Oromia Bank

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Risk Management

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Risk Management

Meaning and Essence of Risk Management

Risk management is the process of identifying, analyzing, and responding to risk factors that may hinder organizational goal and objectives. It helps in calculating the uncertainties to predict their impact, consequently giving organizations a basis up on which they can make decisions. The essence of risk management is the process of identifying, assessing, and controlling threats to organizations capital and earnings. These risks stem from a variety of sources including financial uncertainties, legal liabilities, technology problems, strategic management errors, accidents, as well as natural disasters.

Importance of Risk Management

According to experts of the area no individual can predict risk accurately in this dynamic environment. Though, organizations need to prepare for uncertain and volatile future. To be so, organizations are becoming ever so cautious about learning from past mistakes. Besides, the scope of legality is increasing owing to business practices such as globalization. In the same manner, consumers are becoming aware and learned posing threat for business not adopting accordingly. To minimize risk scholar of the area (Purnima Singh) recommended some important points of risk management. These are:

Risk Management

- Implementation of a robust risk management plan will help companies to build policies and procedures around potential threats and measures to minimize their impact if it occur
- It is crucial for any business to know the nature and extent of risk it is prepared to take the level of risk it can tolerate and communicate the same to its employees at all levels of management. This enables limited control all over the organization
- The ability to understand risk enables the organization to make confident business decision
- It protects the organization from risk of unexpected events that can cause financial and reputational loss
- Planning and developing structures to address potential threats improves the odds of becoming a successful organization.

In nutshell, the practice of risk intelligence and risk management is seen increasing in many industries and companies since it has such and other many more significance for them to endure and sustain in a competitive global market.

Overview of Oromia Bank's Risk Management

In Ethiopia, the banking sector is considerably becoming strong at present. Likewise, banking is considered to be a very risky business. Of course, financial institutions must take risks, but they must do so consciously.

However, it should be borne in mind that banks are very fragile institutions which are built on customers' trust, brand reputation, and above all dangerous leverage. In case something goes wrong, banks can collapse and failure of one bank is sufficient to send shock waves right through the economy (Rajadhyaksha, 2004). Hence, bank management must take utmost care in identifying the type as well as the degree of its risk exposure and tackle them effectively. Moreover, bankers must see risk management as an ongoing and valued activity with the board setting example.

In accordance with the National Bank of Ethiopia Directive, Oromia Bank has established comprehensive risk management processes including Board and senior management Oversight like: identifying, evaluating, monitoring, controlling, and mitigating all risk materials and assessing their overall capital adequacy in relation to their risk profile. The Risk Management Function supervises overall risk which is independent from those who take or accept risks on behalf of the bank and reports directly to the board risk management and compliance subcommittee.

As cited in various sources the risk management function is responsible to ensure that effective processes are in place for:

- *Identifying current and emerging risks*
- *Developing risk assessment and measurement systems*
- *Establishing policies, practices, and other control mechanisms to manage risks*
- *Developing risk tolerance limits for Senior Management and board approval*
- *Monitoring positions against approved risk tolerance limits*
- *Reporting results of risk monitoring to Senior Management and the board.*

Risk Inherent of Oromia Bank

As financial institution there can be wide varieties of risks to be encountered. Some of the major risks may be: credit risk, liquidity risk, market risk, operational risk, strategic risk, reputational risk, and information technology risk. To brief more inherent risk of our Bank:

- *Credit Risk: It is the prospective risk to earnings and capital arising from an obligor's failure to meet the terms of any contract with the Bank. In another expression if an obligor fails to payback as agreed*
- *Liquidity Risk: Liquidity risk is the risk to an institution's earnings or capital arising from its inability to meet its obligations as they fall due, without incurring significant costs or losses*
- *Market Risk: It is the risk that the value of on and off-balance sheet positions of the Bank will be adversely affected by fluctuation in market rates or prices such as: interest rates, foreign exchange rates, equity prices, credit spreads and commodity prices resulting in a loss to earnings and capital*
- *Operational Risk: Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, and systems or external events. It seeks to identify why a loss happened and at the broadest level includes the breakdown by four causes like: people, processes, systems and external factors*
- *Strategic Risk: It is the current and prospective impact on earnings or capital arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to industry changes*
- *Reputational Risk: Reputational risk is the potential that negatively publicize regarding the Bank's business practices, whether true or not, that may cause a decline in the customer base, costly litigation, or revenue reductions. This risk can be resulted from the Bank's failure to effectively manage any other risk types*
- *Information Technology Risk: It is a risk related with the use, ownership, operation, involvement, influence and adoption of the Bank's Information Technology systems.*

Risk Management Process of Oromia Bank

As risk management is a multi-step process, Our Bank's risk management processes include the following major phases. These are:

Risk Management Process

- ***Risk Identification**: Almost every product and ser - vice offered by our Bank has a unique risk profile emanated from multiple risks. Thus, risk identification is a continuing process and it is understood at both the transaction and portfolio levels*
- ***Risk Measurement**: Once the risks associated with a particular activity have been identified, the next step is to measure the significance of each risk. Each risk is viewed in terms of three dimensions such as: size, duration, and probability of adverse occurrences*
- ***Risk Control**: Once risks have been identified and measured for significance, there are basically three ways to control significant risks, or at least minimize their adverse consequences like: avoiding or placing limits on certain activities or risks, mitigating risks, and offsetting risks. It is a primary management function to balance expected rewards against risks and the expenses associated with controlling them*
- ***Risk Monitoring**: Our Bank established Monitoring Information System that accurately identifies and measures risks at the inception of transactions and activities. In general, risk monitoring means developing reporting systems that identify adverse changes in the risk profiles of significant products, services, activities, and monitoring changes in controls that have been put in place to minimize adverse consequences.*

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