Journal of Informatics Education and Research
ISSN: 1526-4726
Vol 5 Issue 1 (2025)

Risk Management in Indian Banks: Analyzing Strategies and Practices in a Globalized Economy

Dr. Ramanjeet Kaur,
Ms Ashwarya Sharma,
Dr. Ranjna
Assistant Professor,
Department of Commerce
Chandigarh School of Business, CGC , Jhanjeri – 140307 , Mohali , India
aujlaraman889@gmail.com

ABSTRACT
Any financial institution must fundamentally understand risk and how to manage it. Risk management, which is the use of proactive strategy to plan, lead, coordinate, and control the vast array of hazards that are incorporated into the fabric of an organization's daily and long-term operation, is essential to the organization's overall success. Due to intense competition, shifting socioeconomic trends, market flexibility, a rise in cross-border activity, and greater foreign currency transactions, risk exposure in the banking system has recently expanded globally in a variety of ways. In most growing economies, including India, the financial sector, particularly the banking sector, is undergoing transition. The developments of novel goods and delivery methods, as well as increased global competition, have elevated risk management to the fore of today's financial scene. The secret to success will be having the ability to assess the risks and take the proper action. The goal of this article is to identify distinct risk types that go into risk analysis in Indian banks. It also looks at the various methods used by bank management to handle these risks in light of Basel committee guidelines. The study mostly uses secondary data from books, journals, and online publications.

Keywords: Risk management, Indian banks, Basel Committee guidelines, Risk analysis Financial sector, Globalization

1.Introduction

Due to the intense competition they face, banks have evolved from a financial intermediary into a risk intermediary, forced to deal with a wide range of financial and nonfinancial hazards. As with any other business, banking is inherently risky in today's uncertain environment. There is now an obligation on banks to distinguish between risks that they can and cannot control, and to concentrate on the latter. Banks face a significant threat to the stability of the financial system if they do not effectively manage risk, or make a balanced choice between the risks they take and the potential rewards they receive. As was most evident during the 2008 financial crisis, unsafe risk management methods controlling bank lending frequently play a significant role in financial turbulence. Most significant in the banking industry is the credit risk associated with loans and forward contracts. The possibility of loan repayment defaults or prolonged arrears is known as credit risk (Tamimi et al., 2007). For most banks throughout the world today, loans are the primary and most evident sources of credit risk, as stated in a consulting document published by the Basel Committee on Banking Supervision (BCBS, 1999). The danger that a bank borrower or counter party won't pay its debts as they come due is known as credit risk. Borrower noncompliance could result from the borrower's incapacity or reluctance to carry out the terms of the original contract. The ownership structure and composition of a bank has a significant impact on the bank's strategy and policies. The private versus public ownership status of a bank also has an effect on the culture, beliefs, and practises of the company. As a result, the degree to which each type of bank is exposed to credit risk varies (Arora et al., 2011). For a healthy economy to thrive, the banking system must be stable. Financial organisations like banks are extremely fragile since they rely on their customers' faith, the strength of their brand name, and, most importantly, the use of high-risk leverage. Banks are vulnerable to failure, and even the collapse of a single bank can have a devastating effect on the economy (Rajadhyaksha, 2004). Unfortunately, many industrialised and developing countries have experienced catastrophic banking crises despite the fact that they have enacted strict laws over the past two decades. As a result, financial institutions must create a system with low vulnerability. Financial institutions need to take risks, but they must do so with caution (Carey, 2001). Management at financial institutions must exercise extreme caution when assessing the nature and extent of the risks they face. As a result of the board's leadership, risk management has become an integral part of daily operations in the banking industry. They take precautions to make sure the risks they take are calculated and well-considered.

Objective of the study

The objective of this study is to identify and analyze various risk types in Indian banks, and to evaluate the risk management strategies employed by bank management in accordance with Basel Committee guidelines. The study aims to provide insights based on secondary data sources.

Reasons for Risk Management

The banking sector all over the world has witnessed fierce rivalry not only from the domestic banks but also from foreign institutions alike. In fact, competition in the banking sector has emerged due to disintermediation and deregulation. When a country's economy is liberalised, it creates opportunities for banks to expand their customer bases and earn more money. In order to capture this opportunity, commercial banks in India also have created various new and innovated goods and facilities like ATMs, Credit Cards, Mobile banking, Internet banking etc. Mutual funds, insurance, and other non-traditional banking services are being developed and promoted in order to expand the bank's customer base and increase profits. Commercial banks' risk exposure has risen significantly as a result of deregulation in the Indian economy, product/technological innovation, and greater volatility in the capital market. This has resulted in a heightened emphasis on risk management inside financial institutions (Sarkar 1999; Sharma et al., 2007). India's commercial banks have been pushed to prioritise risk management by two major trends:

(a)**Phased deregulation:** is the result of reforms to the financial sector that began in the early 1990s. Deregulation has allowed banks more discretion in areas like lending, investment, interest rate structure etc. Therefore, banks must manage their operations independently while keeping their doors open and making a profit. The commercial banking sector now has a greater appreciation for risk management as a result of this.

(b) **Advances in technology**: have given banks a stepping stone toward realising their goal of providing a welcoming space for their clients and a springboard for the development of novel services and products. To better manage their assets and liabilities, banks have taken use of technological advancements such as new delivery channels, faster transaction processing times, less need for human participation in back-office procedures, etc. However, the opportunities afforded by technological ingenuity have become more diverse and complicated, posing new hazards that must be managed expertly.

Numerous Risk in Banking Bussiness

The term "risk" is derived from an Italian word "resicare" which means "to dare". When it comes to taking chances, you have more of a say in the matter than you do in fate. To elaborate on this example, we may say that risk is the degree of uncertainty in exchange for the potential for loss or harm. It may be summed up as the "possibility of loss," which could refer to monetary loss or a loss of face or esteem. It is inherent in the nature of any business, including banks, to take calculated risks. Generally speaking, the stakes would increase in proportion to the level of risk taken. But larger risks may also bring into higher losses.

Techniques of Risk Management

- The GAP Analysis is a balance sheet-based interest rate risk management methodology that focuses on the potential change in net-interest income across given time periods. By categorising interest-sensitive assets, liabilities, and off-balance sheet positions into time bands according to their maturity (in the case of fixed rates) or time left until their next re-pricing date, a maturity/ re-pricing programme can be constructed (in case of floating rate). The interest rate sensitivity of earnings and economic value can therefore be measured with the use of these programmes. Assets and liabilities are then allocated to the chosen time intervals in accordance with their respective maturities (in the case of fixed rates) or first feasible re-pricing times (in the case of flexible rates). Rate-sensitive assets (RSAs) and rate-sensitive liabilities (RSLs) are the assets and obligations that can be re-priced in response to changes in interest rates. A company's interest sensitive gap (GAP) is the difference between its rate sensitive assets and liabilities, and it is calculated as GAP = RSAs - RSLs. The GAP data can help the company anticipate how interest rate fluctuations will affect their bottom line. If the future interest rate rises, the result will be more net interest income than before since interest income has increased more than interest expenses have decreased.
- In the realm of risk management, one of the newest instruments is value at risk (VaR). The Value at Risk (VaR) measures the maximum potential loss or gain over a certain time frame for a given level of risk. VaR provides a numeric summary of the underlying financial risk in a portfolio. While VaR is most commonly associated with calculating market risk, it can also be used to identify risks in areas such as foreign exchange, commodities, and equities.
- Annualized Rate of Return on Capital (RAROC): In terms of the risk/return trade-off in various asset classes, it provides a consistent economic framework for measuring all the relevant risks in a transaction. It is crucial to allocate capital for the various risks faced by financial institutions as economic capital protects these organisations from unexpected losses. A company's overall rate of return on capital is calculated by calculating the risk-adjusted rate of return on capital (RAROC), which reveals the relative demand for economic capital among various goods and enterprises. RAROC is an integrated risk management tool, whereas Risk Adjusted Rate of Return (RAR) can be used to evaluate the capital needs associated with market, credit, and operational risks.
- Securitization is an activity that is researched in the context of structured finance or credit linked notes. A bank can reduce its risk exposures and raise new capital through a process called securitization. The bank pools together a variety of income-generating assets (such as mortgages) and then issues securities against them on the open market, turning its previously illiquid holdings into marketable securities. The onus of repayment is shifted from the originator to the pooled assets, as the returns from these instruments are based on the cash flows of the underlying assets.

Methods used in Risk Management

The following are the stages of the risk management process:

- The first step in managing risk is identifying it in all its forms so that you can assess its potential impact on the day-to-day activities of your bank. Credit, market, and operational risks for a bank with worldwide activities may vary in intensity from country to country. Internally, a bank may face different dangers in its local and international branches.

- To assess the level of danger present, one must compare the item's contents and/or value, intensity, and quantity to some standard. The goal is to identify and understand the precise level of risk components present in each operating environment type. In certain situations, a very basic qualitative assessment may be all that's needed, while in others, more complex methodological/statistical models will be required to determine the monetary value of risk.
- As a crucial function, a risk management system's monitoring of risks entails keeping a careful eye on risk identification and measurement operations in the context of the risk, principles, and policies in place. The system can only function properly if the operational arms go about their business as usual within the bounds of the company's risk tolerance.
- It is imperative that the entire organization's risk management system be governed and directed by an appropriate process using a suite of control devices. Several management procedures can help with this, including routine risk profile assessments, risk-oriented audit feedback analysis, and the subsequent activation of control mechanisms.

Indian bank risk management and the Reserve Bank of India

India's central bank, the Reserve Bank of India (RBI), uses a system called CAMELS to assess the health of commercial banks in the country. Capital Adequacy (C), Asset Quality (A), Management (M), Earnings Quality (E), Liquidity (L), and Sensitivity to Market risk (S) are the six pillars that make up the CAMELS Model (S). In the event of an international settlement, the Basel Committee on Banking Supervision (1988) suggests adopting CAMEL as a criterion for evaluating financial institutions.

Prior to liberalisation in India in the early 1990s, the Reserve Bank of India (RBI) focused its statutory regulation of commercial banks on matters such as licencing, administration of minimum capital requirements, pricing of services (including administration of interest rates on deposits and credit), reserves and liquid asset requirements (Jayadev, 2006). Therefore, solvency concerns have to be prioritised in the monitoring standards. Following the 1988 development of the Basel Committee on Banking Supervision's (BCBS) prudential norms for international settlement, the Reserve Bank of India (RBI) implemented a number of reforms to better align its supervisory and regulatory standards with those of other developed countries. RBI ensured that the prudential norms were applied over the period and across different segments of the financial sector in a phased manner, taking into account the socioeconomic conditions of the country, the business practises and payment systems prevalent in the country, and the predominantly agrarian nature of the economy.

In 1999, the Reserve Bank of India (RBI) released recommendations for the management of assets and liabilities, as well as credit, market, and operational risks, in the country's financial institutions. To meet the stringent requirements of a secure financial system, a new Board for Financial Supervision (BFS) was established in 1994 and has been operating under the aegis of the Reserve Bank of India (RBI) ever since. All of the financial system, with the exception of the capital market and insurance, will now fall under the BFS's purview of supervision. Off-site surveillance, which primarily focuses on the risk profile of the supervised institution, now supplements the periodic on-site inspections and also the targeted appraisals by the Reserve Bank. Since 1999, banks in India have been subjected to a rating procedure based on the CAMELS framework, whereas banks in other countries are evaluated using the CACS framework, which takes into account factors such as capital, asset quality, compliance, and systems & control.

Since then, the Reserve Bank of India has implemented stricter capital adequacy standards and implemented a rating system based on CAMEL (Capital adequacy, Asset quality, Management, Earnings, Liquidity) to assess the health of Indian banks. The scope of the Reserve Bank's regulatory and supervisory authority has been expanded to include both traditional banks and alternative financial firms. For this reason, with the banking industry evolving at such a breakneck pace, the focus is on risk-based supervision (RBS). Banks are the primary focus of the Board for Financial Supervision's (BFS) attention when it comes to both on-site and off-site supervisory issues.

Conclusion

The term "risk" can be interpreted in a variety of ways depending on the context in which it is used. Without taking into account the risk, a bank's profitability metrics are meaningless. After economic liberalisation, financial institutions were unrestricted in their ability to launch new products and set prices for such goods based on the level of risk they posed. As a result, the banking sector faces a variety of threats that threaten its profitability and overall stability. As a result, risk analysis and management have become a novel and difficult facet of the banking industry. In terms of risk management, the Indian banking sector has been set in the right direction thanks to the reform process and the advice of the Basel Committee. They've taken advantage of the latest and greatest innovations and technologies by adopting the most effective organisational frameworks and methods from around the world.

Refrences

- ✓ Al-Tamimi, H. & Al-Mazrooei, F. (2007), "Banks' Risk Management: A Comparison Study of UAE National and Foreign Banks", the Journal of Risk Finance, 8(4), 394 – 409.
- ✓ Anthony, M. S. (1996), "Commercial Bank Risk Management: An Analysis of Process", Wharton Financial Institutions Centre Conference on Risk Management in Banking, Wharton.
- ✓ Arora, S. and Jain R. (2011), "Exploring Risk Assessment and Analysis practices in Indian Commercial Banks", ELK Asia Pacific Journal of Finance and Risk Management, 2(3), 605-614.
- ✓ Baral, K.J. (2005), "Health Check-up of Commercial Banks in the Framework of CAMEL: A Case Study of Joint Venture Banks in Nepal", The Journal of Nepalese Business Studies, Vol. II, No.1, Dec 2005, 41-55.
- ✓ Beckers, S. (Eds.). (1998), "A Survey of Risk Measurement Theory and Practice, Risk Management and Analysis", New York: John Willey & Sons.
- ✓ BIS, Basel Committee on Banking Supervision (1999), "A New Capital Adequacy Framework" Bank for International settlements, Switzerland, CP1
- ✓ Carey, A. (2001), "Effective risk management in financial institutions: The Turnbull approach", Balance Sheet, Vol. 9(3), pp. 24-27.
- ✓ Cumming, C. & Beverly, J.H. (2001), "The Challenges of Risk Management in Diversified Financial Companies", Economic Policy Review, Federal Reserve 10B47ank of New York, 7, 1-17
- ✓ Gilbert, R.A., Meyer, A.P. & Vaughan, M.D. (1999), "The Role of a CAMEL Downgrade Model in Bank Surveillance" , Working Paper 2000-021A, Federal Reserve Bank of St. Louis Review, 81, 41-58.
- ✓ Jayadev, M. (2006), "Internal Credit Rating Practices of Indian Banks", Money, Banking and Finance, 41(11).

- ✓ Kaur, R.(2017), "A Study on Credit Risk Indicators in State Bank of India Using Ratio Analysis", Guru Kashi University Journal of Business Management Journal,V.3,29-34.
- ✓ Murty, G.R.K. (2001), "Credit-risk management in a market driven economy: The acid test for banks", IBA Bulletin, XXIII (3), March, 105-123.
- ✓ Narasimham, M. (1998), Report of the committee on banking sector reforms. Government of India.
- ✓ Oldfield, G.S. and Santomero, A.M. (1997), "Risk Management in Financial Institutions", Sloan Management Review, 39(1), 33-46.
- ✓ Radelet, S. & Sachs, J. (1998), "The Onset of the East Asian Financial Crisis",working paper no. 6680, National Bureau of Economic Research, Cambridge, 14-18.
- ✓ Rajadhyaksha, N. (2004), "The rise of financial conglomerates", Business World, Nov. 28-33.
- ✓ Sarkar, J. (1999), "India‟s banking sector: Current status, emerging challenges and policy imperatives in a globalised environment. In Hanson, James A., & Kathuria, Sanjoy (Eds.), India: A
- ✓ Financial Sector for the Twenty-first Century. (pp. 71-129). India: Oxford University Press.
- ✓ Sharma, A.K., & Vashishtha, A. (2007), "Dynamics and regulatory system of Indian financial markets: A dialectic view", Journal of Financial Regulation and Compliance, 15 (3): 275-302.