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An Examine Of the Risks Emerging In Public Sector Banking Companies in Existing Era

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Abstract

Financial risk is a distress for the entire banking system. So the managers take responsibilities to control the risk and need to protect their investors and profits against unexpected risks. In banking sector, companies' process enhances risk management by using a sustainable risk management framework, executing a continuous and proactive risk assessment process and effective decision-making. In order to create an effective control mechanism to avoid and mitigate risks and its consequence, a well thought of task undertaken by banking company is very important. This study analyses the risk management framework implemented in banking companies and then take appropriate action to control the losses in an investment.

Key word: *Customer Retention Management, Risk Management, Banking Report, Banking Risk, Risk Management.*

INTRODUCTION

Uncertainty is part of everyday life. "Risk is basically linked to uncertainty of the future. The uncertainty associated with the outcome of an event that can lead to loss or profit is known as Risk. Every event has got an impact associated with it; either positive or negative. The negative impact represents risk. It is possibility of something adverse happening. The dictionary meaning of risk is a 'probability of damage, liability, loss, or any other negative occurrence that is caused by external and internal vulnerabilities, and which may be avoided through preemptive action'.

A risk can be defined as an unplanned event with financial consequence resulting in loss or reduced earnings. Therefore, a risky proposition is one with potential profit or a looming loss. Risk stems from uncertainty or unpredictability of the future. In banking companies transaction risk generated profit and loss depending upon the way in which it is managed. Risk management is a process of identification, assessment, analysis and either acceptance decision making to reduce the risk to an acceptable level and maintaining that level of risk. Essentially, risk management occurs anytime a customer or fund manager analyses and attempts to quantify the potential for losses in an investment and then takes appropriate action given their investment objectives and risk tolerance. The 'risk' perceived by one individual or organization not necessarily becomes the aspect of worry to others. Circumstances differ; the strengths and weaknesses differ and at the same time the level of controls built in the processes differ from entity to entity. As a result the risks are required to be identified, assessed, monitored and reported on the backdrop of an associated 'vulnerability' to be organization.

"Any event that will impact achievement of the Company's objectives, including financial as well as non-financial, for its short term and long term objectives, or the level of exposure to uncertainties and the level of vulnerability that the Company must understand and effectively manage as it achieves its objectives."

Classification of risk

Risks can be primarily divided into financial and non-financial risks. A financial risk involvesall those aspects which deal mainly with financial aspects of the bank. This can be further subdivided into credit risk and market risk. Non-financial risks entail all the risks faced by the bank in its regular workings.

Credit Risk

It is the risk of negative effects on the financial result and capital of the bank caused by borrower's default on its obligations to the bank. This is a bank's internal credit approval and monitoring functions of the bank. It looks at how risky transactions are going to be, and whether they are really worth that risk. For, example, it will set the levels of 'risk-adjustment' on credit arrangements. In other words, lending to a company with a poor credit rating will probably mean setting a high level of interest on the loan. This is really an important element of the bank's business because managing the credit risk is vital.

Market Risk

It is the risk of change in the market price of securities, financial derivatives or commodities traded or tradable in the market. It includes interest rate and foreignexchange risk.

Interest Rate Risk

It is the risk of negative effects on the financial result and capital of the bank caused by changes in interest rates. The risk that an investment's value will change due to a change in the absolute level of interest rates, in the spread between two rates, in the shape of the yield curve or in any other interest rate relationship. Such changes usually affect securities inversely and can be reduced by diversifying or hedging. Interest rate risk affects the value of bonds more directly than stocks, and it is a major risk to all bondholders. As interest rate rise, bond prices fall and vice versa. The rationale is that as interest rates increase, the opportunity cost of holding a bond decreases since investors are able to realize greater yields by switching to other investment that reflect the higher interest rate

Foreign exchange risk

It is the risk of negative effects on the financial result and capital of the bank caused by changes in exchange rates.

Operational risk

It is the risk of negative effects on the financial result and capital of the bank caused by omissions in the work of employees, inadequate internal procedures and processes, inadequate management of information and other systems, and unforeseeable external events. This department covers the risks associated with the day-to-day running of the bank. There are different types of operational risks; some of them are internal fraud (tax evasion, bribery); external fraud (theft of information, hacking); employment practices and workplace safety (health and safety, discrimination); clients, products and business practices; damage to physical assets; business disruption and systems failures; execution, delivery and process management.

Investment risk

It includes risk of bank's investment in entities that are not entities in the financial sector and in fixed assets. If the bank acquires another company there will be a whole new set of risks associated with the new company. All these risks need analyzing, and that is one of the tasks of the investment risk manager. The new company will also need to have its risk processes aligned with the parent company.

Country risk

It is the risk of negative effects on the financial results and capital of the bank due to bank's inability to collect claims from an entity for reasons arising from political, economic or social conditions in such entity's country of origin. Country risk includes political, economic and transfer risk.

Liquidity Risk

It is the risk of negative effects on the financial result and capital of the bank caused by the bank's inability to meet all its due obligations.

Reputation risk

It is the risk of loss caused by a negative impact on the market positioning of the bank.

Legal risk

It is the risk of loss caused by penalties or sanction originating from court disputes due to breach of contractual and legal obligations, and penalties and sanctions imposed by regulatory bodies.

TO CONTROL THE RISK IN BANKING COMPANIES

Accuracy and integrity:

Risk formed in banking companies on the basis of data generated with accuracy and integrity out of a largely automated and independent process to avoid error probability.

Completeness:

All material data should be included and shown in paper related on assets and liability, profit & loss position of banking companies.

Timeliness:

Timing shall depend on the nature of the risk being measured and the overall risk of the banking companies and its frequency in reporting.

Risk reporting practices

The next set of principles is related to risk reporting. Data graduate to information only when they are accurate, complete and timely. To help in informed decision-making process is the goal of an effective reporting system. That should be kept in mind in case of designing a reporting framework. It may be advised here to strictly ensure that there exists no trade-off that could materially affect risk management decisions. In case there is any, the Board of the particular bank should necessarily be aware of this and any other shortcoming.

Accuracy:

Risk management reports should accurately and precisely convey data and risk in an exact manner. Reports should be reconciled and validated.

Comprehensiveness:

A risk report should cover all material risks within the enterprise in conformity with its size and complexity and in response to the recipients' requirements.

Clarity and Usefulness:

Reports should include meaningful information tailored to the user needs.

Frequency:

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Report frequency shall be exactly in response to the user need for information. Frequency should invariably increase during the period of risk stress. Frequency is indeed a parameter to understand the nature of information requirement and the speed in the decision making process across the enterprise. Frequency also depends on the type of risk in reality.

Distribution:

Risk management reports should be distributed to the relevant parties while ensuring full confidentiality is maintained.

Review

Supervisors should regularly review and ensure compliance.

Remedial Actions:

Supervisors should have and use the appropriate tools and resources to require effective and timely remedial action by a bank to address deficiencies in its risk data capabilities and risk practices. Supervisors should have the ability to use a range of tools.

RISK MANAGEMENT FRAMEWORK FOR INDIAN BANKING COMPANIES

1. Banks may have a review of the status quo and thus identify what's to be taken care of
2. Banks may have to evaluate how they can co-ordinate with each other in view of reaping the best from adopting the principles
3. The institutions now on, have to ascertain whether, how and how much they are having the knowledge and resources to perform independent and in-depth validation of data governance
4. The set of principles to be followed would require the institutions to go for rational approximation where no risk data is available. To ensure this, a reorganization of internal resources is also recommended.
5. Because of the competitiveness vis-à-vis complexity of the task, the institutions may require extensive review and coordination in their data management to ensure improvement.
6. Banks now surely need to develop data definitions more diligently to support reporting requirements in response to the mandates of the respective regulatory bodies.
7. Banks have to develop now an inventory of the models used falling better sustainability purposes, they should take step for strengthening their stress taking capacity and power of raising alert well in advance.

Risk management is relatively new and emerging practice as far as Indian banks are concerned and has been proved that it's a mirror of efficient corporate governance of a financial institution. Globalisation and significant competition between foreign and domestic banks, survival and optimizing returns are very crucial for banks and financial institutions. However, selecting the efficient customer and providing innovative and value added financial products and services are another paramount factors. In a volatile and dynamic market place for achieving sustainable business growth and shareholder's value, it is essential to develop a link between risks and rewards of all products and services of the bank. Hence, the banks should have efficient risk management framework to mitigate all internal and external risks.

Objective

The objective of this article is to envisage ideal framework of bank-wide risk management for Indian Banks. The presence of accurate measures of bank-wide risk management practice increase shareholder's returns and allows the risk-taking behavior of bank to be more closely aligned with strategic objectives. Bank-wide risk management practice should aim to enhance the drivers of shareholder's value such as: -

1. Growth
2. Risk adjusted performance measurement
3. Consistency of earnings and
4. Quality and transparency of management
5. The important steps of the efficient framework of banking concern should ensure all risks are identified, prioritized, quantified, controlled and managed in order to achieve an optimal risk-reward profile. This entails ideal and dedicated coordination of risk management across the bank's various business units. However, the approach to monitoring and enforcing the adherence of business units within the bank may vary. The factors that influence this decision are: -
   a. The feasibility decisions of the business unit.
   b. The regulatory requirements in respect of the business unit.
   c. The cost of effective monitoring and controlling steps.

Benefits of Bank-wide risk management

Risk management is a line function that needs to be addressed by each individual cost center and business unit. However, a centralized bank-wide risk management framework has certain advantages for the Bank. The advantages are: -

Improving capital efficiency by

1. Providing an objective basis for allocating resources
2. Reducing expenditures on immaterial risks and
3. Exploring natural hedges and portfolio effects

Supporting informed decision making by

1. Uncovering areas of high potential adverse impact on drivers of share value, and
2. Identifying and exploiting areas of risk-based advantage context.

Building investor confidence by

1. Establishing a process to stabilize results by protecting them from disturbances, and
2. Demonstrating proactive risk stewardship

Define cost and profitability centers

Profitability and cost allocation on customer, product, services and branch wide

Current state of Risk management practices in Indian banks

Most of the banks do not have dedicated risk management team, policy, procedures and framework in place. Those banks have risk management department, the risk manager's role is restricted to prefact and postfact analysis of customer's credit and there is no segregation of credit, market, operational and strategic risks. There are few banks have articulated framework and risk quantification. However, the outputs are far from the stressed or actual losses due to usage of un-compatible implications.

The traditional lending practices, assessment of credits, handling of market risks *, treasury functionality and culture of risk-rewards are hauls of public sector banks. Whereas private sector banks and financial institutions are some-what better in this context?

The sheer size and wide coverage of banks is a big hurdle to integrate and generate a cost effective real time operational data for mapping the risks. Most of the financial institutions processes are encircled to 'functional silos' follows bureaucratic structure and yet to come up with a transparent and appropriate corporate governance structure to achieve the stated strategic objectives.

Customer Retention Management (CRM)

Customer Retention Management (CRM) is perceived as a technique of banking companies to explore, retain and also increase the loyal customers in the competitive business era.

The Indian banking industry, which was operating in a bureaucratic style prior to 1991, had to undergo large-scale transformation with the opening up of the economy. The sector has been facing unprecedented challenges with the wave of liberalization, privatization and globalization of the Indian economy. The banks in India are under intense pressure in today's volatile marketplace. Steep competition, globalization, growing customer/consumer demand and exposure to high credit risks are forcing the banks to find new ways for improving profitability. On the other hand, cost-cutting measures have forced banks to manage operations with a few customer relationship managers and product specialists. Industry consolidation also poses fresh challenges to this sector. The search for new strategies began to meet not only the high expectations of customers but also helped in retaining them. The competitive world has witnessed many banks participating in the race to optimize their profits. The banking sectors are implementing new innovative technology, and using it, a customer can accesses his requirement. Hence, all banks are for the adoption of advanced-centric approach to customer-centric approach. In such a scenario, the services have grown rapidly and the customer has been more often a purchaser of services rather than products. These changes are compelling banks to reorganize themselves to cope with the present conditions.

Though the banks are very keen on providing customer retention practices to satisfy the customers and retain them, customers' satisfaction or at the least their expectations towards these practices is not known. A study of the perception of the customers towards the banks' customer retention practices is essential to gain adequate information to satisfy customers further, retain them and provide continuous opportunities to suggest banks in the application of Customer Retention Management (CRM), etc. Hence, the present study tries to find out the perception level of the customers on CRM of the public and private sector commercial bank branches.

CONCLUSION

Risk avoidance is not risk mitigation. When it comes to doing 'business', obviously what comes first is 'risk' which may be a calculate one, successfully so if a strong risk management process is in place. There have been tremendous changes in banking sector. The future of banking industry will undoubtedly rest on risk management dynamics and only those banks that have efficient risk management system will service in the market in the long run. The objective of risk management in banks is to minimize negative effects of risk that can affect the financial result and capital of the bank. Banks are therefore required to prescribe procedures for risk management. They are also required to prescribed procedures for risk identification measurement and assessment, as well as procedures for risk management. An essential component of risk management framework would be to mitigate all the risks and rewards of the products and service offered by the bank. Thus the need for an efficient risk management framework is paramount in order to factor in internal and external risk. Banking companies work within a framework of legal regulation because when regulations change, the bank's operational framework changes, which may impact its ability to generate profits from loans.

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