

# Enterprise Risk Management Implementation of Financial Institutions in Ethiopia



Tamiru Negi Tsige, Ravi Singla

**Abstract:** Recently, even though, more emphasis is given to enterprise risk management (ERM) worldwide to manage risks, there is scant knowledge and empirical evidence on ERM implementation of financial institutions in Ethiopia as there are only limited research works or literature related to ERM trends in Ethiopia. Thus, the main objective of this study was to assess the enterprise risk management implementation of financial institutions in Ethiopia. This study adopted a descriptive research design. In order to obtain relevant data for the study, both primary and secondary data sources were employed. The primary data were gathered through questionnaires while secondary data were extracted from different relevant sources such as books, journals, and websites. The population of the study was the entire banks and insurance companies in Ethiopia. At the time of the survey, there were 35 financial institutions (18 banks and 17 insurance companies) registered with the National Bank of Ethiopia and operating in Ethiopia. The unit of analysis were these institutions' headquarter office chief risk officers, chief financial officers, senior managers, technical staff of risk management units and other employees whose work is related to risk management in each of the selected institutions. The sample respondents were selected using a purposive sampling technique and a total number of sample respondents were 180. The data collected was analyzed and presented using descriptive statistics and the results were presented using pie charts, tables, and graphs. The results of the analyses revealed that the majority of the financial institutions in Ethiopia involved in the survey have a formal ERM in place even though the extent of ERM adoption varies from institution to institution. However, the results of the analysis show that ERM implementation level is low and in its infant stage in financial institutions in Ethiopia and these financial institutions have also less developed ERM practices than international organizations.

**Keywords -** Financial Institutions, Ethiopia, Banks, Insurance, Enterprise Risk Management.

## I. INTRODUCTION

Due to the dynamic and complex environment exists around the business organizations, the risk spheres encountered them are changing fast and expanding. Moreover, risks facing the financial sector are more dynamic,

fluid and highly interdependent by their nature as this industry is one of the highly complex, most dynamic, risky and challenging business emanating from the nature of business activities they are engaging in [1]. As a result, currently, the vulnerability of financial institutions to various risk has been increasing from time to time worldwide and they are continuously exposed to a variety of internal and external risks due to fierce global competition, changing socio-economic patterns, market flexibility, and increased foreign exchange business and cross border activities as well as the introduction of innovative products and delivery channels [2]. These risks have the potential to affect financial integrity, damage the organization, threaten its existence, cause the earnings to dip below acceptable levels, interrupt operations or slow growth, cost money, or in a worst-case scenario, cause the organization to close as a single risk may easily influence several parts of an organization at one [3].

This is also true for financial institutions in Ethiopia since these financial institutions are also exposed to a wide range of risks like other financial sectors. So, these are a call for due attention to risk and its management. Thus, financial institutions mainly require a more integrated approach to manage risk as risks become an important issue that must be taken into account [4].

Risk Management is the most vibrant component that plays a vital role in any business but a remarkably important one for financial institutions as it helps the companies to cope-up with their exposure units properly and achieves their objectives at minimum cost [4]. Therefore, the need of many companies to implement comprehensive risk management schemes so as to efficiently avoid vulnerabilities and surprises along the way, identify and react to risks to protect potential risk exposures increased from time to time [5], [6], [7]. One of the latest risk management approaches that get great attention currently and help firms to manage risk effectively is enterprise risk management (ERM) [8]. Effective enterprise risk management can bring huge benefits to all kinds of organizations irrespective of their industry, size, scope, and nature as per numerous literature and studies [8], [9], [10], [11]. These benefits are: create greater management consensus, minimize earnings volatility, decrease costs and losses, increase risk management accountability, improve profitability and earnings, improve risk-adjusted decision-making, enhance noble risk reporting and communication, help to attain competitive advantages, lead to a better resource allocation, improve owners' satisfaction and improved control of an enterprise which also contribute to improved shareholder value [12], [13], [14], [15], [16], [17], [18], [19], [20].

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# Enterprise Risk Management Implementation of Financial Institutions in Ethiopia

So, a number of business organizations have started applying ERM systems to build a harmonized and integrated company-wide approach to the management of risk [6].

This also implies that financial institutions in Ethiopia also need to have a vibrant enterprise risk management system to manage their risk and achieve their objectives in the most economical way. Nevertheless, despite the growing importance of enterprise risk management, the empirical evidence on ERM implementation of these institutions is inadequate and scarcely available since there are only a few studies on risk management and most of these previous studies have also focused only on traditional risk management practices of these institutions. So, there is a literature gap in ERM implementation in the context of Ethiopian financial institutions. Thus, in view of the above, it is on this base that the researcher intended to conduct this research to fill this research gap by assessing the ERM implementation of financial institutions in Ethiopia.

## II. REVIEW OF RELATED LITERATURE

One of the basic risk management approaches applied today by many organizations to manage risks is an enterprise risk management approach. Enterprise risk management is a risk management approach that goes far beyond the silo-based view of risk and perhaps relatively the latest phenomenon that has got due recognition and attracted the attention of many intellectuals and now a day, implemented by many organizations, all over the world is enterprise risk management approach [21]. Thus, ERM is a young discipline that focuses on identifying, analyzing, monitoring, and controlling all important risks. ERM has come to be the main topic in today's more interrelated world economic environment, complex, replete with threats from natural, technical, political, and economic sources. This approach enables firms to manage a wide set of risks in an integrated and holistic manner by incorporating strategic and operational risk together with the financial risk into one complete risk management framework [8]. In addition, for those who demonstrate a strong ERM program, ERM can serve as a main source of competitive advantage [22]. Therefore, today ERM has become an increasingly popular concept and the practice standard throughout the world and a considerable number of organizations have started implementing this approach as it is viewed as the ultimate approach to effective risk mitigation.

There are several enterprise risk management frameworks that are developed by different organizations and professionals. Some of the most prominent and frequently employed by many organizations are explained below as follows:

The COSO ERM framework which entitled "The COSO Enterprise Risk Management—*Integrated Framework*" was suggested by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in 2004. Nowadays, COSO (2004) framework is the most extensively recognized and popular enterprise risk management framework that is practiced by many organizations [23]. This framework aims to establish a standard to enable the organizations in considering and understanding their risk-related activities at

all levels of the organization as well as their impacts on one another [24].

The other type of ERM framework is the Casualty Actuarial Society framework. CAS established and advocated an independent risk management standard for adopting ERM in 2003 by its ERM committee. According to [25] standard, there are four types of risks that firms are generally exposed for. These risks are a hazard, financial, strategic and operational risks.

The Australian/New Zealand Risk Management Standard 4360 (AS/NZS 4360) is another ERM framework. The Australian/New Zealand Risk Management Standard 4360 (AS/NZS 4360) comprises in-depth commentaries and various application techniques regarding ERM. The first edition of the joint Australian/New Zealand Standard (AS/NZS 4630) for Risk Management which is the world's first risk management standard was developed in 1995 [24]. The latest version of the Australia/Standards New Zealand, 2004 Standard had been embraced and updated as the world's risk management standard – the ISO 31000 (Standards Australia/Standards New Zealand, 2009). Currently, the scope of ISO 31000 risk management is broader than AS/AZ 4360 and it incorporates social, financial, reputational, operational, client-related, political, and cultural and the legal issues of a firm's activities. The major elements available in AS/AZ 4360 and which is recently revealed in ISO 31000 is that risk management needs to be driven into the other management activities, and not be a standalone and distinct activity. The ISO 31000 risk management framework is the risk management standard which is derived from an AS/AZ 4360:1995. This standard was suggested in 2009 (ISO31000, 2009) and as cited by [26], this standard is the recent best standard for risk management as it includes the best practices of the COSO, AS/NZS 4360:2004, Project Management Institute (PMI) as well as other well-known international risk management standards. The main objective of ISO 31000 standard is to formulate a common set of effective principles, guidelines and general application rules on successful risk management that can be used by any association, group or individual, public or private by applying the concept of risk governance and a centralized principle to the process of risk mitigation in order to realize the strategic objectives of the firm [27]. The core concept of this standard is a quality management approach which specifies that the framework is designed, implemented, monitored and continuously improved so that the quality of decision-making is also improved. The ISO 31000 risk management standard comprises five components such as mandate and commitment, design of a framework for managing risk, implementing risk management, monitoring and reviewing, as well as continual improvement of the framework [27].

## III. RESEARCH METHODOLOGY

The population of this study was all banks & insurance companies in Ethiopia. In the course of the data collection period, there were 35 financial institutions (18 banks and 17 insurance companies) in Ethiopia that were registered with the National Bank of Ethiopia (NBE) and operating in Ethiopia with headquarters in Addis Ababa (NBE, 2018).



Hence, the target population of this study embraced these 18 banks and 17 insurance companies in Ethiopia which formed a total population of 35 financial institutions. Since the number of financial institutions was considerably small, the researcher employed a census survey and all financial institutions (banks & insurance companies) in Ethiopia were incorporated in the study. Whereas, the sample respondents of this research were the financial institutions' headquarter offices Chief Risk Officers (CROs)/ risk managers, Chief Financial Officers (CROs)/ Financial Controller, senior managers, all technical staff of Risk Management Units (RMU) and those workers whose work duties are related to risk management in each institute to obtain a reliable information on the subject matter under study. Purposive sampling technique was employed to select the needed respondents from each financial institution and a total of 180 participants were selected for the survey. As a result, a total of 180 questionnaires were distributed to the purposively selected respondents.

In order to get relevant and reliable information on the issue under investigation, both primary and secondary data sources were utilized. But it prominently depended on primary data. Primary data were acquired via different survey questionnaires designed based on the objectives of the study and distributed to the target respondents whereas the secondary data were obtained from different official websites, various journals & articles, relevant books and other published and unpublished materials.

The data of this study were analyzed and presented using descriptive statistic with the help of the Statistical Package for Social Science (SPSS) version 23 software. So, a descriptive statistics tools like frequency distributions, tables, percentages, charts, and other statistical summaries were used in order to elucidate statistical data, give a condensed picture of the data and induce a meaningful interpretation.

**IV. RESULTS OF THE FINDING AND DISCUSSION**

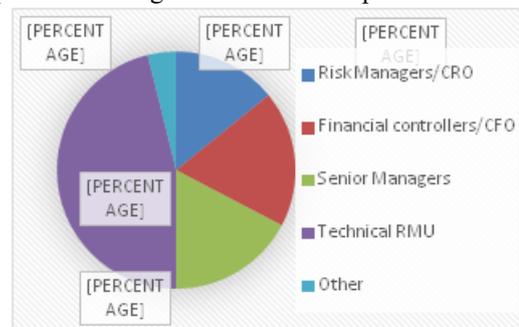
**A. Introduction**

The relevant information needed to achieve the objective of the study was obtained from primary sources via different questionnaires designed and distributed to the respondents and the data collected were analyzed using the SPSS version 23 windows. As a result, out of the 180 questionnaires distributed, 162 (90%) questionnaires were returned while the remaining 18(10%) of the questionnaires were unreturned due to various reasons like respondents' refusal and inability to return some of the questions. From 162 returned questions, 156 questionnaires were properly & completely filled and returned while the remaining returned six questions were found incomplete and excluded from the analysis. Thus, the effective response rate out of the total distributed questionnaires was 86.67%. Therefore, in view of this, the

whole analyses given in this study were based on this response rate that is 156 respondents. Accordingly, data collected through questionnaires survey were analyzed using descriptive statistic and presented below as follow:

**B. Position of the Respondents in the Institutions**

As can be seen, fig.1 indicated the position of the respondents in the institutions. A number of officials having various titles and serving the institutions under survey in different roles took part in this survey. Consequently, to obtain data regarding the distribution of the respondents with respect to their positions, they were asked to indicate the position they hold in their respective financial institutions. Accordingly, out of 156 respondents participated in this study, titles of 22(14.1%) respondents were Risk Managers /CROs/, 29 (18.6%) of the respondents indicated they had a title of Financial controllers/CFOs/, title of 27(17.3%) respondents correspond to senior managers and 72 (46.2%) of the respondents serving as technical staff of RMU while the remaining 6(3.8%) of the respondents represent numerous other managers/ executive positions. As the results of the survey indicated, most of the respondents were technical staff of risk management units (RMU). In general, since the respondents were from diversified designations, it is believed that their opinions and responses were representative and help to get reliable results. Fig.1 presents the respondents' designations in their respective institutions



**Fig.1. Position of the Respondents**

**C. Work Experience of the Respondents**

Table I shows the work experience of the respondents. Moreover, respondents were asked to specify the number of years they worked in their institutions and their responses were analyzed and presented as follow:

**Table- I: Work Experience of the Respondents**

Experience	Frequency	Percent
0-5 years	43	27.6
6-10 Years	53	34.0
Valid 11-15 Years	43	27.6
> 15 Years	17	10.9
Total	156	100.0

Regarding experiences of respondents, as shown in table I, 43 (27.6%) of the respondents have worked for a period of between 0-5 years in the institution. On the other hand, 53(34%) of the respondents had 6-10 years of work experience at their institutions, 43(27.6%) of the respondents had 11-15 years of work experience in the institutions and the rest 17(10.9%) of the respondents having worked at their institutions for more than fifteen years and around 72.4% of all the respondents had over 5 years of experience. This perhaps indicate the respondents have sufficient working experience and understanding of the company's structure and planning as well as the current issue and concern well.



## Enterprise Risk Management Implementation of Financial Institutions in Ethiopia

Thus, this can increase the reliability of the information provided by the respondents and ensure the quality of the responses.

### D. Enterprise Risk Management Implementation

One of the risk management approach recently got more media consideration is enterprise risk management according to [8]. According to several studies effective enterprise risk management can offer enormous benefits to all kinds of organizations irrespective of their industry, dimension, range, and type [10]. Besides these benefits of ERM, today's ever-changing and turbulent environment requires a balanced multidisciplinary group and portfolio of risk as it is very challenging to manage companies in this type of environment. Consequently, as ERM is the cutting-edge tools in keeping companies from potential loss exposures, companies need to adopt ERM to improve their risk management practices [6]. So, by taking these into account, many institutions have started executing ERM programs.

In relation to financial institutions in Ethiopia, to assess the current status of these institutions regarding ERM implementation, the survey participants were asked a question to indicate whether their institutions currently have an enterprise risk management program in place or not.

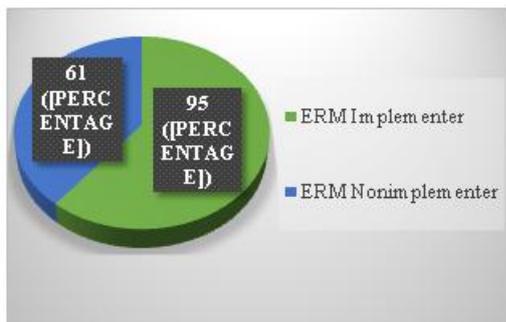


Fig. 2: ERM Implementer & Non-implementer

Fig. 2 shows the implementers and non-implementers of the ERM program. Accordingly, fairly more than half of the respondents in this survey, that is 95 (60.1%) of the respondents indicated that their institutions have ERM process in place while 61(39.1%) of the respondents were stated that their institutions were not implemented an ERM approach to manage risk. This indicated that significantly the majority of the respondents' firms were implemented ERM while the remaining were not. Empirically, the result of this particular study proved that the majority of financial institutions in Ethiopia began practicing ERM since a greater percentage of the respondents approved that their institutions have ERM in place.

### E. Years of Enterprise Risk Management Implementation

ERM implementation is an on-going and iterative process [28], [29] and should proceed in incremental steps [30]. An effective ERM program requires several years to develop [29]. Hence, the implementation level of ERM is often described by a maturity continuum.

To identify the number of years of implementation of ERM by their institutions, respondents who replied that their institutions currently have an ERM program in place were asked a supplementary question about the time when the

formal enterprise risk management process was started in their institutions. Accordingly, the majority (58.9%) of the respondents said that their institutions have started implementing ERM before one year, 31.6% of the respondents specified that their institutions have adopted ERM before five years while the remaining 9.5% of the respondents indicated that their institutions have started adopting ERM before ten years. None of the respondents indicated that their institutions have implemented ERM for more than ten years. This indicated that most of the financial institutions in Ethiopia have started implementing ERM before a few years ago and found at an early stage. The length of ERM implementation among the implementers is shown in fig.3 below.

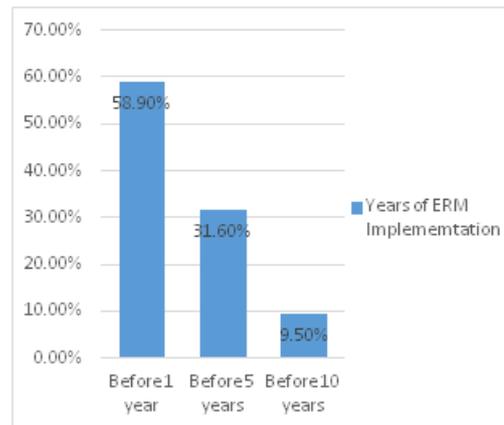


Fig.3: Years of ERM Implementation

### F. Key drivers for Enterprise Risk Management Implementation

Different institutions have different reasons for adopting an ERM plan. The trend toward the adoption of ERM programs is usually attributed to a combination of external and internal factors. The major external influences that have driven the organizations to implement ERM are risks arising from factors such as globalization, industry consolidation and deregulation, increased regulatory attention to corporate governance and technological progress that enables better risk quantification and analysis [31], [32], [33]. While the internal factors are centered on an emphasis to maximize shareholder wealth. [34] identified institutional shareholders as the ones who influence the adoption of ERM. [20] cited the influence of the risk manager, encouragement from the board of directors and compliance with regulatory guidelines as the key factors causing the firms to adopt ERM.

To explore the potential pushing factors to implement ERM with respect to financial institutions in Ethiopia, the survey respondents were asked to specify the key potential contributing factors that driven their institutions to implement ERM. Accordingly, 25.3% of the survey participants stated that the main factors that oblige their institutions to adopt ERM is global crisis such as a recent catastrophe within industry, 7.4% of the respondents stated that their institutions adopted ERM due to pressures from employees whereas 22.1% of the respondents said that their institutions adopted ERM because of pressures from shareholders.

Furthermore, considerably majority (30.5%) of the respondents stated that a key driving force for the adoption of ERM in their institutions was a high completion and other industry-related pressures while the remaining 14.7% of the respondents mentioned encouragement from Board of directors as the key driving forces for ERM adoption in their institutions. Even though factors such as shareholders pressure, pressure from employees as well as encouragement from the Board of Directors are also specified by other respondents as primary and key driving forces for their institutions for implementing ERM, according to majority of

the respondents' point of view, "competition and other industry-related pressures" as well as "global crisis" were the relatively the most commonly cited top driving factor for implementing ERM among financial institutions in Ethiopia. Thus, with respect to financial institutions in Ethiopia, the most perceived potential driving forces behind the adoption or consideration of the ERM approach was competition as well as other industry-related factors. Fig.4 below shows the key driving forces that force financial institutions in Ethiopia to implement ERM as perceived by the respondents.



Fig. 4: The main factors forced the Institutions to implement ERM

**G. Type of ERM framework the institutions used for Implementing ERM process**

Globally accepted methodologies, standards, and tools will help the organization to establish robust risk management practices. There are a number of ERM frameworks that have been developed and proposed by a number of international institutions, associations, consultancies, and professionals from which the organizations have to choose while implementing ERM [16], [11]. These standards provide guidelines for designing, implementing, and maintaining an enterprise risk management program throughout an organization. These frameworks include COSO 2004- ERM

framework, ISO 31000 standards, the AS/NZS 4360:2004 Risk Management Standard and others. However, there is no one common framework that must be followed by all organizations as there is no regulatory requirements of one common standard to be followed. Thus, the management must decide the best suit to their organization.

In relation to financial institutions in Ethiopia, to identify the ERM framework the institutions use for implementing ERM program, the respondents were asked a question to indicate the type of ERM framework their institutions used to implement the ERM program.

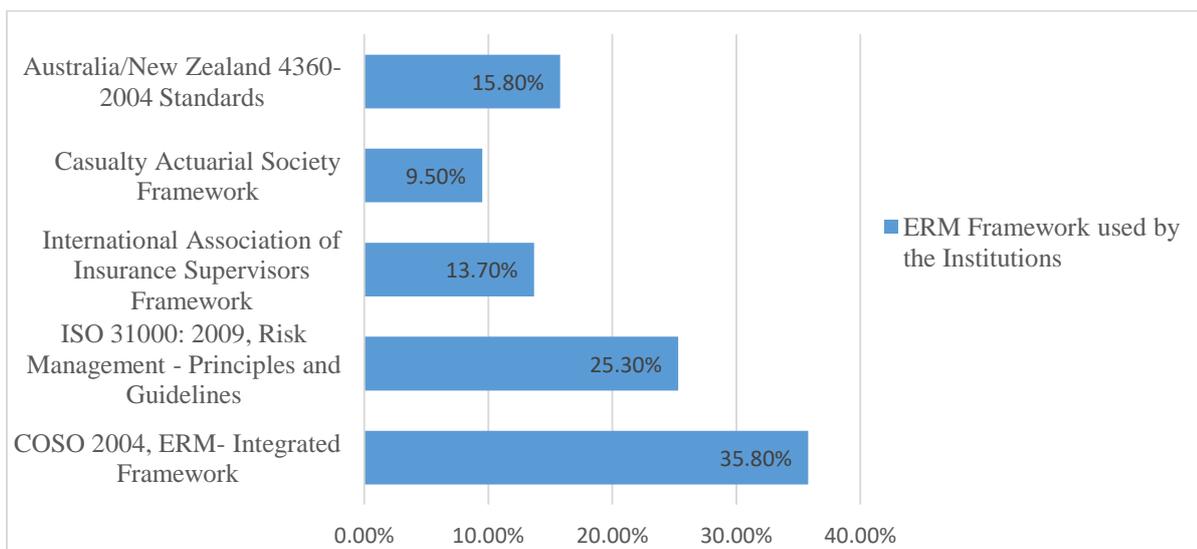


Fig. 5: ERM Framework used by the Institutions

# Enterprise Risk Management Implementation of Financial Institutions in Ethiopia

The above fig. 5 shows the types of ERM framework used as a benchmark in the implementation of the ERM process in by the institutions. Accordingly, 35.8% of the survey participants stated that their institutions used the COSO 2004 ERM- Integrated Framework to adopt ERM, 25.3% of the respondents stated that their institutions adopted the ISO 31000: 2009, Risk Management - Principles and Guidelines to implement ERM whereas 13.7% of the respondents said that their institutions embraced the International Association of Insurance Supervisors Framework to execute ERM. Furthermore, 9.5% of the respondents stated that the ERM their institutions employed for implementing ERM program is the Casualty Actuarial Society Framework while the remaining 15.8% of the respondents mentioned that the Australia/New Zealand 4360-2004 Standards is the ERM framework their institutions used to implement ERM approach. This implies that relatively the majority of the financial institutions in Ethiopia employed the COSO 2004, ERM- Integrated Framework as a benchmark in the implementation of ERM process.

## H. Conclusions

The survey participants were various officials of the institutions with diversified titles and sufficient work experiences which enable them to understand the company's structure, planning, the current issue and concerns regarding ERM practices of their institutions well which in turn help to get reliable results. Hence, the result of the finding indicated that the relatively majority of the financial institutions in Ethiopia have started implementing ERM even though the implementation level is low and found at an early stage as most of them have begun practicing ERM before a few years ago. Besides, these institutions have begun ERM program mainly due to high forces from the competition, other industry-related factors, and global crisis. Moreover, most institutions employed the COSO 2004 ERM- Integrated Framework as a benchmark in the implementation of the ERM process.

The results of this finding will help firms to get better awareness about enterprise risk management and use it as an important input to assess their practices as well as to improve and bring change and increase the success of their business. In addition to this, it will use as an input for other scholars who intend to conduct further studies in this area. Furthermore, the findings from this study will also contribute to Enterprise risk management literature in the Ethiopian business setting.

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