

## HOW OPTIMAL IS BANK CREDIT RISK REPORTING?

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#### ABSTRACT

*Banks forming the heart of the financial system fulfill an important task in the process of the important thing is carefully determine credibility of the credit user with a flexibility. So, to meet in optimal point of monetary policy practice and banking system profits, risk parameter should be carefully investigated and rationally determined. Consequently, it could be contributed to efficiency of financial markets.*

*In this research, we have argued Turkish Banking System Credit Optimization With doing literature review.*

**Keywords:** Banking System, Finance, Bank credits, Credibility, Risk

**Jel Codes:** E42, E43, E44

### 1. Introduction

Banks, as the most effective owner institutions of the real economy due to the flow of money, have the competence to directly affect economic life both in terms of their structure and decisions. In economies where financial markets are developed, the behavior of these institutions through various mechanisms; price level - consumption - production - will affect the employment chain. In other words, providing the required level of funding; at the same rate it will be an indicator of the success of these institutions. In spite of all banks, the concept of risk, which has a significant impact on the funding capacity of the financial system, puts pressure on the banking system on money supply in all cases: Thus, in this study, risk types and risk measurement parameters will be introduced at the theoretical level. In the last section, the most effective level of risk will be determined and redistributed within certain clusters. In addition; a healthy, systematic and consistent risk determination process will reduce or limit the impact of possible bank crises.

### 2. Material and Method

This is a literature study. Discussed with the help of literature.

### 3. Risk and Risk Factors for Banks

Essentially, prudence is an important element for banks. In this context, prudence, companies should be prepared for the undesirable situations that may occur and the system should be established accordingly. However, prudence must be reported as a minimum between the various combinations of values of profits and assets, and the maximum of possible combinations of debts and expenses reported [3]. In addition to these definitions, the summary situation that emerges is that prudence is built on less optimism. Therefore, the risk that forces the bank to prudence is also. Risk from a general perspective before bank risks: the likelihood of undesirable conditions for each person, organization and situation. It is possible to measure these possibilities according to their quantitative structure, to give degrees and to

take measures according to these degrees and to neutralize the risk. The likelihood of a loss is a natural situation for every company. This is called risk. There is always risk. The risk level also determines the level of structuring requirement for each case. İlhan [4] classified total risk into two categories as systematic and non-systematic risk. According to this, systematic risk is caused by risks such as market risk and interest rate which are not caused by the firm itself, but outside the firm and non-systematic risk consists of the internal risks of the firm [2].

In this context, both systematic and non-systematic risk for banks can be perceived as risks that affect each other continuously

Banking is basically a system of money that operates around certain rules. They collect deposits and give credit. These activities can be turned into an opportunity and more activities can be made with commercial profit. Of course, the breadth of these activities also affects the diversity and level of risk. Nevertheless, the main focus of the risk is the credit point. Here, the risk is concentrated on whether the loan is returned or not. Credit is the most important point where counter-structuring is necessary in risk.

Particularly the weak social discipline and high marginal consumption tendency and fully immature infrastructure of developing countries; These are some of the reasons why disinformation and moral collapse risks are higher than developments. Credit optimality is ensured by considering the risk at the superficial level and ignoring the basic elements.

### **3.1.Elements of Banking Risks**

Banks want to be protected from risks by setting certain parameters together with scientific and technological infrastructure while lending. They also reflect the risk premium determined for the sterilization of their losses to the interest. At this point, the correct evaluation criteria will be determined to make an important contribution to the distribution of interest burden to economic units as little as possible. The right criteria will provide useful results, especially as a result of accurate and in-depth assessment of risk elements and dissemination into the system.

The most important risk factor for the banking system is composed of articles related to some of the negative effects of credit return. The most important of these is the information problem.

#### **3.1.1. Information Problem**

The economic unit that wants to use credit will turn to the options it needs in a combination of liquid and many changes. However, the decision they make may not always be correct. It is not the kind of problems that the credit user would like to explain to the lender, which might cause a disruption in the return of the money purchased to the bank. Thus, disinformation problem may arise. This will be the main source of the risk problem for banks.

Credit user; in order to provide the level of funds needed by the economic unit, the bank also imposes the risks it creates to the bank by being aware of these risks and reflects them to the interest rate in the form of risk premiums; however, since the rise in interest rates and money demand will also adversely affect credit demand, the effectiveness of the fund allocation on the macroeconomic level will be adversely affected and distort the overall picture.

The banking system has solved this problem to a great extent by using the technological infrastructure. The credit path and credit history (regularity in payment) are synthesized by a certain algorithm. This method, which operates quite effectively, also severely punishes the disruptions experienced by credit users and causes the credit needs to be not met for a long time. Particularly, periods of economic cycles cause significant agglomeration in this context.

### **3.1.2. Internal and External Economic and Political Cycles**

The functioning of the banking system; it does not just go to the desired level with the perfect infrastructure of the financial system and all the requirements of the flow of funds are met; at the same time, the general economic situation and the political structure of the country in which it operates should be on a solid and stable basis, but these two mechanisms will necessarily show a cycle. At this point, the depth of ups and downs in this cycle will affect the risk structure of the banking system.

The internal conjuncture is dependent on the global system. In this context, it is known that there are two kinds of scientific effects. One of them is the domino effect and the second is the butterfly effect. The domino effect will show up on a global basis and the butterfly effect on a size basis. Considering the existence and effect of an external cycle in each formation; it can be said that the success of the banking system also depends on the external cycle. This cycle is integrated not only in the economic but also in the course of the international political structure.

#### **3.1.2.1. Internal Cycles**

Particularly in developing countries such as Turkey did not complete development stages, which are found to be continuous and have a deep cycle fluctuations. Within this structure, the level of risk that the banking system may be exposed to is reflected in the credit structure.

Turkey in 1994, 1998 and the period after the crisis in 2001 the Turkish banking system has achieved international innovations such as supervision and standardization [5] this means that the risk assessments of the related banks are updated.

The potential to be affected by internal cycles in the banking system depends on its financial structure and the fragility of portfolio diversity in risk factors. Thus, especially in developing countries, this situation occurs on a more slippery ground. Especially because of the economic and political crises triggering each other, it may make a functional negative contribution to the risks that the banking system will face in political instabilities. 2000 November 2001February crises are important examples in this respect [8]. In these crisis environments, there has been a hard bottom point by contributing to the downward movement of the economic cycles and the downward movement of the political cycle. The economic devastation of bank panics after this process; it is a good example of how the association structure of both the financial system and the real economic system is affected by political and economic cycles.

The increase in welfare loss in the real sector and in the aftermath of the real sector will be quite high with the cost of both the occurrence costs and recovery costs of the bank crises, and the cost of the desire to keep the risk level under constant control.

#### **3.1.2.2. External Cycles**

The interacting structure of the modern capitalist economic system; all countries will be particularly affected by the cycles of the economic plane in which the developed western European countries and the US play the leading role, as capital movements and global trade are effective and free.

Especially in countries where capital movements are freely operating, both foreign exchange risk and interest rate risk constitute risk factors simultaneously and thus functionally risk factor in external shocks in the banking system. As in any case, the bank must be prepared to neutralize the risk in terms of both its financial structure and portfolio diversity when a downward trend in the global trend is experienced. Here, interest rates are reflected in the deposit structure, creating a hamper for the efficient distribution of monetary resources, in other words, it causes the resources to be exploited by the global system through the risk channel that will increase the funding costs.

The only pillar of the global cycles is not economic. Furthermore, as can be seen in the historical process, international political military mobility is a risk factor. Although the problem can only be brought under the roof of the economy mainly due to the economic impact, it should also be evaluated in the cycle since it causes high speculative escape in sudden breaks. Particularly due to the recent mobilization in the world, global terror activities are more organized and stronger, and polarization in the world poses a serious risk factor for the banking system and financial markets. This situation leads to the emergence of new monetary flows and / or definitions in the world and it is included in the banking system as a risk function. In other words, unpredictability in the context of both economic and political developments

#### **4. Reflections of Bank Risks on Interest Burden and Negative Externalities**

In the first part of the study, the main risks to which the banking system is exposed are stated; need to know; This is the level of macroeconomic deterioration that will be caused by cost overlay for fund requesters to eliminate the burden.

It's unlikely for Turkey to maximum effect through 2002 to 2015, investment in statistical analysis covering the expected impact on investments of commercial loans is very limited, if he could put forth the [1] It is certain that an increase in interest rates adversely affects investment demand when it decreases the marginal productivity of capital. This will affect the effective distribution of resources and employment and income -consumption relationship negatively.

The current risk environment creates an increase in other costs to be incurred while providing loans. One of these is insurance expenses. Insurance companies in the current risk environment; as they do business with high premiums, it has a negative impact on resource allocation by reflecting on the costs of providing loans.

An increase in interest rates, especially in economies with high interest rate sensitivity of investments; manufacturing industry will result in a significant reduction in investment or scale-up investment movements[7]. Of course, this is not the only thing that can cause a shrinkage in the economy; The contraction in credit demand towards consumption demand will also create pressure on total demand and lead to a contraction in the economy with a dual effect. In other words, it will have an impact that will force the current macroeconomic outlook to decline.

##### **4.1. Negative Externality as a Result of Interest and Exchange Rate Interaction**

When the risk margin is added to the interest margin, which is the result of the combination of many factors under the leadership of the central bank and the motor power of the financial system and the influence of both its internal and global dynamics, the result is; will determine where to invest their own funds based on the earnings situation of global capital.

Rising interest rates will increase the amount of foreign capital and thus the amount of foreign currency (reserves) will cause profits to fall. However, although this decrease in profit will reduce production activities, it will again put negative pressure on the balance of payments that will increase import demand. Another pressure factor is the negative impact of exports due to the fall in profits. The reason for all of this is a highly fragile and unreliable accumulation of funds with a speculative movement.

Another risk factor is determined as currency risk. *"Most of the Turkish banks directed to "carry trade" operations by borrowing from foreign currency at low interest rate and lending as TRL credits at higher interest rates. But those operations were resulted as bankruptcy 1994 and 2001 financial crisis. Carry trade can be defined as investing in a high-interest currency unit by borrowing from a low-*

*interest currency. The profit obtained from a carry trade is the sum of the "interest rate difference between the investment (local) currency and the funding (foreign) currency" [9]*

As can be seen, the interest burden not only perceives productive investments and encourages financial investments, but also leads to a bubble growth, making internal balances quite fragile. The problem doesn't just end there. It causes interest burden costs and an increase in the general level of prices, leading to a stagflationary macroeconomic disease.

## 6. Conclusion

A healthy financial system is only possible with a healthy banking system. Accordingly, it is of utmost importance that banks perceive and manage the risk element correctly. In the national and global crisis that may occur for the Bank, there must be an asset that can hold itself on the surface of the water. The Bank should be able to protect itself with the credit risk policy implemented until then and provide a risk reporting that will provide sufficient credit. In other words, it should ensure optimality in terms of risk[6].

The banking system, with its technical infrastructure and information network, is perhaps the most equipped and advantageous position in the sector. Taking a deeper effort in gathering information and developing measures for all risk elements mentioned in the study will contribute to a significant improvement both in terms of the banking sector and the real sector and thus to a more positive externality.

In assessing the risks of information, reverse selection and malicious intent, the bank should make it based on routine parameters and some more subjective criteria. This requires the development and recruitment of professionally trained customer credit representatives. In order to achieve this, the banking regulatory authority and the central bank have to agree on the legal basis.

Within the internal economic and political risks, the system should be able to observe the political transformation processes well, without deepening the level of prudence, and should prepare a portfolio distribution prepared for possible shocks.

The biggest risk to be created by external economic cycles is the exchange rate risk. Thus, banks should reduce their foreign exchange short positions to a vigilance position, especially when the crisis is on the agenda.

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