RISK MANAGEMENT IN ECONOMIC CRISIS

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Abstract: *The main causes of economic crisis are the unfavorable evolution of the macro-economic behaviour and the poor incautious corporate governance of banks and authorities in decisions involving the granting of loans by banks and mixing factor in a political activity which must be held in essentially on economic criteria.*
Risk management is the art of making decisions in a world governed by uncertainty. Risk management is a process of identification, analysis and response to risks to which an organization is exposed. This process involves analyzing internal and external environment in which the organization operates, identify risks, qualitative and quantitative evaluation of their development and implementation of response, monitoring risks, identifying new situations and develop an environment to assure communication about risk.
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1. Introduction

Any organization can face a crisis, able to endanger its normal functioning and reputation they enjoy in a given community. Some crises are predictable and can be prevented; others can not be suspected or can not be predicted correctly.

The programs responding to crisis, designed and implemented by the departments of public relations must be based on different communication

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strategies, able to influence the public and change how it interprets the crisis.

Just because a crisis appears as a rupture, an undesirable situation that interrupts the normal functioning of an organization and affect its image in the public, are necessary a global strategy for crisis (crisis management), a group well-trained of specialists (cell crisis) and an appropriate communication policy (crisis communication).

Crisis management is a collection of measures prepared in advance, allowing the organization to coordinate and monitor any emergency. An efficient management allows the organization to maximize opportunities and reduce the dangers faced. Crisis management is a set of factors designed to combat the crisis and reduce the damage caused by seizures. Managers' attitudes towards the crisis are included in certain types of strategies and behaviors depending on what each expects from the crisis. (Petrescu I., 2006, pg.212)

2. The results of economic crisis and expectations of companies

After consultations of specialists and analysts in private, in various fields, several waiting directions were systematized as follows:

Increasing the cost of lending will lead to disappearance of some companies, *but will strengthen the position of others*, will scare the negative examples, in turn, potential foreign investors which will redirect to other geographical areas.

Companies' pricing policy will be revised and will return to a normal approach, closer to reality (e.g. real estate prices in the price or to certain products and services);

Those who have cash can benefit from the crisis - can buy properties at reduced prices, shares of companies quoted on the stock market, knowledge, intelligence, being the additional information that can bring the situation to advantage in time of crisis;

Companies that offer alternative products or exporters could benefit, if the leu loses its value. Also, those who have cash or can take credits can benefit. We can buy cheap, especially in real estate or shares in companies quoted on the Stock Exchange. Who will choose the right time to buy will win it. Who buys cheap now, in a time horizon of one year or two, will win;

Entrepreneurs who knew how to properly quantify the value of the money *could win*; those who will be able to keep a balance between expenditure and income, those who will consider the principle of dominoes;

Those who accumulate a reserve fund w*ill benefit* if the attempt to increase the fund is focused on the niche markets, the professionalism in serving the customer, the value added.

In conditions in which decisions are taken in view of future events, the benefits can be immense:

- to anticipate market conditions and competitive advantage;
- understanding the internal and external environment in which the business operates, anticipate the crisis or prevent fraud.

3. Major causes of financial crisis in the world

The main causes of banking crises are the unfavorable evolution of the macro-economic behavior and poor incautious corporate governance of banks and authorities in decisions involving the granting of loans by banks and mixing factor in a political activity which must be held in essentially on economic criteria.

Thus:

- macroeconomic shocks have triggered crises in countries of Latin America such as Chile (early 1980), Mexico (1994-1995) and Argentina (2001);
- lack of caution in granting loans caused banking crisis in Japan in the 90s;
- problems faced Credit Lyonnais (France) in the 90s were the determining factor of the collapse of Credit and International Commerce Bank, which has affected the banking business in Britain, Luxembourg and the United States;
- the interference of political factor in decisions to grant loans occurred in countries where banks are owned by the state, such as China or India;
- in 2001, Berliner Bankgesellschaft, held in the capital city of Germany, entered into major difficulties because of the political decision to grant loans beyond the limits of prudent finance construction of housing;

- in Spain during the 1978-1985 economic recession was triggered by price increases in 1973 of oil combined with poor quality of risk management;
- in Sweden during 1991-1993 crisis was triggered by economic recession which had the effect of lowering the price of real estate with over 50% in a range of only 18 months, with a dramatic increase of unemployment. Losses suffered by the banking sector represented 12% of GDP;
- Switzerland-in the period 1991-1996 crisis was triggered by a decrease in regulated prices in the real estate sector, based on the economic recession, in conditions in which banks had high exposure to loans secured by mortgages. The crisis has affected the banking sector to the equivalent of 10% of GDP;
- in Turkey during the 2000-2004 the beginning of crisis caused by macroeconomic issues. Local banks have financed from external loans in foreign currency the debt in domestic currency of Turkish state, which offered high interest. In autumn 2000, the state has dropped to protect the Turkish lira, which was devalued several months, and banks have recorded substantial losses.

4. Current causes of financial crisis

The global dimension of financial crisis is probably the most obvious feature of the present crisis. In the past, such crises tend to be localized and thus resolve more easily. This time, the difference lies in:

- *the rapid intense financial innovation transmission* - particularly in the modalities of generation and distribution have been designed by leading banks. In this way the risk of spread widely spread at the expense of transparency. As a consequence, the development of the banking system, hidden and powerful unregulated which lacks adequate oversight drew much opacity in the financial markets and increased systemic risks. Trust in the power of „self-regulation" of markets has did not bring the expected results;
- *securing a mortgage* spread financial risk in the economy in a way that exposure of banks to unfavourable loans became negative, nominal, and minimal. Financial innovations designed to reduce risk at the individual or microeconomic reached to increase at the

macro level, thereby increasing systemic risk. Moreover, these innovations have encouraged speculative trading;

- *current major challenges are related to transparency* and liquidity. There is also pressure to impose an accounting more efficient. After the way things are today, central banks and IMF tend to provide procedures for withdrawal with no commission. Financial institutions may be inclined to discipline their behavior if would be subject to pecuniary penalties. For example, it may require several measures to remove speculation;
- *classical methods of risk assessment* have become obsolete. The complexity of instruments currently available in financial markets shows that these methods are lacking confidence. Quantitative methods, often used in making investment decisions and risk assessment in financial markets have inherent, intrinsic conceptual error. The risk can't be reduced to a few numbers, and therefore requires a more profound description;
- *regulatory practices are outdated.* The current system still operates on the premise that banking institutions and markets security are two different entities. Today, that premise is not at all feasible. No attention was given to regulate the shadow banking system. It is obvious need to improve the regulation, to serve all institutions overall.

5. Risk Management

According to the organization The Professional Risk Managers' International Association (PRMIA), risk management is the art of making decisions in a world governed by uncertainty. Risk management is a process of identification, analysis and response to risks to which an organization is exposed.

This process involves analyzing internal and external environment in which the organization operates, identify risks, qualitative and quantitative evaluation of their development and implementation of response, monitoring risks, identifying new situations (Ilie, Gh, 2006, pg. 129) and develop an environment to assure communication about risk.

Combating and preventing risk has multiple aspects:

- risks can arise from the marketing and financial plans, which can not fulfill its objectives. You found a point of equilibrium between expectations and predictable results, so that the degree of satisfaction when the final will be as big;
- best-investment in risk management is education staff. A manager should think about how to do waste, events, surprises management, how to fund risk, how to communicate risk.(Ilie Gh.,2001, pg.93).

The costs of implementing a system of risk management in a company depend on the methods of managing unexpected events. Depending on the organization's profile, there is risk to the project level, product level, the risks that require different approaches and therefore different preparation:

- SMEs in Romania (Daianu D., 2009, on-line source) are poor in culture of risk, which is applied in a much larger share in most countries in Western Europe;
- Risk management should be the practice in any organization. Size that will take the effort of implementation differ from organization to organization, depending on field of activity and size of it.

A crucial component of risk management is the inclusion in the prices of products and services the due costs. In case the risk margin is calculated correctly, the losses due to risk materialization can be covered by the bank. On the international level there is a unitary classification of banking risks.

In banking, (Dobre, D., 2009, on-line source) risk management consists of all processes of risk management and models that allow credit institutions to implement policies and practices based on risk minimization. The domain of models and processes is extended to all risks - credit risk, market risk, liquidity risk and operational risk (Ilie, Gh., 1998, pg.112).

Market risk is related to certain economic cycles. Period of growth in the value of assets, like the property, followed by sudden breakdown with no warning signals regarding to their prices, causing significant losses to investors and funders, including banks.

Operational risk is the loss as a result of deficiencies in the internal activity of banks. One of the most popular categories of risk is the operational risk of fraud. Practice has shown that frauds are common and are carried out either by persons from outside, sometimes with the support of voluntary or involuntary bank staff, or even employees of credit institutions.

The credit risk effect is measured by the cost of replacement of the financial flows that would have occurred if the one who received the loan (the counterparty) would have honored obligations. According to statistical data for financial institutions, credit risk is more important than the market, because diversification is low, due to geographic or sectoral concentration. This is the main cause of bank bankruptcies.

6. Escalation causes of risk situations in present

Until now the situation of risk was seen as a complete far-off likelihood, entirely accidental that result because:

- Lack of board experience in the real risk is not known but assumed situation and an important factor that would have participated in the present situation of crisis;
- Lack of communication between the risk function and the rest of the company is not recognized as a significant cause in the emergence of problems in communication of risk policies at the operational level.

It needs a better interaction with units of financial institutions, as well as internal audit team and audit committee.-relative lack of influence of the risk function, as it is perceived now in the company, must be removed and replaced with a new perception as a new source of competitive advantage and greater authority over key areas of development strategy and capital allocation.

7. Review measures of the risk management field

An essential part of the healing process will be reviewing the entire framework of risk management, not just focusing on isolated issues. Without a full repair, the risk remains that all these should be repeated.

Banks should introduce a robust culture that can address the risk at all levels. Such a culture would mean that employees will become effective managers of risk, but such a change would also mean that employees understand how much the organization is willing to take risks.

Modern structure of risk management should be based on three lines of defense: the operational staff of the units of a company, the office of risk management and internal audit.

Proposals for banking products have now become so complex that only quantitative methods may not be sufficient to assess risk in a volatile and unpredictable market. This crisis was caused by a poor reasoning, with a concentration on the apparent excessive gain short and lack of healthy skepticism.

Romanian financial institutions did not have significant direct exposure to the crisis sub-prime loans because the local market is still dominated by traditional banking products and banking supervision is strict. However, side effects that were felt by their customers must be rectified, including increasing funding costs, the volatility of exchange rates and diminishing of demand in certain areas of the economy. All this undermines the credibility of evaluations of financial products.

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