lo and Sheu, 2007). The value in the banking industry, probably more than in other ones, is created by “consuming” of non-financial capital, since “banks rely predominantly on intellectual, human, and social and relationship capitals to create competitive advantage” (Larsen and Tan, 2015).

The goal of the current paper was to identify the most important non-financial bank value drivers, and to investigate the relationship between bank value and non-financial value factors. To achieve the established goal, the following tasks should be performed: 1) to conduct an expert interview aimed to evaluate their perceived importance of non-financial bank value drivers, 2) to conduct a correlation analysis in order to evaluate the significance of the relationship between bank value and non-financial performance indices.

Two research hypotheses were stated by the authors:

H1: The most important non-financial bank value drivers are those related to customer satisfaction and loyalty.

H2: Bank value is strongly associated with non-financial value indices.

Research period covered 2012–2015. Statistics on bank value was extracted from the report of the survey “Latvia’s most valuable enterprises”, conducted by NASDAQ Riga stock exchange and investment banking and financial advisory company Prudentia. TOP101 initiative was launched in 2005, but the statistics of non-financial bank performance indices is available mostly since 2012. Values of TOP 101 of Latvia’s most valuable enterprises reflects the enterprise value, i.e., value of enterprises future money flow collectively to all company’s finance providers (shareholders/members and financial creditors). The exceptions are banks and insurance companies; their evaluation reflects the company’s equity value (TOP101).

Research sample was limited by the number of Latvian banks included into the list of most valuable Latvian companies in each particular year.

To evaluate importance of non-financial value drivers in banking, experts from 8 largest commercial banks (in terms of assets) of Latvia were surveyed. To evaluate the relationship between bank value and non-financial value drivers, correlation and regression analysis was performed in the SPSS environment. Selection of non-financial value factors was based on the relevant studies in banking (EABIS, 2009; GABV, 2012) and, in particular, in banking (Marie et al., 2014; Ahmed et al., 2015). Further, statistics on available proxies for non-financial value factors were collected.

The most important value drivers from the viewpoint of banking experts are: 1) knowledge and competence of bank employees, 2) effective remuneration and motivation system, and 3) operating efficiency of employees.

Correlation analysis yielded a statistically significant correlation between bank value and all analyzed non-financial bank value indices. However, the attempt to construct a valid regression model was failed.

2. Value drivers in banking

The concept of company’s shareholder value is still being the key theoretical point for strategy development in a modern business. The company’s goal of shareholder value creation is prioritized by academicians and practitioners (Jensen, 2001; Armour and Gordon, 2014; Singh and Pattanayak, 2014).

Shareholder theory has been often criticized by stakeholder value theory proponents (Freeman et al., 2004), who claim that the interests of all stakeholders – e.g. customers, employees, society – should be taking into account, realizing business strategy. However, citing Dobbs (2005): “the more shareholder value a company creates in an effectively regulated market, the better the company serves all its stakeholders”.

The large amount of research papers and reports are devoted to the issue of bank value management and value drivers in banking (Isidro and Grilo, 2012; Fiordelisi and Molyneux, 2006; Titko and Lace, 2013; Tsai et al., 2015).

The relationship between bank value and value affecting factors has been tested empirically, applying different value measures and various proxies for value drivers. Bank value is usually proxied by market performance indices, such as total shareholder return (TSR) (Vardhan et al., 2008) or market-value added (MVA) (Bhunia, 2012), and economic performance measures. Regarding the economic performance indices, the analysts use both traditional single-ratio measures, such as return on equity (ROE) or net interest margin (NIM), and more sophisticated ones, such as economic value added (EVA) (Radić, 2015).
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