ST.MARY'S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

RISK MANAGEMENT AT STRATEGIC LEVEL: THE CASE OF ETHIOPIAN PRIVATE COMMERCIAL BANKS

BY

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ID NO: SGS/0152/2009A

JANUARY 2019

ADDIS ABABA, ETHIOPIA

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A THESIS SUBMITTED TO ST. MARY'S UNIVERSITY, SCHOOL OF GRADUATE STUDIES IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION (GENERAL MANAGEMENT)

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DECLARATION

I, the undersigned, declare that this thesis is my original work, prepared under the guidance of Wubshet Bekalu (PHD). All sources of materials used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree.

______________________________	______________________________
Name	Signature
St. Mary's University, Addis Ababa	January, 2019

ENDORSEMENT

This thesis has been submitted to St. Mary's University, School of Graduate Studies for examination with my approval as a university advisor.

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Advisor	Signature
St. Mary's University, Addis Ababa	January, 2019

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ABBREVIATIONS/ACRONYMS

BOD	Board of Director
CRO	Chief Risk Officer
CBE	Commercial Bank Ethiopia,
COSO	Committee of Sponsoring Organizations of the Tread way Commission
CRM	Corporate Risk Management
CSG	Credit Suisse Group
DBE	Development Bank of Ethiopia
DRC	Director Risk and Compliance
ERM	Enterprise Risk Management
FDRE	Federal Democratic Republic of Ethiopia
ICS	Internal Control System
NBE	National Bank of Ethiopia
NCG	New Corporate Governance
PASAI	Pacific Association of Supreme Audit Institutions
RC	Risk Committee

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ABSTRACT

Risk management has become a highly discussed topic in recent years, Regulatory changes have been the main driver and influence on risk management practices. This study reviews theories and models of strategic risk management, as well as the main standards and regulations on risk management through stratified random sampling method. The data were gathered using questionnaire and face-to-face semi structured interview questions. The questionnaires were distributed to selected commercial banks related to Risk Management department managers & staff at the head office and the interview was conducted with the Board of Directors and Corporate Risk Management of the bank. The results from the questionnaire were analyzed using descriptive statistics and the results from the interview were narrated and quantatively analyzed, Descriptive study is chosen as it enabled the researcher to describe the current risk management practice at the strategic level. The study focused on selected private commercial Banks in Ethiopia, namely, NIB International Bank S.C, Abyssinia Bank S.C and United Bank S.C, Enat Bank S.C, Abay Bank S.C, Birhan International Bank S.C by using primary and secondary data and the results were conclusive that risk management in Ethiopian Private Banks are implemented significant structural changes with the responsibility of all department such as managers, department heads and staff within their area if business - which were different based on the size of a bank - while behavioral changes seem to be taking longer.

The evidence shows that Corporate Risk Management (CRM) is becoming more holistic, more independent, less dependent on models and more integrated with other operations. The study confirms that there is a clear shift from CRM by numbers to holistic CRM. That is obvious as banks of all sizes are considering all risks (including non-quantifiable risks), and adopting a more systematic and strategic view of risks inherent in the aggregate market that cannot be solved by diversification such as recessions, wars, interest rates and others that cannot be avoided through a diversified portfolio.

The findings suggest that, by adopting effective risk management, improving corporate governance practices, and adhering to regulations, Ethiopian private banks can improve their performance. The study concludes that risk management is becoming an integral part of strategy formulation. Finally, how to implement a risk management culture remains to be the most significant issue, but also the most significant improvement opportunity in the field of risk management.

Key Words: Risk management at strategic level: Ethiopian private commercial banks

CHAPTER ONE
INTRODUCTION

1.1 Background of the study

The banking industry is exposed to various kinds of risks due to its wide and dynamic financial sector in any country and the backbone of strengthening country's economic situation through provisioning of finance, which are the principal business activity for most common banks. Credit creation is the main income generating activity of banks (Kargi, 2011).

Risk management is crucial to any bank's success. This is because risks shrink the capacity and ability of financial institutions. If we take the major bank risk known as credit risk, it minimize the lending capacity of the bank. It also denies new applicants access to credit as a bank's cash flow management problems expand in direct proportion to the increasing loan default problem. The higher the exposure of the a bank to credit risk, the higher the tendency of the banks to experience financial crisis and vise-verse as witnessed in the recent phenomena of European financial and economic crisis. It urges the significance a sound credit risk management in lending organizations (Frigo, & Anderson, 2011).

As per the National Bank of Ethiopia annual report, in Ethiopia, the number of banks operating for the year 2010 E.C reached eighteen. The Banks are licensed and supervised by the Central Bank called the National Bank of Ethiopia. In terms of ownership, sixteen is private commercial banks, and the remaining two are state owned banks.

"Strategic Risk Management is a process for identifying, assessing and managing risk anywhere in the strategy with the ultimate goal of protecting and creating shareholder value" (Frigo& Anderson, 2011). It is a primary component and foundation of Enterprise Risk Management; it is affected by boards of directors, management and other personnel; it requires a strategic view of risk and consideration of how external and internal events or scenarios will affect the ability of the organization to achieve its objectives; it requires an organization to define a tolerable level of risk or risk appetite as a guide for strategic decision making; and it is a continual process which should be embedded in strategy setting and strategy management." (Frigo& Anderson, 2011).Strategic risks include all the big dimensions that require companies to think on a grand scale. Thus, strategic risk management begins by identifying and evaluating how a wide range of possible events and scenarios will impact a business strategy execution, including the ultimate

impact on the valuation of the company. In order to be effective, a strategic risk management should at least include the following:

- Strong alignment to protecting and creating shareholder (and stakeholder) value,
- Holistic approach that is broad enough to encompass a wide range of entity-wide risks
- Should be an ongoing process capable of identifying and evaluating a wide spectrum of risks. (Beasley &Frigo, 2010).

Studies revealed that risk management policy instruments have various implications on Bank performance, growth, liquidity, lending behavior. (Solomon, 2013 and Bereket, 2013). Therefore, assessment of risk management at a strategic level is important as it is blamed for creating poor quality of the management and Commercial Banks obtain the bulk of their income from managing credit risk on a continual basis, stress on the liquidity of Banks which in turn influences the bank's overall performance as well as the lending behavior. Therefore, the study tries to assess risk management at the strategic level of Ethiopian private commercial Banks, namely: NIB International Bank S.C, Abyssinia International Bank S.C and United International Bank S.C, Abay Bank S.C, Birhan International Bank S.C, Enat Bank S.C.

1.2 Background of the company

Nib International Bank (NIB) was established by 717 Shareholders on 26 May 1999 under license no. LBB/007/99 in accordance with the Commercial Code of Ethiopia and the Proclamation for Licensing and Supervision of Banking Business Proclamation no. 84/1994 with the paid up Capital of Birr 27.6 million and authorized capital of Birr 150 million. The Bank commenced the operation in 28 October 1999 by 27 employees.

Currently, the authorized and paid up Capital reached Birr 2.2 billion and Birr 1.8 billion respectively. The number of Shareholders and Employees has increased to 4,409 & 3,681 respectively. The Bank has 189 branches spread throughout the country, as per June 2017 Annual report.

Bank of Abyssinia S.C was established on February 15, 1996 (90 years to the day after the first but defunct private bank was established in 1906 during Emperor Menelik II) in accordance with 1960 Ethiopian commercial code and the Licensing and Supervision of Banking Business Proclamation No. 84/1994. BOA started its operation with an authorized and paid up capital of Birr 50 million, and Birr 17.8 million respectively, and with only 131 shareholders and 32 staff.

Currently, the authorized and paid up Capital reached Birr 4 billion and Birr 1.8 billion respectively. The number of Shareholders and Employees has increased to 2,171 &5,005 respectively. The Bank has 258 branches spread throughout the country, as per June 2017 Annual report.

United Bank S.C was incorporated as a share company on 10 September 1998 in accordance with the commercial code of Ethiopia of 1960 and licensing and supervision of banking business Proclamation No 84/1994. The Bank obtained a banking service license from the National Bank of Ethiopia and is registered with the trade, Industry and Tourism Bureau of Addis Ababa city Administration. The number of Shareholders and Employees has increased to 2998 &3253 respectively. The Bank has 193 branches spread throughout the country, as per June 2017 Annual report.

Abay Bank has fulfilled all the necessary requirements of the National bank of Ethiopia to set up a bank, and was officially established on July14, 2010 and started fully-fledged banking operations on November 4, 2010. Currently, the total capital of the bank is Birr 1 Billion as of January 30, 2017 and the number of Shareholders and Employees has increased to 4000 &2412 respectively. The Bank has 158 branches spread throughout the country, as per June 2017 Annual report.

Berhan International Bank S.C is a private Share Company, was formed in accordance with Article 304 of the Commercial Code of Ethiopia with the objective of operating in the banking industry. The Bank was registered and licensed by the National Bank of Ethiopia on 27 June 2009 with an authorized capital of 300,000,000 and established by more than 6,700 shareholders, with a paid-up capital of Birr 95 million and approved capital of Birr 300 million. Thenumber of Employees has increased to 1000 respectively and also103 branches spread throughout the country, as per June 2017 Annual report.

The story of Enat Bank is one of triumph over adversity. Enat Bank was initiated by a diverse group of 11 powerful Ethiopian women, and this tight team of founders has shepherded Enat from an idea to a reality. Enat is a unique success story that should make all Ethiopians proud. Our name of ‘mother’ signifies our attitude to all clients – we want to take care of you. Enat’s 11-person board of directors (6 women and 5 men) boasts leaders from varied economic, social

banking and other business backgrounds. Over 7,000 shareholders – 64% of whom are female – have already invested in Enat. Thenumber of Employees has increased to 720 respectively and also50 branches spread throughout the country, as per June 2017 Annual report.

1.3 STATEMENT OF THE PROBLEM

Banks play the major role in any country's economy. Their relevance to the economy as they involve in mobilizing deposit and availing credit to various economic sectors and being profitable through covering their cost of fund.

Many banks in both developed and developing economies of the world suffered huge losses stemming from poor risk management. A close look at bank failures prior to the world's financial crisis of 2008 and the post crisis period revealed that ineffective management of the inherent risks in banks was one of the root causes of their failures (Sanusi, 2013).

Corporate governance and risk management are interrelated and interdependent. The stability and improvement of any bank's performance are highly dependent on the effective role of both components (Manab ethanol, 2010).

All financial analysis considers the private banks ability to perform in the industry and is very critical for a bank to remain a going concern since risks may lead to failure of a bank (Habtamu Negussie, 2012). Owing to the stated reasons, the National Bank of Ethiopia had issued risk management guideline that covers the most common and interrelated risks facing banks in the country, namely, credit, liquidity, interest rate, market and operational risks.

It was for this reason that the National Bank of Ethiopia formulated directives, supervisory standards and guidelines, recommendations and best practices on issues of risk management in banking. (NBE guideline, 2010). An effective risk management culture would help banks to develop a management system that provides a seamless focus on the risk appetite as one of the determinants of performance.

In Ethiopia problem of strategic risk management has been manifested since long ago (Solomon, 2013 and Bereket (2013). Among possible internal and external factors that contributed to the strategic risk in Ethiopia among others weak/ineffective internal control system, interest rate, market, ownership structure, poor management, capital inadequacy, lack of transparency, credit

and huge nonperforming loans(NPL) are the major strategic risks of the bank. Others are categorized under operational risk management (NBE, 2010).

In this regard, private commercial banks in Ethiopia are currently facing different risk at the strategic level that reflects on the liquidity position, credit evaluation and monitoring, market, overall the performance of the banks and the Bank's risk management practice at the strategic level are limited (Solomon, 2013).

Some researches were conducted in Ethiopia in the different levels of risks such as that of Solomon (2013), Bereket (2013) and Wondimagegnehu (2012). Despite most of the studies reviewed on the part of the liquidity, credit, operational and other risk management in different banks like assessment of credit risk management practices, factors affecting the liquidity position of the banks.

This raises a lot of questions, especially in relation to the assessment of risk management at a strategic level. , in the use of internal and external sources; the integration of strategic planning objectives with risk management over the long run; techniques used by increased complexity of risks faced by banks and alternative diversification strategies used to reduce risk gaps.

Thus, the problem stated above, along with the knowledge gap in the literature calls a research assessed this important area of concern taking the risk management practices at the strategic level of Ethiopian private commercial banks.

1.4 RESEARCH QUESTIONS

More specifically, the following research questions are addressed:

1. How the Ethiopian private commercial banks established appropriate risk management system?
2. How does the banks integrated strategic risk management and internal control system?

3. What is the level of risk control at the strategic level in Ethiopian private commercial banks?
4. What is the level of effective risk management system and practice in Ethiopian private banks?

1.5 OBJECTIVES OF THE RESEARCH

The general objective of the study was to assess risk management at the strategic level of Ethiopian Private Commercial Banks.

The research has four specific objectives:-

1. To assess the appropriateness of risk management system in Ethiopian private commercial banks.
2. To assess the integration of strategic risk management and internal control system.

3. To determine whether there is an adequate control over risk at the strategic level of Ethiopian private commercial banks.
4. To evaluate and identify the effectiveness of risk management system and practice.

1.6 DEFINITION OF USED TERMS

The most commonly used terms and concepts used throughout this thesis are briefly defined in this section. Most of these concepts are discussed in more details in the theoretical part of this thesis.

Corporate Risk Management: "A process, ongoing and flowing through an entity, Effected by people at every level of an organization, Applied in strategy setting, Applied across the enterprise, at every level and unit, and includes taking an entity level portfolio view of risk, Designed to identify potential events that, if they occur, will affect the entity and to manage risk within its risk appetite. (Fraser &Simkins, 2010).

Risk: There is an abundance of risk definitions, most of which focus on the negative side of risk. For example, Deloitte defines risk as "the potential for loss caused by an event (or series of events) that adversely affect the achievement of a company's objectives." This thesis will follow the logic that the upside or positive side of risk is much more significant, so it should equally represented. There are two main ideas associated with risk:

- Uncertainty – usually linked to two-tailed statistical distribution
- Event – can have a negative impact, positive impact, or both.

Risk Management: "Risk Management means adopting a planned and systematic approach to the identification, assessment and prioritization of risks to minimize, monitor and control the probability and or impact of unfortunate events (threats) and maximize the realization of opportunities by using the resources of the organization." (Kalia & Müller, 2007).

Strategic Risk Management: "Strategic Risk Management is a process for identifying, assessing and managing risk anywhere in the strategy with the ultimate goal of protecting and creating shareholder value. (Frigo & Anderson, 2011).

National Bank of Ethiopia (NBE): It is the reserve or central bank of Ethiopia. Besides licensing and supervising banks, insurers and other financial institutions, NBE fosters a healthy financial system and undertakes other related activities that are conducive to rapid economic development of Ethiopia (Proclamation No.721/2010, FDRE, 2010).

1.7 SIGNIFICANCE OF THE STUDY:

As banks move into a new high powered world of financial operations and trading, with new risks, the need is felt for more sophisticated and versatile instruments for risk assessment, monitoring and controlling risk exposures. It is, therefore, timely that bank managements equip themselves fully to grapple with the demands of creating tools and systems capable of assessing, monitoring and controlling risk exposures in a more scientific manner.

Better and effective strategic risk management process is a better way to manage portfolio and appetite for risk. The process provides a framework to ensure consistency between strategy and implementation that reduces potential volatility in earnings and maximize shareholder wealth. Beyond and overriding the challenge is moving towards improved risk management lies in addressing banks' readiness and openness to accept changes to a more transparent system, to rapidly metamorphosing markets, to more effective and efficient ways of operating and to meet market requirements and increased answerability to stakeholders.

The study will have great contribution to the existing knowledge in the area of risk management at a strategic level in the context of Ethiopian private commercial banks. This in turn contributes to the well-being of the financial sector of the economy and the stakeholder as a whole. Therefore, the major beneficiaries from this study are all commercial banks, regulatory bodies and the stakeholder as a whole in the country. The study also helps me to develop in depth knowledge about risk management at the strategic level.

1.8 DELIMITATION/SCOPE OF THE STUDY

The scope of the study was an assessment of the Risk management at strategic level in the case of private commercial Banks. In addition to this, the study has primarily took on a selected

private commercial banks namely: NIB International Bank S.C, Abyssinia International Bank S.C and United International Bank S.C, Abay Bank S.C, Birhan International Bank S.C, Enat Bank S.C, particularly focusing on it's the selected respondent located in Addis Ababa with all its six private banks that perform their own CRM and which also are part of the RM process.

A. People- the Risk management department staffs, top managements, Branch managers, Finance department staffs, International banking department staffs and credit management staffs of the above stated Banks are the targeted group of respondents and who serve the bank at least for one year.
B. Data- Primary (structured questionnaire and limited to the selected branches and head office sources) and secondary (annual reports of the Ethiopia private commercial banks, directives issued by the National bank of Ethiopia, other country experience, books, journals and different thesis).

1.9 ORGANIZATION OF THE PAPER

This thesis is organized into five chapters.

Chapter one is already present in the current section which is research introduction, statement of the problem, objective of the study, definition of terms, scope of the study and significance of the study. Following on this,

Chapter two of the study has presented a review of theoretical and empirical literatures on risk management at different level especially in the banking industry,

Chapter three presents the research methodology use in this thesis. The chapter includes the research approach as well as describing the data collecting and analysis methods issued. Then,

Chapter four analyzed and presented the research findings obtained through the thesis methodology by showing how each of the research objective has attained and how these findings together contribute to the main purpose of the study and presented the results and discussion of the study,

Finally, Chapter five finished the thesis with a Summary, conclusions and possible recommendations. At the end of the thesis document, references and a set of appendices are included that contain the questionnaires of the survey forms used to collect primary data for this work

CHAPTER TWO

REVIEW OF RELATED LITERATURE

INTRODUCTION

The literature review section of the study covers the overview of the Ethiopian banking system and risk management at a strategic level, the theoretical and empirical studies review in the areas of risk management. Moreover, it presents the variable summary and conceptual framework as well as the knowledge gap and conclusion.

2.1. OVERVIEW OF THE ETHIOPIAN BANKING SYSTEM AND RISK MANAGEMENT

2.1.1. Ethiopian Banking System

The banking system in Ethiopia was started in 1905 with the establishment of Abyssinian Bank. Its establishment was based on a fifty year agreement with the Anglo-Egyptian National Bank. A new development bank and two other foreign banks were also established in 1908 (Degefe, 1995 cited in Geda, 2006). However, in 1931 the Ethiopian government purchased the Abyssinian Bank and renamed it as the Bank of Ethiopia.

As stated in Degefe (1995) cited in Geda (2006), banking activity of the country was relatively expanded during the five-years of Italian occupation. During that time, the Italian banks were particularly active. As a result, most of the banks operating during this period were Italian banks. After independence from Italy's occupation, due to the paramount role of the British in its strategic planning during the Second World War, Barclays Bank was established and it remained in operation in Ethiopia in the period of 1941 until 1943.

The State Bank of Ethiopia established in 1943. However, Britain was against it, as a result, the process of the establishment of this bank was painful. Until 1963 the Bank of Ethiopia was operating as both a commercial and central bank. In 1963 it was remodeled into today's National Bank of Ethiopia (NBE). It was also re-established in 1976 and the Commercial Bank of Ethiopia (CBE) to. It was after this period, many other banks were established and those banks were in operation before the 1974 revolution. Nevertheless, all privately owned financial institutions, including three commercial banks, thirteen insurance companies, and two non-bank

financial intermediaries were nationalized on 1 January 1975. The nationalized banks were reorganized and one commercial bank Ethiopia (CBE), a national bank, two specialized banks, that is, the Agricultural and Industrial Bank, renamed recently as the Development Bank of Ethiopia (DBE) and a Housing and Saving Bank, renamed lately as the Construction and Business Bank (CBB), and one insurance company (the Ethiopian Insurance Company) were formed (Degefe 1995 cited in Geda 2006).

Following the downfall of the Dergue regime in 1991 and the 1992 liberalization policy, these financial institutions were reorganized to operate in a market-oriented policy framework. Furthermore, private financial institutions were also allowed to operate alongside the publicly owned institutions. As a result, currently, the major financial institutions operating in Ethiopia are banks, insurance companies and micro-finance institutions. The number of banks operating in the country reached 18 of which 16 are private, and the remaining's are state-owned (NBE, 2016/17).

2.1.2. Strategic risk management in Ethiopia

Strategic risk management

Is the process for identifying, assessing and managing risks and uncertainties, affected by internal and external events or scenarios that could inhibit an organization's ability to achieve its strategy and strategic objectives with the ultimate goal of creating and protecting shareholders and stakeholder value.

Responsible organs on strategic risk management

- **Board of directors**

Ultimately, the overall risk management process of the Bank rests on the shoulder of the Board of Directors. With regard to strategic risk management, the role of the Board would be:

a) Approving the Bank's strategic plan (including strategies contained therein) and any subsequent changes, and reviewing the plan (at least annually) to ensure its appropriateness;

b) Ensuring that the Bank's strategic goals and objectives are set in line with its corporate vision, mission, values, culture, business direction and risk tolerance;

c) Approving the Bank's strategic risk management framework to identify the organization's strategic risks;

d) Ensuring that the Bank's organizational structure, culture, infrastructure, managerial resources and capabilities, as well as systems and controls are appropriate and adequate to support the implementation of its strategies

e) Ascertain that strategic initiatives are supported by sound due diligence and strong risk management systems.

f) Reviewing high-level reports periodically submitted to the Board on the Bank's overall strategic risk profile, and ensuring that any material risks and strategic implications identified from those reports are properly addressed.

- **Executive management**

The Executive Management shall:

a) Develop the strategy, including developing mission, values, and vision; and the strategy formulation;

b) Translate the strategy, including developing strategy maps, strategic themes, objectives, measures, targets, initiatives, and the strategic plan in the form of strategy maps, and strategic expenditures;

c) Plan operations, including developing the operating plan, key process improvements, new product and service planning, resource capacity planning, and budgeting; and

d) Implement the strategy, including profitability analysis and emerging strategies for monitoring.

- **The risk and compliance management department**

The Risk and Compliance Management Department shall:

a) Review the strategy in an integrated and holistic manner in line with the dynamism of the Banking industry;

b) Monitor the strategy, including review of operational strategy;

c) Monitor and evaluate risk through the Bank's performance measurement and management system; and

d) Identify, assess, and manage risk anywhere in the strategy, in line with the objective of the strategy

Strategic risk management process

- **Identification of the strategic risk**

The identification process of the strategic risk incorporates the following:

a) The Bank shall identify how external and internal events or scenarios will affect the ability of the Bank to achieve its objectives;

b) The Bank shall identify the impact of the strategy on each distinct risk category;

c) The Bank shall develop qualitative methods like developing checklist to identify potential risk incidents; and

d) The Bank shall identify potential risks in the current and forecasted industry's activity and market conditions.

- **Measurement of strategic risk management**

A strategic risk measurement or assessment is a systematic and a continual process for assessing significant potential risks. The Bank should design on-going methods for formal assessment of both the strategic and operational plans in relation to its business scope, complexity, external environment, and internal factors. To carry out the measurement process on strategic risk it would be critical to do the following:

a) Achieve a deep understanding of the strategy of the Bank;

b) Gather data on strategic risks; and

c) Prepare a preliminary strategic risk profile. With regard to the measurement of the strategic risk:

d) The Bank shall assess the gap between the actual strategic implementation and the forecasted strategic plan.

- **Controlling and monitoring of strategic risk**

The controlling and monitoring mechanisms for strategic risk management activities provide critical feedback to management with respect to strategy implementation

a) The Bank shall control and monitor the strategic risk in line with the approved strategy;

b) The Bank shall control and monitor the strategic risk using the risk mapping;

c) The Bank shall control and monitor the strategic risk in line with the overall changes in the external environment.

2.2. THEORETICAL REVIEW

This theoretical review part of the study is all about the review of the theories of risk management at strategic level.

2.2.1. Strategic elements of corporate risk management

Strategic Risk Management is a process for identifying, assessing and managing risk anywhere in the strategy with the ultimate goal of protecting and creating shareholder value. Managing risk in a systematic way at a corporate level and the main goal of corporate risk management is to increase the likelihood that an organization will achieve its objectives by managing risks to be within the stakeholders' appetite for risk.

2.2.2. Different types of risks

There are numerous risks that banks face, so Table 1 Business Risk Model Sample presents a generic business risk framework, which can be used to illustrate this complexity banks are facing. It is important to keep in mind, that members for different organizational levels might view the same risks for a different viewpoint; therefore, such risks can fit in more than one of these provisional categories.

Table 1: Business Risk Model Sample

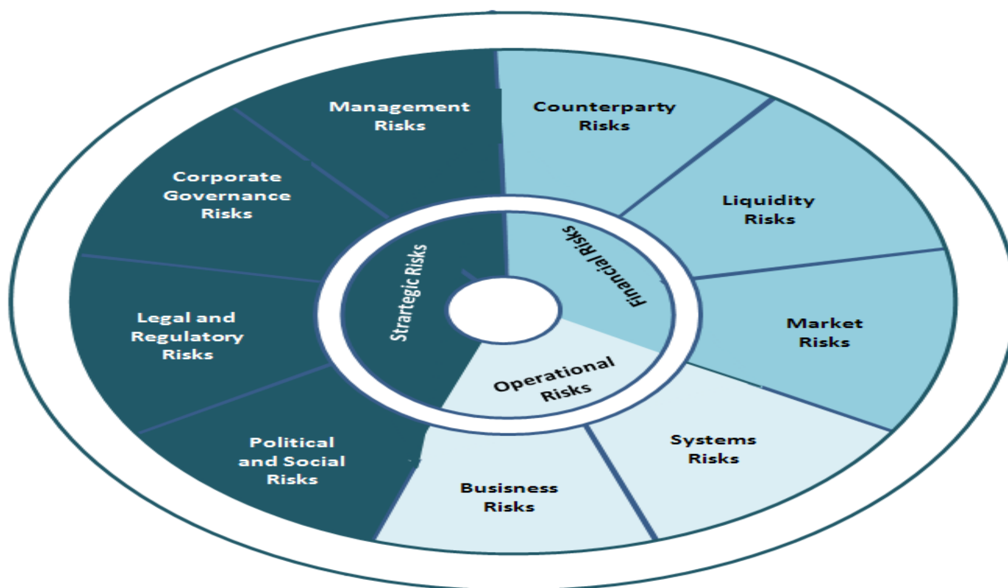
STRATEGIC RISKS		
EXTERNAL FACTOR RISKS		**INTERNAL FACTOR RISKS**
Industry &Economy risk		Reputational risk
Competitor risk		Strategic focus risk
Legal and regulatory change risk		Parent company support risk
Customer needs and wants risk		Patent trademark protection risk
OPERATIONAL RISKS		
PROCESS RISK	**COMPLIANCE RISKS**	**PEOPLE RISKS**
Supply chain risk	Environmental risk	Human resources risk
Customer satisfaction risk	Regulatory risk	Employee turnover risk
Cycle-time risk	Policy and procedures risk	Performance incentive risk
Process execution risk	Litigation risk	Training risk
FINANCE RISKS		
TREASURY RISKS	**CREDIT RISKS**	**TRADING RISKS**
Interest rate risk	Capacity risk	Commodity price risk
Foreign exchange risk	Collateral risk	Duration risk
Capital availability risk	Concentration risk	Measurement risk
	Default and Settlement risk	
INFORMATION RISKS		

FINANCIAL RISKS	OPERATIONAL RISKS	TECHNOLOGICAL RISKS
Accounting standards risk	Pricing risk	Information access risk
Budgeting risk	Performance measurement risk	Business continuity risk
Financial reporting risk	Employee safety risk	Availability risk
Taxation risk		Infrastructure risk
Regulatory response risk		

Source: Moeller (2007)

Classifying same risks in different categories is not only chaotic but highly impractical as well, yet this perspective is still wide-spread in practice. A more elegant and a much superior view of corporate risk management was developed by Kägi and Pauli (2003) and represented in the Figure 1: Risk Radar for Corporate Risk Management.

Figure 1: Risk Radar for Corporate Risk Management



Source: Kägi& Pauli (2003)

2.2.3. Corporate Governance Perspective

"Corporate governance is traditionally defined as the system by which companies are directed and controlled as a set of relationships between a company's management, its board, it shareholders and its other stakeholders." (European Commission 2010).The board is responsible for determining the risk appetite and risk tolerances and establishing environment or structure in which senior management can implement the organization policies, processes, and systems.

As an improvement and an alternative to the traditional corporate governance Hilb (2005) presented "an integrated corporate governance framework, called "New Corporate Governance". The framework has eight main elements and they are as follows:

- ***Communicate and consult*:** The organization should include internal and external shareholders throughout the risk management process.
- ***Establish the context*:** The business should understand its external and internal context, and understand the risk criteria on which decisions will be based.
- ***Identify risk*:** This step requires that all risks are written down.
- ***Analyze risks*:** The organization needs to consider positive and negative consequences of the risks, and their probability.
- ***Evaluate risk*:** Management has to decide on which options to pursue.
- ***Treat risk*:** The organization may decide to do any of the following: Avoid the risk, change the likelihood (add controls), change the consequences (i.e. reducing the amount of stock, requiring protective gear, etc.), share the risk (i.e. joint venture) & retain the risk
- ***Monitor and review*:** Repeating the risk management cycle on regular basis, and performing review.
- ***Record the process*:** Recording should include but not be limited to assumptions, data sources, analysis, results etc.

The framework that integrates the interests of shareholders, customers, employees and the public comprises four parts which are presented in the Table 2: Differences between Traditional and New Corporate Governance. The table provides an overview of the framework, and presents differences between the traditional and the NCG framework.

Table 2: Differences between Traditional and New Corporate Governance

Dimension	**Traditional Corporate Governance**	**New Corporate Governance**
Situational Implementation	No difference between national, industry and corporate culture	Implementation appropriate to the specific context of each firm *(Keep is situational)*
Strategic direction	Strategic development is not a function of the supervisory board	Strategic development is a central function of the supervisory board *(Keep it strategic)*
Integrated board management	Only Isolated nominations and remuneration committees is publicly listed	Integrated and targeted selection, appraisal, compensation and development of the supervisory and managing board *(Keep it integrated)*
Holistic monitoring	Controlling the financial dimension only	Holistic monitoring of results from the perspectives of shareholders, customers, employees and the public *(Keep it controlled)*

Source: reproduced from Hilb (2005)

2.2.4. Corporate Risk Management

Corporate Risk Management (CRM) is a current evolutionary state of the risk management process. The Committee of Sponsoring Organizations of the Tread way Commission (COSO) defines enterprise risk management as:

The characterization of the contemporary CRM is provided by Liebenberg and Hoyt (2003) who state that "unlike the traditional "silo-based" approach to corporate risk management, CRM enables firms to benefit from an integrated approach to managing risk that shifts the focus of the risk management function from primarily defensive to increasingly offensive and strategic."

2.2.5. Ideal Types of Risk Management

Similar to risk qualification, there are several categorizations of risk management types presented in literature. The widely accepted classification was presented by Mikes (2009), please see Table 3: Risk Management Types for more details.

Naturally, these ideal types are never implemented in their true form, so in practice we can expect to see mixture of different types.

Table 3: Risk Management Types

	Silo-risk management	Integrated risk management	Risk-based management	Holistic risk Management
Institutional background	International regulation of bank capital adequacy	Rating agency expectations of bank capital adequacy	Rise of the shareholder value imperative	The rise of risk-based internal control (Anglo-Saxon and German corporate governance)
Related theme in the literature	Risk quantification	Risk aggregation	Risk-based performance measurement	The management of non-quantifiable risks
Focus on	Measurement and control of risk silos; calculation of minimum regulatory capital; tuning capital to the regulatory standard	Assigning a common denominator of risk to the risk silos (economic capital); fine-tuning capital to a given solvency standard; risk limit setting	Calculation of shareholder value created; linking risk management with performance measurement	Inclusion of non-quantifiable risks into the risk management framework; providing senior management with a 'strategic view' of risks

Techniques	Loss distributions; value-at-risk; credit rating models; standardized and advanced measurement approaches set by regulators	Economic capital	Risk-adjusted return on capital (RAROC); shareholder value added; risk pricing; risk transfer; portfolio risk management	Scenario analysis; sensitivity analyses; control self-assessment; special risk reviews

Source: Mikes (2009)

2.2.6. Structure of Risk Management

i. Overview and function of risk management

Depending on a size of the bank the risk management function can range from a single risk champion to a full scale, independent risk management department that is headed by Director Risk and Compliance. Kalia& Müller (2007) provide us with an ideal risk management structure, which is usually implemented in larger institutions.

ii. Implementation in banks

The main developments included strengthening the roles and responsibilities of the Board of Directors and executive management in regards to risk management and control; as well as implementing integrated risk management for the group. The NBE credit operation directorate maintained the integrated risk management at the group level, nevertheless some adaptations were implemented. Table 4: Risk Governance represents the risk management structure at the Ethiopian Banks.

Table 4: Risk Governance

BANK	Board of Director			
	Audit Committee			Risk Committee
	Senior Management Committee			
Department	Internal audit		Risk and Compliance Dep't	
DIVISION	Internal audit	Inspection	Risk Management	Compliance Management

Source: www.NBE.com.et

2.2.7. Aligning Different Elements of Risk Management

A necessity to integrate CRM, ICS (Internal Control System), and corporate governance has been recognized lately by several authors, yet, only a few solutions have been offered so far. NCG doctrine recommends a targeted cooperation between the audit committee (AC), the board,

risk committee, internal, and external auditors in order to achieve complete transparency.(Hilb 2008). Before discussing integration, it is worth noting that there are two fundamental differences between CRM and ICS. Firstly, CRM focuses on both opportunities and risks, while ICS focused solely on risk dimension. While CRM focuses on all dimensions (including strategic) of an organization, internal controls excludes strategic dimension and focus on operations, reporting, and compliance (for more details please see Table 5: CRM and ICS).

Table 5: RM and ICS

<table>
<tr><td colspan="4">CRM</td><td></td></tr>
<tr><td>RM</td><td colspan="3">ICS</td><td></td></tr>
<tr><td>Strategy</td><td>Operations</td><td>Reporting</td><td>Compliance</td><td></td></tr>
<tr><td colspan="4">Control Environment</td><td rowspan="4">Risk mgt and ICS</td></tr>
<tr><td colspan="4">Objectives</td></tr>
<tr><td colspan="4">Risk Identification</td></tr>
<tr><td colspan="4">Risk Assessment</td></tr>
<tr><td colspan="4">Measures</td><td>Primarily ICS</td></tr>
<tr><td colspan="4">Control Activities</td><td>Primarily RM</td></tr>
<tr><td colspan="4">Information and Communication</td><td rowspan="2">Risk mgt and ICS</td></tr>
<tr><td colspan="4">Monitoring</td></tr>
</table>

Source: Schmid & Stebler 2008

2.2.8. Strategic Risk Management

i. General overview

Each organization has some goals, and whatever the goals to achieve them an organization needs to set objectives (what targets and milestones it will pursue on the path to its goals, i.e. corporate objectives) and strategies (how it is going to accomplish its goals, i.e. corporate strategies). The goal of CRM is to increase the likelihood of achieving organizational objectives by managing risks to be within the stakeholders' appetite for risk (Deloitte 2009).

ii. Positioning CRM as value-adding

As just mentioned, the critical part of the effective CRM implementation is aligning it with strategic plan or vision, and to be "…value creating, it must be embedded in and connected directly to the enterprise's strategy." (Beasley & Frigo 2010). CRM is an integral part of strategic planning and strategic execution process. Literature agrees that such process has to be holistic, broad enough to encompass all enterprise-wide risks, has to crate and protect shareholders wealth, and it has to be an ongoing process in order to realign strategies and objectives with the ever changing environment. (Beasley & Frigo 2010).

iii. Critical principles for a strategic risk management process

The following "List of 10 practices worth striving toward" presented in the table 6 was developed by the Strategic Risk Management Lab in the Center for Strategy, Execution, and Valuation at DePaul University. These principles and concepts are widely represented in the CRM literature in similar forms.

Table 6: List of 10 Practices worth Striving Toward

No.	Practices Worth Striving Toward
1	Communicate and share information across business and risk functions and externally. This is considered by some to be the ultimate risk management "best practice".
2	Breakdown risk management silos. Establish inter disciplinary risk management teams, so that each functional area can understand where it fits into the entire company strategy and how it affects other areas.
3	Identify and, where possible, quantify strategic risks in terms of their impact on revenue, earnings, reputation, and shareholder value.
4	Make strategic risk assessments part of the process of developing strategy, strategic plans, and strategic objectives. This requires a combination of skills that can be achieved by creating interdisciplinary teams.
5	Monitor and manage risk through the organization's performance measurement and management system, including its Balanced Score card.
6	Account for strategic risk and embed it within the strategic plan and strategic plan management process. Wherever scenario planning is included in developing the strategic plan, there should also be a discussion of countermeasures in the event that a risk event occurs.
7	Use a common language of risk throughout your organization. Everyone must understand the organization's particular drivers of risk, its risk appetite, and what management considers acceptable risk levels.
8	Make strategic risk management, like strategy management itself, a continual process. Risk is inherently dynamic, so risk management and assessment must evolve from being an event to being a process and must include regular analysis and critical risk information refreshment. Strategic risk management reviews should be conducted as part of regular strategy reviews.
9	Develop key risk indicators (KRIs) to continuously monitor the company's risk profile. Like the Balanced Score card with its measures, targets, and initiatives, the risk management system should include KRIs, thresholds and trigger points, and countermeasures to mitigate or manage the risk.
10	Integrate ERM into Strategy Execution Systems. This means integrating ERM into the entire management system. This will require strategic risk management as a core competency in and a commitment to continuously monitor and manage risk in the strategy and its execution."

Source: Beasley &Frigo (2010).

2.2.9. International Regulation

i. Basel I

The Basel Committee on Banking Supervision became noteworthy on international scene shortly after its establishing in 1974. During the late 1970's large losses were widespread in less developed countries (LDC), causing the Basel regulators to became increasingly worried about possible bank failures. The primary concern was that large banks do not have adequate capital reserves in relations to their risk exposure. Originally, Basel I focused mainly on the credit risk. Interestingly, banks were required to hold higher reserves for ordinary mortgages in comparison to mortgage pools that were securitized.

ii. Basel II

The Basel Committee continues aligning capital requirements and the risks banks face through Basel II Capital Accord. There were two main innovations introduced in the Accord; the first contains three pillars and the second pertaining to introduction of ERM.

The first pillar deals with minimal capital requirements, which are based on credit, market and operational risk. Hence a new category of operational risk was introduced since many risks were not covered under market and credit risks. The second pillar fosters comprehensive dialogue between banks and supervisory bodies. Finally, the third pillar tries to impose the market discipline; hence, aims at increased disclosure.

iii. Basel III

There are two main objectives of this framework. "The first objective is to promote short-term resilience of a bank's liquidity risk profile by ensuring that it has sufficient high quality liquid assets to survive a significant stress scenario lasting for one month. The Committee developed the Liquidity Coverage Ratio (LCR) to achieve this objective; however, LCR is currently being revised by the Basel Committee. The second objective is to promote resilience over a longer time horizon by creating additional incentives for banks to fund their activities with more stable sources of funding on an ongoing basis.

The most noteworthy is an effort to shift the Basel III Accord from guideline to a more complete methodology for risk management.

2.2.10. Key Steps of ERM Process

i. General overview

As mentioned in the previous section the process starts with S*trategic Objective Setting*.

Risk identification"… is the most important and delicate step because it sets the agenda. Risks are normally only discussed when they have occurred or identified before. The worst risks are unidentified ones, which appear suddenly and where there is no guarantee that only the Executive Board (Ex BoD) is the first to observe them." (Kalia& Müller 2007)

Risk assessment and prioritization is performed using qualitative and quantitative techniques. Numerous methods and measurements are used to measure risk in banks; however, many of them have been around for decades. Currently banks uses statistical loss measures that include value-at-risk, expected loss and earnings-at-risk, and stress loss methods that measure the loss that could result from extreme events under specified scenarios (Stress testing is required, as value at risk does not cover worst loss).

Risk analysisis preformed once risks are selected. A next logical step is in depth analysis to assess the main risk drivers in order to effectively manage them. The results of this step are usually presented in the Risk Driver Tree of the Measure Map. (Kalia& Müller 2007).

By considering the probability of occurrence and their impact then classify in four categories:-

Top risks: - take action with first priority

Sever risks: - take action with second priority

Less sever risks: - actions with appropriate effort can be taken

Acceptable risks: - no action required

In depth risk analysis is used to study the risks more precisely, so that they can be precisely quantified based on probabilities. Such quantifiable measure then becomes a benchmark against which the success of the action can be compared.

Action planning is used to plan the future Risk Map, after the mitigation measures took place.

Monitoring, reporting and supervision, is the next logical step. Regular reports need to be generated not only to follow specific risks, but also to assemble a complete picture of all risks facing the banks.

ii. Improvement opportunities

In their work Kalia& Müller (2007) made great strides in the integration of the corporate governance and risk management body of knowledge. However, their wok does not include any recommendations on integration of the internal control systems. This thesis plans to further investigates exactly that avenue and contribute to the further integration of corporate governance and risk management.

2.2.11.The Supervisory Board

i. General overview

While explaining the strategic dimension Hilb (2005) postulates that "great strategy follows great people, and great success follows great strategy".

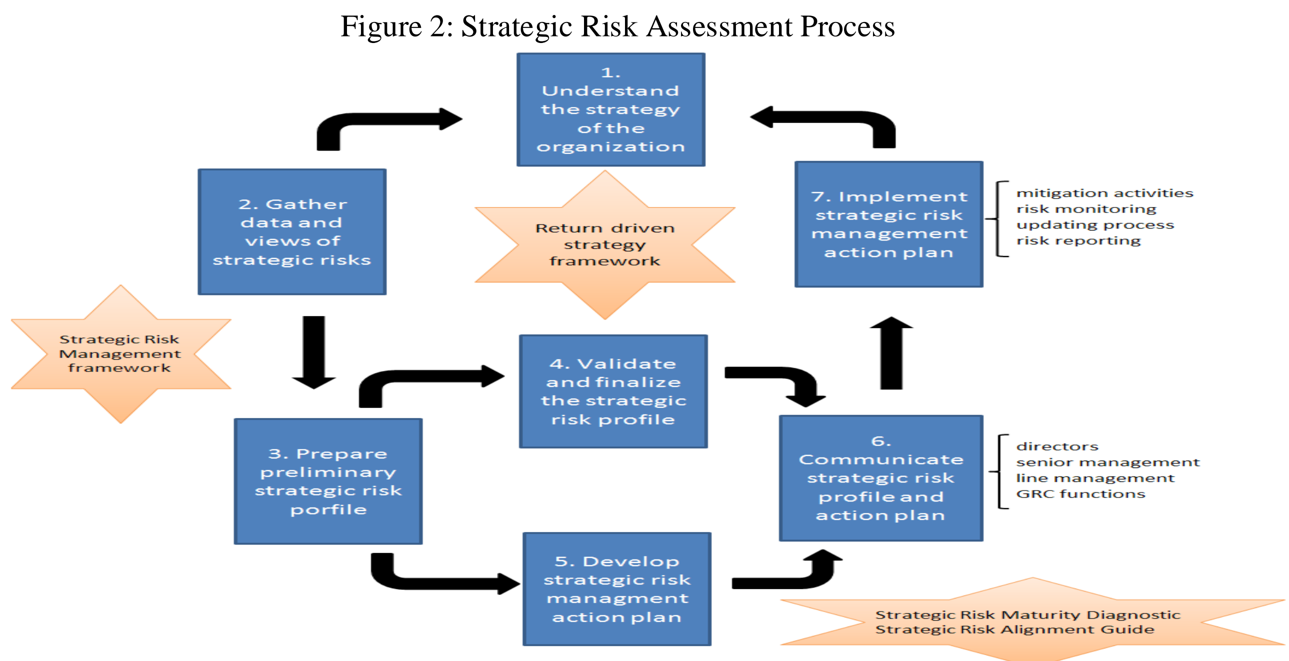
The steps is extremely important, as risks cannot be defined if strategic objectives are not clear. "Based on corporate strategy, the Board of Directors (BoD) has to initiate the creation of the following documents to showcase the objectives, structure and procedures to manage risk:

- Risk Management policy,
- Risk Management directives, and
- Risk Management handbook (Kalia and Müller (2007).

ii. Strategic risk assessment process

Presented here is a basic, high level process that is wide enough for all organizations and requires a significant amount of customization. (Frigo & Anderson 2011). To reflect strategic risk management as an ongoing process, this model is designed to be a circular and closed looped; hence, follows the same logic as the NGC models presented earlier. This strategic risk assessment process presented in Figure 2 is designed to be tailored to a specific organization and specific culture.

Figure 2: Strategic Risk Assessment Process



Source: Frigo & Anderson (2011)

iii. Integrating strategy and risk management

The most recognized model of integrating risk management into strategic planning and performance measurement system was based on the Kaplan-Norton's balance scorecard framework. (Frigo & Anderson 2011). The original Kaplan-Norton's framework is developed for integration of strategy and operations, but it's been extended to include risk management. The Basel report "Principles for the Sound Management of Operational Risks" also recommends use of scorecards to provide a meaningful translation of risk assessment into metrics that give a relative ranking of risks, as a part of risk assessment.

2.2.12.Delegation of Risk Management Functions to Board Committees

i. General overview

With the increased importance of the risk management, the board committees in charge (either the risk management or audit committee) have increased their demand for information on senior management, the boards meet more often and work longer. This increasing trend is in accordance with the New Corporate Governance philosophy that recommends a separate risk management committee in banks (Ladipo & Nestor 2009).

ii. Risk management committee

The primary function of a risk committee is to assist the BoD in fulfilling its risk management responsibilities as defined by law and regulations, (NBE) yet they were not standard even in big banks as of 2013. The objectives of the risk management committee (RC) are following:

(1) To ensure a comprehensive, professional risk management system exists within the bank, particularly as it relates to market, credit, and liquidity & funding risks and

(2) To ensure effective communication between committees, external auditors, management, internal auditors, risk management professional and National Bank of Ethiopia.

Finally, it is worth nothing that not all risk will be a sole responsibility of the risk management committee. For instance the review and assessment of the adequacy of the management of reputational risks is a joint responsibility of the risk committee and audit committee.

2.2.13.Integration of Operational and Strategic Management

"A visionary strategy that is not linked to excellent operational and governance processes cannot be implemented. Conversely, operational excellence may lower costs, improve quality, and reduce process and lead times; but without a strategy's vision and guidance, a company is not

likely to enjoy sustainable success from its operational improvements alone." (Kaplan & Norton 2008).Most companies are lacking a management system to integrate the two crucial dimensions, even though in recent years several frameworks attempted to address that deficiency. Stages of integration of strategy and operations:-

"*Stage 1*: Managers develop the strategy using the strategy tools." Organizations strategic risks have to be identified, so that strategy can be properly clarified and articulated.

"Stage 2*:* The organization plans the strategy using tools such as strategy maps and Balanced Scorecards." Risk based objectives and performance measures need to be developed for balance scorecards and strategy maps, or a separate risk scorecard could be developed.

"Stage 3: Once the high-level strategy map and Balanced Scorecard have been articulated, managers align the organization with the strategy by cascading linked strategy maps and Balanced Score-cards to all organizational units. They align employees through a formal communication process and link employees' personal objectives and incentives to strategic objectives." At this stage risk and control units need to be aligned for more effective risk management.

"Stage 4: With all organizational units and employees aligned with the strategy, managers can now plan operations using tools such as quality and process management, reengineering, process dash-boards, rolling forecasts, activity-based costing, resource capacity planning, and dynamic budgeting." The strategic risk management action plan needs to be reflected in the operational action plan and dashboard.

"Stage 5: As the strategy and operational plans are executed, the enterprise monitors and learns about problems, barriers, and challenges. This process integrates information about operations and strategy in a carefully designed structure of management review meetings." Both strategic and operational risk reviews have to be continual for affective process.

"Stage 6: Managers use internal operational data and new external environmental and competitive data to test and adapt the strategy, launching another loop around the integrated strategy planning and operational execution system." Strategic risk assessment at this stage should also include emerging risks. (Kaplan & Norton 2008).

2.3. REVIEW OF RELATED EMPIRICAL STUDIES

2.3.1. Risk management – empirical studies

The study made by Goran Oblakovic (2013), presented empirical evidence regarding the risk management at the strategic and operational levels of Swiss Banks: current status and lessons learned from the subprime crisis. This study reviews theories and models of operational and strategic risk management, as well as the main frameworks and regulations on risk management. The study focused on all Swiss banks, and the results were conclusive that risk management in Swiss banks has changed significantly since the crisis. Banks implemented significant structural changes which were different based on the size and activity of a bank while behavioral changes seem to be taking longer. The study confirms that there is a clear shift from CRM by numbers to holistic CRM.

The results indicate that a fully integrated model of Corporate Risk Management, which includes integration with corporate governance and other dimension, has been implemented in the biggest banks. The study concludes that risk management is becoming an integral part of strategy formulation. Finally, how to implement a risk management culture remain to be the most significant issue, but also the most significant improvement opportunity in the field of risk management.

Moreover, Okehi Daniel (2014), made an empirical analysis of the Modelling Risk Management in Banks: Examining Why Banks Fail. The aim of this research was to determine why there have been persistent bank failures in Nigeria and to investigate whether ineffective risk management in banks, coupled with poor corporate governance practices and non-adherence to regulations, play a significant role in the banks' performance. The variables were operationalized by taking VaR as the proxy for risk management, having CRO as a proxy for ERM, CAR as a proxy for corporate governance, and ROE as a proxy for performance.

The findings of the study confirmed that there is a significant positive relationship between the independent variables and the dependent variable. These findings suggest that, by adopting effective risk management and improving corporate governance practices, Nigerian banks can improve their performance. This research has positive social implications for those in the banking industry by ensuring the safety of the depositors' funds in banks, and stabilizing the payment system in the economy, which historically would have been disrupted by systemic failure in the banking industry.

2.3.2. Related empirical studies in Ethiopia

A few number of related studies were conducted by different researchers in Ethiopia. Most of them are concentrated on operational risk management. Specifically, Solomon G (2013) studied that the assessment of credit risk management practices at NIB International Bank S.C. the purpose of this study is, therefore, to assess the important area of concern taking the credit risk management practices of NIB bank through examining the policy risk framework in place, credit risk management tools and measurement techniques adopted by the bank. The researcher used simple random sampling technique. The analysis of both primary and secondary data shows that the bank has been trying to adapt a credit risk management framework with numerous documents governing the day to day credit activities. Some good points are a complete lending procedure having different loan sanctioning committee and limits, internal credit rating system, credit policy in managing problem credits, credit classification, provisioning and write off. However, the study concluded that NIB has a problem in NPLs management, credit portfolio concentration and monitoring & follow-up of loans. Thus, it is recommended NBE needs to strengthen its credit administration, portfolio management and monitoring practices.

Wondimagegnehu (2012), assess the liquidity risk management in Ethiopia banks. The findings of the study revealed that there is no uniform (standardized) liquidity risk management policy and procedure in the banking industry which is for all commercial banks in Ethiopia. The directives issued by NBE have no significant impact that will affect the performance of commercial banks instead they are important for the normal operations of banks and the industry in general.

Among the factors that influence liquidity risk management of commercial banks in Ethiopia includes: absence of secondary markets, lack of enough financial instruments and absence of the strong management information system.

Previous studies directly related to this research, to the knowledge of the researcher, are not found. Most of the reviewed researches made in Ethiopia, including the above, had their own limitation. Most of them were focused on different classes of risk management like liquidity, market, credit, interest rate, and operational risk managements instead of taking a view of the full picture.

2.4. CONCLUSION AND GAP IN THE EXISTING LITERATURE

As mentioned, this review (both theoretical and empirical works) included: the history of risk management, major risk management frameworks and regulations, and major elements of the strategic risk management that are directly related to this thesis. The researcher felt that a review of all dimensions was necessary in order to get a complete picture and better understand the risk management theory. The presented literature review shows a few areas of disconnect in the current RM literature. The key messages are presented below.

- The literature indicates there are several issues with implementation of CRM. There is a lack of integration models of integration of corporate governance and risk management, and for especially for integration of the strategic risk management, and incorporation of internal control systems.
- Additionally, the review indicates that boards have traditionally consider only risks that have financial significance to the company, but they have to adopt more systematic and strategic view to consider impact on stakeholders and the resulting reputation for the firm. The literature further indicates that in order to cope with the changing environment, boards became smaller, boards have more independent directors with more banking experience, and boards have better expertise.
- Risk management function should be more involved in setting-up credit and liquidity limits.

In addition to the above summary of the literature review reflected on all significant elements of risk management, their function, and main challenges; yet it never entirely combined all elements and provided the entire picture. The corporate governance literature covered extensively composition and structure of boards in banks and governance implication in different countries; yet, subsidiary governance and control mechanisms for subsidiaries is far less researched. Subsidiary boards often are not very active and they are set up as “puppet boards” to fulfill local legal requirements. Many international banks that have been severely affected by the subprime crisis have failed in subsidiary governance, by establishing subsidiary boards that neither directly nor control subsidiary management. Therefore, the subsidiary boards should be active and composed of independent and knowledgeable local board members, as they are important internal governance mechanism. The subsidiary board is more likely to be active if chaired by the subsidiary CEO that holds management position at headquarters. Although this is widely accepted practice, NCG approach recommends that “subsidiary boards should each be

chaired by a member of the board of directors and not by a member of the management team of the above operative unit." This dimension of corporate governance in the global multinational enterprise is not very regulated, and there are only a few government recommendations.

Most empirical works of their findings contradict each other. For instance, Goran Oblakovic (2013) examined that, regulations became the major impetus on risk management (regulators are much more proactive), board expertise and experience is improving, engagement is intensified, board members are becoming more inquisitive and involved in the risk management, lack of qualified independent directors pronounced and theoretical recommendations to empower subsidiary boards not followed in practice. However, Daniel Onye buchi Okehi (2014) inspected the risk management in different levels like credit, liquidity, market, operational and strategic risk and the findings are presented as follows, the causes of overall bank failures are: ineffective risk management and Poor Corporate Governance. These factors need to be properly grouped to enable bank operators to focus attention properly on them. Further studies are therefore required to obtain additional independent variables that could influence bank performance.

Moreover, both researchers are ignored that most of the regulations cannot be scaled based on the size and activity of the banks, Daniel Onye buchi (2014) are only reported two factors missed the regulation while Goran Oblakovic (2013) is stated regulation as a first factor, But in the case of bigger banks, they forced to implement a lot of regulations; overwhelmed with the volume and difficult to stay as a proactive and they are not clearly put the relationships, rich dialogue, constructive criticisms and the interaction of the board and senior risk executives.

In the context of Ethiopia, Solomon G (2013) assessment of credit risk management practice in case of NIB International Bank S.C, Weldemikael (2012) on the relationship between leverage and firm specific (profitability, tangibility, growth, risk, size and liquidity) determinants of capital structure decision of banks, as well as Wondimagegnehu (2012) factor affecting the liquidity position of the Ethiopian private bank, they were used limited measures like credit, liquidity and operational acidities in their study. All researchers are used only by the risk classes. For example, Solomon G (2013) used only credit risk, Weldemikael (2012) used operational risk and Wondimagegnehu (2012) used only liquidity risk management.

Hence, given the contradicting results of earlier studies on the risk management at the strategic level, the findings were limited and inconsistent in the past researches. Therefore, the researcher

tried to fill in the gap by focusing on an entire of the assessment of risk management at the strategic level of Ethiopia private commercial Banks by using different survey technique.

2.5 CONCEPTUAL FRAME WORK

Based on the related literature of both theoretical and empirical studies the following conceptual framework was developed.

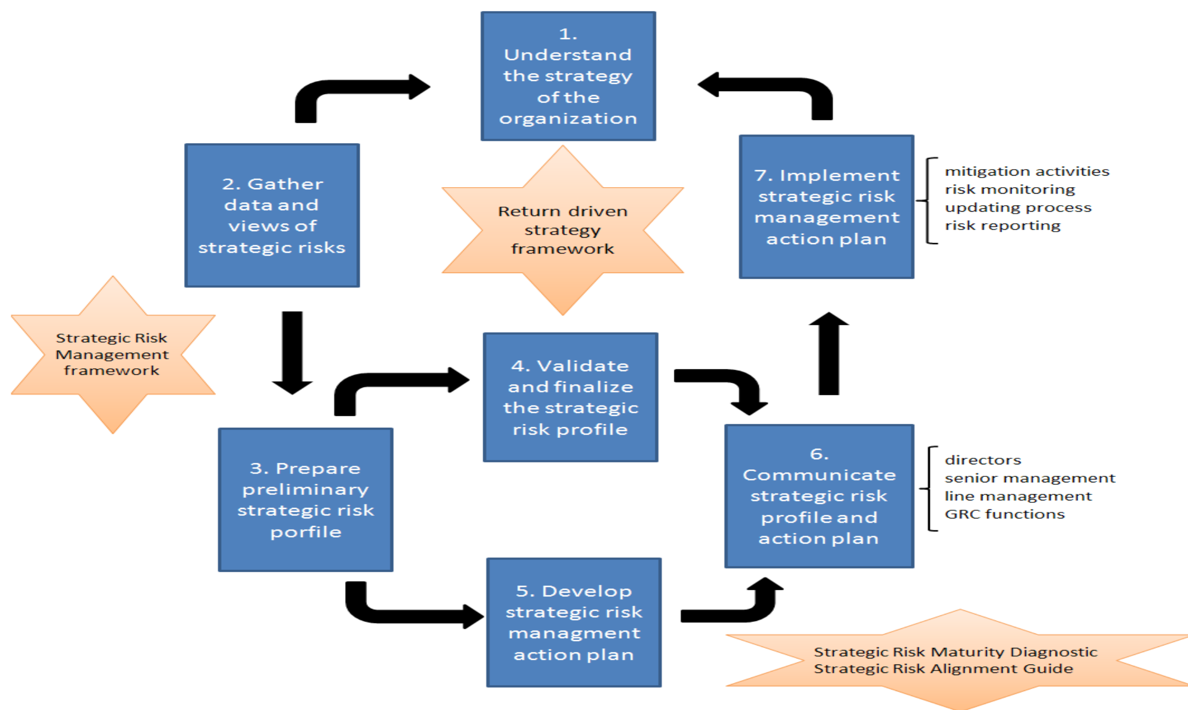


Figure 2: Strategic Risk Assessment Process Conceptual Frame work on the Related Literature Reviewed

Source: Frigo & Anderson (2011)

As we show in the above diagram the general accepted strategic risk assessment model including the following

1. Understand the strategy of the organization: define what you have to achieve to be successful and establish the basis of dealing with risk and future decision.
2. Gather data and views of strategic risks: identify areas of risk which may limit or prevent achievement of objective
3. Prepare preliminary strategic risk profile: evaluate and prioritize the level of risk and quantify frequency of occurrence and impact.

4. Validate and finalize the strategic risk profile: define how we are going to respond to identify risks, eliminate, mitigate, deflect or accept.
5. Develop strategic risk management action plan; document how you propose to tackle risk
6. Communicate strategic risk and profile and action plan; the risk control function implements the risk strategic management plan. This may involve and training and communication. And as the risks and the work environment are continually changing, it is essential to continually monitor and review the level of risk and your ability to effectively respond.
7. Implement strategic risk management action plan; is gaining significance and important due to mitigation activity, risk monitoring, updating process and risk reporting.

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

This chapter sets out various stages and phases that follow to complete the study. It outlines the research methodology that will be used to answer the research questions. According to Brown etal (2003). Research Design provides the glue that holds the research together. Research Methodology includes research design, target population and sample, data collection procedures and data analysis procedures.

3.1. Research Design

In this research, survey approach was used as the research questions are majorly focused on 'what' questions. According to Yin (1994) survey methods are used to answer what questions. Trochin (1999) further explained survey methods are used for non-experimental and descriptive research methods. He further indicated that, the survey can be useful when a researcher wants to collect data on phenomena that cannot be directly observed. Survey design also provides a quantitative or a numeric description of trends, attitudes, or opinions of a population by studying a sample of that population, according to Yin (1994). Descriptive type of researcher to describe the current risk management practice at the strategic level and performance of the banks was consider in this study.

3.2. Research Approach

According to Yin (1994, P. 5) there are two basic approaches to research, qualitative research approach and quantitative research approach. For Yin quantitative research approach involves the generation of data in quantitative form which can be subjected to rigorous quantitative analysis in a formal and rigid fashion. Qualitative research approach on the other hand is concerned with subjective assessment of attitudes, opinions and behavior where research in such a situation is a function of researcher's insights and impressions. The general objective of this study as described in the first chapter is to explore current Risk Management in Private commercial Banks. And to recommend how these practices can further be developed. Hence, considering the nature of each approach, the researcher found both quantitative and qualitative approach (mixed research approach) most suitable for this study.

3.3. Target Population, Sample Size and Sampling Techniques

3.3.1 Target Population

The population of the study is Private Commercial Banks in Ethiopia registered by National Bank of Ethiopia (NBE). Currently, as per NBE (2016/17) annual report, the major financial institutions operating in Ethiopia are banks, insurance companies and micro-finance institutions. The number of banks operating in the country is 18, of which 16 are private banks, and the remaining are state-owned (Construction and Business Bank are merged with Commercial Bank Ethiopia). From these only 17 banks are Commercial Banks. This is excluding the Development Bank of Ethiopia, which provides banking service to the selected government priority sectors.
To meet the desired objective of this study and to make generalizations from sample to population, the researcher used the National Bank of Ethiopia categories based on their year of establishment (peer group I- greater than ten years and Peer group II-less than ten years). Due to this, from 16 private commercial banks operating in the country this study took samples of three for each group which is the sum of six banks namely, NIB International Bank S.C, Abyssinia Bank S.C and United Bank S.C, Enat Bank S.C, Abay Bank S.C, Birhan International Bank S.C.

3.3.2 Sample Size

Sampling is the process of choosing from a much larger population to make a generalized statement considering the selected sample represents the total group. Sample size determination is the mathematical estimation of the number of subject/units to be included in a study. The sample size is an important feature of any empirical study in which the goal is to allow for appropriate analysis and to provide the desired level of accuracy. In practice, the sample size to be used in a study is determined based on expense of data collection, and the need to have validity of significant test.
The sample size determined based on the table show below formula

$$n = \frac{N}{1+N(e)^2} = \frac{172}{1+172\,(0.05)^2} = \underline{\underline{120}}$$

Source: Yamane Taro. (1992)

Where n: Sample size

N: Total number of population e: Variability or Margin of error (5%)

1: The probability of the event occurring

Then after, select those employees from the sampled banks. For the purpose of this research study, 120 employees (each 20 employees) were randomly selected from six different banks, who are directly involved in conducting the Risk management at strategic level. Therefore for the purpose of the study in the area of risk management.

3.3.3 Sampling Technique

In order to find demonstrative data of the research, stratified random sampling technique is applied for the study. Method was also employed to select relevant respondents. Thus, the population of the study is divided into subpopulation or strata. Sample respondents were randomly selected from each stratum are formed based on members shared attributes or characteristics. This sampling technique enabled the researcher to gather the opinion of various personnel working on Risk management department staffs, Top managements, Branch managers, Finance department staffs, International banking department staffs and Credit management staffs.

3.4 Source and Tool of Data Collection

The sources of data i.e the Risk management department staffs, Top managements, Branch managers, Finance department staffs International banking department staffs and Credit management staffs of the private commercial banks undertaken in this study. Moreover, annual reports of the Ethiopia private commercial banks, directives issued by the National bank of Ethiopia, other country experience, books, journals and different thesis were also used.

To accomplish the objectives of this study, the researcher used both quantitative and qualitative data from primary and secondary sources. In order to collect data from primary sources, through questionnaires (both close ended and open ended questions) were prepared and used in English. The open-ended questions offered the respondents the opportunity to freely express themselves on the issues under consideration while the close-ended questions restricted the respondents on the options provided. The questionnaires for the respective respondents were administered by the researcher, assuming that they can get more assistance by the time they fill the questionnaire in case they needed.

For part one questionnaire, the respondents asked to thick "√" in the appropriate box. For part two questionnaire, the respondents asked to rate as per the given five point (1-5) Likert Scale. 1

represents = strongly disagree, 2 represents = disagree, 3 represents = neutral, 4 represents agree, and 5 represents = strongly agree.

The questionnaires distributed had three sections to sampled private commercial banks. The first part of the questionnaire was intended to gather background information of the respondents. The second part consists of questions that were designed to examine practices of risk management Policies and procedure framework and in the third part of the questionnaire, respondents were asked about the risk management at a strategic level.

A personal interview was also conducted on some issues (points) that need more clarification and which are difficult to collect through questionnaires. In addition to the primary data. The secondary data were gathered from the annual reports of the Ethiopia private commercial banks, directives issued by the National bank of Ethiopia, other country experience, books, journals and different thesis.

3.5 Data Collection Procedure

3.5.1 Survey

A great strength of a survey as a primary data collection is its versatility, besides being easy to administer, confidential, efficient and economical (Blumberg, Cooper & Schindler 2008). The researcher chose to use it to reach different organs of each bank. (A participants who are uniquely qualified to answer the desired questions). A number of different dimensions of CRM were incorporated, including:

*Structure and integration of CRM, *Internal control systems and *Regulation, etc.

In order to improve a response rate an accompanying letter explaining the purpose of a study was sent with each survey. The survey was designed to be completely confidential, and that was emphasized in the cover letter.

3.5.2 Interviews

The qualitative semi-structured research, interviews were used to collect a rich and detailed set of data. The semi-structured interviews were chosen as they offer the most flexibility, allowing the researcher to have a structure, keep focus, but at the same time used follow-up questions to explore the topic. The interviews were conducted with heads of risk management, managers at different level in order to better understand the CRM from different viewpoints. The researcher prepared a list of questions. The lists of questions were usually sent in advance, so that participants could prepare.

All participants were initially contacted in person, and were very gracious to promptly respond and contribute their time. The majority of the interviews were recorded in order to capture the entirety of answers, and detailed notes was taken when the interviews were not recorded. A total of twelve interviews were conducted, please see table 7 for breakdown by type of interviewees. The list of questions were sent in advance, so that participants can prepare.

Table 7: Breakdown of Interviewees

Respondent	Number
Board of Director member	6
CRO's	6

Source: Survey (2018)

3.5.3 Documentary Sources

Documentary secondary data are often used in research project like this one that also uses the primary data collection method and plays a prominent role in qualitative research as it is an important information source in all research phases. Secondary data allowed this researcher to expand his understanding of the risk management at a strategic level.

3.6 Method of Data Analysis

After collecting the relevant data through the data gathering methods used in this study, the study categorized the data appropriately for interpretation. Both qualitative and quantitative data analysis techniques were employed in this study. To analyze and interpret the data gained from questionnaires, a quantitative technique involving descriptive statistics (frequencies distribution, mean, standard deviation and percentage) was applied to analyze and present these data. The data obtained from interview were analyzed, summarized and discussed in detail.

Moreover, the data obtained from annual reports of the Ethiopia private commercial banks is considered in this study and analyze using percentages, ratios and interpret quantitatively. Finally, based on the findings of the study, conclusions and recommendations were made.

3.7 Reliability and Validity Assurance

3.7.1 Validity

According to Marczyk (2005), the concept of validity refers to, what the test or measurement strategy measures and how well it does so. Conceptually, validity seeks to answer the following question: "Does the instrument or measurement approach measure what it is supposed to measure?"

The following steps were taken to ensure the validity of the study. Questionnaires were prepared from the literature review as a reference to validate the result. Pilot test was conducted with a sample of the participants to enhance the questionnaire's validity in terms of the respondents understanding and comprehension. Comments from professionals and respondents were solicited to ensure validity.

3.7.2 Reliability

Saunders etal. (2003) defined reliability in this way, "reliability refers to the extent to which the data collection techniques or analysis procedures will yield consistent findings".

Cronbach's alpha is a measure of reliability. Reliability refers to the consistency or dependability of a measuring instrument. It is defined as the proportion of the variability in the responses to the survey which is the result of differences in the respondents. That is, answers to a reliable survey will not differ because respondents have different opinions, but because the survey is confusing nor has multiple interpretations.

The Cronbach's alpha for the total scale and the sub scales are above 80% which means that the scales that will be used in this study are considered reliable.

Table 3.7.2 Reliability Statistics

Reliability Statistics

Cronbach's Alpha	N of Items
.899	110

3.8 Ethical Considerations

The researcher assures that the research is independent and impartial. The respondents were given a privilege of not writing their name and other identities. This was done mainly to hide participants form possible unwanted approach that might come from groups or individuals with interest. Further to this the participants was assured on the confidentiality of their responses. No respondent was forced to fill the questionnaire unwillingly and before the actual purpose of the research was made clear to him/her.

CHAPTER FOUR

DATA ANALYSIS AND INTERPRETATION

After methodical review of the research procedure, research topic and the recent literature developments, the researcher continued to look answer for the original research questions. Likewise, this continues to be a survey study that aims to contribute both theoretically and practically to the better understanding of the corporate risk management process in Ethiopian banks.

4.1. Research finding and discussion

The following sections are organized as follows: initially in section B just a raw data collected through questionnaires presented, in section C summary of data collected through interview presented, and finally in section D all data are combined and discussed. Documentary data were not reviewed separately, but used for discussion of findings (section D).

The researcher used small bank and large bank naming of peer group 1 & peer group 2 respectively.

4.2 Questionnaires

A total of 6 banks were chosen through the stratified sampling technique, a researcher, distributed a total of 120 questionnaires. Ten questionnaires were not included in the analysis, because respondents fail to respond to complete the survey, as a duty they are not in Addis Ababa and no one in their bank has the expertise/knowledge to answer all the questions. Subsequently, the researcher received a total of 110 responses that is used in the analysis.

Table 8: Response Rate

	Number	Percent
Questionnaires sent	120	100%
Total Responses	110	91.7%
Unable to answer the survey	10	8.3%

Source: Survey (2018)

Standard scales for this type of research were used:

- Likert-scale questions: “1=strongly disagree”, “2=disagree”, “3=neither agree nor disagree”, “4=agree” and “5=strongly agree”.

The data were exported directly to a spreadsheet for (Microsoft excel) analysis. Obviously, this research used both types of categorical data: descriptive data and ranked data, but bulk of data

were ordinal as most questions are Likert-type questions. The results are presented using a frequency table which summarized the result in terms of frequency and percentage and a descriptive statistics table which uses mean score and standard deviation. For the latter the following were taken as a base. A mean of above 3 is regarded to measure satisfaction on the items. The Standard deviation as it is used to indicate the variation or "dispersion" from the "average" (mean), a low standard deviation indicates that the data points tend to be very close to the mean, whereas high standard deviation indicates that the data is spread out over a large range of values. This is well elaborated in the table and narratives below which show the responses and the statistics.

4.2.1 Respondent General Representation

The first unit of the questionnaire required personal information from respondents. These questions include: current position in their respective bank. According to collected responses, 36% respondents are top managements, 20% are branch and department managers, another 22% are Division risk management, 11% are senior risk management officer, while 8% are risk officers and other response 3% were junior risk management officer.

Table 9: Background profile of the Respondents

Background	Distribution	Frequency	Percentage
Gender	Male	78	71%
	Female	32	29%
Level of education	Diploma	4	3%
	BA Degree	91	83%
	Above Degree	15	14%
Work experience	1-2	6	6%
	3-5	34	31%
	5-10	42	38%
	Above 10	28	25%

Source: Survey (2018)

As depicted table 9, indicate that, the demographic profile of the respondents were analyzed as per their gender, levels of educational achievements and work experiences. Out of the 110 (100%) respondents, 78 (71%) are Male and 32 (29%) are female. From this, one can deduce that the majority of the respondent were male. According to the information given by respondents 91 (83%) of the respondents are BA degree and 15 (14%) are master's degree holders having educational composition of work force in their relative field. Can get benefit the bank in terms of the decreasing the cost incurred for training. Looking at the working experience age category, 34 (31%) and 42 (38%) of the respondents have 3-5 and above 5-10 years working experience

respectively and 28 (25%) of them have above 10 years working experience. Therefore, the above data collected shows that almost all staff of risk management has gained much knowledge through long years of experience and are capable of doing on the risk area.

4.2.1.1 Organizational structure of risk management

Respondents were asked to state which elements of risk management are implemented in their organization. Multiple answers were allowed. According to questionnaire responses, 68% of participants stated that their organization has an independent risk management function and another 18% of participants stated that risk management is a part of a different department (i.e. credit, finance…), 10% of respondents stated that their organization has the risk management committee of the supervisory board.

4% of respondents used an open ended question to supplement their answers, and stated their organization has an executive risk committee and/or that risk management is in the hands of the CEO and the board. No participant selected the last answer choice, “no formal risk management at present”.

The primary focus of risk management is on the explicit understanding of all risks and their interactions. Participants indicate the frequencies have increased, and focus has shifted to potential trouble areas lately focus areas have been on liquidity and funding side.

Further, a majority of interview participants believes that developing an adaptive framework, which includes all risk, is crucial. Naturally, all participants point out there is no substitute for common sense. The prevailing opinion is that models should be used only as an input into the thought process, and should never be a substitute for critical analysis. Therefore, participants agree that risk management is less reliant on models, but recognize the increased use of scenarios and increased importance of counterparty risk. While the majority of participants value scenarios as a starting point of the thought process, others (less than a forth) disregard the value of all models.

Finally, one participant stated that improvements in risk management are probably more an issue of education than one of rules and standards. Education is the key management issue in any quality assurance system. The recommendation is that the lower management level should be relieved from other, less important issues and focus on RM dimension even more. But this is unfortunately not the case in practice. In the opinion of the mentioned participant, the formal aspects of RM are those that prevail, as in the wake of the current development concerning

corporate governance, compliance and similar issues, where all stakeholders are focusing on form rather than on substance this should not be of any surprise at all.

Table 10: Organizational structure of risk management

Organizational structure	Percentage
Independent risk management function	68%
Risk management committee at the Supervisory board	10%
Risk management that is part of a different department (Finance, Accounting…)	18%
Others	4%

Source: Survey (2018)

4.2.1.2 Employees survey about risk management

Respondents were asked to state how often are all employees in their banks surveyed in regards to risk management. According to questionnaire responses, 19% percent of participants stated that employees are surveyed once a year; and another 6% of participants stated that employees are surveyed twice a year in regards to risk. Other, 19% of respondents stated that their organization surveys employees once every few years, while 56% of respondents stated their bank does not survey employees on risk related matters. From the response given by employees every risk management must survey twice a year accordingly as per the directive of National Bank of Ethiopia.

The prevailing opinion seems to be that the biggest concerns of banks are not financial risks but financial instability. This issue consumes most of the time of CROs and risk committees. There are no more safe havens, i.e. buying bills is not safe anymore.

Another identifiable theme for all banks seems to be an increased focus on reputation risks. The participants just kept pointing out that dimension, and focusing on a newly rediscovered focal point. Two participants also indicated that some traditional risk numbers are being reintroduced in practice and becoming relevant again, i.e. loan-to-value and amortization ratios.

Table 11: Surveying employees in regards to risk

Employees survey	Percentage
Never	56%
Twice a year	6%
Once a year	19%
Once every few years	56%

Source: Survey (2018)

4.2.1.3 Risk management strategies

A majority of respondents or 85% agreement by the participants that the risk management strategy in their organization is well defined and updated on a regular basis. Only 5% of respondents strongly agree that the risk management strategy in their organization is neither well defined nor up-dated on a regular basis we can clearly see that banks undertakes risk management strategies in planning its well defined & updated on regular basis. This is evident from the 85% agreement by the participants and also by the 4.14 mean score and 0.72 SD which shows how the responses are close to the mean. However, on the contrary the result shows us that the banks has some limitations in well-defined but up-dated on regular basis in terms of their adjustment and continuous assessment possess. We can see this from the 20% disagreement on the item. This result is slightly supported by the mean score which shows a result a little short of 3.

All of interview responses confirm that the risk management is becoming integral part of strategic planning. One participant stated that an explicit demand from regulators prompted this change in his bank. About a third of respondents stated that the recent regulatory changes, and diminished risk appetite influenced major strategic changes. In order to minimize risk exposure larger banks are simplifying their strategy, looking for synergies, integrating not only business divisions but also product suites, and shutting or scaling down non-integrated parts. The remaining participants stated that the regulatory changes and others did not affect their banks significantly and any changes in strategy are minimal and related to regulations. For example, half of participants stated regulatory capital regulations will affect their strategy. One participant reflected on an extreme case, where the failed strategy led to the dissolution of a bank. Participants positively reflected in the development that NBE requires all banks to explicitly define strategy, guideline, program and assessment in regard to risk management.

Table 12: Risk Management Strategies

Items		Opinion					Mean	SD
		SDA	**DA**	**N**	**A**	**SA**		
Well defined and updated on regular basis	Fre.	2	5	4	23	55	4.1458	0.7143
	%	3%	7%	5%	25%	60%		
Neither well defined nor up-dated on regular basis	Fre.	0	1	85	0	3	3.9167	1.0883
	%	0%	2%	93%	0%	5%		
Well defined but updated on regular basis	Fre.	2	13	41	19	8	3.9167	1.0883
	%	4%	16%	45%	25%	10%		
Currently being revised as a result of the changing regulations and directives	Fre.	0	6	59	13	8	4.2917	0.71335
	%	0%	8%	65%	15%	12%		

Source: Survey (2018)

4.2.1.4 Risk management strategies

Table 13 presents the frequency distribution regarding the risk category that was mostly impacted. According to questionnaire results, 47% of respondents agree that the credit and liquidity risk management were the most affected, followed by operational risk 37%, strategically 31%, reputational 27%, market 26%, and the other 16%. One third of respondents agreed that the following risk categories were also impacted: compliance risk, legal/tax risk, counterparty risk, and risk associated with the internal controls.

Interview results indicate that strategic management is shifting focus to include/assign a risk owner for each process and encourage sound management. Most participants believe that the strategic risk management is all about prudent management and controlling the environment. Interview participants indicated that hedging is used for strategic risk in the control environment. One of the significant strategic change is that bankers are now charged for use of scarce resource, improper implementation of decisions, lack of responsiveness to industry change and impact on earnings or capital arising from adverse business decision. As one participant claims: “it’s a very effective way of changing behaviors”. The same participants explain that such strategy constructs are extremely effective, as policies are implemented “up-stream”, and therefore require much less internal control efforts afterwards. Tools, methods, and processes are being regular basis, as required by regulators.

Table 13: Risk Management Strategies (risk classes)

Items		Opinion					Mean	SD
		SDA	**DA**	**N**	**A**	**SA**		
Credit Risk	Frequency	12	5	25		43	3.6875	0.74822
	%	16%	7%	30%		47%		
Liquidity Risk	Frequency	7	4	33	18	22	2.875	0.73296
	%	10%	5%	38%	21%	26%		
Operational Risk	Frequency	12	3	29	31		2.8125	0.81623
	%	25%	6%	32%	37%			
Strategic Risk	Frequency		6	53	3	19	2.6875	0.51183
	%		9%	60%	5%	26%		
Reputational Risk	Frequency	15	3	41	11	9	2.6667	0.75324
	%	19%	5%	49%	16%	11%		
Market Risk	Frequency	14	3	46	8	11	2.5417	0.82406
	%	17%	6%	52%	10%	15%		
Others	Frequency	21	28	14	8	11	2.8958	0.928
	%	25%	32%	17%	10%	16%		

Source: Survey (2018)

4.2.1.5 The main challenges to effective CRM

In the next question, respondents were asked to state their opinion on what they consider to be the main barriers/challenges to the effective risk management in their bank. A frequency distribution representing their response can be found in Table 14. A majority of respondents or 79% agrees that uncertainty over future regulation is the biggest challenge, 42% agree that lack of expertise at the board level is the biggest challenge and 53% believe there is no major challenges at present to the effective risk management, 69% of respondents disagrees that poor communication is a challenge to CRM. Additionally, 64% believe that lack of strong leadership in RM is a challenge; however, 27% of respondent disagrees with that opinion. Opinions were divided on whether major challenges are: insufficient real time data, insufficient processes, procedures and tools, or lack of expertise at the board level. In this case results are also presented using a frequency table which summarized the result in terms of frequency and percentage and a descriptive statistics table which uses mean score and standard deviation. For the latter the following were taken as a base. A mean of above 3 is regarded to measure satisfaction on the items. The Standard deviation as it is used to indicate the variation or "dispersion" from the "average" (mean), a low standard deviation indicates that the data points tend to be very close to the mean, whereas high standard deviation indicates that the data is spread out over a large range of values. This is well elaborated in the table and narratives below which show the responses and the statistics.

Table 14: The main challenges to effective CRM

Challenges		Opinion					Mean	S.D
		SA	A	N	D	SD		
Uncertainty over future	Frq	46	40	18		6	4.1250	0.9812
	%	42%	37%	16%		5%		
No major challenges at present	Frq		23	17	12	58	2.0288	1.2461
	%		21%	15%	11%	53%		
Poor communication throughout the bank	Frq	18		16	41	35	2.3125	1.3862
	%	16%		15%	37%	32%		
Lack of strong leadership in RM	Frq	18	12	10	12	58	2.3333	1.6286
	%	16%	11%	9%	11%	53%		
Lack of expertise at the board level	Frq	26	29	25	17	13	3.3958	1.3327
	%	24%	26%	23%	15%	12%		

Source: Survey (2018)

4.2.1.6 Effectiveness across risk management

In this question, respondents were asked to rate how effective their organization is across several risks or risk related dimensions, please see the frequency distribution of their answers Table 15.

A significant majority or 85% agrees that the board level expertise in regard to risk management is not effective in their bank and 63% agree that the operational risk management in their organization is not effective. 58% of respondents agree that their organization is not effective at installing and maintain a risk aware culture, but only 26% of respondent agree that risk training is effective at all levels. Further on only 26% agrees that real time risk management is effective in their organization. More than half of the respondents agree that internal controls and risk reporting are effective in their organizations.

All but one participant stated that the board engagement intensified, board members are becoming more inquisitive, more involved, they are forming stronger relationships with management and increasingly probing.

It is a prevailing opinion that board members feel more accountable (both executive and inclusive); therefore, they ask more prudent questions, requires much richer information, more frequently. Another prevailing opinion is that boards are much better at defining roles and responsibilities at the board level and establishing clear separation of duties. The remaining interview participant stated that the board in his company is very limited experience, and no desire to become more involved. However, even those boards set up credit limits without any input from the risk management function. Subsidiary boards are chaired by a member of a board of directors.

The interview participants have quite different opinions regarding the experience and expertise at the board level. In regards to experience, participants believe there is a sufficient, even vast experience on the board level, while the rest believe more experience is required. Only one third of interview participants claim that their board's posse sufficient technical expertise regarding risk management. More than 80% of the participants explain this situation by stating that there is a lack of qualified independent directors, and this problem might only grow as all-time commitments are increasing at the board level. Further, all communication is limited by the level of expertise on the board. Overall, the prevailing opinion is that the expertise and experience is improving, just not fast enough. Over 70% of interview participants believe there is still room for improvement at the board level. Interview results further indicate that as boards get much more involved, they are providing a lot more explicit approvals and directives.

Finally, participants were asked to express their opinion on whether the boards should be evaluated in regards to risk management. A feedback loop concept was offered as a solution. The majority of participants liked the idea and possibility of boards being evaluated; however, interview participants unanimously agreed that the risk management function should not be involved in such evaluation. A slight majority of participants believes that the board self-evaluations and auditor's evaluations are sufficient. However, all participants stated that constructive criticisms, close relationship, and interaction of boards and executives, with a lot of good feedback is a key to aligning strategic risk management. Further, participants felt that the relationship between the risk function and the board would be impeded by concepts such as the "feedback loop". Interestingly, as a solution, one participant suggested that the board of directors should have to review and vote on the risk assessment report at least once a month.

Table 15: Effectiveness across risk management

Items		Agreement					Mean	SD
		SDA	**DA**	**N**	**A**	**SA**		
Risk reporting	Frequency			39	39	14	4.1042	0.90482
	%			42%	42%	16%		
Internal controls	Frequency		8	26	28	22	4.0000	0.5835
	%		12%	30%	31%	27%		
Risk training at all levels	Frequency	22		69			3.8542	0.3567
	%	26%		74%				
Installing/maintaining risk aware culture	Frequency	42	8	8	8	15	3.2083	0.4104
	%	47%	11%	11%	11%	20%		
Real time risk management	Frequency			69	4	15	2.5833	0.91868
	%			74%	6%	20%		
Risk function expertise at the operational level	Frequency	3	16	9	43	14	3.1667	0.69446
	%	5%	20%	12%	47%	16%		
Board level expertise	Frequency	50	29		5	4	3.3333	0.75324
	%	53%	32%		9%	6%		
Overall risk expertise	Frequency	9	31	14	9	3	2.125	0.8411
	%	12%	35%	18%	12%	5%		

Source: Survey (2018)

4.2.1.7 **Utilization of regular activities in managing risk**

Table 16 shows the frequency distribution of several different activities which are all related to risk management. According to questionnaire responses, 67% of respondents claim their banks are computing risk exposures quarters, 28% on a monthly basis, and 5% annual. A majority or 61% of respondents stated that risk management practices and models are being evaluated on an

annual basis. Further, 61% of respondents claim that the internal financial risk report is prepared for the executive board each quarter, while 78% state that the risk report for the supervisory board is prepared for the quarterly basis. Ad-hoc reporting for internal use is performed on either monthly 39% or quarterly 33% basis. Majority 55% is sending reports on either quarterly or annual basis. Finally, 72% of respondents stated that their organization is sending a report to regulators on an ad-hoc basis, either monthly 10%, quarterly 72%, or annually 18%.

4.2.1.8 Table 16: Utilization of regular activities in managing risk

Different activities	Daily	Weekly	Monthly	Quarterly	Annually
Compute your risk exposures			28%	67%	5%
Evaluate existing risk management practices		6%	11%	22%	61%
Evaluate existing risk management measurement models		17%	11%	11%	61%
Publish internal financial Risk Report for the Executive Board		6%	28%	61%	5%
Publish internal financial Risk Report for the Supervisory Board		5%	11%	78%	6%
Prepare ad-hoc reports for internal use	11%	11%	39%	33%	6%
Send reports to regulators	11%	12%	22%	55%	
Prepare ad-hoc reports for regulators			10%	72%	18%

Source: Survey (2018)

4.2.1.9 Effects of the new NBE Directive

Respondents were asked how the new NBE directive influenced several dimensions, including RM, compensation, internal control, training, culture, etc. Please see Table 17 which presents the frequency distribution of their responses. One half of respondents or 50% disagrees that the risk management became more holistic. A vast majority of respondents or 88% disagrees with the statement that risk management became more dependent on models. A majority or 57% of respondents disagrees with a statement that compensation decreased, 44% of respondents agree that compensation is unchanged, 76% disagree with the statement that claw-back measures were introduced, 79% of respondents agree that their organization increased the risk management training efforts. Finally, a vast majority or 40% of feels that a risk-based audit function was not implemented

In order for the participants in the questioner NBE in risk management Guidelines properly to establish comprehensive risk management program should at least contain (Active Board and

senior management oversight, adequate polices, procedure and limits, adequate risk monitoring & management information system & adequate internal control).

Table 17: Effects of the new NBE Directive

Items		Opinion					Mean	SD
		SDA	DA	N	A	SA		
Risk management became more holistic	Frequency	25	18	23	16	3	2.5	0.77184
	%	30%	20%	26%	19%	5%		
Risk management became more dependent on models	Frequency	63	14		7	1	4.1667	0.69446
	%	69%	19%		9%	3%		
Compensation in our organization decreased	Frequency	28	19	13	3	14	2.6667	0.95279
	%	31%	26%	19%	5%	19%		
Claw-back measures was introduced into compensation structure	Frequency0	13	47	4		12	2.5833	0.87113
	%	24%	52%	8%		16%		
Compensation is unchanged	Frequency	10		39	11	28	2.3333	0.55862
	%	13%		43%	13%	31%		
Organization increased risk management training efforts	Frequency	7	2	4	58	13	2.5833	0.76724
	%	10%	5%	6%	63%	16%		
Averse culture was strengthened in our organization	Frequency	15	7	28	28	5	2.5833	0.87113
	%	20%	11%	31%	31%	7%		
Organization implemented the risk-based auditing function	Frequency	19	13	25	14	9	3.6667	0.47639
	%	25%	15%	29%	18%	13%		

Source: Survey (2018)

4.2.1.10 Controls

According to collected responses, 74% of respondents agree that their organization has the most benefit from preventive controls. 44% agree that their organization has the most benefit from detective controls; however, 25% of respondents disagree. While 41% of respondent agree that their bank has the most benefit from corrective controls, 59% disagreeing. While 71% agree that their bank has the most benefit from directive controls, 15% disagreeing.

Interview participants were asked to discuss the internal control system in their institutions. More than two thirds of participants stated that ensuring operational efficiency should be the focus of the ICS. ICS is viewed as a part of operational risk controls, and an overall component of CRM, that is also used for financial control and compliance. More than half of participants fear that focus on compliance is taking a lot of capacity, and banks should not forget core business of internal controls and risk management. The prevailing view is that the front office always catches fraud so the operational dimension is much more critical for ICS. Approximately, a third of participants stated that internal controls are used primarily to control financial transactions and

reporting, and as such controls are operating completely independently of risk management. Those participants claim that even such systems are still ensuring operational effectiveness within their banking model.

Finally, when asked about different types of controls they employ in their banks, all participants stressed the importance of finding the right mixture of controls. About 40% of participants stated their organizations are making an effort to rely more on the directive and preventive measures and less on corrective and detective measures. The rest of the participants stated that all measures are being utilized and adjusted according to the organizational needs.

Once again a majority of participants stresses the importance of risk culture. Or as one participant puts it: “you can take the horse to the water but can’t make it drink”, but resumes by saying that “at least the horse is not in the desert any more”. Then again, participants agree that not everyone is responsible as they should be.

Participants agree that personal attitudes are more important to ICS than formalities. Integrity to stick to the rules, even while nobody is watching you is crucial. Walk the talk is imperative for managers, but not everybody understands this issue.

IC regulators want more documentation, so risk manager need to make sure controls are implemented not just documented, as many people use 10% of the time performing tasks and 90% documenting them. Naturally, that would be a wrong solution. Some participants go as far to say that documentation is counterproductive.

Table 18: Controls

Items		Opinion					Mean	SD
		SDA	**DA**	**N**	**A**	**SA**		
Directive controls	Frequency	3	16	28		39	2.5	0.77184
	%	6%	19%	31%		44%		
Preventive controls	Frequency	3	9	4	31	32	4.1667	0.69446
	%	6%	12%	8%	36%	38%		
Detective actions	Frequency	7	3	11	49	14	2.6667	0.95279
	%	10%	5%	14%	52%	19%		
Corrective actions	Frequency	38	15		31	3	2.5833	0.87113
	%	42%	17%		35%	6%		

Source: Survey (2018)

4.2.1.11 Impact of Directives and regulations

The respondents were asked about which recent regulations had to most impact on their organization. Please see Table 19 for the frequency distribution of their answers. According to collected responses, 24% of respondent's disagree with the statement claiming that liquidity or equity regulations had an impact on their bank; however, 53% of respondents stated that equity regulations had the most impact on their bank. Additionally, 11% of respondents agree that their banks are influenced by cross-border liquidity regulations, although 30% of respondents disagreed with that statement. The majority of the respondents, 82% agreed that some other regulations have the most impact for their bank, and they include: paid-up capital increment, NBE Bill purchase and foreign currency allocation. The same procedures were adopted to further elaborate the results as we did in section 4.2.1.6. The data were presented using a descriptive statistics table in addition to frequency and Percentage.

Although interview participants had very different opinions on regulations, several themes can be identified. Firstly, interview participants are not against regulation, but they would like to see smart, good solutions. Banks are forced to implement a lot of regulations, which make no sense to them. They indicate that, banks are overwhelmed with regulations, compliance is very costly, and has a limited economic effect. Participants are further concerned that the regulations are too stringent, and over reliant on reporting. Prevailing opinion is that the main pressure for more regulation comes from NBE. Several participants voiced their frustration with different regulators that are not on "the same page", on how to solve certain issues; therefore, making compliance and implementation extremely difficult. Further, there is lack of consistency, as competition is setting up in loose regulatory environments. At the same time, banks recognize that different regulators are attempting to collaborate on different issues, with a goal of more uniform regulations.

Table 19: The most impacting regulations

Challenges		Opinion					Mean	S.D
		SA	A	N	D	SD		
Equity regulations	Frq	36	22	25	7	20	3.4792	1.4438
	%	33%	20%	23%	6%	18%		
Liquidity regulations	Frq	26	32	9	11	32	3.1458	1.5844
	%	24%	29%	8%	10%	29%		
Cross-border regulations	Frq	32	12	33	13	20	3.1667	1.4780
	%	29%	11%	30%	12%	18%		
Others	Frq	90		20			4.6250	0.7889
	%	82%		18%				

Source: Survey (2018)

4.2.1.12 Attitudes towards regulation

Table 20 shows the frequency distribution of respondents' attitudes toward regulatory changes. A significant majority or 74% or respondents disagree that their organizations have the capabilities to address recent regulatory changes. However, few respondents view recent regulatory changes as positive (23% agreeing that regulatory changes are positive). Additionally, close to a half or 43% of the respondents agree that the recent regulatory changes will have negative future implications for their banks (consistent with the view of 58% of respondents that disagrees with the claim that recent regulatory changes will have positive future implications for the company). 21% of respondents agree there is a high probability of losing a great deal of the recent regulatory changes (consistent with the view of 63% of respondents that disagrees with the claim that there is a high possibility of gaining a great deal from the recent regulatory changes).

Table 20: Attitudes towards regulation

Items		Opinion					Mean	SD
		SDA	**DA**	**N**	**A**	**SA**		
We feel we have the capability to address the recent regulatory changes.	Frequency	43	24	1		19	3.1045	0.52122
	%	47%	27%	4%		22%		
We feel that there is a high probability of losing a great deal from the recent regulatory changes.	Frequency	19	19	28	12	9	2.0115	0.92196
	%	21%	21%	32%	15%	11%		
We view the recent regulatory changes with negative future implications for us.	Frequency	7	7	31	33	3	4.1447	0.61246
	%	11%	11%	36%	37%	5%		
We label the recent regulatory changes as something negative	Frequency	22		32	31		2.0142	0.53262
	%	26%		38%	36%			
We feel that there is a high probability of gaining a great deal from the recent regulatory changes	Frequency	25	28	13		17	2.3312	0.75224
	%	30%	33%	16%		21%		
We view the recent regulatory changes with positive future implications for us	Frequency			38	30	19	2.5413	0.86113
	%			42%	35%	23%		
We label the recent regulatory changes as something positive.	Frequency	16	23	30	9	6	3.2567	0.41439
	%	19%	24%	34%	12%	11%		

Source: Survey (2018)

4.2.1.13 The effect of regulation change

Table 21 represents the frequency distribution of responders' position regarding the impact of recent regulations on their institutions. A majority of respondents or 64% agree that the regulatory changes will have a significant influence on products and services, and 69% of respondent agree that regulatory changes will significantly affect profitability. Only 11% of respondents agree that the changes will significantly affect culture, and 42% agree they will

affect capital structure. 37% of respondents agree that the changes will affect risk management, while only 26% agree that the regulations will affect organizational structure. 43% agree that the overall business model will be affected.

Additionally, standardization of regulation has some other threats as well. One participant points out that moving in the same direction is increasing systematic risk for some unforeseen tail risk. All participants believe that it is crucial for regulations to contain a degree of flexibility.

Further, all participants stated that some regulations are directly influencing business practices and affecting profits, so banks are not happy with that. As a solution to some of these issues most participants like the idea of using principle based regulations, which would allow for adjustments based on the size and activity. However, the participants were agreed that a combination of principle and rule based regulations is needed.

Table 21: Effect of regulation change

Items		Opinion					Mean	SD
		SDA	**DA**	**N**	**A**	**SA**		
Products and services	Frequency	3	6	16	17	39	3.4782	0.6124
	%	5%	11%	20%	22%	42%		
Capital structure	Frequency	5	15	23	13	23	2.1667	0.4126
	%	9%	21%	28%	16%	26%		
Organizational structures and internal processes	Frequency	27	15	19		23	2.1427	0.5219
	%	32%	18%	24%		26%		
Risk management	Frequency	15	8	31	29	3	2.6017	0.91279
	%	16%	11%	36%	32%	5%		
Profitability	Frequency	8	4	11	48	13	3.1367	0.47839
	%	11%	7%	13%	53%	16%		
The overall business model	Frequency	16	3	28	20	13	2.5833	0.91868
	%	21%	6%	31%	26%	16%		
Culture	Frequency	20	14	42		7	1.0212	0.1133
	%	26%	16%	47%		11%		

Source: Survey (2018)

4.2.1.14 Changes in response to new regulation

In the final question the participants were asked to reflect on the actual changes that were conducted or planned see Table 22 for the frequency distributions. The most affected was a business strategy (18% of respondents state high degree of change, while 60% of respondents stated at least some changes), and business model/product portfolio (65% of respondents expect at least some changes). 65% of respondents stated some changes to ICS, but no one stated high

degree of change. 47% of respondents stated some changes to risk management practices and procedures, but again, no one included a high degree of changes. Leas affected was internal power distribution (47% of respondents stated no change at all) and organizational structure (29% stated no change at all).

The overall feeling is that banks do not need more rules, rather good systems, meaningful controls, less formalities and more substance. As one participant puts it, we live in a world where politicians and the media believe that everything can be controlled and risks can be either eliminated almost completely or we can "buy insurance" against risks. This is simply not true. As an extreme illustration, one participant stated that the best prevention for "careless risk taking" is the "let them fail approach", meaning that we should let them go broke and not burden the governments with the mess of such bankruptcies.

Table 22: Changes in response to new regulation

Items		Opinion					Mean	SD
		SDA	**DA**	**N**	**A**	**SA**		
Business Model/product portfolio	Frequency	9	7	10	26	31	2.1032	0.5324
	%	12%	10%	13%	30%	35%		
Business Strategy	Frequency	2	3	23	39	14	1.9814	0.3216
	%	5%	6%	29%	42%	18%		
Organizational Structure	Frequency	26	11	19	23	3	2.0214	0.6129
	%	29%	15%	21%	29%	6%		
Internal Power Distribution	Frequency	32	7	21	10	11	2.4157	0.7819
	%	37%	10%	24%	14%	15%		
Risk Management practices and procedures	Frequency		7	38	29	9	2.3214	0.45239
	%		10%	43%	35%	12%		
Internal Control Systems	Frequency		12	17	38	19	2.8714	0.61468
	%		15%	20%	41%	24%		

Source: Survey (2018)

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

In this chapter, the thesis is reviewed, the conclusions are drawn based on the major findings and limitation of the study is presented followed by the recommendation of the researcher.

5.1. Summary of Major Finding

5.1.1 Implementation of risk management in practice

Interviews reflected on the level of implementation of risk management in banks. Interview participants were quick to point out that, based on NBE directives, banks have to have both a risk management system as well as a risk management organization, However, when inquired about the dimensions of risk management technique (Corporate governance, Internal control, legal & compliance dimensions), differences were apparent.

More than half of the participants stated their banks were notably affected by changes in regulations and environmental pressures. Interview results confirm the big banks are ensuring that the risk management function is structurally independent of business units, and part of corporate/group office. More importantly, they are ensuring the financial independence from the business unit, i.e. departmental CEO's are not controlling austerity, as costs for risk management are being allocated to a business unit. Further, interview results indicate that the head of risk management usually sits on the executive board and reports to the supervisory board more frequently.

Approximately 80% of interview participants stated that risk committees in banks of all sizes are growing in size and/or importance, becoming independent, and forming a stronger relationship with the operational risk level; however, the level of change is not uniform. For smaller banks, that independence is exhibited through defining risk management positions and/or introduction of formal risk positions, i.e. some banks are introducing the formal RM position, other are introducing the RMO to assist the RM, and/or detaching the risk department from other departments. Smaller banks are converging towards integration of all risks under one centralized function. The results indicate that CRMs form a much closer relationships with the CEOs, after reviewing of the report by CEO's the CRM can directly contact with the board.

5.1.2 Culture

Interview participants agreed in a clam that culture should be a focal point of the risk management adaptation; a risk culture based on natural uncertainly and integrity.

68% of participants agree that in each bank there are two levels of change, while structural changes took place in most banks, it will take a long time for behavioral change to be fully implemented. A participant illustrated this point with an example from his team. The participant stated that with structural changes even the members of risk management have a hard time adjusting. Structure changes take place on paper, but mindsets and a feeling of belonging did not, i.e. members still loyal to business divisions (old structure).

82% of participants stated that culture should be shaped through guidelines, rules, and training; yet only two participants stated their organizations have some risk training. Once again, it was reiterated that the lower management should be relieved of less important duties and focus on RM. With more time to devote to RM those managers could continuously train/educate employees. Only one interview participant believes that training does not help, and behavioral changes should be enforced with policies and controls.

Finally, the prevailing opinion seems to be that installing and maintaining a risk culture and natural uncertainly are most crucial for the front office, as it can often be found in the back office but not the front.

5.1.3 Integration of risk management, corporate governance and ICS

Most interview participants believe that RM cannot exist without CG, The remaining participants feel that any formal and explicit integration concepts are completely unnecessary. Interview results indicate most banks are striving towards integration of these dimensions, mainly through improved communication and closer relations between the board and senior management. However, a few participants were of opinion that process should not be too formalized. Too many rules lead to an overload, as people will simply not be able to have everything in mind during their daily work.

Again, the divide based on the size and activity is present. More established banks have more formal and defined processes, and participants from those banks don't see too many improvement opportunities. Overall, approximately two thirds of interview participants are

satisfied with the integration of different dimensions of risk within their banks. On the other end of the spectrum, small bank recognizes the need to first of all fully define the different dimensions (CG, RM and ICS) and then work on further integration.

- The CRM is becoming more holistic, more independent, less dependent on models, and more integrated with other operations. As mentioned, in the survey ten respondents (8.3% of the respondents) were unable to answer the survey as to unable to complete the survey. Risk management changes in such institutions are primarily driven by external forces, i.e. regulatory change and industry papers. The findings also show that all banks just started working on the framework that would integrate all risks as required by NBE, as until this year such banks were focused primarily on financial risks.
- Empirical evidence also indicates that reputational risks are becoming increasingly important for all banks. Based on size and activity, the banks are controlling different dimensions of reputational risk; yet, reputational risk is one of the top priorities for all banks.
- The biggest impact on all banks is exerted through numerous regulations. As regulations are attempting to ensure financial stability, the credit and liquidity risk management seem to be the most affected dimension of the CRM. The findings once again confirm the theoretical findings that the banks have various risk management practices and that their unique risk management mix can be classified in one of the four ideal types of risk management (Silo-risk, Integrated, Risk-based and Holistic/Traditional risk management) (Mikes 2005).
- The Silo-risk management approach is evident in the smallest banks, and as mentioned risk management in those banks is being modified only in response to regulatory pressure. Such banks usually have a simple business model, a shallow capital structure and tight liquidity, in other words, they are very financially unstable, and that is why they raise many regulatory concerns. Yet, although this recent pressure is still quite high, but it is obviously aimed at the implementation of a more integrated approach, i.e. the integrated risk management. In the next couple of years the silo-risk management approach might disappear from Ethiopia banks. Further, empirical evidence not only confirms the existence of all four risk management types, but also indicates a possible evolution of the mentioned categories. The most obvious indication is the use of soft

tools (scenario analysis, sensitivity analysis, etc.); finding confirms almost all banks utilize those tools traditionally a characteristic of the holistic type.

- Finally, the finding empirical evidence suggests that risk managers like the idea and possibility of boards being evaluated; however, interview participants unanimously agreed that the risk management function should not be involved in such evaluation. A slight majority of participants believes that the board self-evaluations and auditor's (evaluations) evaluations are sufficient. The findings show that constructive criticism, close relationship, and interaction of boards and executives.
- The findings show that renewed focus of ICS is ensuring the efficient and effective operations; supporting a view that ICS is a part of operational risk controls and an overall component of CRM. And all controls are utilized in banks, it is evident that preventive and directive measures are more in focus in recent years. The findings show that over 60% of banks believe their current IC are efficient. More cover, empirical evidence confirms that personal attitudes are more important to ICS than formalities and the determination to identify and access risks in all business activities and behave accordingly.
- Empirical findings established that banks are applying best practices that were discussed in detail in the theoretical part. Empirical evidence also confirms that the risk management is becoming an integral part of strategic planning. So it's not surprising that the results also confirm that most banks have well defined strategies, updated on a regular basis. In order to minimize risk exposure larger banks are simplifying their strategy, looking for synergies, integrating not only business divisions but also product suites, and shutting or scaling down non-integrated parts and any changes in strategy are minimal and related to regulations. Participants positively reflected in the development that NBE requires all banks to explicitly define strategy in regard to risk management.
- The overall feeling towards regulation is negative, as practitioners feel that banks do not need more rules; rather, they need better systems, meaningful controls, less formalities and more substance. Practitioners also prefer principle based rules, but the same as regulators, they recognize that both principle and rule based rules are necessary for stable financial markets. The findings further indicate that most banks are difficult to address the recent regulatory changes. Liquidity and equity regulations were the first to emerge, they do not have a significant impact on banks any longer, as most banks are

currently more concerned with Bill purchase, Capital increment, Credit quality & increment, Profit maximization & Branch expansion regulations.

- The theory indicates a need for integration of corporate governance and risk management, and integration of the strategic risk management. Overall, the finding suggests that approximately two thirds of experts are satisfied with the integration of different dimensions of risk within their bank. On the other end of the spectrum, small banks recognize the need to first of all fully define the different dimensions (CG, RM and ICS) and then work on further integration. The finding indicates most banks are striving towards integration of operational and strategic risk management, mainly through improved communication and closer relations between the board and senior management. The theory also recognizes the need for rich communication and strong risk culture, but surprisingly does not offer a specific model for achieving that goal.
- The findings indicate that culture should be a focal point of the risk management modifications, a risk culture based on natural uncertainty and integrity. That is somewhat surprising since 60% of participants suggest that their banks are effective at installing and maintaining a risk aware culture; and even more surprising since only about a quarter of respondents agrees that risk training is effective at all levels.
- Evidence from the field demonstrates that culture should be shaped through guidelines, rules, and training; yet only two participants stated their organizations have specific risk training. Once again, it was reiterated that the lower management should be relieved of less important duties and focus on RM. The theory states that an excessive risk taking culture in banking is a result of incentives with more time to devote to RM those managers could continuously train/educate employees. Finally, the findings indicate that installing and maintaining a risk culture and natural uncertainty are most crucial for the front office, as it can often be found in the back office but not the front.

5.2. Conclusions

The study focused on the assessment of risk management practices at a strategic level in Ethiopian private commercial banks. To be more precise, the study attempted to assess the risk management process in respect to literature aspect, to assess the integration of strategic risk management and internal control system, to assess the appropriateness of risk management system, to examine the relationship between risk management, measurement and monetary system with strategic management (investigation of the board of director in line with risk management) and to evaluate and identify the effective risk management system and practice.

The finding confirmed the theoretical predictions that the CRM is becoming more holistic, more independent and less dependent on models, and more integrated. The study confirms that there is a clear shift from CRM by numbers to holistic CRM. That is obvious as banks of all sizes are considering all risks (including non-quantifiable risks), and adopting a more systematic and strategic view of risks. This shift is further illustrated through the following dimensions.

- ✓ Risk Management System*:* Based on their needs and cost-benefit analysis, banks are adopting more complex types of risk management. Regardless of size and activity, all banks make use of soft tools (scenario analysis, sensitivity analysis, etc.), which are traditionally a characteristic of the holistic type of risk management.
- ✓ Practices of risk management (Regulations)*:* Regulations in Ethiopia are the main impetus of most changes in risk management. In their attempt to ensure that there is stability in financial institutions, regulators (NBE) are assigning numerous new roles and duties to risk management and expanding old ones. Overall, the regulators became much more engaged and proactive and their actions are spurring growth of risk management. New regulations (increase paid up capital, increase the number of branches, loan quality & amount increment and bill purchase) were issued for almost all dimensions of risk management. Most importantly, through their new supervisory approach regulators are emerging into risk management partners.
- ✓ Practices of risk management (Structure)*:* Structural changes are evident in banks of all sizes and activities. Bigger banks are ensuring that the risk management function is structurally independent of business units and they are decentralizing their operations and, in many cases, integrating different dimensions of risk management.

- ✓ Measurement and Strategy*:* Results show that a vast majority of banks presently have well defined strategies that are updated on a regular basis. The, study indicates that reputational risks are becoming increasingly important for all banks at all levels, especially at the strategic level. Strategy is defined through a much richer interaction of the board and senior management. In response, CRM duties are shifting from traditional (compliance and modeling expert) to more strategic duties (strategic controller and adviser).
- ✓ Monitory and Strategic risk management*:* Findings confirm that risk management is becoming an integral part of strategic planning. The board engagement intensified, board members are becoming more inquisitive and more involved and they are forming stronger relationships with management and are increasingly probing. CRMs/heads of risk are increasingly having a direct rapport with the board, even in smaller banks in which they report to different senior executives. Availability of the talent seems to be the most important remaining issue. Theory indicates that banks do not have enough board members with sufficient levels of expertise relevant to the company's core business, and empirical results confirm that claim. There was a lack of qualified independent directors, so now that a board position requires even more time commitment, qualified directors will sit on fewer boards and that the deficiency will be even more pronounced. The problem can be mediated through increased recruitment.
- ✓ Strategic Risk Management and Internal Control System*:* Findings indicate that strategic management is integrating with ICS and shifting focus to include or assign a risk owner for each process and encourage sound risk management. Study findings indicate that risk managers believe that strategic risk management is all about prudent management and control of the environment. In order to succeed, managers should be relieved of other less important duties; and further, there is no need for yet another formalized process as it would only impede their ability to manage. Although all controls are utilized in banks, it is evident that preventive and directive measures are the preferred choice in recent years. The findings indicate that risk managers approve the current concepts and believe the implementation is the main issue, i.e. ensuring that all structural and procedural changes are supported by appropriate behaviors. The culture plays a crucial role in the success of strategic risk management and ICS.

- ✓ Risk Management Process (Culture): In the most general terms the study concludes that the Ethiopian private commercial banks are slowly moving towards the culture of quantitative uncertainty. The study concludes that installing and maintaining a risk culture based on natural skepticism is the most crucial part, as well as the biggest remaining challenge and opportunity for improvement of risk management. Once again, it is reiterated that management should be relieved of some less important duties and focus on risk management. With more time to devote to risk management, those managers could continuously train/educate employees, as banks are trying to change the "bankers" culture and mindset. (The study identified a lack of risk training and a lack of surveys in regards to risk management as the most significant issues in establishing the effective culture).
- ✓ Risk Management Process (Integration): Findings indicate that most banks are striving towards integration of the operational and strategic risk management, mainly through, clearly defining roles and responsibilities, through improved communication and closer relations between the supervisory board and top management.
- ✓ Adequate Control over Risk (Boards): Combined findings demonstrate that as the board engagement intensified, risk management committees are growing in size and expanding responsibilities, board members are becoming more inquisitive and involved and they are forming stronger relationships with management. Experience and expertise (technical risk management knowledge) remain the biggest problem at the board level. Findings suggest that risk managers like the idea and possibility of boards being evaluated; however, they unanimously agree that the risk management function should not be involved in such evaluations. Their objections were based on a hierarchical issue. Ideally, the independent CRM function reports directly to the executive and supervisory board; by implementing this feedback loop risk manager would have to effectively evaluate their superiors and practitioners see that as a potential conflict. Risk managers fear this type of loop would prevent close relationships, rich dialogue, constructive criticisms, and interaction of boards and executives, all key elements in aligning strategic risk management. Findings suggest that participants find the board self-evaluations and auditor's (external) evaluations sufficient.

5.3 Recommendations

Based on findings and conclusions made above, this researcher established a set of recommendations. Those incremental recommendations can be found in this section of the study. The study recommends that banks should establish close relationships, rich dialogue, constructive criticisms, and the interaction of the board and senior risk executives. Further, to ensure knowledge about the RM issues and their implementation. Specific recommendations are based on the literature and findings of this study and pertain to strategic risk management.

- Need to develop the Corporate Risk Management (CRMs) should involve in strategy formulation; yet, strategic risk assessment is only a part of the process of developing strategy, strategic plans, and strategic objectives.
- Need to estimate it is crucial to the Corporate Risk Management (CRMs) should involve in strategy formulation; yet, strategic risk assessment is only a part of the process of developing strategy, strategic plans, and strategic objectives. It is crucial to understand that risk managers are not defined or setting strategy (no “dream making”), but mitigating a strategic plan.
- Need to establish a board provides oversight and direction to senior management by: Setting (in cooperation with senior management) the organization’s risk appetite (amount of risk an organization is willing to accept in pursuit of value) and Being apprised of the most significant risks to the organization and whether senior management is responding appropriately (i.e. in relation to the agreed upon risk appetite).
- Need to give enough emphasis that all banks should segregate risk management and internal control system in both structural and procedural changes based on the appropriate behaviors because culture plays a crucial role in the success of strategic risk management and ICS.
- Should develop and implement that structural changes in risk management were implemented, but behavioral changes are lagging. Culture/practice is addressed as a prerequisite for effective risk management in all the major risk management works; therefore, banks should strengthen the culture/practice and change that behavior. Therefore, the biggest opportunity for improving corporate risk management is through strengthening the culture. Plus to the above recommendation, all employees should be surveyed in regards to risk management at least once a year. This process should be an

integral part of annual or semi-annual performance reviews, as a question (or several) at the end of the review would be simple to administer.

- Further, the study discovered that there is a very little risk management training in practice. Risk management education is not discussed at the board or management level. Therefore, this study recommends the banks and NBEs should give regular strategic training/education to the Board of Directors and Managements.

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APPENDIXES

Appendix 1: Data Collection Instruments (Interview)

Dear Madam/Sir,

My name is Temesgen Teklay, and I am an MBA student at the St' Mary's University. I am conducting an empirical study of Risk Management at the Strategic Level of Ethiopian Private commercial banks, under supervision of Dr. Wubshet Bekalu. To validate my results I hope to conduct several interviews with key opinion leaders of the banking industry.

Banks were pioneers in the implementation of corporate risk management (CRM), with some of the most comprehensive CORPORATE RISK MANAGEMENT systems available to date, their risk management systems had numerous weaknesses. As a result, regulatory and best practice changes are sweeping the industry.

This study will assess risk management at a strategic level. More specifically, the study focuses on the integration of corporate governance, risk management and internal control systems, and aims to examine:

- How boards can be evaluated and managed in regards to risk management, and
- How can the whole risk management be optimized through the inter-linkage of different global CORPORATE RISK MANAGEMENT dimensions.

The goal of this study is to establish a set of recommendations that would aid in this optimization.

Your participation as an opinion leader in the industry is very important and I hope you will find the time and the inclination to take part in an interview. Of course, in my gratitude I will furnish you with the results of the empirical study as well as a complimentary copy of my thesis. The interview would last for less than an hour, and all responses will be kept confidential and anonymous. The information will only be used for this study.

I will contact your office, in the coming week to take an interview. Please feel free to contact me anytime if you have any questions or concerns regarding the interview process. My number is 0911 56 84 75, and my email is adianateklay@gmail.com or teklay_temesgen@yahoo.com . Thank you very much for considering my request and hopefully I will talk to you soon.

Kind regards,
TemesgenTeklay
St' Mary's University
Encl: Proposed Interview Questions

Proposed Interview Questions

1. Do you consider to have fully implemented risk management in your bank? How long has it been fully implemented? What dimensions does it include?
2. How is the risk management in your bank changing as a result of the inflation, deflation and financial crisis?
3. What is the main focus of your current risk management strategy?
4. What are the biggest risk management challenges for your bank?
5. What is the role of the board of directors (supervisory) in regards to risk management in your bank?
6. How is your bank ensuring that the board can be evaluated and managed in regards to risk management? Should the board be evaluated/ monitored through corporate risk management?
7. How do you ensure relevance of risk management processes and procedures at a strategic level? Have they changed, how? Is there a formal process?
8. Has there been an emphasis on changing the culture (bankers)? Is it changing and how? Please discuss the impact of risk management training?
9. How can auditing assist the risk management function in banks?
10. In your opinion have you achieved a greater integration of risk management, corporate governance, and internal control system since the banking establishment?
11. Please discuss regulatory changes and their impact on your bank? What would you like to see regulators require/demand, i.e. the report/action that would give a clear picture of risk management in your bank?
12. Do you have any other remarks regarding risk management in your bank?

Appendix 2: Data Collection Instruments (Questionnaire)

Disclaimer: We assure you that all responses will be kept confidential and anonymous. The information will only be used for this thesis titled "Risk Management at the Strategic Level of Ethiopia private commercial banks" at the St' Mary's University. If you would like to receive the results of the study, please put your email address in the required space or you can email your request separately to adianateklay@gmail.com or teklay_temesgen@yahoo.com.

Remark: Please respond to the items frankly and honestly. Your feedback is very important. There is no need to write your name on the questionnaire. Put tick mark. [√]

(1) Strongly disagree (2) Disagree (3) Neutral (4) Agree (5) Strongly agree

I. Personal Information

1. Back ground of the respondent Sex

Male [ ] Female [ ]

2. Education back ground

Diploma [ ] Degree [ ] Above degree [ ]

3. Work experience

1-2 years [ ] 3-5 years [ ] 5-10 years [ ] above 10 years [ ]

4. What is your current position (title)?

____

II. Question related to the study

1. Your bank currently has:

A. Chief Risk Officer.

B. Independent risk management function.

C. Risk Management that is part of a different department (Finance, Accounting…)

D. Risk management committee at the Supervisory board.

E. No risk function at present.

F. Risk management in other form (please specify).________________________________

2. How frequently do you survey your employees in regard to risk?

A. Once a year.

B. Twice a year.

C. Once every few years.
D. Never.

3. Risk management strategy in your bank: (1) strongly disagree, (5) strongly agree

	1	2	3	4	5
A. Well defined and updated on regular basis.					
B. Well defined but not updated on regular basis.					
C. Neither well defined nor updated on regular basis.					
D. Currently being revised as a result of the changing regulations and directives.					

4. In which of the following areas (if any) has needs the most change.

(1) Strongly disagree, (5) strongly agree

	1	2	3	4	5
A. Credit risk.					
B. Market risk.					
C. Liquidity risk.					
D. Operational risk.					
E. Strategic risk.					
F. Reputational risk.					

G. Other (please specify). ______________________________

5. What do you consider to be main barriers/challenges to effective risk management in your bank? (1) strongly disagree, (5) strongly agree

	1	2	3	4	5
A. No major challenges at present.					
B. Uncertainty over future regulation.					
C. Insufficient risk management processes, procedures, and tools.					
D. Poor communication throughout the organization.					
E. Lack of expertise at the board level.					
F. Insufficient real time data					
G. Lack of strong leadership in the risk management function.					

H. Other (please specify).______________________________

6. How effective is your organization in each of the following areas. (1) Strongly disagree, (5) strongly agree

1	2	3	4	5

A. Overall risk expertise.					
B. Board level expertise (in regards to risk management).					
C. Risk function expertise at the operational level.					
D. Integration of risk management across divisions/functions.					
E. Real time risk management.					
F. Installing/maintaining risk aware culture.					
G. Risk training at all levels.					
H. Internal controls.					
I. Risk reporting.					
J. Aligning risk management, internal controls and auditing.					

7. How frequently do you:

	D	W	M	Q	A
A. …. compute your risk exposures?					
B. …. evaluate existing risk management practices?					
C. …. evaluate existing risk management measurement models?					
D. …. publish internal financial Risk Report for the Executive Board?					
E. …. publish internal financial Risk Report for the Supervisory Board?					
F. …. prepare ad-hoc reports for internal use?					
G. …. send reports to regulators?					
H. …. prepare ad-hoc reports for regulators?					

(D) Daily, (W) Weekly, (M) Monthly, (Q) Quarterly, (A) Annually

8. Since the new NBE directive (paid up capital increment, credit quality and increment, branch expansion and profit maximization)… (1) strongly disagree, (5) strongly agree

	1	2	3	4	5
A. …. our risk management became more holistic.					
B. …. our risk management became more dependent on models.					
C. …. compensation in our organization decreased.					
D. …. compensation structure (variable part) is better linked to a long term performance.					
E. …. claw-back measures was introduced into compensation structure.					
F. …. compensation is unchanged (was always conservative with a small variable part).					
G. …. our organization increased risk management training efforts.					
H. …. risk averse culture was strengthened in our organization.					
I. …. our organization implemented the risk-based auditing function.					

9. In our bank we see the most benefit from: (1) strongly disagree, (5) strongly agree

	1	2	3	4	5
A. Directive controls.					
B. Preventive controls.					
C. Detective actions.					
D. Corrective actions.					

E. Other (please specify.)____

10. Which recent regulations have the most impact on your bank:

(1) Strongly disagree, (5) strongly agree

	1	2	3	4	5
A. Equity regulations.					
B. Liquidity regulations.					
C. Cross-border regulations.					

D. Other (please specify).____

11. To what extent do you agree/disagree with the following statements?

(1) strongly disagree, (5) strongly agree

A. We label the recent regulatory changes as something positive.
B. We view the recent regulatory changes with positive future implications for us.
C. We feel that there is a high probability of gaining a great deal from the recent regulatory changes.
D. We label the recent regulatory changes as something negative.
E. We view the recent regulatory changes with negative future implications for us.
F. We feel that there is a high probability of losing a great deal from the recent regulatory changes.
G. We feel we have the capability to address the recent regulatory changes.

1	2	3	4	5

12. The regulatory changes will have significant effects on …

(1) Strongly disagree, (5) strongly agree

A. ….products and services.
B. ….capital structure.
C. ….organizational structures and internal processes.
D. ….risk management.
E. ….profitability.
F. ….the overall business model.
G. . …culture.

1	2	3	4	5

13. Facing regulatory changes, which of the following did you or will you substantially alter? (1) no change, (5) high degree of change

	1	2	3	4	5
A. Business Model/product portfolio.					
B. Business Strategy.					
C. Organizational Structure (create new divisions, shift functions between divisions).					
D. Internal Power Distribution (e.g., change in functional backgrounds of our top management team).					
E. Risk Management practices and procedures.					
F. Internal Control Systems.					

Please provide us with additional comments you would like to make in regards to the Risk Management function at your bank.

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If you would like to receive the results of the study, please put your email address or you can email your request separately to adianateklay@gmail.com or teklay_temesgen@yahoo.com. Phone: 0911 5684 75.

E-Mail ____

Thank you very much for completing the survey!