

# **EMERGING RISKS IN BANK CREDIT ACTIVITY IN TERMS OF FINANCIAL BANKING MARKETING**

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**Abstract:** "Whether you know it or not, we all practice marketing. The difference arises between those who do it by ear and those who turn it into a successful career".<sup>1</sup> The role of marketing in the financial-banking sphere resides in identifying and meeting the criteria of the most profitable market segments, determining and assessing present and future needs of these particular clients, establishing the activities' objectives of development and prepare plans for their achievement, promote various products and services to accomplish the marketing forecast.

The present paper aims at identifying the main risks arising in bank lending activity in terms of financial banking marketing, in order to find the best ways of addressing them.

**JEL classification:** M19, M31

**Keywords:** financial-banking marketing, credit risk, credit policy, financial risk.

## **1. INTRODUCTION**

"Financial-banking marketing represents all actions taken by financial and banking institution to investigate and research the market, adapting products and services to market demands or market segments held or who intend to enter, create, promote and launch

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<sup>1</sup> Preda, O, Furdui, I. – *Elemente de marketing financiar-bancar*, Ed. Universitara, Bucuresti 2009, pag.7

new products, influencing the market and customers in order to achieve immediate goals or prospects of the bank."<sup>2</sup>

Banks adopt an emphasized marketing orientation in order to better satisfy their customers, to consolidate its position on the market. It is important for banks to keep abreast with rapid changes in the environment. They must have the ability to adapt, to change strategies, introduce products and services to meet the new needs of the particular customers, to forecast new needs and to give customers an attractive offer.

The risk is determined in all cases by the amount of information the bank holds on its customer when they create the partnership. Traditionally, knowledge, no matter how wide it might be, is limited to careful analyze a series of economic and financial indicators, that cannot capture the entire situation of the customer at that time, and therefore proper risk assessment. Thus it is estimated that marketing has a decisive role in risk assessment because it can provide the specific research information, much more valuable and more complex regarding risk occurrence.

The need to integrate the notion of risk in marketing policy must redefine the relationships between marketing and financial section in order to ensure market development in efficient conditions. A successful business implies taking chances. Multiple risk-taking creates opportunities to obtain substantial profits, creating opportunities for future benefits.

## **2. OBJECTIVES**

In this paper we tried to identify the categories of risks in the field of bank credit activity in terms of banking marketing, including risks determined by the product market, risks arising from capital market, risks arising from banking criterion, risks covered by the Bank for International Settlements.

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<sup>2</sup> Preda, O, Furdui, I. – *Elemente de marketing financiar-bancar*, Ed. Universitara, Bucuresti 2009, pag. 9

### 3. METHODOLOGY

In this paper methodology includes the methods applied to collect data from different sources: ISI and CNCSIS articles, international databases, books, magazines, conference publications, websites. After collecting data we have determined the emerging risks in bank credit activity in terms of financial banking marketing.

### 4. KNOWLEDGE LEVEL ON THE TOPIC

Authors Begg, Fischer and Dornbusch said in the paper Economics, quoting Benjamin Franklin, that in the world we live there are only two sure things: death and taxes <sup>3</sup> but even they have their degree of risk, for no one knows when death will come nor the amount of taxes one will have to pay. We could say we live in an uncertain world, that a present action will not result in a secure future, which involves taking a risk.

In her comprehensive paper "Banking risk management", Luminita Roxin believes that "when defining risk and risk management, most authors focus on traditional functions of banks, brokerage in the area of financial risk by dividing them; in this regard, a particular problem is treating unforeseen losses in banking assets, losses caused by market risk, credit or liquidity".<sup>4</sup>

"Risk Consult " magazine states that "the risk is practically the threat that an event affects a company's ability to function and to pursue strategic objectives. The risk is generally not so much the likelihood that something good happens, but the possibility of something bad happening."<sup>5</sup> "The economic life is governed by uncertainty and any projection of future events is, by definition, hit by risk of failing to achieve the set parameters".<sup>6</sup>

Ion Nițu in "Banking Risk Management" illustrates the existence of permanent risk that covers like a shadow all the bank's businesses, and occurs or not, depending on which conditions are created; more simply said, the banking risk is the probability that a

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<sup>3</sup> Begg, D., Fischer, S., Dornbusch, R., "Economics" : "The only certainties are death and taxes" Economisc four edition, McGraw-Hill Book Company, London 1994, p.236

<sup>4</sup> Luminița Roxin „Gestiunea riscurilor bancare”, EDP, București, 1997, p.11

<sup>5</sup> revista „Risc Consult”, nr.2-3/2002, p.1

<sup>6</sup> Aurel Ioan-Giurgiu „Finanțele firmei”, Editura Presa Universitară Clujeană, Cluj-Napoca, 2000, p.67

transaction does not obtain the expected profit and even experiences a loss. It can be said that banking risk is a phenomenon that occurs during the course of banking operations and causes adverse effects on those activities by deteriorating business, reducing profit or loss record, affecting the functionality of the bank.

In our opinion, the banking risk is a phenomenon present in all the banks' areas of activity and represents the uncertainty of achieving a certain level of profit or the likelihood of a leak.

The Committee on Banking Supervision in Basel published under the title "Basic principles for effective banking supervision", eight categories of risk: credit risk, country risk and transfer risk, market risk, interest rate risk, liquidity risk, risk operational, legal risk, reputation risk.

## **5. CATEGORIES OF RISKS THAT MIGHT OCCUR DURING THE LENDING PROCESS**

Some risks are new and are due to its improved form of operating electronic systems. Thus<sup>7</sup>:

- operational risk - arising from the alleged shortcomings of the operation or integrity of circuits involved in any operations and is especially dangerous and difficult to control when they do not occur in the bank's own networks, but in the clients connections;

- security risk operations – occurs when the geographical expansion and open access opportunities create unprecedented opportunities for fraud against banks and customers;

- risk of reputation - represents the loss of credibility of the banks affected by a series of events: the installation or removal of defects produced substantial electronic accounts.

Other specialists<sup>8</sup> group banking risks in the following categories:

- Risk of delay;

- Purchasing power risk (the loan repayment);

- Interest rate risk or market risk, which adds to the portfolio risk.

Also, risks can be classified by the following criteria<sup>9</sup>:

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<sup>7</sup> Radu Negrea „Diversificarea riscului bancar”, Piața financiară, nr.9/1998, p.98

<sup>8</sup> Marin Opreșcu, Cristi Spulbăr „Considerații privind reforma sistemului monetar și restructurarea sistemului bancar”, Analele Universității din Craiova, Seria Științe Economice, Editura Universitaria, Craiova, 1996, p.108

### **5.1 Risks determined by the product market**

- credit risk, considered the most important risk on the product market, thanks to the depreciation value as a result of bankruptcy or default on the loan;
- risk strategy (business) is the risk that the entire line of business might succumb because of competition or obsolescence;
- Risk related to banking regulations may imply a significant loss of investment opportunity by revoking the licenses of financial institutions which operate as profit centers;
- operating risk is the risk that computer systems may not function properly; It's a significant risk on the product market which can not be ignored by any financial institution;
- risk cargo due to commodity prices that could affect banks and lenders sometimes unpredictably; it has an impact on the economy and borrowers;
- the risk of human resources is the most subtle form of risk; it is difficult to measure, resulting in staff policy: recruitment, training, motivation and maintenance specialists;
- legal risk can manifest itself as the responsibility of creditors when debtors were claiming that their failure was due to the fact that the bank promised that it will withdraw the loan or that will provide additional loans;
- product risk refers to the risk that the products offered by a financial institution may wear out and become uncompetitive.

### **5.2 Risks arising from capital market**

- interest rate risk, represented by cash flow sensitivity to changes in interest rates. The aim is to minimize interest rate risk depending on the ratio of interest-bearing assets and liabilities, which should be as close to one;
- liquidity risk is when a bank does not have adequate liquidity to meet financial obligations at a time, the most important risk capital market;
- currency risk or rate risk affect both product market and capital market and it is highlighted whenever buying or selling any currency other than in the accounts;
- settlement risk, that particular form of error risk relates to the transfer of amounts between local and international banks and presumes involvement of bank competitors, being administered through sophisticated tracking technology payments.

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<sup>9</sup> Ion Nițu „Managementul riscului bancar”, Editura Expert, București, 2000, p.57

### **5.3 Risks arising from banking criterion**

- risks arising from the pure current activity, may take the form of physical risk, financial fraud and criminal liability;
- profit or speculative risks are those arising from the operations and seeking to obtain additional profit.

### **5.4 Risks covered by the Bank for International Settlements <sup>10</sup>**

- financial risks, including interest rate risk, exchange rate risk, liquidity risk, investment risk
- risks arising from partners, which include: risk customers, appeared on the interbank market risk, country risk;
- commercial risk category in which we have product risk, risk services, market risk, the risk of image;
- technical and operational risks arising from the computerization of the bank and the quality of operations;
- risk management of domestic banks, including regulatory risk, risk communication, risk strategy, internal control risk, the risk of human resources.

A World Bank study<sup>11</sup> shows according to the paper "Analyzing and Managing Banking Risk" by Hennie van Greuning, Sonja Brajovic Bratanovic, that in general banking, risks fall into four broad categories:

- financial risks, which include pure risks (liquidity risk, credit risk, solvency risk) and risk hedge (interest rate risk, currency risk, price risk or market position);
- operational risks associated with internal organization and functioning of the bank, including computer systems and other technologies that involve the establishment by the governing rules that banks must comply;
- business risks associated with working in a bank environment, including macroeconomic and political concerns, legal and regulatory factors, and infrastructure and payment system to the

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<sup>10</sup> Banca Reglementelor Internaționale „Risk management Guidelines for Derivates” Basel Committee on Banking Supervision, Basel, 1994

<sup>11</sup> Hennie van Greuning, Sonja Brajovic Bratanovic „Analyzing and Managing Banking Risk”, Casa de Editură Irecsson, București, 2004, p.12

entire financial sector. This group of risks is often known as country risk;

- risks of events includes all types of exogenous risks which, if it materialized, would jeopardize the operations of a bank or the financial condition could damage the appropriateness of that banks capital. Such risks include political events (the fall of a government), banking crises, natural disasters and civil wars, banks unable to meet or maintain a certain level of capital adequate protection. Regarding the risks of events, supervisors have a critical importance in assessing the impact of such events on the state and condition of the banking system and markets, they serve to ensure that appropriate arrangements are established to minimize the impact and size of business interruption and mobilization of other authorities to deal effectively from the consequences of certain events and, finally, monitor the systematic exit of bankrupted institutions from the market.

## **6. BANK RISK MANAGEMENT**

A risk group is favorable for banking. We all know that the main product is the credit bank. "The whole business of lending, the bank comply exactly with the laws on banking activity, Law no. 312/2004 on the State National Bank of Romania, banking rules, instructions and regulations issued by the NBR as the central bank with regulatory powers in the field of credit (...) and their working rules and instructions."<sup>12</sup> Banks, in order to ensure continuity in a world in constant movement and to lead successful and achieve the objectives proposed especially in lending activity is necessary to have a effective management of credit risk. A psychological factor of lending is trust, because the word credit <sup>13</sup> is derived from the Latin "creditum-credit", meaning "to trust". The rules for the authorization and prudential supervision of the NBR credit risk is defined as: "risk

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<sup>12</sup> Preda O., Furdui, i., "Elemente de marketing financiar-bancar" Ed. Universitara, Bucuresti 2009, pag. 63

<sup>13</sup> A. M.Dima. – "Banking Elements", (Part two-Lecturing and Applications), Editura ASE, p.151, Bucuresti, 2006

of loss or registration of the estimated profits of not following the failure by the counterparty of contractual obligations."<sup>14</sup>

Basel Committee on Banking Supervision is an international body composed of representatives of banking supervisory authorities and central banks of major industrialized countries, operating through regular meetings (every three months) made at the Bank for International Settlements in Basel, as follows: Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, Netherlands, Sweden, Switzerland, England and USA.

There was the need to create a more risk-sensitive framework for credit institutions to provide incentives in terms of improving assessment techniques and risk management. Presently, this cardu is offered by Basel II will help strengthen financial stability by increasing the degree of risk analysis and internal assessment.

The main purpose of Basel II is to promote the adequate capitalization of banks and encourage taking action to improve the management of banking risks as strengthening banking and financial system stability is based on several pillars:

- Pillar I - minimum capital requirements - the minimum capital of the bank rate will be calculated using the following formula: Total Capital / Credit risk + Market risk + Operational risk (capital adequacy ratio - a minimum of 8%).

- Pillar II - the Banking Supervision - each bank must have internal processes efficient, able to assess the adequacy of capital based on an assessment of the risks of the portfolio.

- Pillar III - market discipline - market discipline is an important element in promoting safety and soundness of banks and financial and banking system as a whole. Publication of certain information by banks will help to better inform market participants, investors, depositors etc. and will facilitate effective market discipline.

Credit risk assessment act in two dimensions: qualitative and quantitative. The first refers to the analysis of customer's financial situation and future expectations in order to establish loan repayment capacity and the second refers to getting information about the financial responsibility of the customer, finding the risks involved in client work, determining the real purpose for the customer wants credit.

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<sup>14</sup> Norma BNR nr. 12/2002 si Regulamentul nr. 5/2002 privind clasificarea creditelor si plasamentelor precum si constituirea, regularizarea si utilizarea provizioanelor specifice de risc de credit.



In terms of credit use by institutions of advanced risk management techniques, rules settled by the Base Agreement have become less relevant throughout the years.

## 7. CONCLUSIONS

Financial bank marketing includes a lot of activities like market studies, demand and supply of banking products studies, consumer's needs research, promotion of banking products, consumer behavior research, etc., all this activities wanting to boost consumption. The banking system is the element of cohesion and harmonization of the interdependencies that occur between the main links of the market economy and because the stability of national economy is inseparable correlated with the stability of the entire bank system, we believe that all banks should continue to show concern and support to base the best methods and techniques for risk reduction and limitation relating to the work to ensure a framework of sustainable development.

On the credit policy of banks, we propose that through this to promote and encourage diversification of loan portfolio to avoid risk concentration only on specific sectors and to provide opportunities for adaptation and personalization of bank credit supply function the quality, features and reputation of clients, evaluated on the basis of comprehensive interviews to their knowledge of our relationship and establishing lasting cooperation.

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