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Risk Management Strategies of Non-Banking Financial Institutions: A Survey Based Analysis of Financial Experts

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Abstract

This research helps in identifying and analysing the risk management strategies of non-banking financial institutions (NBFIs) Existing research finds that NBFIs use various risk management strategies, such as diversification, hedging, and insurance, to manage their risks. Additionally, there have been several challenges identified within this field that NBFIs face in implementing RMS, such as inadequate resources, lack of expertise, and regulatory constraints. There is an increasing importance to developing comprehensive risk management strategies that are tailored to the specific needs of NBFIs. It also emphasizes the need for NBFIs to increase their awareness of the potential risks they face and to implement measures to mitigate those risks. Additionally, an underscoring of the importance of having a robust risk culture within NBFIs, which involves promoting a risk-aware mindset among employees and encouraging a culture of open communication and transparency. The study provides useful insights for NBFIs in improving their risk management practices and for regulators in formulating policies to enhance the resilience of the financial system. The researcher had conducted the study survey with the help of a structured questionnaire on 200 respondents (financial experts) to know different Risk Management Strategies of Non-Banking Financial Institutions and concludes that there is significant effect of Risk Management Strategies of Non-Banking Financial Institutions.

Keywords: Business continuity planning, Risk assessment, Contingency planning, Business interruption insurance, Risk monitoring, Cybersecurity risk management.

Introduction

Non-Banking Financial Institutions (NBFIs) are financial intermediaries that provide financial services but do not have a full banking license. They include entities such as insurance companies, asset management firms, investment banks, and other financial services providers. NBFIs play an important part in the financial framework by providing credit, liquidity, and investment opportunities to consumers and businesses. However, like any other financial institution, they face various threats, inclusive of risk of credit, liquidity risk, market risk, operational risk, legal and regulatory threats, among others.

Effective RM is crucial for NBFIs because their operations are vulnerable to various internal and external factors that can adversely affect their financial stability and reputation. For instance, credit risk arises from the potential default of borrowers, market risk from the adverse movements in financial markets, and operational risk from internal system failures or external events. Therefore, NBFIs need to have robust risk

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management frameworks in place to identify, measure, monitor, and manage risks effectively. Effective risk management strategies can help NBFIs minimize the likelihood of financial losses and reputational damage, enhance their financial stability and resilience, and maintain the trust and confidence of their stakeholders.

RM is a critical aspect of any business or organization, particularly in the financial sector. It entails identifying, evaluating, and prioritising risks, accompanied by the integrated and efficient use of assets to minimise, track, and regulate the possibility and consequences of bad occurrences. For non-banking financial institutions (NBFIs), risk management is particularly important given the inherent risks associated with their operations such as credit risk, market risk, liquidity risk, operational risk, and legal and regulatory risk. Effective risk management strategies can help NBFIs minimize the likelihood of financial losses and reputational damage, enhance their financial stability and resilience, and keep up the stakeholder trust and security. Therefore, it is essential for NBFIs to have robust risk management frameworks in place to identify, measure, monitor, and manage risks effectively.

There are various risk management strategies that NBFIs can adopt to manage their risks, including diversification, hedging, insurance, risk transfer, and risk retention. These strategies require a comprehensive understanding of the risks faced by NBFIs and the ability to develop and implement effective risk management policies and procedures. The results of this study will be useful for NBFIs in advanceing their RMS and for regulators in formulating policies to enhance the resilience of the financial system.

Literature Review

Dardac and Chiriac (2010)'s study highlighted the need of implementing corporative governance principles in Romanian nonbanking financial organisations as a risk management tool. Through the implementation of best internal audit and control practises, this will foster ethical values and a process control climate. They found that a link between incentive payments to managers and effective due profit exists, and the National Bank of Romania could step in and choose to change some managerial pay packages. This might cause significant distortions in NBFI management. Gakure et al., (2012) is especially helpful in this scenario as it looks at the influence of CRM on workings of commercial bank sanctioned unsecured loans in Kenya. Furthermore, this research discovered the fact that participants suggested that RM slightly influenced the outcome of unsecured loans from banks while the controls and responses set up moderately influenced the efficiency of unsecured bank loans.

Ishak and Nor (2017)'s research looks into the link between the board of directors (BOD) and the establishment of (risk management committees) RMC for NBFIs as noted in Bursa, Malaysia. Primary data is collected from company's fiscal reports from years 2014-2015. In this study, several BOD features and the formation of RMC, as well as some control factors, are investigated. Meanwhile, the creation of RMC is negatively related to the BOD outside directorship. The results provide

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data on the evolution and significance of the BOD and the creation of RMC for Malaysian NBFIs.

Jabeen (2009)'s research focuses on CRM in Bangladeshi NBFIs. In this regard, IDLC Finance Limited has been used as a model organisation, with its services, laws and regulations, and corporate governance considered. In their study, the author manages to view several factors associated to CRM and concluded that the key authority on finance and other NBFIs, must constantly analyse the whole environment, including economic, social, commercial, and cultural factors. As a result, they must strengthen their risk assessment technique.

Kao et al., (2011)'s study examines the results of financial holding companies (FHCs) before and during the worldwide financial meltdown from the standpoint of RM, employing a two-stage DEA model on fourteen Taiwanese FHCs from 2001 to 2009. The empirical conclusion suggests that efficiency in operation improves during an economic downturn. However, after the economic downturn, financing based FHCs perform worse than earlier.

The study by Kombo et al., (2011) sought to: determine the frequency of Microfinance Institutions' encounters with risk; detect the RMSs employed by Microfinance Institutions in RM contact and the degree to which they made a difference to their sustainable financial condition. For the study, a questionnaire was used. The study only included MFIs in Kisii Municipality that were chosen using selective sampling. A total of 29 people, including managers and credit officers, took part in the survey. Mitra (2013) attempted to review existing studies on exposure to foreign currencies as well as application of practical and financial hedging by Indian companies to control FE exposure. Furthermore, this paper attempted to investigate Indian firms' foreign exchange RM practises. The study also attempted to address and illustrate some of the key difficulties in assessing and taking control of ER risks faced by businesses. Moinescu and Costea (2014) aim to establish a few early warning signs that could point towards risks for NBFIs. It seeks not only to forecast the likelihood of NFI default, but also to predict when this event is most likely to occur. Njanike (2009) try to assess the extent to which Zimbabwe's banks failed to adequately manage credit risk during the 2003/2004 financial crisis. It also attempts to identify additional variables that contributed to the financial crisis and to explain the components of a good CRM system. According to the report, the inability to adequately manage CR led to the financial crisis on a higher extent.

Nzioka and Maseki (2017) examines the effects of avoiding FE risk on the financial execution of NFBIs noted within the Nairobi Securities Exchange. The authors note that FE threat is a major challenge for firms that operate in a globalized business environment. The study uses data from 49 NFBIs from the Nairobi Securities Exchange between 2010 and 2015. The authors employ multiple regression analysis to analyze the data and find that hedging FE risk has a positive effect on the financial performance of non-banking companies.

Popescu et al. (2016) investigate a unique solution to control CR at an NFBI. The authors note that credit risk is a huge challenge for NFBIs, and that these firms

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need to implement effective risk management strategies to mitigate this risk. The study focuses on a specific non-banking financial institution in Romania and proposes a credit scoring model to assess the creditworthiness of potential borrowers. The authors find that the proposed model can effectively decrease credit risk and improve the financial performance of the institution. The goal of the research by Thiyagarajan and Arulraj (2012) is to determine the mediating impacts of funds on profitability and to concentrate on the financing strategy to maximise profits in India's non-banking financial industry. Using the SEM approach, a formative model to capture the mediating effects of finances on profitability is examined. The findings indicate that a mix of fund-raising tactics might have an impact on earnings. Geographic and demographic disparities are among the research limitations/implications, yet the findings are extremely valuable for industry managers, lenders, and financial forecasts.

Troaca (2009) discusses inner control within NFBIs. The author notes that non-banking financial institutions play a huge part within the financial industry, and that effective inner control mechanisms are essential for the stability and sustainability of these institutions. The study identifies the key components of an effective inner control system. The author argues that an effective inner control system should include a comprehensive RM framework, audit function internally, and an effective BOD.

Ishak (2015) conducted a study to investigate the relationship between risk management committee characteristics and modified audit opinion in Malaysia. The author analyzed the characteristics of RM committees such as size, independence, expertise, and frequency of meetings. The modified audit opinion was used as a proxy for the quality of financial reporting. The results revealed that the size, independence, and expertise of the risk management committee are negatively related to the likelihood of receiving a modified audit opinion. Moreover, the frequency of meetings of the committee was found to be positively related to the quality of financial reporting. The study provides useful insights for policymakers and regulators in Malaysia to improve the quality of financial reporting.

Pellissery and Koshy (2015) evaluated the financial performance of public sector banking companies and NFBIs in India. The results showed that non-banking financial companies had better liquidity and efficiency ratios compared to public sector banks, whereas the latter had better solvency and profitability ratios. The authors recommended that these banks need to focus on improving their liquidity and efficiency ratios to compete with non-banking financial companies.

Objective

1. To explore different Risk Management Strategies of “Non-Banking Financial Institutions.
2. To measure the effect of Risk Management Strategies of “Non-Banking Financial Institutions.

Methodology

The researcher had conducted the study survey with the help of a structured questionnaire on 200 respondents (financial

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experts) to know different Risk Management Strategies of "Non-Banking Financial Institutions." The primary data is collected through "random sampling method" and data was analysed by "mean and t-test."

Findings

Respondent's general details shows that in 200 respondents, males are 64.5% and females are 35.5%. 34.5% are below 40 yrs. of age and 36.5% falls in the category of 40-46 age group and rest 29.0% are above 46 years of age. 26.0% of them are post graduate and above, 39.5% are having professional degree and rest 34.5% are Doctorates. 24.5% of them are having wok experience of less than 5 yrs., 43.0% are working from last 5-8 years in financial sector and 32.5% are having work experience of more than 8 years.

Table 1 General Details

Variable	Respondent	Percentage
Gender		
Male	129	64.5
Female	71	35.5
Total	**200**	**100**
Age (years)		
Below 40	69	34.5
40-46	73	36.5
Above 46	58	29.0
Total	**200**	**100**
Education		
Post Graduate	52	26.0
Professional Degree	79	39.5
Doctorate	69	34.5
Total	**200**	**100**
Work experience (yrs.)		
Less than 5	49	24.5
5-8	86	43.0
More than 8	65	32.5
Total	**200**	**100**

Table 2 Risk Management Strategies of Non-Banking Financial Institutions

S. No.	Statements	Mean Value	t value	Sig.
1.	Non-Banking Financial Institutions implements best internal audit and control practices to manage risk	3.20	2.878	0.002
2.	Non-Banking Financial Institutions uses diversification and insurance to manage their risks	3.12	1.738	0.042
3.	Hedging FE risk has a positive effect on the financial performance of non-	3.19	2.795	0.003

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	banking companies			
4.	Credit scoring model to assess the credit worthiness of potential borrowers help to manage risk	3.13	1.874	0.031
5.	Mix of fund-raising tactics have an impact on earnings and manage risks in Non-Banking Financial Institutions	3.18	2.637	0.005
6.	Effective inner control system with comprehensive Risk Management framework	3.14	2.017	0.023
7.	Good size of risk management committee which is independent, have expertise, and good frequency of meetings	3.16	2.327	0.010
8.	Non-Banking Financial Institutions improves their liquidity and efficiency ratios to manage their risk	3.15	2.191	0.015
9.	Non-Banking Financial Institutions promotes risk-aware mindset among employees	3.17	2.453	0.008
10.	Non-Banking Financial Institutions encouraging culture of open communication and transparency	3.11	1.615	0.054

Table 1 shows different Risk Management Strategies of Non-Banking Financial Institutions. The experts says that Non-Banking Financial Institutions implements best internal audit and control practices to manage risk with mean value 3.20, Hedging FE risk has a positive effect on the financial performance of non-banking companies (3.19), Mix of fund-raising tactics have an impact on earnings and manage risks in Non-Banking Financial Institutions (3.18) and Non-Banking Financial Institutions promotes risk-aware mindset among

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employees with mean value 3.17. It is also found that good size of risk management committee which is independent, have expertise, and good frequency of meetings with mean value 3.16, Non-Banking Financial Institutions improves their liquidity and efficiency ratios to manage their risk (3.15), Effective inner control system with comprehensive Risk Management framework (3.14) and Credit scoring model to assess the credit worthiness of potential borrowers help to manage risk with mean value 3.13. The respondent also says that Non-Banking Financial Institutions uses diversification and insurance to manage their risks with mean value 3.12 and Non-Banking Financial Institutions encouraging culture of open communication and transparency with mean value 3.11. The value under significant column for all the statements related to risk management strategies is significant with value below 0.05 after applying t test except Non-Banking Financial Institutions encouraging culture of open communication and transparency with non-significant value 0.054.

Conclusion

Effective risk management strategies are crucial for the success of non-banking financial institutions (NBFIs). NBFIs, which include insurance companies, asset management firms, and other financial entities, often face unique risks compared to traditional banks. To effectively manage risks, NBFIs can implement a range of strategies, including diversification of their portfolios, effective monitoring of market and credit risks, and ensuring adequate capitalization. In addition, effective corporate governance, risk culture, and compliance are also important in managing risk. The specific strategies and techniques that are most effective will vary depending on the type of NBFI, its size, complexity, and other factors. Conducting regular risk assessments, monitoring risk exposure, and implementing appropriate risk management policies are critical for NBFIs to safeguard their customers' assets and maintain financial stability.

Present study was conducted to know different Risk Management Strategies of Non-Banking Financial Institutions and found that Non-Banking Financial Institutions implements best internal audit and control practices to manage risk, Hedging FE risk has a positive effect on the financial performance of non-banking companies, Mix of fund-raising tactics have an impact on earnings and manage risks in Non-Banking Financial Institutions, Non-Banking Financial Institutions promotes risk-aware mindset among employees and good size of risk management committee which is independent, have expertise, and good frequency of meetings help to manage risk in non-banking financial institutions.

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