

CHAPTER 7
THE APPLICATION OF HOLISTIC RISK
MANAGEMENT IN THE BANKING INDUSTRY:
CONCLUSIONS AND RECOMMENDATIONS

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SYNOPSIS

It was determined that holistic risk management is an appropriate management process to manage risk in the banking industry in general and the South African banking industry in particular. It was furthermore resolved through empirical surveys that holistic risk management in the South African banking industry is a concept that could be used by the management of banks to manage risk.

It was subsequently concluded that, in view of the need in the South African banking industry for a structured means of managing risk holistically, and in view of holistic risk management constituting such a process, there is relevance for the implementation of holistic risk management in the South African banking industry. In this regard a number of general recommendations were made, with respect to managing risk holistically, the analysis of holistic risk management, the implementation of holistic risk strategy, the planning of holistic risk management, the review of holistic risk management, the motivation and control of holistic risk management, the review of holistic risk systems, and holistic risk evaluation and plan modification. A framework was furthermore suggested for the application of holistic risk management in the banking industry in the belief that this framework and the overall research reported in this thesis could be of theoretical as well as empirical value for management of holistic risk in the South African banking industry. European and American banks have to cope with fierce international competition and they consequently have paid particular attention to their risk management abilities. South African banks, on the other hand, have been excluded from international competition and have suffered due to the loss of foreign banking and technology. To enable a smooth re-entry into international markets, South African banks should seriously consider their risk management abilities.

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7.1 INTRODUCTION

The global and international changes in the banking industry in general and the South African banking industry in particular poses various challenges. While the manner in which European and American banks have coped with their changing banking industry is well researched, the question arises whether South African banks can use the same strategies to cope with their changing banking industry.

This chapter needs to be seen within the context of the preceding chapters with the accent on the need for managing risk in a holistic manner within the banking industry of South Africa.



Various aspects of holistic risk management (HRM) were emphasised in this study. Firstly, the theoretical concepts risk and risk management as well as the application of HRM were deliberated. The relevance of holistic risk management as a concept in proactive risk management in the banking industry was empirically tested. The study therefore centred around the problem statement and four objectives as stated in Chapter 1.

7.2 ACHIEVEMENT OF STATED OBJECTIVES AND IMPLICATIONS FOR THE STUDY

This study essentially centred on the gaining of insights into the management of risk in the banking industry in general and holistic risk management in particular. To achieve this purpose the following objectives were set:

7.2.1 To attain an understanding of the existing strategies used by South African banks to manage risk and to ascertain whether these strategies are relevant in managing risk efficiently

Objective 1 constituted the first theoretical objective of the study and comprised of a deliberation of risk management issues. The results lead to the following conclusions derived from Chapter 2.

It was established that risk management is a process of identifying, analysing, and verifying risks in the banking industry. The various types of risks were explored and explained. The various risk management processes were also investigated and explained.

Analysis of risk management provided a useful foundation for the study on risk management. It was the intention of this study to establish whether risk management as a concept could be used as a strategy to manage holistic risk management in the banking industry. Before risk management could be investigated, it was necessary to address the risk management culture within the South African banking industry. This was done in Chapter 2.

Chapter 2 also clarified the concept of risk management in order to facilitate discussions of the risk management process involved. Literature study on holistic risk management revealed that holistic risk management is a process which involves the creation of new ideas as well as the commercialisation or implementation of the new ideas in terms of managing a bank. Elements to be included in a risk management culture were explained in detail. The intention was to determine whether the South African banking industry has a risk management culture so as to implement holistic risk management as a strategy to manage risk.

From the theoretical discussion it was established that the culture of a bank is the deeper level of basic assumptions and beliefs shared by the members of the bank. These values could impact on the perceptions of risk and the management of risk on the banking industry.

7.2.2 To explore the concept of holistic risk management as a means of efficiently managing risk in the banking industry.

Objective 2 constituted the second theoretical objective of the study and comprised of a deliberation of HRM within the banking industry. The results lead to the following conclusions:

In Chapter 3 the literature study on HRM revealed that HRM is a process which involves the creation of new ideas as well as the commercialisation or implementation of these new ideas in terms of managing a bank. HRM in itself can constitute a risk or HRM can occur because of changes in the banking industry. HRM and risk are thus inseparable. Chapter 3 explained the concept of HRM. The evolution of HRM has integrated various processes into two main areas namely strategic and operational risk management which form the basis of this study. HRM is a two way system, that means it deals with how things are done inside the bank and how the communication with the outside world should be done. HRM shares common elements with some other management disciplines, such as change, six sigma, McKinsey's 7s model, economic value adding (EVA) and quality management.

The emerging role of Chief Risk Officer (CRO) was also mentioned as more and more major corporations are appointing CROs. The role of CRO is expected to gain a foothold and become an indispensable position in the corporate structure of the bank. HRM is a tool for performance not conformance. Organisations that have adopted this approach have gained noteworthy tangible benefits such as growth in shareholder value, loss reduction, and reduced earnings volatility, engendering a sentiment of confidence in the management of risk.

HRM was furthermore linked to the costs of building an information technology infrastructure to support it. It is also linked to compensation. It is therefore important to establish whether compensation and incentives are producing the desired levels of performance and rewards to the organization. Compensation and incentives is probably the key driver of human behaviour and as such, it has a significant potential to impact, negatively or positively, on the organization in general and HRM in particular.

Just as business strategies and product plans give direction to a business, HRM sets the boundaries telling a business where and when to stop taking risks. With a carefully orchestrated and executed HRM policy together with clearly defined checks and balances, it becomes easy for organizations to know their limits and boundaries that will help to minimize risk exposure.

7.2.3 To gain an understanding of the critical success factors for the implementation of holistic risk management in the banking industry

Objective 3 constituted the third theoretical objective of the study and comprised of a deliberation of the critical success factors for the implementation of holistic risk management in the banking industry. This was done in Chapter 3.

The objective of the discussion of the critical success factors was to provide some guidelines for the management of risk in the South African banking industry. Three critical success factors to HRM were identified, namely: Firstly, a strategy that is concerned with the establishment of a clear direction for the bank and a means of getting there. Secondly, the implementation of strategies in order to yield effective performance. Thirdly, innovation to ensure that the strategies are improved and renewed.

It is common knowledge that managers are obligated to know their businesses. It is important that all employees understand how their individual accountabilities could affect the risks of the organization and how their functions and responsibilities relate to others within the company. This increases risk awareness at an enterprise wide level, which is highly encouraged in HRM.

Measures used by different organizations to track and manage individual performance levels are a key driver to human behaviour. To this end, the literature review advocates for the use of a “balanced scorecard” in the establishment of performance measures that are geared toward quality, customer satisfaction and internal processes as a management tool to improve the bottom line and proactive risk management.

It is important that HRM should furthermore be "anchored at the highest level" of the Chief Executive Officer/Managing Director and the Executive Board of the banking institution.

7.2.4 To suggest a framework for the implementation of holistic risk management

Objective 4 constituted the fourth theoretical objective of the study and comprised of a theoretical deliberation in Chapter 3. A framework for the implementation of holistic risk management in the banking industry was suggested. Objective four was also achieved through the application of quantitative and qualitative empirical research components.

7.2.4.1 The theoretical component

A suggested framework for HRM was provided in Chapter 3. The framework was used to empirically evaluate the degree of HRM in the South African banking industry.

7.2.4.2 The empirical component

The suggestion of a HRM framework had to be empirically investigated. This was done by means of quantitative and qualitative research methods as described in Chapters 4 and 6 respectively.

- The quantitative research results

The quantitative research results were analysed and presented in Chapter 5. The results were obtained through a structured questionnaire consisting of Sections A, B, and C.

Section A of the questionnaire

Although it was established that South African banks do have a culture like described in the literature review and that this culture is also innovative, banks should establish culture individually. In doing so banks should establish whether it

has a risk culture by questioning employees at various levels of the organizational hierarchy. This study has proved that persons at various levels of the organizational hierarchy differ regarding their perception of the culture of the bank. Questioning more than one person in a bank is of utmost importance.

Section B of the questionnaire

Results obtained from Section B of the questionnaire revealed that banks do analyze their current position of risk. They also formulate HRM strategies and establish plans for the management of risk. The implementation of HRM is done according to certain goals, targets, and objectives. Review of results is done against pre-set targets and evaluation and plan modification followed throughout. It can therefore be concluded that HRM forms an integral part of the management of risk and that it is done in a strategic manner. The relationship between these dependent variables and the independent variables from Section C of the questionnaire will be discussed in the following paragraph.

Section C of the questionnaire

Section C provided descriptive statistics in terms of the maturity, size listing status of banks. These independent variables were used to search for relationships with the dependent variables derived from Sections A and B of the questionnaire. The responses derived from these analyses lead to the following conclusions:

- Young, growing and mature banks

The mature banks in the South African banking industry manage holistic risk management more like the proposed framework than young and growing banks. The mature banks, with its many advantages such as established banking practices, market knowledge, contacts, credibility and financial strength is therefore in a far better position than the young banks to manage the holistic risk management process. This is, however, not the case for the younger banks. It is therefore necessary for younger and smaller banks to discover the possible barriers preventing them from being more successful in managing risk from the holistic risk management viewpoint.

Young, growing and mature South African banks also display different cultures. Differences occur in the norms, corporate policy and ethics and relations of the culture. It was evident that all banks have the same factor, crucial aspects, included in their culture. The South African banks show a culture, which is like a risk management culture. The results of the factor, crucial aspects, confirms the innovative risk management culture of the South African banks. Smaller and younger banks, however, have a more innovative culture to the management of risk than larger banks.

- Banks using a different number of departments to initiate holistic risk management.

The results emphasized that banks using two or more departments to initiate risk management manage holistic risk management like the proposed framework. Banks using one or no department to initiate risk management do not manage holistic risk management. This indicates the importance of holistic risk management throughout the bank. The initiation of holistic risk management should not be restricted to one department only.

When the number of departments used to initiate risk management was used as a criterion to distinguish between banks, results indicated that all banks had an innovative risk management culture. However, banks using one or no department to initiate risk management have an innovative risk management culture.

- The size of the bank

Two criteria were used to determine the size of the bank, namely the number of employees and the annual income.

The results obtained indicated that large banks manage holistic risk more like the proposed framework than small banks. Small banks, however, seemed to be superior on the step, risk analysis, planning, strategy, and review of results. The number of employees in a bank and its turnover influence its management of risk. A bank employing a large number of employees and which has a large turnover manages holistic risk management more like the proposed framework than banks with a small number of employees and a small turnover.

The only difference that occurs in the culture of large banks (based on the number of employees and annual turnover) is that they attend more to their external risk relations than smaller banks (based on the number of employees and annual turnover). Small banks should therefore attend more to external risks impacting on their banks.

- Listed and unlisted banks

Listed banks in South Africa manage holistic risk management like the proposed framework. Unlisted banks behave more like small banks in their management of holistic risk management. The step, review of results, is executed more like the framework by unlisted banks, which strengthens their similarity to the small bank.

Banks, which are listed on the Johannesburg Stock Exchange and unlisted banks tend to have the same cultures. Unlisted banks have innovative cultures and should therefore seriously address their management of holistic risk management.

- Position of the respondent

Respondents of this survey were both from managerial positions and top management positions. Statistical relationships between these two groups of respondents indicated that they did not differ in their responses. Top management and management in the South African banking industry agree on holistic risk management in their banks.

Analysis of all the independent variables led to the conclusion that whenever differences occurred in the management of holistic risk management; these differences appeared in the formulation of strategies. It appeared that South African banks differed on how they formulated holistic risk management strategies. This aspect needs particular attention. Implementation of holistic risk management strategies also needs attention as it indicated a large difference among banks. The implication of this proposition is that although South African banks manage risk holistically they should attend to their strategy formulation and implementation.

- The qualitative research results

The purpose of the qualitative study was two fold: One, to confirm or reject the results of the initial quantitative research results, and two, to render the research more recent.

The results seem to confirm the original research that although not always formalised, there is a culture of risk management in all banks; that personnel are motivated; that current positions are analysed; and that strategies and plans for risk management are being implemented. Results also confirm that plans are controlled, evaluated and if necessary modified.

The fact that the qualitative research was done at a later time schedule makes the study also more recent and therefore valid.

7.3 MAIN CONCLUSIONS



To end this study ultimate conclusions should centre around the questions posed as part of the original problem statement in Chapter 1. Answers that had to be found to the following questions:

- What are the existing strategies used in the banking industry to manage risk?
- What role can holistic risk management play as a strategy to manage risk in the banking industry?
- What are the critical success factors for the implementation of holistic risk management in the banking industry?
- How can holistic risk management be implemented to effectively and efficiently manage risk in the banking industry?

Firstly, from the analysis of structured questionnaires to banks and representatives (branches) of banks and the interpretation of results obtained from semi-structured interviews with the four major banks in South Africa it can be concluded that HRM is

being applied in all banks, albeit in different degrees, depending on the size of the bank; the formulation of strategies, and the prevailing culture in the bank. Most banks, however, follow the proposed HRM framework as suggested in Chapter 3 namely, a holistic approach to environmental analysis, planning, implementation, evaluation, review and control.

The role that HRM can play as a strategy to manage risk in the banking industry is significant. HRM is a management approach to the comprehensive management of risk by taking into consideration the external and internal environment of the organisation; the prevailing risk culture among employees and managers and the different critical success factors and operations for efficient risk management.

The critical success factors for the implementation of holistic risk management was extensively discussed in Chapter 3. The views of various authoritative authors were considered.

Lastly, the way in which HRM can be implemented to effectively and efficiently manage risk in the banking industry is closely linked to the implementation of the suggested framework. The conclusion that can be reached, and which was indeed supported by the empirical component of the research, was that the application of the suggested framework, with its critical factors for implementation should be the norm for the implementation of HRM in the banking industry.

7.4 RECOMMENDATIONS

Although this study has revealed that the South African banking industry is managing HRM, there is still room for improving the holistic risk managerial processes. Analysis of the nature and extent of the management of HRM has indicated that the mean values of the results are only slightly above the neutral mean values. As the culture of the South African banks is of such a nature that it can implement HRM to its full extent as a strategy to manage risk it needs to be encouraged. As any cultural change is an open and participative process and should not be a manipulative one. Executive management who are responsible for the development of a risk management culture are required to do the following:

- Clarify the vision of the bank. A clear perception of the direction of the bank should be determined as well as the risks involved. These need to be communicated to all management levels within the bank.
- Provide strategic context based upon the needs of customers, the meeting of their needs but more importantly the risks associated with any operational and marketing plans.
- Senior management need at all times be committed to the HRM programme and processes.
- Identify and select the right people to perform as innovators and risk managers.
- Manage, educate and train employees. It is important that those employees who will not be directly involved in the HRM process, should understand the HRM process so as to not resist consequent changes.
- Smaller and growing banks exhibits an innovative risk culture, but they are not so successful in the management of the HRM process. Management in small banks should therefore raise the profile of HRM by reconsidering managerial processes whereas bigger and mature banks should develop a more innovative culture of risk taking. The difference in culture of risk taking is evident when comparing the larger established banks such as ABSA with smaller micro-lending banks like ABIL.

7.5 SHORTCOMINGS OF THE STUDY

This study has certain shortcomings, which need to be considered.

Firstly, the role of trade unions and their influence on the managerial processes were ignored. Trade unions and their demands can be restrictive to a risk management culture. An important element of the risk management culture is flexible working conditions. Working conditions are influenced by trade unions. The South African banking industry is highly unionised. A study on the influence of trade unions on the innovative ability of banks is recommended.

Secondly, this study was restricted to the secondary sector of the economy and some institutions in the tertiary sector. A similar study including the service and primary sectors is proposed.

Thirdly, the role of the government and measures taken by it to stimulate HRM were not considered in this study. The government plays an important role in HRM by way of legislation, regulations and incentives. The banking charter was not considered in this study. The influence of the government on HRM in South African banks, however, warrants a separate study.

Lastly, the influence of the organizational structure of the bank was not considered in this study. An adequate organizational structure is important for any bank, which considers implementing HRM. Although organizational structure without many levels of hierarchy are conducive to HRM, it should be determined if such organizational structures can be used in the South African conditions. The researcher is of the opinion that the matrix organizational structure will be more appropriate for the introduction of HRM in South African conditions. Further research on this aspect is necessary.

7.6 FURTHER RESEARCH PROPOSALS

This study has indicated certain areas, which need further investigation. The following research topics can be proposed:

- HRM in the financial services industry in the service and primary sectors of the economy.
- The influence of trade unions on the innovative risk management abilities of South African banks.
- The role of government in stimulating HRM in South African banking industry.
- The organizational structure of South African banks: Does it stimulate HRM?
- Development of risk management programmes for South African banks.

- HRM in the top four commercial banks in South Africa.
- HRM in the developmental banks in South Africa.
- The role of the Financial Services Board (FSB) in the Financial industry.

To conclude, HRM in the South African banking industry still assist the South African banks to use its innovative risk management ability. Lam (2000 : 235) makes a very appropriate statement with which conclude this study:

Banks and economies flourish because of pressures, challenges and new opportunities, not a docile industry or outside 'help' that eliminates the need to improve. Progressive HRM comes from change, not from a preoccupation with stability that obstructs it (Lam, 2003 : 235).

7.7 CONTRIBUTION OF THIS STUDY

This study has managed to contribute to the body of knowledge in the following manner:



A comprehensive literature review was provided on all aspects of risk, the management of risk and HRM. The various processes of risk management were researched and the relationship between the culture of banks; the size and growth phases of banks and risk management was also investigated.

The research adds value to the existing body of knowledge from the perspective of the academic reader and from the banking industry respectively.

7.8 CLOSURE

Banks are the custodians of people's money and assist the Reserve Bank in determining the speed and the amount of money in circulation on a daily basis. Banks are also creators of indirect financial securities such as bonds, credit guarantees, fidelity guarantees, advance payment bonds, bid bonds, and supply bonds. They furthermore supply vital financial information and are the main dealers in foreign currencies. They also provide services such as

cheque account facilities and lines of local and international credit. They also raise capital from investors in the form of fixed deposits and pass it on as capital to investors.

Banks are, however, highly geared financial risk takers. It is therefore imperative that proper control procedures and rules for understanding and controlling of commercial and other risks in the banking industry are assessed properly and managed proactively. When this is not done properly the problem can easily spread from one bank to the whole industry, or from one country to the global financial industry.

Conventional risk management has been around since the 1960s with the focus on lending and the management of credit risk. In recent years the corporate governance framework was designed to manage risk through, inter alia, the accountability mechanisms of financial reporting, audit and internal control. However, notions of risk are mutable and continue to evolve. Different risks are furthermore subject to different, and hitherto un-integrated regimes with little consensus about appropriate ways to manage it. The adverse consequences of risk are also likely to result from a complex chain of events and circumstances rather than from isolated occurrences. Within the broad conceptualisation of risk as manageable, perspectives also differ, ranging from the objective quantifiable to the socially constructed. Current thinking thus underscores the importance of developing a new approach to the management of risk, embracing the full span of management philosophies. This study deliberated the concept of holistic risk management (HRM) as a meaningful approach to risk management. It ultimately suggested a framework of holistic risk management for the effective and holistic management of risk in the banking industry of South Africa.