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Risk Management in Banking: A study of Contentment in Indian Private Banks

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ABSTRACT

Risk is an unpredictable approach which every business or organization need to go through. To understand the financial behavior one first need to understand what is Risk and its effect on private banking.Considering, the present era, increasing competition, has made risk management an important element for the banking industry. Financial institutions should take charge of risk in order to manage efficiently.Risk managementis a method to arrange ,lead ,sort out,and manage the broad mixture of danger to adjust into the structure of organizational routine work long termly and short termly. As risk management, different banks adopt different risk management system, they bifurcate risk into Credit risk, Market risk and so on. The aim of the study is to analyze that whether private banks are satisfied with their risk management system, as every bank carries a risk management approach.Current paper also, talks about the risk and its effect on Private Banks. It includes its types and process of risk management. Paper includes a survey (Questionnaire) filled by 5 private banks which is further analysis through F-Test and ANOVA.

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Introduction

Meaning of risk

"Managing a business in a volatile environment is just like navigating a ship in turbulent weather."

Before starting with any other definition it is very important to understand and study what is risk and how it affect business or organization, especially with respect to banking sector. According to different author's, risk management depicts as anact of activities considered to reduce the negative impact of uncertainty regarding the probable losses occurred by the organization. There are different tools and models for calculated the risk. From last many centuries banking sector has flourish themselves from many phases. As in staring from simply banking like lending and borrowing to the complicated region like hedge funding investment portfolios, etc and with all this they have realize to mange a very important factor called Risk.

The objectives of risk management include to:

- Reduce remote trade misfortunes,
- decrease the unpredictability of money streams,
- Guard profit variances,
- Add to benefit,
- Make sureendurance of the organization.

The risk administration is a mind boggling capacity and it's requires particular aptitudes and ability. All around, banks have been moving towards unifying risk administration with an incorporated treasury administration capacity. The essential obligation of comprehension the risk keep running by the banks and guaranteeing that the risk is fittingly oversee.

The broad parameter of risk management function should encompass:

- Given the mixture of balance sheet profile, it is hard to embrace a consistency structure for management of risk in India. The outline of Risk Management ability ought to be bank specified, managed by the size, density of capacity, the level of specialized mastery and the nature of MIS.
- Organizational structure: A noteworthy issue in setting up a suitable risk administration association structure is picking between a centralization and decentralization.
- Comprehensive risk administration approach: an essential for foundation of a viable risk administration framework is the presence of a vigorous MIS, reliable in quality. The current MIS, however, obliges considerable up degree and reinforcing of the information gathering.
- Risk administration approaches endorsed by the Board which ought to be steady with the more extensive business systems, capital quality, administration aptitude, and general readiness to expect hazard. Guideline and different parameters used to represent risk taking incorporates point by point structure of prudential points of confinement.
- Highly efficient MIS for reporting, checking and calculatingrisks.
- Sound methods, successful control and complete risk reporting structure
- Separate hazard administration structure autonomous of operational divisions and with clear outline of levels of obligation regarding administration of risk
- Periodical audit and assessment

Types of risk

- The risk undergone by the investors, government and corporate is called Political risk.Such risk can be diluted by foresight and best speculation.

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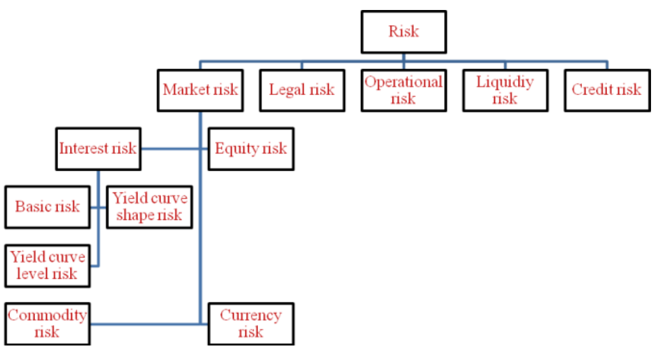
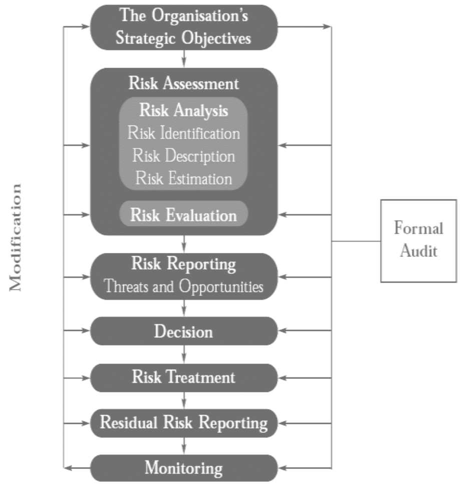
- Non-monetary risk: The risk connected with the procurement of managing an account administrations contrast by the sort of administration rendered. Diverse creators have gathered these risks in different approaches to add to the systems for their investigations, however the ones which are well thought-out in this study are credit risk, business sector risks (which incorporates liquidity risk, premium rate risk and remote trade risk), operational risks which infrequently incorporate legitimate risk, and all the more as of late, key risk.
- Financial Risk: Financial risk is a collection of different types of risk related tomoney, including budgetary trade that combineorganization credits inrisk of default. Risk is a term habitually used to propose downside risk, impact the insecurity of a landing and the potential for cash related disaster.
- Credit risk: Credit risk emerges from the possibility that an obligor is either reluctant to carry out on a commitment or its capacity to perform such commitment is disabled bringing about financial misfortune to the foundation.
- Borrower hazard: a purchaser may overlook to make payment due on a home loan credit, charge card, line of credit, or other advance.
- Industry hazard: an organization is not able to reimburse sums secured by a settled or drifting charge over the advantages of the organization.
- Market risk: business sector risk is the risk that the estimation of a portfolio will diminish because of the adjustment in estimation of the business risk variables. The four standard business risk variables are stock costs, interest rates, outside trade rates, and ware costs.
- Interest rate hazard: It is the risk that intrigues (e.g. Libor, Eurobor, Inflation, and so forth) and/or their inferred unpredictability will change.
- Liquidity hazard: liquidity risk is the risk that a given security or resource can't be exchanged rapidly enough in the business sector to keep a misfortune.
- Operation hazard: an operational risk is characterized as a risk emerges because of the exercises of business operation. Operation chance fundamentally concentrates on risk emerges from the three segment of a business i.e. individuals, framework and procedure. It is further ordered into legitimate risks, physical or ecological risk, extortion risks.
- Strategic Risk: Strategicrisk is the risk that emerges as of the failure to putting right marketable strategies and techniques enthusiastically, it likewise emerge because of the absence of versatility and choice making concerning dispersion of assets in the business/ working environment.



Process of risk

Risk management as anplanned course of action for the classification and valuation of pure loss coverage faced by an organization or an individual, and for the assortment and execution of the most appropriate technique for treating such exposure. The process involves: classification, dimension, and administration of the risk.



Effect of risk management on banking sector

- Its help in keeping information confidential which further help in controlling the risk
- It helps in diversification of risk
- Risk management focus on corporate governance and also helps in careful restructuring of the alliance.

Numerous private banks official accept that the business' increased concentrate on risk administration is a standout amongst the best result of the emergency, constraining senior administration to in a broad sense reexamine their key way to deal with risk. The following are three methodologies private banks are taking.

• Reassessing and incorporating risk hankering: sheets and senior administration are plainly characterizing risk resilience and limits the level acknowledgement hazard must be evaluated and decided for every risk sort and line of business. Unique business objective, powerless correspondence and spotty implementation can bring about disengagement between the risk parameters set at the board and senior administration level and normal administration of the business.

• Strengthening risk ID procedures: banks are taking a gander at risk comprehensively and accepting a more careful position in risk distinguishing proof strategies and systems. Change here incorporates day by day constant checking of risk, stricter portfolio risk evaluating, and more tightly screening of on boarding method for new customers. A few establishments have framed new cross useful risk ID board of trustees made out of supervisors from fund, hazard, innovation, agreeability, treasury, bookkeeping and the specialties units.

Literature review

Crouhy, Gala, Marick have budgetary establishment compressing the consideration rule of big business wide Risk Management, according to the authors, Risk Management society ought to permeate from the panel level to the most lower level representative. Organizations will be obliged to make noteworthy speculation important to conform to the most recent finestapproaches in the novel era of Risk parameter and Management, commercialsupremacyguideline with the approach of Sarbanes-Oxley Act and a few other enactment in different nations additionally give the system to perfect Risk Management outlook. Until now, endeavor wide Risk Management existed just for name purpose. By and large firms did not initiate a really coordinated arrangement of Risk measures, systems or Risk Management Architecture. The following decades will introduce another arrangement of Risk Management instrument enveloping all the exercises of a business. The coordinated Risk Management framework would wrap ranges like Corporatefulfillment, Corporate supremacy, Capital Management, and so forth. As dependably it will be the Banks and the budgetary Service firms which will lead the route in this transformative procedure. The agreeability necessity Of Basel II and III concurs will likewise oblige banks andto put set up vigorous Risk Management approaches.

Carl fesenfeld outline the examples of global Banking regulation and the wellsprings of overseeing law. He surveyed the present practices and advancing changes in the field of control frameworks and administrative environment. Managed a large territory of administrative part of Banking in the United States, regulation of worldwide Banking, global Bank administrations and universal financial trade. The work endeavored inside and outside investigation of all parts of Bank Regulation and Supervision. Money laundering has been of genuine concern around the world. Its risk has wide repercussions.

Hannan and Hanweck.felt that the bankruptcy for Banks turns out to be genuine when current misfortunes deplete capital totally. It additionally happens when the return on Assets (ROA) is not exactly the negative capital-asset ratio. The likelihood of bankruptcy is clarified as far as a mathematical statement p,1/2(Z2). The assistance of Z-statistics is usually utilized by Academicians in registering probabilities.

G. Dalai, D.Rutherberg, M.Sarnat and B.Z. Schreiber Risk are characteristic for managing an account. However that administration of risk has picked up noticeable quality in perspective of the developing modernity of saving money operation, subsidiaries exchanging, securities, guaranteeing and corporate counseling business and so on.

RekhaArun Kumar and Koteshwar felt that the Credit Risk is the most established and greatest risk that Banks by prudence of their exceptional nature of business acquire. The prevalence of credit risk is the principle segment in the capital distribution. According to their assessment, credit risk takes the significant piece of the Risk administration device representing more than 70 % of all Risk.

S.K.Bagehi observed that in the realm of back all the more particularly in Banking, Credit Risk is the most prevalent risk in Banking and possesses approximately 90-95 % of risk portion. The remaining portion is by virtue of business sector risk, operational risk, and so on, he feels that such an extensive amount concern on operational risk is lost. According to him it might be only one to two % of banks risk.

Problem definition

The problem of the research is to analysis the prevailing trends of different banks using the different tools and techniques of risk management and the satisfaction of the bank employees regarding those tools and techniques.

It is fundamental to declare that private banking industry, risk management is not that build up and most of the private banks are willing to adopt new and innovative technique for other successful financial institutions.

Research objective

The Indian private banking industry is a very large industry consisting of number of portfolios and investment. In this era of competition different private's banks have different risk management objectives. As risk is unpredictable, this study helps in finding out the necessary facts regarding Banks opinion and perception regarding Risk Management system. The main objective of the study is:

- Whether, Private Banks are following effective or satisfactory risk management system for managing the risk.

Hypothesis

In this hypothesis statement there are two hypotheses the null (Ho) which states that there is no relationship between the two variables and the alternative hypothesis (H1) that states that there is a relationship between the two variables.

- H0: Private Banks are not satisfied with the risk management method adopted by them.
- H1: Private Banks are satisfied with the risk management method adopted by them

Research Methodology

Instrument of survey

We have taken questionnaire as an instrument of survey.It is considered as the finest method to collect the primary data. Reason being, as it is less costly and less time Consuming. Moreover, the questionnaire cannot lead to incline the interviewer. This questionnaire contains the questions related to whether private banks are following effective and satisfactory risk management system for managing risk.

Primary data is collected through questionnaire and secondary data is collected through various magazines, internet and books.

- **Sampling method**

Data collected for this study is comprises through convenient and random sampling.

- **Sampling unit**

Private Bank

- **Sample size**

5 Private Banks

- **Statistical tools and technique**

ANOVA

Data Analysis

After dealing with branches of different private banks in India, the survey questionnaire was mailed to 10 different private banks branches where, 50%response achieved, which is, 5 responses. The questionnaire was coded and the responses were processed in the Microsoft Excel in order to analyze them further and reach conclusion.

Internal Risk Rating System is an essential apparatus in checking the nature of individual acknowledges and additionally portfolios. A very much organized internal rating framework is a decent method for separating the level of risk in distinctive exposures of a bank. An internal risk rating system orders risk into different classes. To proceed with, the questionnaire contains closed questions and questions with the type of Likert scale so as to analyze how firmly the sample agrees or disagrees these inquiry furthermore to evade deviation in their answer that can prompt misconception.

Table 1. Ranking System

Factors	Rating
Highly Satisfactory	5
Satisfactory	4
Neither Satisfactory Or Dissatisfy	3
Dissatisfy	2
Highly Dissatisfy	1

The set of risk factors that measure risk in each business unit such as integrated risk management system, ERP model, Robust MIS, Two track approach, survival strategies for liquidity, credit and interest rates, etc

Table 2. Ranking the kind of factors preferred by the respondents

Particulars	Yes Bank	ICICI	INDUSIND	HDFC	KOTAK
Integrated Risk Management System with Treasury management	4	3	3	3	4
Hi-Tech system of measuring risk like ERP	4	3	4	4	2
Robust MIS for Data Integrity & Reliability	3	4	3	5	3
Separate Risk Management System for Operational Department	3	4	4	4	3
Two-track approach of Risk Management	3	3	3	3	3
Comprehensive Risk Measurement Approach for risk ascertainment	5	4	5	5	5
Survival Strategies for liquidity & interest rate risk	4	4	4	2	4
NPA's Strategies	5	4	5	4	5
NPA's Surveillance System	5	5	5	4	5
Periodical Reviewing of Risk	5	5	5	4	5

The data analysis was done through rating method for study of risk and statistical method for testing the hypotheses. Also we used F-test analysis for testing equality of variance within banks and risk factors. Analysis of Variance, or ANOVA, is used for testing difference within and between several group means of risk in selected banks and difference within and between means in risk factor.

Table 3

Summary				
Groups	*Count*	*Sum*	*Average*	*Variance*
Column 1	10	41	4.1	0.766667
Column 2	10	39	3.9	0.544444
Column 3	10	41	4.1	0.766667
Column 4	10	38	3.8	0.844444
Column 5	10	39	3.9	1.211111

ANOVA						
Source of Variation	*SS*	*df*	*MS*	*F*	*P-value*	*F crit*
Between Groups	0.72	4	0.18	0.217742	0.927189	2.578739
Within Groups	37.2	45	0.826667			
Total	37.92	49				

SS = sum of squares, df = degrees of freedom, MS = mean square (SS/df)

The P-value of 0.000 is less than the significance level (0.01), so we cxan reject the null hypothesis and safely assume that Private Banks maintains the risk management system in there organization.

The P value (0.927189) is greater than the significance level (0.01), so we can reject the null hypothesis that the means are equivalent. F (0.2177) is less than F crit (2.578), so again, we cannot accept the null hypothesis.

Conclusion

The above study signifies that, there is a large difference between theory and practice for the risk reduction in Private Banks in India. Considering the Risk factor, Private Banks has a negative impact of risk management as in MIS data integrity, no enough data and useful data system, Two track approach of Risk management is missing. In the same manner Private Banks also appreciates the positive impact of risk management in certain risk factors like NPA's strategies, NPA's Surveillance, Periodical reviewing of risk management.

In the end, lets conclude, by coding that undoubtedly banking risk management will continue to grow from a negligible to a major factor in banking management, turning from a defensive weapon to an important part of the offence. It means Private banking industry is showing the boom and is keeping up with updated tools, capability, constancy and force of a financial system.

Private banks also required a proper structure for risk identification, analysis and easing process can moderate the risk associated with private banks and it need to develop properly educational programs and work shop.

From the above analysis it is proved that some where private banks are not highly satisfied with their system. But down the line by improving their approaches and tools banks can increase their level from satisfied to highly satisfied.

"…………………………A bank's success lies in its ability to assume and aggregate risk within tolerable and manageable limits"

Limitation

- The researchers needed to face a ton of trouble in assembling the essential information as the bank authority faltered to give the information to examination and understanding of risk.
- Being risk management a new idea the awareness about the concept is not much seen in bank staff.

- The credit score models are being created by different banks separately it is not in broad public area. So detail dialog on this theme is not being conceivable.
- Due to the absence of experience, it was hard to guarantee that the surveys were adequately compose.
- Inadequate time in order to conduct the research and to analyses the finding.
- The reduce number of responses from Private Banks was another important limitation.

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