

Sensitivity of Indian Bank Stocks: the Predictive Role of Risk Management Capabilities

MINIMOL M C*

Abstract

The study was intended to test whether there is any link between the risk management capabilities and the bank stock returns. The risk management capability is measured through indicators such as net-interest margin, non-interest margin, capital adequacy ratio and provisions to total assets. The study examines the relationship of these proxies of risk management capability on stock returns by using OLS based regression analysis. The results of the current study indicate that risk management capability significantly and positively contributes to the stock returns of the banks. The work undertaken in this study can be extended in several ways. Financial statements can be further researched to come up with other indicators of risk management. Risk management score can be used to measure risk management capability, rather than using the individual indicators of risk management capability. Various techniques for developing risk management scores, can also be explored.

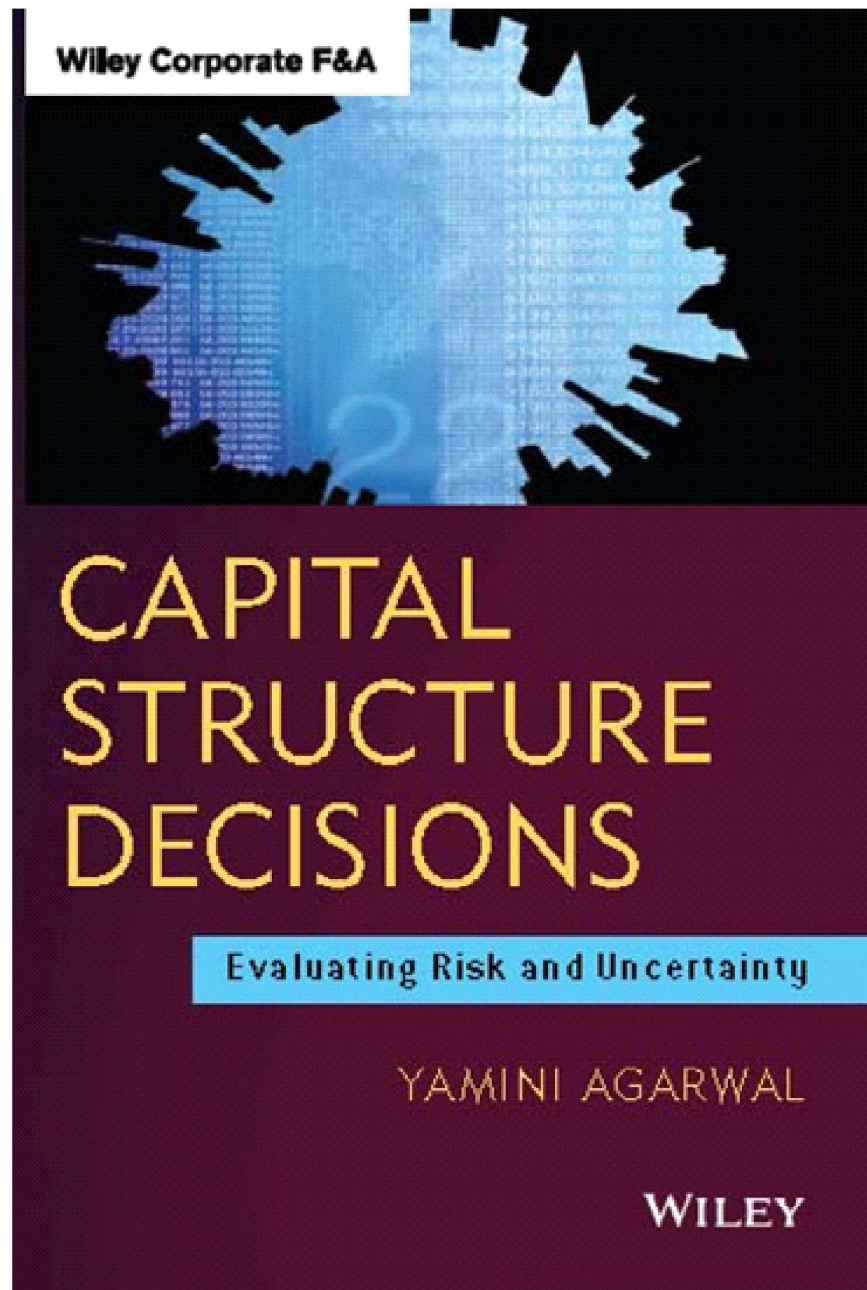
I. Introduction

RISK MANAGEMENT IS a crucial and central function of banks and other institutions in the financial system to maximize shareholders and customers value. The study was conducted in Indian banks – both public and private sector banks because of the emphasis given on risk management by Indian banks driven by the guidelines issued by the central bank (Reserve bank of India) of the country as well as banks' own recent initiatives towards risk management. This recent focus can be endorsed to various factors. Before 1992, Indian banks were exposed to a system of rigorous control imposed by the Reserve Bank of India. Financial liberalization introduced in 1992 was intended to improve the profitability of the banks and to make the system more efficient, and resilient. The liberalization measures resulted in some radical changes in the operating conditions of Indian banks. By the time the

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ISBN No. 978-1-118-20313-2

Pages: 272
Price: ₹ 9,500/-
US: \$ 120/-

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