STUDY ON THE RISK MANAGEMENT IN BANKING INSTITUTIONS

BALTEŞ Nicolae
Lucian Blaga University of Sibiu, Romania

CIUHUREANU Alina-Teodora
Romanian-German University of Sibiu, Romania

Abstract:
Risk is a key factor for businesses, because you cannot get profit from any activity without risk. Since banking risks are a source of unpredicted expenses, their proper management might stabilize revenues, having the role of shock absorber. At the same time, strengthening the value of banking shares can only be achieved through real communication with the financial markets and the implementation of adequate programmes of banking risk management. The paper analyzes, for the beginning, a series of general aspects regarding risk and banking risk management. Then, we present the conclusions resulting from the quantitative research descriptive type which had as objective the analysis of knowing the measures that have to be taken in the banking management for a better management of risks that might cause bankruptcy and opinions about the NBR responsibilities to monitor and control the banks in the system.

Keywords: *risk, management, bank*

1. Introductive aspects

So far, risk has been regarded as a negative concept. The positive interpretation of risk reflects a new understanding of the relationship between the well-managed risk and the improved performance. The risks faced by any organisation are considered continuous. They can be evaluated in terms of unexpected events, uncertainty and opportunity, and also from the point of view of the influence they have on the level of performances and of achieving the strategic objectives.

In a synthetic sense, **risk** *is the variability of results under the pressure of factors from the environment in which the organisation operates. Risk can be regarded from the viewpoint of uncertain events that might affect the strategic, operational and financial objectives. Risk is a measure of the inconsistency between different possible* *results, obtained under more or less favourable or unfavourable conditions* (Mihalcea and Androniceanu, 2000).

There is always the distinction between risk and uncertainty. **Risk** *can be related to a situation in which various possible effects might occur and there is a past relevant experience that would allow obtaining some statistics to estimate the effect*s. **Uncertainty** *occurs where there are various past effects but the previous statistics do not allow estimating them* (Drury, 1992).

It is a universal truth that the existence of risk implies the existence of failure. Not all risks are identical and nor failures have the same magnitude. In fact, failure may occur for several reasons, each of them having a particular importance in the risk management (Haubrich, 2001):

- the first reason refers to the *unsuccess of the managerial control*;
- the second category of reasons includes the situations in which *managers intentionally assume certain risks and lose*;
- the third possibility can be considered more subtle: *the organisation takes certain risks which, on their own, are the best – the management understands and accepts the importance of the exposure – but the sum of the undertaken risks are not socially optimal*.

As a conclusion, we may state that risk can be considered as the variation of real values as compared to the average values or the estimated ones, variations however caused by accidental causes. One situation is considered risky if there are certain doubts as how to obtain an expected outcome (Ciuhureanu, 2009).

The banks' place and role in the economy is closely related to their quality of main intermediary in the savings-investments relation, a decisive relation for economic growth. As intermediaries between savings depositors and credit beneficiaries, the banks undergo a series of operations: they collect funds; they assume the debtors' risks (they analyse credit applications and take the associated risks); they assume the risk of the interest rate, because intermediation involves a change of maturity.

As a consequence of efficiently achieving these functions, the banks get a reward, this representing the basic source of the banking profit. Banking institutions, like any other enterprise that produces goods and services, have as a major purpose the responsibility towards stakeholders, to maximise profits (Isaic-Maniu, 2010).

There can be found various classification criteria in the specialty literature. We shall further on present a brief selection of them.

- depending on the degree of exposure: pure risks, lucrative risks
- depending on the market that causes the risk: risks caused by the product's market and risks caused by the capital market;
- depending on the banking characteristic: financial risks, performance risks, environmental risks;
- depending on the allocation within the financial system: diversified risks, undiversified risks.

Taking the risk involves overcoming individual opposition and that of the unfavourable decision context. They say that a manager who hesitates to take risks should not work in business or management (Dijmărescu, 1998). Risk management is characterised by the management of a large volume of information. Thus, there is the necessity of having the risk management whose main purpose is to give the banking institution the possibility to meet its objectives (Constantinescu and Dobrin, 1998), provided that the unexpected part of the revenue, the one that results from unexpected events, quantifies the real risk of the business. After all, if we would get what we expected without doing anything, we would not be talking about risk, uncertainty, the management of risk and performance.

Risk management (Ciuhureanu, 2005) aims a better achievement of business objectives and the successful implementation of strategies. Risk management provides the necessary elements to answer the complexity of risk monitoring. The concept of risk management consists both of preventing and minimising the occurrence of certain events and also in their system of identification, evaluation and quantification. Moreover, the risk management goes through development stages, being of great usefulness nowadays in the implementation of measures for diminishing losses that might occur.

Identifying risk is a crucial stage in the process of banking risk management, being generated and influenced by the following **factors of change** that characterise the business environment: *the competition's pressure, political changes, globalisation, legislative pressure, financial openness*.

It is important that managers make sure that risk is well-defined and explained to facilitate further studies. An exact definition of risk implies **the development of a risk profile**, which is of utmost importance for the success of the banking risk management. Once the risk has been identified, managers shall make an **evaluation** of a possible impact and of the probability of occurrence by using some adequate parameters that would facilitate the drawing up of a risk map. In the planning stage, managers shall have to agree on the best definition of risk and on the risk categories that might be used during the evaluation of the occurrence probability and their impact.

Assessing the potential impact of a risk may become difficult because there is a wide range of possible effects and also because the risk may occur several times during a particular period of time. Such complications should be anticipated, managers adopting an adequate approach by even trying to estimate the worst effects of risk in a given period of time (usually one year). The evaluation of the impact that risk might have on the bank should take into consideration the financial impact, the impact over the bank and the evaluated objectives, the impact on the political and social sensitivity. The study can be qualitative or quantitative, but it should allow comparisons over time. One example of qualitative study can be achieved by considering the impact as having bad, medium or insignificant consequences.

The risk management process is complex, starting with the establishment of an infrastructure and continuing with identifying, analysing and evaluating risks, implementing certain prevention measures or loss minimisation, as well as adopting the decisions regarding the necessary financial treatment to minimise inevitable losses.

The defining characteristics of bank risk management process can be summarised as follows (Soviani, 2003; Faulkner and Bowman, 2000; Lewis et. All, 1995; Bărbulescu at. all, 2002):

- *it is an inclusive and support process of the management* ;
- *it produces, structures and presents the best available information on risk*;
- *requires a high level of commitment of the managerial team*;
- *allows management decisions to generally facilitate communication between operators, regulators and the public regarding the nature of risk and is management*;
- *it includes the risk identification and analysis*;
- *it includes the identification, analysis and selection of risks' alternative control measures and the evaluation of performance*;
- *it gives the possibility to plan "the way" to meet the set objectives*;
- *it structures logically, brings consistency, documents and explains the approach of choice, according to uncertainties and benefits, between competitive alternatives* ;
- *it needs adequate and sufficient information*;
- *it must cover the entire spectrum of risks*;
- *the risk management problems are structured, but flexible, they include performance measurement and request monitoring, tracking and reporting of progresses regarding the expected results.*

The implementation of risk management is not an answer to risk, but rather an organisational paradigm which involves changes in the way the banking institution (IFAC and FMAC, 1999): *organises, assigns responsibilities, and approaches the risk management as a key competence, continuously and in due time implements the risk management.*

In conclusion, the risk management should be an integral part of the bank management, promoting operational efficiency rather than bureaucracy, by permanently analysing the cost/benefit generated by the reaction to risks.

2. The research methodology

Depending on the pursued objectives, the study included two successive researches: a qualitative research, exploratory type and a quantitative research, descriptive type.

The exploratory type qualitative research aimed the elaboration of certain hypotheses that have made the object for the further descriptive type quantitative research, the establishment of further research priorities. The methods used in this preliminary research were the following: analysing the secondary information, which involved turning the available information from different sources aiming to discover certain problems, ideas, solutions; the interviews among experts had as objective to get additional information from banking experts; workgroups or focus groups enabled some discussions on the topic.

Depending on the venue, the conducted research was a field research, and depending on the frequency of deployment, the research was occasional.

In formulating the hypotheses, the information and conclusions depicted from the previous exploratory research were had in view.

One of the objectives of the research, described in the paper, is *the analysis of the measures that have to be taken in the banking management for a better management of risks that might cause bankruptcy and of the opinions regarding the RCB responsibilities in the supervision and control of the banks in the system*.

In order to measure the phenomena, several scales and scaling methods were used, which were selected according to the quantity and quality of the desired information, the characteristics of the employed phenomenon, the respondents' capacity, the measuring context and the post-measurement analysis possibilities of the collected information. Under these circumstances, in order to scale the collected information, ordinal scales have been used. The Likert scale was used to measure the ordinal variables.

Two questionnaires were used in the research: A questionnaire for the managers and a questionnaire for the customers of the banking institutions.

The questionnaire for managers was distributed in 45 banks (central, branches) from the Centre Region (the counties of Alba, Brasov, Covasna, Harghita, Mures, Sibiu). 35 questionnaires were returned out of which 5 were annulled due to some errors while filling in. Thus, there are 30 valid questionnaires.

The questionnaire for the customers of the banking institutions was distributed to 340 people (natural individuals and representatives of the legal persons) in Sibiu county. There were returned and validated 300 questionnaires.

In the data processing stage there were used standardised procedures for data encoding and the data processing was done on the computer. The SPSS 10.0 for Windows programme was used, the Microsoft Excel spreadsheet programme included in Microsoft Office XP.

One of the most important limitations of the research consists of the small size of the sample. We mention, however that when the size of the sample was established, the objectives of the research were had in view, considering that the study has a high level of accuracy even if the chosen sample is small.

Considering the purpose of the conducted selective research, the distributed questionnaire was anonymous, researchers ensuring respondents of the confidentiality of the provided information.

3. Conclusions resulting from the research

a. Favourite customers

The proper management of risk, limiting it are very important both for the banks and for any other organisation, regardless of its type or how it is formed. The success of achieving the objectives depends in the end on how managers are concerned about the risk and about how to reduce it. Under these circumstances, one first objective of the research is to know the preferences of the banking managers regarding their type of customers. For this, there was formulated in the questionnaire the question: "In your current activity, what kind of customers do you prefer (managers and other specialists)?" The collected information is summarised in table 1.

Table 1. Favourite customers

Current no.	Valid	Frequency	Percentage
1	Oriented towards preventing risk	19	63,33
2	„We shall see what we are doing tomorrow" type	11	36,67
Total respondents/answers		30/30	100

After processing the information, we can conclude that the majority of respondents (63,33%) would rather work with "customers oriented towards preventing risk", and 36,67% of them have as favourite customers the "we shall se what we are doing tomorrow" type. This makes us wonder why are there bad loans, which are the reasons for granting a loan. In conclusion, the hypothesis stated before the research ($I_{10\ M.S.}$: *In the banking organisation, most managers want to work with customers that take into consideration the prevention of risk in their own companies)* is being confirmed. We believe that financing the "we shall se what we are doing tomorrow" type of customers is a lack of responsibility, in an effort to gain only short term profit.

b. Managed risks

Another objective of the research was to know the respondents' opinion on the risks managed by banks where control and banking auditing can play a key part. The collected data are presented in table 2.

Table. 2. Managed risks

Current no.	Valid	Frequency	Percentage
1	The risk of liquidity	30	100
2	The credit risk	30	100
3	The market risk	15	50
4	The operational risk	15	50
5	The reputational risk	15	50
6	The currency risk	10	33,33

7	The transfer risk	5	16,66
8	The price risk	5	16,66
9	The rate of interest risk	5	16,66
10	The risk of insolvency	5	16,66
11	The risk of management	5	16,66
12	The resource risk	5	16,66
13	The risk of the activity	5	16,66
Total respondents/ answers		30/150	

Processing the collected information outlined the fact that the majority of managers from the banking institutions know the five major risks in the banking activity managed with signs of danger, where the control and banking auditing may play a key part.

According to banking managers and specialists, the five major risks in the banking activity are:

- the credit risk, according to 100 % of the questioned managers;
- the liquidity risk, according to 100% of the questioned managers;
- the market, operational, reputational risk in a proportion of 50% from the questioned managers.

Consequently, the stated hypothesis (*Most managers know the five major risks in the banking activity, managed with signs of danger, where control and banking auditing may play a key part*) is being confirmed.

c. Measures to diminish risks

Reverberating bankruptcies of banking institutions and not only were due to some known risks, but unconsidered by the management. It is the most serious error that happened to banks, with the most known consequences worldwide. From this perspective, the third objective of the research aimed to identify certain measures which, according to the bank managers, may prevent such situations. The collected information is presented in table 3 with a graphic representation in figure 1.

Table 3. Measures to diminish risks according to managers

Current no.	**Valid**	**Frequency**	**Percentage**
1	Prudential regulation of the banking activity	14	46,66
2	Involvement of material responsibility	14	46,66
3	Giving up on high-risk banking products	12	40
4	Medium and long term risk analysis	9	30
5	Granting good loans	9	30
6	Compliance with the regulations of the NBR	8	26,66

7	Orientation on the customer and not exclusively on profit	8	26,66
8	Forecasting risk, not only analysing it	8	26,66
9	Maintaining the balance between raised or placed resources	4	13,33
10	Developing new procedures to fight or diminish risk	2	6,66
11	Changing the managing team that does not take measures to reduce risk	2	6,66
Total respondents/ answers		30/90	

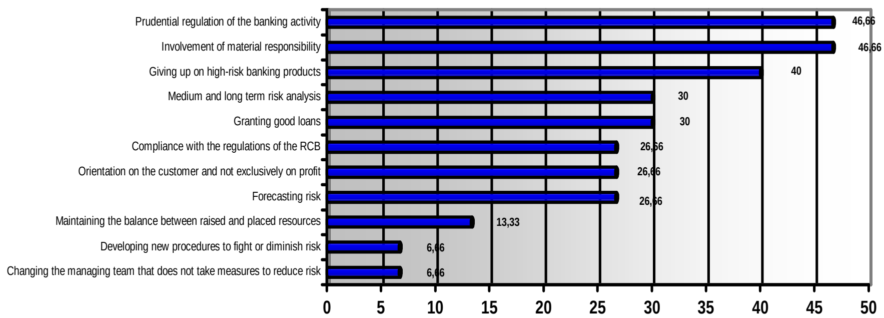

Figure 1. Measures to diminish risks according to managers

After processing the collected information, we can notice that according to most respondents (46,66%) there are required two measures that should be adopted by the banking management in order to prevent banking bankruptcy: “The prudential regulation of the banking activity” and “The involvement of material responsibility”. At a close distance (the option mentioned by 40% of the respondents) is “Giving up on high-risk banking products”. The lowest percentage (6,66%) is for “The development of new measures to fight or diminish risk” and “Changing the managing team that does not take measures to reduce risk”.

In our opinion, the most important three measures that should be adopted by the banking institutions, under the current economic context, are the following:

- „Giving up on high-risk products” – mentioned by 40% of the respondents;
- „ Orientation on the customer and not exclusively on profit” – mentioned by 26,66% of the respondents, which shows the interest for profit to the detriment of the careful study of the customer, a conclusion also supported by the processing of the answers for point a. “Favourite customers”;
- „ Forecasting risk, not only analysing it” – option mentioned by only 26,66% of the questioned persons.

The hypothesis stated before the research (*Most bank managers know the measures that should be adopted by the banking management in order for the Romanian banks to properly manage the risks that may cause bankruptcy*) is being confirmed.

The data collected from the banks' customers is shown in table 4.

Table 4. Measures to diminish risks according to customers

Current no.	Valid	Frequency	Percentage
1	Involvement of material responsibility	210	70
2	Forecasting risk, not only analysing it	200	66,66
3	Improving regulation in the field of risk analysis and strengthening control	180	60
4	Giving up on sophisticated, high-risk products	110	36,66
5	Orientation on customer, and not exclusively on profit	90	30
6	Awarding managers according to the volume/value of loans	20	6,66
Total respondents/ answers		300/810	

After processing the collected information, we can conclude that most interviewed customers (70%) consider that in order to diminish risks the involvement of material responsibility is required. Moreover, 66,66% of the respondents consider that one measure is the improvement of regulations in the field of risk analysis and control strengthening.

Therefore, the hypothesis stated before the research (*Most customers do not know the measures that should be taken to reduce the risks that might cause the bank's bankruptcy) is invalidated.*

d. Opinions on the responsibilities of the National Bank of Romania in preventing risks

The National Bank of Romania, through its surveillance and control activity, plays a decisive part in establishing banking order and discipline and preventing risks in this field. Under these circumstances, the respondents – the managers of the banking institutions – were requested to mention two opinions on the responsibilities of the National Bank of Romania the field of risk prevention. The collected information is presented in table 5 with.

Table 5. Responsibilities of the National Bank of Romania in preventing risks according to managers

Current no.	Valid	Frequency	Percentage
1	NBR responsibilities are limited as compared to the international and national macroeconomic and financial context	15	50,00
2	NBR supervision is beneficial for the Romanian banking system	12	40,00
3	NBR inability to monitor and control the flows towards the parent banks	12	40,00
4	Compliance with the regulations	11	36,66
5	The NBR provisions on reducing risk in the banking activity have prevented collapses of middle-sized banks	5	16,66
6	Greater supervision and control of the NBR	5	16,66
Total respondents/ answers		30/60	

The research has outlined that according to 50% of the respondents, “NBR responsibilities are limited as compared to the international and national macroeconomic and financial context”, and 40% of them consider that “The NBR is unable to monitor and control the flows towards the parent banks”. We have also noticed that 40% of the respondents appreciate the fact that “NBR supervision is beneficial for the Romanian banking system”.

Consequently, the hypothesis stated before the research (*Most managers and bank specialists know the responsibilities of the NBR that play a decisive part in establishing order and banking discipline and prevent risks in the banking field*) is being confirmed.

The information collected from the customers of banking institutions is shown in table 6.

Table 6. Responsibilities of the National Bank of Romania in preventing risks according to customers

Current no.	Valid	Frequency	Percentage
1	Greater supervision and control of flows towards the parent bank	220	73,33
2	Control responsibilities are limited, only for the banks with Romanian capital	210	70
3	NBR actions should be directed towards imprinting a tendency to reduce interests and reviving lending	70	23,33

4	Increasing transparency of the NBR control	50	16,66
5	NBR banking prudential policy	50	16,66
Total respondents/ answers		300/600	

After processing the collected information we notice that most of the respondent customers (73,33%) claim that there can not be an financial order and discipline as long as the National Bank of Romania is not allowed to, according to the provisions on the subject, control the transfers of foreign currency towards the parent banks. Moreover, 70% of the respondents admit that there can not be a financial discipline as long as the control responsibilities are limited only to the banks with Romanian capital.

In conclusion, the stated hypothesis (*Most customers do not know the NBR responsibilities that play a decisive part in establishing the banking order and discipline and preventing risks in the banking field*) is not valid.

References

Bărbulescu Christiana; Romascu, Gabriel; Diaconu, Anca; Diaconu, Ştefan (2002), *Aspecte privind managementul riscului şi utilizarea sa în activitatea decizională din domeniul transportului energiei electrice*, http://www.stcv.ro/timisoara/s_tm2002/13b/13a.htm

Ciuhureanu Alina-Teodora, (2009), *Management financiar*, Lucian Blaga University Publishing House, Sibiu, p. 155

Ciuhureanu, Alina, (2005), *Importanţa managementului riscului de firmă în condiţiile schimbării mediului de afaceri*, Cotidianul Tribuna Sibiu, no. 4240, p. 23.

Constantinescu, Dan Anghel; Dobrin, Marinică, (1998), *Asigurarea şi managementul riscului*, Tehnica Publishing House, Bucureşti, pp. 40-41

Dijmărescu, Ion, (1998), *Managementul inteligenţei economice*, Lumina Lex Publishing House, Bucureşti, p. 189

Drury, Colin, (1992), *Management and Cost Accounting*, Chapman & Hall, London

Faulkner, David; Bowman, Cliff, (2000), *Elemente de strategie concurenţială*, traducere, Teora Publishing House, Bucureşti, p. 105

Haubrich, G. Joseph, (2001), *Risk Management and Financial Crises*, http://econpapers.hhs.se/ article/fipfedcec/y_3A2001_3Ai_3Afeb1.htm

Isaic-Maniu Irina, (2010), *Măsurarea şi analiza statistică a riscului în România. Suport de curs,* http://www.biblioteca-digitala.ase.ro/biblioteca/carte2.asp?id=206&idb=, cap. 4

Lewis, S. Pamela; Goodman, H. Stephen; Fandt, M. Patricia, (1995), *Challenges in the 21st Century*, South-Western College Publishing, Cincinnati, p. 648

Mihalcea, Radu; Androniceanu, Armenia, (2000), *Management: fundamente, interferenţe, studii de caz, soluţii*, Economică Publishing House, Bucureşti, p. 317

Soviani, Paul, (2003), *Management eficient – prin Strategic Performance Management de la SAS -* , Revista “Finanţe publice, contabilitate”, no. 7-8, p. 39

*** *Enhancing Shareholder Wealth by Better Managing Business Risk*, study 9, International Federation of Accountants (IFAC), Financial and Management Accounting Commitee (FMAC), PricewaterhouseCoopers, june 1999, http://www.ifac.org/Store/ , pp. 26-27