Efficiency of the Slovak Commercial Banks Applying the DEA Window Analysis

Iveta Řepková

Abstract—The aim of this paper is to estimate the efficiency of the Slovak commercial banks employing the Data Envelopment Analysis (DEA) window analysis approach during the period 2003-2012. The research is based on unbalanced panel data of the Slovak commercial banks. Undesirable output was included into analysis of banking efficiency. It was found that most efficient banks were Postovabanka, UniCredit Bank and Istriobanka in CCR model and the most efficient banks were Slovenskaspoptelna, Istriobanka and UniCredit Bank in BCC model. On contrary, the lowest efficient banks were found Privatbanka and Citibank. We found that the largest banks in the Slovak banking market were lower efficient than medium-size and small banks. Results of the paper is that during the period 2003-2008 the average efficiency was increasing and then during the period 2010-2011 the average efficiency decreased as a result of financial crisis.

Keywords—Data Envelopment Analysis, efficiency, Slovak banking sector, window analysis.

I. INTRODUCTION

The aim of this paper is to estimate the efficiency of the Slovak commercial banks employing the Data Envelopment Analysis (DEA) window analysis approach during the period 2003-2012. The paper employed an extended DEA approach, specifically DEA window analysis for the efficiency assessment of commercial banks in Slovakia. It is based on panel data for the period from 2003 to 2012. We use the DEA window analysis based on an input oriented model to measure banking efficiency in this paper. The contribution should be able to see the bank efficiency evolves over time and to see whether any size effect exists in the banking efficiency. This analysis provides trends of efficiency and the rank of each bank evaluated in terms of its effectiveness. The obtained results allow for an analyses of trends of the overall banking sector efficiency. By this approach, the technical efficiency is analyzed sequentially with a certain window width (i.e. the number of years in a window) using a panel data of the commercial domestic banks. The main idea is to capture the temporal impact on bank technical efficiency and see its short-run evolution from one window to another, in particular the pure technical efficiency and scale efficiency. We include undesirable output into analysis. It is the first application of the window analysis on Slovak commercial banks during the period 2003-2012.

The structure of the paper is follow. Next section describes empirical literature about banking efficiency in the Slovak banking sector. Third section presents the methodology of DEA window analysis and Section IV describes data and selection of variables. Next part of paper reveals the estimated results and last section concluded the paper.

II. LITERATURE REVIEW

Empirical analyses of banking efficiency which included the Slovak banking sector exist several. We mention some of them. Some empirical studies e.g. reference [18], [35], [5], [20] or [19] examined the banking efficiency in several European countries and Slovak banking sector was included in panel data.

Reference [15], [6] or [14] estimated banking efficiency in 1990s and they investigated the impact of bank privatization. They found that private banks were more efficient than state-owned banks and privatized banks with majority foreign ownership were more efficient than those with domestic ownership. Reference [24] examined that the banking systems of Slovakia showed significant levels of cost and profit inefficiency, indicating that on average banks operate far above (below) from the cost (profit) efficient frontiers. But they found that cost efficiency increased between 1995 and 2002.

Reference [30] estimated efficiency and profitability in the selected banking sectors, including Slovakia. They found that Central European Countries are less efficient than their counterparts in the European Union member countries. Their conclusion is the refutation of the conventional wisdom of higher efficiency from foreign-owned banks than from domestic-owned banks, and size is one of the factors that determine efficiency. Reference [29] examined the increasing value of the efficiency of the Slovak banking sector during the period 1999-2003, but they also found that Slovak banking sector was lower efficient banking sector than other Visegrad countries. Reference [34] found that the average efficiency slightly decreased and the number of efficient bank also decreased. Reference [17] estimated banking efficiency in five countries of Central and Eastern Europe including Slovakia. In Slovakia the results showed that the average cost efficiency was 51.8% and profit efficiency reached 43.2% in the years 1995–2006.

Results of [4] were that the foreign-owned banks were bit more cost efficient than domestic private banks, state-owned banks were significantly less cost efficient when compared to domestic private banks. Reference [1] estimated relative efficiency of banks in emerging Europe before the recent boom, just before the crisis and right after the crisis using the Data Envelopment Analysis. Their results suggested that the
banking efficiency in Slovakia decreased during the pre-crisis boom and also fell during the crisis. They found the significant decrease in efficiency during the period 2004–2009.

Mentioned studies examined efficiency in several banking sectors, on contrast [31] estimated banking efficiency in Slovakia. They applied the parametric Stochastic Frontier Approach and Cobb–Douglas production function on commercial banks in the period 2001–2005 and found that the average efficiency increased and their results point out a better ability of Slovak banks to use the inputs in the production process. References [23] and [22] estimated the cost and profit efficiency of the Slovak commercial banks and they found that the average cost and profit efficiency was decreasing in the Slovak banking sector during the period 2003-2012. And then they found that small and medium-sized banks were more efficient than the largest banks in the Slovak banking market.

The empirical literature review concluded that only few studies examined the Slovak banking sector individually. Most of the empirical studies research several banking sector which included Slovakia and the second findings is that the most studies examined banking efficiency during 1990s. Thus, the literature review shows the motivation for this paper. This paper could fill the gap following time line in the empirical literature. Efficiency of the Slovak banking sector was estimated using the Stochastic Frontier Approach or DEA model. The contribution of this paper is the fact, that the DEA window analysis approach will be applied on the Slovak commercial banks. Also we consider undesirable output.

III. METHODOLOGY

The study of the efficient frontier began with [13], who defined a simple measure of a firm’s efficiency that could account for multiples inputs. The term Data Envelopment Analysis was originally introduced by [8] based on the research of [13]. DEA is a non-parametric linear programming approach, capable of handling multiple inputs as well as multiple outputs [2].

This methodology allows handling different types of input and output together. A DEA model can be constructed either to minimize inputs or to maximize outputs. An input orientation objects at reducing the input amounts as much as possible while keeping at least the present output levels, while an output orientation aims at maximizing output levels without increasing the use of inputs [11].

Data envelopment analysis is a mathematical programming technique that measures the efficiency of a decision-making unit (DMU) relative to other similar DMUs with the simple restriction that all DMUs lie on or below the efficiency frontier [27]. DEA measures the relative efficiency of a homogeneous set of decision-making units in their use of multiple inputs to produce multiple outputs. DEA also identifies, for inefficient DMUs, the sources and level of inefficiency for each of the inputs and output [9]. It provides a means of comparing the efficiency of DMUs with each other based on several inputs and / or outputs. It derives its name from a theoretical efficient frontier which envelops all empirically-observed DMUs.

This analysis is concerned with understanding how each DMU performs relative to others, the causes of inefficiency, and how a DMU can improve its performance to become efficient. In that sense, the focus of the methodology should be on each individual DMU rather than on the averages of the whole body of DMUs. DEA calculates the relative efficiency of each DMU in relation to all the other DMUs by using the actual observed values for the inputs and outputs of each DMU. It also identifies, for inefficient DMUs, the sources and level of inefficiency for each of the inputs and outputs [9].

The CCR model is the basic DEA model, as introduced by [8] and then it was modified by [3] and became the BCC model, which accommodates variable returns to scale. The CCR (Charnes, Cooper, Rhodes) model presupposes that there is no significant relationship between the scale of operations and efficiency by assuming constant returns to scale (CRS) and delivery of overall technical efficiency. The CRS assumption is only justifiable when all DMUs are operating at an optimal scale. However, firms or DMUs in practice might face either economies or diseconomies to scale. Reference [3] extended the CCR model by relaxing the CRS assumption. The resulting BCC (Banker, Charnes, Cooper) model was used to assess the efficiency of DMUs characterized by variable returns to scale (VRS). The VRS assumption provides the measurement of pure technical efficiency (PTE), which is the measurement of technical efficiency devoid of scale efficiency (SE) effects. If there appears to be a difference between the TE and PTE scores of a particular DMU, then it indicates the existence of scale inefficiency [32].

As e.g. [25] showed, the DEA has some limitations. When the integrity of data has been violated, DEA results cannot be interpreted with confidence. Another caveat of DEA is that those DMUs indicates as efficient are only efficient in relation to others in the sample. It may be possible for a unit outside the sample to achieve higher efficiency than the best practice DMU in the sample. Knowing which efficient banks are most comparable to the inefficient bank enables the analyst to develop an understanding of the nature of inefficiencies and reallocate scarce resources to improve productivity. This feature of DEA is clearly a useful decision-making tool in benchmarking. As a matter of sound managerial practice, profitability measures should be compared with DEA results and significant disagreements investigated.

Data Envelopment Analysis is performed in only one time period, hampering the measurement of efficiency changes when there is more than one time period. A DEA model is sometimes applied on a repeated basis, e.g. the so-called window analysis method [9] when a panel data set comprising both time series and cross-section samples is available, but this produces little more than a continuum of static results, when in fact a static perspective may be inappropriate [28].

Window analysis is one of the methods used to verify productivity change over time. As [26] showed, window analysis technique works on the principle of moving averages [9], [36] and [10]. DEA window analysis was proposed by [7] in order to measure efficiency in cross sectional and time varying data. Thus, it is useful in detecting performance trends...
of a decision making unit over time. Each DMU (i.e. bank) is
treated as a different bank in a different period which can
increase the number of data point. In the other word, each
DMU in a different period is treated as if it was a different
DMU (independent) but remains comparable in the same
window [12]. Such capability in the case of a small number of
DMUs and a large number of inputs and outputs would
increase the discriminatory power of the DEA models [12].
Therefore, small sample sizes problem can be solved. And
another advantage of DEA window analysis is that the
performance of a bank in a period can be contrasted against
themselves and against other banks overtime [2].

The performance of a unit in a particular period is
contrasted with its performance in other periods in addition to
the performance of other units. This results in an increase in
the number of data points in the analysis, which can be useful
when dealing with small sample sizes. Varying the window
width, that is the number of time periods included in the
analysis, means covering the spectrum from contemporaneous
analysis, which include only observations from one time
period, to intertemporal analysis, which include observations
from the whole study period [21]. A DEA window analysis,
with a window width somewhere between one and all periods
in the study horizon, can be viewed as a special case of a
sequential analysis. It is assumed, that what was feasible in the
past remains feasible, and all previous observations are
included. This is not the case in the window analysis, where
only observations within a certain number of time periods (i.e. a
window) are considered. Once the window is defined the
observations within that window are viewed in an
intertemporal manner and the analysis is therefore better
referred to as locally intertemporal [33].

The number of firms that can be analyzed using the DEA
model is virtually unlimited. Therefore, data on firms in
different periods can be incorporated into the analysis by
simply treating them as if they represent different firms. In
this way, a given firm at a given time can compare its performance
at different times and with the performance of other firms at
the same and at different times. Through a sequence of such
windows, the sensitivity of a firm’s efficiency score can be
derived for a particular year according changing conditions
and a changing set of reference firms. A firm that is DEA
efficient in a given year, regardless of the window, is likely to
be truly efficient relative to other firms. Conversely, a firm
that is only DEA efficient in a particular window may be
efficient solely because of extraneous circumstances. In
addition, window analysis provides some evidence of the
short-run evolution of efficiency for a firm over time. Of
course, comparisons of DEA efficiency scores over extended
periods may be misleading (or worse) because of significant
changes in technology and the underlying economic structure
[36].

Following [2] and [16], consider \( N \) DMUs (\( n = 1, 2, \ldots, N \))
observed in \( T \) (\( t = 1, 2, \ldots, T \)) periods using \( r \) inputs to
produce \( s \) outputs. Let \( DMU^t_n \) represent a \( DMU \) in period \( t \)
with a \( r \) dimensional input vector \( x^t_n = (x^t_{n1}, x^t_{n2}, \ldots, x^t_{nr})' \) and
\( s \) dimensional output vector \( y = (y^t_{n1}, y^t_{n2}, \ldots, y^t_{ns})' \). If a
window starts at time \( k (1 \leq k \leq T) \) with window
width \( w \) (\( 1 \leq w \leq t - k \)), then the metric of inputs is given as follows:

\[
x_{kw} = \left( x^1_{kw}, x^2_{kw}, \ldots, x^k_{kw}, x^{k+1}_{kw}, x^{k+2}_{kw}, \ldots, x^T_{kw} \right)
\]

(1)

The metric of outputs as:

\[
y_{kw} = \left( y^1_{kw}, y^2_{kw}, \ldots, y^k_{kw}, y^{k+1}_{kw}, y^{k+2}_{kw}, \ldots, y^T_{kw} \right)
\]

(2)

The CCR model of DEA window problem for \( DMU^t_n \)
is given by solving the following linear program:

\[
\min \, \theta, \quad \theta X_t - \lambda X_{kw} \geq 0 \\
\text{subject to} \quad \lambda Y_{kw} - Y_t \geq 0, \quad \lambda \geq 0 \quad (n = 1, 2, \ldots, N \times w).
\]

(3)

BCC model formulation can be obtained by add the
restriction \( \sum_{n=1}^{N} \lambda_n = 1 \)[3]. The objective value of CCR model
is designated technical efficiency and the objective of BCC
model is pure technical efficiency. The BCC model is
illustrated as:

\[
\min \, \theta, \quad \theta X_t - \lambda X_{kw} \geq 0 \\
\text{subject to} \quad \lambda Y_{kw} - Y_t \geq 0, \quad \sum_{n=1}^{N} \lambda_n = 1, \quad \lambda_n \geq 0 \quad (n = 1, 2, \ldots, N \times w).
\]

(7)

Reference [2] point out that there are no technical changes
within each of the windows because all DMUs in each
window are compared and contrast against each other and
suggest a narrow window width should be used. Reference [9]
found that \( w = 3 \) or 4 tended to yield the best balance of in
formativeness and stability of the efficiency scores. In order to
be sure that the results will be credible, a narrow window
width must be used. Therefore, a 3 year window has been
chosen in this paper (\( w = 3 \)).

IV. DATA AND SELECTION OF VARIABLES

The data set used in this paper was obtained from the
database BankScope and the annual reports of commercial
banks during the period 2003–2012. All the data is reported on
an unconsolidated basis. We analyze only commercial banks
that are operating as independent legal entities. As we have
reliable data extracted directly from annual reports, we
eliminate the risk that incomplete or biased data may distort
the estimation results. We use unbalanced panel data from 12
Slovak commercial banks (with regard to mergers and
acquisitions of banks).
In order to conduct a DEA window analysis estimation, inputs and outputs need to be defined. Four main approaches (intermediation, production, asset, and profit approach) have been developed to define the input-output relationship in financial institution behavior. We adopted an intermediation approach which assumes that the banks’ main aim is to transform liabilities (deposits) into loans (assets). Consistent with this approach, we assume that banks collect deposits to transform them, using labor, in loans. We employed two inputs (labor and deposits), and two outputs (loans and net interest income). We measure labor by the total personnel costs covering wages and all associated expenses and deposits by the sum of demand and time deposits from customers, interbank deposits and sources obtained by bonds issued. Loans are measured by the net value of loans to customers and other financial institutions and net interest income (NII) as the difference between interest incomes and interest expenses. We consider loan loss provision as undesirable output. Descriptive statistics of inputs and outputs are in Table I.

<table>
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<tr>
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<th>Deposit</th>
<th>Labor</th>
<th>Loanloss provision</th>
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<td>112.99</td>
<td>38193.70</td>
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<tr>
<td>Median</td>
<td>1051.50</td>
<td>42.27</td>
<td>1378.45</td>
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<tr>
<td>Max</td>
<td>7266.50</td>
<td>465.70</td>
<td>3536153.17</td>
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<td>Min</td>
<td>17.60</td>
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<td>87.40</td>
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<tr>
<td>St.Dev.</td>
<td>1971.74</td>
<td>122.43</td>
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V. EMPIRICAL ANALYSIS AND RESULTS

We adopted DEA window analysis SBM (slack based model – non-radial) models that can evaluate the overall efficiency of decision-making units for the whole terms as well as the term efficiencies. We used the DEA window analysis to estimate efficiency under the assumptions of constant and variable returns to scale. For empirical analysis we used MaxDEA software.

Banking efficiency was estimated using DEA window analysis models, especially an input-oriented model with constant returns to scale and input-oriented model with variable returns to scale. The reason for using both techniques is the fact that the assumption of constant returns of scale is accepted only in the event that all production units are operating at optimum size. This assumption, however, is in practice impossible to fill, so in order to solve this problem we calculate also with variable returns of scale. We use panel data of 12 Slovak commercial banks (with regard to mergers and acquisitions of banks).

The results of the DEA efficiency scores under constant variable of scale during the period 2003-2012 are presented in Table II. Moving average efficiency is shown in three-year window. During the period 2003–2012, the average efficiency calculated using the CRS ranges from 77% to 91%. This development shows that Slovak commercial banks are on average considered to be efficient, with only marginal changes over time. The results show that the average inefficiency of the Slovak banking sector in the CCR model was in range 9-23%. The reason for the inefficiency of Slovak banks is mainly the excess of client deposits on the balance sheet of banks.

<table>
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<tr>
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</table>

| Mean | 0.9102 | 0.8904 | 0.8507 | 0.8738 |

The results of the efficiency of individual banks show that the most efficient banks were Postovabanka, UniCredit Bank and Istrobanka. On the other hand, the lowest efficient banks were Privatbanka, CitiBank and TatraBanka. We found that the largest banks in the Slovak banking market are lower efficient than medium-size and small banks. The reason for this inefficiency is that the group of large banks has excess of deposits in balance sheet. Thus, the excess of deposits reflected negatively to net interest income by increasing interest costs of banks.

Table III presents the efficiency of the Slovak commercial banks estimated under the variable return to scale. The average efficiency calculated in BCC model reached the value from 83 to 94%. The most efficient banks were Postovabanka, UniCredit Bank and Istrobanka. In BCC model, the lowest efficient bank was Privatbanka and then CitiBank and CSOB.
The development of the efficiency showed that the average efficiency was increasing during the period 2003-2008. After year 2008 the average efficiency decreased. This decrease was probably as a result of financial crisis. The decrease in the net profit was registered in the balance sheet of the most Slovak commercial banks. In the last window 2010-2012 the average efficiency increased.

VI. CONCLUSION

The aim of this paper was to estimate the efficiency of the Slovak commercial banks employing the Data Envelopment Analysis (DEA) window analysis approach during the period 2003-2012. It was the first application of the DEA window analysis approach on the Slovak banking sector. The research was based on unbalanced panel data for the period from 2003 to 2012. It was applied the DEA window analysis based on an input oriented model to measure banking efficiency.

We found that in CCR model the most efficient banks were Postovabanka, UniCredit Bank and Istrobanka. On contrary, the lowest efficient bank was found Privatbanka, CitiBank and Tatrabanka. We found that the largest banks in the Slovak banking market are lower efficient than medium-size and small banks. In BCC model the most efficient banks were Slovenskaspotitelna, Istrobanka and UniCredit Bank. The lowest efficient bank was Privatbanka and then CitiBank and CSOB in assumption of variable return to scale. The average efficiency score in BCC model reached the higher value than in CCR model. Other results of the paper is that whereas during the period 2003-2008 the average efficiency was increasing, during the period 2010-2011 the average efficiency decreased as a result of financial crisis. The results confirm the study of [1] who presented that the banking efficiency in Slovakia decreased during the pre-crisis boom and also fell during the crisis.

ACKNOWLEDGMENT

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REFERENCES


TABLE III

EFFICIENCY OF SLOVAK COMMERCIAL BANKS IN BCC MODEL

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