

**ENTERPRISE RISK MANAGEMENT PRACTICES
IN ETHIOPIAN PRIVATE BANKS
CASE STUDIES**

*Addis Ababa
University
(Since 1950)*



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SCHOOL OF GRADUATE STUDIES**

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Enterprise Risk Management Practices in Ethiopian Private Banks

Case Studies

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Declaration

I, Samuel Ademe certify that this Project Paper, which I now submit for examination for the award of Executives Masters of Business Administration, is entirely my own work and has not been taken from the work of others and to the extent that such work has been cited it has been acknowledged within the text of my work and it has not been submitted in whole or in part for an award in any other University or Institute.

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17/03/2015

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Signature

Date



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Acronym

NBE	National Bank of Ethiopia
RMP	Risk Management Program
CBSD	Commercial Bank Supervision Directorate
CRO	Chief Risk Officer
LC	Letter of Credit
ERM	Enterprise Risk Management
NPL	Non Performing Loan
BoD	Board of Directors
DB	Dashen Bank
NIB	Nib International Bank
AdIB	Addis International Bank
IRM	Institute of Risk Management
BCI	Business Continuity Institute
COSO	Committee of Sponsoring Organizations
NCO	Net Cumulative Cash Outflow
BCBS	Basel Committee of Banking Supervision
GHOS	Governors and Heads of Supervision
RMU	Risk Management Unit
RM	Risk Management
VP	Vice President



Abstracts

The reluctance of banks to effectively run Enterprise Risk Management program was the concern of NBE for years. This Project paper, therefore, is aimed to explore the practice of Enterprise Risk Management in Ethiopian Private Banks. Currently, there are 16 private commercial banks working in the country, some of which are celebrating their 20 years anniversaries. To represent all the 16 private banks, the researcher grouped them in to three categories. Dashen, Nib and Addis International banks were selected from each category in simple random sampling method. The data was collected through questionnaire and face to face interview. The questionnaires were distributed to Risk Committee members of the Board; senior executives of the bank management; Risk Management Unit personnel and Chief Controller of each bank. The interview was made with NBE's CBSD expert assigned by the Director. The research reveals that the practice is well understood by all stakeholders but is in its infant stage where continuous follow up and development requires.

Key words: Enterprise Risk Management, Risk Management Program, Risk Management Unit, Chief Risk Officer, Credit Risk, Liquidity Risk



Chapter I. Introduction

1.1 Background.

In 2003 National Bank of Ethiopia (NBE) took the initiative to develop the first guideline for preparation of Risk Management Program (RMP) and disseminate same to some selected banks operating in the country as a pilot program.

In November 2009 the NBE conducted the survey on risk management practices of 15 banks working in the country at that time, to identify the status of their risk management practices and to forward recommendations to address weaknesses observed.

Based on the survey result NBE:

- ✚ Has revised the existing risk management guideline, with emphasis on **Credit, Market, Liquidity & Operational** risks, and issued it in 2010 to all banks.
- ✚ At the same time it required all banks to develop their own RMP based on the guideline. Individual banks also having the right to scan their environment to identify additional risk factors, analyze them, and prepare their mitigating measure since the guideline only served as a baseline.
- ✚ It also required the banks to present the RMP to NBE's Commercial Bank Supervision Directorate (CBSD) Officials and pass a walkthrough test to get it approved. Accordingly most banks had done as requested by NBE.



- ✚ NBE also recommended the need of establishing a Risk Management Unit (RMU) which will entirely be involved in risk management function and preferably accountable to the Board of Directors. According to the statement of one of the NBE's CBSD official, almost all banks have set this unit in their organizational structure and appointed individuals to run the unit. But, according to this Official, some banks make the Chief Risk Officer (CRO) accountable to the president instead of to the Board and most units are a one man Department doing almost nothing.

Banking industry in Ethiopia has a history of more than 100 years. In 1905 the National Bank of Egypt, which was owned by British nationals, established the first Ethiopian bank as Bank of Abyssinia. This bank, though it was private, had a 50 years contractual agreement with Ethiopian government to issue currencies in addition to its commercial banking services. (Mihiretab et al, 2010)

Since the establishment of the first bank, the banking industry in Ethiopia has passed through different ups and downs being affected by the regimes of the Monarchy, the Italian invasion, the Derg Juntas and EPRDF, details of which were stated here and there by different scholars. Today, along with the three government owned banks, 16 locally owned Private Commercial Banks are working in Ethiopia.



1.2 Statement of the problem

Doing a business in general, involves full of uncertainty that negatively or positively affects the objectives of the organization. in the case of banking business specially, certain events may not only affect the respective individual bank involved, but also other banks working in the system, be it national or international, that can call-up-on governments' interest in controlling the risks that commercial banks faces. Therefore, proactive (not reactive) measures of risk management actions became mandatory to sustainably stay in the business and to run the banking business internationally through Letter of Credit (LC) arrangements and the like.

However, though NBE takes the initiative to establish a risk management program in all banks working in the economy by giving more emphasis on Credit, Market, Liquidity & Operational risks, most banks are either do not undertake the program at all or fail to do so on a full-fledged basis (Director, CBSD, 2014).

If proactive risk management practices are mandatory for commercial banks of Ethiopia to be reputable business partner internationally and thereby sustainably make profit, and if their performances are not satisfactory in the eyes of the regulatory body – NBE, then more must be known about the status and why Ethiopian commercial banks are reluctant to undertake proactive structured risk management practices – Enterprise Risk Management (ERM).

Therefore, the purpose of this study is to qualitatively examine the current practice of private commercial banks in undertaking an Enterprise Risk Management.



1.3 Research Questions

This study tries to address the following research questions in the process of adapting structured risk management practices in the private commercial banks.

1. What is the rationale behind the NBE in demanding Commercial Banks to develop their own Risk Management Program?
2. What initiates Board of Directors & Top Management to manage bank risks proactively instead of taking reactive measures after risks are materialized?
3. What do the compliance of targeted banks look like to the regulatory body's directives, regarding risk management practices?

1.4 Objectives of the study

1.4.1 General Objective

The general objective of this study is to assess the level of commitment of Ethiopian private commercial banks towards using ERM Program and to review the advantages and disadvantages of adapting structured proactive risk management practices in Ethiopian banking industry and reveal the extent of their involvement in risk management function.



1.4.2 Specific Objectives

- ✚ Assess the rationale /real motive/ of NBE in demanding banks to implement RMP in their activities;
- ✚ Assess the initiative of Board of Directors & Top Management in managing the bank risks proactively instead of taking reactive measures after risks are materialized;
- ✚ Asses the compliance of targeted banks to the regulatory body directives regarding risk management practices;
- ✚ To conclude and recommend possible way outs for any problem observed in the practice banks handling inherent risks.

1.5 Significance of the Study

Risk management is a common practice of modern business. Especially, banks need to assess their environment and mitigate negative risks and enhance positive risks that have impact on their long and short term objectives. This study is therefore significant to:

1. **NBE** – that it will help to understand how commercial banks perceive the initiative of the Bank in requiring them to adapt the risk management practices and take measures accordingly.
2. **Respective commercial banks** – will see and compare the merits and demerits of practicing ERM Program to the sustainable growth of the banks.



3. **Government** – it will help the government to set policies regarding banking operation.
4. **Scholars** – it will initiate further researches over banks enterprise wide risk management practices.

1.6 Scope of the Study

The study focuses on the following three private banks that are selected randomly from three groups i.e. from those established very early – about 20 years ago, in the middle and very lately.

- 1) Dashen Bank (DB) - 1995,
- 2) Nib International Bank (NIB) - 1999,
- 3) Addis International Bank (AdIB) – 2007.

by giving more focus to credit and liquidity, risks of banks as the former encompasses all other risks of banks and the later if happened will result in bankruptcy of the bank and endanger other banks through systemic behavior of the risk.

1.7 Limitation of the Study

- ✚ The study focusing on BoD – risk committee, top management members, specially the President and Vice Presidents, Chief Risk Officer and risk management unit staffs and Internal Audit Head (Controller) and CBSD of NBE, who do not have time to entertain my queries.



- ✚ In some banks, their board and top management members were unable to fill my questionnaires,
- ✚ All banks were not willing to provide me their three years data regarding NPL and foreclosures and NBE was also not willing to give me the industry aggregate except from the aggregate Balance Sheet and Income Statement,
- ✚ Adequate literature was not available especially in the context of banks.

1.8 Organization of the Paper

The paper has four chapters. The first one deals with introductory part. The second chapter shows what literatures say about ERM practices in financial sector in general and banking industry in particular and the role of regulatory bodies over risk management practices. The third chapter deals with the analysis of the data collected regarding the risk management practices of Ethiopian private commercial banks and finally the fourth chapter summarizes the paper and gives some recommendations.



Chapter II. Literature Review

‘A Ship is safe in harbor, but that is not what ships are for.’

- William G.T, Shedd

2.1 Introduction

Literature review is a milestone in a research study as it accomplishes several issues. As per Creswell J., (2003) as cited by Abdulhamid Yusuf, (2013) Literature review shows what literatures say about the subject under consideration, what other studies reveal or failed to reveal regarding the subject by filling in gaps and extending prior studies (if any).

This chapter deals with the theoretical framework in which the practice of Enterprise risk management developed. It tries to show definitions, concepts ERM and conceptual framework of the study.

2.2 Theoretical Framework

2.2.1 Risk Definition

In the older time the term ‘Risk’ refers to the situation where there is the possibility of something bad happenings (Kate Woodford, et al, 2003). Oxford English Dictionary also defines risk as “a chance or possibility of danger, loss, injury or other adverse consequences”. The above definitions show that the former understanding of risk more emphasizes the negative part only. Now days, however, taking risk can also result in a positive outcome (Paul Hopkin, 2010). Hence risk is an event where both positive and negative outcomes might happen.



Different institutions and organs had defined Risk in different ways among them the most popular according to Poul Hopkin, (2010) are:

1. The definition given by the Institute of Risk Management (IRM) states that "Risk is the combination of the probability of an event and its consequence, where, consequence can range from positive to negative".
2. The other definition is that of ISO 31000 or ISO Guide 73. It defines risk as "Effect of uncertainty on objectives". This definition is somehow very brief which requires clarification as for example 'effect in this case may be positive, negative or a deviation from the expected (Poul Hopkin, 2010) which denote opportunity, Hazard and uncertainty respectively.
3. Institute of Internal Auditors also defines risk as "the uncertainty of an event occurring that could have an impact on the achievement of the objectives". It also state that risk is measured in terms of consequences and likelihood (Poul Hopkin, 2010).

In any way the definition of the term 'risk' shifts from the indication of negative aspect to an event where both negative as well as positive happenings might occur.

To identify any risk, be it positive or negative, first there must be an objective. Say for example, Ato Kebede lives in Addis and has no intention to go to Nazareth in a given particular day. The meteorology, however, forecasted in that particular day that the weather of Nazareth will be a rainy day. Ato Nasir lives at Nazareth, who sells cloths in open market for a living and has a plan in that



particular date to takeout his merchandise to the market. The forecast is, therefore, has nothing to do with Ato Kebede but it maters very much for Ato Nasir. (Adapted from the example given by Dr. David Hillson at Munich in June 2006)

2.2.2 Types & Classification of Risks

The commonly known types of risks are '**Pure**' and '**Speculative**' risks, where by the pure risk can be transferable and the latter will not. Others, however, indicate the third type of risk as '**control**' or '**uncertainty**' risk which is defined as "risks that cause doubt about the ability to achieve the mission of the organization" (Poul Hopkin, 2010). Control or uncertainty risk is a risk of deviation from the anticipated benefits of a project in time, budget and quality. Therefore, as indicated on Poul Hopkin (2010) control management is concerned with reducing the uncertainty associated with significant risks and reducing the variability of outcomes. However, there is no 'right' or 'wrong' subdivision of risks as different scholars in different disciplines classify risk differently (Poul Hopkin, 2010). Therefore, each and every organization should classify its own risk based on the risk classification system that suits them best (Poul Hopkin, 2010).

2.2.3 Risk Management

The future cannot be precisely predicted and no one has ever been successful in forecasting all types of risks with their major financial implication (Michel et al, 2006). But every organization can be affected by risks with potential impact (Giancarlo Nota, 2010). Therefore, in order to minimize the negative consequences of risks and enhance the positive once in achieving the objectives of the



organization as stated by Michel et al, (2006) organizations should try to manage the financial risk that arises from uncertainty. And this is according to Michel et al, (2006) what distinguishes the modern economies from those of the past.

2.2.4 Historical Development of Risk Management

Risk Management is originated in the United States out of the insurance management (Poul Hopkin, 2010). In 1950, due to measures taken by the insurance companies, the cost of insurance increased tremendously while the coverage of perils decreased. This called organizations to realize that, they should not only be relied on transferring risks to insurance companies, as the coverage was not only insufficient to handle all their risks specially related to health and safety, product liability issues and other risk control concerns but also it was not economical (Poul Hopkin, 2010). Furthermore, as stated before, insurance can only be used for the portion of hazard risks. Therefore, risks related to finance, commercial, marketplace and reputational issues are recognized as being hugely important but outside the historical scope of insurance (Poul Hopkin 2010) and hence risk management has become a must.

2.2.5 Definition of Risk Management

Similar to that of risk, different institutions and standards define risk management in their context. The following are some of these definitions sited by Giancarlo Nota, (2010):



IRM:

"Risk Management is a process which aims to help organization understand, evaluate, and take action on all their risks with a view to increasing the probability of success and reducing the likelihood of failure."

Business Continuity Institute (BCI):

"Risk Management is a culture, processes and structures that are put in place to effectively manage potential opportunities and adverse effects".

COSO (Committee Of Sponsoring Organizations of the Treadway commission):

"Risk Management is a process, affected by an entity's board of directors, management and other personnel, applied in strategy setting and accrues the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regard in the achievement of entity objectives".

2.2.6 The Process of Effective Risk Management

Hopkin, (2010) indicates that historically, the term risk management has been used to describe an approach that was applied only to hazard risks. Hence, IRM develops the following model, which is called **7Rs & 4Ts** of Hazard risk Management (Poul Hopkin, 2010). Gradually, however, it is developed to cover the improved management of control risks and opportunity risks.

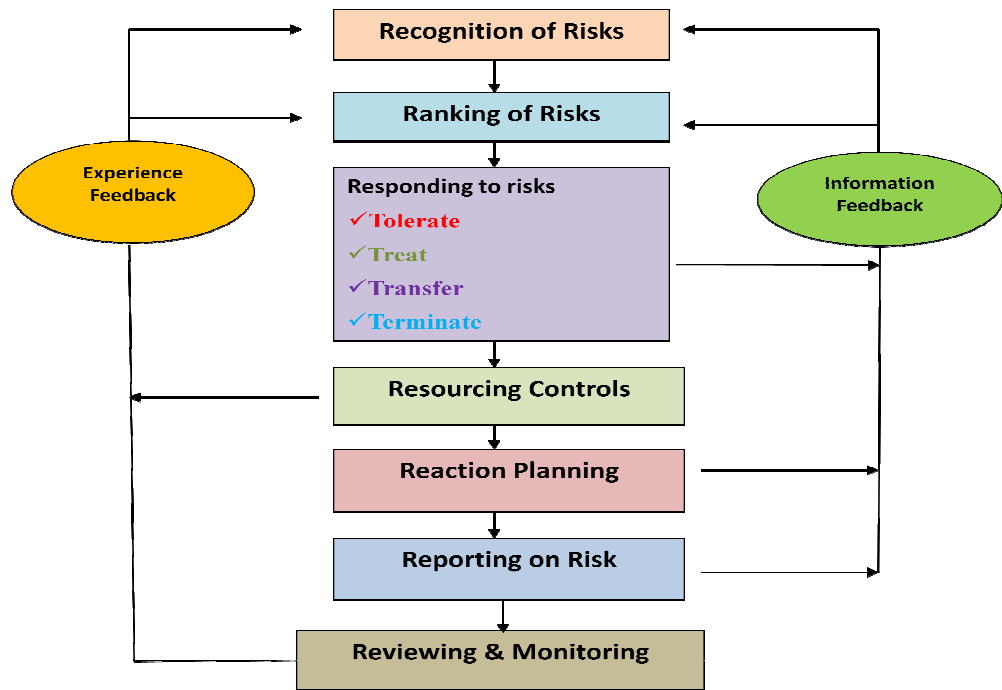


Figure: 1 7Rs and 4Ts Hazard Risk Management Model

The first step, according to this model is **Recognizing** the risk or identification of risks along with its nature and the circumstances in which it could materialize. After recognizing the risk that has impact in our objective the second step is **Ranking** or evaluation of risks in terms of magnitude and likelihood to produce the 'risk profile' that is recorded in a risk register.

As resources are limited, it is not possible to handle all identified risk, therefore **Responding** to significant risks is the third step that include the decisions on the appropriate action regarding the following options:

- tolerate;
- treat;
- transfer; and
- terminate.

Which are normally referred to the model as the 4Ts.



Resourcing controls to ensure that adequate arrangements are made to introduce and sustain necessary control activities which will then follow as the fourth step. Then after, **Reaction**, which means planning and/or event management; **Reporting** and monitoring of risk performance, and **Reviewing** the risk management system, including internal audit procedures and arrangements for the review and updating of the risk architecture, strategy and protocols are the fifth, sixth and seventh steps respectively.

When we come to Ranking, different scholars use different approaches to denote the degree of severity of identified risks. Some group classify risks into five while others into four but, the most common one is to categorize all risk issues in to three groups that use the traffic light system Red, Yellow and Green. The **Red** means 'stop' it is either bad threat or great opportunity; therefore, priority should be given to these risks. **Yellow** indicates 'be careful' 'think twice before you act' that indicates management should monitor these risks as situation may convert them to red or green. And the **Green** one indicates to hurry up as there is none or minimal danger or opportunity – management can seldom review them for their status. (Taken from the lecture of Dr. David Hillson at Munich in June 2006)

As we have discussed earlier, risk can be positive or negative, which means we have to prepare two Probability Impact Matrix, one for the **Threat** that results negative impact and one for the **Opportunity** that results positive impact. By putting these two matrices in a mirror wise as Hillson, (2006) puts it, we will get to the following figure that puts our focus in between.

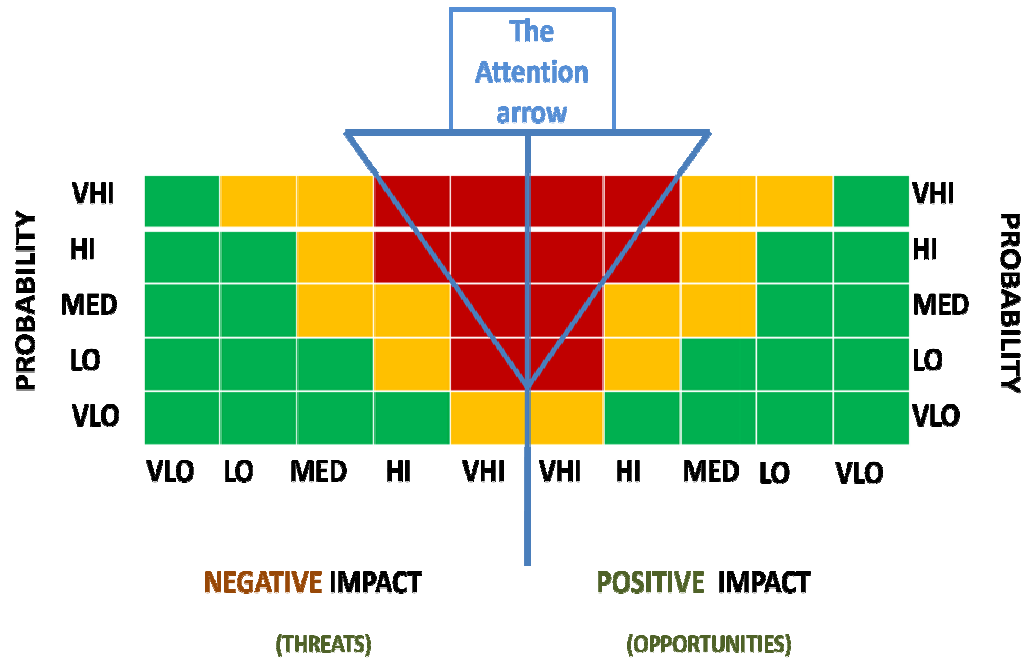


Figure: 2 The “Mirror” double P-I Matrix

Source: Dr. David Hillson, PMP, FAPM, FIRM presentation power point

2.2.7 Benefits of effective risk management

Effective risk management helps a company to reduce the negative and enhance the positive impacts of risks and thereby assist the company to sustainably stay in business.

A company that has effective risk management can make informed decisions; can increase the likelihood of successful risk taking, i. e. exploiting opportunity risks; can protect its reputation/ goodwill; can improve the quality and reliability of its products and services; can increase the likelihood of achieving strategic goals or objectives; can reduce costs and/or increase profits; can reduce failure or downtime;

and above all can properly utilize competitive advantages (Andy Osborne, 2012).

2.2.8 Kinds of Risks

Different organizations face different kinds of risks depending on their purpose and objectives. The following diagram shows common kinds of risks found in most organizations.

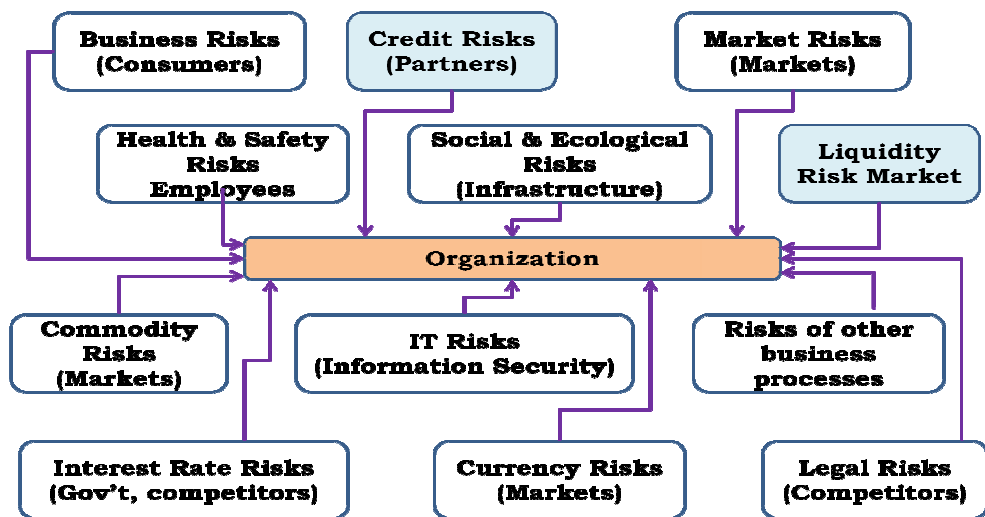


Figure 3. Different risks and standards facing an organization (Source: adapted from Nikonov & Kogan, 2009)

Nikonov & Kogan (2009), as cited by Giancarlo Nota (2010), considers that although the organization administrates different risk types, the structure of risk management is the same everywhere and a unique standard can contribute to decreasing the risk of “too many risk standards”. Therefore, it is not a wise advice to consider all types of risks indicated in the above figure.

Different scholars argued that even if the application of risk management is widely spreading aggressively, it doesn't prevent the



market disruptions and business accounting scandals observed in 1998, 2002 & 2008. (Michel Crouhy et al 2006 and Poul Hopkin 2010) But, according to Hopkin (2010) the failure was a failure in correctly applying risk management processes & procedures. Therefore, as long as organizations carefully undertake each step in risk management process, they will definitely benefit from Risk Management.

The traditional risk management evolves to an enterprise wide risk management (ERM) which focuses on the core existence of an enterprise and review all stakeholders role towards the effective achievements of the core process.

On the other hand, it will be dangerous if one involves extensively in risk management as it will prevent entrepreneur decisions. Hopkin (2010) stated its damages as:

"When an organization becomes obsessed with risk, there will be over-dependence on process and this may limit the ability to manage risk effectively. There will be over-reliance on information at the expense of good judgment, and dependence on process to define the rationale behind decisions. Individuals may become risk averse for fear of criticism and procedures are followed only to comply with requirements, not because benefits are sought".

2.2.9 The Basel Committee

Basel is a city in northwestern Switzerland, situated on the highest navigation point of the Rhine with a population of less than two hundred thousand as per 2005 estimate (Encarta, 2008). The name of the city is attached with one renowned committee when we talk regarding the risk management of banking industry.



During the last days of the Second World War, representatives of 44 nations set up IMF and International Bank for Reconstruction and Development in Breton Woods conference, which is named after the name of a resort that hosted the conference at New Hampshire. The conference had set a system that manages to stabilize the exchange rate worldwide, which was functional until 1973 (Encarta, 2008).

Following the breakdown of the Breton Woods system, some banks were closed in 1974 sustaining heavy exchange rate loss (BCBS, 2013) and other banks working with these banks also hurt due to their closure. In response to these disruptions Central Bank Governors of the G10 Countries established a Committee on Banking Regulation and Supervisory Practice, which was latter called the Basel Committee on Banking Supervision (BCBS).

Since its establishment in Feb. 1975, BCBS promotes to enhance financial stability by improving supervisory know how and the quality of banking supervision worldwide. The member countries increase from ten to twenty seven in almost 35 years period. The committee, which is accountable to Group of Central Bank Governors and Heads of Supervision (GHOS), get comments from observer countries in developing standards.

BCBS developed the first standard, which is commonly referred to as Basel I or Basel Capital Accord or simply the 1988 Accord that focuses on Capital Adequacy of Banks. Then, in June 1999 the Committee issued a proposal for a New Capital Adequacy framework to replace the 1988 accord, which was released in June 2004 as 'Basel II'. Now the committee is introducing and enforcing different standards following the endorsement of Basel III by the G20 leaders in Nov. 2010 at Seoul.

2.3 Empirical Review

As indicated in the 'limitation of the study', the researcher managed to find only one study conducted in risk management. The study was done by Endalkachew Wedaje in 2007 under the title "Risk Management in Commercial Banks in Ethiopia (a case study of CBE). However, the study solely focuses on how Credit Risk was handled in the bank and the impact was shown as a result.

2.4 Conceptual framework

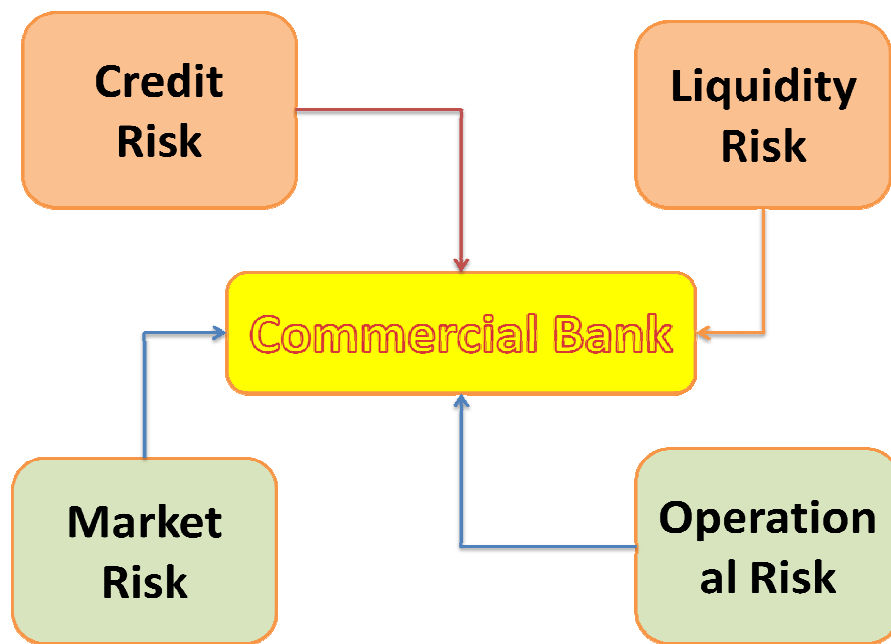


Figure 4 Risks affecting Commercial Banks

Significant risks affecting the Banking Business

As shown in figure 4 above inherent risks that are found in the banking business according to NBE (2010) are Credit Risk, Market Risk, Liquidity



Risk and Operational Risks. Among them, the researcher focuses on Credit and Liquidity Risks which have significant impact on the performance of any Bank.

2.4.1 Credit Risk

According to Bassis, (2002) Credit Risk is the potential loss in the event of default of a borrower, or in the event of deterioration in credit standing. For banks, credit risk is among the first risks being handled cautiously, as its management is an integral part of the loan process (Musyoki et al, 2012). Due to mismanagement of this risk and failure to collect loans granted to customers has been the major factor behind the collapse of many banks around the world (NBE, 2010). That is why the first capital adequacy accord of the Basel Committee, which commonly referred to as the Basel Capital Accord called for a minimum capital ratio of 8%, which is the ratio of capital to Loan receivable i. e. credit risk, by the end of 1992.

In the early years, credit risk is related to borrowers, individual firms or financial institutions (Bassis, 2002) nowadays, however, it is treated in a structured way as different covenants ruling the life of the structure (Bassis, 2002). The purpose of credit risk management is, therefore, to maximize a bank's risk adjusted rate of return through the means of keeping the risk exposure within acceptable range (Musyoki, et al 2012).

When we talk about credit risk, we need to discuss about its four major drivers (Bassis, 2002).

1. The first one is "**Exposure**", as per Bassis, (2002) it refers to the amount of money at risk. Here, what will be considered is the



concentration of loan provided to a single sector. Credit risk management, therefore, imposes limits to exposures by firm, industry or region.

2. The second driver is the “**default probability**”, which refers to the probability of default occurs during a given period. According to Bassis, (2002) it varies from a payment after few days delay from the due date to bankruptcy or restructuring which may result in major failure of payment obligations. And the percentage of default probability varies accordingly.
3. **Migration** is the third driver of credit risk. As per Bassis, (2002) it is the probability that a firm migrates from one risk class to any other. This move, will either deteriorate or improve the credit standing of the obligor. A migration to any state other than default doesn't trigger loss, whereas under default, the loss materializes and it will be the amount of risk less recovery.
4. The fourth driver is **Recovery**, which refers to the guarantees secured for a given loan. It can be in the form of:
 - a. **Collaterals** – assets seized by the lender if the borrower defaults;
 - b. **Third-party protections** – where the third-party agrees to provide a payment to the lender under default from the part of the borrower.
 - c. **Covenants** – contractual clauses such as maximum debt cover ratio or a legal obligation not to diversify away from the core business. Breaches of covenants trigger an obligation of prompt payment.



2.4.2 Liquidity Risk

Unlike Credit Risk, Liquidity Risk is a secondary risk. That is, as per Neu et al, (2007), before increase in liquidity risk, a Bank should face a severe loss due to one or more other financial risks like market, credit or operational risks, and hence it is a consequential risk.

Normally it is hard to believe that a bank that usually does for the liquidity of the economy will face liquidity problem by itself (Neu et al, 2007). That is why its adequacy determination is subjective and very difficult task (NBE, 2010).

The purpose of Liquidity management in financial institution is to ensure that the organization fully meets its financial/ contractual obligations (NBE, 2010). Therefore, in managing liquidity risk, the aim is to meet the net cumulative cash outflow (NCO) within a certain time period. That is, to keep the liquidity risk under control the cash inflows which could be generated from the transaction in a given time should exceeds the NCO of same period.

The ability of a bank to bear liquidity risk according to Neu is linked to the amount of Capital it possesses and the losses it can absorb; but one can happen without the other (Neu et al, 2010). Therefore, according to Neu, capital may not be an appropriate buffer in a liquidity crisis situation.

Though, liquidity risk is a consequential loss and rarely happens, its effect affects not only the individual bank but also all other banks working in the system. Therefore, the liquidity risk analysis must be made under different bank – specific and market – systemic scenarios (Neu et al, 2010).



Chapter III. Research Methodology

The research methodology is all about steps taken to conduct the study including the way it was designed, the approach used, the type of research method chosen, about method of sampling employed, the way data are collected and analyzed, etc. (Sekaran, 2003)

3.1 Research approach

Due to unavailability of data related to NPL and Foreclosure, the impact analysis of Credit and Liquidity risks could not be done. Therefore, the research study regarding the interest of private commercial banks of Ethiopia towards the adaption of ERM was conducted using only exploratory research methods, which is based on qualitative research approaches.

3.2 Sampling Design

Random sampling technique was used to select the three banks among the sixteen private banks working in the industry. However, in order to represent the diversity of all banks working in the industry, the researcher groups these banks into three categories based on their time of establishment and randomly choosing one bank from each category. Accordingly:

- Dashen Bank (DB) was among the first private banks established in Ethiopia as of the 1991 change of government and its subsequent economic reform. It was established on September 1995, one year after the “Licensing and Supervision of Banking Business Proclamation No. 84/1994” of Ethiopia, and commenced its operation on 1st January 1996. (www.Dahenbanksc.com)



- Nib International Bank (NIB) on the other hand showed up in October 1999 after about half of the current banks were established (www.Nibbanksc.com); while
- Addis International Bank (AdIB), which was established in 2007, is among the youngest banks in Ethiopian Banking industry (www.Addisbanksc.com).

3.3 Target Population

After banks are chosen on strata random sampling, the target population for questionnaire and interview question were identified based on their position relevance to risk management activities. Accordingly, all Risk Committee members of the Board, and top management members (specifically the President and VPs) of the selected banks along with their CRO and her/his RMU staff and the Controllers were considered as the target population of the research. In addition to this, CBSD Director was a target point for the interview prepared to understand the policy related issues of the NBE/ Government.

3.4 Method of Data Collection

Questionnaire and structured and unstructured interview questions were used to gather primary data for the analysis.

The questionnaires were distributed to board of directors, top management members, Chief Controller & CRO and RMU staffs of the selected commercial banks. And the interview was made with the appointee of the Director of the CBSD of NBE.



3.5 Research Instrument

The questionnaire was the main instrument used for the study. The questionnaire was developed in such a way that it can be manipulated using likert scale. The questionnaire has two parts. The first part asks for general information about the person who fills the questionnaire. The second part deals with the main study. There are 30 questions arranged in three parts. The first part (21 questions) assesses the initiative and commitment of BoD and Top management of Banks in the issues of Risk management. The second part (7 questions) assesses how far these banks are incompliance to the requirement of the NBE. And finally the third part (the last 2 questions) asks for the perception of BoD and Top management of these banks about the initiative of NBE in promoting the practice of ERM in commercial banks.

Structured interview questions were prepared for CBSD Director of NBE to understand the stand of the regulatory body regarding the ERM practices of Commercial banks.

Unstructured interview was made with the CRO and Controller of Dashen Bank to clear some points that were not properly addressed in the questionnaire.

3.6 Data Analysis method

The results of the questionnaire were analyzed with Likert scale using SPSS software. The correlation of Credit and Liquidity risks with the profitability of the bank and reduction of NPL, however, was not done due to unavailability of related data.



3.7 Validity and Reliability issue

In order to test the viability of the questionnaire, the researcher got comments from the Chief Risk Officer of CBE and other staff of RMU of the Bank on the draft questionnaire, before distributing it to the targeted respondents.

The work capacity and work experience of the respondents were considered in the analysis of the result of the questionnaire. Therefore, the validity and reliability of this study has been ascertained.

3.8 Ethical Issue

The study respects the rights and confidentiality of the banks and their higher officials who participated in the study through filling out the questionnaires and answering the interview questions. The study also considers prohibitions against fabricating, falsifying, or misrepresenting research data, and it promotes the truth and avoids error.



Chapter IV. Result Analysis

4.1 Introduction

This chapter is the final part of the research paper. It involves making sense of data gathered. In qualitative research, like this one, more focus is given for understanding the phenomena rather than predicting or interpreting (Anol, 2012).

This research was based on primary data, which, was collected through questionnaires and face to face interview.

The questionnaire was developed by three general and thirty detailed questions (Annex A) distributed to board audit committee members; top management (President and VP positions) members; CRO and Chief Internal Auditor/ Controller; and all technical staff of (RMU). Accordingly, as shown in table 3.1, 38 questionnaires were distributed to the selected private banks and 32 of them were collected. The response rate was more than 84%. And when we took out the vacant CRO position at NIB the response rate rose to more than 86% which was by far more than acceptable, commonly, the response rate of paper based questionnaire is 56% (Duncan, 2008).

Table: 3.1 Target population and response rate

Target position	NIB	Dashen	AdIB	Total	Returned	
Board risk Committee	3	3	3	9	7	78%
Top Mgt. (President and VP only)	4	4	4	12	11	92%
Controller/ Chief Internal Auditor	1	1	1	3	2	67%
Chief Risk Officer (CRO)	1	1	1	3	2	67%
Tech. staff of RM unit	4	5	2	11	10	91%
Total	13	14	11	38	32	84%
Returned	11	11	10			



Regarding experiences of respondents, as shown in table 3.2, 25 out of 31, who indicated their experiences, had more than 3 years of work experience directly or indirectly related to risk management functions that constitutes more than 80%. On the other hand, the technical staff of RMU, who were only 6% had less than 1 year of experience. Hence, the research will consider this fact in analyzing the detailed questions.

Table: 3.2 Respondents years of experience in RM related jobs

Position	<1 year	1 - 2 years	3 - 5 years	> 5 years	Total
Board of Director risk Committee	0	1	4	2	7
As top Management member	0	0	4	6	10
As Chief Internal Auditor/ Controller	0	0	0	2	2
As Chief Risk Officer	0	0	0	2	2
As staff of Risk Management Unit	2	3	4	1	10
Total	2	4	12	13	31

The interview, on the other hand, was made with the principal expert who was assigned by the Commercial Banking Supervision Directorate Director of NBE (see interview questions in annex B). The response of the expert, for this research, is considered as Government policy.

4.2 The initiative and commitment of BoD and Top Management

In order to assess the commitment that the target group has in the aggregate risk management and the support they are providing for the success of the RM unit the questionnaire raises different questions from different perspectives.

4.2.1 To test attitude

Questions like those that ask about their understanding of the difference and similarity of Enterprise Risk Management (ERM) and that of traditional RM practices; their rating of the importance of ERM and RM unit to the success of the Bank were raised. Accordingly:

I know and understood what Enterprise Risk Management (ERM) is and its similarity and differences with the traditional risk management issues.

Table 3.3 Understanding of ERM

Position	S	A	N	DA	SDA	Total
• As Board Director accountable for risk management oversight	3	4	0	0	0	7
• As top Management member	5	5	1	0	0	11
• As Chief Internal Auditor/ Controller	0	2	0	0	0	2
• As Chief Risk Officer	2	0	0	0	0	2
• As staff of Risk Management Unit	1	7	2	0	0	10
Total	11	18	3	0	0	32

As can be seen from the table above, 90% $((11+18)/32)$ of respondents know what ERM is and how it is differentiated from traditional RM and the rest are neutral.

As shown in Table 3.4 and Table 3.5, all respondents rate the importance of ERM as either extremely important or important. No respondent said it was not important or put himself in between the two extremes. Regarding the importance RMU too, about 94% of the respondents did not support the idea of managing risks individually and opts for the establishment of RMU.

Table 3.4 Importance rating of ERM for a bank

Is ERM important for the bank?	Count	Percent
• Extremely important	17	53.1
• Important	15	46.9
• Neither Nor	0	0
• Trivial	0	0
• Extremely Trivial	0	0
Total	32	100.0

Table 3.5 Rating the importance of RMU establishment in banks

Risk management is the responsibility of all individual functional units and hence independent risk management unit is not necessary.	Count	Percent
• Strongly Disagree	8	25
• Disagree	22	68.8
• Neutral	0	0
• Agree	1	3.1
• Strongly Agree	1	3.1
Total	32	100.0

Regarding Credit Risk, More than 93% respondents know that the behavior of borrower is a very determinant factor for Credit Risk. The individual loan portfolio and the financial exposure to other party, follows in their order in affecting the Credit Risk.

Furthermore, respondents ranked the impact of Credit risk based on their significance. Accordingly, its impact on NPL; over the profitability of the Bank; and on the Liquidity position of the Bank, takes the lion share. (See Table 3.6 and 3.7 below)



Table 3.6 Major causes of Credit Risk

The major causes of Credit Risk in banking industry	Yes Responses	
	Count	Percent
<ul style="list-style-type: none"> • The potential that a borrower will either be unwilling or unable to perform on an obligation in accordance with agreed terms; 	29	93.5%
<ul style="list-style-type: none"> • The financial exposure resulting from a bank’s dependence on another party to perform an obligation as agreed; 	14	45.2%
<ul style="list-style-type: none"> • The entire portfolio or from individual loans or transactions; 	20	64.5%
<ul style="list-style-type: none"> • Other assets and activities i. e. not confined in its loan portfolio only; 	2	6.5%
<ul style="list-style-type: none"> • Other 	1	3.2%

Table 3.7 Impacts of Credit Risk

The likely impact of Credit Risk	Yes Responses	
	Count	Percent
<ul style="list-style-type: none"> • Has direct impact on NPL. 	30	93.8%
<ul style="list-style-type: none"> • Has direct impact on the number of foreclosure. 	22	68.8%
<ul style="list-style-type: none"> • Has direct impact over the profitability of the Bank. 	29	90.6%
<ul style="list-style-type: none"> • Has direct impact on the activities of the bank with other banks and institutions. 	16	50.0%
<ul style="list-style-type: none"> • Has direct impact over its reputation. 	26	81.2%
<ul style="list-style-type: none"> • Has overall impact on sustainable growth of the bank. 	26	81.2%
<ul style="list-style-type: none"> • Has direct impact on the Liquidity position of the Bank. 	28	87.5%



In the same way respondents also expressed what Liquidity risk is all about. Accordingly, they gave priority to “the inability to meet cash flow obligation”; “capital inadequacy” and “systemic risk” that will cause Liquidity risk, in their order. (See Table 3.8) This shows that it is consequential risk that derived from other big or small materialized risks.

Table 3.8 Major causes of Liquidity Risk

The causes of Liquidity Risk in banks.	Responses	
	Count	Percent
<ul style="list-style-type: none"> • The potential for loss to the bank arising from either its inability to meet obligations as they fall due or to fund increases in assets without incurring unacceptable cost or losses; 	25	80.6%
<ul style="list-style-type: none"> • Inability to meet cash flow obligations; 	30	96.8%
<ul style="list-style-type: none"> • Liquidity short fall at a single bank can have system-wide repercussions; 	19	61.3%

Regarding the impact that this Liquidity risk bring about, the majority of respondents agreed that it has an impact over sustainable growth of the bank; its reputation; its profitability and its relationship with other banks and institutions. See Table 3.9

Table 3.9 Impacts of Liquidity Risk

Impact of Liquidity Risk	Yes Responses	
	Count	Percent
<ul style="list-style-type: none"> • Has direct impact on NPL. 	3	9.4%
<ul style="list-style-type: none"> • Has direct impact on the number of foreclosure. 	1	3.1%
<ul style="list-style-type: none"> • Has direct impact over the profitability of the Bank. 	27	84.4%
<ul style="list-style-type: none"> • Has direct impact on the activities of the bank with other banks and institutions. 	25	78.1%
<ul style="list-style-type: none"> • Has direct impact over its reputation. 	29	90.6%
<ul style="list-style-type: none"> • Has overall impact on sustainable growth of the bank. 	31	96.9%



As shown on Table 3.10 and 3.11, 87% of respondents said that Credit and Liquidity risks had been treated prior to the establishment of RMU. And 75% of them said that they were handled by executive committee from top management of the bank and individually by Credit and Finance Department. This shows that these risks were being handled by Banks, even if, risks were not treated in aggregate.

Table 3.10 Prior experience in controlling Credit and Liquidity Risks

Do Credit and Liquidity risks, among others, be treated at your bank prior to the developments of RMP as per the guideline given from NBE?	Count	Percent
Yes	28	87.5
No	2	6.2
Missed	2	6.2
Total	32	100.0

Table 3.11 The way Credit and Liquidity Risks were handled prior to the establishment of RMU

If Credit and Liquidity Risks were treated prior to the development of RMP, how was it done?	Count	Percent
<ul style="list-style-type: none"> The board was responsible to assess and develop measures to mitigate the risk exposure. 	3	9.4
<ul style="list-style-type: none"> The executive committee of the Bank takes the responsibility of assessing and developing measures to mitigate the risk. 	13	40.6
<ul style="list-style-type: none"> Risks are assessed and possible measures were taken to mitigate the impact of the risks individually i.e. Credit Department regarding Credit risk and Finance Department regarding the liquidity risk. 	11	34.4
<ul style="list-style-type: none"> Missing System 	5	15.6
Total	32	100.0

Regarding the issue of undertaking the responsibility to organize RMU, as shown in Table 3.12, 66% of respondents said it was undertaken by BoD and 16% said it was undertaken by the President and others, except one, said it was undertaken by different organs of the bank. One respondent missed this question.

Table 3.12 Organizer of RMU

Who took the responsibility of organizing the risk management unit?	Count	Percent
Board of Directors	21	65.6
The President	5	15.6
Executive Management	2	6.2
Other	3	9.4
Missing System	1	3.1
Total	32	100.0

On the other hand, as shown in Table 3.13, about one third of the respondents believe that, if it hadn't been the requirement of NBE, their bank won't establish the RMU.

Table 3.13 Rating of commitment to establish RMU without NBE's Requirement

If it was not for NBE requirement, do you opt to establish the risk management unit in your bank?	Count	Percent
YES	22	68.8
NO	9	28.1
Missing System	1	3.1
Total	32	100.0

From these facts, we can conclude that there is no gray area as to the understanding of ERM and its importance for the success of a Bank and clearly supports the establishment of RMU to handle the risk management function. These facts go along with the stand of NBE that requires the understanding of



ERM and managing bank risks in aggregate. And the right body (BoD), From NBE point of view, took the responsibility of organizing the RMU. But it required much effort to bring back the observed non supporters in to track.

4.2.2 To test support

In order to test the support that the bank is giving for the successful risk management activities, a direct question with possible answers were given, from which respondents can choose more than one answer. According to their response shown in table 3.14 below, the bank is supporting its RMU; by structuring it under the BoD; by setting up competent RM team; by appointing the right person to the position of CRO; by allocating enough budget and resources and through obeying to the RM policy and procedure of the Bank. But most of them didn't agree that banks gave training to the technical staff of the RMU and that the RMP of the bank were updated regularly.

Table 3.14 Supports given to RMU

How your bank supports its RM unit?	Yes Responses	
	Count	Percent
• Structuring the risk management unit next to the President level and accountable to the Board	25	78.1%
• Appointing the right person to the position of CRO	19	59.4%
• Setting up competent risk management team	21	65.6%
• Allocating enough resources to the unit	19	59.4%
• Updating Risk Management Plan regularly	11	34.4%
• Giving training (local and abroad) to technical staff of the unit	13	40.6%
• Obeying to the risk management policy of the Bank	19	59.4%



4.3 Meeting the requirements of NBE

Organization of BoD

As can be seen in Table 3.15 below, all the three target banks BoD have either a two or three member committee which either solely responsible to risk management or also oversee the risk management function. However, the Chief Internal Auditor and all staff of RMU of AdIB didn't know that there is such committee in the board, which shows that there is communication gap between BoD and RMU.

Table 3.15 Existence of Risk Committee in the BoD

Is Risk Committee found in the Board?	In what capacity are you working?	To whom are you working for?			
		NIB	Dashen Bank	AdIB	Total
Yes there is one committee that solely or along with others oversee the risk	• As Board Director accountable for risk management oversight	3	2	2	7
	• As top Management member	4	3	4	11
	• As Chief Internal Auditor	0	1	0	1
	• As Chief Risk Officer	0	1	0	1
	• As staff of Risk Management Unit	4	4	0	8
	Total	11	11	6	28
No there is no.	• As Chief Internal Auditor			1	1
	• As Chief Risk Officer			1	1
	• As staff of Risk Management Unit			2	2
	Total			4	4

As can be seen from table 3.16, more than 90% of respondents said that the bank properly handles the four inherent risks of the banks. 6% of them, however, said that they are not handling it yet and they will not do it in the future too unless demanded by NBE. One respondent missed this question.



Table 3.16 Handling of the four inherent risks

Is your bank handling the four inherent risks	Frequency	Percent
Yes	29	90.6
No	2	6.2
Missing System	1	3.1
Total	32	100.0

Organizational structure of RMU

As can be seen from Table 3.17 below 81% of respondents agree that the RMU is structured below the level of VP but accountable to the Board. Regarding the staffing of the units, the majority i.e. 59% of respondents agreed that the Units have 2 to 5 technical staff other than the CRO.

As to the NBE, the level of the CRO position is not much important as far as it is accountable to BoD. Therefore, all banks met the requirement of the NBE.

Table 3.17 The position of CRO

What is the position of CRO	Count	Percent
• VP level and accountable to the Board.	3	9.4
• Directorate Director or less and accountable to the Board.	26	81.2
• VP level and accountable to the President.	1	3.1
• Directorate Director or less and accountable to the President.	2	6.2
Total	32	100.0

Regarding the competence of the CRO and technical staff of RMU, as can be seen from Table 3.18, more than 90% of respondents agree or strongly agree that both the CRO and Technical staff of RMU have the required competence.

Table 3.18 Competency of CRO and Technical Staff of RMU

		The Technical staffs in RMU are competent					Total
		S A	A	N	DA	SDA	
The CRO has the required academic background and work experience:	S A	6	11	0	0	0	17
	A	0	12	1	1	0	14
	N	0	0	1	0	0	1
	DA	0	0	0	0	0	0
	SDA	0	0	0	0	0	0
Total		6	23	2	1	0	32

As can be seen in table 3.19 and 3.20, about 94% of the respondents said that they have an approved RMP. But according to their response, the majority, about 41% believe that it is only known by the CRO and staff of RMU, which, according to the researcher, has a drawback in the effective implementation of the program.

Table 3.19 Availability of approved RMP

Does your Bank have approved Risk Management Program (RMP)?	Count	Percent
Yes	30	93.8
No	1	3.1
Missing System	1	3.1
Total	32	100.0

Table 3.20 Knowledge about the detail of RMP

Who did know about the RMP in detail?	Count	Percent
<ul style="list-style-type: none"> • Only the President and the CRO of the bank know the RMP in detail. 	1	3.1
<ul style="list-style-type: none"> • Only the CRO and the staff of the RMU of the bank know the RMP in detail. 	13	40.6
<ul style="list-style-type: none"> • All Senior management members of the bank know the RMP in detail. 	11	34.4
<ul style="list-style-type: none"> • All management members of the bank know the RMP in detail. 	2	6.2
<ul style="list-style-type: none"> • All bank staff know about the RMP in detail 	3	9.4
<ul style="list-style-type: none"> • Missed 	2	6.2
Total	32	100

Regarding the management of Credit and Liquidity Risks, the majority i.e. more than 60% said both risks are handled by Credit and Finance Departments respectively. About 26% of respondents, on the other hand, said these risks are handled by RMU and respective Departments jointly, the rest, however, name different organs (units) of the Bank. (See Table 3.21).

These responses show that the majority didn't understand the way NBE and risk experts expect. Because, according to NBE and CRO from Dashen Bank, though individual risks must be handled by their respective functional units, RMU should assist the individual work units from corporate point of view in the identification and assessment of possible risks. It should also compile the total risks in corporate level after securing risk appetite and guidance from the board.



It also conducts follow up of implementation through quarterly reports submitted by individual work units to assure the Board that all risks of the Bank are identified and properly controlled and that the program is working effectively. Therefore, according to CRO and Controller of Dashen Bank, it doesn't overlap with the responsibility of Internal Audit of the bank.

Table 3.21 Who has the responsibility to control credit and liquidity risks

		Who has the responsibility to control the Liquidity risk?					Total
		President Office	Credit Dep't	Finance Dep't	RMU	Other	
Who has the responsibility to control the Credit risk?	President Office	1	0	0	0	1	2
	Credit Department	0	1	16	0	2	19
	RMU	0	0	1	1	0	2
	Other	0	0	3	0	5	8
	Total	1	1	20	1	8	31



Chapter V. Summary, Conclusion and Recommendation

5.1 Summary

Financial sector in general and commercial banking industry in particular has significant effect on the economic development of a given country. This is, because, naturally a bank is established to play an intermediary role between a depositor, who has idle money, and a borrower, who has a business idea but has no enough money to do it (Interview with NBE Expert, 2014). A bank, in its intermediary role, collects idle money in the form of deposit for which it pays minimal interest and gives loan with higher interest rate to an entrepreneur who will invest indifferent ventures; which enhances the economic development of a country in which it operates.

In lending the depositors money for higher interest rate, the bank has to ensure that the loan will be collected at the end of the period; which, otherwise, will lead the bank to a significant loss and subsequent liquidation. Therefore, it has to manage its credit risk so that it will minimize the negative risk i.e. NPL and maximize the positive risk by lending in high return earning credit portfolios.

A bank's capital structure indicates that owner's equity in Ethiopian case (as Ethiopia is implementing Basel I) will only consist of 8%, the rest, 92%, comes from depositors (Interview with NBE Expert, 2014). To run business as usual, therefore, a bank needs to win the confidence of these depositors. To keep their confidence, it should be adequately liquid. Therefore, the other inherent risk of a bank is liquidity risk.

The major problem regarding liquidity risk is its systemic effect. A liquidity problem arise in one bank will led the depositors of other banks to withdraw their money in anticipation of the happening of same problem in their bank. Their



reaction for that fear will create the liquidity problem at the bank which is relatively on sound conditions, as all try to withdraw their money at a time. Such incidences were the reasons that create the Basel Committee. That is why Government want to interfere and in some cases bailout the banks in trouble.

Other risks, like, 'operational' and 'market' risks emanate from its operational activities which in one way or another have an impact over the former two risks. Therefore, all possible risks which are associated with the banking business should be treated in aggregate and a unit that is solely responsible for the consolidation and assurance of the effectiveness of ERM practices should be established and should undertake its assignment appropriately.

5.2 Conclusion

The researcher draws the following conclusive remarks:

➤ **Regarding NBE initiative**

- The interest of share holders, who contribute 8% of bank's total asset, will be protected by its elected board of directors. Hence NBE is obliged to protect the interest of the public at large – depositors, who contribute 92% of the bank.

➤ **Regarding the initiative of BoD and Top management of Banks**

- All stakeholders, especially BoD and Top Management of a bank understand what ERM is all about and the benefit of handling risks in aggregate. And hence, as an owner of a bank, the BoD, through its risk committee, assumes the responsibility of establishing RMU's and overseeing its activities.



- The majority of all stakeholders understand what **Credit** and **Liquidity** risks are and their likely impact over the performance of the bank, which, according to the researcher, is a cornerstone to develop risk responses.
- **Regarding the compliance of banks to NBE's directives**
- RMUs of all banks are accountable to BoD and hence are enjoying relative independence. And the CRO and all other technical staff of the units are competent.
 - All banks have an approved RMP and RMUs are allocated with enough resources for its implementations. But the majority do not understand the program, as it is only known around RMU staffs, according to the researcher, this will hinder the effectiveness of RMUs in managing bank risks.

In general, we can conclude that the initiative of NBE in introducing ERM to commercial banks of Ethiopia is well taken care of. The risk management practice in the private commercial banks is well known by all stakeholders of the banks, despite being in its infant stage.

5.3 Recommendation

Based on the research findings, the researcher recommends that:

- Though the majority of stakeholders understand the importance of handling risk management in aggregate wise, others, however, believe that it was/is being done to fulfill the requirement of NBE. According to others, they will continue with the unstructured way of handling risks individually and/or in ad-hoc committee. In order to bring this force into the supporting group, a continuous development program should be provided by the banks or NBE.



- Banks like AdIB should exert much effort to communicate the progress of RMU related functions (activities) between BoD and other organs of the Bank to facilitate the risk management functions.
- Regarding handling of the identified inherent risks, though the percentage of respondents is very minimal, the researcher is concerned over the response which claims that they are not handling the risks yet and that they will not undertake it either unless forced by NBE. Banks are, therefore, recommended to assign responsibilities and measure the performance of each role player in the issue of handling risk management.
- RMP is an organized plan of activities to be done to control the exposure to possibilities of unknown future events (AS/NZS 4360). The effectiveness of RMP, therefore, depends on the knowledgeable contributions of all parties involved in its practices. The researcher, therefore, recommends RMP of all banks to be known by all employees of the Bank.
- The researcher also recommends other researchers to conduct further studies over the subject.



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Appndex A. Questionnaires

Colledge of Business and Economics

Management Department

Executive Masters of Business Administration (EMBA)

Questionnaire

A study on Enterprise Risk Management Practices in the case of Ethiopian Private Commercial Banks

Dear Respondents:

The purpose of this research project is to review the practice of Enterprise Risk Management (ERM) observed in Ethiopian Private Commercial Banks and its implied impact over the profitability of the banks by reducing the Non Performing Loans (NPL) and subsequent foreclosures.

Your participation in this research project through properly filling this questionnaire is very much important. With your participation, the researcher can draw the extent of the ERM practice in Ethiopian Private Banks in general and that of your bank in particular and the pros and cons of fully implementing ERM over its profitability and reduction of NPL and subsequent foreclosures. All information you provide will be used for academic purpose only. Therefore, the researcher kindly requests you to be open and candid with your responses and to make sure that you completely fill all items in the questionnaire.

I thank you for your valuable cooperation.

Very Respectfully,

Samuel Ademe, CIA



General Instruction in filling-out the questionnaire:

1. This questionnaire takes approximately 15 minutes of your valuable time
2. Please tick in the box that corresponds to your answer of each questionnaire

Part I. General Information

A. To whom are you working for?

- Nib Bank
 Dashen Bank
 Addis International Bank

B. In what capacity are you working?

- As Board Director accountable for risk management oversight
 As top Management member
 As Chief Internal Auditor/ Controller
 As Chief Risk Officer
 As staff of Risk Management Unit

C. How many years do you serve the bank in your current position?

- For less than 1 year 3 – 5 years
 1 – 2 years More than 5 years

Part II. Detailed Questions

A. The initiative and commitment of BoD and Top Management

1. I know and understood what Enterprise Risk Management (ERM) is and its similarity and differences with the traditional risk management issues.

- Strongly Agree Disagree
 Agree Strongly disagree
 I somehow agree



2. How do you rate the importance of ERM practice for the Bank?

- | | |
|--|--|
| <input type="checkbox"/> Extremely important | <input type="checkbox"/> Trivial |
| <input type="checkbox"/> Important | <input type="checkbox"/> Extremely trivial |
| <input type="checkbox"/> Neither nor | |

3. Risk management is the responsibility of all individual functional units and hence independent risk management unit is not necessary.

- | | |
|---|--|
| <input type="checkbox"/> Strongly agree | <input type="checkbox"/> Disagree |
| <input type="checkbox"/> Agree | <input type="checkbox"/> Strongly disagree |
| <input type="checkbox"/> Indifferent | |

4. Who took the responsibility of organizing the risk management unit?

- Board of Directors
- The President
- Executive Management
- The Internal Audit/ Controller
- Chief Operational/ Credit Officer
- Other specify _____

5. How does your bank support its risk management function? (You can choose more than one answer.)

- Structuring the risk management unit next to the President level and accountable to the Board
- Appointing the right person to the position of CRO
- Setting up competent risk management team
- Allocating enough resources to the unit
- Updating Risk Management Plan regularly
- Giving training (local and abroad) to technical staff of the unit
- Obeying to the risk management policy of the Bank



6. If it was not for NBE requirement, do you opt to establish the risk management unit in your bank?

Yes No

7. Irrespective of NBE's requirement, which of the Bank's inherent risks will you consider most?

Credit risk Liquidity risk
 Market risk Operational risk

8. Is the Board Chairperson a member of Risk Committee?

Yes,
 No,
 No, because the Board Chairman is not a member of any subcommittees
 I don't know.

9. Have you tried to measure and handle any of the four types of inherent risks of the bank yet?

Yes No

10. If 'No' when will you begin to manage it?

Within one month period
 Within three month period
 Within six months period
 A year after
 Not at all until NBE required us.

11. The person appointed as CRO has the required academic background and work experience:

Strongly agree Disagree
 Agree Strongly disagree
 Indifferent



12. Technical staffs assigned to the unit are capable and competent

- Strongly agree Disagree
 Agree Strongly disagree
 Indifferent

13. How many technical staff does the risk management unit have?

- Only one staff 6 – 10 staffs
 2 – 5 staffs More than 10 staffs

14. Please rate how often your bank uses the following method of communication

Methods	Always	Very often	Fairley often	Sometimes	Never
Memo/ Note/ Fax	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
E-Mail	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Telephone	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Face to face	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Meeting	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

15. Who did know about the RMP in detail?

- All bank staff know the RMP in detail.
 All management members of the bank know the RMP in detail.
 All Senior management members of the bank know the RMP in detail.
 Only the President and the CRO of the bank know the RMP in detail.
 Only the CRO and the staff of the Risk Management Unit of the bank know the RMP in detail.



16. In your understanding Credit risk in Banking Industry arises from: (You can choose more than one answer.)

- The potential that a borrower will either be unwilling or unable to perform on an obligation in accordance with agreed terms;
- The financial exposure resulting from a bank's dependence on another party to perform an obligation as agreed;
- The entire portfolio or from individual loans or transactions;
- No other risks i. e. it can exist in isolation from other risks;
- Other assets and activities i. e. not confined in its loan portfolio only;
- Other, specify _____

17. How do you value the likely impact of Credit Risk? (You can choose more than one answer.)

- Has direct impact on NPL.
- Has direct impact on the number of foreclosure.
- Has direct impact over the profitability of the Bank.
- Has direct impact on the activities of the bank with other banks and institutions.
- Has direct impact over its reputation.
- Has overall impact on sustainable growth of the bank.
- Has direct impact on the Liquidity position of the Bank.

18. In your understanding Liquidity risk in Banking Industry arises from: (You can choose more than one answer.)

- The potential for loss to the bank arising from either its inability to meet obligations as they fall due or to fund increases in assets without incurring unacceptable cost or losses;
- Inability to meet cash flow obligations;
- Liquidity short fall at a single bank can have system-wide repercussions;
- Other, specify _____



19. How do you value the likely impact of Liquidity Risk? (You can choose more than one answer.)

- Has direct impact on NPL
- Has direct impact on the number of foreclosures
- Has direct impact over the profitability of the Bank
- Has direct impact on the activities of the bank with other banks and institutions
- Has direct impact over its reputation
- Has overall impact on sustainable growth of the bank

20. Do Credit and Liquidity risks, among others, be treated at your bank prior to the developments of RMP as per the guideline given from NBE?

- Yes No

21. If your answer for question 5 is yes, how was it done?

- The board was responsible to assess and develop the mitigative measure.
- The executive committee of the Bank takes the responsibility of assessing and developing the stated risk mitigative measures.
- Risks are assessed and possible mitigative measures were taken Individually i.e. Credit Department regarding Credit risk and Finance Department regarding the liquidity risk.

B. Compliance to the requirement of NBE

1. Is Risk Committee found in the Board?

- Yes there is one committee solely oversee for risk management.
- Yes there is one committee that also oversee the risk management.
- No there is no.
- I don't know.



2. If your answer for Q8 above is a) or b) what is the number of committee members?

- 2
- 3
- 4 and above

3. The status and accountability of CRO is:

- VP and accountable to the Board
- Directorate Director or less and accountable to the Board
- VP and accountable to the President
- Directorate Director or less and accountable to the President

4. Does your Bank have approved Risk Management Program (RMP)?

- Yes
- No

5. Who has the responsibility to control the Credit risk?

- President Office
- Finance Department
- Credit Department
- Risk Management Department
- Other specify _____

6. Who has the responsibility to control the Liquidity risk?

- President Office
- Finance Department
- Credit Department
- Risk Management Department
- Other specify _____

7. What do the treat of profit, number of NPL and foreclosure looks like through the last three years?

No.	Description	2013/14	2012/13	2011/12
1	Net Profit			
2	NPL			
3	Amt. of foreclosure			



C. The Understanding of the initiative taken by NBE to introduce Risk Management Program in Banking industry

1. How do you rate the importance of NBE's interference regarding the risk management?

- | | |
|--|--|
| <input type="checkbox"/> Extremely important | <input type="checkbox"/> Unimportant |
| <input type="checkbox"/> Important | <input type="checkbox"/> Extremely unimportant |
| <input type="checkbox"/> Neither nor | |

2. Do you fear that the implementation of risk mgt practices exposes your bank's internal problem to regulatory body instead of helping?

- | | |
|------------------------------|-----------------------------|
| <input type="checkbox"/> Yes | <input type="checkbox"/> No |
|------------------------------|-----------------------------|

**Would you like to have a summary of the study results sent to you by e-mail?
If yes, please fill in your email address.**

- | | |
|------------------------------|-----------------------------|
| <input type="checkbox"/> Yes | <input type="checkbox"/> No |
|------------------------------|-----------------------------|

Email address _____

I once again want to "Thank You!!" for your time and dedication.

Samuel Ademe



Appendix B. Interview questions prepared for CBSD of NBE

1. What was/is the main reason of the National Bank to require commercial banks to prepare their own Risk Management Program (RMP)?
2. You proposed four inherent risks of the Banking industry in your RMP preparation guideline. Can we reorder them according to their severity?
3. Is there any bank that incorporated other than the four risks mentioned above in its RMP?
4. Is NBE responsible to provide training over Enterprise Risk Management issues to commercial banks?
5. What is the role of RMU regarding the identification, assessment and response of bank risks?
6. Whom you think should undertake the responsibility of overseeing the risk management unit of the bank? Board of Directors or Top Management or other?
7. What did NBE expect the organizational structure of risk management unit should be? And what did you observe so far?
8. What did NBE recommend the status of CRO i. e. its position and accountability?
9. Have NBE set the requirement that any CRO should met?
10. Can you tell us the best three banks that undertake the risk management function properly?
11. How do you evaluate that the banks are managing their risks properly?
12. When and how NBE communicates that information to the individual banks?
13. How do you/ a rating agency/ rate the soundness of the Ethiopian Banking Industry as compared to the other countries?



14. What is the status of Ethiopia regarding the Basel committee?

15. Please provide statistics regarding

- NPL recorded by individual banks in the past three years
- Capital adequacy of each bank in the past three years
- Profit registered in the past three years
- Foreclosure executed in the past three years