

Banking in the Gozitan Economy*

CARMEN SALIBA**

Introduction

It is reckoned that Malta's financial system is healthy, well supervised in the context of a comprehensive legal framework, and strongly compliant with most of the international standards and code. However, Maltese financial institutions are continuously facing challenges in our small and open economy. The economic vulnerability of small island states like the Maltese Islands arise from the fact that their economies are to a large extent, shaped by forces outside their control, mostly due to their economic openness and high dependence on a narrow range of exported products. This means that their financial development is likely to be dictated mostly by forces outside their control.

The Banking System

Financial liberalisation and privatization fundamentally transformed the Maltese financial system during the 1990s. Restrictions on bank interest rates were gradually removed and the relaxation of capital controls facilitated the growing integration of Maltese financial markets with those abroad. Laws governing the sector were entirely overhauled and a regulatory framework was introduced based on European Union legislation.

Banking in Malta is regulated by the Central Bank of Malta Act 2002 and by the Banking Act 1994. The CBM has the authority to define and impose statistical reporting requirements and to establish the actual reporting population and standards for transmission so as to enable it to bring Malta's monetary and

financial statistics in line with international standards. For this reason a Memorandum of Understanding with the Malta Financial Services Authority (MFSA) has been signed, and a co-operation agreement with the National Statistics Office (NSO) has been made, thus establishing an ongoing working relationship on matters related to financial stability. The introduction of a general obligation of professional secrecy in the Professional Secrecy Act of 1994 and the introduction of the Prevention of Money Laundering Act (1994), which have been strengthened and updated on several occasions, have consolidated the integrity of the legislative framework itself and the credibility of Malta as a financial centre.

A healthy and vibrant economy requires a financial system that moves funds from people who save, to people who have productive investment opportunities. Despite the growth of non-bank financial intermediaries and the development of a domestic capital market, banks remain the principal financial institutions in Malta. The Maltese banking industry is highly concentrated, reflecting the small size of the domestic market and the history of the industry.

The two major deposit money banks in Malta are Bank of Valletta plc. and HSBC Bank Malta plc (previously Mid-Bank Bank). The other commercial banks operate on a smaller scale. The privatisation of Mid-Med Bank in 1999 introduced higher competition and new financial instruments and decreased state ownership in the banking sector to a remaining 25% in Bank of Valletta plc. Plans are now in hand to start the process for the selling of shares in Bank of Valletta plc. Despite the high concentration in the sector by the two major banks, which account for about 90% of total deposits and loans of domestic credit banks, the degree of competition is reasonable given the size of the economy, and has led to higher

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** Carmen Saliba is currently following a course leading to the MA in Islands and Small States Studies at the University Gozo Centre.

diversification.

Maltese commercial banks offer all forms of commercial banking services. This also includes standard lending services of overdraft, loans and trade finance. Banks are flexible in considering applications for finance. The retail banks also have separate institutions, mainly on a joint venture basis, to provide specialised financial services, such as life insurance, fund management, underwriting and security issues, long-term housing schemes and leasing.

The two major banks have even furthered their delivery channels through the provision of internet banking. Credit institutions also engaged in consolidation processes by centralizing back-office functions. Some domestic banks are expanding their business operations by acquiring international subsidiaries and increasing their collaboration with foreign entities, as well as by opening offices abroad to gain exposure to new markets. Moreover, the enactment of the Special Funds (Regulation) Act 2002, establishes the statutory basis for retirement schemes and retirement funds, thus leading to the development of schemes run by the banks.

Banking in Gozo

Gozo is a small island with an area of 67km². Its settlements are small and the population of around 30,500 is scattered over fourteen different localities, thus requiring a spread of various public and private services all over the island. In Gozo commercial banking is conducted by four banks. These include the two major banks: Bank of Valletta plc and HSBC Bank (Malta) plc; Lombard Bank (Malta) plc and APS Bank Ltd. Lombard Bank (Malta) plc and APS Bank Ltd are represented only by one branch, which is situated in Victoria, while the major banks are represented in more than one locality.

In Malta financial products during the last few years became more innovative and

sophisticated, thereby giving customers a broader choice of investment opportunities. The positive economic effect of this development is that a greater proportion of the country's savings is being mobilized through the financial system and channeled to the productive sectors for investment purposes. Despite the unfavorable economic climate of recent years, the profitability of the credit institutions in Malta and Gozo has continued to improve steadily.

The high crucial financial intermediary role of the deposit banks is evidenced by the high propensity of residents who place their savings in bank deposits. During the last ten years Gozitans have played a major role in the expansion of banking deposits. This is an important indicator of economic development in Gozo.

Banks play a major role in channeling funds to borrowers with productive investment opportunities, they are important in ensuring that the financial system and the economy run smoothly and efficiently. However, whereas in Malta a high percent of bank deposits are loaned to the private sector, in Gozo only a small percent of deposits are loaned to the same sector. This is an important indicator of under-development and lack of investment opportunities available in Gozo. If the level of loans and advances in Gozo were to be on the same level as those of Malta, there will be an increase in investment in the Gozitan economy with all the resultant benefits in wealth generation and job creation. In Gozo private entrepreneurs must be encouraged to invest not only in the expansion of their existing businesses but also in new ones. This can be done if Gozitan savings can be invested in the Gozitan economy for the benefit of the whole society.

Perceptions of Gozitans on Local Banks

The marketing orientation of Maltese financial institutions is evidenced by their focus on customer needs and on market segmentation,

product development, pricing policies, personal selling and advertising and promotional programmes. In the month of August 2004 a survey on the perceptions of Gozitans on local banks was carried out. The results were based on a sample of two hundred individuals ranging from an age of 18 to that of 94. The replies received provide an insight on the Gozitans' banking activities with their most preferred banks and how they perceive the service provided by the local banks. Moreover, the preferred localities and frequent banking transactions have also been outlined. The relevance of the survey results is undoubtedly constrained by the limited sample size and the limited amount covered in the questionnaire.

Eighty two per cent of respondents have chosen either Bank of Valletta plc (BOV) or HSBC Bank Malta plc (HSBC) as their best bank in Malta. On the other hand, only 33 percent of the respondents hold accounts only with their preferred bank. The survey illustrates that Gozitans are interested in getting an efficient and fast service. Gozitans also prefer to deal with helpful staff, who thus enable their preferred bank to gain a trustworthy and reliable image. Cash withdrawals, cheque encashments, and depositing of funds result the most frequent banking transactions. Given the limited number of branches and agencies, Victoria emerges as the preferred locality for effecting banking transactions. However, there are cases where branch location is a key factor and influences a customer's choice of a financial institution.

In the Maltese Islands the rationalization process has been facilitated by the massive growth in automated banking. The availability of ATMs and sharing arrangements like those of APS with BOV, give card holders of APS the ability to use the cash machines of several others, thus reducing the customer demand for such extensive branch networks. In the survey 67 per cent of respondents utilize a debit card, and 37 per cent of respondents utilise a credit card. Only 21 per cent of respondents utilise internet banking as shown in Figure 1.

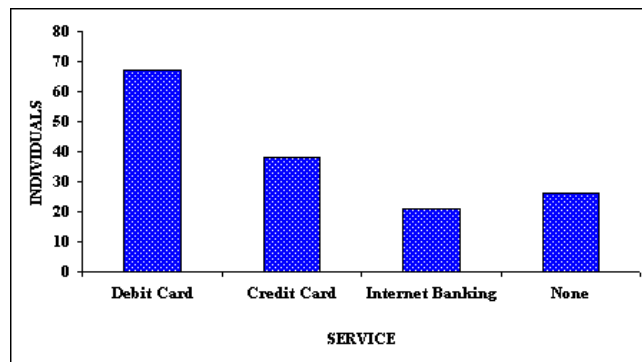


Figure 1: Survey Results: Use of Automated Services by Gozitans

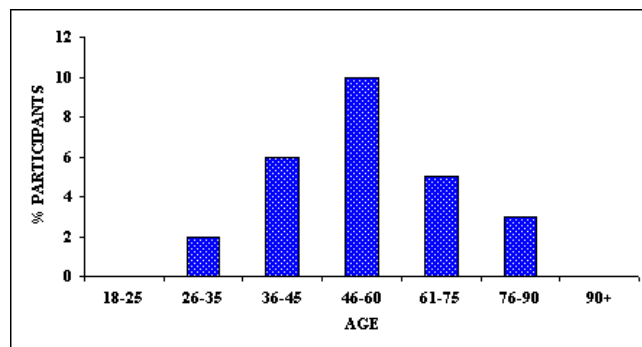


Figure 2: Survey Results: Percentage Age Profile of Participants with no Automated Banking Services

Figure 2 shows the age profile of 26 percent of respondents who do not make use of any automated bank services offered in Gozo.

When internet banking became available, many professionals predicted the death of the branch. And yet, branch-based business has not only maintained its place in banking, it is growing. In the survey only 16 per cent of the respondents think that local banks are already efficient and thus no other measure must be adopted. The other respondents highlighted the need to increase the number of branches/agencies and ATM machines in other villages in Gozo. An increase in the opening hours was also requested, while 52 per cent of respondents clearly viewed, that there is the need to adopt effective measures in order to reduce queues and thus be able to give a faster service.

According to 35 per cent of respondents, no measure must be adopted by Maltese local banks in order to become more client-friendly. The remaining participants highlighted the need of continuous training as a priority area

and a key element in the professional development of banks' employees in order to achieve their business objectives and ensure quality standards.

Conclusion

Local commercial banks play an important role in the social and economic development of Gozo. With their achievements local banks prove that they are the banks with whom one can plan his or her financial future. But it is not just the financial strength that Gozitans can take comfort in. Gozitans believe that a sense of commitment, quality and service must be at the core of their business. The future of local banks in Gozo lies in offering customers an increasingly personalized and professional service. A subsequent challenge is to ensure that the service delivered meets the specification set.

This is essential since during the last ten years Gozitans have played a major role in the expansion of banking deposits. However, local

banks need to nurture their loan portfolio by tapping related marked segments in Gozo. The Gozitan economy will benefit from the introduction of a strategically defined service quality programme; in order to monitor the changing environment with respect to Gozitan customer needs and expectations; technology and product development; business and economic conditions; and competitor activities. This is a must for the Gozitan community which is becoming increasingly demanding, better informed and ready to play a more active role in their relationship with a bank.

Better data to assess the real role of financial institutions in the island of Gozo is essential. This will help promote Gozo's own interests, and render the demand for disparity reductions more credible. Moreover there is the need of further studies in order to come up with proposals to support and encourage the Gozitan economy, in order to be able to exploit the strengths and opportunities that Gozo offers.

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trees to attract birds for hunting. These groves are sprouting everywhere, not only preventing the establishment of any undergrowth, but consist of alien species incompatible with our indigenous vegetation and landscape. Gozo also has to endure widespread illegal hunting of protected birds. The Peregrine and the Barn Owl, to mention just two species, have been lost due to illegal hunting. Illegal shooting of protected birds also prevents other species such as the Kestrel to settle and breed here.

Bird trappers, too, should share the blame of the degradation of Gozo's landscape. They transform rich garigue areas and agricultural land into bird trapping sites, not infrequently spraying herbicides on these sites to prevent vegetation growth. They set up netting sites in ecological areas, along cliff edges and hillsides, turning a beautiful landscape into one big eyesore. Tal- Maġun, Ta' Ċenċ, Wardija Point and several other places are evidence of these atrocities against Gozo's natural environment.

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