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Management

Assessment of Risk Management Practice in Ethiopian  
Commercial Banks

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**Addis Ababa University School of Commerce: - Department of Corporate Finance Specialty in Investment Management.**

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## **STATEMENT OF DECLARATION**

I hereby certify that this study, "Assessment of Risk Management Practice in Ethiopian Commercial Banks," is my original creation. With my research advisor's assistance, I completed the research on my own. All sources of information used in this research project have been properly acknowledged, and it has not been submitted to any other university.

Declared by: Name: Segni Teshome

Signature: \_\_\_\_\_

Date: \_\_\_\_\_

Place: Addis Ababa, Ethiopia

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## List of acronyms

GDP	Gross Domestic Product
IMF	International Money Fund
NBE	National bank of Ethiopia
ROA	Return of Asset
SBP	State Bank of Pakistan
SPSS	Statistical Packed for Social Science
S.C.	Share Company
TRNC	Turkish Public of North Cyprus
VaR	Value at Risk

### **ABSTRACT**

The purpose of this research is to “*assess the risk management practices of Ethiopian commercial banks. The study is used descriptive survey method and applies a mixed method research strategy for each stratify as representative sample by taking the quantitative method as major component while the qualitative method plays a supplementary role. Data was collected from purposely selected commercial banks permanent staff and analysis was carried out using descriptive statistics supporting by SPSS v 23. Based on the descriptive and analytical analyses results of the questionnaire data, Likewise, the overall usefulness of the risk management practices in selected banks found well prefund by the managing risk based on the empirical data analysis. This thesis unveils higher mean of agreement between the managing market risk and the risk management practices. These results indicate that the managing liquidity risk is also another valuable aspect to improve the usefulness of the risk management practices of selected commercial banks. Furthermore, the descriptive statistics result stated that managing liquidity risk with the risk management practices has been found and endorses that it is important for the management to give more consideration to deal with the liquidity risk in order to bring improvement in the risk management practices of all banks. This study further confirms the role of managing operational risk in the whole banking risk management approach and has found moderates of implementations of the managing operational risk and the risk management practices in selected commercial banks is strongly minimized its risk. The main conclusions of this paper are selected banks should develop a common understanding about the strategy, policy and procedures across the bank and under no circumstance should the bank violate the limit set by NBE and finally prepare training for risk related staffs to manage risk effectively and efficiently. Therefore, the banking sector and other related sectors should be introduced with the necessary work to be completed on this subject, nonetheless by making a start with the determination of the road maps and national initiatives.*

**Key words: Risk Management Practice, Basel principles, selected commercial Banks,**

# CHAPTER ONE

## 1 INTRODUCTION

### 1.1 Background of the Study

A bank is a business that deals in currency and its equivalents and offers additional services linked to money. A bank is a financial intermediary that grants loans and takes deposits. It makes money from the difference between what it pays to attract and maintain deposits, including interest payments, and what it gets from interest that borrowers pay it or from securities. It's also an institution that trades in money and its substitutes.

The modern banking environment has undergone a number of significant global changes, the most notable of which are the liberalization of the trade in services, significant advancements in technology, and an increase in competition, both within banks and between banks and other institutions. In light of these developments, banking itself must evolve in order to keep up with the modern developments, making it imperative to pay attention to revealing and clarifying the various risks that banks may encounter, as well as providing a method for assessing such risks and managing them, as well as suggesting means (Khalid and Amjad, 2012).

Risk can be considered to be “the effect of uncertainty on your business objectives” and it is an inherent part of being in business. When you make investments in your business the hope is, that they will generate a positive return, but that return can be negative, positive or even far beyond your expectations. It is that type of uncertainty that we would call risk.

Risk is unavoidable like the common death and taxes. It is one of the few things in life that is inevitable. Risk arises due to uncertainties, which in turn arises due to changes that could take place in the economic, social and political environments and as well as due to lack of information availability concerning such changes. Risk is also the exposure to a transaction that has a chance of resulting in a loss, even while such loss can be anticipated, quantified, and reduced. Every firm, regardless of its size, shape, industry, or line of goods and services offered, is always exposed to a wide range of dangers, both big and little. Indeed, businesses can only prosper by successful risk taking as argued by (Norman, Peel and Clarke, 2007).

Theoretically, there are two types of economic units: surplus and deficit, and these units like to move money between themselves through financial institutions, or intermediaries. Undoubtedly, this procedure enhances the significance of financial intermediaries in the economy; nonetheless, it also presents certain risks to these establishments (Abu Hussain and Al-Ajmi, 2012).

Therefore, They are most worthwhile initiatives that boost the economy receive the funding (Aebi, Sabato and Schmid, 2012). However, there are certain inherent risks associated with transferring money from one unit to another. Typically, banks manage those risks as part of their daily business operations.

In the banking industry, risk management is defined as "the logical creation and execution of a plan to deal with potential losses." In the banking industry, the primary objectives of risk management protocols are typically controlling an institution's exposure to losses or risk and protecting the value of its assets. Generally speaking, the banking industry is thought to be risky (Ishtiaq, 2015).

Banks establish risk management departments in order to administer their risk management systems efficiently. The risk management department of a bank ensures that all of the bank's risks are being tracked simultaneously. It also aims to maintain a bank's risk profile within the predetermined bounds (Settlements, 2009).

In the last three decades, approaches to identifying, controlling, and managing various risks have evolved. Approaches to asset and liability management like gap analysis and duration have primarily been used as a hedge against interest rate risk since the 1970s. Some of the state-of-the-art risk management strategies that have been developed in response to the different financial risks that have emerged as a result of financial market liberalization and globalization include value at risk (V a R), back testing, stress testing, and the standard method. These risk management techniques are currently used worldwide to measure and manage banking risks (Committee, 2009).

Banks will face challenges from a variety of risk types, including credit, interest rate, liquidity, market, off-balance sheet, foreign exchange, country or sovereign, technological, insolvency, and operational risks (Saunders and Cornett, 2018). For any bank to survive and prosper, risk management is crucial. Because a significant portion of income is obtained from loans and a significant amount of money is invested in credit, credit risk is given the most attention of all risks. As stated by Colquitt (2007). When a borrower or counter

party fails to make timely payments on their contractual debt, credit risk arises because the lender could lose money.

In financial institutions such as banks, risk is regarded as the primary determinant of earnings. As a result, they must strike a balance in the correlation between risk and return. In actuality, risk management is the only thing that financial institution management entails. It becomes even more crucial to professionally and methodically manage financial risk. Risk management has become increasingly important in today's financial environment due to factors like growing deregulation, rising global competition, and the introduction of novel products and delivery methods. The secret to success will be in your ability to assess the risks and make the right decisions. One could argue that those who take risks will thrive, risk averse people will probably perish, and skilled risk managers will prosper.

The financial sector in Ethiopia has grown at a remarkable rate in recent years. There are currently 36 microfinance organizations, 18 insurance companies, and 32 commercial banks in the financial industry.

The nation's banking industry is expanding, diversifying, and growing quickly in terms of quantity and quality. Additionally, it is staying up to date with the latest developments in technology, aptitude, stability, and financial system drive. Emphasize the special need for a strong and effective control system that takes into account the business risk involved in the areas where commercial banks are important.

(National Bank of Ethiopia, 2011) Is tasked with advising all financial institutions on risk management systems and is the only regulatory body overseeing all financial institution operations in Ethiopia. This is why the bank updated its risk management rules from 2003 to 2010 and included the most recent advancements in the field. A risk management method for banking risks is presented in the guideline.

According to best practices and international standards, it is envisaged that this revised paper will set minimal risk management (risk identification, measurement, monitoring, and control) criteria for all banks operating in the nation. It covers the most common and interrelated risks that banks may face throughout the nation: credit, liquidity, market, and operational risks.

It is evident from the discussion above that there is an opportunity to conduct a targeted study into the risk management procedures utilized by Ethiopian banks. Thus, this study's objective is to explore and tackle every facet of risk analysis, with an emphasis on Ethiopian commercial banks' risk management procedures.

## 1.2 Statement of the Problem

Banks work in a highly competitive, dynamic environment that changes quickly, negatively affecting the majority of their operations and affecting profitability. Commercial banks take deposits that can be withdrawn whenever needed and lend the money to other participants in the economy since they serve as a source of resource mobilization.

According to Li, (2003) he found out an economic surrounding that an organization carries out its day to day activities, is highly volatile and unpredictable. The ever growing unpredictability, larger dependence and latest risks have made structure of risk disclosure of resource mobilizing institutions more complex. Volatility of foreign exchange rates and interest rates have been increasingly significantly thus the necessity to have action plans in place to hedge against risk.

The impact of competition on bank profitability may need the implementation of regulatory measures, since increased profitability resulting from market dominance may have detrimental effects on customers in the form of higher lending rates, lower deposit rates, and subpar financial services. However, technical inefficiencies or intense rivalry among banks can also lead to reduced profitability; in these cases, governments must respond appropriately to balance competition and improve managerial expertise.

According to (Şanlısoy, Aydın and Yalçınkaya, 2017) Growing political unrest in a nation first raises political risks, which in turn raises economic risks that originate in the political sphere, or put another way, political risk. The country's microeconomic and macroeconomic performance is negatively impacted by the rising political risk, which also has an impact on financial and real economic indicators. Based on this premise, the financial sector's fundamental component, the banking industry, is subject to these impacts in terms of both supply and demand. By driving up bank expenses, rising interest rates and an increased risk premium brought on by the escalation of political risks have an impact on the supply side.

For the past five years, intentionally chosen commercial banks have struggled with risk management, and they lack the policies and processes needed to handle the risks involved in their operations. In this way, the research will contribute to closing this gap. Determining bank risk management procedures and assessing the risk management procedures of particular commercial banks is the aim of this study.

These are my primary motivations for studying particular commercial banks in order to add to the body of research by examining various risk types, approaches, and the effectiveness of the bank's risk management procedures. Determining the risk management practices employed by banks and assessing the practices of certain commercial banks are the research's objectives.

## **1.4 Research Questions**

The following research questions are attempted to be addressed by the study:

- How to Access commercial banks identify risk?
- What methods of risk management do commercial banks employ?
- How to commercial banks response a risk?
- How to access commercial banks risk management activities?

## **1.3 Objectives of the Study**

The study has both general and specialized objectives, depending on the problem that is covered in the above discussion.

### **1.3.1 General Objective**

This study's main goal is to assess the risk management procedures used by Ethiopian commercial banks.

### **1.3.2 Specific Objectives**

The following are the specific goals of this study:

- To assess how commercial banks identify risk.
- To evaluate the risk management strategies used by commercial banks.
- To access how to commercial banks response a risk.
- To access how commercial banks risk management activities.

## **1.5 Significance of the Study**

Both the nation's regulatory body and the institutions under examination may utilize the findings and recommendations of this study as a component and informational resource. Furthermore, it gave the professional and academic groups extensive knowledge on risk management. As a result, this analysis provides the regulatory body with important information about the bank's risk management situation. Other banks may also utilize the results to assess their operations, spot possible risk exposures, and implement remedial measures. Moreover, it will serve as a resource for others seeking to conduct further research on the same or related topics.

## **1.6 Scope of the Study**

The theoretical focus of the study is on assessing the risk management practices of commercial banks that were specifically chosen. The primary focus of the researcher's study is on carefully chosen employees of commercial banks who are employed by the Addis Ababa head office in the credit administration, credit

evaluation, credit analysts, and risk management departments. In terms of technique, the study employed mixed research methodologies. The study will include the findings from a questionnaire that makes use of both field data that the researcher collected and publically available data from previous research on comparable issues.

### **1.7. Limitation of the study**

The study includes Banks that were specifically chosen. Due to time limits and other resource limitations, the study only looked at the credit administration, credit evaluation, credit analysts, and risk management divisions of a specific bank's head office; therefore, its conclusions might not apply to all commercial banks. Since it is difficult to take into account every employee in the bank, the study was restricted to sample respondents from the credit activity and risk management departments of chosen Banks who are still based at the Addis Ababa head office.

### **1.8. Organization of the paper**

Forming the research questions, developing the methodology, gathering and analyzing data, and drawing conclusions all follow a logical path. The study was thus split up into five chapters. Thus, the first chapter, which also functions as the introduction, presents the study's history, issue statement, research questions, objective, importance, scope, and methods. The second chapter is devoted to a review of related literature. The third chapter is a brief description of the methodology, which covers the study's demographic and sample design, data sources, tools/instruments used for data collection, data gathering procedures, and data analysis methodologies. The fourth chapter provides an interpretation and summary of the study's findings. In final the fifth chapter is make summary about the paper.

## CHAPTER TWO

### 2 LITERATURE REVIEW

#### 2.1 Theoretical Concept of Risk in Banking Industries

#### 2.2 Defining Risk

This chapter presents several theoretical aspects of risk, including its definition, types, and management. It also discusses empirical concerns and works pertaining to risk management practices in the banking sector.

Several researchers have looked closely at how "risk" is defined in the banking sector.(Ms and Eds, 2022); (Sweeting, 2011)it hasn't been defined universally in recent years. Diverse authors employ diverse methodologies to delineate the extent of the term. Within the banking sector, risk refers to the possibility of encountering an unforeseen circumstance that could deviate from the projected or expected profits (Sweeting, 2011) ;(Prime *et al.*, 2021).

According to (Prime *et al.*, 2021) The risk associated with banking is defined as the potential for financial loss due to negative events such as recessions, unfavorable changes to trade and fiscal policies, changes in interest rates or foreign exchange rates, or declining stock values.

Furthermore ('Bessis, J. (2002), Risk Management in Banking, John W', 2002) and ('Schroeck, G., 2002 Risk management and value creat', 2002)In the banking industry, risk is defined as adverse effects on returns caused by various distinct sources of uncertainty. Moreover, both have considered the limitation that banking risks are dependent on real conditions, which are essentially a confluence of external environmental factors.

Similar, (National Bank of Ethiopia, 2010) defines risk as: The possibility of unfavorable outcomes from an activity or event in banking institutions. These outcomes could result in a direct loss of capital or earnings, or they could cause business organizations—even those in the same industry—to defer risk to varying degrees and in different ways depending on the organizational structure, task complexity, and kinds of services or goods offered. Thus, there are always hazards associated with the activities and endeavors of corporate organizations.

Concerning the categorization of risk (Settings, 2023) explains how hazards are categorized in a variety of ways. One way is to distinguish between business and financial risks. Business risk arises from the operations of a corporation. It has to do with factors that affect the product market. Financial risk is the possibility of suffering losses in the financial markets as a result of adjustments to financial variables. Usually, it has to do with leverage and the potential for current assets to fall short of commitments and obligations (Gleason and Press, no date).

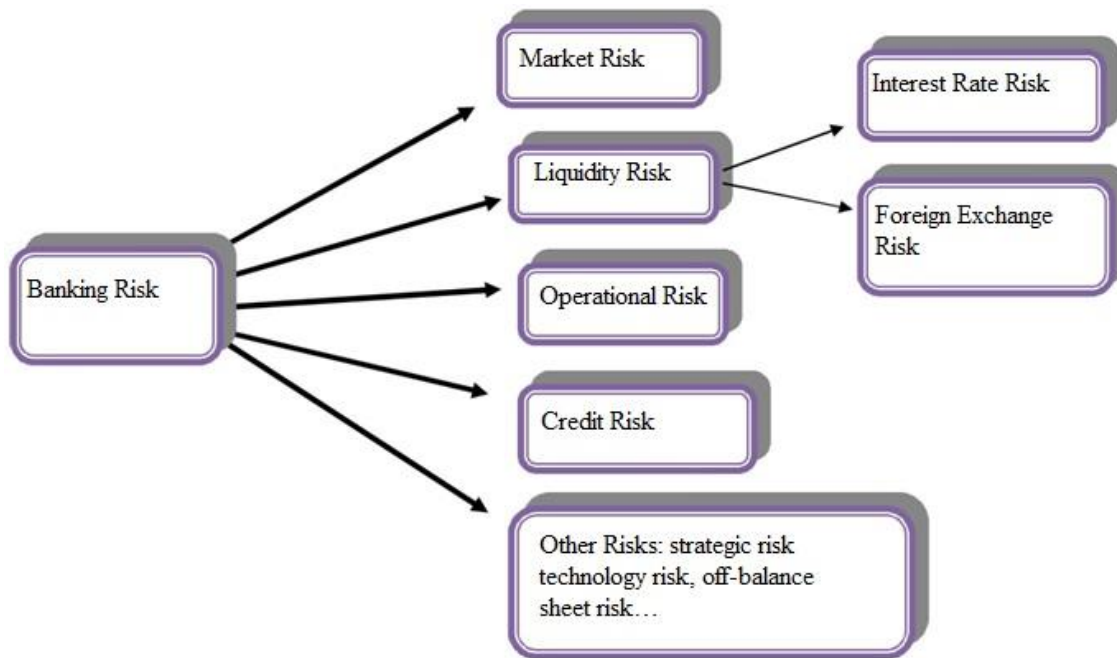
Another approach is to distinguish between the systematic and unsystematic components of risk. Unsystematic risk is tied to a specific asset or business, whereas systemic risk is associated with the economy or market as a whole. Systematic risk cannot be diversified; nevertheless, a large diversified portfolio can help decrease unsystematic risk related to an asset. However, some parts of systemic risk can be reduced by risk transfer and mitigation techniques restricting the bank's ability to achieve its objectives. The following section discusses a range of banking hazards.

### **2.3 Types of Risk in Banking Sector**

Banking acts as a go-between for people who want to raise funds for their enterprises and those who wish to save money. As a result, while providing financial services, banks assume a range of risks, both monetary and non-monetary. Additionally, the risk associated with offering their services varies according to the good or service (Adarkwa, 2011). To create the frameworks for their investigations, different authors have categorized these hazards in different ways.

According to (Bergendahl and Lindblom, 2011) The three main categories of risk are market, credit, and interest rate risk. However, banks also run the risk of operating bankruptcy, off-balance sheet risk, country/sovereign risk, and foreign exchange, technology, and liquidity issues.

*Figure 1: Types of risk in banking sector*



### 2.3.1 Credit Risk

Among the most important and prestigious types of banking risk is this one (Colquitt, 2007). Credit risk refers to the potential for a counterparty to a contract to default on its obligations due to a decline in their capacity to repay funds or because they decide to deviate from the terms of the agreement. ((Marie *et al.*, 2001) (Bergendahl and Lindblom, 2011); ('Schroeck, G., 2002. Risk management and value creat', 2002); (Colquitt, 2007)). Credit risk, then, results from a bank's inability to collect the money it has provided to a counterparty borrower, or an obligation. According to (Parbat, 2024), The chance that a bank won't be able to collect principle and interest on securities and loans in the specified amount is known as credit risk.

(Parbat, 2024) have established The possibility of suffering losses as a result of a deterioration in the credit profile of the counterparty or borrower is known as credit risk. Outside default, which occurs when a client or counterparty is unable or unwilling to meet their obligations, is the main cause of losses in the bank's portfolio. Reductions in credit quality, whether actual or imagined, may also result in drops in portfolio value.

(Van Greuning and Brajovic-Bratanovic, 1999) specify Credit risk is the chance that a debtor or issuer of financial instruments—a person, company, or country—won't comply with the terms of the credit agreement and won't pay back the principal and other cash flows associated with the investment. In the banking

industry, credit risk is inevitable. This means that nonexistent or delayed payments may cause cash flow problems and affect a bank's liquidity.

### 2.3.2 Liquidity Risk

(Shankar, 2017) specify the unexpected rise in depositor withdrawals, known as liquidity risk, could force banks to liquidate their holdings. According to (National Bank of Ethiopia, 2011), This Risk is the potential loss that could happen if a bank fails to perform its obligations. Liquidity risk can be caused by a variety of things, including an unanticipated rise in the bank's depositors' demand for short-term investments, insufficient market depth, and market disruption (Asadollahi *et al.*, 2021); (Saunders and Cornett, 2018).

According to (Crouhy, Galai and Mark, 2014) claim that inadequate liquidity can lead to unexpected cash shortages that require expensive solutions and reduce a bank's profits. However, a number of other financial risks, including market, interest rate, credit, and strategic risks, are further impacted by the liquidity risk (Bergendahl and Lindblom, 2011) and (Tahir, 2012)) however takes into account the risk of liquidity from three different angles.

- a) When factors such as transaction volumes, interest rate levels and fluctuations, and funding challenges with counterparties make it difficult for the bank to raise money at a fair cost.
- b) Considers liquidity as a safety net that buys time in trying circumstances. When short-term asset values are insufficient to cover short-term liabilities or unanticipated withdrawals, this is referred to as liquidity risk.
- c) When the extreme circumstance is thought to be liquidity risk. Large losses can result in this kind of scenario, raising concerns about the bank's future and liquidity. Other institutions may attempt to safeguard themselves against a potential default by shutting credit lines or making large withdrawals of money as a result of these uncertainties. Both have the potential to cause a severe liquidity crisis that could lead to bankruptcy.

### 2.3.3 Market Risk

(Saunders and Cornett, 2018) The potential for a bank to suffer a loss due to fluctuating market circumstances is known as market risk. It's the chance that shifts in the pricing of commodities, currencies, and the equities and interest rate markets would adversely affect the value of off-balance sheet assets. The

risk that changes in the market rate of interest rates or the cost of stocks, foreign exchange, and securities, as well as the volatility of those prices, present to the profits and capital of a bank. We call this market risk.

#### **2.3.4 Interest Rate Risk**

As interest rates rise and the market value of bank assets, loans, or securities falls, this risk gets greater. (Bergendahl and Lindblom, 2011) defines interest rate risk as the chance that fluctuations in interest rates would result in a decrease in a bank's earnings. Certain academics contend that an imbalance between banks' assets and liabilities causes interest rate risk (Crouhy, Galai and Mark, 2014) and (Saunders and Cornett, 2018)).

(Saunders and Cornett, 2018) call attention to the fact that falling market prices of assets and obligations are a result of rising interest rates, and that this risk is directly tied to market risk. Consequently, banks use a range of derivative techniques, including forward contracts, swaps, options, and futures, to control the interest rate risk. (Bergendahl and Lindblom, 2011) and (Tahir, 2012).

#### **2.3.5 Foreign Exchange Risk**

(Raghavan, 2003)Some definitions of foreign exchange risk as the possibility that a bank would experience losses due to unfavorable fluctuations in exchange rates when it holds open positions in the same foreign currency, either forward or spot.

(Saunders and Cornett, 2018)Definition of foreign exchange risk: the possibility that changes in the foreign exchange rate could have a negative impact on the reported value of assets or liabilities represented in foreign currencies. Similarly, (Bergendahl and Lindblom, 2011) defines foreign exchange risk is the potential for losses as a result of adverse fluctuations in exchange rates. The potential cause of these losses is Off-balance Sheet Risk.

According to the theory behind currency risk, long-term macroeconomic factors such as changes in interest rates on a national and international level as well as the amount and direction of trade and capital movements within a country lead to volatility in the value of that country's currency. Short-term factors, such as expected or unexpected political developments, shifts in participant expectations, or speculation-based currency trading, can also contribute to volatility in foreign exchange.

#### **2.3.6 Operational Risk**

As stated by(National Bank of Ethiopia, 2010), Operational risk is the potential for a financial institution to sustain losses, either directly or indirectly, as a result of external environmental conditions or inefficient

internal systems, staff, or protocols. This justification is in line with several other points of view that claim state operational risk is linked to the potential for detrimental effects on the bank's capital and financial performance due to staff negligence, inadequate internal processes, inadequate management information systems, or unforeseen and undesirable external events(Saunders and Cornett, 2018).

Operational risk is described as "the risk of direct or indirect loss resulting from inadequate or failed internal processes, people, and systems or from external events" in the New Basel Accord. If routine operational routines are disrupted, there could be a financial loss. Fraud or fakes caused by disobeying laws, regulations, or policies could be the cause.

(Soyemi, Ogunleye and Ashogbon, 2014) Operational risk is mostly caused by internal bank operations, as opposed to other risks like credit and market risk. However, because they are essentially unpredictable and uncontrollable, a range of external circumstances, such as competitive activities, natural disasters (such as floods and earthquakes), and terrorist attacks, can represent an operational risk to banks (Ms and Eds, 2022).

Operational risk can have catastrophic consequences if major risks are disregarded and rudimentary action is done in the absence of efficient risk tracking and reporting, as it is an event risk. Higher levels of operational risk in banks have resulted from a number of developments in the modern banking environment, including an increased reliance on sophisticated technology, the growth of e-commerce, the expansion of retail operations, the outsourcing of functions and activities, and an increased use of structured finance (derivative) techniques that purport to lower credit and market risk(Van Greuning and Brajovic-Bratanovic, 1999).

## **2.4 Risk Management in Banking**

It is a given that during the course of doing business, an organization is going to face unpleasant and frequently unanticipated events that could undermine or even worse, completely destroy the company. That's the essence of risk, and how an organization or a person handles it will decide if it survives and prospers or not. Risk is the term used to characterize the occurrence of future ambiguity, negative expectations, the possibility that something unpleasant would occur during these uncertainties, and the potential for a result to deviate from an anticipated or estimated outcome. There is a chance that the bank will experience a loss in the banking industry. In the banking industry, risk and return should be taken into account and managed together. It will be possible to control risk by being prepared under all circumstances by creating comprehensive scenarios of what could go wrong in terms of expectations, calculating loss probabilities for

each scenario, and identifying any potential negative effects on the bank's own funds (capital) (Crouhy, Galai and Mark, 2014).

Risk Management is described as the performance of activities designed to minimize the negative impact (cost) of uncertainty (risk) regarding possible losses (Iijima, 1998). (Amini, 2015) Also defines risk management as a systematic process for identify, evaluation of pure loss exposure faced by an organization or an individual, and for the selection and implementation of the most appropriate techniques for treating such exposures.

Numerous authors claim that risk management has evolved from being a purely banking activity that was tied to loan quality to a very intricate system of processes and tools in the contemporary financial world. It emphasizes how crucial it is for an organization to be able to foresee change and take appropriate action in lieu of waiting for it to happen and responding to it.

The procedure consists of three steps: risk management, evaluation, and identification. Risk management is an active, strategic, integrated process that combines risk monitoring and mitigation in order to optimize a bank's value while reducing its likelihood of bankruptcy ('Schroek, G., 2002 Risk management and value creat', 2002).

(Bergendahl and Lindblom, 2011) highlights that risk management is a set of tools and frameworks for evaluating and controlling risk as well as a process. Minimizing foreign exchange losses, lowering cash flow volatility, protecting against swings in earnings, increasing profitability, and ensuring the firm's survival are among the goals of risk management (Fatemi and Glaum, 2000) . Therefore, risk management is now on the financial industry's agenda. Risk management focuses on what will be faced in the future as a result of past transactions and what sorts of troubles, difficulties, and losses will develop as a result of these risks rather than what has happened recently or in the past (Crouhy, Galai and Mark, 2014). It takes into account potential dangers in the future and concentrates on how to guarantee sufficient capital (own funds) against these risks as well as how to build a long-lasting capital structure. The two main types of risks that banks face are control risk and transaction risk, which is connected with transactions.

According to (Santomero, 1995) The management of the banking organization implements a risk management system through a series of protocols. These usually consist of four sections: standards and

reporting; investment guidelines or strategies; position constraints or rules; and incentive contracts and remuneration. These tools are usually intended to measure exposure, outline procedures for managing these exposures, limit individual positions to acceptable bounds, and encourage decision-makers to manage risk in a manner consistent with the goals and objectives of the organization.

#### 2.5 Categories of Risk Management

As mentioned by (Merton, 1995), One important aspect of financial institutions, such as banks, is the way in which risks are bundled and unbundled. But not every risk associated with a business needs to be taken on by them directly; some can be transferred or traded, and others can be completely avoided. In order to apply the proper techniques to minimize the risks, it is helpful to decompose the risks associated with their activities and assets into three distinct categories based on their type.

(Oldfield and Santomero, 1997)Consequently, make the case that based on a managerial outlook, the risk that financial institutions face can be divided into three distinct types. These include risks that can be transmitted to other parties, risks that need to be actively handled at the firm level, and risks that can be removed or avoided by following basic business procedures. The aim of business procedures that completely avoid risk is to remove risks from the bank that are not necessary for the services it provides, or to absorb the right amount of a certain type of risk. This is accomplished by implementing strategies including diversification, hedging, reinsurance, underwriting requirements, and due diligence investigations, which all serve to lower the likelihood of specific losses by removing risks superfluous to the bank's operations.

There will still be certain operational and systemic risks after this, which should be reduced as much as feasible and their magnitude and associated expenses shared with stakeholders. This is due to the fact that making a concerted effort to limit these risks will both limit risks and lower business activity profitability. When there is no value added or competitive advantage in taking on and/or managing a risk, the bank may also transfer some of its risk to other parties that are better suited to handle and profit from it.

There is another category of risks that, for valid reasons, call for the employment of additional resources in their management, and these too should be internalized and vigorously handled at the level of the originating bank. Activities where the nature of the embedded risk may be complex and challenging to disclose to non-firm stakeholders are among those whose inherent risks the bank must manage. For example, it may be more costly or difficult for banks to disclose the nature of their complex, illiquid, and proprietary assets than it is to

hedge the underlying risk. Furthermore, disclosing private client or customer information could provide rivals an unfair edge.

## **2.6 The Process of Risk Management**

The procedure for risk management entails steps like identifying potential risks that banks may face, digitizing, analyzing, supervising, and reporting those risks using suitable risk measurement techniques, establishing risk policies, choosing risk management actions to be taken in response to those risks, and evaluating the effectiveness of the policy for risk management (YAYLALI and SAFAKLI, 2015). During the risk identification step, the characteristics and causes of the risk exposures are recorded, and it is ensured that all departments have access to this information. Effective institutional communication channels are critical to this process. Regulatory and supervisory authorities view the board of directors and senior management of banks as the entities responsible for formulating and implementing risk management strategies, as well as for establishing and enforcing regulations. The board of directors develops the banks' risk policies and the methods for implementing them while taking the risk management unit's recommendations into account (YAYLALI and SAFAKLI, 2015). These are defined as written standards that senior management is responsible for implementing and that the board of directors creates and enforces with written authorization. (Notification of the Central Bank of TRNC). It is imperative that the risk policies are structured in a clear, workable, and helpful manner and specify the exact needs for every division within a bank. At the very least, risk management policies and the content of the related implementation approaches should address the following headings (YAYLALI and SAFAKLI, 2015).

- a. The structure and effectiveness of risk management
- b. Techniques for quantifying risk.
- c. The extent of the risk management group's duties and obligations.
- d. The membership and structure of the various level risk committees.
- e. The procedures to be followed in the event of a violation and the techniques to determine risk limits
- f. Establishing and putting into practice notification and warning mechanisms
- g. In a number of circumstances, mandatory confirmations and approvals must be provided.

The proper procedures for reporting and approval should be outlined in risk management policies. For instance, in situations when the general manager's approval is required for protect transactions that exceed predetermined financial limitations, or when certain transactions require two signatures. Consequently, it is

essential that an internal audit system be in good working order .If this step isn't done correctly risk management could collapse (Phallis, Thomas by Giustino Varrassi 1,\*ORCID, Flaminia Coluzzi 2, 3ORCID, Diego Fornasari 4, Flavio Fusco 5, Walter Gianni 6, Vittorio Andrea Guardamagna 7, Filomena Puntillo 8, 2016).

As a result of risk management, we require a framework for measuring the risks that are now present using various statistical techniques, evaluating these risks collectively, and evaluating the risks that the risk management models can't to measure using scenario analysis and stress testing.

Computing the risk taken, the return obtained, and the capital allocation on a sector-by-sector basis is necessary to ensure the effective use of an integrated risk management system and capital. Examples of policies related to asset side risk management include diversification of the bank's credit offerings based on industries and goods, preventing intensity by growing the client base, and establishing credit limits (Keith, 2000).

There exist several strategies to mitigate market risk: investing in a range of risk and return categories within the bank's securities portfolio; monitoring market price swings on a daily basis; modifying the market value of the portfolio in response to daily and seasonal variations by accounting for changes in the assets comprising the portfolio (marking to market); selecting the size of the position to assume; using the pre-established loss limitations (stop loss) to stop trades that are generating losses as a priority; acquiring fresh market assets and determining the size of the stake to be taken(Keith, 2000).

Successful implementation of financial risk management strategies depends on balance sheet management, loan selection, and management. Policies on the liability side are those that are put into place with the understanding that some risks cannot be fully managed and that a sufficient amount of risk must be taken in order to be profitable. These are the guidelines for determining whether or not to insure against risks(Keith, 2000).

## **2.7 The Development of Risk Management**

Regarding Banking Like in other nations, Ethiopia's banks operate in a very dynamic and concentrated context. The NBE has also noted that in order for Ethiopia's local banks to meet their goals, they must mitigate a variety of risks, and that poor risk management could have a detrimental effect on the long-term viability of these financial institutions(Jabir and Tole, 2019). Consequently, the NBE has imposed risk

management guidelines on the banking sector in 2012. As a result, in 2012, the NBE mandated risk management regulations on the banking industry.

These risk management recommendations are designed to give financial organizations a comprehensive picture of all the necessary actions, arranged based on risk categories. These guidelines are meant to complement the current risk management requirements that have been published by the Basel Committee (International Monetary Fund, 2012).

These guidelines, however, only provide a general overview of all the necessary steps and are not intended to present a comprehensive plan of action for any control method that these institutions may implement. An overview of key guiding concepts in brief (based on the risk management guidelines issued by the NBE in (2003;2012) is presented in the subsequent sections.

## **2.8 General Requirements**

The rules for risk management include an overview of risk management as well as a detailed description of the primary risks that may exist in various banking institutions in Ethiopia (NBE, 2003; 2012). These rules state that identifying, evaluating, measuring, monitoring, controlling, or minimizing all risks inherent in the banking industry constitute the components of risk management in banks. All financial institutions are expected to implement the fundamentals of risk management without taking their size or complexity into account. These essential guiding concepts have the following concepts such as

The board of directors of banks is ultimately responsible for risk management, and they are tasked with developing policies that align with the various business segments of their institutions. The bank's top management is in charge of creating risk management strategies, which are detailed plans and procedures for reducing or controlling risks. The board of directors must properly approve all of these plans and activities. Senior management must take a comprehensive approach to monitoring and managing the risk profiles of banks. Risk assessment must be done at the operational level based on portfolios or business lines.

- a. In spite of a separate management function or risk review, all bank executives in charge of various portfolios or business lines are likewise accountable for the risks they incur
- b. Each and every possible risk needs to be quantified, reported, and mitigated.
- c. Regardless of who accepts and bears the risk, an independent role is required for the risk review. Stress tests are used in the review function to expose the portfolios to unforeseen changes in the crucial variables or the major systemic shocks.

- d. Financial institutions are mandated to maintain backup plans to address unexpected or catastrophic events.

In addition to the previously mentioned, all banking institutions are required to create an efficient risk management system using the guidelines' outlined principles to address the main risks, including credit, market, liquidity, and operational risk (International Monetary Fund, 2012). A succinct description of the same is given below:

### **2.9 Guidelines on Credit Risk**

The boards of directors are responsible for developing a clear credit policy, according to the credit risk regulations. The boards have been directed to approve the banks' credit risk strategy and important credit risk management rules, which are contingent on the institutions' overall business plan. (Abate and Kaur, 2023). To access and manage credit risk, bank top management must establish an authorized organizational structure in addition to implementing systems, rules, and procedures.

A creative credit risk management division fit for the size and complexity of the bank's credit portfolio must also be established by Ethiopian banks. The function of loan origination is regarded as the most important one in credit risk management, with focus on the appropriate assessment of the borrower's financial situation and the lender's ability, intention, and creditworthiness. (Ielise2014).

This feature is further strengthened through the implementation of the credit management function. Ethiopian banks are required to provide this job, which includes maintaining loan documentation and credit files, monitoring loan covenant compliance, and ensuring that their operations adhere to their rules and procedures. Furthermore, banks should develop internal credit ratings and assign them according to the credit risks associated with each individual. Banks operating in Ethiopia are required to provide monthly reports on an individual, aggregate, and sector-by-sector basis in addition to conducting frequent reviews of the loan portfolio. Finally, it is advised that banks develop strategies or action plans to address the troublesome loans.

### **2.10 Guidelines on Market Risk**

To mitigate potential losses arising from adverse fluctuations in interest rates, equity or commodity prices, foreign exchange rates, or other market variables, the market risk guidelines instruct the bank's top management and board of directors to establish a suitable framework for managing market risk. This framework contains an organizational structure that, in addition to being suitable for the size, scope, and

complexity of the company, must be in accordance with the techniques, processes, and procedures used to evaluate, monitor, control, and/or mitigate market risk.

Establishing a middle office between the front and back offices of Ethiopian banks is advised in order to create a stand-alone market risk management unit. The market risk standards provide that the independent function must determine, quantify, and analyze the market risks that are present in bank treasury operations and that these risk exposures must be reported immediately to upper management.

Additionally, it is proposed that Ethiopian banks use a variety of methods to estimate market risk in accordance with their individual needs, from complex risk models to simple gap analyses. Lastly, in order to monitor market risk, local banks must ensure that they have enough control mechanisms and relevant arrangements, such as regular reviews or audits (Abate and Kaur, 2023).

### **2.11 Guidelines on Liquidity Risk**

The suggestions about liquidity risk state that top management of banks need to design a comprehensive system for recognizing, evaluating, and controlling liquidity risk. According to these principles, the key components of an efficient liquidity risk management strategy include having an informed board, competent management, staff with the required abilities, and operational systems and procedures. It also says that senior management is needed in order to maintain an efficient organizational structure and regularly review the liquidity situations of banks.

Every financial institution must create a creative framework for managing its liquidity, accounting for both the overall and particular risks associated with the many types of deposits or account holders it has. Banks are required to perform regular cash flow evaluations under various market situations and scenarios in order to identify any potential liquidity gaps. The aforementioned guidelines emphasize the critical components of an effective liquidity management technique, which include risk limitations, effective management information systems, and emergency funding strategies.

### **2.12 Guidelines on Operational Risk**

Banking institutions are required under the operational risk standards to take into account a broad range of material operational risks that have an influence on their business operations. These risks include the possibility of loss as a result of external occurrences as well as ineffective or inadequate internal processes, procedures, personnel, controls, and systems. The board of directors is required to make sure that senior

management of their institutions has implemented adequate processes, procedures, controls, and systems for all the important areas of operations, in addition to setting a tolerance level for operational risk.

Regardless of size or complexity, all banking institutions are required to use the six fundamental principles of operational risk management for this reason. Senior management of banking institutions must also make the appropriate preparations to give their concerned staff the necessary training, as well as firmly convey all established procedures and rules down the line. Finally, in order to offer a trustworthy framework for evaluating their operational risk monitoring, all banking institutions must promptly publish information.

The NBE's risk management guidelines have helped banking institutions establish an adequate risk management system. The banks have been counseled to implement risk management strategies by taking the necessary actions. In addition to publishing these principles; the NBE has created a roadmap for Basel's implementation.

According to the explanation of risk management principles given above, banks must comprehend the dangers they face and use a variety of risk management strategies in order to succeed. Numerous studies on risk management techniques have been carried out for this reason, and a quick summary of some pertinent studies is given in the following section.

## 2.11 Techniques of Risk Management

- **GAP Evaluation** It is an approach to controlling interest rate risk that is based on the balance sheet and focuses on potential changes in net interest income over periods of time that are predetermined. The GAP information allows the management to assess how changes in interest rates may impact net income. A positive GAP indicates that an increase in future interest rates would boost net interest income since the change in interest income is greater than the change in interest expenses, and vice versa (Spivack, 2001).
- **GAP analysis** is an additional method of managing net interest income, which takes into consideration all individual cash inputs and outflows, and evaluating interest rate risk. The duration, a value and time weighted measure of the maturity of the cash flows, represents the average period necessary to recover the invested funds. The duration gap, or DGAP, is calculated using the time disparities between the cash flows from liabilities and assets.

$$DGAP = DA - u DL.$$

Where DA is the average duration of the assets, DL is the average duration of liabilities, and u is the liabilities/assets ratio. When interest rate increases by comparable amounts, the market value of assets decrease more than that of liabilities resulting in the decrease in the market value of equities and expected net-interest income and vice versa (Spivack, 2001).

➤ **Value at Risk (VAR):** It's a more recent tool for risk management. VAR shows how much a company can profit or loss over a specific time period with a particular possibility. Financial risk present in portfolios is condensed into a single figure using VAR. While VAR measures market risk generally, it also takes into account a wide range of other risks, including those related to foreign exchange, commodities, and stocks (Jorion and Khoury, no date).

➤ **Risk Adjusted Rate of Return on Capital (RAROC):**-It provides an economic foundation for reliably measuring every relevant risk and acts as a tool for managers to make effective judgments about the trade-off between risk and return in various assets.

Financial organizations need to set aside money for a variety of risks because economic capital shields them from unexpected losses. The overall return on capital of a company is calculated using the Risk Adjusted Rate of Return on Capital (RAROC) methodology, which also illustrates how much financial capital, is required for various goods and enterprises. Though Risk Adjusted Rate of Return can be used to estimate the capital requirements for market, credit and operational risks, it is used as an integrated risk management tool (Crouhy, Galai and Mark, 2014) and Robert, 2001).

➤ **Securitization:** It is a process investigated under credit-linked notes or structured finance systems. One way for a bank to raise additional capital and lower its risk exposure is through the securitization of its loans and assets. The bank converts intangible assets into tradable asset backed securities by pooling a collection of income-earning assets (such as mortgages) and selling securities against these in the open market. The responsibility of repayment is shifted from the originator to these pooled assets since the profits from these securities are dependent on the cash flows of the underlying assets (Crouhy, Galai and Mark, 2014) and Robert, 2001).

➤ **Sensitivity Analysis:** It is quite useful when attempting to ascertain whether the actual effect of a particular variable deviates from the assumption. By creating a particular set of scenarios, the analyst can ascertain how changes in one or more factors would affect the target variable (Spivack, 2001).

- **Internal Rating System** An internal rating system helps financial institutions manage and control credit risks related to lending and other activities by collecting and managing borrower creditworthiness and credit transaction quality (Spivack, 2001).

## 2.12 Review of Empirical Literature

An overview of several studies that have been published on how banks in established and developing nations manage risks is given in this section.

A study of Ali & Daly (2010) attempted to address the query of what macroeconomic variables have the greatest potential to impact the credit risk of US and Australian commercial banks. They discovered, through the use of the logistic regression model, that the GDP and short-term interest rate are the same macroeconomic variables that have an impact on both Australia and the United States. Additionally, the study verified that the US economy is more vulnerable to changes in macroeconomic variables than Australia's economy.

(Khalid and Amjad, 2012) carried out a study on Pakistani Islamic banks' risk management.

The writers employ the identical model proposed by (Ahmed, 2015) of risk management practices. The findings show that Islamic banks are reasonably effective at managing risk when it comes to comprehending risk, risk management, credit risk analysis, and risk monitoring. These factors have the greatest influence on risk management practices.

Evidence from the African context indicates that a variety of macro and microeconomic factors affect the degree of credit risk that commercial banks bear. For instance, (Warue, 2013) discovered that bad loan practices by Kenyan commercial banks are primarily determined by per capita income and profitability (ROA), with varied degrees of importance for small, medium, large, local, and international banks. Both fixed effect panel models and pooled (unbalanced) panel models were used to observe this.

In contrast to the foregoing outcome, (Iwuamadi, 2014) contends that macroeconomic concerns ought to receive greater consideration. For this study, a classified sub panel of sub-Saharan nations that are part of the CAF and those who are not, pseudo-panel econometric models were used. According to (Iwuamadi, 2014) research, economic development, real currency rate appreciation, real interest rates, net interest margins, and interbank loans are the main factors contributing to credit risk in the majority of sub-Saharan nations.

From the perspective of Ethiopian commercial banks, not many studies were carried out. Investigated the factors that contribute to failing loans in Ethiopian commercial banks, among other things Ethiopian commercial banks, both publicly and privately held, provided primary and secondary data for the study.

In this case, the study found that deliberate default by borrowers and their lack of knowledge, fund diversion for unplanned purpose, inadequate or excessive financing by banks, an underdeveloped credit culture, loose credit terms and conditions, aggressive lending, harmed integrity, weak institutional capacity, unfair competition among banks, and inadequate or inadequate financing by banks are the causes of loan default in Ethiopia.

On the other hand, (Tehulu and Olana, 2014) looked at the factors unique to Ethiopian commercial banks for determining credit risk. Thus, their study demonstrated that ownership, operating inefficiencies, bank size, and credit growth all had statistically significant effects on credit risk.

On the other hand, (Lelissa2014) we discovered that the quantity and caliber of risk-related (bank-specific) attributes sufficiently account for the proportion of problematic loans in Ethiopian commercial banks. This study separated credit risk determinant variables into two categories: quantity risk and quality risk components. Ethiopian commercial banks' credit risk is significantly influenced by their size, and among the quality risk factor categories, loans to total asset and credit concentration have a strong correlation with credit risk..

Additionally, research by (Abebe, Kassaw and Mengistu, 2019) was done to determine the factors that influence Ethiopian commercial banks' degree of credit risk. It was discovered that BAS and LDR have beneficial effects. The study's findings also showed that GDPR and LGR have a significant detrimental impact on the quality of assets in the Ethiopian banking industry

## **2.13 Research Gap**

For the past five years, intentionally chosen commercial banks have struggled with risk management, and they lack the policies and processes needed to handle the risks involved in their operations. In this way, the research will contribute to closing this gap. Determining bank risk management procedures and assessing the risk management procedures of particular commercial banks is the aim of this study.

These are my primary motivations for studying particular commercial banks in order to add to the body of research by examining various risk types, approaches, and the effectiveness of the bank's risk management procedures. Determining the risk management practices employed by banks and assessing the practices of certain commercial banks are the research's objective

## **CHAPTER THREE**

### **3. RESEARCH METHODOLOGY**

The research approach used for the study is covered in detail in this chapter. As a result, subjects like sample size calculation, target population and sampling strategies, data source and collection methods, data analysis and presentation methods, and research design are covered. The study's objective is to evaluate Ethiopian commercial banks' risk management practices in order to find out if they are managing risks in accordance with the Basel Committee's principles, NBE policies and directives, and the bank's own policies and procedures. This will allow the study to identify any best practices that the banks have yet to implement.

#### **3.1 Research Design**

It is widely acknowledged that the problem at hand determines which research design should be used and how. As a result, the researcher employed a descriptive style of research methodology in this study and attempted to evaluate the risk management procedures of Ethiopian commercial banks using a mixed technique, or quantitative and qualitative data.

According to (Bergman, 2011), The descriptive survey method was selected as the overall strategy for this investigation due to its ability to integrate a range of approaches and strategies in the data gathering and analysis that centers on the many aspects of the investigation for phenomena and explanation in a way that is scientific. Prior to examining the risk management protocols of commercial banks, it is important to discern patterns within the descriptive occurrences.

#### **3.2 Research Approach**

This study's technique, which integrated quantitative and qualitative methodologies, was used to organize the concepts, characteristics, descriptions, counts, and measures to show the implications of the issue under aims. A structured and semi-structured questionnaire is used in the quantitative approach, and in-person interviews with the sampled participants who will be chosen for this study are used in the qualitative approach. As stated by Mouton & Marais (2001), found about when assessing the motivations behind a study, quantitative approaches are typically employed. Qualitative research mostly uses language, visuals, descriptions, and stories, whereas quantitative research involves gathering data through numerical counts and measurements of various objects.

On the other hand, (Goddard, W. & Melville, 2004) claimed that the goal of qualitative research was to comprehend people's daily lives, speech patterns, behaviors, and areas of interest and suffering. The most effective evaluation research combines quantitative and qualitative elements. It is helpful to do statistical comparisons and have a thorough grasp of the mechanisms that either produce the observed outcomes or prevent the expected results from occurring. This is the reason this specific research design will be used to examine the risk management practices at commercial banks.

### 3.3 Data Collection Techniques

The core data were gathered through the use of structured questionnaires from commercial banks that were specifically chosen based on categories from the national bank of Ethiopia. These banks included risk and compliance management, credit analysts, and directors of risk management, all of which had offices in Addis Ababa. The goals of the research and the examination of the literature served as a guide for the questionnaire's design, which includes both closed- and open-ended structured questions. This is useful in addressing the research purpose, which is to describe the present risk management practice of a chosen bank. Using the same methodology, additional study might be done to verify the instrument's reliability. Furthermore, determining the most important risk management techniques that are currently

## 3.4 Study Population, Sample Design and Sample Procedure

### 3.4.1 Population of the Study

As stated by (Bryman, A. and Bell, E., 2011), The study's population refers to "the universe of units from which a sample is to be selected". This research aims to assess the risk management strategies of Ethiopian commercial banks, which make up the target group.

### 3.4.2 Target Population

(National Bank of Ethiopia, 2024), distinguishes (based on asset size) three types of commercial banks: large, medium, and small banks. The Commercial Bank of Ethiopia is in large category and in medium category there are a totally five banks of Ethiopian in this categories and the list of them are Awash Bank, Bank of Abyssinia, Cooperative Bank of Oromia, Dashen Bank, and Hibret Bank. In the small category, there are a totally 24 banks in Ethiopia. Targeted populations was selected from the large category which is commercial bank of Ethiopia, three medium categorized banks such as Awash Bank SC, Bank of Abyssinia and Dashen bank and five in small category banks such as Nib International bank, Oromia bank SC, Wegagen Bank SC,

Enat Bank SC and ZemanBank SC. because the project target members are homogeneous, purposive sampling can be used for study purposes.

From large categories the total populations 30 from risk management directors and risk and compliance management , 40 total populations from purposely selected medium categories banks and 40 total population from purposely selected small categories which is from risk management directors and risk and compliance management. i.e. A total of 110 employees from the target populations were selected using the stratified random sample technique.

### 3.4.3 Sample size determination

As Mike (Glen, 2012) created a method to calculate the representative potential sample size from a big population. The Mike Slovin formula, which has a 95% confidence level, a 50% maximum variability, a sampling error of  $\pm 7\%$ , and facilitates the straightforward determination of the middle representative sample size from a big population, can be used. There were 110 selected workers in total across all categories at the project site. The researcher considers three approaches that can yield varying sample sizes in order to identify the right sample size for the study. The degree of variability, confidence level, and accuracy or sampling error of the attributes being measured serve as the foundation for calculating the sample size in each case. The researcher employed option (2), or 27 (0.07), in this regard.

$$n = N / (1 + N I^2)$$

Where: N = Population Size n = Sample Size

e = Precision (Sampling Error): 7%

Option 2 is more suitable because it reduced the sampling error from  $\pm 10\%$ ,  $\pm 7\%$ , and  $\pm 5\%$  to reach the middle sample size.

Confidence Level = 95%

Degree of Variability = 50% (Maximum Variability)

Sampling Error =  $\pm 7\%$

Total Population = Total Population = 110

The sample size is computed as follows:  $n = N / (1 + N I^2)$

$$n = 110 / (1 + 110 (0.07)^2)$$

$$n = 71.47 \approx 72.$$

Ser. No	Categories	population	Sample size
1	Large categories	30	20
2	Medium categories	40	26
3	Small categories	40	26
Total No of employees		110	72

Source: Commercial banks from three categories offices Report, 2023

Based on the Mike (Glen, 2012) sample size determination formula total 72 commercial banks employees will be taken as representative samples have been taken proportionally from each Stratified as representative sample.

### 3.5 Sampling technique for quantities method

The ideas of probability influenced the sample selection process under the quantity technique. The representative sample was chosen using the stratified random selection technique from among various commercial bank types Sample magnitude. As identified by (De Vaus and de Vaus, 2013), In social science, sampling is used to provide representative samples of population components. Obtaining a sample that is as representative of the target population as feasible is the primary goal of the sampling procedure.

Observing the advantages of a multistage, systematic sample drawing process, drawing a probability sample instead of a non-probability sample, and providing a clear description of the population are some of the criteria used in the sampling process, as well as the validity of the study and an unbiased, representative sample.

### 3.6 Data Analysis

The process of extracting (summarizing) and categorizing (grouping) meanings is called data analysis. Groups in the analysis process use narrative to structure (order) meanings ('(Mark Saunders, Philip Lewis, Andrian Thornhill, 2009)', 2009). Examining, purifying, manipulating, and modeling data with the intention of highlighting important information, generating recommendations, and assisting in decision-making is the process of data analysis. Additionally, data analysis converts the gathered information into a form that is clear and meaningful. Basic descriptive statistics were used to examine the data gathered for this study. The primary purpose of using the descriptive method of analysis is to characterize the study's features in relation to risk management procedures. In order to provide a detailed explanation of the data, charts, standard

deviations, percentages, frequencies, and mean scores were employed. Additionally, a thorough discussion of data gathered via open-ended questionnaires has been held. As a result, when the raw data from the questionnaire is carefully collected, it is entered into a computer spreadsheet using the SPSS software application. Therefore, the respondents' points of view were compiled and categorized using the IBM Statistical Package for Social Sciences (SPSS) computer program.

### **3.7. Ethical Consideration**

Fairness, honesty, transparency, disclosure of techniques, and the objective of the research should all be upheld when conducting ethical considerations. In this instance, data collected from respondents who were specifically chosen to be commercial employees in Addis Ababa was retained for a fair amount of time. Confidential files and matters pertaining to the personal information of employees, the organization's policies and strategies, and other highly classified material that must remain secret are valued and maintained in confidence.

## CHAPTER FOUR

### 4 DATA PRESENTATION, ANALYSIS AND INTERPRETATION

#### 4.1 INTRODUCTIO

The quantitative data gathered via questionnaires is analyzed and presented in this chapter. Closed-ended questions make up the questionnaires, which are then compiled and statistically displayed in tables using SPSS 23 software. Some secondary data from the case organization's published and unpublished records was also used by the researcher.

#### 4.2 Summary of the questionnaires respondents

The demographic traits of the study participants were examined in the analysis. The respondent's profile is shown in this section. It comprises information on length of service, gender, and educational attainment, as well as bank types, educational attainment, and performance expectations for the post. The goal of analyzing these variables was to find any indications of a relationship between them and the different answers.

A total of 72 sets of questionnaires were distributed in order to conduct the structured questionnaire survey. Out of the 72 surveys that were sent, 65 were returned. Seven of them were discovered to have been absent because of the epidemic. Consequently, Table 4.1 shows that 65 sets of questionnaires, or 90.27% of the response rate, were viable (complete) for additional analysis.

. Table 4.1 Summary of survey carried out.

Parameters	Values
The quantity of questionnaires that were sent out	72
The amount of incomplete questionnaires	7
Many of the questionnaires were invalid or incomplete.	0
Quantity of answers	65
The percentage of answers that might be used for analysis (%)	90.27 %

**Source: Own Survey, 2024**

#### 4.3. Analysis of Background of Respondents

The purpose of this section of the analysis is to give readers some general information about each respondent. As mentioned in the methodology section of the study, samples from credit analysis, portfolio management, and risk management were gathered from specifically chosen commercial banks. During this training, a sample of all 72 employees was selected and given the opportunity to complete a set of standardized questionnaires with four primary sections each. By its very nature, risk management requires in-depth knowledge, expertise, and the ability to monitor the risk linked with them. In order to obtain the

information required for the study, the researcher must deal with those who are convenient and subject to risk management.

**Table 4.2: Demographic Characteristics of the Respondents**

Demographic characteristic	Description	Frequency	Percentage
Sex	Male	55	76.4
	Female	17	23.6
	Total	72	100
Experience	1-4 years	5	6.9
	4-8 years	28	38.9
	8-12 years	38	52.8
	Above 12 years	1	1.4
	Total	72	100
Educational level	Diploma	0	0
	Bachelor Degree	32	44.4
	Master Degree	38	52.8
	PHD	2	2.8
	Other	0	0
	Total	72	100
Field of study	Accounting	26	36.1
	Management	24	33.3
	Marketing	22	30.6
	Other	0	0
	Total	72	100
Categories	Large	20	27.8
	Medium	26	36.1
	Small	26	36.1
	Total	72	100

**Source: Own Survey, 2024**

According to table 4.2, which is shown above, 76.4% of the respondents were men and the remaining 23.6% were women. As a result, male employees predominate in the risk area's employee mix almost proportionately more than female employees. This demonstrates that the bank offers men greater employment opportunities in risk management roles than it does for women. Table 4.2 once more demonstrates the respondents' educational attainment. All of the respondents were found to be focused on the first, second, and PhD categories. 32 people, or 44.4 percent of the respondents, held a first degree; 38 people, or 52.8 percent, held a second degree; and 2 people, or 2.8 percent, belonged to the PhD category. This suggests that the commercial banks have highly educated employees who can eventually provide the bank with high-quality work in the field of risk management and other crucial responsibilities. As the above data shows, 6.9% of respondents have work experience in the range of one to four years, 38.9% have work

experience in the range of four to eight years, 52.8% have work experience in the range of eight to twelve years, and 1.4% have worked for more than twelve years overall. This suggests that the majority of respondents have enough experience, which makes it easier for them to comprehend risk management procedures. Similar to the total banking experience, a sizable percentage of employees—38% of respondents—have more than eight to twelve years of expertise in risk management operations. This suggests that the majority of risk management process workers are reliable and content with the incentives provided by the banks. It is thought that keeping experienced staff in risk management will help commercial banks as a whole manage their risk, even if further research is needed to determine why this is occurring. Extras to the preceding Thirty-six percent have a history in marketing, thirty-one percent have a background in management, and thirty-six percent have a background in accounting. This demonstrates that the respondent with an accounting experience is more reliable in a risk management role.

#### 4.4. Risk Management in selected commercial banks

A strong risk management program depends on the following factors: staff quality, credit culture, dedicated top management, appropriate training programs, appropriate organizational structures, an adequate level of internal control, and the performance of the intermediation function. (Basel 1999).s

The means and standard deviation (SD), two descriptive analysis metrics, were employed in this chapter to assess the state of risk management in a few Ethiopian commercial banks. A larger mean value and a smaller SD value serve as the foundation for the study's overall thesis. The current study suggests using a variety of variables to look into risk management procedures in local settings, including risk identification, understanding, credit risk management, market risk management, interest rate management, and operational risk management. The purpose of these analyses is to provide answers to certain research issues that center on the assessment of commercial banks' risk management practices.

Table 4.3: Risk Awareness

Items	Response	Frequency	Percentage (%)	Mean	Standard deviation
Everybody at the bank understands risk management in the same way.	Strongly Disagree	0	0	4.51	.531
	Disagree	0	0		
	Natural	1	1.4		
	Agree	33	45.8		
	Strongly Agree	38	52.8		
	Total	72	100		

there is proper system for understanding various risks	Strongly Disagree	0	0	4.49	.556
	Disagree	0	0		
	Natural	2	2.8		
	Agree	33	45.8		
	Strongly Agree	37	51.4		
	Total	72	100		
responsibility for risk management is clearly set out and understood throughout the banks	Strongly Disagree	0	0	4.65	.508
	Disagree	0	0		
	Natural	0	0		
	Agree	24	33.3		
	Strongly Agree	48	66.7		
	Total	72	100		
accountability for risk management is clearly set out and understood throughout the banks	Strongly Disagree	0	0	4.69	.464
	Disagree	0	0		
	Natural	0	0		
	Agree	22	30.6		
	Strongly Agree	50	69.4		
	Total	72	100		

**Source: Own Survey, 2024**

In accordance with Table 4.3 above, which asks whether employees of commercial banks have a common understanding of risk management, a significant portion of the workforce—38, or 52.8%—strongly agree and 33, or 45.8%—agree with the idea, while just 1 employee, or 1.4%, shows very minimal support for the notion. It is clear that the numerous employees of carefully chosen commercial banks share a common knowledge of risk management.

Significantly more than half of the respondents—37, or 51.4 percent—strongly agreed that there is a proper system in place for commercial banks that have been carefully chosen to understand the risks involved. Another 33, or 45.8%, agreed, and two respondents, or 2.8%, were neutral or unsure. We can infer from this that certain commercial banks have a shared concept.

48 (66.7%) of the respondents strongly believe that risk management responsibilities are clearly defined and understood throughout the banks, as seen in table 4.3 above. On this problem, the data collected from respondents was good. Nonetheless, 24 (33.3%) of those surveyed concur that risk management

responsibilities are well-defined and widely acknowledged within banks. This indicates that a greater number of the chosen commercial banks who responded are accountable and knowledgeable about risk management.

The banks all have a thorough understanding of and accountability for risk management. 22 respondents (30.6%) merely agreed with the statement, whereas 50 respondents (69.4%) strongly agreed. In this context, the bank receives the maximum point.

**Table 4.3.1: Risk Identification**

Items	Response	Frequency	Percentage (%)	Mean	Standard deviation
the banks carries out a compressive and systematic identification of its risks relating to each of its declared aims and objectives	Strongly Disagree	0	0	4.65	.479
	Disagree	0	0		
	Natural	0	0		
	Agree	26	34.7		
	Strongly Agree	47	65.3		
	Total	72	100		
the banks finds it difficult to prioritize its main risks	Strongly Disagree	47	65.3	1.35	.479
	Disagree	25	34.7		
	Natural	0	0		
	Agree	0	0		
	Strongly Agree	0	0		
	Total	72	100		
change in risk are recognized and identified with the banks roles and responsibilities	Strongly Disagree	0	0	4.63	.488
	Disagree	0	0		
	Natural	0	0		
	Agree	27	37.5		
	Strongly Agree	45	62.5		
	Total	72	100		
the bank is aware of the strengths and weaknesses of the risk management systems of other banks	Strongly Disagree	0	0	4.47	.503
	Disagree	0	0		
	Natural	0	0		
	Agree	38	52.8		
	Strongly Agree	34	47.2		
	Total	72	100		
the bank has developed and applied procedures for the	Strongly Disagree	0	0	4.69	.470

systematic identification of opportunities	Disagree	0	0		
	Natural	0	0		
	Agree	23	31.9		
	Strongly Agree	49	68.1		
	Total	72	100		
it's crucial for bank to apply the most sophisticated techniques for risk identification	Strongly Disagree	0	0	4.68	.470
	Disagree	0	0		
	Natural	0	0		
	Agree	23	31.9		
	Strongly Agree	49	68.1		
	Total	72	100		

**Source: Own Survey, 2024**

Based on the information presented in Table 4.3.1 above, it can be inferred that a significant proportion of employees—47, or 65.3.2 percent—strongly agree and 26 (or 34.7%) agree that the banks identify their risks in a compressive and systematic manner in relation to each of their stated goals and objectives.

47 respondents, or 65.3%, strongly disagreed that banks found it difficult to rank their top risks. Additionally, 25 respondents, or 34.7%, disagreed with the statement that banks find it challenging to rank their top risks. As was said in Chapter 1, a bank faces a variety of hazards, two of which are credit risk and liquidity risk. Here, the bank receives the highest rating.

Although 27(37.5) of respondents believe that changes in risk are acknowledged and linked to the duties and responsibilities of banks, 45(62.5%) strongly agree that such changes are identified. This demonstrates that a significantly higher percentage of respondents from chosen commercial banks acknowledge and link changes in risk to their respective jobs and responsibilities.

Of the respondents, 34 (47.2%) strongly agree that the bank is aware of the advantages and disadvantages of other banks' risk management systems, while 38 (52.8%) agree that the bank is aware of this information.

The bank has created and implemented methods for the systematic identification of opportunities, according to 49 respondents (68.1%), who strongly agree with this; 23 respondents (31.9%) agree with this.

Of those surveyed, 49 (68.1%) strongly agree that banks should use the most advanced techniques for risk identification, while 23 (31.9%) agree that banks should use the most advanced techniques for risk identification.

**Table 4.3.2: Managing Credit Risk**

Items	Response	Frequency	Percentage (%)	Mean	Standard
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					deviation
The credit risk strategy set by the board of directors are affectively transformed and communicated within the bank in the shape of policies and procedures by the top management	Strongly Disagree	0	0	4.6	.494
	Disagree	0	0		
	Natural	0	0		
	Agree	29	40.3		
	Strongly Agree	43	59.7		
	Total	72	100		
the bank has an effective risk management frame work(infrastructure,process and policies)in place for managing credit risk	Strongly Disagree	0	0	4.74	.444
	Disagree	0	0		
	Natural	0	0		
	Agree	19	26.4		
	Strongly Agree	53	73.6		
	Total	72	100		
the bank has a credit risk rating frame work across all type of credit activities	Strongly Disagree	0	0	4.78	.419
	Disagree	0	0		
	Natural	0	0		
	Agree	16	22.2		
	Strongly Agree	56	77.8		
	Total	72	100		
the bank monitors quality of the credit portfolio on day-to-day basis and takes remedial measures as and when any deterioration occurs	Strongly Disagree	0	0	4.81	.399
	Disagree	0	0		
	Natural	0	0		
	Agree	14	19.4		
	Strongly Agree	58	80.6		
	Total	72	100		
the bank regularly prepares periodic report of credit risk	Strongly Disagree	0	0	4.81	.399
	Disagree	0	0		
	Natural	0	0		
	Agree	14	19.4		
	Strongly Agree	58	80.6		
	Total	72	100		

**Source: Own Survey, 2024**

Over half of respondents—59.7% strongly agree and 40.3% agree—respond that the credit risk strategy established by the board of directors is effectively transformed and disseminated throughout the bank in the

form of policies and procedures by top management. This suggests that the credit-granting procedure used by commercial banks is explicit.

Accordingly, nearly all respondents—73.6%—strongly agree that the bank has a framework for effective risk management—including procedures, rules, and infrastructure—which suggests the bank is well-positioned to reduce risk. Regarding the bank's credit risk rating framework for all credit activities, 77.8% strongly agree and 22.2% agree, which is a noteworthy practice. Similarly, with regard to taking the bank monitors quality of the credit portfolio on day-to-day basis and takes remedial steps as and when any deterioration occurs 80.6% of the respondent strongly agreed and in case of the bank regularly prepares quarterly report of credit risk Among participants, 80.6% strongly agreed.

**Table 4.3.3: Managing market risk**

Items	Response	Frequency	Percentage(%)	Mean	Standard deviation
market risk management provides a comprehensive frame work for measuring monitoring and managing interest rate foreign exchange and equity	Strongly Disagree	0	0	4.79	.409
	Disagree	0	0		
	Natural	0	0		
	Agree	15	20.8		
	Strongly Agree	57	79.2		
	Total	72	100		
change in interest rate affects, earning values of assets liability of balance sheets items and cash flow	Strongly Disagree	0	0	4.85	.362
	Disagree	0	0		
	Natural	0	0		
	Agree	11	15.3		
	Strongly Agree	61	84.7		
	Total	72	100		
market risk management is high in our banks	Strongly Disagree	0	0	4.67	.628
	Disagree	0	0		
	Natural	3	4.2		
	Agree	15	20.8		
	Strongly Agree	54	75		
	Total	72	100		

**Source: Own Survey, 2024**

Table 4.3.3 reveals that a majority of respondents—79.2%—strongly agree, and 20.8% believe that market risk management offers a complete framework for tracking, assessing, and managing equities, foreign exchange, and interest rates. Concerning the same issue, 15.3% and 84.7% of respondents, respectively, strongly believe that purposively selected commercial banks have a good understanding of how changes in interest rates impact cash flow and the earning values of assets and liabilities listed on balance sheets. Regarding the high level of market risk management in our banks, 75% and 20.8% of respondents, respectively, expressed strong agreement and agreement, while 3 (4.2%) respondents had no response.

Table 4.3.4: Managing interest rate

Items	Response	Frequency	Percentage (%)	Mean	Standard deviation
in the bank interest rate is measured by duration	Strongly Disagree	0	0	4.72	.451
	Disagree	0	0		
	Natural	0	0		
	Agree	20	27.8		
	Strongly Agree	52	72.2		
	Total	72	100		
interest rate can have adverse effect on banks earning in economic values	Strongly Disagree	0	0	4.71	.458
	Disagree	0	0		
	Natural	0	0		
	Agree	21	29.9		
	Strongly Agree	51	70.8		
	Total	72	100		
interest rate risk can effect net income of the banks	Strongly Disagree	0	0	4.79	.411
	Disagree	0	0		
	Natural	0	0		
	Agree	15	20.8		
	Strongly Agree	57	79.2		
	Total	72	100		
the level of success in handling interest rate in our banks is very high	Strongly Disagree	0	0	4.75	.599
	Disagree	0	0		
	Natural	0	0		
	Agree	14	19.4		
	Strongly Agree	58	80.6		
	Total	72	100		

**Source: Own Survey, 2024**

Table 4.3.4, in particular, showed that while 27.8% of respondents agreed that the bank interest rate is determined by duration, more than half of respondents—72.2% of them strongly agree—agreed. Purposively picked commercial banks are aware that interest rates might have a negative impact on their earnings in terms of economic values. Of the responders, 29.9% agree and 70.8% strongly agree. Regarding how interest rate risk may impact banks' net income It was discovered that 79.2% and 20.8% of respondents, respectively, highly agreed and agreed. The percentage of respondents who strongly agree and who believe that our banks are doing a very good job of managing interest rates is 80.6% and 19.4%, respectively.

**Table 4.3.5: Managing Liquidity Risk**

Items	Response	Frequency	Percentage (%)	Mean	Standard deviation
there is proper set of rules and guidelines for managing liquidity risk available in the bank	Strongly Disagree	0	0	4.75	.436
	Disagree	0	0		
	Natural	0	0		
	Agree	18	25		
	Strongly Agree	54	75		
	Total	72	100		
the liquidity risk strategy set by board of directors are effectively transformed and communicated within the bank in the shape of policies and procedures by the top management	Strongly Disagree	0	0	4.57	.499
	Disagree	0	0		
	Natural	0	0		
	Agree	31	43.1		
	Strongly Agree	41	56.9		
	Total	72	100		
the bank has an effective risk management frame work9infrastructure ,process and policies)in place for managing liquidity risk	Strongly Disagree	0	0	4.54	.502
	Disagree	0	0		
	Natural	0	0		
	Agree	33	45.8		
	Strongly Agree	39	54.2		
	Total	72	100		
the bank regularly prepares periodic report of liquidity risk	Strongly Disagree	0	0	4.53	.503
	Disagree	0	0		
	Natural	0	0		
	Agree	34	47.2		
	Strongly Agree	38	52.8		
	Total	72	100		

	Total	72	100		
applications of liquidity risk management techniques reduce costs or expected losses	Strongly Disagree	0	0	4.53	.503
	Disagree	0	0		
	Natural	0	0		
	Agree	34	47.2		
	Strongly Agree	38	52.8		
	Total	72	100		

**Source: Own Survey, 2024**

More than half of respondents—75 percent strongly agree and 25 percent agree—think that the bank has an appropriate set of rules and procedures for controlling liquidity risk. This suggests that the commercial banks' carefully chosen criteria on liquidity risk are unambiguously expressed. Nearly all of the respondents—56.9% strongly agree and 43.1 agree—believe that the bank's top management has successfully transformed and communicated the liquidity risk strategy established by the board of directors through policies and procedures. 54.2% and 45.2%, respectively, firmly and agree that the bank has an efficient risk management framework (infrastructure, procedure, and rules) in place for controlling liquidity risk.

In conclusion, 52.8 and 47.2 percent of participants strongly concur that using liquidity risk management strategies can lower expenses or anticipated losses.

**Table 4.3.6: Risk management technique practices in commercial**

Items	Response	Frequency	Percentage (%)	Mean	Standard deviation
risk adjusted rate of return techniques in your banks is used to estimate the capital requirements for market ,credit and operational risk	Strongly Disagree	0	0	4.61	.491
	Disagree	0	0		
	Natural	0	0		
	Agree	28	38.9		
	Strongly Agree	44	61.1		
	Total	72	100		
value at risk (VAR) techniques is used to measure various risk	Strongly Disagree	0	0	4.76	.430
	Disagree	0	0		
	Natural	0	0		
	Agree	17	23.6		
	Strongly Agree	55	76.4		
	Total	72	100		
securitization of banks assets and loan is advice for raising new funds and reducing banks risk exposure	Strongly Disagree	0	0	4.81	.399
	Disagree	0	0		

	Natural	0	0		
	Agree	14	19.4		
	Strongly Agree	58	80.6		
	Total	72	100		
securitization is best techniques to handle risk in case of our bank	Strongly Disagree	0	0	4.85	.362
	Disagree	0	0		
	Natural	0	0		
	Agree	11	15.3		
	Strongly Agree	61	84.7		
	Total	72	100		
the banks management regularly reviews the organizations performance in managing its business risk	Strongly Disagree	0	0	4.83	.375
	Disagree	0	0		
	Natural	0	0		
	Agree	12	16.7		
	Strongly Agree	60	83.3		
	Total	72	100		
our banks use sensitivity analysis to handle the change that one variable will have on the target variable	Strongly Disagree	0	0	4.83	.375
	Disagree	0	0		
	Natural	0	0		
	Agree	12	16.7		
	Strongly Agree	60	83.3		
	Total	72	100		
the banks risk management procedures and processes are documented and provide guidance to staff about managing risk	Strongly Disagree	0	0	4.78	.419
	Disagree	0	0		
	Natural	0	0		
	Agree	16	22.2		
	Strongly Agree	56	77.8		
	Total	72	100		
the banks risk policy encourages training program the area of risk management	Strongly Disagree	0	0	4.83	.375
	Disagree	0	0		
	Natural	0	0		
	Agree	12	16.7		
	Strongly Agree	60	83.3		
	Total	72	100		

the bank emphasizes the recruitment of highly qualified people having knowledge in risk management	Strongly Disagree	0	0	4.86	.349
	Disagree	0	0		
	Natural	0	0		
	Agree	10	13.9		
	Strongly Agree	62	86.1		
	Total				
your bank views the supervisory role of the National bank of Ethiopia (NBE) as critical in risk management	Strongly Disagree	0	0	4.90	.298
	Disagree	0	0		
	Natural	0	0		
	Agree	7	9.7		
	Strongly Agree	65	90.3		
	Total	72	100		
your bank has internally developed risk management procedures or guidelines	Strongly Disagree	0	0	4.92	.278
	Disagree	0	0		
	Natural	0	0		
	Agree	6	8.3		
	Strongly Agree	66	91.7		
	Total	72	100		
the bank is aware of the strengths and weaknesses of the risk management systems of the other banks	Strongly Disagree	0	0	4.94	.231
	Disagree	0	0		
	Natural	0	0		
	Agree	4	5.6		
	Strongly Agree	68	94.4		
	Total	72	100		

**Source: Own Survey, 2024**

Table 4.3.6, in particular, showed that over half of respondents—61.1% strongly agree, and 38.9% of respondents agreed—agreed that your bank uses risk-adjusted rate of return approaches to assess the capital requirements for credit, market, and operational risk. In a similar vein, value at risk (VAR) approaches are employed in specifically chosen commercial institutions to quantify different types of risk; 23.6% and 76.4% of respondents, respectively, strongly agree and agree. Regarding the recommendations for obtaining additional money and lowering banks' risk exposure with reference to the securitization of banks' assets and loans It was discovered that 80.6% and 19.4% of respondents, respectively, highly agreed and agreed. The appropriate identification of the risk present in all of the products and operations of the specifically chosen

commercial banks received the same favorable response. Securitization is one of the finest ways for our institutions to manage risk. 15.3% agree, and 84.7% strongly agree. The management of the bank is operating with vigor as it evaluates the organization's performance on a regular basis in controlling business risk. Comparably, our banks employ sensitivity analysis to manage the impact that a change in one variable will have on the target variable; their documented risk management procedures and processes advise personnel on risk management; their risk policy promotes risk management training; and they place a strong emphasis on hiring highly qualified individuals with risk management expertise. Your bank has developed internal risk management procedures or guidelines and is aware of the strengths and weaknesses of other banks' risk management systems. It also gave positive feedback on the establishment of appropriate risk management practices of purposefully selected commercial banks. Your bank views the National Bank of Ethiopia's (NBE) supervisory role as critical in risk management

## CHAPTER FIVE

### 5. SUMMARY, CONCLUSION AND RECOMMENDATIONS

The primary goals of the thesis have been to evaluate the risk management procedures at commercial banks that were specifically chosen. There are three sections to this chapter. The study commences by deliberating on the principal discoveries obtained from the examination and interpretation of the gathered data. Subsequently, conclusions are drawn from the research findings, and lastly, suggestions are made to tackle the challenges that have been identified. Consequently, the researcher presents a summary of the key findings in relation to the study's objectives in this chapter, draws conclusions, and makes recommendations based on the secondary data that was collected and the analysis of the data.

#### 5.1. Summary of major findings

This study aims to evaluate several commercial banks' risk management procedures. The study employs a mixed method research strategy, with the quantitative method serving as the primary component and the qualitative technique serving as a supplemental one. It also uses the descriptive survey method. The representative sample was chosen using the stratified sampling technique from various levels of carefully chosen commercial banks. Data from a few chosen commercial banks was gathered. Analysis was done with permanent staff and descriptive statistics were used. The overall efficacy of risk management procedures in banks is also determined by the results of the descriptive and analytical studies performed on the data from the questionnaire. Based on the study's conclusion that managerial staff members of specifically chosen commercial banks share a common knowledge of risk management. It could provide a crucial indication of the chosen bank's ability and effectiveness in handling any risk exposures in the future. In addition, banks have put in place a methodical and rigorous process for identifying, evaluating, and controlling risks. Controlling risk has a significant impact on the overall effectiveness of banks' risk management strategies in certain banks. A positive correlation was found between risk management approaches and market risk management. It has been found that there is a significant direct relationship between risk management practices and controlling liquidity risk. This suggests that in order to improve risk management practices across the board for banks, management must focus more on managing liquidity risk. Additionally, key components of certain commercial banks' risk management protocols include risk identification, comprehension, measurement, and analysis, monitoring, and control, as well as managing credit, market, liquidity, and operational risk.

## 5.2 Conclusions

Regarding the collection of particular aims, the study's findings have led to the following conclusions. First, the chosen banks' risk management procedures are doing a great job. Even though the risk management practice scores are average to above average, certain factors, such as the caliber of the staff and the timely provision of sufficient and efficient risk management training for the bank's employees, should be given careful consideration. As a result, it is necessary to strengthen and improve the risk management procedures of the chosen Banks through the hiring of skilled risk specialists and experts as well as the provision of ongoing, pertinent training. Second, the bank is observed making significant efforts to close the gaps in its risk management practices' methodology in comparison to NBE norms and other international risk management conventions, such as The Basel Committee. In this regard, even while intriguing findings supported this, the bank should place a strong emphasis on a few areas, such as maintaining an acceptable risk administration, measurement, and monitoring process. When asked if the banks had established a suitable environment for risk management, the majority of participants responded favorably. As a result, the Bank must continue to develop by encouraging a shared understanding of risk management strategy, policies, and procedures within the bank and by implementing these strategies, policies, and processes consistently across all of its products. This study's findings support the notion that the Bank's risk system is significantly impacted by the risk management process, as well as by having robust risk management standards and systems. As a result, the Bank must continue to develop by encouraging diversification of its exposure to various economic sectors and geographic regions for risk management.

## 5.3 Recommendations

The researcher recommended the following to certain commercial banks based on the paper's primary findings and conclusions. The first step towards having a successful risk management practice in the bank is to ensure that all employees have a common understanding of the risk management strategy, policy, and procedures. This will enable the bank to carry out its operations in an effective and efficient manner. Second, the management of the chosen institutions has to make sure that there is never a violation of the exposure and diversification limits established by NBE. This is due to the fact that the likelihood of a risk occurring will undoubtedly rise if the bank is only paying attention to a small number of carefully chosen geographic areas, economic sectors, or individuals or groups of individuals when it comes to risk. Thirdly, through it has to be the bank's management ought to focus more on improving the expertise of employees who operate in risk-related fields. Fourth, in order to have good credit risk management, the bank should enhance the credit granting procedure and reinforce the evaluation of the creditworthiness of its clients in order to reduce credit

risk. Fifth, the bank ought to prioritize the best practices that were overlooked during the process, such as emphasizing the counterparty's company.

#### **5.4. Recommendation for Future Research**

Further research should look closely at a variety of risks and how Ethiopian banks assess and quantify each one on a regular basis to successfully manage it, especially in light of the growing demand from investors for robust earnings growth and consumers for high-quality goods and services. Therefore, it is important to inform the banking sector and other relevant industries about the important work that needs to be done on this issue, starting with the creation of national initiatives and road maps.

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## APPENDIX I



Addis Ababa University  
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SEEK WISDOM, ELEVATE YOUR INTELLECT AND SERVE HUMANITY !



Addis Ababa University School of Commerce: - Department Of Accounting and Finance for the Program of:  
- MSc in Corporate Finance Specialty in Investment Management

**Questionnaires to be filed by Employees of a purposely selected commercial Banks.**

This questionnaire is designed to collect information about the **Assessment of Risk Management practice in Ethiopia Commercial Banks**. This questionnaire's goal is to gather primary data for the study I'm conducting on the aforementioned topic in order to partially complete the requirements for my MBA program at Addis Ababa University. The investigator expresses gratitude ahead of time for your thoughtfulness and the valuable time you dedicated to completing the survey. Feel free to respond without signing your name on the survey, please. All information will be kept private and used exclusively to further the goals of this investigation.

**Thank you for your Cooperation in advance!!**

Segni Teshome (**The researcher**): **0943083303**

**Part One: Personal information**

**Please use this  $\surd$  mark for the following for question to indicate your response.**

1. Gender: Male  Female

2. How Long have you employ in banks?

1-4 Years  4-8 Years  8-12 Years  above 12 Years

3. Your level of education?

Diploma  Bachelor Degree (BA, BSC)  Master Degree  PhD

Other

4. What is your educational back ground (field of study)?

Accounting  gement Marketing

5. From Which Banks Categories?

Large  Medium  Small

**Part Two: Risk management Practice**

Please evaluate the rationale behind the Risk Management Practice evaluation judgments, which pertain to the degree to which banks are in line with the system and are explained below:

(1) Strongly Disagree		(2) Disagree		(3) Natural		(4) Agree		(5) Strongly Agree	
<b>I Risk Understanding</b>									
No	Item	1	2	3	4	5			
1	Everybody at the bank understands risk management in the same way.								
2	There is a proper system for understanding various risks								
3	Responsibility for risk management is clearly set out and understood throughout the bank								
4	Accountability for risk management is clearly set out and understood throughout the bank								
<b>II Risk Identification</b>									
1	The bank carries out a compressive and systematic identification of its risks relating to each of its declared aims and objectives								
2	The bank finds it difficult to prioritize its main risks								
3	Changes in risks are recognized and identified with the bank's roles and responsibilities								
4	The bank is aware of the strengths and weaknesses of the risk management systems of other banks								
5	The bank has developed and applied procedures for the systematic identification of opportunities								
6	It is crucial for bank to apply the most sophisticated techniques for risk identification								

**Fill your confidential ideas For the following question given below**

(1) Strongly Disagree	(2) Disagree	(3) Natural	(4) Agree	(5) Strongly Agree
<b>III Credit risk</b>				
<b>No</b>	Item			
1	The credit risk strategy set by the Board of Directors are effectively transformed and communicated within the bank in the shape of policies and procedures by the top management			
2	The bank has an effective risk management framework (infrastructure, process and policies) in place for managing credit risk			
3	The bank has a credit risk rating framework across all type of credit activities			
4	The bank monitors quality of the credit portfolio on day-to-day basis and takes remedial measures as and when any deterioration occurs			
5	The bank regularly prepares periodic report of credit risk			
<b>IV Market Risk</b>				
<b>No</b>	Item			
1	Market risk management provides a comprehensive frame work for measuring monitoring and managing interest rate foreign exchange and equity			
2	Change in interest rate affects, earning values of assets, liability of balance sheets items and cash flow.			
3	Market Risk Management is high in our banks			
<b>V Interest Rate Risk</b>				
<b>No</b>	Item			
1	In the bank interest rate is measured by duration of time			
2	Interest Rate can have adverse effect on banks earning in economic values			
3	Interest Rate Risk can affect net income of the banks			
4	The level of success in handling interest rate risk in our banks are very high			
<b>VI Liquidity Risk</b>				
<b>No</b>	Item			
1	There is a proper set of rules and guidelines, for managing liquidity risk, available in the bank			

2	The liquidity risk strategy set by the Board of Directors are effectively transformed and communicated within the bank in the shape of policies and procedures by the top management					
3	The bank has an effective risk management framework (infrastructure, process and policies) in place for managing liquidity risk					
4	The bank regularly prepares periodic report of liquidity risk					
5	Applications of liquidity risk management techniques reduce costs or expected losses					

**Part Three: Risk Management technique Practices in purposively selected commercial banks. Please**

**use this √ mark for the following for question to indicate your response**

(1) Strongly Disagree	(2) Disagree	(3) Natural	(4) Agree	(5) Strongly Agree				
No.	Questions	1	2	3	4	5		
1	Risk adjusted rate of return techniques in your banks is used to estimate the capital requirements for market, credit and operational risk							
2	sValue at risk (VAR) techniques is used to measure various risk							
4	Securitization of banks assets and loan is a device for raising new funds and reducing banks risk exposure							
5	Securitization is best techniques to handle risk in case of our banks							
6	The bank’s management regularly reviews the organizations performance in managing its business risk							
8	Our banks use sensitivity Analysis to handle the change that one variable will have on the target variable							
9	The bank’s risk management procedures and processes are documented and provide guidance to staff about managing risk							
10	The Bank’s risk policy encourages training program the area of risk management							
11	The bank emphasizes the recruitment of highly qualified people having knowledge in risk management							
12	Your banks views the supervisory role of the National Bank of Ethiopia (NBE) as critical in risk management							

13	Your bank has internally developed risk management Procedures or guidelines.					
14	The bank is aware of the strengths and weaknesses of the risk management systems of the other banks					

Finally, if you would like to comment or suggest any thing you feel about your bank’s risk management system, please mention it.

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What is your suggestion about the risk exposures in your banks?

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Generally what is your felling about the effeteness of risk management in your banks? Justify your idea briefly

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