



## BANKING RISK MANAGEMENT AS THE MOST IMPORTANT CONDITION FOR COMPETITIVENESS AND RELIABILITY



### GRIGOL NEMSADZE

PhD Student of Georgian

Technical University

E-mail: giga.nemsadze@gmail.com

Tel.: 577 45 43 43;

### ABSTRACT

*The contemporary development of the banking system is unthinkable without risk, risk is involved in any operation. In addition, the development of globalization processes of international cooperation, the creation of high technologies in the field of telecommunications and communications, computerization and automation of most processes in the economy, the perfection of artificial intelligence systems, the need for in-depth understanding of the essence of risks and their sources.*

*Uniqueness of banking risk lies in the fact, that the study and valuation of all other economic activities is carried out during the banking activities. This applies to the manufacturing process, service, trade or the industrial sector.*

**Keywords:** Risk management, credit, Banking risk.

### INTRODUCTION

Successful risk management is the most significant condition for competitiveness and reliability of any lending institution. As evidenced in practice, the most serious types of risk (credit, operational, currency) can provide not only a serious deterioration in the financial condition of any lending institution, but also the loss of capital and bankruptcy in utmost cases. Proper assessment and management of risks provides significant minimization of losses. Effective development of recent lending institutions is based on the selection of proper strategy, rational market approach and construction of effective system for the financial management. Financial management together with flexible marketing policies are key tools for enabling business management to be operational by the bank owners and top managers.

The structure of key elements of financial management may be represented as follows:

- Development of predefined balances, financial plans and budgets;
- Formation of optimal structures of assets and liabilities;
- Risk management;

- Adjustment to the pricing policy and management of prime cost;

On a provisional basis, development of risk management may be divided into two stages. In the first stage of risk analyses the general attention is paid to the risk assessment of current activities. On the second stage, upon reaching higher level of development by the lending institution, in addition to the operational analysis of risks within the financial management system, risks associated with the potential development process is researched. The existence and ability of proper assessment of effective procedures and operable mechanisms of risk management in the bank increases overall profitability and sustainability of business as well as minimizes the quantity of potential loss. The scheme of building a successful business is quite simple - the current activities must be carried out in accordance with the business plan and development strategy, which are based on revenue maximization and specific management of the risk system. The purpose of existing risk management methods is to minimize the allowable level of risk of possible loss limitation.

Risk accompanies the activity of bank during total pe-



riod of its business activity and normally is determined as the hazard, the possibility of loss or damage. Risk is estimated as the negative event which if not completely excluded should be limited upon opportunity. In general, complex control of risks with specific forms includes problem field research, identification, systematization, analyses, quantitative assessment and management of risks. The above mentioned procedures are not always performed in the risk control process. Besides, problem of risks assessment and management is not infrequently reduced to the pure mathematical or technological issues, leading to the alteration of its essence.

Banking risks as a research subject are known not only to the modern commonwealth. Their importance in the regulation of banking activities was noted by researches as early as the XVIII and XIX centuries, in particular, N. Bunge in his study of credit and banks noted "the need to balance insurance premiums (accounting interest) with the risk size. The latter circumstance is very seldom used in the calculation, however there is nothing fairer as the insurance premium being proportionate with the reliability of the guarantee, and forcing each class of credit consumers to allocate costs proportional with the size of the losses which may be the cause of their disability. Undoubtedly, honesty and accuracy in fulfilling credit obligations also have a great impact on risk reduction ... "[3].

Consideration of banking risks significance remains a matter of debate until today. In the number of cases, all in all, their main point will be replaced with their reason of origin, that is, everything will be reduced to different circumstances, factors leading to losses. Therefore, for example, according to I. V. Berner and J. K. Cole, credit risk as a type of banking risk - are unforeseen circumstances that can arise before the end of the loan repayment. According to M. K. Ong, credit risk is the risk directed to losses should the contractor fails to perform its obligations within the agreed time according to the agreement. Quite often the essence of the risk is reduced to the uncertainty that is revealed in some transaction.

There are many different definitions of risk in the national literature. At risk is usually understood the possibility of danger, of failure; Action in the hope of a happy ending to success, indicating two sides of risk: danger and a successful end.

From a clear terminological point of view, "risk" - Italian *risico* - is a threat; to take a risk; Literally - to travel around a scale, steep cliff; According to V. Dali, risk is to take a journey to success, wrong case, to dare, to go to "possibility", to do something without proper estimation, to hope for chance, to hope for happiness, to act in a new free way. In the beginning, calculation of risk had mathematical image and only in future the

influence of risk upon multiple problems solving and study decision as an optimal option were transferred to separate aspects of public and economic life.

Modern scientists are unanimous in the fact that risk, which turns out to be an objective event of any human activity, is simultaneously a historical economic category. Financial risks arose during the emergence of cash flow and "borrower-creditor" relationships and accompanied the activities of the commercial structure. The "fee for risk" was first used in the Entrepreneurial Income Structure by Adam Smith in a study of entrepreneurial profits as compensation for possible risks associated with entrepreneurial activity.

The entrepreneurial business risk was most actively studied by the representatives of German economical school Mangoldt and Thünen who conducted studies on the association of entrepreneurial profit and entrepreneurial risk with the entrepreneurial personality. Mangoldt believed that a time factor was needed to assess and manage risk, more precisely to study risk dynamics.

In the 1930s, economists A. Marshall and A. Pigou developed the basic neoclassical theories of entrepreneurial risk, which were based on entrepreneurship and defined profit as a random quantity.

Economist D. M. Keynes defined financial risk as the uncertainty of receiving the expected return on investment. He believed that the cause of uncertainty was the future-oriented nature of the economic process itself and suggested strengthening the role of the state in reducing the degree of uncertainty in the economy.[1]

In the Financial-Credit Dictionary, banking risk is defined as "the risk of losses due to the specifics of banking operations carried out by credit institutions". A. A. Khandurev speaks of risk as danger or the possibility of losses in the event of adverse circumstances.

The peculiarity of banking risk, which is closely related to the essence of banking activity, is that it is manifested both in the production process and in the circulation of public products, as well as in the field of exchange and payment turnover[2]

Mainly in relation to the bank business modern foreign specialists give explanations of bank risk complex and they consider under risk the occurrence of foreseen or unforeseen circumstances in bank business. J. Sink considers risk as uncertainty, which is related to any circumstance or its outcome, while probability is characterized by the distribution of probabilities of occurrence of any circumstance.

Considerations of georgian economists I. Kovanadze, G. Gamsakhurdia, M. Kakulia, J. Shatirishvili, Z. Chkhaidze, A. Kutateladze, G. Tsaava, Kh. Barbakadze, R. Burdiashvili, V. Mosiashvili. L. Asatiani et al. regarding bank management is almost similar with above men-



tioned authors in relation with explanation of bank risk and it may be formulated as follows: Under bank risk is meant possibility (probability) of incurring losses and(or) worsening liquidity in the result of undesirable circumstance by credit organization peculiar to bank activity that is connected with internal factors (complexity of organizational structure, level of employees qualification, organizational changes, fluctuation of labor and etc.) and (or) external factors (change of economic conditions in the activity of credit organization, usable technologies and etc.) [1; 2].

Therefore, upon consideration of references of Georgian and foreign specialists, determination of risks in the activity of credit organizations is specified as follows:

Risks of commercial banks are feature of probabilistic circumstances that may, eventually, lead to the receipt of additional income or full disbursement, or non-receipt of income, or incurring losses as a result of the credit organization's actions under the influence of internal and external factors in times of economic uncertainty.

The nature of the risks is directly related to the uncertainty of the outcome, which is due to inaccuracies, incomplete and insufficient data on possible circumstances. As a result, reducing uncertainty in any possible way leads to risk reduction. Upon all the existing directions in relation to risk must be distinguished its three main aspects:

- 1) risk that considers the possibility of circumstance;
- 2) if circumstance is performed then it will have substantial consequences;
- 3) as a rule, "human factor" is revealed with different forms;

Providing special feature peculiar to risk, it may be determined as the situational designator of activity that expresses uncertainty of result and possibility of unprofitable outcome.

The objectivity of banking risks is related to the existence of factors, the existence of which, in the end, does not depend on the activities of a commercial bank, at the same time they have a subjective basis as they are always realized through the staff of the organization..

#### CONCLUSION

The contemporary development of the banking system is unthinkable without risk, risk is involved in any operation. In addition, the development of globalization processes of international cooperation, the creation of high technologies in the field of telecommunications and communications, computerization and automation of most processes in the economy, the perfection of artificial intelligence systems, the need for in-depth understanding of the essence of risks and their sources.

#### REFERENCES:

1. I. Kovanadze, G. Kontridze – Contemporary banking: Theory and Practice, Manual – Tbilisi, Sezar LTD Publishing House, 2014, P.548.
2. G. Tsaava, G. Khantadze – Banking management (Theory, methods and practice), Manual – Tbilisi, Publishing House Dani, 2015 – P. 80.
3. G. Tsaava, R. Burdiashvili, V. Mosiashvili – Riskology: Strategic management of financial risks, Manual (edited third edition) – Tbilisi, Publishing House Dani 2020 – P. 374

### საბანკო რისკ-მენეჯმენტის როგორც კონსერვატიული ფინანსების და სავაჭრო უზენაესი უზენაესი პირობა

გრიგოლ ნემსაძე

საქართველოს ტექნიკური  
უნივერსიტეტის დოქტორანტი

#### ანოტაცია

საბანკო სისტემის თანამედროვე ეტაპზე განვითარება წარმოუდგენელია რისკის გარეშე, რისკი ნებისმიერ ოპერაციაში მონაწილეობს. გარდა ამისა, საერთაშორისო თანამშრომლობის გლობალიზაციის პროცესების განვითარებამ, ტელეკომუნიკაციისა და კავშირგამბმულობის სფეროში მაღალი ტექნოლოგიების შექმნამ, ეკონომიკაში უმეტესი პროცესების ინფორმატიზაციამ და ავტომატიზაციამ, ხელოვნური ინტელექტის სისტემების სრულყოფამ, რისკებისა და მათი წარმოქმნის წყაროების არსის სიღრმისეული გაგების აუცილებლობას განაპირობებს.

საბანკო რისკის განსაკუთრებულობა მდგომარეობს იმაში, რომ ყველა სხვა ეკონომიური აქტივობის რისკის შესწავლა/შეფასება კეთდება, საბანკო საქმიანობის განხორციელებისას. ეს შეეხება როგორც წარმოების პროცესს, სერვისის მიწოდებას, ვაჭრობას თუ ინდუსტრიულ სექტორს.

**საკვანძო სიტყვები:** რისკ-მენეჯმენტი, კრედიტი, საბანკო რისკი.