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Assessment of Commercial Bank's Activities Using Risk Management Methods

Shakhzod Abduvakhobov, Abdumalik Bektemirov

Samarkand Institute of Economics and Service, Samarkand, Uzbekistan

Annotation: This article is devoted to the areas of assessment of the activities of commercial banks using risk management methods associated with the lending process. It provides an analysis of the views of economists, in which conclusions and recommendations for the analysis of the situation on the application of risk management methods are formed.

Keywords: commercial bank, risk management, credit risk, loan portfolio, method.

Introduction

A commercial bank is involved in a number of financial relationships during its financial activities and is exposed to various risks during its lending activities. Protecting commercial banks from these risks serves to ensure their financial stability and build confidence in it.

The risk management system plays an important role in ensuring the financial stability of commercial banks. The risk management system is a guarantee of the competitiveness of banks and is one of the most important elements of business. Such an approach to the risk management system has existed in the West for many years.

Literature review

During N. Konovalova, I. Kristovska and M. Kudinska's research, it was argued that credit risk management should be aimed at achieving the following goals:

- identification of general models of economic behavior of bank customers;
- formation of a set of differentiated requirements for a specific group of borrowers in accordance with their specific characteristics;
- Determining the amount and term of the loan and the risk appetite of the person making the decision on the interest on the loan [1].

R. Arunkumar notes that the future of the bank's activities depends on the dynamics of risk management. According to him, only banks with an effective risk management system will survive in the long-term market [2]. Hence, effective credit risk management is an important component of comprehensive risk management necessary for the long-term success of a banking institution.

Karl Berch declares, “The key component of any company’s risk management philosophy is to determine its risk appetite. Risk appetite reflects the amount of risk that may arise depending on the company's financial and operating capabilities, growth rates and profitability prospects by stakeholders ”[3].

D. Nafasov in his research argued that the methods of risk management of commercial banks are a set of approaches and equations that serve to assess the level of risk management, ensuring the security of banks to achieve their goals [4].

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D. Toshpulatov emphasizes that senior managers and employees of the bank must strictly adhere to the goals and objectives of risk management, adhere to the values and ethical standards adopted by the bank [5].

Methods and results

Banks of our country are realizing the importance of integrated risk management. The choice of risk management or outsourcing is made by the bank based on its activities. Both choices have strengths and weaknesses. It should be noted that not only successful development, but also the operation of the bank is impossible without the application of the practice of systematic integrated risk management.

In general, the concept of risk management includes a system, a set of measures. For a risk management system to work effectively, it must be defined taking into account its instruments. Risk management as an integrated management system includes two internal structures: the object of management and the subject of management.

The object of risk management is the economic relations of business entities in the process of risk, risky capital investments and risk realization. These economic relations include the relationship between the insurance organization and the insured, the lender and the recipient, the entrepreneurs, and so on.

The subject of risk management is a special group of employees (financial manager, insurance specialist, etc.). These entities provide a specific goal-oriented activity of the management object through various methods and means of management.

The process of an entity's exposure to an object, i.e., the process of governing, can take place in the context of the flow of specific information between the controlled and the controlled structure. The control process is directly related to processes such as receiving, sending, processing, and using data more accurately. Clearly, in such an environment, the adoption of reliable and adequate information in risk management plays an important role and allows clear decision-making on risk management.

Risks are divided into open and closed types in terms of opportunities and methods of risk management. Open risks do not require management. Closed risks, on the other hand, are managed through the implementation of a policy of diversification, ie the total volume of operations of the organization is divided into a large number of small loans; certificates of deposit are issued; loans and deposits are insured; careful and thoughtful management of assets and liabilities. The risk in terms of impact on performance is pure and speculative (artificial). While net risks always lead to losses, speculative risks can also bring additional income to the bank [6].

To date, the entire technological structure of banks in modern banking is focused on solving specific accounting issues, as well as business planning and financial planning. This causes professionals and risk managers to spend a lot of time searching for and compiling information. The state of data integration is becoming more complex due to the lack of an alternative methodology.

In general, it was concluded that the banking risk management system consists of three links due to the increase in the range of operations and services of banks, as well as the widespread use of financial instruments and increased competition between credit institutions (Figure 1).

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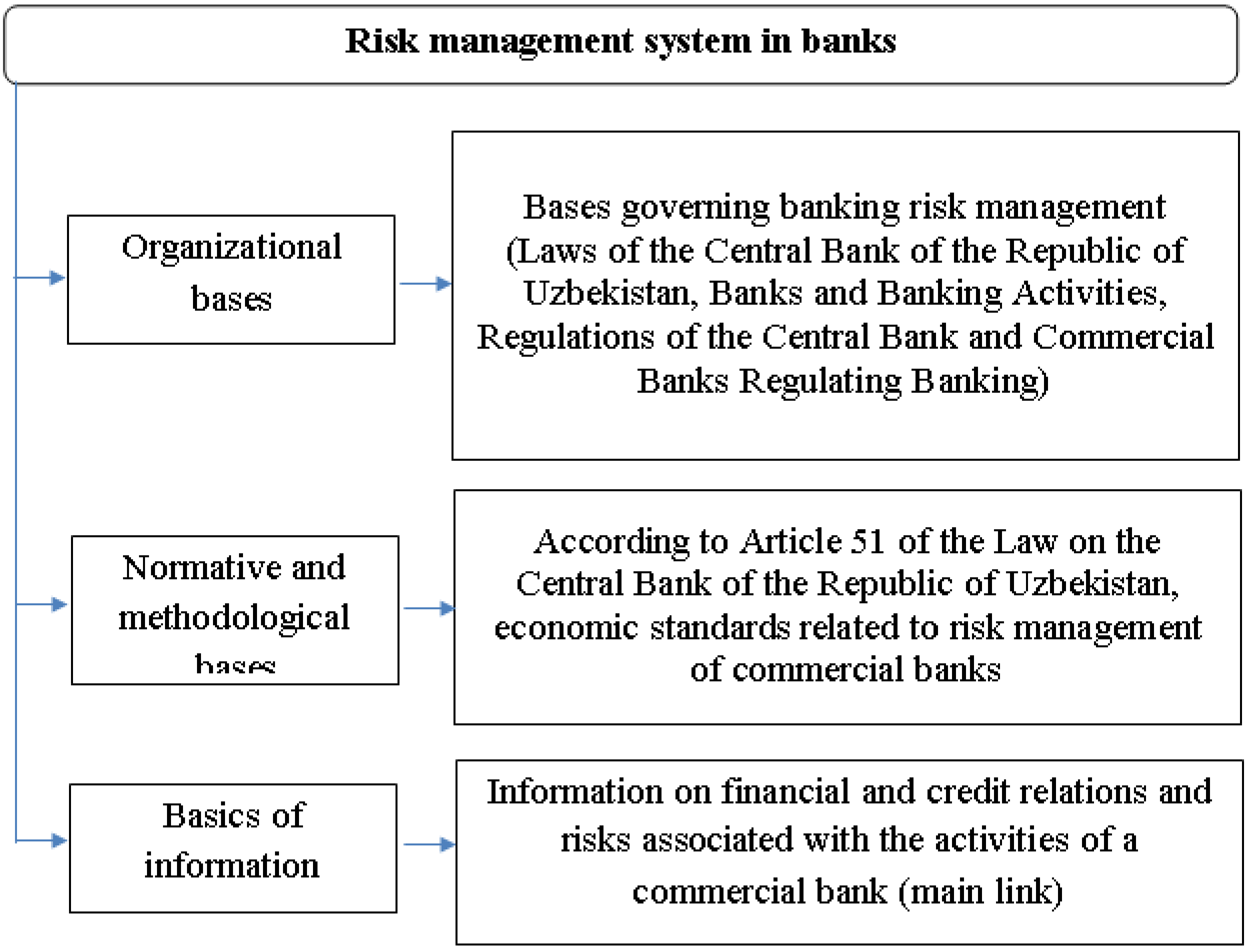

Figure 1. Risk management system in banks

Two aspects of methodology can be distinguished, the first being the theoretical aspect, in which the methodology is based on the philosophical philosophy of epistemology. The second is its practical aspect, in which the ways and means of achieving a practical solution to an existing problem are applied. Thus, in the theoretical aspect of the methodology, its optimal models are considered, and in practice, the solution of existing problems is determined on the basis of a program (algorithm), a set of methods and techniques to achieve the appropriate result.

However, we concluded that it would be appropriate to conditionally divide them into formal and informal groups. To the official group of risk management methods we can cite the criteria and standards officially established by the bodies supervising the activities of commercial banks, Central Banks and International Banking Committees.

Informal methods of risk management are logical conclusions and recommendations made by bank analysts and experts based on observation and analysis of the processes taking place in local and international financial markets. Such methods may include delphi analysis, morphological analysis, scenario analysis, coefficient analysis, and other analytical methods. Figure 2 below shows the conditional order of application and implementation of risk management methods.

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Figure 2. The process of applying and implementing methods in risk management

As can be seen from Figure 2, the risks are first identified, ie the main issue in the organization of bank risk management is to determine the causes, extent and impact of risks. After that, the necessary methods for their management are selected. This process is carried out by means of expert evaluation method (dolphin analysis, morphological analysis, scenario analysis, coefficient analysis).

Differential, integral, logarithmic, index, simple series, correlation, regression analysis, factor analysis and other methods are used in risk assessment.

When choosing a risk management strategy, it is advisable to use the methods of limiting (limiting), reserve, hedging (including insurance), diversification and optimization.

The control phase focuses on issues such as the definition of powers and the allocation of responsibilities, monitoring and reporting system.

In the organization and implementation of risk management of commercial banks, the bank's shareholders' council, the bank's board of directors and members, as well as officials working in the system will need to organize work collectively. Of course, informal approaches are also introduced in the process of risk management, along with formal methodologies.

An informal approach to risk management is a logical conclusion and recommendation made by bank analysts and experts based on observation and analysis of the processes taking place in local and international financial markets. Such methodologies may include coefficient analysis, scenario analysis, and other methods.

From the above, it is clear that two aspects of the risk management methodology of commercial banks play an important role. The first is if it has a theoretical basis, and the second is to create and apply methods to solve existing problems. It is obvious that ensuring a safe level of risks of commercial banks and their effective management requires the introduction of a number of methods.

The multifaceted risks that arise in the activities of commercial banks require constant improvement of their management methods. In particular, some of them are listed below:

- borrowers are unable to repay the principal amount of loans received from the bank and interest accrued on them in a timely manner or at all;
- demand of bank depositors for early withdrawal of funds;

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- negative impact of bank loan interest rates on the loan value;
- decrease in the value of investments in securities by the bank and other similar factors contribute to the diversity of bank risks.

Conclusion

As a result of research on the theoretical and practical aspects of banking risk management, we have formed the following conclusions:

- Increased competition in international and domestic markets, sharp fluctuations in the price of financial resources and risky assets increase the relevance of banking risk management methods;
- There is no single approach to risk management methods of commercial banks, but although their form is different, their content is focused on one goal, it is advisable to study and apply banking risk management methods by dividing them into formal and informal groups;
- The organization of risk management of commercial banks, the choice and implementation of management methods involves a number of steps, taking into account that the introduction of risk management methods without following these steps will not give the appropriate effect. it is expedient to focus on the solution of existing problems.
- ensure that any method used in bank risk management is aimed at preventing the economic damage that banks may incur by reducing risks to a safe level.

In conclusion, it should be noted that any commercial bank is exposed to a variety of interrelated risks that require constant evaluation, supervision and management. Therefore, the main task of the risk management unit is to ensure strategic and operational risk management or coordination of the main divisions of the bank. These tasks allow you to make the right decisions in a timely manner and achieve overall results. However, a number of commercial banks do not have a systematic approach to risk management. In many cases, risk management leads to compliance with control standards, the completion of a large number of internal documents and the creation of a security service that controls employees, contractors. This creates obstacles to the establishment of a comprehensive risk management system and the exchange of information between the main departments of the bank. However, comprehensive measures to address these problems will provide a basis for ensuring the financial stability of banks.

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