

RISK MANAGEMENT FOR BANKS: EVIDENCE FROM BANKS OF KAZAKHSTAN

BANKALARDA RİSK YÖNETİMİ: KAZAKİSTAN ÖRNEĞİ

Yrd.Doç.Dr.Osman ŞAHİN¹

ABSTRACT

Still Kazakh financial institutions have to further develop their methods of risk management as it is still far behind from that of European risk management systems. We are going to make an assessment of risk management system of JSC "ATF Bank". We use different financial statement analysis technics that help us to assess and understand the bank's market position in the banking sector. Later, by analyzing financial statements of some other banks, there will be a comparison between them and finally suggested actions to further improve the risk management in local banks.

ÖZET

Kazakistan Finansal kurumları, hala batılı risk yönetim sistemlerine göre çok gerilerde bulunduğundan kendisini geliştirmek zorundadır. Bu çalışmamızda Kazakistan bankalarından ATF bankın risk yönetim sistemi, finansal tablolar analiz teknikleri kullanılarak ve diğer kazakistan bankaları ile karşılaştırarak değerlendirilmektedir. Buradan hareketle Kazakistan bankalarının risk yönetimlerini geliştirebilmeleri için gerekli faaliyetler hakkında tespitler yapılmaktadır.

Risk Management, Financial Statement Analysis, Banks of Kazakhstan.
Risk Yönetimi, Finansal Tablolar Analizi, Kazakistan Bankaları.

1. INTRODUCTION

Risk management is an open system. The risk management expert tries to determine, minimize and cover the losses, where it is possible. The success of a certain task is predetermined exactly by those factors.

Until recently the risk management had no importance in Kazakhstan banking. The interest rates were fixed, the structure of financial

¹ Turgut Özal Üniversitesi, İşletme (İngilizce)

instruments was also predetermined, the financial markets were comparatively passive, banks were not allowed to operate with foreign currency, planning was done only at the general level, banks had limited autonomy, and the legislation did not support open information, that would allow to determine profitability of certain entity or the capital availability.

Nowadays, the situation is remarkably changing, that required strengthening of the financial and risk management in financial institutions. It is also generally known that to have a successful business for a long period of time the correct preparations should be done for any kind of unexpected external and internal occasions. Still Kazakh financial institutions have to further develop their methods of risk management as it is still far behind from that of European or Western risk management systems.

We are going to make a deep analysis and assessment of risk management system and overall financial performance of JSC “ATF Bank”. Consolidated financial statements for the years 2006 up to 2008 give information of its profitability and risk measurement efficiency. We use different financial ratios that help us to assess and understand the bank’s market position in the banking sector. Later, by analyzing financial statements of some other banks, there will be a comparison between them and finally suggested actions to further improve the risk management in local banks.

Financial ratio analysis is one of the approaches that had historically been employed to make service provider comparisons using performance related data (DeLancer, 1996; Hatry & Fisk, 1992; cited Nyhan and Martin, 1999). Financial ratios have been used by Chesnick (2000) to evaluate differences in financial management and goals between the investor-oriented firms and cooperative enterprises.

Four main types of ratio analysis have been identified by Chesnick (2000). These are liquidity, leverage, activity, and profitability ratios. Liquidity ratios measure the ability to fulfill short term commitments with liquid assets. Although these ratios provide a good indication of liquidity, they do not address the quality of liquid assets. Leverage ratios measures the extent of the firm’s total debt burden while activity ratios show the intensity with which a firm uses assets in generating sales. He explained further that activity ratios give an indication whether a firm’s investment in current and long term assets is too large, too small, or just right. Finally, profitability ratios measure the success of the firm in earning a net return on its operations.

Athanassopoulos and Ballantine (1995) citing Lawder (1989) observed that one of the main advantages of financial ratio analysis is the ability to measure the relationship between two numbers in the financial statements. They noted that ratio analysis as a performance measurement tool enables the performance of the business to be decomposed into a number of aspects, for example, profitability and liquidity thus enabling significant, abnormal and changing trends to be identified and subsequently acted upon.

Financial statement ratios are useful analytical tools in the current research for assessing profitability and risk of some banks.² Financial ratios express relationships between various items from the three financial statements.(The Balance Sheet, The Income Statement , The Statement of Cash Flow)

However, the univariate nature of ratio analysis presents a major limitation in spite of its apparent widespread use for assessing performance (Athanassopoulos and Ballantine, 1995). Conducting an analysis of complex organisations that produce multiple outputs with the aid of ratios of outputs to inputs (Ludwin & Guthrie, 1989). Therefore In this paper will be used ratio analysis with other financial statement analysis technics.

One analytical tool used was *common-size financial statements* that is helpful in highlighting financial data relations both within statements and across statements. Common-size statements express all items in a particular financial statement as a percentage of some common base. Total assets are a common base in common-size balance sheets. Sales revenue is a common base in the common-size income statement.

Another analytical tool is *percentage change statements*, that is helpful in highlighting the magnitude of changes in financial statement data over time. These statements present the percentage change in the amount of an item relative to its amount in the previous period.

Trend analysis is also useful for identifying unexpected variances that may indicate strategic or operational changes or entity weaknesses worthy of additional exploration and analysis. Trend analysis calculates the percentage change for one account over a period of time of two years or more. Significant changes can then be investigated further.

2. FINANCIAL STATEMENT ANALYSIS AND ASSESSMENT OF ATF BANK IN COMPARISON WITH BANKCENTERCREDIT AND KAZKOMMERTSBANK

Analysis of ATF Bank - Bank's short overview: The bank was established on the 3rd of November, 1995. ATF Bank and its subsidiaries provide services in Kazakhstan, Russia, and Kyrgyzstan. The bank is the member of compulsory insurance of deposits system. The system works with accordance to Law of RK "Compulsory insurance of the second-tier bank deposits" as of July 3, 2006 and is regulated by AFN (Agency of Financial Supervision). The bank is included in the main list of Kazakhstan Stock Exchange and its marketable securities registered at London Stock Exchange.

The size of the bank and its operations determine its structure. As a rule, the smaller the bank the more flexible its structure and the higher decentralization will be. ATF Bank's share for assets size in banking system

² P. Stickney Clyde, Paul R. Brown, James M. Wahlen. Financial Reporting and Statement Analysis: A Strategic Perspective, 5th edition by South-Western. Chapters 4-5.

of Kazakhstan is 8,5%. And is said to be in first 10 biggest banks that has market share of 3% in housing loans and 12% in customers' loans. Starting from 2004 ATF Bank gives loans for housing by special Governmental Program for Development of Housing Construction in Republic of Kazakhstan for the 2005-2007y.y, the mentioned program is prolonged for 2008-2009 y.y.

Table 1: On 31st of December 2008: Stockholders of ATF Bank

	<u>2008 (%)</u>	<u>2007 (%)</u>
Unicredit Bank Austria*	99,86	99,70
Others,	0,14	0,30
	100,00	100,00

Source: Reports of JSC "ATF Bank"

*UniCredit Austria is a factual mother enterprise of the Group.

Bank's risks: The Banks have following set of risks:³:

- credit risk; as the major type of risk
- internal risks: interest rate risk, operational risk, currency risk, liquidity risk
- country risk
- market risk
- subsidiary and affiliated organizations risk

Operational Risks: The Bank is also subject to operating risks. The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Bank's strategic planning process.

ATF Bank manages its operational risk through the system of control that foresees the effective division of responsibilities, right for access, confirmation and comparison procedures, staff training, as well as assessment procedures, including internal audit. Below in the Table 2, you can see the operational risks that ATF has determined, as of year 2007

³ Charles Tapiero, "Risk and Financial Management: Mathematical and Computational Methods" John Wiley & Sons, 2004, 10-15

Table 2 : Operational Risks

	OPERATIONAL RISKS	ACTIONS PROPOSED FOR THEIR REDUCTION <i>Management is done through..</i>
1	Indeterminacy, inadequate organizational structure of bank, including distribution of responsibilities, accountable structure and management;	<ul style="list-style-type: none"> - internal normative documents of the bank, ordering execution of all operations and predetermines if needed double control; - The system of internal control, that supports the accomplishment of internal documents - Apply new technology and usage of reserve principles and duplication - Operational risk management is done on each level of Bank structure - Estimation of operational risk management is done through the analysis of all Bank operations within the system of internal control. The structural subdivision responsible for efficiency analysis and improvement of internal control system is internal audit.
2	Inadequate strategies, policies, and/or standards in the information technology field, deficiency in usage of software;	
3	Inadequate information or its inappropriate usage;	
4	Irrelevant staff management and/or unqualified bank staff;	
5	Inadequate construction of business process or poor control of keeping internal rules;	
6	Unforeseen or incontrollable external factors with its effect on bank operations;	
7	Incorrect actions of governing body and bank staff, that will entail narrowing of clients, distrust and negative perception by clients and counteragents;	
8	Alterations in legislation, or risk related with imperfections or mistakes in internal documents/rules, that are regulating conducting of bank activities	

Source: Operational Risk Structure, Credit Policy of JSC “ATF Bank” as of year 2007.

Credit Portfolio: Diversification definitely increases the quality of credit portfolio, but only if it is accompanied by professional management.

ATF Bank has regionally diversified credit portfolio. It has its representing unit all over Kazakhstan. So that it has relatively low regional risk compared to other institutions in Kazakhstan, but comparatively high risk compared to the multinational financial institutions.

The corporate loan portfolio of the bank grew by 38,2% from January 1, 2007 year. The share of corporate loans in the Bank's total loan portfolio is 61.3%. ATF undertook a number of large and important projects in the regions with the best investment climate, resulting from proper administrative policies towards investors and financial institutions from local authorities.

As we see the corporate lending has the greatest part in credit portfolio. The Bank mostly grants its funds for financing different projects in the fields of economy. Large shares in construction, real estate activities and food industry are explained of long term lending policy in the part of diversification portfolio on a reasonable economic sector.

Table 3: Corporate Loans

No	Name	Share, %
1	Construction	17,98
2	Wholesale trade and trading through commission agents	14,58
3	Transactions with real estate	12,99
4	Production of food products	12,98
5	Activity which is ancillary towards financial intermediation and insurance	11,57
6	Agriculture, hunting and connected services	4,91
7	Hotels and restaurants	2,78
8	Financial intermediation	2,55
9	Services rendered mostly to enterprises	2,38
10	Renting without personnel	2,17
11	Retail trading and fixation of home-use articles	1,76
12	Individuals	1,74
13	Rest and recreation, culture and sport activity	1,55
14	Production of other nonmetallic mineral products	1,13
15	Ancillary and additional transportation activity	1,12
16	Production of textile products	1,03
17	Land Transportation	1,00
18	Raw oil and natural gas extraction; services connected with oil and gas	1,00
19	Other	5,00
		100.00

Source: Annual Financial Report of JSC "ATF Bank" for 2007

The Financial Statement Analysis: will aim us to assess a bank's profitability and risks. We are going to examine balance sheet, income statement and statement of cash flows of three banks. They are ATF Bank,

BankCenterCredit and Kazkommertsbank. These banks are taking about one third of the whole market share.

Both of the above stated analysis are attached as an additional columns to Balance Sheet and Income Statement of JSC “ATF Bank” for the years 2005-2008yy.

2.1.1. Common Size Financial Statements, Percentage Change Statements Analysis Of ATF Bank

First we would like to make an analysis of ATF Bank’s asset structure and total liabilities and stockholder’s equity structure.

Asset structure indicates the relative change of current assets to long-term assets over period of 2004-2008yy. The relative ratio is somehow stable for the years 2004, 2005, 2006 with only small changes. And in years 2007 and 2008 the relative structure of current assets decreases and long-term assets increases. This happened due to debt repayment together with initial stage of financial crises in summer 2007. The sum of total assets in the table below differentiate from the sum in the balance sheet because of notes to the consolidated financial statements including information on the maturity dates of assets and liabilities.

Table 4: Asset Structure of ATF Bank and its Percentage change for the 2004-2008yy.

	2004	2005	2006	2007	2008
Total assets	174 998 92	360 385 291	1 029 386 388	957 291 237	986 387 518
Current Assets	97 113 517	207 230 620	612 908 833	304 352 048	375 950 327
Long-term Assets	77 885 075	153 154 671	416 477 555	652 939 189	610 437 191
Asset Structure	2004	2005	2006	2007	2008
Current Assets	55,5%	57,5%	59,5%	31,8%	38,1%
Long-term Assets	44,5%	42,5%	40,5%	68,2%	61,9%
Percentage Change	2004- 2005	2005- 2006	2006- 2007	2007- 2008	
Current Assets	113,4%	195,8%	-50,3%	23,5%	
Long-term Assets	96,6%	171,9%	56,8%	-6,5%	

Source: prepared by authors from Data is from Consolidated Financial Statements of JSC “ATF Bank”

Total liabilities and stockholder’s equity structure: We can say that current liabilities relative structure is stable for the period with only

slight changes. But when considering its percentage change we see a large increase in 2006 and a decrease between the years 2006 and 2007. In 2007 there was a short term liability reduction, basically REPO. And by the October 2007 the bank attracted a syndicated debt totaling KZT 12 billion tenge that is seen between years 2007-2008.

In 2007 the rise of net income by 96,3 % compared with 2006 and also a healthy client base growth made a significant impact on profitability. A short fall in L-T liability can be due to decrease of Kazakh banks ratings and strict requirement with high rates.

Table 5: Total Liabilities and Stockholder's Equity Structure of ATF Bank and its Percentage change for the 2004-2008yy.

	2004	2005	2006	2007	2008
Total Liabilities & Equity	173 648 217	359 068 943	934 338 196	984 654 421	1 019 577 514
Current Liabilities	87 860 076	189 414 042	617 677 560	506 723 654	546 835 133
Long-term Liabilities	67 608 152	141 827 079	259 435 475	403 030 303	376 849 632
Total Equity	18 179 989	27 827 822	57 225 161	74 900 464	95 892 749
Total liabilities and SE Structure	2004	2005	2006	2007	2008
Current Liabilities	50,6%	52,8%	66,1%	51,5%	53,6%
Long-term Liabilities	38,9%	39,5%	27,8%	40,9%	37,0%
Total Equity	10,5%	7,7%	6,1%	7,6%	9,4%
Percentage Change	2004-2005	2005-2006	2006-2007	2007-2008	
Current Liabilities	115,6%	226,1%	-18,0%	7,9%	
Long-term Liabilities	109,8%	82,9%	55,3%	-6,5%	
Total Equity	53,1%	105,6%	30,9%	28,0%	

Source: prepared by authors from Data is from Consolidated Financial Statements of JSC "ATF Bank"

2.2. Trend Analysis of ATF Bank:

The trend analysis shows us the changes in revenue, net income and earnings per share for over a time. Net income and EPS are closely related to each other as dividends are paid out of net income. Revenue may increase due to expand in the market or interest and non-interest income rise but it does not mean that return to investors will be high too. The rise in total

revenue but decrease in net income can be due to poor cost management or some other reasons of ineffective management of assets. The fall between years 2007 and 2008 is also accompanied by negative external factor such as financial crises, strict governmental rules and limitations and decrease of consumers borrowing and putting deposits.

Table 6: Trend Analysis Figures and Trend Analysis Of ATF Bank

Figures	2005	2006	2007	2008
<i>Revenue</i>	27 309 597	59 887 320	117 819 785	133 513 643
<i>Net income</i>	4 056 222	4 295 410	7 244 026	- 7 201 026
<i>EPS</i>	118	181	360	- 324

Trend Analysis

	2005	2006	2007	2008
<i>Revenue</i>	100,00%	219,29%	431,42%	488,89%
<i>Net income</i>	100,00%	105,90%	178,59%	-177,53%
<i>EPS</i>	100,00%	153,39%	305,08%	-274,58%

Source: prepared by authors from Data is from Consolidated Financial Statements of JSC "ATF Bank"

2.3. Ratio Analysis of ATF Bank in Comparison With Bankcentercredit and Kazkommertsbank

Financial Statement Ratios Analysis will examine aspects of bank's *profitability* and *risk*. Our analysis examines changes in the financial ratios for banks over time, a process referred to as time-series analysis. We attempt to answer questions like:

- Is ATF Bank becoming more or less profitable overtime?
- Is it becoming more or less risky?
- Are changes in bank's strategy, economic conditions, competition, or other factors causing its profitability and risk to change?

The comparison of financial ratios of ATF Bank and those of its competitors will be made, a process referred to as cross-section analysis. There are 36 banks functioning in local market for the year 2008 and we have taken BankCenterCredit and Kazkommertsbank to make a comparison as these banks possess different structures of management, shareholders, and risk management system approach. We will also compare their results with industry averages.

2.3.1. Profitability Analysis of ATF Bank in Comparison With Bankcentercredit and Kazkommertsbank

Profitability Analysis-ATF Bank: Profit margin for ROA is decreasing over the period that is profit out of total revenue continually falls. *ROA_earnings* are good for 2005, 2007, and low for 2006, and negative for

2008. Profit margin for ROE is low for amount of total revenue in 2005 and negative for years 2006, 2007, 2008. ROE return on equity is positive and is more than 10% that is said to be enough to pay common share dividends and retain for business growth. LLP the higher this ratio the better the bank is handling itself toward problematic loans. The reserve to loan is enough in 2006, in 2007 is low but in 2008 it is very low that means decrease of quality of assets

Table 7: Profitability Ratios of ATF Bank

<i>Profitability Ratios</i>	<i>2005</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>
Profit Margin for ROA	56,26%	48,00%	49,14%	33,97%
ROA	1,34%	0,65%	1,36%	-0,86%
Profit Margin for ROCE	2,40%	-18,54%	-5,54%	-16,93%
ROE	1,22%	0,43%	0,80%	-0,78%
LLP(loan loss provision)	1,74%	12,50%	7,77%	2,71%

Source: prepared by authors from Data is from Consolidated Financial Statements of JSC “ATF Bank”

Profitability Analysis-BankCenterCredit: Profit margin for ROA is continually decreasing from 2005 up to 2008, that indicates increasing cost structure, or decreasing production efficiency, but these numbers of profit margin are acceptable. *ROA* is adequate for the period except for 2008. Profit margin for ROCE is enough to pay dividends and retain for business growths but in 2008 the level falls below 10% that indicates inadequate sum to pay out dividends. ROE is very good for years 2006, 2007 but falls below 10% in 2008

Table 8: Profitability Ratios of BankCenterCredit

<i>Profitability Ratios</i>	<i>2005</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>
Profit Margin for ROA	45,52%	37,62%	36,51%	35,98%
ROA	1,57%	1,88%	2,19%	0,76%
Profit Margin for ROCE	14,57%	11,99%	10,98%	3,87%
ROE	-	28,94%	28,61%	7,03%

Source: prepared by authors from Data is from Consolidated Financial Statements of JSC “BankCenterCredit”

Profitability Analysis-Kazkommertsbank: Profit margin for ROA is high and stable for the periods 2005, 2006, 2007 and in 2008 we see just a small drop but still the bank is able to make profit.

ROA is quite good that shows the efficiency of generating profits from assets employed. All sums are positive.

Profit margin for ROCE is enough to pay dividends and retain for business growth for the all period listed above except for the last year 2008 where there is a drop but still the bank generates return not in adequate amount.

ROE is very satisfying for the all periods except for 2008 but still bank generates positive return on equity. The highest amount was in 2005 then it dropped in 2006 and again rose in 2007 and there was a large fall. The fall in all these indicators are due to decrease of customer solvency, financial crises and other internal factors.

LLP is quite good and it also indicates the higher non-performing loan the higher LLP. But the numbers are acceptable to say that the bank has enough resources to come against problems with bad loans.

Table 9: Profitability Ratios of Kazkommertsbank.

<i>Profitability Ratios</i>	<i>2005</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>
Profit Margin for ROA	52,82%	50,81%	51,41%	37,97%
ROA	1,85%	1,69%	2,46%	0,44%
Profit Margin for ROCE	19,46%	16,70%	16,47%	5,23%
ROE	28,35%	17,84%	20,74%	6,45%
LLP(loan loss provision)	5,90%	4,62%	5,46%	6,16%

Source: prepared by authors from Data is from Consolidated Financial Statements of JSC Kazkommertsbank

Cross-sectional Analysis-ATF Bank and BankCenterCredit: ATF Bank (2005-2007, 2008) ROA exceeds ROE, the bank do not generate a higher return on capital provided by creditors and preferred shareholders than the cost of that capital. Profitability of operations are well performed but in 2008 the bank faces problems with both return on capital and return to common shareholders.

BCC (2005-2007,2008) ROE exceeds ROA, The bank in this case can generate a higher return on capital provided by creditors than the cost of that capital, the excess return belongs to common shareholders. Despite financial crises even having low ROE the sum is not negative that states effective financial leverage, as an example for year 2007:

$$\text{FL for BCC is } 28,61\% / 2,19\% = 1308,35\%$$

$$\text{FL for ATF is } 0,80\% / 1,36\% = 58,82\% \text{ comparatively very low to BCC}$$

We measure incremental effect of financial leverage beyond ROA by computing the ratio of ROCE divided by ROA. So financial leverage works less effectively for ATF Bank.

Profit margin for ROCE comes after financing costs and for ATF Bank it is low on its own and low compared to two other banks.

Cross-sectional Analysis-ATF Bank and Kazkommertsbank: The situation in Kazkom is better by comparing all five ratios. Non of the sum is negative for Kazkom compared to ATF Bank. All ratios are satisfied and despite the crises the Kazkom is able to generate returns and revenues even with small amount.

2.3.2. Risk Analysis of ATF Bank in Comparison With Bankcentercredit and Kazkommertsbank

Risk Analysis of ATF Bank: Short-term liquidity risk is high, as no one of these ratios meet the standards for healthy firms that frequently close any cash flow gap in their operating cycles with short-term borrowing. The reasons may be longer-term solvency difficulties. For example in this case the bank has very high debt structure in its capital.

Table 10: Risk Ratios of ATF Bank

Short-term liquidity risk	2005	2006	2007	2008
Current ratio	1,09	0,99	0,60	0,69
Quick ratio	0,17	0,25	0,11	0,17
Operating cash flow to CL ratio	- 0,35	0,09	- 0,31	- 0,01
Long-term Solvency risk				
Long-term debt ratio	39,50%	24,77%	40,93%	36,96%
Debt/Equity ratio	514,90%	453,36%	538,09%	392,99%
Liabilities to Assets ratio	92,33%	94,54%	92,39%	90,59%
Interest coverage ratio	0,80	0,95	0,98	1,07
Operating cash flow to TL ratio	-19,86%	5,75%	-18,18%	-0,83%

Source: prepared by authors from data of Consolidated Financial Statements of JSC "ATF Bank"

Long-term solvency risk is high too, as indicators still below standards for healthy bank. Except for 2006 there was a positive cash generating case but in all other years it is negative that makes situation risky. According to these ratios we found that the bank is not able to make interest and principal payments on long-term debt when they come due. The cause can be low earnings over a period of years.

Risk Analysis of BankCenterCredit: Short term liquidity risk is high as ratios are lower than set standards. The reasons may be longer-term solvency difficulties. For example in this case the bank has very high debt structure in its capital.

Table 11: Risk Ratios of BankCenterCredit

Short-term liquidity risk	2005	2006	2007	2008
Current ratio	0,29	0,73	0,19	0,34
Quick ratio	0,14	0,42	0,17	0,13
Operating cash flow to CL Ratio	0,00%	13,71%	-0,02%	27,33%
Long-term Solvency risk				
Long-term debt ratio	56,56%	69,84%	62,37%	70,03%
Debt/Equity ratio	727,24%	1002,61%	753,90%	696,19%
Liabilities to Assets ratio	92,22%	93,03%	91,73%	89,94%
Interest coverage ratio	0,72	0,72	0,76	0,93
Operating cash flow to TL Ratio	0,00%	4,11%	-0,01%	7,32%

Source: prepared by authors from data of Consolidated Financial Statements of JSC "BankCenterCredit"

Long-term liquidity risk is high too. Together with not able to repay its long-term debt the risk of bankruptcy is increased too. There is a high proportion of debt to capital structure that makes the situation very risky for future functioning of the bank.

Risk Analysis of Kazkommertsbank: Short-term liquidity risk; Lets summarizing each of them individually: CA/CL is preferable and bank has enough current assets to cover current liabilities but one indicator is not enough and we consider the other two. Quick ratio is acceptable. The last one was negative in years 2006 and 2007 but in 2008 it generated positive sum of cash. But that amounts are not enough to pay obligations so we say that it is not satisfactory ratio for the bank.

Table 12: Risk Ratios of Kazkommertsbank

Short-term liquidity risk	2005	2006	2007	2008
Current ratio	1,22	1,15	1,02	1,03
Quick ratio	0,62	0,47	0,38	0,23
Operating Cash Flow to CL Ratio	7,26%	-28,27%	-18,13%	7,33%
Long-term Solvency risk				
Long-term debt ratio	44,71%	41,45%	45,52%	45,95%
Debt/Equity ratio	605,17 %	383,93 %	427,42 %	382,80 %
Liabilities to Assets ratio	92,61%	89,20%	89,35%	88,00%
Interest coverage ratio	0,59	0,76	0,75	0,85
Operating cash flow to TL Ratio	3,75%	-14,96%	-9,26%	3,55%

Source: prepared by authors from data of Consolidated Financial Statements of JSC Kazkommertsbank

Long-term Solvency risk is high and the situation is risky for long run period. All ratios are acceptable with high risks. Operating cash flow is negative or small that states unhealthy business. But still the bank has good internal policies and governmental support that may have positive impact on its long run position.

Cross-sectional Analysis: ATF Bank and BCC both have high risk for short term and long term. But difference is that CA/CL ratio is somehow higher in ATF than in BCC. But BCC has positive cash flow from operations. So the situation is risky for both of them but this small differences do not show the priority of one of them.

ATF Bank and Kazkom, in both of the risk of short term solvency presents, but in Kazkom it is comparatively lower. First four ratios for both banks approximately the same but the last one states that both banks have problems with generating positive cash flow from operations.

The Comparison with Industry:

Table 13: Sector Statistics and Overall Financial Performance

	Sectors statistics			
	2008	2007	2006	2005
Number of Banks	36	35	33	34
Gross foreign debt(US\$bn)	-	46,00	33,30	15,30
Total assets(US\$bn)	97,50	97,12	69,86	33,75
Total Liabilities(US\$bn)	85,50	81,00	54,00	30,00
Total equity(US\$bn)	11,95	11,86	6,93	4,37
Overall Financial performance				
ROA,%	0,04	2,3	1,4	1,8
ROE,%	0,22	18,6	14,7	14,1
CAR,%	-	14,2	14,5	15

Source: AFN (<http://www.afn.kz>)

ATF Bank: ROA and ROE are both below the industry that shows low return on asset in bank. Income generated from operations are low. Steps to overcome the problem may refer to cost management that includes operating expenses and personnel and administrative expenses.

BankCenterCredit :ROA and ROE are better than in ATF Bank, and comparing with industry are quite meeting them. ROE is higher for years 2006, 2007, 2008. Comparing with industry we can conclude that the situation is less risky in BCC than in ATF Bank. And profitability or return to equity is higher too. Recently, the bank experiences higher proportion of liabilities in the capital structure, that is higher is the probability to experience bankruptcy.

Kazkommertsbank: ROA and ROE are higher in Kazkom than in whole industry. ROE is much more higher than in industry. So Kazkom's relative profitability is high. But there is a combination of high profitability and high debt ratios that requires bank to operate in less risky manner.

3. CONCLUSIONS AND SUGGESTED ACTIONS TO DEVELOP RISK MANAGEMENT IN BANKS OF KAZAKHSTAN

Since 2003, the supervision of the banking system has been performed by a specially established Agency of the RK on Regulation and Supervision of the Financial Market and Financial Organizations (AFN). The Agency also controls activities of insurance companies, pension and investment funds as well as operations on national financial and stock markets. The Agency imposes strict regulations on the local banks and aims to increase the efficiency and stability of the financial system.⁴

⁴ Kazakhstan's Banking Sector – VTB Bank Europe Research. 15 April, 2008

Until recently the risk management had no importance in Kazakhstan banking. The interest rates were fixed, the structure of financial instruments was also predetermined, the financial markets were comparatively passive, banks were not allowed to operate with foreign currency, planning was done only at the general level, banks had limited autonomy, and the legislation did not support open information, that would allow to determine profitability of certain entity or the capital availability.

Below is the list of what has to be done to further develop methods of risk management:

- 1- The financial information needs to be transparent and be available at request
- 2- The overall financial policy has to be clearly determined
- 3- Attractive career path have to be developed, so that there is sufficient number of experts in risk management sector
- 4- Develop the process of assets and liabilities control
- 5- Restructure the organizational system
- 6- Clearly assign the responsibilities and increase the control effectiveness

Above listed should allow the Kazakhstan banking sector, that is still far behind its European or Western competitors to become competitive in risk management.

In our opinion the method of joint management of assets and liabilities is more preferential. In modern time with high competition in banking sector Kazakh banks need to pay more attention to develop strategies of liquidity management and create special group responsible for that.

Kazakhstan faced a financial crisis for the first time since its independence, and judging by existing preconditions, this crisis has all chances to spill well beyond the banking sector. Understandably, amid the constant economic growth in recent years, risk management received the least possible attention. The requirements set by regulators, commercial banks created risk management systems a long time ago, while private businesses have only now realized that they should reconsider their corporate management standards. The crisis will demand that all the existing shortcomings be corrected both at an individual level and on the macroeconomic scale. The government has already adopted a set of measures to stabilize the situation and it has pledged to draft a large-scale anti-crisis program. Time will show how efficient this program will be.

Increasing number of a non-payments in the country are related to underestimation of the importance of credit risks, those banks until recently used to ignore while formulating their policies.

While evaluating financial ability of the client it is important to consider all related factors otherwise the bank may incur large losses. The

credit departments need to continuously analyze and use the foreign experience and to increase experience of Kazakhstan banks.

Banking in Kazakhstan is changing. To increase the economic effectiveness and develop new methods of resource allocation, the government is taking steps to motivate competition and establish open economy principles. In order, to compete the bank structures need to become flexible, adaptable and quickly react to dynamics of environment.

The principles of government interventions into the financial sector of economy also have changed. The government agency provides such political and legislative environments, so that banks can operate effectively. In competitive environment the banks should be able to exercise their autonomic role, and be independent in their credit policies.

Financial liberalization, increasing competition and diversification challenge the banks to solve new problems and motivate occurrence of new risks. Without well-developed risk management, banks of Kazakhstan may face a crisis of large-scale.

Risk management is defined as an art that can never reach its top. Frequently people think that brilliant staff would predetermine the success of the bank. The expert staff is important, but it is the structure of control, financial perspective and the professionalism of the staff that guarantees the success.

The purpose and the tasks of risk management department are usually predetermined by the dynamic economic environment in which bank has to operate. Below is the list of common that characterizes recent Kazakhstan economy:

- high inflation
- world price decrease of Kazakhstani main export goods
- devaluation of tenge
- increased number of financial institutions under the threat of insolvency
- new regulations by government
- the overall growth of financial industry of the country
- the introduction of new, non-traditional bank services
- Increasing competition, etc.

According to above stated condition it is expected to be a difficult year for local banks. And Banks having strong strategic foreign shareholders could remain to be more stable in current difficult time, than those who do not have them.

Risk undertaking is an important aspect in the management of any financial institutions activities. We need early warnings, as the courses of corrective actions are easier when there is a time to make demanded adjustments. The purpose of bank existence is to make sure its operations are

profitable, which is possible only when the risks undertaken are reasonable, controllable and within the limits of their financial capabilities.

REFERENCES

1. Annual Report of JSC “ATF Bank” for years 2005, 2006, 2007, 2008
2. Athanassopoulos, Antreas D. and Joan A. Ballantine (1995) “Ratio and Frontier Analysis for Assessing Corporate Performance: Evidence from the Grocery Industry in the UK” *The Journal of the Operational Research Society*, Vol. 46, No. 4 pp. 427 – 440
3. Chesnick, David S. (2000.) “Financial Management and Ratio Analysis for Cooperative Enterprises,” US Department of Agriculture, Rural Business Cooperative Service, RBS Research Report 175.
4. Clyde, P. Stickney and Paul R. Brown, James M. Wahlen. *Financial Reporting and Statement Analysis: A Strategic Perspective*, 5th edition by South-Western, part of the Thomson Corp., 2004. – 1080p.
5. Consolidated Financial Statements of BankCenterCredit, Kazkom for years 2006, 2007, 2008
6. Credit Policy of JSC “ATF Bank” as of June, 2007
7. DeLancer, P. M. (1996) “Public Productivity and Data Envelopment Analysis (DEA): How compatible are they?” Paper presented at the annual Meeting of the American Society of Public administration, Atlanta, GA.
8. Global Financial Stability Report. IMF April, 2009 p.145
9. Hatry, H. and Fisk, D. (1992) “Measuring Productivity in the Public Sector. In M. Holzer (Ed.) *Public Productivity handbook*, New York, Marcel Dekker.
10. Ibiwoye, Ade. “Evaluating Financial Services Productivity: A Comparison Of Ratios, Index Numbers and Frontier Methods”, *Journal of Economics and Engineering*, ISSN: 2078-0346, February, 2010
11. Kazakhstan Financial Stability Report as of December 2007
12. Kazakhstan’s Banking Sector – *VTB Bank Europe Research*. 15 April, 2008
13. Law on Development of Financial Instruments in RK, as of July 2, 2003 #461-II
14. Law on Insurance Activities in RK, as of December 18, 2000 #126-II
15. Law on Bank and Banking activities in RK as of December 2006
16. Lawder, K. (1989) “Ratios 101; Back to the basics of financial analysis.” *Business Credit*, June, 28-30.

17. Ludwin William G. and Guthrie, Thomas, L. (1989) "Assessing Productivity with Data Envelopment Analysis" Public Productivity Review Vol. 12 No.4 pp.361-372
18. Nyhan, Ronald C. and Lawrence L. Martin (1999) "Comparative Performance Measurement: A Primer on Data Envelopment Analysis" Public Productivity and Management Review, Vol. 22,
19. The structure of Risk Management Department of JSC "ATF Bank" as of June, 2007
20. Tapiero, C.. Risk and Financial Management: Mathematical and Computational Methods: 2004 John Wiley & Sons Ltd. 10-15 p.
21. <http://www.imf.org>.
22. <http://www.afn.kz>