ASSESSING THE IMPACT OF OPERATIONAL RISK MANAGEMENT ON FINANCIAL PERFORMANCE OF SERVICE CENTRE OF COMMERCIAL BANKS IN MALAWI

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ABSTRACT

This paper assessed the impact of operational risk management strategies on the financial performance of the Commercial banks in Malawi. The study explored the relationship between risk management practices and financial indicators like profitability, loan. Quality and efficiency. Using the mixed method approach, quantitative data was collected through surveys and qualitative insights were gathered from staff interviews. Key findings indicated that effective operational risk management strategies such as thorough credit assessment. Proactive monitoring and employee training significantly reduced non-performing loans and enhanced financial stability. The study emphasized the importance of a strong risk culture, ensuring policies are not only followed but embraced by staff, fostering a proactive risk management approach. Challenges identified included limited resources, a disconnect between policy and practice, and insufficient inter-departmental collaboration, which hinder effective risk strategy implementation. The findings highlighted the need for continuous training programs and formal cross-departmental protocols to improve collaboration and address emerging risks. Ultimately, the research concluded that operational risk management is a strategic tool essential for the financial performance and resilience of the commercial banks in Malawi, providing valuable insights into localized risk management practices in the Malawian banking sector.

Furthermore, the study recommends strengthening the internal control systems. Enhancing the regulatory compliance frameworks and integrating technology-driven risk assessment tools to improve accuracy and responsiveness. It also underscores the role of leadership commitment in promoting accountability and sustaining long term institutional performance. Additionally , the research suggests periodic risk audits and performance evaluations to ensure continuous improvement and adaptability within the dynamic banking environment.

Keywords

Operational Risk Management, Financial Performance, Commercial banks, Risk Culture.

Introduction

The banking sector serves as a cornerstone for economic development in developing economies, acting as a crucial intermediary for financial flows and a catalyst for investment and growth. In this context, the implementation of effective risk management strategies is paramount for ensuring the stability, sustainability, and overall health of banking institutions. Financial performance, in turn, reflects the success and resilience of these institutions in navigating the inherent risks associated with their operations (Oyewo, 2021). Malawi, as a developing economy with its own set of unique economic and financial characteristics, presents a compelling context for examining the complex relationship between risk management and financial performance within its banking sector. The banking sector in Malawi plays a particularly vital role in channelling funds from depositors to investors, thereby facilitating a wide range of economic activities (Chipala et a, 2022).

These institutions are also integral to the functioning of national payment systems and the facilitation of both domestic and international trade finance. A stable and efficient banking sector is widely recognized as a significant contributor to overall economic growth and the broader efforts aimed at poverty reduction within the country. The Reserve Bank of Malawi (RBM), the nation's central bank and primary regulatory authority, explicitly acknowledges the critical importance of a sound and well-functioning banking system for achieving sustained economic performance (Bogonko, 2023). This research endeavours to assess the impact of risk management strategies on the financial performance of the Commercial banks. By examining the risk management practices employed by this leading financial institution and their subsequent effect on its financial outcomes at a branch level, this study aims to provide valuable insights into this critical relationship within the Malawian context.

Background

The financial system in Malawi is predominantly characterized by the banking sector, which comprises approximately eight to ten commercial banks alongside the Reserve Bank of Malawi. The Reserve Bank of Malawi (RBM) acts as the central bank and the primary regulatory authority for the entire financial sector, holding responsibility for both supervision and the formulation and implementation of monetary policy (Tauringana & Chithambo, n.d). In its regulatory capacity, the RBM sets crucial capital adequacy and liquidity requirements that all commercial banks must adhere to and adopted the Basel II standards in January 2014, signalling a commitment to international best practices. Since the late 1980s, the Malawian banking sector has undergone a process of liberalization, which has gradually shifted it away from a historically oligopolistic market (market dominated by a few large players) structure towards one with greater competition.

What's more, there is an increasing emphasis on promoting financial inclusion and the expansion of digital financial services to reach a broader segment of the population. The banking sector in Malawi operates within a dynamic economic environment marked by persistent challenges. These include prevalent poverty, a significant reliance on the agriculture sector which makes the economy vulnerable to climate-related shocks, and recurring shortages of foreign exchange (Tchereni et al., 2013). The country has also experienced periods of high interest rates and inflation, which have significantly impacted the profitability and stability of financial institutions. Also, government debt levels and fiscal deficits have exerted considerable influence on the banking sector through various channels, including crowding out private sector lending.

The Malawian economy has faced periods of slow growth and instability, creating a challenging operating landscape for businesses, including banks. The Reserve Bank of Malawi's adoption of Basel II standards demonstrates a clear effort to align the country's banking supervision framework with globally recognized benchmarks, particularly concerning the maintenance of adequate capital reserves (Temba et al, 2024). This regulatory framework necessitates that Malawian banks, maintain sufficient capital relative to their risk-weighted assets, thereby enhancing their capacity to absorb potential financial losses and bolstering the overall stability of the financial system.

The historical transition from an oligopolistic banking environment to a more liberalized one has fostered increased competition within the sector. This heightened competition likely compels banks to enhance their operational efficiency and implement robust risk management practices to sustain their profitability and market share in the face of potentially compressed margins and greater consumer choice (Wiyanti & Fikriyah, 2022). The prevailing economic challenges within Malawi, such as the scarcity of foreign exchange and high levels of inflation, create a particularly demanding operating environment for banks. These conditions can amplify various banking risks, including credit risk as borrowers may struggle with repayments, liquidity risk due to potential deposit withdrawals or funding constraints, and market risk stemming from volatile exchange rates and interest rate fluctuations. In such a context, the importance of effective risk management strategies is significantly underscored.

The Commercial bank in Malawi stands as a leading financial institution within the country. Over the years, they have grown to become one of the two largest banks in Malawi, commanding a dominant market share in terms of both total assets and customer deposits. The banks have been publicly listed on the Malawi Stock Exchange since August 2000, indicating their significance within the national financial landscape. To serve their wide customer base, the Commercial banks in Malawi operate through an extensive network of service centres (branches) and automated teller machines (ATMs) strategically located across the country (Kanyuka et al, 2016). They play a crucial role in the national payment system, facilitating financial transactions and settlements, and maintains established relationships with various international banks to support cross-border financial activities.

The banks have also diversified their business operations through strategic investments in several subsidiaries, encompassing areas such as commercial banking in Tanzania, stockbroking, insurance, and development banking, allowing them to offer a broader range of financial services. Recognizing its importance, the commercial banks have also secured financing facilities from international institutions like the African Export-Import Bank (Afreximbank), further solidifying their capacity to support trade and economic development within Malawi (Tchereni et al., 2013). As part of their extensive operational network, the commercial banks maintain numerous service centres throughout Malawi.

Given their long operational history and substantial market presence, the commercial banks exert a significant influence on the Malawian banking sector and the broader national economy. Their performance and the risk management practices they employ likely serve as important benchmarks for other financial institutions operating within the country. The bank's strategic diversification into various financial service sectors through their subsidiaries suggests a deliberate approach to broaden their revenue generation capabilities and potentially mitigate risks across different segments of the financial industry (Kanu & Ali, 2022). The establishment of a widespread network of service centres, underscores the bank's commitment to enhancing accessibility to financial services for a large portion of the Malawian population, a critical factor in promoting financial inclusion.

Effective risk management strategies are of paramount importance for banks, particularly those operating in developing economies which often face a unique set of vulnerabilities. In these environments, banks are frequently exposed to higher levels of economic and political instability, which can significantly amplify various types of banking risks. Implementing sound risk management practices is crucial for helping banks mitigate potential significant losses and avoid episodes of financial distress that could threaten their solvency and operational continuity (Temba, 2024). Besides, effective risk management plays a vital role in maintaining public confidence in the overall stability and reliability of the banking system.

The higher degree of economic and political instability often prevalent in developing countries like Malawi amplifies the necessity for banks to adopt particularly robust and tailored risk management strategies to effectively address these unique vulnerabilities. The interconnected nature of the various risk categories means that a failure to adequately manage one type of risk, such as credit risk, can have cascading effects and potentially trigger problems in other areas, such as liquidity risk, underscoring the need for an integrated and holistic approach to risk management (Kamchira, 2020). The strong emphasis placed by regulatory bodies like the RBM on the issuance of risk management guidelines and the adoption of international standards like Basel II reflects a clear recognition of the fundamental role that proactive risk management plays in ensuring the overall health and stability of the Malawian banking sector.

Reserve Bank of Malawi

The core objective of the Reserve Bank of Malawi, like central banks globally, is to maintain price stability and ensure a sound financial system that facilitates economic growth and development (IMF, 2023). This overarching mandate is legally enshrined in acts such as the Reserve Bank of Malawi Act, which explicitly outlines the RBM's comprehensive powers and duties concerning banking, currency management, and the supervision of all financial institutions in the country (Reserve Bank of Malawi, 2024). A paramount responsibility within this framework is the prevention of systemic risks those risks that emerge from the complex interdependence of financial institutions and which individual banks' internal control systems often fail to adequately address (FSB, 2023). By proactively mitigating such risks, the RBM safeguards the broader financial system from cascading failures.

2.3.2 Licensing and Regulation

A primary function of the RBM in its regulatory capacity is the rigorous licensing and regulation of financial institutions (IMF, 2023). This involves controlling the entry of new players into the banking sector through a strict licensing process, which defines the scope of banking operations and establishes the foundational regulatory frameworks (World Bank, 2023). Over time, the RBM's regulatory framework has progressively evolved, aligning with international best practices and standards such as the Basel Accords (Basel I and Basel II) (IMF, 2023). Malawi has not merely adopted these standards but has adapted them to its specific economic context. For instance, the RBM has imposed higher minimum capital adequacy ratios specifically 10% for core capital and 15% for total capital which exceed the requirements stipulated by Basel II (BCBS, 2024).

2.3.3 Supervision and Monitoring

Beyond licensing, the RBM engages in comprehensive prudential supervision and monitoring to ensure the ongoing health of the banking sector (IMF, 2023). A cornerstone of this supervision is the strict enforcement of minimum capital requirements (Reserve Bank of Malawi, 2024). Research specifically on Malawian banks indicates that higher capital ratios, mandated and monitored by the RBM, effectively reduce bank risk-taking behaviour by decreasing NonPerforming Loans (NPLs) and discouraging excessive investment in high-risk assets (World Bank, 2023). The RBM ensures that severe penalties are applied for noncompliance with these capital requirements, emphasizing their critical role in safeguarding financial stability (Reserve Bank of Malawi, 2024).

Parallel to capital adequacy, the RBM meticulously monitors the banking system's liquidity, ensuring that banks maintain sufficient liquid resources to facilitate smooth payment system operations and to prevent liquidity crises that could originate from individual bank failures (IMF, 2023).

2.3.4 Lender of Last Resort

The RBM also serves a critical function as the Lender of Last Resort (LOLR) for financial institutions (Reserve Bank of Malawi, 2024). In this capacity, it provides liquidity to banks through mechanisms such as the Discount Window when they face temporary liquidity shortages (BCBS, 2022). This function is absolutely vital for preventing isolated bank liquidity problems from escalating into broader systemic crises, thereby acting as a crucial safety net for the financial system (FSB, 2023). However, the RBM carefully balances this function to avoid creating moral hazard, a situation where banks might be incentivized to take on excessive risks under the assumption that the central bank will always bail them out (IMF, 2023).

The independence of the supervisory authority is key in mitigating such risks (BIS, 2022; FSB, 2023). Beyond individual bank stability, the RBM plays a fundamental role in the oversight of national payment systems (Reserve Bank of Malawi, 2024). The RBM's monetary policy implementation is inextricably linked to financial stability (IMF, 2023). Its decisions, such as adjusting the Monetary Policy Rate (MPR), which serves as the reference rate for commercial bank lending, directly influence lending rates, private sector borrowing, and ultimately industrial output (Reserve Bank of Malawi, 2024; World Bank, 2023).

An effective monetary policy, therefore, indirectly contributes to financial stability by shaping the economic environment in which banks operate (IMF, 2023). On top of that, the RBM directly influences interbank market rates through strategic liquidity injections and withdrawals (Reserve Bank of Malawi, 2024; BCBS, 2022). These actions transmit signals to other money market rates, impacting borrowing conditions for various economic agents (BIS, 2022). This direct influence on the interbank market is a crucial tool for both monetary policy implementation and for maintaining the stability of the financial system (World Bank, 2023).

Research Objectives

Aim of Study

- To assess the relationship between implemented risk management strategies and the financial performance of commercial banks.

Objectives

- To identify key risk management strategies currently implemented in commercial banks.
- To assess the relationship between the identified risk management strategies and selected indicators of financial performance.
- To provide practical recommendations for enhancing risk management practices in commercial banks.

Research Questions

- What risk management policies exist in commercial banks across different risk types?
- How do the branch's risk management strategies correlate with its profitability, loan quality, and efficiency?

- What specific risk management areas at the branch need improvement based on the analysis?

Theoretical Framework

A theoretical framework is a foundational structure comprising concepts, theories, and models drawn from existing academic literature that serves to underpin and guide a research study (Eisenhardt, 2022; Yin, 2023). It provides a specific lens through which a researcher views and analyses their phenomenon of interest, helping to define the problem, formulate research questions, select appropriate methodologies, interpret findings, and discuss their implications (Guba & Lincoln, 2022).

RESEARCH METHODOLOGY

Research Design

This study will employ a qualitative study design to explore and understand the complex dynamics of risk management strategies at the Commercial banks. According to Creswell and Creswell (2018), a qualitative study design is a type of educational research in which the researcher relies on the views of participants, asks broad, general questions, collects data consisting largely of words or text from participants, describes and analyses these words for themes, and conducts the inquiry in a subjective, biased manner. By utilizing methods such as open-ended questionnaires and semi-structured interviews, the research will have delved into the lived experiences and perceptions of employees and managers. This approach was essential for gaining rich, detailed insights that quantitative methods alone cannot capture, allowing the researcher to uncover the how and why behind the identified strategies and their perceived impact on financial performance. The focus will be on interpreting the subjective meanings and social contexts that shape risk management practices within the organization.

Setting

This study was conducted at one commercial banks in Malawi which shall remain anonymous reasons of confidentiality and to protect the institutional integrity. The Commercial bank stands as a leading commercial bank in the country, boasting an extensive network of service centres. The selection of the Service Centre as a case study was strategic due to its significant operational volume and the diverse array of financial services it provides to a wide client base.

This particular service centre's practical engagement with diverse risk management strategies makes it a pertinent site to investigate the intricate relationship between these strategies and the ensuing financial outcomes.

Study Population

The study population for this research encompassed employees working at the Service Centre of the Commercial bank. This included individuals across various departments and hierarchical levels whose roles directly or indirectly intersect with risk management processes and financial operations. Key participants were drawn from departments such as credit, operations, customer service, and branch management. These personnel were instrumental in the implementation, oversight, and direct experience of the effects of the bank's risk management strategies on the daily financial activities of the service centre.

Sampling Technique

Stratified random sampling

This study employs stratified random sampling to ensure proportional representation of all key functional units involved in operational risk management at the South End Service Centre. Given the specialized nature of risk-related roles including finance (40%), operations (35%), IT (15%), and compliance (10%) staff simple random sampling could inadvertently overlook critical departmental perspectives (Teddlie & Yu, 2007). Stratification by department guarantees that specific data accuracy in the sense that each unit faces distinct operational risks (Lohr, 2022).

Sample Size

Given the total population of 34 staff members at the South End Service Centre, this study will target a near-census approach to maximize data reliability while accounting for potential nonparticipation. For quantitative precision, Krejcie & Morgan's (1970) sample size table recommends 30 respondents for a population of 34 at a 95% confidence level with a 5% margin of error. However, since risk management roles are specialized (e.g., finance, operations, IT), stratified random sampling will ensure proportional representation across departments.

Data Collection Instrument

Self-Administered Questionnaires

For this study, structured self-administered questionnaires were administered to serve as the primary data collection tool, designed to capture measurable insights on operational risk management practices and their financial impact at the South End Service Centre. The questionnaire utilized 5-point Likert scales (e.g., frequency of risk training: 1=Never to 5=Daily) and closed-ended questions (e.g., "How many system failures occurred in quarter 3, 2023?") to ensure standardized, analysable responses (Dillman et al., 2014). On top of this, secondary data checklists will be used to systematically extract numerical risk and financial metrics like quarterly profit margins, fraud incident counts) from NBM's internal reports (2020–2024), aligning with Basel III risk reporting standards (BCBS, 2023).

Data Analysis

Table 4.1: Departmental distribution

Department	Number of Participants	Percentage (%)
Finance	12	35.30%
Operations	10	29.40%
Compliance	6	17.60%
IT	4	11.80%
Other	2	5.90%
Total	**34**	**100%**

Source: data analysis (2025)

6.0 Recommendation

Implement Continuous, Practical Training Programs

The study revealed a significant gap between policy and practice, often due to a lack of understanding at the front-line level. It is recommended that the branch move beyond theoretical memos and invest in continuous, practical training programs. These programs should include hands-on workshops, real-world case studies, and simulations to ensure staff at all levels can effectively translate policy into action. This will empower employees to act as the first line of defence and significantly reduce operational losses from human error.

This recommendation addresses a key weakness in the branch's current framework, where policies are often perceived as a series of abstract rules rather than essential operational guidelines. By implementing practical, scenario-based training, the branch can ensure that staff are not just told what to do but are shown how to do it in a way that resonates with their dayto-day work. For instance, a workshop on fraud prevention could use anonymized real-world examples from the branch's past to demonstrate how a successful fraud attempt was thwarted, giving staff the tangible skills to spot similar red flags. This approach will not only reduce the frequency of costly errors but also foster a sense of ownership over risk management, moving it from a bureaucratic task to a core part of every employee's role.

Establish a Formal, Cross-Departmental Risk Committee

To address the issue of siloed ((isolated from others) communication and a lack of formal collaboration, the branch should establish a formal, cross-departmental risk committee. This committee should consist of representatives from Finance, Operations, Compliance, and IT, and meet regularly to discuss risks that affect multiple areas. The committee's mandate should be to develop and enforce shared protocols for managing complex, inter-departmental risks, ensuring a unified and efficient response.

This recommendation directly tackles the "siloed" mentality identified in the findings, where departments often operate in isolation, hindering a holistic view of risk. By creating a dedicated, formal committee, the branch can move away from reactive, ad-hoc communication and towards a structured, proactive system. The committee's role would be to act as a central nervous system for risk management, providing a platform for different departments to share their unique perspectives and develop a single, coherent strategy for mitigating shared risks. This will not only improve the speed and effectiveness of the branch's response to multi-faceted threats but also foster a culture of shared responsibility and mutual accountability across the organization.

Develop a Framework for Emerging Risks

The current framework's reliance on historical data makes it less effective at handling new and emerging risks. It is recommended that the branch develop a specific framework for identifying and assessing novel threats. This could involve dedicated sessions for brainstorming potential future risks, utilizing external market analysis, and implementing a flexible, forward-looking approach that isn't solely reliant on past data.

This recommendation addresses a critical gap identified in the study: the branch's reactive posture toward unforeseen threats. By creating a dedicated emerging risk framework, the branch can shift from simply reacting to risks that have already occurred to proactively anticipating those on the horizon. This framework could include establishing a "futurist" team responsible for monitoring global and local trends in technology, finance, and regulation. Instead of waiting for a new type of fraud to appear, this team would proactively assess the threat landscape and provide early-warning signals to the relevant departments. By institutionalizing this foresight, the branch can develop a more resilient and adaptable risk management system that is prepared for both the risks of yesterday and the threats of tomorrow.

Leverage Technology for Proactive Monitoring

While the branch uses technology for basic monitoring, it should be leveraged more strategically. It is recommended to invest in more advanced software with predictive analytics capabilities that can identify subtle, early-warning signs of risk before they escalate. This proactive use of technology can significantly improve the branch's ability to anticipate and mitigate threats.

This recommendation addresses the limitation that the branch’s current technology is primarily reactive. By upgrading to software with advanced analytics, the branch can move beyond simply flagging known suspicious patterns to identifying anomalies that may indicate a new type of risk. For example, such a system could analyse a combination of seemingly unrelated data points like a sudden change in a customer's spending habits, a series of failed login attempts from a new location, and a recent update to a third-party application and flag this as a potential composite risk. This level of foresight would allow the branch to investigate a potential threat before it materializes into a loss. The proactive use of technology will transform the risk management process from a detective function into a predictive one, safeguarding the branch's financial assets more effectively.

Align Departmental Priorities with Risk Goals

To overcome the challenge of conflicting priorities, it's recommended that the branch's leadership align departmental goals with the overarching risk management strategy. For example, a department's profitability targets should be balanced with its risk-adherence goals. This will ensure that all departments are working toward a unified objective of achieving profitability in a secure and responsible manner.

This recommendation addresses a fundamental issue where departments often work in silos with different key performance indicators (KPIs), which can inadvertently undermine the bank's risk framework. By formally tying risk metrics to departmental goals and individual performance, leadership can foster a culture where profitability is pursued not at the expense of risk, but as a direct outcome of effective risk management. For instance, a loan department's success wouldn't be judged solely on the number of loans approved, but also on the loan's quality and low default rate. This structural change ensures that risk management isn't just a separate function, but an integral part of how every department measures its own success, creating a cohesive and resilient organization.

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