

THE SYSTEM OF MANAGING THE SHAREHOLDERS' CAPITAL OF COMMERCIAL BANK

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The article considers system approach to managing the shareholder's capital of commercial bank, formulate the demands to the system, characterize its elements, show the difference between the regulatory and economic capital in the system, as a result determine the system criteria of capital management.

Each credit company should independently develop the policy of capital management targeted at providing its sufficiency taking into account the strategy of its development. However capital management is not studied from the point of view of system approach both in national and foreign literature as its maximum efficiency can be achieved only in case it influences the current importance of the research.

Such system should be complex, dynamic, open. Its complexity is determined by the heterogeneity of its components and structural variety that causes the difference of system elements, their interrelations, tendencies and changes. Its dynamic character is caused by the fact, that under the influence of the changing factors of external environment there is the movement of capital, the sources of financing are in con-

stant dynamic development since their absolute value is changing, there are structural changes inside the system that supposes the increase of the relations with external environment and proves its openness. Therefore, it is necessary to take into consideration that the sufficiency of bank capital is a complex and high-quality condition in present and future - dynamic condition suffering from the systematic changes under the influence of external and internal factors.

Like any system, capital management consists of two subsystems: a managing one- the subject of management and a managed one - the object of management. There is no doubt that there is a close interaction and interdependence between the elements of the system of capital management (fig. 1).

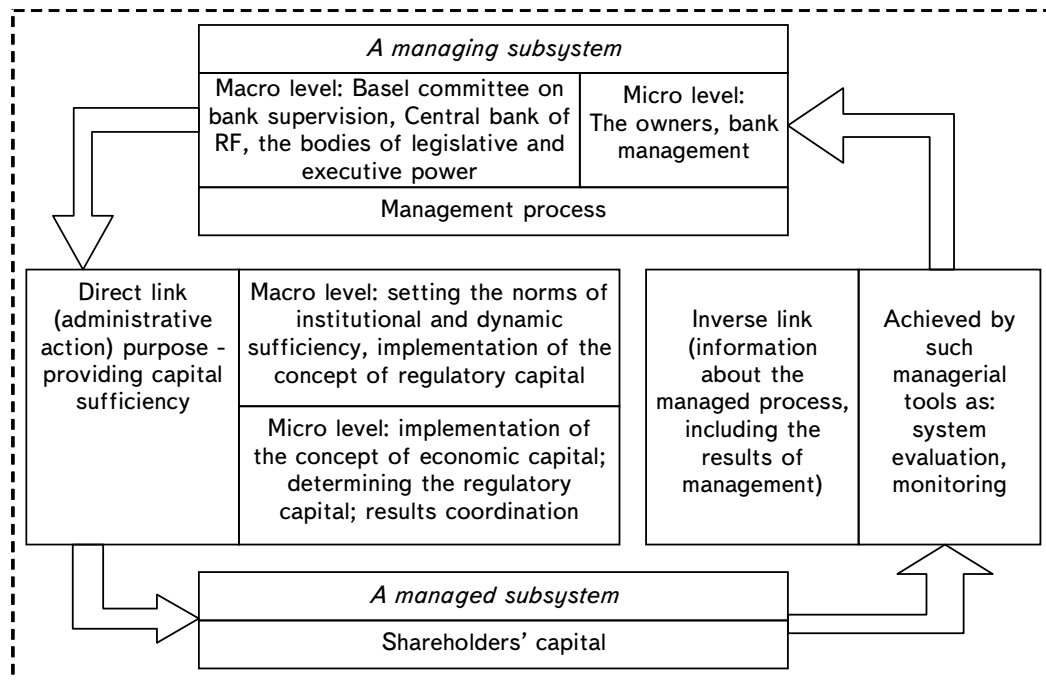


Fig. 1. The structure of "shareholder's capital" management system of commercial capital

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As the shareholder's capital is the tool for both government regulation and internal bank management, it is necessary to differentiate the subjects of macro (Basel committee on bank supervision, Central bank of RF, the bodies of legislative and executive power) and micro levels - bank manager.

At the level of bank system the regulation of capital foresees the establishment of:

- 1) requirements to the minimum size of shareholder's capital for getting the license for the bank for certain types of activity, permission to open the subsidiaries;
- 2) economic norms of bank activity supposing establishing the dependence of active bank operations from the volume of shareholder's capital;
- 3) standards of organizing the activity of internal control and risk management service;
- 4) methods of evaluating the sufficiency of own capital both at national and international levels.

The important place in the system of managing the shareholder's capital belongs to bank management. It should coordinate the shareholder's capital of the bank not only because of the necessity to satisfy obligatory standards but also from the point of view of making optimizing managerial decisions for their implementation in the functioning of credit companies targeted at achieving their own aims. The manager should closely interact with analytical services

of the bank and the department of internal control and audit.

Bank management, having full and exact information about the current situation in the bank and planning its future according to its aims, is able evaluate capital sufficiency. Therefore there is a necessity to define economic capital - important indicator in the system of bank risks management; it measures the level of capital necessary for the bank in the situation of certain risks in different types of activity. According to the concept of economic capital, bank management should be responsible for the presence of the efficient methods of management corresponding to certain risks. The scales of financial service and the functions of corresponding subdivisions depend on the size, organizational and legal form of property of credit company.

Any managerial decision should be based on certain primary parameters and contain a number final indices characterizing both the past and current state of management object. In relation to this it is important to distinguish such system element as evaluation. Using the results of evaluation bank manager forms the final decision about the efficiency of capital management that should be full, well-defined and exact. The content of the process of managing bank capital is represented in fig 2.

Strategy is the basic element of managing the capital of credit company. It determines the

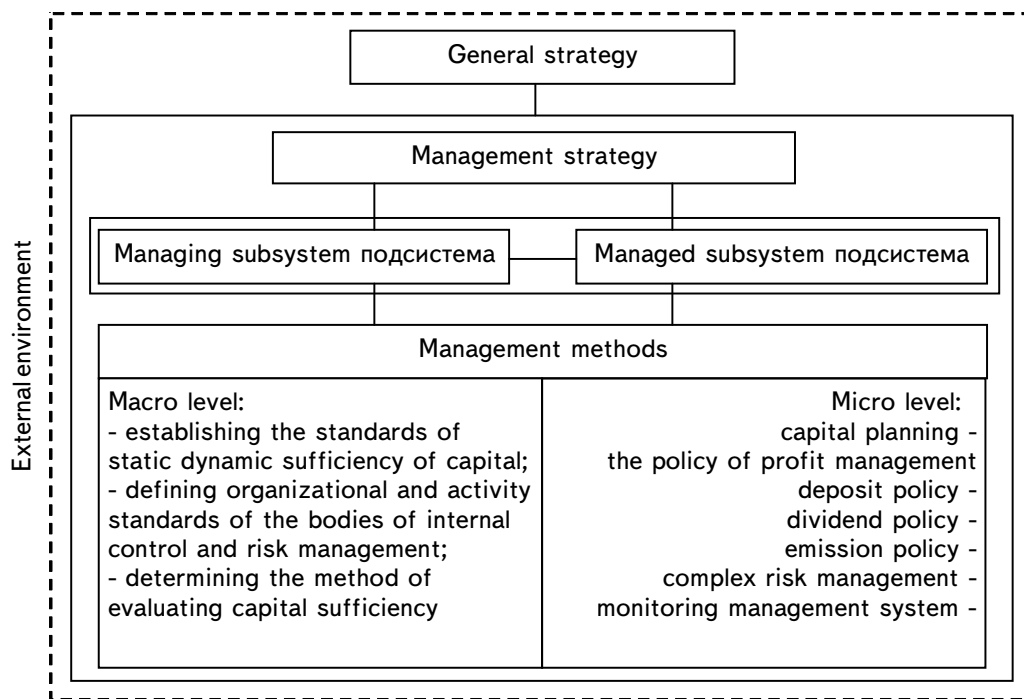


Fig. 2. The content of the process of managing the own capital of commercial bank

system of criteria of evaluating capital and factors influencing on it, as well as the priorities in managing capital and the activities of active management. It is mentioned in Bazel Agreement II that in order to determine internal capital, credit companies should develop a serious, efficient and full strategy and process for evaluating and constant support of sums, types and distributing internal capital that they treat as adequate for the character and level of risks.

The general rule of strategy is the following: it should be targeted at achieving the certain growth of the market cost of the bank, its shares or the growth of ROE, ROA and include the strategic plans in all types of activity.

It is possible to distinguish the following types of capital management strategy in relation to the current activity of credit company.

its aims, the degree of risk and conditions of state regulation.

Stage 4. Evaluating and choosing the source of capital that can meet the demands and aims of the bank.

As it was already mentioned before, the problem of choosing the sources of bank capital growth directly depends on the activity of regulator. There are two main sources of capital formation in the system of managing bank own capital: internal and external.

Formation, distribution and use of profit can be reflected in the policy of bank profit management. Capital growth can be achieved by increasing the profitability of asset operations in credit policy, and also by providing the balance of liabilities on terms and types, reducing the price of resource base - deposit policy. The border of eco-

The strategy of managing the own capital of the bank

Strategies	Advantage	Disadvantage
Liquidity support	Stability in short-term period in the situation of high risks of bank activity	Understated profit, low dividends, , liquidity surplus
Maximum return of capital	High profitability of capital, profit norm and dividends	High demands to the qualification of all bank specialists and high risk to lose liquidity
Balanced	Optimal safety of credit company	Technically complex and labour intensive process of capital management

After choosing bank strategy and determining the degree of the influence of these or that factors on the process of capital management, it is necessary to develop the mechanism of capital management and determine the instruments and methods of implementing the chosen strategy in accordance with the demands of supervision bodies.

Therefore, capital planning should be accomplished by achieving the correspondence between the size of attracted capital and the assets being formed. The size of own capital is represented as a balanced index in the strategic planning of bank activity and determining the level of risk.

Consequently, the process of planning the demand in capital should be accomplished due to the following stages:

Stage 1. Developing the general financial plan of the bank.

Stage 2. Determining the size of capital that can be financed at the cost of internal and external sources.

Stage 3. Determining the size of capital necessary for the bank taking into account

economic expediency of attracting the borrowed means is determined by the effect of financial instrument. Financial instrument ("financial leverage") - is the tool of managing the profitability of own capital at the cost of optimizing the correlation of the used own and borrowed financial assets.

The important and necessary component of managing the internal sources of own capital is complex management of assets and liabilities. The advantage of this method of accumulating capital is that there are no costs of attracting resources, no threat of losing the control by the shareholders, the decrease of their share and profitability for 1 share. The disadvantage - the capital in the process of generation is sensible to the change of interest rates and economic conditions.

The possibility of profit capitalization is directly connected with determining and implementing dividend policy as one of the components of the strategy of managing bank capital. Dividend policy makes it possible for the bank to pay dividends to the owners on relatively constant level and gradually accumulate the capital in order to increase the volume of asset operations.

One of the important methods of capital management is emission policy, able to provide the attraction of assets from external sources by the most efficient method. It is implemented by the additional emission of shares, attracting additional share capital, emission of subordinated debt liabilities. The main aim of emission policy is to attract the necessary amount of financial assets in financial market in the shortest possible terms and at minimum cost.

For the effective implementation of emission policy, it is necessary to provide high-quality analytical work on the research of security market and the position of the shares of the bank in this market, clear understanding of the aims of emission and the correlation of the planned positive result from the additional issue of securities with its costs. The following stages are assumed:

1. The research of the possibilities of effective placement of possible emission.
2. Defining the aims of emission.
3. Establishing the volume of emission.
4. Defining the nominal, types and quantity of emission instruments.
5. Evaluating the cost of attracted shareholder's capital.

The alternative method of managing the own capital is the exchange of shares for debt securities, as a result the bank strengthens its capital and avoids future costs for paying the percentage on cancelled liabilities.

While implementing emission policy it is important to form the real capital of the bank. With introducing the system of deposit insuring the structure of the property of commercial banks became more transparent. In order to reveal the fictitious, "virtual" capital, the Bank of Russia controls its formation what is reflected in the Regulation of the Central Bank of Russian Federation from 10.02.2003 ¹ 215-П "About the method of defining the own assets (capital) of credit companies" by excluding from capital calculation the part of own assets sources for which formation the investors were using improper assets.

Complex management of bank risks. As the concept of the sufficiency of economic capital needs specific approach to risk evaluation, the defining of economic capital becomes an important component of the system of risk management and is a complex process. Consequently, the importance of complex risk management increases.

The complex approach is revealed in the following directions: calculating the whole variety of risks, influencing on the size of capital; the use of various approaches and instruments that help to have a different view on providing capital sufficiency; the use of complementary approaches and methods for achieving the set aims. The complex system of risk management can be considered as a continuous interconnected process that should involve all key subdivisions of the bank. In order to manage the risk of the bank it is necessary to structure the directions of its activity combining them due to certain segments. At the same time we should not underestimate the importance of institutional environment and bank infrastructure. The level of the system of risk management is connected with the abilities of each commercial bank, the scale of its activity and conducted operations.

In the context of implementing the concept of economic capital, commercial banks should have sufficient capital for the support of credit, market and operational risks.

The less implemented aspect in risk management is operational risk management that is connected with the complexity of its formalization, evaluation and measurement. The necessity of operational risk management is determined by the significant amount of possible operational losses that can create a threat to the financial stability of credit company. Risk management includes revealing, evaluation, monitoring, control and minimization of operational risk.

In Russia according to the concept of regulative capital the demands to the minimum amount of capital necessary for covering credit and market risks (interest, currency, fund) are determined, as well as the limitations of insolvency risk that is reflected while calculating the norms of capital sufficiency. In the meanwhile, significant risks taken by the banks are not taken into account that contradicts the principals of effective bank supervision (the 6th principal). The demands of the Central Bank of Russian Federation should be considered as a minimum necessary level that should be used in developing the own complex system of risk management. Such system should correspond to the scale and structure of the bank, has unified methods of risk management, internal methods and models.

In classical approach to credit risks management the coverage of expected losses is done at the cost of the formed reserves, unexpected losses - at the cost of capital.

In banking activity the risk of losing liquidity is closely connected with interest, currency, credit and operational risks, that is of special importance in the situation of global financial crisis.

As a rule, in cumulative bank risk the risk connected with operations having the biggest unit weight among the "clear" assets is predominant. In case the quality of managing separate types of risks is at low level, they considerably influence the cumulative bank risk. Bazel Agreement II accepts that banks should have sufficient capital regarding the character of its risk and have a strategy of its support. Depending on the types and amount of operations and the quality of managing the typical bank risks it is necessary to define their influence on the sufficiency of bank capital. The conclusion about the overall level of the cumulative bank risk is done on the basis of professionally motivated grounds. The derivative from all bank risks influencing on bank capital is the risk of insufficiency of capital. In this case the role of risk-management is in the coordination of risk evaluation on the level of separate functional subdivisions and aggregating the results in cumulative risk evaluation.

The process of capital management should be based on its close monitoring. Monitoring is the system of supervision, analysis, evaluation, diagnostics, adjustment of strategy, evaluation of the accrual of capital cost and the adjustment of the interaction of management subject and object. The monitoring of the system of managing the own capital of commercial bank provides the flexibility and adaptation of management, as well as the dynamic character of this process. Its main role is in tracking the changes: the situation with the capital of credit company, the structure when the chosen strategy of forming and use of capital will contribute to its maximum efficiency. As the aim is to provide and save capital sufficiency, taking into account the specific character of the object, we can formulate the following principals: continuity, fullness, reliability, clarity and relevant character of information. Using the results of monitoring there is the renovation and reinforcement of information about the process of capital management, evaluation of the efficiency of conducted activities, targeted at the adaptation of the system of risk management to the changed condi-

tions of environment functioning and the aggregate of risk influencing on the bank.

Therefore, own capital management comes from the fact that bank is a complex system, the object of banking business. Own capital management has a multilateral character, the subjects are supervisory bodies, the bodies of legislative and executive power, the shareholders, bank management, rating agencies. For the effective management it is necessary to integrate their efforts, and their management should firstly be targeted at providing the sufficient amount of capital. Therefore, it is possible to give definition to the effective management of own capital as the system providing the motivation of all management subjects and people interested in its sufficient amount.

In order to provide the efficiency the system of capital management should satisfy the following criteria:

- ◆ the planning system is adaptive: financial aims are corrected and changed depending on the condition of environment;
- ◆ strategic and operative levels of management are interrelated: there is the possibility to evaluate the influence of current decisions on achieving strategic aims;
- ◆ separate management processes are approved and integrated;
- ◆ management technologies support making managerial decisions in the regime of real time;
- ◆ people making decisions act in the framework of the unified information space.

Thus, the system of capital management is understood as the aggregate of subsystems and elements interrelated and influencing the process of formation and use of the capital of commercial bank in the context of forming the certain principals and methods of managing these processes.

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