AN ASSESSMENT ON THE EFFECTIVENESS OF OPERATIONAL RISK MANAGEMENT AMONG TANZANIAN FINANCIAL INSTITUTIONS: THE CASE STUDY OF SELECTED BANKS IN DAR ES SALAAM

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A DISSERTATION SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION OF THE OPEN UNIVERSITY OF TANZANIA

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CERTIFICATION

The undersigned certifies that he has read and hereby recommends for acceptance by the Open University of Tanzania a thesis titled: ***"An Assessment on The Effectiveness of Operational Risk Management among Tanzanian Financial Institutions:" The Case Study of Selected Banks in Dar es Salaam"*** in partial fulfilment of the requirements for the degree of Master of Business Administration of the Open University of Tanzania.

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Dr. I. Mnzava

(Supervisor)

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Date

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DECLARATION

I, **Fatuma A. Masenene,** do hereby declare that, this dissertation is my own original work and that it has not been presented and will not be presented to any University for similar or any other degree award.

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Signature

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Date

DEDICATION

This study is dedicated to God who has enabled me pursue studies up to the higher degree level. I also dedicate it to my lovely husband Ibrahim Ismail, my daughter Falhat Ibrahim, sons Ismail and Ikram Ibrahim, also my late father Abdallah Masenene and my late mother, Amina Abdallatif who encouraged me during my academic career.

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The success of this study is a result of the contribution of many people, individuals and organizations that deserve thanks for their contribution. I also express my thanks to the selected commercial banks I used as a sample in my study.

ABSTRACT

The study was done to assess the effectiveness of operational risk management among the financial institutions in Tanzania whereby five banks in Dar es Salaam were selected as a sample. The study had drawn 84 respondents randomly from the chosen five banks in the region, whereby the conclusions were generalized to all the banks in Tanzania. The sample was investigated using questionnaires and interview. It was found that operational risks policies, procedures and instruments are there in financial banks though to some extent they are not effectively managed. Also methods used to manage operational risks were not well implemented. Awareness of bankers on principles guiding operational risks was found to be minimal among them. The results revealed that most of the respondents proved that operation risk management in Tanzanian financial institutions were found not well implemented. The study concluded that there were a lot of weaknesses in management of DOR including lack of strong risk management departments, weak rules and principles, unimplemented policies and biasness in the implementation of compensation. The study recommended a need for strong risk control departments, training and availability of insurance that are active in organizations. It is lastly suggesting areas for further studies to focus and asses the contribution of Tanzanian financial organizations to the developments of their employees and to examine the effects of adopting the automated technologies among the banks in Tanzania.

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D.O.R	Daily Operational Risk
RMCD	Risk Management Control Department
DRM	Daily Risk Management
FR	Financial Risk

CHAPTER ONE

INTRODUCTION

1.1 Overview

This Chapter introduces the study by presenting the background information to the problem, statement of the problem, purpose of the study, objective of the study, research questions, and significance of the study, delimitation of the study and definition of the key terms. This part introduces basic information about this research study.

1.2 Background Information

Nowadays, the management of operational risk by banks is a phenomenon that is widely accepted by most banking industries worldwide .This is substantiated by the fact that most of the banks are taking cognisance of the qualitative and quantitative criteria for operational risk management advocated by the Basel Committee on banking supervision (2003).

The financial and economic crisis has increased the preoccupations for the development of risk management over the last few years. As a result an appropriate terminology of the risk, sustained by modern and efficient methods and management instruments were developed. Guides, methodologies and standards have been drawn up with the purpose of formalizing the risk management implementation and the process, the organizational structure and the objectives of risk management (Ferguson, 2003). The guides and standards not only provide information on the process to be adopted in risk management, but also contain advice on how that process should be implemented successfully (Basel 1998). The standards formalize the operational risk management process in order to improve their effectiveness, but they don't guarantee it.

Once an organization decides to adopt a standard for risk management, it also has to deal with some practical considerations in order to implement it successfully by elaborating a plan for operational risk management implementation, designing an organizational structure for risk management. With a greater level of specificity, making risk management part of the enterprise culture, determining all risks categories of the organization, establishing a group of criteria and indicators that measure risk management effectiveness (Berger, 1997).

Operational risk is not a new risk in banking. In fact, it is that banks must manage, even before they make their first loan or execute their first trade. However, the idea that operational risk management is a discipline with its own management structure, tools and processes, much like credit or market risk, is new (PWC, 1997).

PWC (1997) defined operational risk as the risk of direct or indirect loss resulting from inadequate or failed internal processes, people, and systems or firm external events. Such events can lead to financial losses through error, fraud, fire or other disaster (Basel, 1998). Commercial Banks have explicitly dealt with risk throughout their existence. The very nature of banking activities requires these institutions to assume financial risks while providing innovative products to meet the needs of their clients. Institutions will continue to rely on gap management, credit scoring, and risk based capital requirements to cope with risk. However, new approaches must be developed and implemented to cope with the new financial products and services brought on by rapidly changing technology, the availability of real-time information, and increased competition bankers Magazine (1997).

According to Kimei (1994) emphasizes in the implementation of operational risk management system to meet the challenges of the twenty-first century. Specifically, management of these institutions will be compelled to identify their current risk exposure as well as potential exposure resulting from new business opportunities. These institutions will then be required to institute strategies to minimize these risks.

Commercial banks are in the risk business. The past decade has seen dramatic losses in the banking industry. Firms that had been performing well suddenly announced large losses due to credit exposures that turned sour, interest rate positions taken, massive frauds, or derivative exposures that may or may not have been assumed to hedge balance sheet risk. In response to this, commercial banks have almost universally embarked upon an upgrading of their operational risk management and control systems in order to survive in the new risk environment (Santomero, 1997).

Recent cases of theft of millions of money occurred in City, NBC Ltd, Stanbic and CRDB Bank demonstrated the significance of taking risk seriously by implementing effective internal controls. Barclays bank has shown the way by creating an independent unit responsible for managing operational risks. Operational Risk Manager heads the unit. This unit monitors and controls risk on daily basis. Despite of the relevant units, operational Risk manager is responsible for ensuring that the bank is not excessively exposed. This emphasizes the role of risk management.

The effect of risk materializing is widespread and is illustrated by documented failures in both centralized and decentralized economies (Saunders, 1994; Chijoriga, 1997; Honohan, 1997; Brownbridge, 1998; Basel, 1998 and Mitchell, 1999). In Africa, failure has been experienced in more than 40 countries including Ghana, Kenya, BukinaFarso, Burundi, Cameroon, United Republic of Congo, South Africa, Uganda, Tanzania, (Kimei, 1998). The tragedy is that this is a continuing trend encouraged by both internal and external factors.

As seen in the recent development in the southern American economies, bank failures lead to contraction of activities and decline in output in the economy. They normally lead to a multitude of losers such as;- uninsured depositors losing all or part of their deposits; insured depositor suffering temporary liquidity problems; firms losing financing and other bank benefits; Chief Executive Officers (CEOs) of the banks and bank employees losing their jobs or getting unwanted transfers and banks which have banking relations getting negative spill-over effect (Chijoriga, 1997).

Furthermore, bank failures impose substantial costs in the economy, and in particular on taxpayers, who have borne the burden of the central bank's losses and of reimbursing insured deposits (Brownbridge & Harvey, 1998). They also have an adverse effect on other local small financial institutions that have been managed in an honest and prudent manner (Brownbridge & Harvey, 1998). Bank failures damage the credibility of financial institutions throughout the financial sector, raising costs of deposits and forcing financial institutions to maintain high levels of excess liquidity as a precaution against bank runs (Brownbridge and Harvey, 1998).

Bank failure is caused by several factors identified by various researchers (Kathawala & Johnson, 1990; Banker, 1992; Banker, 1995; Santomero, 1995; Williams, 1995; Chijoriga, 1997; Brownbridge and Harvey, 1998; Casson, 1998; Dowd, 1998; The Economist, 1998; Kimei, 1998 and Basel 1998). These are; breakdown of internal controls which lead to fraud and dishonesty, embezzlement, poor credit risk management, failure to cope with technological changes, poor and sluggish monetary and fiscal policies, bank deregulation/regulation policies and procedures, uncontrolled involvement of political connections to secure public sector deposits as well as heavy reliance on deposits from a few particular parastatals. Casson (1998; Dowd, 1998), reveals that, a number of recent banking problems arise from breakdowns of internal controls such as; Lack of adequate management oversight, accountability, and failure to develop strong control culture, absence or failure of key control structures and activities, inadequate communication of information between levels of management and inadequate or ineffective audit programs and monitoring activities.

Additionally, selective exposures such as credit cards, credit and financial risk are not the causes of insomnia today, in large part because banks have a good handle on how to control them. The big worries today and going forward are the risks that are harder to measure and predict operations compliance, litigation, reputation, and strategic risks and the interrelationships among them.

The management of these risks is typically informal, implicit, and often not as effective as we might like. We have already seen well-publicized evidence of just how much damage can be done to banks' shareholder value by exposure to these risks. Public reports on incidents such as at Barings and Daiwa suggest that they were due to operation failures (Ravi, 2000).

Cynthia (1997) further notes that system accidents were bound to happen. There are numerous other examples of systems failures and human errors that, much to the relief of the affected banks, have not been publicized. Nevertheless, they have caused serious internal problems, raised regulatory red flags, and resulted in sleepless nights for directors and bank management. Reducing the volatility of earnings resulting from risk exposures, risk management is the only path to follow. Risk management combines an expanded view of risk and a framework that builds risk management and control into everyday banking activities, at all levels of a bank.

George (2001) defines risk management as the act or practice of controlling risk. It includes risk planning, assessing risk areas, developing risk handling options, monitoring risks to determine how risks have changed, and documenting the overall risk management program. It calls for a structured yet flexible approach that constantly remaining scanning the constant but with adequate facilities to receive and give management feedback on changes and developments.

Basel (2001) recognizes that the exact approach for operational risk management chosen by an individual bank will depend on a range of factors, including its size and sophistication and the nature and complexity of its activities. However, despite these differences effective operational risk management has five components, a strong internal control culture (including, among other things, clear lines of responsibility and segregation of duties), effective internal reporting, and contingency planning are all crucial elements of an effective operational risk management framework for banks of any size and scope.

George (2001) explores that the key to successful risk management is early planning and aggressive execution. Good planning includes an organized, comprehensive, and iterative approach for identifying and assessing risk and risk handling options that are necessary to refine a program acquisition strategy. Now we can ask ourselves, do Tanzania Banks have operational risk management programs? How has operational risk management been integrated with business planning and operations? This study examines how commercial banks are managing operational risks. However, Banks should identify and assess the operational risk inherent in all material

products, activities, processes and systems and its vulnerability to these risks. Banks should also ensure that before new products, activities, processes and Systems are introduced or undertaken, the operational risk inherent in them is Subject to adequate assessment procedures**.** While a number of techniques are evolving, operating risk remains the most difficult risk category to quantify. It would not be feasible now to expect banks to develop such measures.

However the banks could systematically track and record frequency, severity and other information on individual loss events. Such a data could provide meaningful information for assessing the bank’s exposure to operational risk and developing a policy to mitigate or to control that risk. On the other hand, this study assessed the effectiveness of the operational risk management on the commercial banks in Dar es Salaam.

1.3 Statement of the Problem

The demand for operational risk management in the commercial banks in Tanzania is important because operational risk exist everywhere in the business environment. It is the oldest risk facing any commercial institution and in particular banks, insurance companies and other financial institutions. Previous studies of financial risk Tanzania as well as in Dares Salaam focused on Credit risk management rather than on operational risk management (Basel, 2001& Anbar, 2006).

Deregulation and globalization of financial services, together with the growing sophistication of financial technology are making the activities of banks (and thus their risk profiles) more diverse and complex (Dowd, 1998). Developing banking practices suggest that risks other than credit, interest rate and market risk can be substantial (Basel, 2001). Examples of these new and growing risks faced by banks include the use of more highly automated technology which has the potential to transform manual processing errors to system failure risk. Due to highly automated technology, greater reliance is placed in globally integrated systems, there is growth of e-commerce that brings with its potential new risks (eg external fraud and system security issues) that are not yet fully understood (Barger, 1997).

Although, commercial banks have almost universal embarked on upgrading their operational risk management and control system (Santomero, 1997), this study assessed the effectiveness of operational risk management in Dare es Salaam commercial banks. Basing on Tanzanian financial work organizations, the studies have been made to investigate the risks that take place in these firms. This study dealt with the effectiveness of operational risk management in the banking institutions of which other studies have not covered. The study used 5 banks from Dar es Salaam to investigate this problem.

1.4 Research Objectives

The general objective of this research was to assess the effectiveness of operational risk management in Tanzanian commercial banks. Specifically, the research intended to;

(i) To assess whether the operational risks are effectively managed in bank operations.

(ii) To examine the methods used by commercial banks in management of operational risk.

(iii) To examine factors that influence operational risk management.

(iv) To assess the awareness of bank employees on the principles and regulations related to the operational risk management of the banks.

1.5 Research Questions

In order to address the research problem, purpose and objectives, the following questions had been asked;

(i) Are the Commercial banks operations effectively manage operational risk functions in Tanzania?

(ii) What are the methods used in management of the operation risk?

(iii) What factors are influencing operational risk management in commercial banks?

(iv) Are the bank employees aware of the principles and regulations of the operational risk management of the banks?

1.6 Significance of the Study

Experience with large losses is infrequent and many banks lack time series of historical data on their own operational losses and their causes (Basel, 1998) This study, provide practical guidance on best practice in regard to an effective way of operational risk management. Management of Banks benefited from the research by utilizing the findings to adjust or re-design their operational risk management programs.

It makes awareness to bankers on principles guiding operational risks in Tanzania banking systems. This will be done through add more values on the few studies done about operation risk management in Tanzania. Despite the fact that literatures indicating the absence of studies about operational risk management in commercial bank Tanzania are lacking, ineffective, yet research recognize the existence of many studies about the topic under concern which have been conducted in other nations upon which study will seize its urgency too (Saunders,1999).

It will further contribute to build knowledge on methods used to manage operational risks, the area of operational risk management, provide suggestions to the improvement of the operational risk monitoring, and control practices in the commercial banks.

Finally, it will show factors that affect operational risks and identify areas for further research in operational risk management. The study therefore, has theoretical, empirical, and managerial significance.

CHAPTER TWO

LITERATURE REVIEW

2.1 Overview

This Chapter represents the reviewed literature related to the concept of risk management, financial risk management, risk mitigation, importance of financial risk management, and the impact of globalization in financial risk management, financial risk strategies and financial theory.

2.2 Definition of Key Terms and Concepts

This part of the report defines and gives the meaning of words / terms and concepts used in this study. It clarifies the main words / terms as well as relevant concepts as used in this study.

2.2.1 Key Terms

2.2.1.1 Risk

Rower (1997) defines risk as ‘potential for unwanted negative consequences of an event or activity ‘where as Dominic (1993) defines risk as the volatility of potential outcomes and the outcomes could be both negative and positive. In this study risk implied any unintended or unexpected outcome of decision or course of action. Expected losses are those that the bank knows with reasonable certainty occurred and are typically reserved for in some manner and Unexpected losses are those associated with unforeseen events; Banks rely on their capital as a buffer to absorb such losses.

2.2.1.2 Financial Risk Management

The term means the art of managing uncertainties by making probabilities (Williams, 1995). Chijoriga (1997) defines risk management as the process of conserving the earning power of the assets of the firm or family by minimizing the financial impact of losses. It also ensures that management, operational staff, stakeholders, and the board of directors are in agreement on key issues of risk (Crockford, 1986). The term will be used in this study in the context Risk Management as a discipline at the core of every financial institution and encompasses all the activities that affect its risk profile. It involves identification, measurement, monitoring and controlling risks ensuring that, the individuals who take or manage risks clearly understand it. The organization's Risk exposure is within the limits established by Board of Directors. Risk taking Decisions are in line with the business strategy and objectives Set by BOD expected payoffs compensate for the risks taken, Risk taking decisions are explicit and clear, sufficient capital as a buffer is available to take risk of a process of dealing with the uncertainties resulting from financial markets which involves assessing the financial risks facing an organization and developing management strategies consistent with internal priorities and policies credit risk, market risk and operational risk.

2.2.1.3 Market risk

The term means a possibility for an investor to experience losses due to factors that affect the overall performance of the financial markets. Market risk, also called "systematic risk," cannot be eliminated through diversification, though it can be hedged against. The risk that a major natural disaster will cause a decline in the market as a whole is an example of market risk. Other sources of market risk include recessions, political turmoil, changes in interest rates and terrorist attacks (Peterson, 1989).

2.2.1.4 Credit Risk

Smithson et al (1995) provided the simplest and possibly best definition of risk as the possibility of loss, injury, disadvantage, or destruction. He further pointed out that the other two definitions of risk that are currently fashionable within some procurement circles: proposal risk versus performance risk.

2.2.1.5 Operational risk

The term is defined as a risk incurred by an organization's internal activities. Operational risk is the broad discipline focusing on the risks arising from the people, systems and processes through which a company operates. It can also include other classes of risk, such as fraud, legal risk, physical or environmental risks. Revell (1979) operational risk is the risk of loss resulting from inadequate or failed internal processes, people, and system or from external events.

In this study, Operational risk is associated with human error, system failures and inadequate procedures and controls. It is the risk of loss arising from the potential that inadequate information system; technology failures, breaches in internal controls, Operational risk exists in all products and business activities.

2.2.1.6 Liquidity Risk

This means the risk stemming from the lack of marketability of an investment that cannot be bought or sold quickly enough to prevent or minimize a loss. Liquidity risk is typically reflected in unusually wide bid-ask spreads or large price movements (especially to the downside). The rule of thumb is that the smaller the size of the security or its issuer, the larger the liquidity risk (Wilford, 1995).

2.2.2 Key Concepts

2.2.2.1 Concept of Risk Management

Risk management is the process which involves identification, assessment and judgement of risks, assigning ownership taking action to mitigate it or anticipate them, monitoring and reviewing progress (Treasury, 2004). Risk management is the process by which managers satisfy these needs by identifying key risks, obtaining consistent, understandable, operational risk measures, choosing which risks to reduce and which to increase and by what means and establishing procedures to monitor the resulting risk position (Pyle, 1997).

2.2.2.2 General Theory on Risk and Operational Risk Management

Risks are uncertain future events, which could influence the achievement of the bank's strategic, operational and financial objectives. The dimensions of risk included the impact on a bank's reputation, even the loss of legitimacy from activities deemed unacceptable to the community. Wharton F, (1992) suggests that the origin of the word risk is thought to be from either the Arabic word risq or Latin word riscum. Chijoriga (1997) further suggests that the Arabic word has the connotations of both a favorable and fortuitous outcome, while the Latin has an equally fortuitous meaning, but with favorable events. The Greek meaning of the word risq has neither positive nor negative implications. However the French risque word has mainly negative and occasionally positive connotations.

Rower (1977) defines risk as "the potential for unwanted negative consequences of an event or activity" whereas Lawrence (1976) defined risk as "a measure of probability and severity of a adverse effects" Rescher (1983) define risk as "the chancing of a negative outcome". However, some authors have offered different views in defining risk. Dominic (1993), defined risk as the volatility of potential outcomes and the outcomes could be both negative and positive. As cited by Chijoriga, (1997) a more practical definition is the one given by Wharton (1992), to imply any unintended or unexpected outcome of decision or course of action.

Williams (1995) defines risk management as "the art of managing the uncertainties by making probabilities" Chijoriga 1997 defines risk management as the process of conserving the earning power of the assets of the firm or family by minimizing the financial impact of losses. While Kloman (1992) defines risk management as simply good common sense in coping with possible and actual daily mishaps, and occasional major disasters, that lead to financial losses and unfulfilled plans for individuals and organizations- indeed our society as a whole.

On the other hand, operational risk management is an integral part of business and risk is good if it commensurate with an adequate level of return. Management in general must closely link operational risk management, achievement of corporate goals and reduced volatility of outcomes to drive performance.

In achieving this, management must be willing to expand its approach to shareholder value by integrating a dynamic concept of risk into its existing focus on growth and return. The work of Chijoriga 1997, Basel 1998, PWC 1997, Andrew 1995, George 2001, Cynthia 1997, urges that risk management process involves risk analysis (identification), risk assessment (measurement), risk handling, risk implementation, and risk review. Risk analysis is the process of identifying the different risk involved, and determining the possible outcomes of actions or decisions. Through risk analysis, all possible risk exposures that may be faced by the firm are identified, and then classified based on probability and potential effect.

Global executives are launching major initiatives to improve their companies' management of risk to drive performance (Lee Puschaverel at 1996). These initiatives focus on actively managing risks that must be taken in the pursuit of opportunity and ultimately, profits. This new look at risk contrasts with the more common notion of operational risk management, which has concentrated on protecting the bank from losses through conformance procedures and hedging techniques. Such management tactics seek only to avoid the downside of financial loss.

2.2.2.3 Operational Risk Management Initiatives in Tanzania

Chijoriga, (1997) urges that in order for the bank to make money, they must embrace risk management. They will always make errors and omissions, but with better risk management their mistakes should be less costly (Economist, 1993). Empirical evidence suggests that an effective operational risk management framework can protect and enhance shareholder value (PWC 1997). The primary benefits received from the operational risk management initiatives are the protection of shareholder value, internal awareness of operational risk, protection of reputation, and lower levels of operational losses. An effective operational risk management framework can add value by improving competitive advantage and reducing the level of losses from both large events that can imperil financial condition and smaller, more frequent incidents (Cynthis, 1999).

2.2.2.4 Framework for Operational Risk Management

According to PWC, (1999) the integrated approach to operational risk management is emerging and appears to be more proactive and is representative of emerging best practice compared to the dispersed approach. The integrated operational risk management characteristics include: Operational risk management structure-embedded in the bank to facilitate the timely identification and communication of risk, Resources investment is sufficient to support management's objective for implementing operational risk management, Risk culture which strengthens management's decision-making process. Tools and techniques – developed to enable efficient and consistent management of risk across the Bank.

Risk management is approached at an institutional- wide basis policies, procedures, and reporting mechanisms to identify the various types of risk in all products and services. The achievement of this requires the involvement of all levels of the organization (Dominic, 1993& Williams, 1995).

Financial institutions must be willing to commit significant funding for the establishment of operational risk management systems, which must be able to identify, measure, monitor, and control risk. First, the operational risk management process requires management to identify and fully understand the nature of risk associated with their commercial banking activities. Second, the commercial bank must be able to measure each of these risks; this requires bankers to put in place systems capable of measuring these risks. Third, these risks must be continuously monitored to ensure that they remain at an acceptable level. Fourth, the system must permit management to take appropriate action to control the level of risks.

A successful operational risk management system requires an investment in the bank's infrastructure, and the key to success lies in the staffing of the operational risk management function. Individuals charged with this responsibility must have a clear understanding of the role that operational risk management plays in maintaining a sound and financially strong institution. Further, they must have a thorough understanding of the risks that a financial institution is exposed to during the normal course of business. The board of directors must lay out the guidelines under which the operational risk management function and set policies, procedures, and guidelines for the risk managers to follow.

The board also must ensure that those charged with operational risk management responsibility have the resources necessary to carry out their tasks and that they function as an independent unit. It is important that the organization must not treat the operational risk management unit as a profit center; the central idea is to reduce risk, not to increase profit. In addition, the operational risk management group must be independent of the activities that it is charged with.

Finally, the operational risk management unit should report directly to senior management. In short, the board of directors is ultimately responsible for ensuring that banks carry out strategies and policies consistent with sound operational risk management practices.

Commercial banks have been dealing with specific risks category such as credit risk or liquidity risk alone without taking integrative approach to manage the risk exposure of the bank as whole. This is known as traditional operational risk management, which is insufficient in the new risk environment. The traditional operational risk management was applicable in a world where bank earnings were derived from interest earned on loans and securities, bank liabilities were in regulated deposit accounts, and use of technology was limited.

In response to these developments, banks are structuring a new position of Head of operational Risk. Operational risk has traditionally been managed in the business and it is still the business units that are primarily responsible for taking and managing operational risk on a day-to-day basis. While the trend for market risk and credit risk is towards increasing centralization, operational risk by its nature is decentralized PWC 1997, Basel 1998. Structuring a new position aims at integrating operational risk management with market and credit risk in bank’s wide risk management. In Tanzania only Barclays bank has a position of Head of Operational Risk, which is responsible for the bank’s operational risk management. Other banks use the internal audit unit to oversee operational risk management issues.

The use of internal audit unit to manage operational risk has been ineffective compared with the new approach of having a unit solely responsible for risk management. Although Barclays bank is new in Tanzanian environment, no reported loss has been recorded so far whereas theft or other operational risk incidences in the past two years have been experienced amounting to billions loss of money. These losses can be attributed to breakdown of internal controls bank such as Backlays, NBC Ltd, CRDB Bank, Stanbic just to mention a few. A survey conducted in UK by PricewaterhouseCoopers suggests that the concept of having a head of operational risk is a trend gaining widest acceptance. Their findings came up with a corporate operational risk organizational model shown in Figure 2.1.

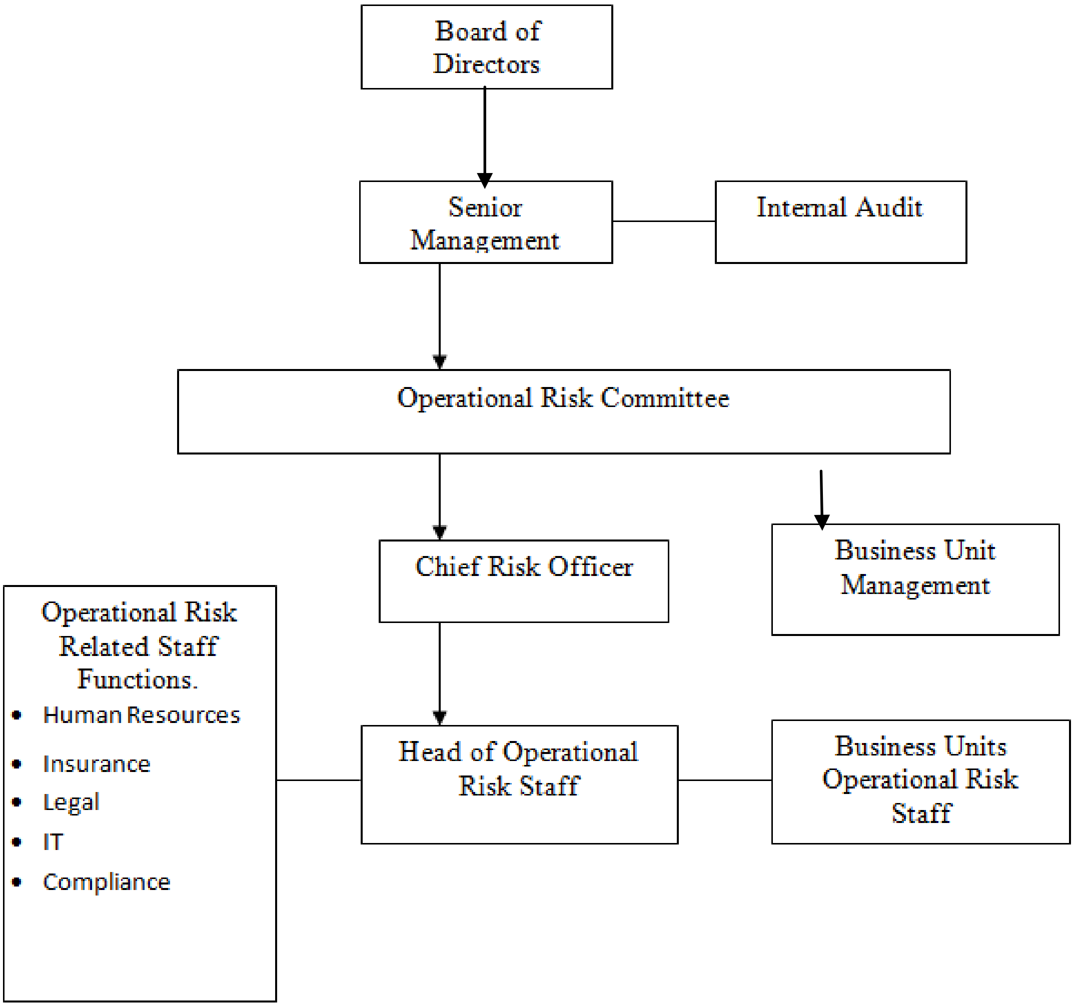

Figure 2.1: Corporate Operational Risk Organization Model

Source: Cruz (2013)

The head of operational risk report to the Chief Risk officer. Below the head of operational risk staff is dedicated to supporting individual business units. Other aspects of the model are additional organizational units that play important role, the Board of Directors takes a more active interest in reviewing operational risk policies and major issues. Operational Risk Committee is established to heighten the awareness and prioritize resources, other Risk related functions (e.g. IT, Legal, Compliance, and Human Resources) have responsibility for specific operation risk issues.

2.2.2.5 Operational Risk Management Process

Operational risk management process sets out the overall procedures for operational risk management (PWC, 2001), Controls-definition of internal controls or selection of alternate mitigation strategy such as insurance, for identified risks. Assessment programs to ensure that controls and policies are being followed and determines the level of severity. These may include process flows, self –assessment programs, and audit programs, Measurements of a combination of financial and non-financial measures, risk indicators, escalation triggers and economic capital to determine current risk levels and progress toward goals, reporting information for management to increase awareness and prioritize resources.

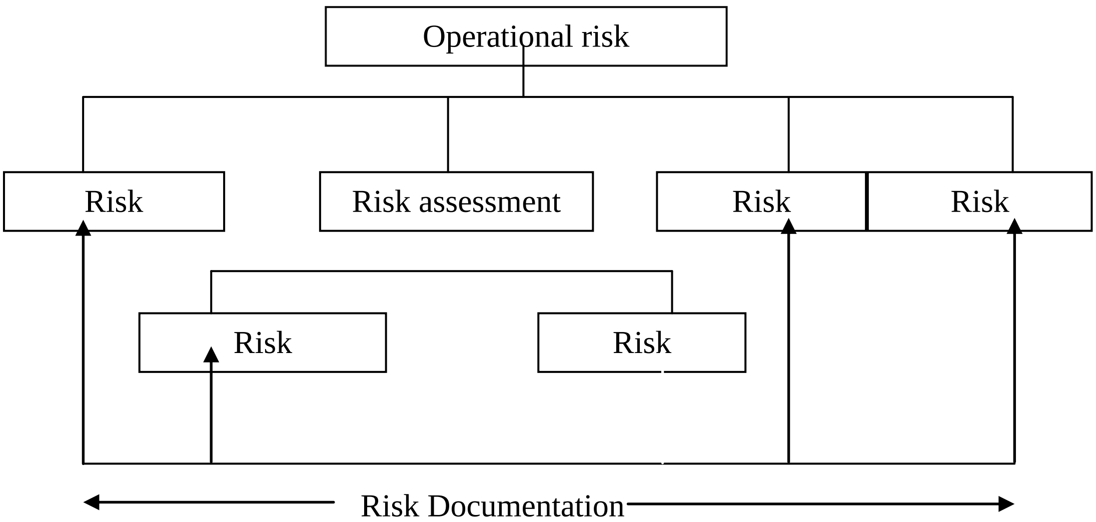

Figure 2.2: A Summary of General Concept of Operational Risk Management as a Continuous Process
Source: Desiderio, (2009)

(i) Risk Identification and Analysis

Identification is a crucial stage in the operational risk management process. Risk analysis is the process of identifying the different risk involved, and determining the possible outcomes of actions and /or decisions. Chijoriga (1997), explained that management and other relevant personnel could identify key risks in business through workshops and interviews, brainstorming, use of questionnaires, and process mapping which involves identifying and mapping the core business processes/value chains (PWC, 1999) Risk identification is paramount for the subsequent development of viable operational risk monitoring and control.

Effective risk identification considers both internal factors (such as the complexity of the bank's structure, the nature of the bank's activities, the quality of personnel organizational changes and employee turnover) and external factors (such as changes in the industry and technological advances) that could adversely affect the achievement of the bank's objectives.

Basel (2002) revealed that several processes commonly used by banks to help them identify and assess operational risk, these are: Self- Assessment that a bank assesses its operations and activities against a menu of potential operational risk vulnerabilities. This process is internally driven and often incorporates checklists and/or workshop to identify the strengths and weaknesses of the operational risk environment, Risk Mapping in this process, various business units, organizational functions, or process flows are mapped by risk type. This exercise can reveal areas of weakness and help priorities subsequent management action. Key Risk Indicators that are statistics and/or metrics, often financial, which can provide insight into a bank's risk position. These indicators tend to be reviewed on a periodic basis (such as monthly or quarterly) to alert banks to changes that may be indicative of risk concern. Such indicators may include the number of failed trades, staff turnover rates and the frequency and or severity of errors and omissions, Scorecards provide a means of translating qualitative assessments into quantitative metrics that give a relative ranking of different type of operational risk exposures.

Some scores may relate to risk unique to a specific business line while others may rank risk that cut across business lines. Scores may address factors inherent risks, as well as the controls to mitigate them. In addition, scorecards may be used to allocate economic capital to business lines in relation to performance in managing and controlling various aspects of operational risk. Thresholds/limits**:** typically tied to risk indicators, threshold levels, (or changes) in key risk indicators, when exceeded, alert management to areas of potential problems.

Measurement: some forms have begun to quantify their exposure to operational risk using a variety of approaches. For example, data on a bank's historical loss experience could provide meaningful information for assessing the bank's exposure to operational risk and developing a policy to mitigate/control the risk.

An effective way of making good use of this information is to establish a framework for systemically tracking and recording the frequency, severity and other relevant information on individual loss events. Some firm have also combined internal loss data with external loss data, scenario analyses, and qualitative assessment factors.

(ii) Risk Assessment

Andrew (1995) points out that entity face variety of risk from external and internal sources that need to be assessed. A precondition to risk assessment is establishment of objectives, linked at different levels and internally consistent. He further defined risk assessment as the identification and analysis of relevant risk to achievement of the objectives, forming a basis for determining how risk should be managed.

Once risks have been identified, an assessment of possible impact and corresponding likelihood of occurrence have to be done. In the planning stage, management should agree on the most appropriate definition and number of categories to be used when assessing both likelihood and impact.

(iii) Risk Measurement

Once the source of risk have been identified and assessed, financial institutions must begin to measure the risks. As the foregoing list of risk indicates, this risk measurement process can be quite a challenge (Chijoriga 1997). According to financial theory, standard deviation is used as a good proxy measure of risk, and covariance of analysis is a more refined measure of risk.

Many non-market risks faced by commercial banks, (i.e. reputation risk, compliance risk) may be difficult to measure. They are nonetheless crucial to the firm's profitability and must be tracked. The market-related risks (i.e., interest rate risk, price risk, and foreign exchange risk) can be estimated though various modeling techniques.

(iv) Risk Monitoring

This part of the operational risk management process entails a comparison of the actual risk levels with the levels permissible under the bank's operational risk management guidelines. Thus, the bank's risk level would be continuously monitored to ensure that it remains within the acceptable range.

In addition to market risks, the bank would monitor other risk limits to ensure that their levels are consistent with established policies. In all of these instances, it is critical that the monitoring system provides immediate feedback to the management when actual risk levels depart from acceptable risk levels.

(v) Controlling Risks

Control activities are the policies and procedures that help ensure management directives are carried out (Andrew, 1995). They help ensure that necessary actions are taken to address risks to the achievement of the bank's objectives. Andrew (1995) asserts that control activities should occur throughout the organization, at all levels and in all functions.

A careful monitoring of the bank's risk will provide management with red flags whenever the risk levels are beyond those permitted as specified in the operational risk management guidelines. In these instances, corrective measures should be undertaken to ensure that the risks are brought back in line with the guideline. The integrity of the operational risk management system will depend on the strength of its reporting system and internal control processes.

2.2.2.6 Factors Influencing Operational Risk Management Process

Operational risk management is one among the various activities of the banks and is influenced by several factors, external and internal to the bank (Basel 2001). External factors includes: technological advancement, unstable political, economic, and legal factors. Technological advancement, unstable political environment, as well as adverse economic situation increase the chance of the bank's exposure to risks.

Internal factors are within the control of the bank. These factors include; internal controls and operational risk management function within the bank. The literature indicates components of effective internal controls (internal control environment, risk assessment, internal control activities, information and communication, and monitoring). Internal controls as well as operational risk management function are the most influential factors (, Cynthia, 1997, john 1997, Basel, 1998, Terry & mark 2001, Jacqueline, 2002)

2.2.2.7 Effectiveness of Internal Controls

Basel,(1998) reveals that control as a process, is effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objective in the following categories; effectiveness and efficiency of operations, reliability of financial reporting, compliance with applicable laws and regulations. Internal controls are tools that help managers be effective and efficient while avoiding serious problem such as overspending, operational failures, and violation of law. Internal controls are the structure, policies, and procedures put in place to provide reasonable assurance that management meets its objectives and fulfills its responsibilities.

A system of strong internal controls can help to ensure that the goals and objectives of a banking organization were to be met, that bank will achieve long-term profitability targets, and maintain reliable financial and managerial reporting. Such a system can also help to ensure that the bank will comply with laws and regulations as well as policies, plans, internal rules and procedures, and decrease the risk of unexpected losses or damage to the bank's reputation. The internal control process has five components: internal control environment, risk assessment, internal control activities, information and communication, and Monitoring (Basel, 2001).

2.2.2.8 Internal Control Environment and Management Oversight

Internal controls are likely to function well if management believes that those controls are important and communicates that view to employees at all levels (Basel, 2001). If management views controls as unrelated to achieve its objectives, or even worse, as an obstacle, this attitude will also be communicated. Despite policies to the contrary, employees will then view internal controls as "red tape" to be "cut through" to get the job done. An effective internal control environment. Sets the tone of an organization influencing the control consciousness of its people, provides discipline and structure, describes organizational culture, and encompasses both technical competence and ethical commitment (John, 1997& Basel, 2001).

(vi) Risk Recognition and Assessment

Operational Risk assessment is the process used to identify, analyze, and manage the potential risks that could hinder or prevent the bank from achieving its objectives. Risk increases during a time change, for example, turnover in personnel, rapid growth, or introduction of new product/services, cash receipts, direct third party beneficiaries, and prior problems.

(vii) Control Activities and Segregation of Duties

Information must be reliable to be of use and it must be communicated to those who need it. For example, supervisors must communicate duties and responsibilities to the employees that report to them and employees must be able to alert management to potential problems. Information must be communicated both within the organization and externally to those outside and it must be ongoing within and between various levels and activities of the agency.

(viii) Monitoring Activities and Correcting Deficiencies

After internal controls are put in place, their effectiveness needs to be periodically monitored to ensure that controls continue to be adequate and continue to function properly. Management must also monitor previously identified problems to ensure that they are corrected.

(ix) Operational Risk Management Function of the Bank

In the past, bank relied almost exclusively upon internal control mechanisms within business lines, supplemented by the audit function in the management of operational risk. While these remain important, recently there has been an emergence of specific structures and processes aimed at managing operational risk. In this regard, an increasing number of organizations have concluded that an operational risk management program provides for bank safety and soundness, and are therefore making progress in addressing operational risk as a distinct class of risk similar to their treatment of credit and market risk.

The literature indicated that, the operational risk management process is influenced by the operational risk management function of the bank (Basel, 1998; Terry & Mark 2001). This referred to the nature of the organizational operational risk infrastructure, that is, procedures for setting policies to ensure that there are necessary internal controls for managing operational risk. The structure can either be centralized or decentralized. Centralization occurs where all operational risk management functions are taken into one department, whose sole function is to analyze and control risks for the whole organization. With decentralization regime, responsibility belongs to individual department (Clive 1996, PWC, 1997). Basel (1998), suggests structuring an operational risk management with other risks in bank's wide risk management.

2.2.2.9 Developing Effective Operational Risk Management

In developing sound practices for effective Operational Risk Management Framework, operational risk to mean the 'identification, assessment, monitoring and control/mitigation' of risk. The Basel Committee has suggested seven principles for effective Operational risk management framework. (Basel.1995)

2.2.2.10 Developing an Appropriate Risk Management Environment

The board of directors should be aware of the major aspects of the bank's operational risk as a distinct risk category that should be managed, and it should approve and periodically review the bank's operational risk management framework. The framework should provide a firm-wide definition of operational risk and lay down the principles of how operational risk is to be identified, assessed, monitored, and controlled/mitigated.

Not only that but The board of directors should ensure that the bank’s operational risk management framework is subject to effective and comprehensive internal audit by operationally independent, appropriately trained and competent staff. The internal audit function should not be directly responsible for operational risk management.

Additionally, senior management should have responsibility for implementing the operational risk management framework approved by the board of directors. The framework should be implemented throughout the whole banking organization, and all levels of staff should understand their responsibilities with respect to operational risk management and should also have responsibility for developing policies, processes and procedures for managing operational risk in all of the bank’s products, activities, processes and systems.

2.2.2.11 Risk Management: Identification, Assessment, Monitoring, and Control

Banks should identify and assess the operational risk inherent in all material products, activities, processes, and system. Banks should also ensure that before new product, activities, processes, and systems are introduced or undertaken; the operational risk inherent in them is subject to adequate assessment procedures.

Also Banks should implement a process to regularly monitor operational risk profiles and material exposure to losses. There should be regular reporting of pertinent information to senior management and the board of directors that proactive management of operational risk. However, Bank should have policies, processes and procedures to control or mitigate material operational risks. Banks should assess the feasibility of alternative risk limitation and control strategies and should adjust their operational risk profile using appropriate strategies, in light of their overall risk appetite and profile.

2.3 Positive Accounting Theory

Managers have different reasons to make accounting choices given that the markets are not perfect. Under these assumptions, there are three reasons to accept different accounting choices (Watts and Zimmerman, 1986). The first reason is the presence of agency costs. Management might have incentives to choose an accounting method that maximizes their compensation schemes. This has been one of the areas where a relation between the manager's incentives and their accounting choices can be seen. The second reason is related to the intention of managers in influencing the asset prices or stock prices given the information asymmetry prevailing between managers and investors.

Managers take actions toward smoothing earnings over time, to avoid losses or to try to maximize the earnings over a period. The third reason is related to the intention of managers to influence external parties. Different accounting choices have different impact on the financial numbers, and managers expect to influence them with the information presented. The most important argument in favor is that corporate risk management creates value. In addition, accounting plays an important role reflecting the "reality" of the firm, which is in turn shown to the market through disclosure rules. On the other hand, increased market efficiency is achieved. The problem arises when those disclosure rules affect the decision- making process of risk management by providing different accounting choices. One of those options is hedge accounting; companies are allowed to take profits generated from hedging in reserve and account them in the operating income matching the operations when they occur, thereby smoothing operating profits (Fields, T. 2001).

2.4 Empirical Literature Review

Today's most of occurring changes and innovations are product of inquiries. This signifies that what is being done now is doubtlessly of what have already been conducted years and years back. So, reviewing them will necessarily give the urgency for actual study to be conducted. Despite the fact that literatures indicating the absence of studies about operational risk management in commercial bank Tanzania are lacking, ineffective, yet research recognize the existence of many studies about the topic under concern which have been conducted in other nations upon which study will seize its urgency too (Saunders,1999)

Bank should have in place contingency and business continuity plans to ensure their ability to operate as going concerns and minimize losses in the event of severe business disruption. Financial theory suggests that risk management can smooth variability in firm value (Bartram et al, 2009). The Theory says that risks should be redistributed to those better equipped to handle them. Industrial companies are unlikely to have a comparative advantage in bearing foreign-exchange risk, interest-rate risk or commodity risk. This removes the tails of the distribution as Stulz (1996) identifies three major costs associated with higher variability in cash flow: Higher expected bankruptcy costs, higher expected payments to stakeholders and higher expected tax payments. If risk management can smooth variability on terms with stakeholders, it will increase firm value. As for tax payments, risk management works in the simple way as to manage taxable income to ensure that the largest possible proportion of corporate income falls within the optimal period in the business cycle.

A fundamental starting point for understanding and dealing with operational risk is information about current practices. In the work of PWC and British Banker's Association done in 1997 in UK and Australia revealed that 25% of the respondents experienced individual losses of more than $ I million in the past three years. The study further shows that high levels of loss were reported in the category of system, failures, criminal acts, legal action, erroneous funds transfer, business disruption costs and damage to assets. The same study established that an average of 73% of the respondents think that operational risk is more significant that either market or credit risk thus, calling for its closer management. The prevalence of high-profile losses in the media is raising awareness of the critical importance of operational risk issues. However, further findings show that 47% of UK respondents and 30% of Australia respondents do not report on operational risk other that through internal audit.

The big worry today is that operational risk is harder to measure and predict. Empirical evidence suggest that the management of this risk is typically informal, implicit, and often not as effective as we might like. We have already seen well-publicized evidence of just how much damage can be done to banks' shareholder value by exposure to this risk. Public reports on incidents such as at Barings, Eaton's NatWest, Sumitomo, and Daiwa suggest that they were due to operating failures

(Ravi 2000, Cynthia 1997, PWC 1999). Cynthia further notes that “Year 2000” systems accidents were bound to happen.

Failure to properly manage operational risk may lead to bank failure. The work of (Kathawala and Johnson, 1990; Bankers Jounal, 1995; Santomero, 1995; Williams, 1995; Chijoriga, 1997; Brownbridge and Harey, 1998; Casson, 1998; Dowd, 1998; The Economist, 1998; Kimei, 1998 and Basel, 1998) shares same views that banks may fail because of breakdown of internal controls which lead to fraud and dishonesty, embezzlement, poor credit risk management, failure to cope with technological changes, poor and sluggish monetary and fiscal policies, bank deregulation/regulation policies and procedures, uncontrolled involvement of influential politicians as shareholder and /or directors of banks, use of political connections to secure public sector deposits as well as heavy reliance on deposits from a limited sources specifically from parastatals .

However, Casson & Dowd (1998), explains that a number of recent banking problems arise from breakdowns of internal controls such as; lack of adequate management oversight, accountability, and failure to develop strong control culture, absence or failure of key control structures and activities, inadequate communication of information between levels of management and inadequate or ineffective audit programs and monitoring activities.

Additionally, the outcomes of the study conducted by PWC in 1999 suggest that development of operational risk management, as distinct internal function with its own process, structure, tools and measures is the trend where most banks are going.

With this structure, head of operational risk will manage operational risk management as a discipline.

From the literature, the framework of study and analysis will investigate the risk planning, risk assessment, evaluation, control and monitoring of commercial banks in Tanzania and how well operational risk management process is well integrated in the organization structure hence forms the basis for the study.

2.5 Literature Gap

Basing on Tanzanian financial work organizations, the studies have been made to investigate the risks that take place in these firms. This study dealt with the effectiveness of operational risk management in the banking institutions of which other studies have not covered. The study used 5 banks from Dar es Salaam to investigate this problem. So the need to investigate the operation risk was inevitable since most of the study made on this issue did not take more time on operational risks specially to financial institutions. Also the studies made in this issue are not done on Tanzanian financial institutions based environment.

2.6 Conceptual Framework

According to Ndunguru (2007) conceptual framework is an assemblage set of research concepts cum variables together with their logical relationships often presented in form of diagrams, charts, graphs, pictographs, flow-charts, organ gram or mathematical equations. Linked to the problem statement, the conceptual framework "sets the stage" for presentation of the specific research question that drives the investigation being reported. It seeks to give description of the research concepts together with the variables such as the independent variables (I.V) and dependent variable (D.V) as isolated but work in a unified system of relationships. The conceptual framework of this research looks as shown in Figure 2.3.

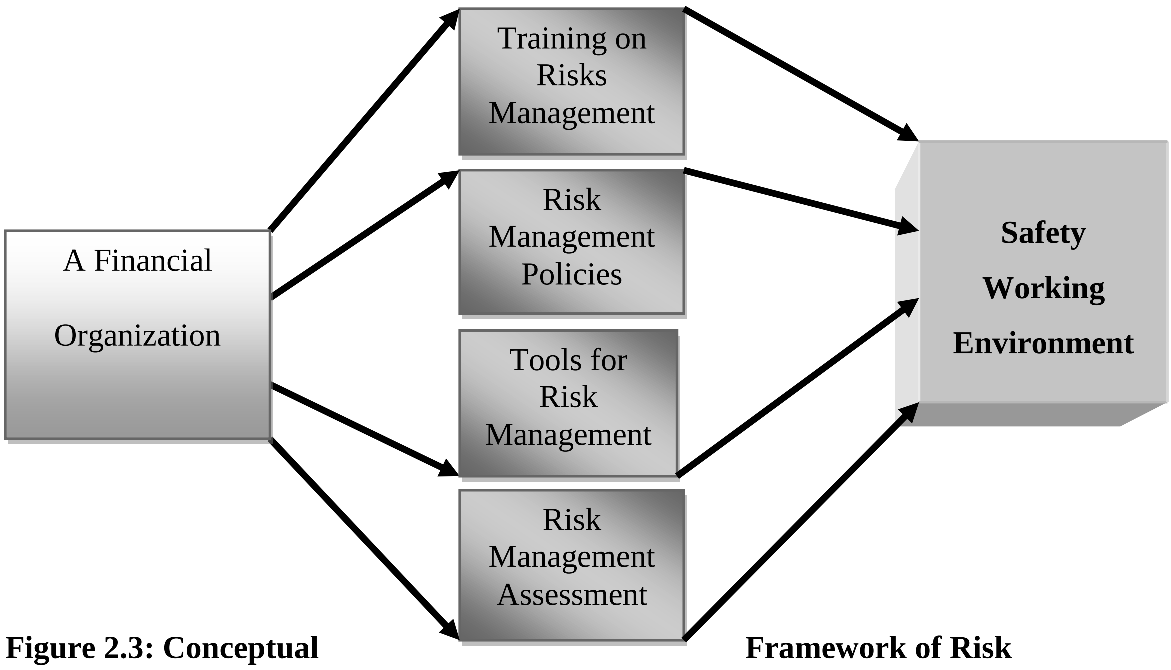

Figure 2.3: Conceptual Framework of Risk Management in a Financial Work Organization

Source: Own Developed Model, 2014

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Overview

This chapter presents the research methodology that has been used in this study. More specifically, the chapter presents the research design, area of the study, target population sample size, sampling and data collection techniques and data analysis procedures.

3.2 Research Design

Research design is a road map used to guide the implementation of the study (David, 1980). This study used Survey that was be carried out between September 2012 and June 2013. the survey conducted in five Commercial banks; CRDB bank, NBC Ltd ,Barclays, Standard Chartered and Akiba Commercial Bank which are located in Dar es Salaam.The study used a questionnaire and interviews in data collection The survey design have appropriately been used by various researchers for collecting data through questionnaires and interviews. Thus, the researcher used questionnaire as the main instrument for collecting data on operational risk management to identify different factors affecting operational management.

The Survey designed to solicit demographic information such as roles, which used to describe the characteristic of the respondents. Survey also allows the use of self-report, which used to collect information about the effectiveness of operational risk management. The information, which will be obtained from the self-report, will be used to identify the tools and technique used for the effectiveness of the operational risk management. Self report used for measuring personal experience on operational risk management. Operational risk managers required to report factors affecting operational risk management. Then, the information obtained will later be used to describe the effectiveness of the operational risk management in the banks.

In the second phase interview conducted with Human resource officers, Branch managers, chief risk officer, insurance officer, legal officer, IT officer, and compliance officer will have depth information on operational risk management in banks. Interview will be used to inquire about awareness of the employees about policies and regulation used for effectiveness of operational risk management.

3.3 Target Population

The population in this study included all workers of the financial banks in Tanzania specifically those of selected five banks in Dar es Salaam where the sample was selected. However, the researcher could not collect information from all banks in Tanzania; only five banks allocated in Dar es Salaam were involved in the study as it illustrated on Table 3.1 on.

3.4 Sampling Procedure and Sample Selection

This part analysis the techniques used to the whole process of obtaining a sample. It analysis the sampling procedures and the methods used for sample selection.

3.4.1 Sampling Procedures

This study used random sampling in a selecting sample banks. All commercial banks had equal chances of being selected to a sample. Out of 34 commercial banks operating in Tanzania, only five commercial banks were sampled. All of these banks are located in Dar-es-salaam. Due to time and financial constraints, the study covered only respondents in Dar-es-salaam and limited but when choosing the sample bank a clustered random sampling was applied. Clustered was used due to the fact that all financial banks have the same characteristics in relation to the studied problem of risk management. The other reasons for choosing banks in Dar es Salaam were the nature of the studied population being bank workers under the banks with also the same qualities and the banks being many and accessible in this area compared to other regions in Tanzania.

Respondents were selected based on the role they played in the organization. Staff from Board of directors, senior managers, internal auditors, operational risk committee, chief risk officers, human resource officers, legal officers, IT officers and compliance officers was involved in the study. These people were the major stakeholders in operational risk management because their functions were directed with operations.

Table 3.1: List of Banks Used in the Study

Name of the bank	Total Number of Workers in Tanzania	Number of Participant in Dar es Salaam
CRDB Bank Limited	2144	39
NBC Ltd	1300	23
Barclays	586	11
Standard chartered	337	6
Akiba Commercial Bank	300	5
Total	**4667**	**84**

Source: www.bot.go.tz (2012)

3.4.2 Area of the Study

Since the aim of the study was to assess the effectiveness of operational risk management in the performance of financial institutions in Tanzania, the researcher using simple random technique, CRDB bank, NBC Ltd, Barclays, Standard Chartered and Akiba Commercial Bank were selected to a sample. These banks are located in Dar es Salaam and hence Dar es Salaam was used as an area of the study.

3.4.3 Instrument of Data Collection

3.4.3.1 Questionnaire

The questionnaire designed to capture relevant information from the field. The questionnaire composed both closed and open-ended questions, which gave respondents an opportunity to select the appropriate answers at the same time giving them an opportunity to express their information without any limitation. The questionnaire made up of measurement questions (scales type of questions). Scaling techniques in data collection enabled the researcher to collect standardized and measurable data, thus provide quantitative measures, which had greater precision, ease for statistical manipulation. The choice of using questionnaire in data collection was given greater priority because of its advantages over other methods, as it is efficient, cost effective and ability to capture more information from the source.

The questionnaire designed to elicit information on how these banks managed operational risk management and indicate how these banks suffered as a result of operational loss over the past three years. The questionnaire is easy to respond by respondents whose banks have formal operational risk management functions because most the issues asked had been well known to them. Before administering the questionnaire, pre-testing to five different respondents were done. The pre-testing aimed at clarifying any misunderstanding, ambiguities to questions. The respondents had been selected from two banks and had been assistance in shaping the quality and clarity of the questions in the questionnaire.

3.4.3.2 Interview

Personal interview was conducted, involving structured and non-structured questions, to the selected financial organization to get more information which were not covered by questionnaires. The researcher administered personally interview to all respondents to get more information on areas not well covered by the questionnaires and the data obtained was added to give well-analyzed information.

3.5 Variables of the Study

This study had the variables that influence the operational risk management in Tanzanian financial management. Operational risk is defined as the risk of loss resulting from inadequate or failed processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputational risk (Global Association of Risk Professionals, 2010). Basing on the definition of operational risk, this study have the following variables.

Effective management of operational risks. Effective management of operational risk, as used in this study, involve the situation whereby the financial institutions make sure that the operational risks are well and carefully controlled so as to avoid losses. Methods used to manage operational risks. Methods for managing operational risks involve tools and techniques used by the financial organizations to control and monitor the operational risk.

Factors that affect operational risks management. In this study, factors affecting operational risk management include all issues that influence the financial operational risk. Awareness of bankers on principles guiding operational risks. This variable assesses the knowledge of the bankers towards daily operational risks. Of these variables were accessed using primary data. The data were collected from the sample through questionnaire, interview and partially observation method to reach about the findings of this study.

3.6 Data Analysis

Data analysis started with processing of collected data by editing to detect and correct errors and omissions, and coding. The analysis-involved calculation of statistical values like mean performances. Given the nature of the study frequencies and simple percentages will be determined. Cross tabulation calculated to present the relationship between variables. A chi Square used to analyze relationships between variables. Computer software (SPSS) also was used for data summarization and analysis.

Data analysis performed in order to achieve the research objectives. General description on how commercial banks manage operational risk had been detailed, including operational risk definition and policy, operational risk management function, operational risk policy, strategy formulation, monitoring and control as well as tools used to assess operational risk. To achieve these, frequency tables and percentages had been generated and calculated. Responses from open-ended questions had been summarized with the view to make pie chart frequency tables and percentages. All recommendations from the respondent had been documented and formed the basis of research recommendations.

3.7 Ethical Considerations

Since the research involved people, the researcher considered ethical issues. In this study ethical issue such as informed consent for one to participate in the study, privacy, anonymity and confidentiality had been adhered to as argued by Cohen, Manion and Marrison (2007). Research clearance had been obtained from the Open University of Dar es Salaam authorities who allowed a researcher to contact the Regional and Municipal authorities, in order to be allowed to collect the required data.

3.8 Validity of the Study

According to Phelan, C. and Julie Wren (2005), validity of the study refers to how well a test measures is supposed to measure. The concept of validity described by a wide range of terms in qualitative studies. This concept is not a single, fixed or universal concept but rather a contingent construct, inescapably grounded in the processes and intentions of particular research methodologies and projects.

Although some qualitative researchers have argued that the term validity is not applicable to qualitative research, but at the same time, they have realised the need for some kind of qualifying check or measure for their research, Golafshani (2003).

This study shows validity as the research findings resemble the findings of the pre-test (pilot study) done on the same study area. The findings of the pilot study discovered that the issue of risk management among the financial organization was not effectively implemented.

CHAPTER FOUR

FINDINGS AND ANALYSIS OF DATA

4.1 Overview

This chapter presents the findings of the research, the analysis and interpretation of the findings. The findings are analyzed in relation to the objectives of the study and the literature reviewed earlier. To recap, the objectives of this study are enumerated below so as to make a close look of the findings in line with the objectives:

(i) To assess whether the operational risk management is effectively managed in the Banks operations.

(ii) To examine whether commercial banks have methods used in management of operational risk

(iii) To assess the awareness of employees on the principles and regulations related to the operational risk management of the banks.

(iv) To examine factors influencing operational risk management process.

The chapter has been grouped into two sections. The first section covers general description of the respondents' characteristics and their background information. It explains about their sex, the time they have worked with their financial institutions and the level of the education an employee has attained. These issues of sex, time working with a financial institution and education level of an employee contribute a lot on the understanding and interaction of daily risk management at their work organizations. The second section involves the general findings. This area describes in detailed manner about the specific objectives of this study. The assessed areas that address specific objectives include effective management of operational risks, methods used to manage operational risks, factors that affect operational risks and awareness of bankers on principles guiding operational risks in Tanzanian financial banking institutions.

4.2 General Findings

This part analyses in detail about the characteristics of the respondents of this study. It explains about their sex, the time they have worked with their financial institutions and the level of the education an employee has reached. These variables contribute a lot on the understanding and interaction of D.R.M at their work organizations.

4.2.1 Sex of the Respondents

Most of the respondents were males making up to 56.0% of the total respondents of the study while 44.0% of the respondents were females. This may simply imply that the financial organization have got a large number of males compared to female as the result show 56.0% of the sampled population being males.

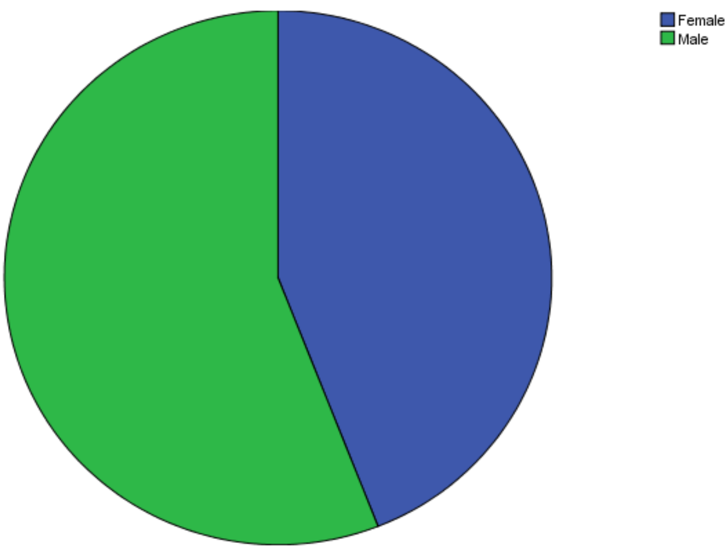

Figure 4.1: A Pie Chart Showing the Gender of Research Respondents
Source: Field Data (2014)

4.2.2 Duration and Employees who had been Working with the Financial Institution

The study investigated the duration of a respondent who had been working in his/her current financial organization. The time was divided into 4 categories from which the majority of employees who were found stayed at their work stations for the duration ranging from 3 to 5 years making up 44.0% of the total respondents.

The second category of respondents was represented by 0 to 2 years that made about 22.6% of total research representatives. The category of 6 to 8 years at work comprised about 19.0% of the total respondents while category four comprised those who stayed at their current work stations for more than 9 years comprising 14.3%. This observation shows that most of the employees of the financial institutions stay at their work stations for less than 10 years.

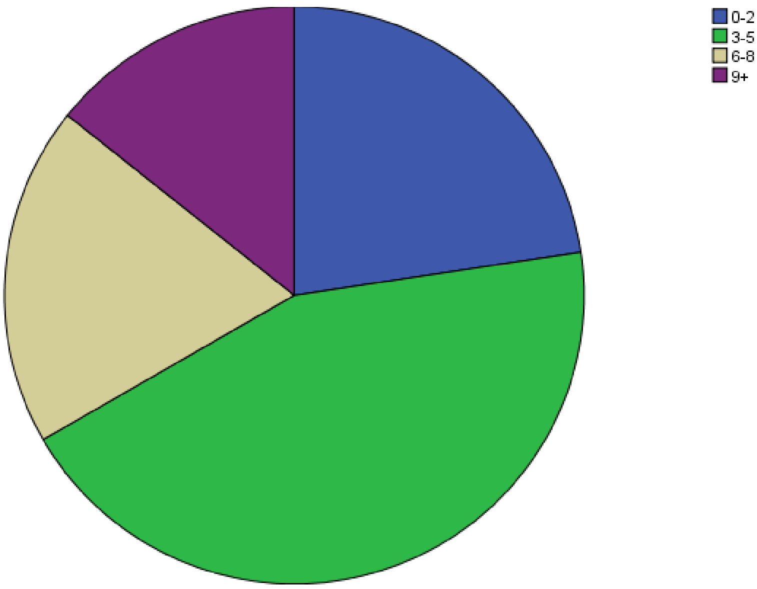

Figure 4.2: A Pie Chart Showing How Long an Employee had been Working with a Financial Institution

Source: Field Data (2014)

4.2.3 Education Level of a Respondents

This study did an investigation on the level of employees of the financial institutions in Tanzania due to its importance in understanding risk management at work. It was found that 41.7% were those with advanced diploma or university degree making the majority of the total respondents. The employees with an ordinary diploma were 26.2% of the total study respondents making the second largest group of financial institutions workers who were interviewed. Certificate and masters degree had 10.7% each making up the third largest category of respondents. Professional bankers had 7.1% as the fourth category while the level of education represented by few was PhD holders being the fewest in the financial institutions with 3.6% of the total respondents.

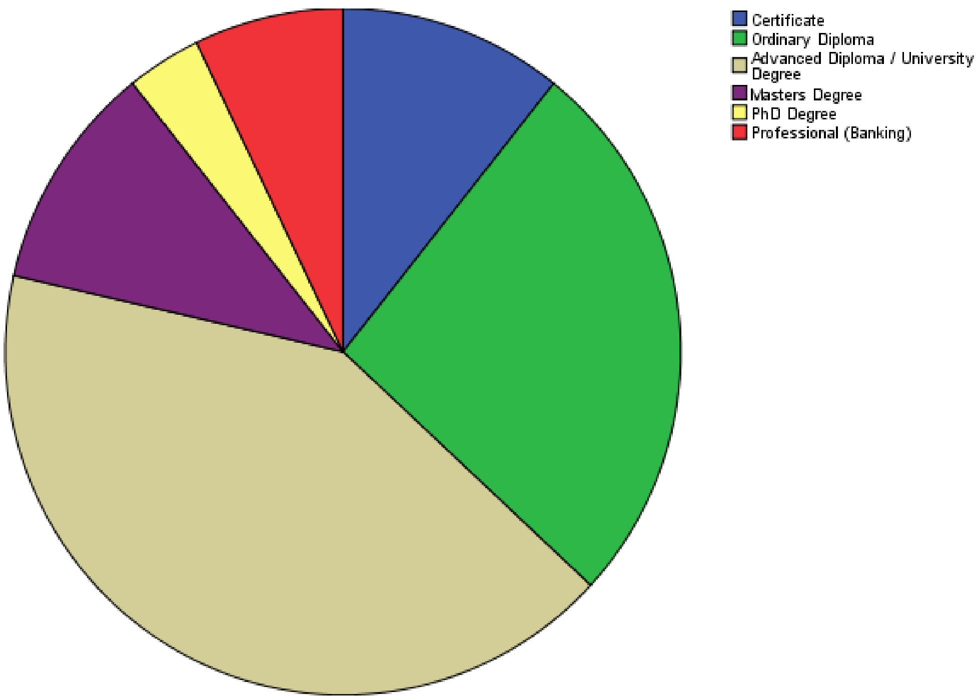

Figure 4.3: A Pie Chart Showing the Level of Education of the Study Respondents

Source: Field Data (2014)

4.3 Specific Findings

This part assesses different areas of specific objectives of this study about the financial risk management. These include effective management of operational risks, methods used to manage operational risks, factors that affect operational risks and awareness of bankers on principles guiding operational risks.

4.3.1 Effective Management of Operational Risks

4.3.1.1 Presence of Risk Management and Control Department and its Effectiveness

Risk Management and Control Department is very important to any organization for the purpose of controlling and monitoring of risks at a work organization. The study investigated the presence of these departments in financial organization in Tanzania. It was found that almost all of the respondents of this study agreed that there were Risk Management and Control Departments in their work organization composing of 98.8% total respondents. This category comprised respondents from five commercial banks selected in Dar es Salaam to represent the rest in the whole country. 1.2% didn’t choose any side among the two variables of yes or no. This may be due to the reason that the departments available were not maximally utilized in terms of activeness as it is supported by the views of interviewed respondents.

On the other hand, the interview was used to investigate more on the same issue. Most of the respondents showed that the departments were not active hence there were no effectiveness on controlling daily risks in these banking institutions. Kimei and Basel (1998) shares same views that banks may fail because of breakdown of internal controls which lead to fraud and dishonesty, embezzlement, poor credit risk management, failure to cope with technological changes, poor and sluggish monetary and fiscal policies, bank deregulation/regulation policies and procedures, uncontrolled involvement of influential politicians as shareholder and /or directors of banks, use of political connections to secure public sector deposits as well as heavy reliance on deposits from a limited sources specifically from parastatals. Control activities are the policies and procedures that help to ensure management directives are carried out (Andrew, 1995). They help ensure that necessary actions are taken to address risks to the achievement of the bank's objectives. Andrew (1995) asserts that control activities should occur throughout the organization, at all levels and in all functions.

Table 4.1: Presence of Risk Management and Control Department

Responses	Yes	No	None Response	Total
Frequency No	83	0	1	**84**
Percentage	99.8	0	1.2	**100**

Source: Field Data (2014)

4.3.1.2 Presence of Operational Risk Policies

According to Encarta (2008) a policy is a program of actions adopted by a person, group, or government, or the set of principles on which they are based. This study investigated if there were regulations and procedures for governing risk management in the financial organizations in Tanzania. 94% of all respondents of the study, from five selected commercial banks, agreed that there were operational risk policies at their workstations. The rest 5% did not say anything about the policies that control daily risks. This might be due to lack of awareness of these rules and procedures. Then the respondents were asked, through interview, to tell whether the policies are well exercised. Most of them pointed out that the procedures to guide operation risks are well written but not well implemented. Deorig (2003), states that in spite of my critical observations on data and statistics, I am a proponent of a credible and relevant internal database system, which is structured, cost efficient, systematic and consistent along the suggested 5 major categories: organization, policy and process, technology, human and external. It fosters transparency and is good modern management. Today, there is also a better IT connectivity potential. Thus, the policies for daily operational risks are well written and kept in book without being effectively implemented.

Table 4.2: Presence of Operational Risk Policies

Responses	Yes	No	None Response	Total
Frequency Number	79	0	5	**84**
Percentage	94	0	6	**100**

Source: Field Data (2014)

4.3.2 Awareness of Bankers on Principles Guiding Operational Risks

4.3.2.1 The Extent an Organization Encountered to Daily Operational Risk (DOR)

The study investigated if the financial baking institutions were encountered to daily operational risks. It was found that 96.4% agreed that there were DOR in their work organizations place they were working. 2.4% of the total respondents did not indicate anything on the issue that there were DOR in their work organization. This might be caused by the reason that they were not sure or not expedited the DOR at their work organizations. The remaining 1.2% disagreed that there are DOR in their work organizations and no any respondent who strongly disagreed. Doerig (2003) argue that risk management is a daily struggle against uncertainty and a daily learning process: Risk management is not a program, but a process for which senior management and Board of Directors are increasingly called upon to ensure. New governance requirements are quite explicit about this responsibility. Good risk management is not only a defensive mechanism, but also an offensive weapon. Hence, it can be concluded that the DORs exist in financial organization in Tanzania as the majority of the respondents more than 96.4% fall under agreeable side that there were DORs in their work organizations.

Table 4.3: Financial Organizations are Encountered to DOR

Response	**Frequency Number**	**Percent**
Disagree	1	1.2
Agree	81	96.4
Non Response	2	2.4
Total	**84**	**100**

Source: Field Data (2014)

4.3.3 Methods Used to Manage Operational Risks

4.3.3.1 Provision of Training on Operational Risks

Ngirwa (2006) defines training as a learning process in which people acquire knowledge, skills, experience, and attitudes that enable them to achieve their organizational and individual goals. The components, knowledge (K), skills (S), experience (E), and attitudes (A) are introduced here to refer to the ability that a trainee derives from training. Training is a very important issue in any work organization as it makes employees to acquire knowledge of different issues related to work organization like risks at work. This study investigated if there were training on risks likely to take place in the finical institutions in Tanzania. Most of the respondents disagreed responding on the question wanted to know if there were training on operational risks making about 59.5% of the total respondents.

Those who agreed made up 39.4% of the total respondents. There were 1.2% of the respondents who didn't say anything on this issue as a non-response part of the respondents. Those who were interviewed supported the disagree part as they said that in most of the cases the organization train on other operational activities rather than on DORs. Deonne, (2005) on the issue of education, points out that interestingly, financially educated directors seem to encourage corporate hedging while financially active directors and those with an accounting background play no active role in such policy.

This evidence combined with the positive relation reported between hedging and the firm's performance suggests that shareholders are better off with financially educated directors in their boards and audit committees. Our empirical findings also show that having directors with a university education in the board is an important determinant of the hedging level. Indeed, our measure of risk management is found to be an increasing function of the percentage of directors holding a diploma superior to a bachelor degree. This result is the first direct evidence concerning the importance of university education for the board of directors in general. Training on operational risks are not well implemented in Tanzanian financial institution as most of the respondents fall under disagree while those who agreed were few.

Table 4.4: Provision of Training on Operational Risks

Response	Frequency Number	Percent
Disagree	50	59.5
Agree	33	39.4
Non Response	1	1.1
Total	**84**	**100**

Source: Field Data (2014)

4.3.3.2 Presence of Monitoring and Control of Operational Risks

Risks monitoring and control are very important factors in the work organizations due to their abilities of reducing or preventing of the risks likely to take place in the work organizations. This study found out that most of the financial work organizations were dealing with monitoring and control of risks likely to take place in their areas.

This was proved by the majority of the respondents who agreed that there were monitoring and control of operational risks in their working places forming about 72.6% of the total respondents. 26.2% of the total respondents were not satisfied with the presence of monitoring and control of operation risk hence disagreed. Deonne, (2005) the risk management and control, implies dealing with derivatives and other financially sophisticated tools. Thus, considering the risk management decision makes it possible to test whether an independent board/audit committee is capable of taking complicated mandatory decisions that benefit shareholders, or whether we need to impose financial knowledge on the directors to achieve this goal. We contribute to the risk management literature by proposing a new set of explanatory variables that have never been explored before. To the best of our knowledge, we are the first to establish relationship between corporate hedging and the background and education of the board and the audit committee members.

We also add to the literature on corporate governance by considering a broader definition for financial knowledge. Previous papers limit their analysis to directors engaged in financial activities and more precisely to those with a banking/insurance experience. We are the first to constitute that directors could have a financial background in addition to their education. Our empirical evidence shows the importance of education for directors suggests that only financially educated members of the board and audit committee affect corporate hedging. Since the total number of agreed respondents form the largest part, then it can be concluded that the issue of risks monitoring and control is available in most of the banks in Tanzania.

Table 4.5: Presence of Monitoring and Control of Operational Risks

Response	**Frequency Number**	**Percent**
Disagree	22	26.2
Agree	61	72.6
Non Response	1	1.2
Total	**84**	**100**

Source: Field Data (2014)

4.3.3.3 Presence of Compensation to Workers who Gets Operational Risks

The issue risks, when occurring, take place accidentally in any ways hence may occur to the employees as well as work organizations at large. The study investigated the compensation to workers who get risks at their work organizations. It was discovered that 50% of the total respondents agreed that the employees who got risks at work were compensated. Those who disagreed composed of 48.8% of the total respondents while 1.2% did not say anything as none response.

The study added a question of interview and the results was shown that most of the employees who are highly compensated were those with top positions in the financial organizations. On the issue of compensation, Deorig (2003) points out that compensation-system banks are regularly being criticised for the - Anglo-Saxon influenced - bonus systems according to "plain volume performance". While all banks are under massive competitive market pressure, it is a serious issue, which is relevant for operational risk management as well. Pure short-term orientation can be damaging for the shareholder, other stakeholders, the organization and even the individual concerned.

Table 4.6: Presence of Compensation to Workers who get Operational Risk

Response	Frequency Number	Percent
Disagree	41	48.8
Agree	42	50.0
Non Response	1	1.2
Total	**84.0**	**100.0**

Source: Field Data (2014)

The assessment of a line manager has to include control and reputational performance. With the supportive literature, the results generally show that largely there is compensation to financial bank workers who get operational risks at work but also some of the employees are not considered.

4.3.3.4 Availability Already Prepared Instruments for Daily Operational Risks

This study wanted to know if the organizations had already prepared tools to deal with daily operational risks. Among the total respondents of this study, 53.6% agreed that there are already prepared tools for dealing with daily operational risks likely to occur in the financial institutions in Tanzania. The rest part of respondents composing of 46.4% disagreed about the presence of instruments for covering operational risks. There were no none response in this category as all respondents either responded to agree or to disagree.

Chijoriga (1997) urges that risk management process involves risk analysis (identification), risk assessment (measurement), risk handling, risk implementation, and risk review. Risk analysis is the process of identifying the different risk involved, and determining the possible outcomes of actions and/ or decisions. Through risk analysis, all possible risk exposures that may be faced by the firm are identified, and then classified based on probability and potential effect.

Deorig (2003) suggests that, many risk areas cannot be measured. They require judgment accordingly. Two types of data, qualitative data and quantitative data must be distinguished. These data types are just like pictures taken by two totally different instruments i.e. a camera and a tape recorder. They therefore also require different treatment, interpretation and analysis. In this context it is extremely important that the information to be captured in the data is clearly defined, in terms of content, feature and unit. This is a precondition for standardisation and tracking possible failures of reporting, formats, and so forth. It can be concluded that the tools for dealing with DOR in Tanzanian financial work organizations are halfly available, meaning that in some work organizations they are available and in some are not, as the study shows that almost half of the respondents fall under the disagree portion.

Table 4.7: The Presence of Already Prepared Instruments for Solving Risks at the Work Organization

Response	**Frequency Number**	**Percent**
Disagree	39	46.4
Agree	45	53.6
None Response	0	0
Total	**84**	**100.0**

Source: Field Data (2014)

4.3.3.5 The Issue of Risk Control is Taken to a Great Consideration at the Financial Work Organizations

Controlling of risks was one of the main issues to be studied with this study. This study investigated if the financial work organizations take into great consideration the issue of risk control. The majority of the respondents about 78.6% agreed that the issue of risk control was taken to a great consideration at their financial work organizations while about 21.4% disagreed. There were no any respondent who opted for none response. Andrew (1995), supports the findings arguing that control activities are the policies and procedures that help ensure management directives to be carried out. They help ensure that necessary actions are taken to address risks to the achievement of the bank's objectives. They asserts that control activities should occur throughout the organization, at all levels and in all functions. Then the observation shows that the issue of risk control is taken to a great consideration as the majority of respondents about 78.6% fall under the agree part of the question interviewed.

Table 4.8: Issue of Risk Control is Taken to a Great Consideration at the Financial Work Organizations

Response	**Frequency Number**	**Percent**
Disagree	18	21.4
Agree	66	78.6
None Response	0	0
Total	**84**	**100.0**

Source: Field Data (2014)

4.3.3.6 Organization Deal with O.R on its Side or Side of an Employee

There was a need to compare the extent the work organizations deal with operational risks taking place on the side of themselves and on the side of employees. Those who agreed were 76.2% of the total respondents and there were none respondent. Deorig (2003) argue that satisfying its employees enables a company to satisfy its clients. Various staff aspects were discussed above. Key is a formal and informal mutually acceptable understanding between employer and employee, which should provide the needed identification. The implication of this is that many financial work organizations take more consideration on the OR risks taking place on their sides than those taking place on the sides of employees as the majority of the respondents of this study fall under the agree part forming about 76.2% of all total respondents of this study.

Table 4.9: Organization Dealing with O.R on its Side or Side of Employees

Response	**Frequency Number**	**Percent**
Disagree	20	23.8
Agree	64	76.2
None Response	0	0
Total	**84**	**100.0**

Source: Field Data (2014)

4.3.3.7 Presence of an Active Insurance to Cover Daily Operational Risks

Insurance is a very important to cover DOR in any organization. The research also investigated if the financial work organizations had the active insurance to cover these risks in their environment. Most of the respondents about 68.8% agreed that there were active insurance to cover daily operational risks in their working areas.

The disagreed part formed about 31.2%. There were no any respondent who opted for no response. Deorig (2003), argue that risk avoidance, risk reduction and control were discussed previously. This chapter deals primarily with risk transfer through commercial insurance and also with risk financing through special purpose vehicles and other financing options. Some argue that insurance is a wastage of money: "Buying a bank stock is implicitly buying an industry which is exposed to Operational Risk fluctuations; losses disappear between the cracks as part of doing business and often disappear in the P&L." Insurance - in my opinion - is a valuable instrument to transfer risk, to complement and also to cover operational risk management. It forces a bank to analyse its operational risk, to differentiate between their impact and frequency and avoids the high risk/low frequency situation, hence helps to optimise economic risk capital and regulatory capital requirements. If the insurance coverage can be deducted, it can smoothen earnings, and provide liquidity and assume proper contract. Insurance is part of operational risk management. Thus, the general implications show that the financial organizations in Tanzania have active insurance in their working environment to cover daily operational risks, as the majority of the respondents agreed that to a great extent they don’t depend on a bank, that is why 31.2% opted to disagree.

Table 4.10: The Presence of an Active Insurance to Cover D.O.R

Response	**Frequency Number**	**Percent**
Disagree	27	31.2
Agree	57	68.8
None Response	0	0
Total	**84**	**100.0**

Source: Field Data (2014)

4.3.4 Factors that Affect Operational Risks

4.3.3.7 Weak Rules and Principle Accelerate Daily Operational Risks

Strong principles and rules are one of the key factors for implementation of any agreed issue in an organization. There is the issue of strong rules and principles in controlling risk among the Tanzanian financial institutions. It was discovered that the majority of the respondents, about 63.1%, agreed that presence of weak rules and principles accelerate DOR at their financial work organizations. Those who disagreed were about 36.1% of the total research respondents. No any respondent opted for none response. Revell (1979) found that operational risk is the risk of loss resulting from inadequate or failed internal processes, people, and system or from external events. Deorig (2003) argues that risks arises from weaknesses in processes such as settlement and payment, non-compliance with internal policies or external regulation or failures in products or client dealings. The implications of these data show that the majority of the respondents fall under the agree side whereby more than 63.1% agree that the weak rules and principles are the source of DOR at their financial work organizations.

Table 4.11: Weak Rules and Principle Accelerate D.O.R

Response	**Frequency Number**	**Percent**
Disagree	31	36.9
Agree	53	63 1
None Response	0	0
Total	**84**	**100.0**

Source: Field Data (2014)

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Over View

This presents summary of the findings, conclusion and recommendations, furthermore the chapter presents limitation of the study and areas for further studies. The intention of this study was to assess the effectiveness of operational risk management in commercial banks in Tanzania. The study used 84 respondents that included the workers and administrative staff of the selected banks in Dar es Salaam as a case study.

5.2 Summary of the Findings

It was found that operational risks were occurring in most of the financial banks in Tanzania. Banks were aware about the strategies for monitoring and controlling them, though to some extent they were not effectively managed to the maximum potential. The awareness of bankers on principles guiding operational risks was found to be minimal among them. The results revealed that most of the respondents proved that operation risk management in Tanzanian financial institutions ware found not well implemented.

The essence of this study was to assess the effectiveness of operational risk management in commercial banks in Tanzania. The results revealed that most of the respondents proved that operation risk management in Tanzanian financial institutions were found not well implemented. Most of the respondents showed that there were a lot weaknesses in the management of DOR at their work organizations including lack of strong risk management departments, weak rules and principles, un implemented policies and biasness in the implementation of compensation.

5.3 Conclusions

The study was done to assess the effectiveness of operational risk management among the financial institutions in Tanzania whereby five banks in Dar es Salaam were selected as a sample. The results revealed that most of the respondents proved that operation risk management in Tanzanian financial institutions were found not well implemented.

It was found that in Tanzanian commercial banks, the issue of effectiveness of operational risk management was not done effectively. The results revealed that most of the respondents proved that operation risk management in Tanzanian financial institutions were found not well implemented. The respondents interviewed shown that though there were daily operational risks but they said they were not well managed basing on daily risk solving strategy.

5.4 Recommendations

The study recommends the financial organizations stakeholders and investors in Tanzania to invest on risk control and management for the efficiencies of the performance. Risks occurring daily affects their organizations as they affect both working environments and customers of these banks. There is a need for training on risks taking place at work rather than making general training on general issues and leaving risk management as a less important issue in work organizations. The trained employees on risks will assist on managing risks likely to cause loss at work.

The need for active insurance and compensation is very important to both sides of employers and employees. These will make the smooth working environment for employers, employees and also for the customers.

5.5 Suggested Areas for Further Studies

Apart from making an assessment on the effectiveness of operational risk management in commercial banks in Tanzania, there are needs to investigate the following:

(i) To assess the contribution of Tanzanian financial work organizations to the developments of their employees. This will show these financial institutions benefits themselves or the employees.

(ii) To examine the effects of adoption of the automated technologies among the banks in Tanzania. This will investigate more on the risks likely to be caused by these new technologies.

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APPENDENCES

Appendix I: A Questionnaire

Answered by employees who have worked with the banks for more than six months from selected banks in Dar es Salaam Region.

Preamble

Dear Colleague,

Please assist me to collect information for a research study on the assess of the effectiveness of operational risk management in commercial banks in Tanzania; The Case Study of Selected banks in Dar es Salaam.

The study is a part of my research academic and it will be used for academic reasons strictly. For this reason, your name or any of your used materials will not be presented in the way that any user of the findings recognizes you.

Thank you very much for being cooperative.

Sincerely,

Fatuma A. Masenene

Instructions:

Please put a Tick (√) on front of what you consider most appropriate answer. Remember there is no wrong one.

Part I, Preliminary Information of a Respondent

1. Sex of the Respondent

1	Female	
2	Male	

2. How long have you been employed by the bank?

Years		Months	

3. What is your highest education level attained?

i	Certificate	
ii	Ordinary Diploma	
iii	University Degree/Advanced Diploma	
iv	Masters Degree	
v	PhD Degree	
vi	Professional (Banking)	

No	Clue	Yes	No
4	The financial institution you are working for has the risk management department		
5	There is operational risk policies in your work organization		

Part II, Information about Operational Risk Management.

Qn	Clue	Disagree	Agree	No Response
6	The organization has been encountered to daily operational risks			
7	The organization you work for provides training on operational risks			
8	There is monitoring and control of risks likely to occur in your work environment			
9	There is compensation to the worker who gets to the operational risks at work			
10	There are already prepared instruments for encountering risks at your organization			
11	The issue of risk control is taken to a great consideration at your work			
12	The work organization take more consideration on risks occurring to its side than on side of employees			
13	There is an active insurance made to cover daily operational risks at your work organization			
14	Lack of strong rules and principles for operational risk management cause more risk to take place.			

Appendix II: A Structured Interview

1. To what extent is the department active? (More on Question no. 4)
2. Do you think the policies are well exercised? Give reason (s) for your answer. (More on Question no. 5).
3. What does your bank do on the issue of training of its employees? (More on Question no. 7).
4. Who are more compensated between administrator and those who are being administered? (More on Question no. 9).