RESEARCH PAPER | Management | Volume : 6 | Issue : 5 | May 2016 | ISSN - 2249-555X | IF : 3.919 | IC Value : 74.50

The Analysis of Key Risk Indicators in Banks

KEYWORDS

* Frank Mtaki	Dr. B. Ganesh
Ph.D. student, Kuvempu University, Department of Management, Jnanasahyadri, Shankaraghatta 577451, Shimoga, Karnataka * Corresponding author	Director CDC & Research Supervisor, Kuvempu University, Department of Management, Jnanasahyadri, Shankaraghatta 577451, Shimoga, Karnataka.

ABSTRACT *The Banks role in risk management has come under increased scrutiny, resulting in tightening risk policies and increased regulation. While theory predicts that Bank risk management can benefit by increasing banks profit, financial stability, researchers argue that failure in analyzing and measure risk indicators in response to bank management practices may simply be window-dressing. Using survey data on risk management practices, we examine the influence of risk management indicators on creating equitable risk governance in banks. We find that risk awareness, tone of the top, training, the independency of risk department and audit responsibilities to be a major indicators of risk management in banks, with greater analysis in banks that assign responsibilities to the risk officers as well as its committees.*

Introduction
Risk is one of those concepts that can be defined in different ways. Gallati (2003) defines risk as a condition in which there exists an exposure to adversity, or a state in which there exists a possibility of changes from a desired outcome that is expected or hoped for. According to (Bessis, 2002; Machiraju, 2008; Schroeck, 2002) involves the restriction that risk is based on real world events, including a combination of circumstances in the external environment.

Risk management can be regarded as an active, strategic, and integrated process that encompasses both the measurement and the mitigation of risk, with the ultimate goal of maximizing the value of a bank, while minimizing the risk of bankruptcy (Schroeck, 2002). Risk management is often performed by an organizational unit, ideally an independent staff function reporting directly to the board of directors, making risk management a board responsibility and task.

The board has to set strategic targets and ensure, via strict controls, that the delegated goals are actually achieved within the centrally mandated guidelines. Running a risk management function in a centralized manner is advantageous because it allows for an independent, integrated view of all types of risk, so that only the net positions need to be managed and specialized staff can achieve better pricing in the capital markets. Management has to develop strategic goals for the various risk areas (risk strategy) that are proportionate with the ultimate objective to maximize company value.

If the bank does not want to avoid some risk, it can decide to transfer it to other market participants. The decision to transfer the risk to other market participants is made on the basis of whether or not the bank has a competitive advantage in a specific segment and whether or not it can achieve the fair market value for it. The alternative to transferring risks is to keep the risks, to absorb (manage) them. Some risks must or should be absorbed at the bank level, because they are to complex, or cannot be traded or hedged easily or they are a business necessity. Some risks play a central role in the bank's business purpose and should therefore not be eliminated or transferred.

The main objective of the study is to analyze risk management practices in banks by focusing on the relationship between basic bank practices.

Review of earlier works
Survey has been conducted by different researchers in the area of risk management. Al-Tamimi and Al-Mazrooei (2007) in their study concluded that the most common types of risk facing the UAE commercial banks are foreign exchange risk, credit risk, and operating risk. Risk identification, risk assessment and analysis are the most influencing variables in risk management practices. The paper opined that, UAE banks should emphasize risk management practices for the survival of banks in the business. Alam and Masukujjaman (2011) discussed the risk management practices of some selected commercial banks operating in Bangladesh; they explained types of risk facing the banks, procedure and techniques used to minimize the risk. The study reveals that banks are facing credit risk, market risk and operational risk. Credit risk is the biggest risk facing banks, Risk management Committees monitors risk and the Audit Committee oversees all the activities of banking operations. The overall study depict that, the performance of risk management in Bangladesh is in a moderate form. Nazir et al (2012) explore the current risk management practices that are adopted by commercial and Islamic banks in Pakistan, they found that, that there is significant difference in risk management practices of the Islamic and conventional banks of Pakistan.

Hypotheses of the study
H1. Risk awareness is positively related to effectiveness of risk management in banks

H2. Tone at the top is positively related to the type of bank

H3. Risk training is positively associated to effectiveness of risk management in banks

H4. Independency of risk department and audit have positive association to the effectiveness of risk management in banks

Methodology

The descriptive research has been used to design the study that basically involve obtaining information concerning the risk management in banks. The survey was done in eight large banks based on asset size that operate in India in which two hundred respondents who are bank managers and the risk officers were involved. The survey covered the period from December 2015 to March 2016. The theoretical secondary information was used for reviewing earlier works. The data was analyzed by using SPSS version twenty.

Analysis

Table 1, show summary descriptive statistics. We find that, the average proportion of gender is 0.90. In terms of education level, we see that the average proportion is 1.45, majority of the respondents have post-graduation during the time of survey. The average experience level is 2.78, there is adequate experience level in understanding banking risk activities. The respondent's average 3.62 urged that, they are aware of the risk management process taking place in their banks. The respondent's average 3.43 urged that, tone at the top is important in assuring effectiveness of risk management in banks. The other indicators shows that the average 3.59, 4.63 and 2.86 of the respondents reveals that, risk Training, Risk independency and Board oversight are very important for effectiveness of risk management in banks. The descriptive results reveals that, risk independency has the highest mean, respondents have recognized the importance of independency of risk department and audit. The respondents are aware of the risk management in banks. Generally, the responds have sufficient understanding of risk indicators and their role towards risk management process in banks.

Table 1: Summary descriptive Statistics

Variables	Mean	Std. Dev.	Min	Max	N
Gender	0.90	0.63	0.00	1.00	200
Education	1.45	0.56	1.00	2.00	200
Tenure	2.78	3.16	1.00	3.00	195
Bank type	0.19	0.93	0.00	1.00	200
Risk effectiveness	4.68	0.52	4.00	5.00	192
Awareness	3.62	0.78	3.00	5.00	194
Tone at the top	3.43	0.80	2.00	5.00	200
Training	3.59	0.66	3.00	5.00	197
Risk independency	4.63	0.59	3.00	5.00	200
Board oversight	2.86	0.64	2.00	4.00	200

Source: Field survey

Table 2 presents the correlations between the variables. First, we find the correlations between the risk indicators variables. Although we argue that these variables are separate constructs, it is not surprising that they are significantly related, as they are all measures of different aspects of risk management.

Hypothesis 1. Risk awareness is positively related to effectiveness of risk management in banks

It is observed that, Risk awareness is positively related to effectiveness of risk management in banks. Risk awareness includes: awareness of bank mission, vision and its objectives, awareness of types of risk facing banks, awareness of risk policy and its application have a positive impact on the effectiveness of risk management. The risk officers opined that, risk awareness should be the central issue to start in during the process of risk management.

Hypothesis 2. Tone at the top is positively related to the effectiveness of risk management

We find the significant positive relationship between the tone at the top and effectiveness of risk management in banks. The respondents urged that, the board and senior management are the starting point for setting the financial bank's core values, their behavior must reflect the values being espoused. A key value that should be understood is that, the lower bank employees follow orders from the top level. When the bank executives doing what they say, they influence other employees to follow the same, the appropriated behavior or information from the top might lead the whole organization towards effectiveness of risk management.

Hypothesis 3: Risk training is positively associated with effectiveness of risk management in banks

We find that, there is significant positive association between risk training and risk management effectiveness in banks. Risk training should be tailored according to the needs and objectives of banks. Risk training helps in keeping aware, updating skills and knowledge of the trainees regarding methods, principles of risk management in banks. The more the risk training the more the effectiveness of risk management in banks. In order to strengthen risk management banks have to schedule risk training in the operating calendar year.

Hypothesis 4. Independency of risk department and audit have positive association to the effectiveness of risk management in banks

The Pearson correlation shows the positive significance between independency of risk department and audit and effectiveness of risk management. The strongly independency helps to reduce interference from other departments or any kind of influence in fulfilling its activities and in making decisions regarding risk, and so maintaining confidentiality. The more independency of risk department and audit, the more risk management effectiveness in banks.

Table 2. Pearson Correlations for Variables

Variables	1	2	3	4	5	6	7	8	9	10	11
Gender	1.00										
Education	-.127	1.00									
Tenure	.093	-.076	1.00								

Volume : 6 | Issue : 5 | May 2016 | ISSN - 2249-555X | IF : 3.919 | IC Value : 74.50

Bank risk	.060**	.017**	.056**	1.00							
Bank type	-.023	.029**	-.027	-.041**	1.00						
Risk management effectiveness	.157**	-.053	.102	.043	.022	1.00					
Risk awareness	-.202**	.102	.057**	.128	.051**	.009**	1.00				
Tone at the top	.114	.084**	.050**	.043*	.016**	.038**	.124**	1.00			
Risk Training	.035**	-.038	-.040	.035**	.009**	.073**	.043*	.007	1.00		
Risk independency	.079	.055*	.090	.257**	.040**	.142**	-.091	.114**	-.024	1.00	
Board oversight	.047**	.115	.050**	-.083*	.056**	.028**	-.090*	.094**	.068	.025	1.00

Source: Field survey

*. Correlation is significant at the 0.05 level (2-tailed).

**. Correlation is significant at the 0.01 level (2-tailed).

The variable for risk management is positively and significantly correlated with gender (coefficient: 0.157, $p<0.01$); Risk awareness (coefficient: 0.009, $p<0.05$), Tone at the top (coefficient: 0.038, $p<0.01$), Risk training (coefficient: 0.073, $p<0.01$), Risk independency (coefficient: 0.142, $p<0.01$) and Board oversight (coefficient: 0.028, $p<0.01$) are significant correlated with risk management effectiveness.

Conclusion

Risk management should be a continuous, integral and developing process which runs throughout the Banks's strategy and the implementation of that strategy. The Board management has to ensure efficient risk governance which includes ensuring maximum Risk awareness, tone at the top, risk training, independency of risk department and risk officers. All risk indicators should be measured and analyzed clearly to energize the process of risk management in banks. Risk management structures and related strategies should be embedded in a bank's risk framework to ensure effective financial stability.

References

1. Alam and Masukujjaman (2011): Risk management practices: a critical diagnosis of some selected commercial banks in Bangladesh, Journal of Business and Technology, Volume–VI, Number–01.
2. Al-Tamimi, H., Al-Mazrooei, F. (2007), "Banks' Risk Management: A Comparison Study of UAE National and Foreign Banks", the Journal of Risk Finance Vol. 8, Issue: 4, pp. 394 – 409
3. Bessis, J (2002). "Risk management in banking", John Wiley & Sons Ltd
4. Gallati, R (2003). Risk management and capital adequacy, New York: McGraw-Hill
5. Machiraju, HR (2008). Modern commercial banking, 2nd edition, New Delhi: New Age International (P) Ltd. Publishers
6. Nazir, M.S., A.Daniel and M.M, Nawaz (2012): «Risk management practices: A comparison of conventional and Islamic banks in Pakistan», American Journal of Scientific Research, Issue 68, pp. 114-122.
7. Schroeck, G (2002). Risk management and value creation in financial institutions, New Jersey: John Wiley & Sons, Inc.