RISK MANAGEMENT IN BANKING INDUSTRY IN THE REPUBLIC OF KOSOVO

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Abstract: Banks have been responsible for the smooth functioning of the economy for decades. However, the credit crisis, global recession and Covid-19 pandemic have hit the banking sector hard lastly. Risk management (RM) in the banking sector is a rare topic in academic research in the Republic of Kosovo. The purpose of this study is to examine the implementation of RM in the banking sector and in particular their impact on bank performance. This study focuses on commercial banks in the Republic of Kosovo. The primary data used is collected from surveys. The survey questionnaire consists of ten questions. The survey contains open-ended questions about statements made to avoid misunderstandings. Moreover, this study identifies that bank are known with RM implementation to examine the different risks during the operations. As a conclusion, the research propose to all commercial banks in Republic of Kosovo should implement RM seriously because it has been proved that RM implementation delivers positively impact towards banks profitability and other risk threatening the banks.
Keyword: Risk, Management, Banks, Republic of Kosovo

1. INTRODUCTION

The high degree of uncertainty and unprecedented pace of change in the world today is severely challenging more formulaic and stationary approaches to Risk Management. RM presents a significant paradigm, supporting banks to identify risk management level. Moreover, many factors drive banks to engage in the RM process, including the potential for sustained financial and related costs, poor revenue performance, growth opportunities, and board independence.(Khan et al, 2016). Risk management failures were one of the main triggers of the recent global financial crisis of 2007 and 2008, making risk management critically important for banks**.** (Olson et al, 2008). According to Meerssche and Heghe (2012), prior to and early in the financial crisis (2007), risk managers were sometimes seen as those trying to stifle growth. Today, that perception has changed. The function of risk managers is evolving and all managers are looking for colleagues to exchange experience and benchmark. Several financial services firms have strengthened their risk departments, created new governance structures and established risk committees, giving more responsibility to their Chief Risk Officers in such cases. The explains the vast body of research dedicated to RM. Then, it was a significant shift in the role of risk management in banking. That is, from vague responsibility for one type of risk to responsibility and accountability assigned to all risks known as Risk Management (Power, 2004). Moreover, the derivatives market was created to help businesses, organizations, and even governments manage the risk associated with their operations. Banks use derivatives instruments as part of their off-balance sheet activities to control the risks that their businesses are exposed to. Furthermore, financial risk management, which examines and discusses derivatives instruments, is based at the core of concept. Derivatives are forward, futures, options and swaps that are used for hedging, speculation and arbitraging (Tursoy, 2018). According to Nguyen (2019), the most significant factor contributes to the way banks manage their risk is the regulation. Specifically, banks risk management under the regulators' perspective on the risk based-capital regulation and bank risk-taking behaviors. On the other hand, Akhavan et al (2018), argue that the most challenging work for expert system designers is to develop a mode of uncertainty which is widely used in systems analysis.
The purpose of the study is to examine the way commercial banks use RM if they are known with, which technique they do use for identifying risks in the banks and also, what are the main risk in the banks, objectives of risk, type of risks are being measured, managed and controlled, the procedures and tools bank use to analyze these risks, if risk management implemented in the culture and strategy of the organization, main responsibilities for RM.

2. LITERATURE REVIEW

The Risk Management (RM) process is significant developed across the world. RM has gradually gained relevance in recent years due to the complexity of risks and the further development of the regulatory framework**.** (Lechner and Gatzert, 2017) then, there has been a marked shift in the role of risk management in companies. Ranging from vague ownership of some types of risk to all risks with assigned ownership. Risk is often seen as a negative thing in everyday life, B. Hazard, Risk or Loss. However, we know that some risks lead to economic gains, while others have purely negative consequences. Depends on the situation organization's ae facing. (Peterson and Fabozzi 2010). According to Khan et al, (2016) Risk management is an approach that requires the integration of all organizational risks and employs a portfolio view to manage a bank's organizational risks. Moreover, the aim of risk management

is to reduce uncertainty by using a complex models to avoid possible scenarios and making forecast based on probable within a rang possibilities. (Akhavan et al., 2018).
Lastly, the significant contribution to know about risk management is research of Knowing Risk Management. Those studies focused on some phases of Knowledge Risk Management implementation such as awareness, complexity, identification and classification, strategy, and protection(La Torre, 2020). According to Bratianu (2018), the implementation of Knowledge Risk Management approach include three filed of knowledge: rational emotional and spiritual, this approach by connecting the risk with each of these fields, gave the concept of knowledge risk greater width and complexity. Overall, the precis definition of Knowledge Risk Management is a systematic approach of applying techniques and tools to identify, analyse and respond to risk associated with the creation, application and maintenance of organization's knowledge. Knowledge Risk Management should have long term orientation and various Knowledge Management practices expect to supported continuity risk management of an organization's knowledge that is up to date and relevant (Durst & Henchel, 2020).

3. RISK MANAGEMENT

Definitions
There are various definitions for RM the most known are mention bellow:

"*Risk* is a condition in which there exists a quantifiable dispersion in the possible outcomes from any activity. It can be classified in a number of ways." (CIMA Official Terminology,2005)

"Risk management is encompasses the identification, analysis, evaluate, and treat loss exposures and monitor risk control and financial resources to mitigate the adverse effects of loss.(Arena, M., & Arnaboldi, M. (2014).

"Risk management involves identifying, analyzing, and responding to risk factors that are part of an organization's life. Effective risk management means trying to control future outcomes as much as possible by being proactive rather than reactive. Effective risk management therefore has the potential to reduce both the likelihood of a risk occurring and its potential impact**.**(Houston J. and C. James (1996)

4. RESEARCH METHODOLOGY

The research adapts the qualitative methodology. This method is a data collection technique supported by the concept of describing and explaining qualitative data. (Sounders, 2000).The primary data used in the study are collected from three commercial banks in Republic of Kosovo through a questionnaire which consists ten questions. The study focus on three commercial banks in Republic of Kosovo. By using questionnaire we will discover the importance of Risk Management in banks industry. The survey contains open questions about statements made to avoid misunderstandings. This study emphasizes on two hypotheses to examine the RM implementation in bank performance.
H1: RM has significant implementation within banks
H2: Banks are not known with RM implementation

5. RESULTS AND DISCUSSION

In general banks are known with process of Risk Management and they use different steps.
Two of banks are answered that they have established the department of Risk Management.The purpose of the department is to manage credit, market and liquidity risk as well as operational risk in an appropriate manner to ensure that the bank's activity is in compliance with relevant laws, CBRK regulations, industry standards and best practices. The mission of the Risk Management department is to support the sustainable growth of the banks by minimizing exposure to various risks, including credit, market, liquidity and operational risk as the most prominent risks to which the banks are exposed. The objective of the Risk Management department is to minimize the negative effects that risks may have on the bank's financial result and capital through the identification, measurement, evaluation and continuous monitoring of the risks that the banks are exposed too. Another important objective is the creation of a risk culture based on trust, values and awareness of risk perception and risk taking. Each risk has its own characteristics and the way of management differs. However, in general, the Risk Management process begins with risk identification, measurement, control, treatment and reporting. So there is a comprehensive framework where for each stage of the process there are relevant methodologies that are applied to achieve the desired results. On the other hand the third bank answered that the Board of Directors, defines the controls and it applies to identify risk. The bank performs risk analysis on an annual basis, determines key risk indicators. At the moment of applying the risk self-assessment, the definition or description of the risk is also made and the degree of impact is assessed. The results of all operational risk events are reported to the Board of Directors.

The most important banking risks in Republic of Kosovo

− *Credit risk*: The risk of loss if the borrower or buyer does not pay as promised in the transaction.
− *Market risk*: Risk arising from characteristic behavior of the market as a whole or asset class.
− *Liquidity risk*: In a two-party transaction, the risk that one party to the transaction suffers a loss because one of the parties is unable to execute the transaction due to lack of liquid funds. In financial markets, there is a risk that the liquidity of the market as a whole will runs out and transactions will stall.
− *Operational risk*: Risk of loss resulting from inadequate or failed internal processes, people, systems or external events.

The banks use different techniques to identify risks

Banks use various technique to identify the risk such as Brainstorming, Risk Ranking, Heat Maps Brainstorming is done by including all individuals within the company, who evaluate different situations that can generate potential risk, and then the same are evidenced in internal policies together with mitigating measures for each scenario. The risk ranking is done according to the policies approved by the board as well as according to the standards required by the regulator, and the same are then followed by each department leader, and if they occur, they are reported to the chief risk officer. Also, depending on the types of risks, appropriate techniques are also used to identify the risks. For example, for the identification of credit risk, techniques such as analysis of financial statements, statistical analysis, quantitative analysis, brainstorming, brain writing, the interview, and checklist. As for other risks, in general, techniques of gathering information from different sources, either internal or external, are used. Banks use the various procedures and tools to analyze identified risks, depending on the nature of the risk , internal risk assessment models such as, internal customer rating, model of expected loan losses based on the international standard (IFRS 9), probability of failure, migration matrices ,the model of the impact of macroeconomic factors on the level of non-performing loans, risk register, various trend analysis and similar analysis another answer is most risks are analyzed by building stress testing, simulating different scenarios to measure the financial impact of each risk. In the question is risk management implemented in the culture and strategy of the organization, the answer is that banks need to build a sustainable framework to manage all the risk. On the other hand regards responsibility of Risk Management in banks they have answered that in principle, risk management falls on all departments as they are indirectly an integral part of mitigating the risks that each department may face. However, according to legal requirements, it is the risk management department headed by the Chief Risk Officer. The effectiveness of Risk Management in the bank are to support the sustainable growth of the bank by minimizing exposure to various risks, including credit, market, liquidity and operational risk. The effects of Risk Management in the bank include but are not limited to facilitating the lending process by focusing on lower risk segments, better decision making based on aggregated and qualitative information, more accurate forecasting and budgeting to minimize surprises. Caused by potential financial losses. Risk Management also ensures compliance with regulatory requirements, predicting and minimizing the effects of risks related to the bank's operations, support in the design of the bank's strategy, and provides plans for business continuity. Also, Risk Management in the bank is not an option, but it is mandatory according to the laws in force, as a result, good risk management helps the company from eventual financial damages, whether from external or internal effects. On the other hand, Risk Management helps prevent harmful events for the bank, which with the right management steps and the right mitigation measures, ensures solvent operation of the banks in harmony with the legal requirements and business expectations of the shareholders. In the question if the communication of Risk Management towards the board of directors, stakeholders their answers are that risk management is communicated through the Board of Directors, but the same is in full harmony with the regulator, in this case CBRK. The party responsible for the construction of risk management policies is independent from the ownership of the company, therefore the possibility of any conflict of interest for breaking procedures is prevented.

6. CONCLUSION

Risk Management plays a vital role in banks. In general banks in Republic of Kosovo are known with Risk Management and they implement various technique to prevent the different risk during the operation. However one of the most important objectives of the bank is to create a culture of risk management. Therefore, risk management is cultivated to be part of the organization's culture, which eases and mitigates many risks that would otherwise be more difficult to identify, measure and manage. Risk management is incorporated into the bank's strategy, where along with the business ambitions, the risk appetite is determined. The bank's policies and procedures support management to cultivate a risk culture across the banks.

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