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THEORETICAL BASES FOR BANK STRATEGIC RISK MANAGEMENT UNDER THE IMPACT OF MACRO- AND MICROENVIRONMENT

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Abstract:
This paper examines the theoretical bases for banking strategic risks management through examining the impact of micro- and microenvironment on the credit organization performance

Keywords:
strategic management, commercial banking environment, financial management, financial risks, and plan chart of strategic management, classification of banking risks.

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Strategic management is a basic foundation for planning the developmental path of the organization in the long-run period. Continuous changes of the business environment and competitors' behavior play an important role in the strategic management development.

The elements of commercial bank environment should be defined in order to evaluate the role and meaning of commercial banks' strategic management. This environment can be divided into micro- and macro-environment. Microenvironment can be further divided into internal and external relations (1, p.18).

As it can be seen in the pic.1, macro marketing is a system of managing the market on the society-wide scale. External environment characterizes factors and forces outside of the commercial bank. They influence banks' resources important for successful performance. However, the direct bank administration cannot influence external factors. One of the important macro environmental factors is demography – science that encompasses the study of size, structure, age of the population (2, p.39). Purchasing power is also important for the market, as its level depends on the income, prices, savings, and credit availability. Economic factors consist of economic climate, spending capacity of the citizens, consumption patterns, financial level of the country (2, p.39).

Changes in the environment also influence services, offered by the bank. Scientific and technological factors consist of pace and scope of scientific, technical and technological changes; innovation rate; innovative potential of the company and its major competitors; personnel experience, etc. (2, p. 39).

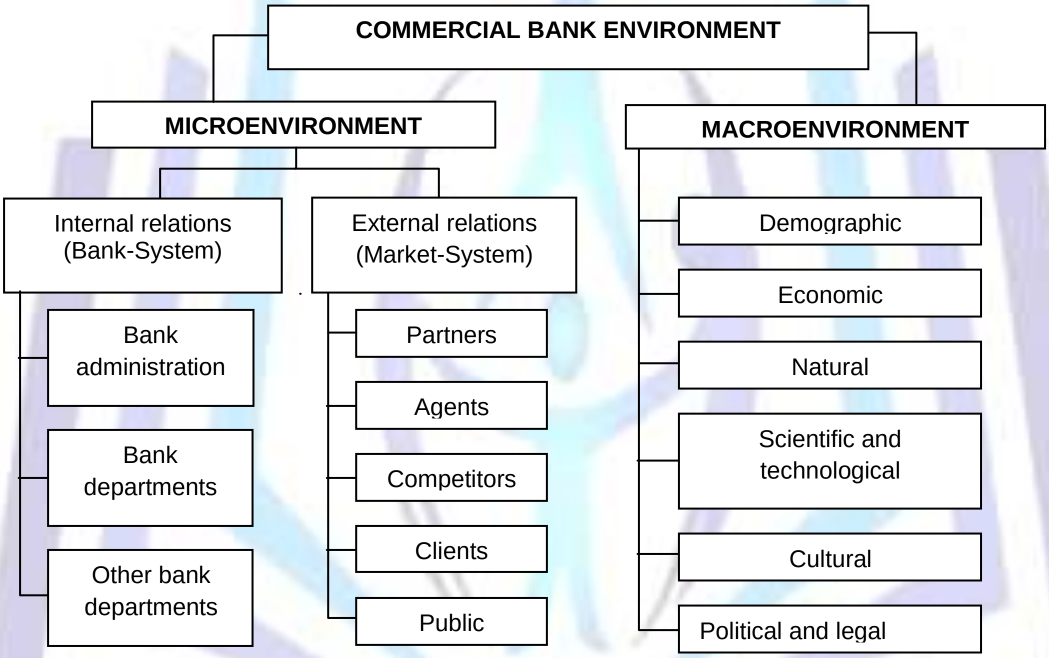

Fig. 1: Commercial Bank Environment

Such cultural factors as level of cultural development, culture forms, characteristics of cultural values of customers, and social conscience exposure to external effects influence strategic decision-making.

Events in the political and legal environments also influence banks' performance, as they depend on social influence on the governmental decisions (2, p. 36-37).

"Strategic management" term was introduced by D. Schendel and K. J. Hatten in 1972 (3). Development of strategic management was connected to new conditions of corporate performance in the United States in the beginning of 1960s (4).In our opinion, strategic management is a process of administrative decisions implementation, based on the use of strategy with the possibility of its dynamic renewal, which provides for competitive advantage.

Strategic management allows for securing the future of the credit organization under changing external and internal conditions. At the same time operational management use previously developed strategy in order to reach current goals.

Principles of strategic management are the bases for strategic management methodology. They are the main rules, provisions, requirements for strategic management.

Authors believe that the bases of strategic management consist of the following principles (Table 1).

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Table 1. Principles of strategic management

№	Principle	Explanation
1	Longtermness	Secures successful development of organization in future.
2	Realizability	External and internal resources of the organization should be considered when setting strategic goals in order to evaluate the possibility of its realization.
3	Flexibility	Consideration of possible changes in the realization process of strategic management due to changes in external and internal factors.
4	Organization	Process of strategic management should be clearly outlined, regulated and realized.
5	Economic advisability	Profit gained from strategic management should exceed expenses on its realization.
6	Complexity	Process of strategic management should be realized in the whole organization and not in separate departments. All of the departments should be focused on the same goal.
7	Controllability	Process of strategic management realization should be wholly controlled.

In the process of strategic management realization banks should use all of the structural elements of administration process. As a result, financial management, organizational management, personnel management will be employed.

Financial management of the banking sphere has specific characteristics that can be described as a lack of unified management processes within the limits of unified banking system. Under the conditions of market competition every credit organization works out their own regulations of financial administration; constantly changing economic situation requires adjustments of already developed administration processes.

Banking financial management is a very dynamic process; it depends on the value of financial resources, profits and expenditures, range of supply and demand (5, p. 32). These factors provides for viewing banks financial management as a system, that organizes a process of administration by the credit organization itself and being an agent between the bank and external environment.

In general, a map of strategic goals is typical for banks' financial management. The main goal is maximizing the welfare of its owners, that provides for organized administration process.

Level of environmental uncertainty is the base of choice of any strategy (6, p. 330).

Commercial banks are exposed to various kinds of risks, because financial market in Russia is loosely regulated. Risks in banking business often deal with “possibility of losses, possibility of unfavorable outcome of the financial operation” (1, p. 15).

Thus, financial risk in a wide sense (the one, including banking risks) is a possibility of unfavorable outcome of financial operation, losses, profit loss or other non-expected expenditures. Under the provisions of Bank of Russia, bank risk is «a possibility of losses by the credit organization and (or) liquidity loss due to unfavorable outcome related to internal factors (organization structure complexity, personnel experience, organizational changes, personnel turnover etc) and (or) external factors (changes in economic situation, introduced technologies, etc.)» (7).

When performing different operations and transactions commercial banks should thoroughly and objectively evaluate risks, which they run in the process of their activities. One of the reasons for bankruptcy of commercial banks in Russia is unskilled management, neglecting risks level in some banking operations (8, p.108)

Under the regulations of Bank of Russia, that are based on Basel list of risks, there are following kinds of risks: credit risk, country risk, market risk (includes fund risk, currency risk, interest rate risk), liquidity risk, operational risk, legal risk, reputational risk, strategic risk). (9, p.125)

However risk classification proposed by Central Bank of Russian Federation doesn’t describe all of the possible risks of the commercial banks. The full list of all possible risks is much more comprehensive. The reason for this is that “basic” risks and their separate elements can form various combinations and serve as sub-risks. The number of such combinations can vary according to bank’s goals and environment. (9, p.26)

The main characteristics of risks, which define their affiliation to one or another risk groups, are qualitative and quantitative characteristics. The system of various parameters, different for each operation of bank’s portfolio serves as a base for attribution of risk to any of the group. Quantitative characteristic is evaluated in currency. (10, p.11)

Nowadays there are several approaches to risks classification. Each of them depends on basic characteristics.

One of the classification approaches is a method, based on characteristic of risks and losses, which bank can bear in case of their occurrence. It appears as follows:

1. Financial risks
2. Functional risks
3. Other external risks

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Financial risks are directly connected to unexpected changes on volume, profitability, asset and liabilities value and structure. They include: credit risk, liquidity risk, price risk, interest rate risk, bases risk, currency risk, market risk, inflation risk, inability to pay risk.

Functional risks appear due to inability to control financial and economic process timely and in full measure, and inability to collect and analyze information. In authors' opinion, such risks as marketing risk, social risk, organizational risk, technical risk, personal risk, and transport risk can be added to the list presented above.

Other risks usually include country risk, political risk, regional risk, market risk, reputation risk, legal risk and natural risk.

Irrespected of classification, banking risks are interconnected. When performing any kind of financial operation, bank runs several risks. As a result, aggregate level of risk grows. Because definition of banking risks is developing, the number of elements that are used in the description of the risk characteristics is also growing. (9, p.29). V.A. Gamza suggests following classification according to the generalization degree:

1. Elementary risks (technical risk, legal risk, transport risk, natural risk, personal risk, inflation risk, and interest rate risk)
2. Compound risks (basis risk, social risk, financial risk, technological risk, operational risk, currency risk, property rick, price risk, and corruption risk)
3. Cumulative risks, as a result of accumulation of unpleasant impact of elementary and compound risks (ineffectiveness risk, organizational risk, political and strategic risk, investment risk, country and reputation risk, inability to pay and liquidity risk, market and profit loss risk, marketing risk, credit and regional risk)

As mentioned above, this classification is more general; it is based on the volume and complexity of risk.

The risks are divided into external and internal risks according to range of influence and appearance.

External risks are risks, that are not directly connected to bank's or client activities. For example, G.N. Beloglazova and L.P.Krolivetskaya believe that external risks include country (system) risk, regional risk, political risk, legal risk, financial (fund) risk, social risk, and technical risk (11. p297-299). V.S. Sakharov spheres their opinion and believes that system risks are those risks, that affect the whole banking system (including the Central Bank and commercial banks) and not individual banks (ibid, p.23)

G. Grafova and P. Alexeev believe that external risks are those, not depending on individual bank's activity. T.V. Stuchenkova highlights market risk, as a risk of possible losses of balance and out-of-balance positions that occur due to negative change in market prices (13, p.22). Authors believe that this risk can also be attributed to external risks.

According to regulations of Bank of Russia, external risks include following factors: change in economical conditions of credit organization, technologies applied etc.; internal risks include: complexity of organizational structure, level of personnel experience, personnel turnover etc. (14, p.3). Thus, bank risks evaluation require analysis of internal and external factors, which affect credit organization activities (15, p. 116-118).

Thus, risks can be divided into those appeared under the influence of macro environment and microenvironment.

Analysis, conducted by the authors, allows for developing following list of macro environment risks (p. 2):

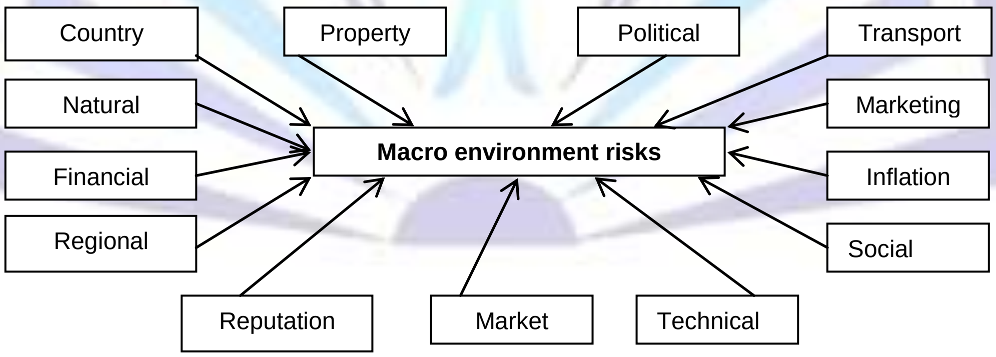
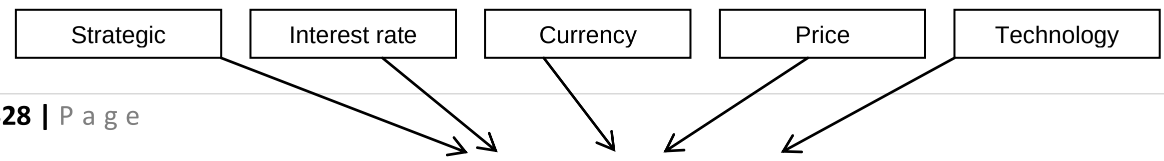


Fig. 2: Macro environment risks

Microenvironment risks are risks, driven by the bank activity itself, by its lenders and borrowers, its clients. Microenvironment risks depend on bank specifications, its partners and type of activities.

Usually the following types of internal risks are pointed out in publications: credit risk, currency risk, and interest rate risk. (12, p. 300-303). Investment risk, profit loss risk, corruption risk, liquidity risk, price and basis risk, inability to pay risk, strategic and technology risk, ineffectiveness risk, personal risk, and organizational risk supplement this risk.



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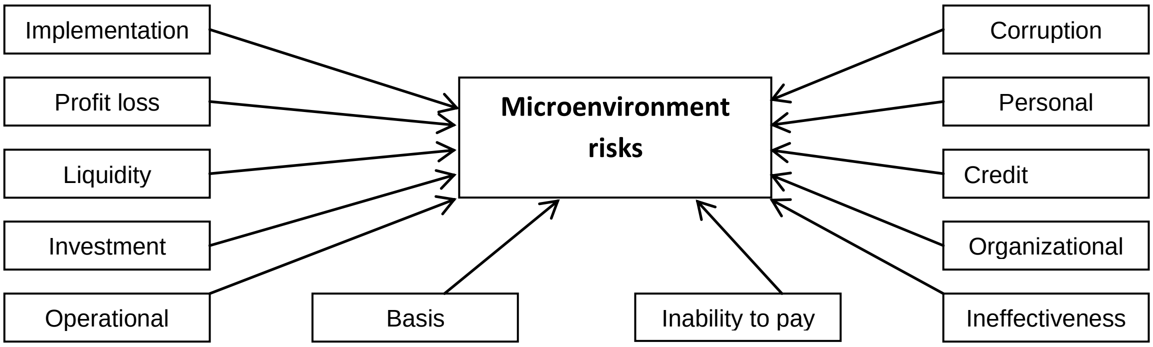

Fig. 3: Microenvironment risks

The authors conducted analysis and research of modern theory and practice of strategic risk management in banks. This allows for drawing the following conclusions:

1. Strategic management is a process of administrative decisions implementation, based on the use of strategy with the possibility of its dynamic renewal, which provides for competitive advantage.

Strategic management allows for securing the future of the credit organization under changing external and internal conditions. At the same time operational management use previously developed strategy in order to reach current goals.

2. Financial management of the banking sphere has specific characteristics that can be described as a lack of unified management processes within the limits of unified banking system. Under the conditions of market competition every credit organization works out their own regulations of financial administration; constantly changing economic situation requires adjustments of already developed administration processes.

Financial management is comprised of the most important combination of structural elements, being the most important element of strategic risk management and one of the most important elements of banking management.

3. Thus, financial risk in a wide sense (the one, including banking risks) is a possibility of unfavorable outcome of financial operation, losses, profit loss or other non-expected expenditures.

Financial risks are directly connected to unexpected changes on volume, profitability, asset and liabilities value and structure. They include: credit risk, liquidity risk, price risk, interest rate risk, bases risk, currency risk, market risk, inflation risk, inability to pay risk.

4. Bank risk is a monetary equivalent of a possible event, which can lead to losses.

Today, there are several approaches to bank risks classification. One of the main classifications is a division of risks into internal and external ones, or into microenvironment risks and macro environment risks.

Conducted analysis of internal and external characteristics allows authors to propose a list of macro environment and microenvironment risks and thus evaluate these risks.

Obviously, commercial banks should evaluate risks from the perspective of bank's ability to manage them.

This paper proposed a relatively new approach to risk management. It is based on their origin, thus the importance of this research lays in the fact that researched material, drawn conclusions, recommendations can play an important role not only in the development of banking system, but also in the development of course of new researches in the sphere of evaluation of bank risks. Some theoretical aspects studied in this paper might be of interest for those who work out practical measures for risk avoidance.

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