

THE PERCEPTION OF ERM IN THE ZIMBABWE 'S SHORT TERM INSURANCE INDUSTRY: A CASE FOR BULAWAYO METROPOLITAN CITY

ABSTRACT

The study was carried out to establish the perception of Enterprise Risk Management (ERM) by short-term insurance companies in Zimbabwe's second capital city ,Bulawayo . The Zimbabwean insurance companies have not adopted ERM despite the benefits that this holistic approach to risk management offers. The research instrument used was a closed questionnaire with a Likert five point scale on a sample of 35 short term companies in and around Bulawayo. The questionnaire sought to gain an insight on the perceptions on ERM from the short term insurance industry. The survey explored perceptions on the factors which **could** influence the short term insurance companies to adopt ERM, the benefits to be acquired by the companies that implement ERM, and the challenges that the companies are likely to encounter in their efforts to implement ERM. The results of the survey revealed that short term insurers perceive that ERM will bring benefits to their companies, and acknowledge that efforts towards finally adopting ERM will be influenced by both internal and external forces such as shareholder considerations. The short term insurers also acknowledge that there are challenges that may hinder their implementation efforts.

Keywords: Zimbabwe, ERM, short term insurance, **Traditional risk management**

1. INTRODUCTION

In the last decade, there has been a radical alteration of the insurance operating business environment. At present, insurers face growing competition, more challenging stakeholders and more capital pursues too little business. According to Sabhani and Osman (2011) the insurance industry is progressing with dynamic transformation in technology, distribution systems and customer expectations that produce new risks and challenges high performance. The Zimbabwean insurance companies are emerging from a decade - long crises that was ended by the dollarization in 2009. Although dollarization brought some stability to the whole economy, it also brought about some challenges, which have also affected the insurance industry. Dollarization brought about a liquidity deficit in the market resulting in players experiencing recapitalisation challenges, limited investment options and inability to attract foreign investment to inject new capital and low disposable incomes resulting in shrinkage of the market. The result of the challenges was that the number of people who could afford to pay premiums was reduced. As a result there is increased competition which has placed downward pressure on premiums, leading to low margins. Claims have been soaring while premiums have softened thus creating an unsustainable business model. Risk management has always been at the heart of insurance companies operations; however the complexity of risks now, has called for a more efficient mechanism of managing company risks. A new risk management concept which has gained popularity is Enterprise Risk Management

(ERM). ERM has emerged to address the risk management challenges faced by insurance companies and other business enterprises. Organizations in all industries are looking to insurance companies to help them meet their own ERM challenges, whether the need is sophisticated risk assessment, risk modelling, risk mitigation, or risk financing, the financial services industry is assumed to be more knowledgeable. A financial institution that can demonstrate that it has, in fact mastered ERM internally will make itself more credible in the market place and, as a result, more likely to attract and retain increasingly sophisticated customers (Standard and Poor, 2005).

2. LITERATURE REVIEW

The concept of ERM is new and thus literature on the subject is still in its infancy as much of the existing evidence comes from survey and case studies (Eckles, Hoyt and Miller, 2011). However interest in ERM has continued to grow in recent years. ERM is defined as a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives (COSO, 2004).

2.1 Benefits of ERM

Hopkin (2010) states that ERM involves the identification and evaluation of significant risks, assignment of ownership, completion and monitoring of mitigating actions to manage these risks within the risk appetite of the organization. Hopkin (2010) further states that, the outputs are the provision of information to management to improve business decisions, reduce uncertainty and provide reasonable assurance regarding the achievement of the objectives of the organization. ERM represents a radical paradigm shift from the traditional risk management (TRM) method of managing risks individually to managing risk holistically. In other words, ERM emphasizes managing risks as a portfolio (risk portfolio) as opposed to managing individual risk separately (Eckles, Hoyt and Miller, 2011). The level of decision making under enterprise risk management is also shifted, from the insurance risk manager, who would generally seek to control risk, to the Chief Risk Officer (CRO), and overseen by a board of directors charged with monitoring risk measures and setting limits for these measures (Nocco and Stulz, 2006). Hopkin (2010) highlights that during the 1990s, risk financing products emerged that combined insurance with derivatives. At the same time, corporate governance and listing requirements encouraged directors to place greater emphasis on ERM and the appointment of a CRO occurred at the time. During the 2000s, financial services firms have been encouraged to develop internal risk management systems and capital models. Hopkin (2010) also adds that, there has also been consideration of the fact that many risks are interrelated and that traditional risk management fails to address the relationship between risks. With the ERM approach, the relationship between risks is identified by the fact that two or more risks can have an impact on the same activity or objective. The ERM approach is based on looking at the objective, key dependency or core process and evaluating all of the risks that could impact the item being evaluated. Proponents of ERM argue that by integrating all risk classes, firms are able to avoid duplication

of risk management expenditure by exploiting natural hedges (Liebenberg and Hoyt, 2011). The International Actuary Association (2008) notes that, the concept of ERM has been embraced by an increasing number of insurers in recent years and ERM is increasingly regarded as an appropriate response or indeed a solution to managing risk in today's more complex and interdependent markets and operating environments. The insurers will be seeking to improve their management practices and the operating performance of their businesses. Hopkins (2010) highlights that the financial crisis of 2008 called into question the contribution that risk management can make to corporate success, especially in financial institutions. However, there is no doubt that the application of risk management tools and techniques failed to prevent the global financial crises. The financial crisis was a failure to correctly apply risk management processes and procedures, rather than inherent defects in the risk management approaches. Eckles, Hoyt and Miller (2011) expound that part of the rationale for adopting ERM and/or appointing a CRO is to break down the departmental budgetary and political barriers in the identification, evaluation and management of risk. Breaking down the departmental budgetary and political barriers will allow the firm to consolidate its "non-core" risks into a risk-portfolio and hedge the risk-portfolio in a coordinated manner. The International Association of Insurance Supervisors (2010) argues that the objective of ERM is not to eliminate risk. Rather, it is to manage risks within a framework that includes self-imposed limits. However, in setting limits for risk, the insurer should consider its solvency position and its risk tolerance. Firms that engage in ERM are able to understand the aggregate risk inherent in different business activities and this provides them with a more objective basis for resource allocation, thus improving capital efficiency and return on equity (Hoyt and Liebenberg, 2008). Meulbroek (2002) also adds that, firms that pursue ERM are able to comprehend the collective risk intrinsic in different business actions and this gives objective stance for resource allocation, as a consequence improving capital efficiency and return on equity. Organisations with a wide range of investment opportunities are likely to benefit from being able to select investments based on a more accurate risk adjusted rate than was available under traditional risk management approach (Meulbroek, 2002). Individual risk management activities may reduce earnings volatility by reducing the probability of catastrophic losses, however, there are potential interdependences between risks across activities that might go unnoticed in the TRM model. ERM provides a structure that combines all risk management activities into one integrated framework that facilitates the identification of such interdependences (Meulbroek, 2002). PriceWaterhouseCoopers (2008) found that insurers perceived benefits and contribution of ERM in the following order namely: better risk and return decision making, value creation, instilling risk awareness into the business and creating a common language of risk, portfolio view of risks and reinforcing ownership of risk and control at the business unit level.

2.2 Drivers for ERM adoption

Previous studies have identified numerous influential factors of ERM adoption among firms. According to Subhani and Osman, (2011), the trend towards the adoption of ERM is attributed of external and internal factors. The foremost external controls that have determined organization to move towards risk management in a holistic manner are a broader scope of risks arising from factors such as globalization,

143 industry consolidation, and deregulation; increased regulatory attention to corporate
144 governance; and technological progress that enables better risk quantification and
145 analysis (Miccolis and Shah, 2000). Internal factors are crucial to maximize
146 shareholder's wealth. There are a number of forces that drive the growth in, as well as
147 acceptance of ERM and comprise organization disasters that have raised awareness
148 level of the board members and senior executives; new regulatory capital and
149 examination requirements; industry initiatives on corporate governance and risk
150 management; and leading corporations which have experienced significant benefits
151 from using ERM programs (Lam, 2006). Ituntas, Berry-Stölzle and Hoyt (2011) found
152 that ERM adoption is negatively associated with lagged changes in performance.
153 Altuntas, Berry-Stölzle and Hoyt (2011) findings suggest that a negative past
154 performance may influence the actions of CEOs to protect their career concerns and
155 therefore, shareholders will believe that the management is capable of handling poorly
156 performed years and will desist from sanctions against the management board. One of
157 the reasons why insurance companies implement an ERM frame work is be that it
158 might be required by an industry regulator, or by firms auditors or investors or rating
159 agencies (Sweeting, 2011; Casualty Actuarial Society ERM Committee, 2003).
160 Standard and Poor began incorporating ERM analysis into their credit-rating process
161 for insurance companies in 2005. ERM is now one new category of analysis along
162 with the existing categories of competitive position, management and corporate
163 strategy, operating performance, capitalization, liquidity, investments, and financial
164 flexibility (Standard and Poor, 2005). Sweeting (2011) states that ERM processes are
165 sometimes implemented in response to a previous risk management failure in an
166 organisation. However, a risk management failure in one's own organisation is not
167 necessarily the precursor to an ERM framework. A high profile failure in another
168 firm, particularly a similar one, might prompt other firms to protect themselves
169 against a similar event. The Casualty Actuarial Society ERM Committee (2003)
170 appears to agree that ERM may be adopted in response to a failure of another
171 organisation and further highlight that, awareness of operational and strategic risks
172 has increased due to a succession of high-profile cases of organisations crippled or
173 destroyed by failure of control mechanisms for example the Barings Bank or by
174 insufficient understanding of their business for example the General American
175 Insurance company. The Casualty Actuarial Society ERM Committee (2003) note that
176 companies are now exposed to more complicated risks and this is a driving force to
177 ERM adoption. New risks emerge with the changing business environment. The
178 growing tendency to quantify risks has been another drive to ERM adoption.
179 Advances in technology have made quantifying risks easier for infrequent,
180 unpredictable risks that historically have been difficult to quantify (Casualty Actuarial
181 Society ERM Committee, 2003). However the use of technology gives rise to new
182 risks that should be evaluated as soon as they occur without delay. Kleffner, Lee and
183 McGannon(2003) found that forces driving firms to adopt ERM include the influence
184 of risk managers, encouragement from the board of directors, and compliance with
185 Toronto Stock Exchange guidelines, while the main deterrence to ERM adoption is
186 organizational inertia. According to Acharyya and Johnson (2006) the key driving
187 forces for ERM are leadership of CEO, solvency II, corporate governance, leadership
188 of CRO and the changing landscape. Regulations primarily influence the behaviour of
189 organizations through the exercise of state power and stability of the insurance market
190 is a primary concern of insurance regulators. Traditionally, insurance legislation is
191 focused on managing and reducing risks arising from insurance and investment
192 operations. Consequently, regulations, in terms of ensuring solvency through risk and

capital management and appropriate corporate governance, are seen as the key driver towards ERM in the insurance industry.

2.3 Implementation challenges

Ratcliffe, Samer and Langer (2009) states “ERM implementation is still a challenge for the insurance industry, although significant progress has been made, as studies from Pricewaterhouse Coopers show”. The implementation of a successful ERM is a challenging exercise. One factor is the explicit commitment of the executive management. But senior management must also be closely involved. An ERM system must be comprehensive and consistent, meaning that no part of the company must lag behind. Jabbour (2011) noted that, some organizations that attempted to implement ERM have failed or experienced setbacks that prevent the gaining of expected benefits. The main cause of these failures could be the lack of buy-in from senior management and oversight committees such as audit committees (De La Rosa, 2007). Failure is also caused by lack of theoretical ERM knowledge; a poorly customized ERM approach; incorrect or incomplete set-up of oversight structures to support the ERM initiative; poor tone at the top, including ethical culture and lack of formalized business strategies; insufficient financial and human resources to support implementation and maintenance of the ERM process; inability to maintain the momentum of the ERM implementation project beyond the first year; poorly defined ERM language; Inefficient supervision of consultants (De La Rosa, 2007). According to Tillinghast-Towers Perrin (2000), embedding ERM is proving to be a significant challenge. According to the study conducted by Tillinghast- Towers Perrin (2000), large insurers are significantly more advanced in most ERM aspects. European insurance companies are better prepared than in North America and in the Asia and Pacific region. Another challenge in implementing ERM is that a company must develop its own system, based on needs, culture and resources and this makes the installation of a well-functioning ERM framework a major challenge in the management task (Ratcliffe, Samer and Langer, 2009). Nocco and Stulz (2006) state that, a major challenge for a company implementing ERM is to ensure that decision-making is not just by senior management, but by business managers throughout the firm, takes proper account of the risk-return trade off. To make this happen, the risk evaluations of new projects must be performed, at least initially, on a decentralized basis by the project planners in the business units. Nocco and Stulz (2006) further explain that, for a company to succeed in implementing ERM, it is critical that people throughout the organization understand how it can create value. Managers must understand that it is not an academic exercise but a critical tool for executing the firm’s strategy and therefore, ERM must be “sold” to and “bought into” by all levels of the organization. In order for the whole organization to support the ERM strategy, considerable thought must be devoted to the design of managerial performance evaluation and incentives. Acharyya and Johnson (2006) divided the challenges in implementing ERM into two sections which are operational challenges and technical challenges. The findings of the study examining ERM practised by four European-based insurance companies showed that risk communication (in the absence of a common risk language and a common risk culture) was identified as the key operational challenge and the other operational challenges were risk awareness amongst middle level staff, risk communication between different disciplines, accuracy, consistency and inadequacy of data. Acharyya and Johnson (2006) showed that the technical challenges were, measurement of operational risks, modelling of

risk, measurement of strategic risk, calculating of correlations among business lines, profiting risk and calculating correlations among risk classes. Communication is often a challenge associated with an emerging topic. Acharyya and Johnson (2006) suggested that lack of understanding is a major obstacle; risk communication must be improved and conflict overcome in order for the goals of ERM to be achieved. However, risk communication is not an isolated issue; it is essentially linked to the attitude of individuals towards risk and is subsequently linked to culture. Moreover, all these issues are linked to the motivation of achieving risk management goals. Furthermore, an effective risk communication system can introduce a culture of choosing good risks and rejecting bad risks at every level of the organization.

3. RESEARCH AIM

The primary objective of the research was to establish the perception of ERM by short-term insurers in Bulawayo, Zimbabwe. This was meant to increase their risk awareness, facilitate effective decision making and increase firm's value. The research looked at what benefits ERM can bring to the Zimbabwean Market, identified factors that would influence short term insurance firms to adopt ERM and considered the challenges that the firms are likely to meet when implementing ERM.

4. RESEARCH METHODOLOGY

Primary and secondary data were used in this research. The research instrument used was a closed questionnaire with a Likert five point scale on a sample of 35 short term companies in and around Bulawayo, Zimbabwe. The population was selected from a listing of 80 companies, 40 were selected from the frame that was obtained from the Ministry of Finance. The Sample was selected using simple random sampling. It was observed that all companies selected had an equal chance of being selected. There were limitations on time constraints and also the limitations regarding confidentiality clauses signed by managers implied certain questions were answered partially. A survey was used to collect the primary data. Secondary data was collected from journals, a variety of publications and text books, financial reports for short term insurance companies were used to complement the findings of the primary data. A positivistic approach suggests that closed questions should be used; therefore closed ended questions were used in the questionnaire in this research (Collins and Hussey, 2003). Short term insurance includes both short term insurers and reinsurers. There are many departments in the insurance company varying from underwriting, claims, accounts and finance, human resources, to managing directors and board. In this research our respondents are employees of short term insurance companies in the working fields of the insurance company's value chain. The group of people asked to participate in this research was randomly chosen in the working fields of the insurance company's value chain including underwriters and claims. The reason for covering all areas and fields of work in the insurance companies is to have a holistic view of the perceptions of employees on the subject of study, ERM. The sample size was eighty six.

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4. RESEARCH FINDINGS

5.1 Reliability statistics

Cronbach's alpha coefficient was calculated for internal consistency reliability of scales in the questionnaire. An overall reliability coefficient for the entire survey instrument was also calculated. The reliability statistics for the four categories are shown on Table 1.

Table 1: Reliability statistics

	Cronbach's Alpha	N of Items
Benefits of ERM	.760	7
Operational Challenges	.886	14
Technical Challenges	.871	10
Drivers for ERM adoption	.732	4

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The reliability coefficients for the different categories and the entire survey instrument have a value greater than 0.7 .George and Mallery (2003) provide the following rules of thumb: “_ > .9 – Excellent, _ > .8 – Good, _ > .7 – Acceptable, _ > .6 – Questionable, _ > .5 – Poor, and _ < .5 – Unacceptable” .Therefore, the survey instrument is generally good and acceptable.

5.2 Perceived benefits of ERM in the short-term insurance industry

There are numerous benefits for the insurance companies who embrace an enterprise-wide approach to risk. Respondents were asked a question on the value that ERM will provide to their companies. The mean value and standard deviations for this question is shown in Table 2.

Table 2 –Descriptive statistics for benefits of ERM

	Mean*	Std. Deviation
24) Capital adequacy assessment	3.98	1.047
22) Increased ability to escalate critical issues to senior management	3.87	1.001

25) Improved understanding of risk and controls	3.83	.914
27) Enhanced risk culture and better balance of risk and rewards	3.83	1.156
23) Increased perception by regulators	3.75	1.082
28) Enhanced shareholder value through improved stock price	3.75	1.046
26) Annual business planning	3.70	1.234

303

304 *-(The following scales are used to measure the importance of respondents'
305 perceptions.

306 ☐ Mean scores ranging from $1.0 \leq M < 1.8$: Very low importance

307 ☐ Mean scores ranging from $1.8 \leq M < 2.6$: Low importance

308 ☐ Mean scores ranging from $2.6 \leq M \leq 3.4$: Neutral

309 ☐ Mean scores ranging from $3.4 < M \leq 4.2$: High importance

310 ☐ Mean scores ranging from $4.2 < M \leq 5.0$: Very high importance)

311 From the results obtained, the average was observed as 3 hence there is a high
312 importance placed on ERM based on their perceptions.

313 The respondents considered all the benefits that can accrue from implementing ERM,
314 such as enhanced risk culture and better balance of risk and rewards as items of high
315 importance to their companies. The standard deviations of the items on the benefit of
316 improved understanding of risk and controls is around one, which indicates that the
317 responses for each item do not differ greatly from each other. For the rest of the items
318 standard deviations of the items are slightly greater than one, which indicates that the
319 individual responses on average were a little over one point away from the mean.

320 **5.3 Drivers for adoption of ERM**

321 In this part, the respondents were required to indicate which of the four listed factors
322 would most likely influence their companies to adopt ERM. The mean value and
323 standard deviations for this question is shown in Table 3.

324

325

326 **Table 3: Descriptive statistics for drivers for adoption of ERM**

	Mean*	Std. Deviation
56) To maximise earnings and financial strength	3.96	1.204
55) Shareholder considerations	3.68	1.237
54) Overall business complexity	3.57	1.152
53) Zimbabwe insurance regulating commission and other regulating expectations	3.47	1.367

327

328 100% of the respondents' perceptions about the influence of the listed drivers of
 329 adoption of ERM were that they are of high importance to their companies. All the
 330 factors would influence their companies to adopt ERM. The standard deviations of all
 331 the items are slightly greater than one, which indicates that the individual responses
 332 on average were a little over one point away from the mean.

333 **5.4 Implementation Challenges**

334 While ERM will bring benefits to the insurance companies, there are challenges that
 335 companies might experience in implementing an effective ERM program.
 336 Respondents were questioned on these challenges. In the questionnaire 14 operational
 337 challenges and 9 technical challenges were listed. This list of challenges is not
 338 exhaustive but touches on the main challenges. The respondents were asked to
 339 evaluate these challenges according to their company's capabilities.

340 **5.5 Operational challenges**

341 **Table 4: Descriptive statistics for operational challenges of implementing ERM**

	Mean*	Std. Deviation
33) Appropriate risk analysis techniques	3.13	1.272
42) A common risk language	3.12	1.308
38) Data accuracy	3.11	1.204

31) Risk awareness at the top level	3.10	1.142
32) Risk classification	3.08	1.181
35) Data adequacy	3.08	1.299
34) Linking risks with corporate strategy	3.00	1.386
40) Risk awareness at middle level	3.00	1.240
41) A common risk culture	3.00	1.386
39) Risk communication across discipline	2.98	1.232
36) Data consistency	2.96	1.091
30) Risk communication	2.96	1.073
37) Risk controlling	2.92	1.269
29) Data storing	2.74	1.129

342 The respondents' perceptions on the operational challenges of implementing ERM
343 were neutral. The standard deviations on the other hand show that the responses are
344 concentrated around the mean.

345 **5.6 Technical challenges**

346 **Table 5: Descriptive statistics for the technical challenges in implementing ERM**

	Mean*	Std. Deviation
50) Risk modelling	3.40	1.276
48) Allocation of capital across business lines	3.30	1.119
52) Risk measurement: operational	3.28	1.166
44) Calculating risk based capital	3.21	1.261
49) Determining correlations among business lines	3.08	1.152
45) Allocation of capital across business units	3.06	1.183

43) Determining risk appetite	2.96	1.055
51) Risk measurement: strategy	2.94	1.134
46) Risk identification	2.89	1.266
47) Risk integration	2.88	1.247

The only important technical challenge perceived by respondents in terms implementing ERM in their organisations is risk modelling (mean = 3.40). This may be because this technical aspect would require the involvement of the skills of an actuary and it is expensive for companies to source the expertise of an actuary. The perceptions of the respondents on the other items were neutral. The standard deviations of all the items are slightly greater than one, which indicates that the individual responses on average were a little over one point away from the mean.

5. CONCLUSION AND AREAS OF FURTHER STUDY

5.1 Conclusion

The respondents were asked to state their perceptions on the benefits sought from the application of ERM. The researcher selected seven benefits of ERM and accordingly asked the respondents to assess these seven benefits in the case of ERM implementation. In other words, to what degree they think that their company will achieve to these benefits if their company were to adopt ERM. In conclusion, the results are consistent with prior literature. The majority of respondents perceived the seven benefits to be of great importance to their firms. This means that the Zimbabwean short term insurance companies will take advantage of these benefits, if they adopt ERM.

Additionally, the researcher provided an examination of the likely challenges those insurers would encounter in their efforts to implement ERM. The majority of the respondents believed that the listed major obstacles will hinder ERM implementation. The respondents perceive risk modeling to be a neutral challenge to their companies. This may be because risk modeling requires the expertise of an actuary and is expensive to source the expertise of an actuary. A list of both internal and external factors that can influence the companies to adopt ERM was provided to the respondents for them to indicate which factors would influence their companies to adopt ERM. Zimbabwean short-term insurers believe that all the factors listed would influence their companies to adopt ERM. Furthermore, they expressed that all the factors are of high importance to their companies. These include maximising earnings and

financial strength, shareholder considerations as well as the Zimbabwean regulating commission and other regulating bodies.

6.2 Areas of further research

Further research is needed to look into the different frameworks that the short-term insurers can adopt in their efforts to adopt a holistic view to risk management. There are many frameworks available like the COSO ERM framework; the challenge is selecting one that is suitable for the Zimbabwean short term insurers.

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