BANK STRATEGIC AND RISK MANAGEMENT: A SURVEY TO DETERMINE THE IMPACT OF THE CURRENT WORLD FINANCIAL CRISIS ON FUTURE BANK MANAGEMENT IN SOUTH AFRICA

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Abstract

The purpose of this research was to determine how the banks in South Africa perceive the future of bank management and banks risk management over the next couple of years within the context of the financial crisis that recently played out globally. It is clear from the survey results that South African (SA) banks were not affected as much by the crisis as some of their international counterparts. Primarily because of the credit legislations introduced in SA recently. Other reasons may be due to conservatism and sufficient capitalisation of banks and less involvement in global markets where major problems were experienced. The survey indicates that SA banks are prepared to learn from the crisis and are planning to improve financial risk management. Consolidation or centralisation of the risk management functions may be prevalent. According to the survey, liquidity risk management that used to be a fairly low risk management priority in previous bank and treasury surveys, now tops the list of important risks te better manage in the future.

Keywords: risk management, bank risk management, subprime crisis, bank management

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Introduction

The world financial crisis that commenced with earnest during 2008 and which continued in 2009, had a negative impact on financial markets across the globe. This has led to considerable blame being directed at poor risk management and corporate governance within the financial services industry, and especially within the banking environment.

Although the global financial crisis has had such an adverse effect on financial institutions around the world, it did not affect South Africa that much. This is due to measures taken to enhance banks' capital ratios and risk management frameworks (Temkin, 2008) and also the recently introduced National Credit Act had a positive influence.

Many lessons have been learnt and many management issues need to be reevaluated. Many challenges as it relates to risk and strategic management within the South African (SA) banking environment need to receive new attention. South African banks will surely revise their risk appetite and their risk management processes in order to remain profitable and to ensure that their risk management systems are proving effective in these volatile markets. The South African banks have shown some resilience in the face of the challenges posed by the crisis.

The effective management of risk is fundamental to a banks' core business. The question is what impact the current world financial crisis will have on risk management and strategic management frameworks within the South African banking environment.

Objectives of the research

The primary focus of the study was to determine the impact of the recent turmoil in the minds of bank managers in the South African banking environment. A survey of all South African banks was conducted to determine the perceived impact of the world financial crisis on future bank risk management and strategic management in SA.

Among others, information about the following major issues was gathered:

1. Identifying the key problems and challenges for the SA banking industry caused by the crisis.
2. Determining what the effect of these problems and challenges will be on the SA banking industry.
3. To Identify and quantify the key risks faced by the SA banks.
4. To determine the impact of the crisis on these risks and how bank strategic and risk management practices will have to be altered, if at all, in the future.
5. To determine whether the SA banks felt that they were sufficiently geared/prepared for the turmoil. For example, was stress testing and scenario analysis done sufficiently within

the South African banking industry for the events leading up to the crisis?

6. To determine what the SA banks did wrong in the events leading up to the crisis and gathering information about risk management deficiencies in the SA banks.
7. And finally, determining briefly, what bankers feel the impact of the crisis has been on South Africa as an emerging economy.

Bank risk management

The cave in of high profile banks around the globe, the emergency rescue of others, laying-off of Chief Executive Officers and other senior managers and efforts by banks to raise fresh capital have all been signs that banks get risk management wrong. Prior to the crisis, many boards of directors would have acknowledged that their risk management was adequate. Now what would their views be? How should they change their risk management systems or policies so that this question may be answered (Conover *et al.*, 2008)?

According to Chance (2003), "Risk management is the process of identifying the level of risk that an entity wants, measuring the level of risk that an entity currently has, taking actions to bring the actual level of risk to the desired level of risk, and monitoring the new actual level of risk so that it continues to be aligned with the desired level of risk. The process is continuous and may require alterations in any of these activities to reflect new policies, preferences, and information." Since risk management is at the core of the banking business, banks must identify their key risks, manage these risks successfully and adopt a risk appetite that will achieve an appropriate balance between risk and reward in the business. Risk and return management is also integral to the evaluation of strategic alternatives and the setting of objectives (ABSA, 2009).

A lot has been said about the sub-prime crisis over the past few years. However, its very nature posed a very real threat to any financial institution and implies that the old ways of managing are not enough to protect a bank. Basel II introduced many new refinements as it related to managing banks. However, the question is, is it enough? It is encouraging to note that South African banks have not experienced the levels of volatility which their international peers have been forced to put up with. The local banks also did not facing the same liquidity challenges and levels of write downs which we have seen in the international banking environment. For the past year rand liquidity also remained stable, with the interbank lending market continuing to operate efficiently.

According to (Nedbank Annual Report, 2008) "our banking environment is highly advanced with sophisticated, world class risk management techniques that have been more conservatively applied than has often been the case offshore."

Although it is well equipped to face the challenges posed by the global crisis, the local banking industry will without a doubt be faced with new risk management and strategic management challenges. It is important that a clear understanding of risk management is obtained and to correctly identify the main risks to which the banking industry is currently exposed.

An interesting aspect which emerged from the literature, which is worth mentioning here, were the main factors which contributed to the South African banking system remaining structurally sound amidst the crisis. The most important factors included (Nedbank, 2009):

- Sound regulation of the financial services industry, especially the banking sector
- The use of excessive securitization, exotic financial products and complex credit derivatives, which results in excessive leverage, was not followed to the same extent in South Africa as it was abroad
- Locally, interest rates never fell for so long and to such low levels as was the case in the US. In the US, these low levels of interest rates encouraged excessive borrowing and lead to unmanageable levels of household debt. South Africa has also not had negative real interest rates
- The National Credit Act was successfully implemented in South Africa to help minimise irresponsible lending practices, over-gearing and excessive consumer debt
- Exchange controls prevented huge flows of funds from local institutions out of the country
- Stable rand liquidity with the inter bank market operating normally
- Good risk and capital management
- Successful implementation of Basel II in SA.
- Lessons learned from the 2002/3 SA banking crisis.

Poor risk management together with vital elements that lack from the process, clearly made a major contribution to the credit crisis. The credit crisis has also highlighted some specific weaknesses in how organisations measure, report and manage risk. Credit risk arises from the primary activities of a bank such as lending money to borrowers, making deposits with other institutions and conducting general transactions in the financial markets (South African Reserve Bank, 2009). As advancing money and granting credit is the core of a bank's business it has a major affect on bank exposure but it also means that banks will lose money due to this activity. Many banks have significant exposure to, for instance, residential real estate under weak loan structures and this also poses problems to the banking sector (Lascelles, 2008). It must be remembered that access to bank credit and other bank services is absolutely essential for virtually any economy to be able to grow (Fraser & Rose, 1988). Overextending credit, ignoring sound business principles and ignoring the global business environment is what cased all the financial problems. Overconfidence and irrationality gave rise to wrong impressions about default risk. Banks overvalued real estate assets, seeing it as a low risk. In the case of default, the house would simply be sold (Cohen, 2008).

The current impact of the financial crisis has made it clear that thorough risk management is going to be a crucial element in rebuilding the confidence in the banking industry. Banks now need to take action and focus on getting the fundamentals of risk management right. They must measure risk better, using adaptive risk management tools. The question is also whether banks place enough emphasis on stress testing. According to Hilbers and Jones (2004), stress testing is a process of identifying vulnerabilities and providing an estimate of the sensitivity of balance sheets to a variety of shocks. Banks must also do more in-depth scenario planning when reporting on strategies. And finally, banks must learn to set sensible limits on risks that fit the culture and ambition of the individual business. Such an approach can lay a foundation for risk governance that is flexible enough to meet the current changing and challenging market conditions (Conover *et al.*, 2008). An aspect also worth mentioning is competition in the retail sector. According to Okeahalam (2001) there is a need to introduce greater competition into the retail sector in the banking industry in South Africa. This may force banks to pursue ways to improve margins by doping better business. However, this may lead to too much emphasis on gaining market share.

Survey result

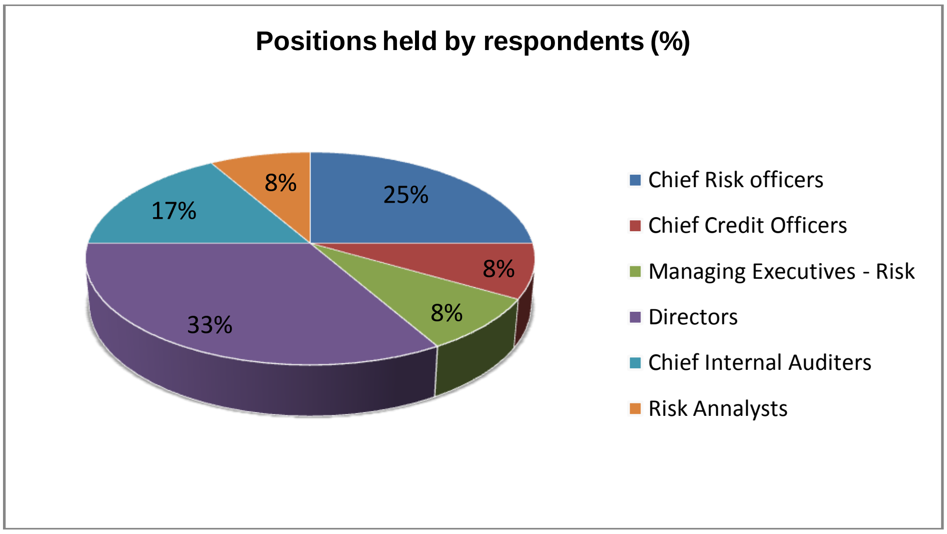
Since the outbreak of the financial crisis, considerable blame has been directed at poor risk management and corporate governance within the financial services industry. The question to be answered was how the crisis would impact current and future bank risk and strategic management in South Africa.

The survey was designed to learn how senior bankers, risk managers and close observers of the banking scene perceive these issues as well as the various risks facing the banking industry as they look ahead.

A total of 20 questionnaires were sent out of which 12 duly completed questionnaires were received back. This is a response rate of 60% of the total bank population in SA. The South African banking industry is dominated by four large banks, with these banks holding more than 80 percent of the country's deposits. Therefore in order to make the study reflective of the South African banking environment, it was very important to obtain feedback from these four institutions. This was achieved.

Since this study was based on very specific issues regarding the SA banking environment, it was aimed at professionals and executives within the banking industry. Therefore in order to draw credible conclusions, the quality of and the quantity of responses is therefore important. Figure 1 provides a breakdown of the positions held by the various respondents within their companies.

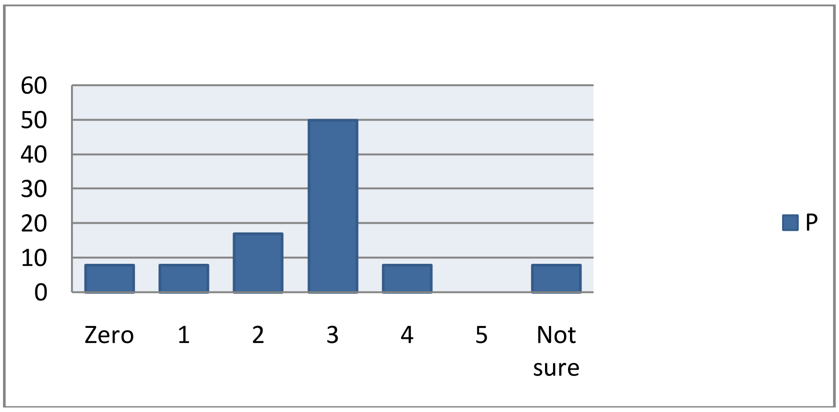
Figure 1. Breakdown of positions held by respondents



As can be seen from the figure above, respondents were senior employees.

It was important to determine how the South African banking environment had been affected by the subprime crisis. Respondents were asked to indicate how badly they felt their institution had been impacted/affected by the American crisis. A number of Zero meant that their institution was not impacted at all and five meant that it was affected severely.

Figure 2. Severity of the impact of the sub prime crisis



Half of the respondents indicated a number of three to the abovementioned question. Therefore it can be concluded that the respondents felt that their institution was moderately impacted/affected by the global financial crisis. These results indicate that the South African banking industry has felt the effects of the subprime crisis in their business and that this impact was moderate.

Respondents were asked in an open question to describe their main concerns about the safety of their own institution and the safety of the South African banking system as a whole as they look ahead over the next one to three years. It is important to note that this survey did not require respondents to list their concerns in order of importance. The list below (not in any particular order) contains the issues that emerged from the survey.

The following important issues came to light:

- Firstly it is important to note that none of the major or smaller SA banks needed government support/intervention as was the case with global banks. The United States, United Kingdom and Europe the recent problems experienced by Greece and Turkey are examples. This was indicated as a positive aspect and a distinguishing feature of the local banking industry when compared to the global banking industry.
- Most of the respondents indicated that the South African banks remain sound and well positioned to weather the storm posed by the crisis, mainly because they are well regulated and governed. The majority felt that the early adoption of the Basel II Accord, the limited exposure of the South African banks to international toxic assets due to strict exchange controls and the National Credit Act played a big part in the survival of the South African banks during the crisis. Thus a collapse of a major bank in South Africa seems highly unlikely and is not regarded as a major concern by the South African banking community. However, there is still some uncertainty regarding the survival of some of the smaller banks.
- The significant increases in impairment levels (bad debts) since the commencement of the crisis is a major concern for the South African banks. The banks are also concerned about future impairment losses and about the extent to which consumers over-extend themselves by borrowing more money than they can afford in the current low interest rate environment.
- The current state of the South African economy and uncertainty regarding the economy's ability to recover from its current state over the next few quarters is seen as a major concern for banks, as the current operating environment is regarded as an extremely testing one for the financial services industry. Among the respondents there was widespread concern about the South African banks' ability to raise adequate capital and obtain funding in the current limited market setting.
- In order to assist in the recovery of the South African economy, government might place expectations on banks with regard to lending to "poorer" communities. This is seen as a concern as this could also contribute to the already mounting levels of impairments.
- Many respondents indicated that a major concern for South African banks over the next two to three years will be the impact of over-regulation and increased supervision which is expected to be introduced in order to prevent further crises of the current magnitude from happening in the future. Over-regulation is as concern as it will make doing business more difficult and could increase the cost of doing so.
- The South African banking community will also be faced with uncertainty over the next number of years with regard to the impact of new legislation. These include:

  - Basel II enhancements to capital and liquidity requirements which will almost certainly require additional capital to be held. The concern is that this factor, together with available capital in the economy decreasing, could lead to lending and credit shortages in the real economy.
  - Legislation regarding remuneration schemes in banks
  - Companies Act amendments
  - KING III accord on corporate governance
  - The Competition Act
  - Banks may be forced to enter into commercially non-viable transactions as part of Broad-Based Black Economic Empowerment (BBBEE).
- Respondents indicated that their institutions may adopt further risk averse positions which could reduce profitability over the next few years.
- Managing the maturity gaps of assets and liabilities is expected to pose a greater challenge facing the banking industry over the next few years. Bank customers generally want to borrow over longer periods than the periods that depositors are prepared to deposit the funds. The uncertainty that the crisis has brought among market participants and the perception of increased uncertainty and therefore risk in the banking industry which may make it even more difficult to obtain deposits for the required periods.
- For the smaller banks, "flight to quality" could be a major concern over the next one to three years. In times of stress and uncertainty, people place their money where they believe it will be the safest. This would make it very difficult for the smaller and less renowned banks to remain competitive.
- The lack of proficiency of employees and the shortage of expert skills are seen as major threats and concerns by the South African banking environment.
- Access to liquidity is regarded as an immense concern facing South African banks when the markets experience turmoil. The credit shock in Ireland and Iceland, for example, was more to do with the lack of liquidity in the wholesale markets and falling domestic asset prices than the direct link to the US sub-prime crisis. As a result, a severe shortage of liquidity is seen as a major concern for the South African banks.
- The use of complex financial derivative instruments are still believed to remain a concern.
- Internationally, especially in the United States and United Kingdom, the trust that people have in banks suffered due to recent events. The value that international banks lost over recent times certainly had a negative effect and SA clients feel that it may also affect SA banks.
- Finally, another interesting point emerged from the study. Many respondents felt that since the South African banking landscape is dominated by the big four banks, with more than 80 percent of the SA clients already banking with these four institutions, will be how to expand/grow these banks over the next few years. As such, large South African banks wanting to grow have mainly two options, namely, expand offshore or take on more risk in an attempt to achieve their hurdles.

Respondents were asked to indicate the main risks they believe the South African banking industry is currently being faced with as a direct result of the subprime crisis.

As can be seen from the table above, the South African banking environment is currently being faced with a multitude of different risks. There are also various other risk factors identified which will pose serious threats and challenges to the South African banking environment over the next one to three years. The risk management frameworks of the various local banks will have to appropriately identify, quantify, and address these risks.

The question to be answered was how well prepared the local banking industry was in order to deal with the risks identified above. Respondents were asked to indicate how well prepared they believe their own, and other institutions were, and are, to successfully manage the risks that they have identified. These results can be seen in the figures below.

Table 1. Major risks facing the South African banking industry (not in any specific order)

MAJOR CURRENT RISKS

- The critical shortage of liquidity in the financial markets
- Increased cost of funding
- Credit spreads
- Impairments - both in the retail and commercial banking sectors.
- Possibility of a big corporate failure which owes large amounts of money to the banking sector
- Poor global economic growth
- Significant contraction in consumer demand
- Retaining and motivating skilled employees, especially risk specialists
- Finding the necessary risk management skills
- Robust risk management
- Negative perceptions of banks
- Tighter regulation
- Access to international funds
- Currency/exchange rate risk
- Costs of compliance (FICA, etc)
- Costs of operations
- Funding competent black banking professionals

MAJOR FUTURE RISKS

- Less innovation due to the stricter regulatory control
- Greater Basel II requirements for capital and liquidity
- Liquidity within the financial markets not being easily available
- Bad debts resulting from the downturn in the economy
- Consolidation in the banking industry
- Lending criteria being too cautious
- High cost of long date funding
- Low interest rate environment may put profits under pressure
- High costs due to changes to accounting standards
- Higher returns being demanded by shareholders
- Limited growth opportunities
- Identifying and correctly pricing for risk
- Skills shortages, especially at board level
- Funding competent black banking professionals
- Quality of risk management
- Political instability
- Prolonged global recession
- Costs of implementing KING III

Figure 5.3. Own institution preparedness

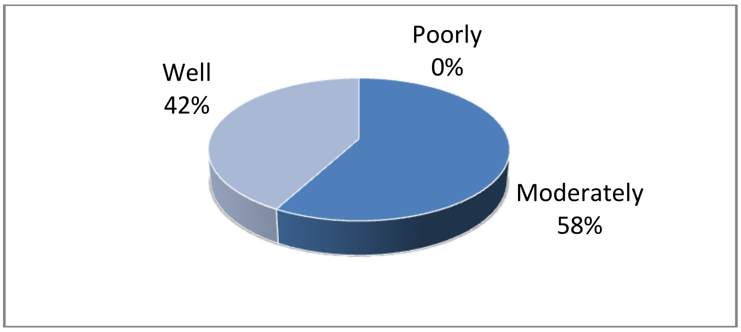
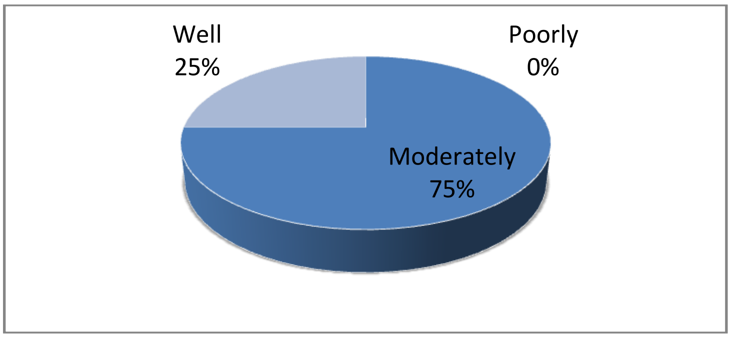


Figure 5.4. Other institutions' preparedness



The above figures appear to reflect a rather cautious response regarding bank preparedness to handle the risks identified. Although not a single respondent indicated that he believes his own and other banks were poorly prepared, only 42 percent indicated that his own institution was well prepared while only 25 percent of respondents indicated that they believe that other institutions were well prepared to face the risks previously identified. The 42 percent of respondents who indicated that they believe their own institution was well prepared, may be somewhat overstated. There is a strong possibility that this percentage may be biased and/or reflect overconfidence as respondents regard their own institution's capabilities as superior. It may also be that respondents did not want to react in a way that would in any way reflect negatively on the organization, even though over optimistic.

From the data, one can conclude that local bankers felt that the local banking industry was moderately prepared to deal with the risks identified. However, these results do not paint a very colorful picture as it seems evident that some very challenging times lay ahead for the South African banking industry if they want to successfully combat the risks identified

Respondents were asked to indicate how well they believe stress testing and scenario analysis was planned and carried out in their institutions in the time leading up to the crisis. Figure 5 indicates the response to this question.

Figure 5. How well stress testing and scenario analysis is planned and carried out

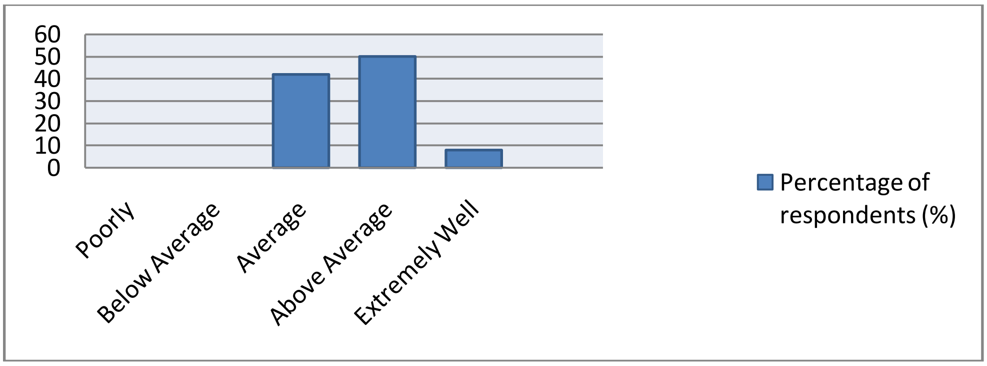


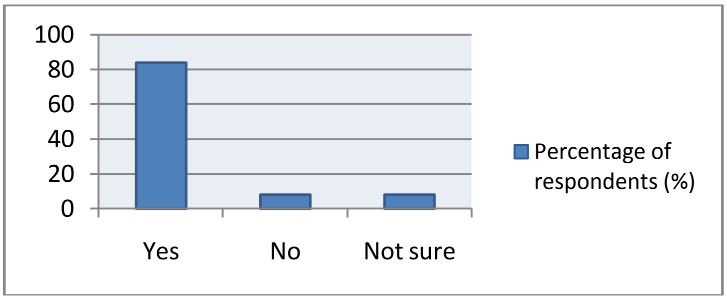
Figure 5 indicates that 92 percent of respondents felt that stress testing and scenario analysis was prepared average to above average in their institutions for the events leading up to the crisis. Not a single respondent indicated that these tests were prepared for poorly or below average in their various institutions. It is doubtful whether this is a true reflection of what actually happened in practice. International banks were certainly not prepared well enough. This may also be true of SA.

Since the occurrence of the American subprime crisis, considerable blame has been directed at poor risk management within the financial services industry. This study attempted to shed light on how risk management systems have been impacted/affected by the world financial crisis and how risk management systems and policies will be altered within the South African banking environment in the future as a direct, or indirect result of the subprime crisis.

Firstly, it was important to identify whether risk management systems/policies/procedures had been changed or altered by any means within the South African banking industry as a direct, or indirect result of the American subprime crisis.

From figure 6 below it can be seen that as many as 83 percent of respondents indicated that risk management systems/policies/procedures had been changed or altered in their institutions as a result of the American subprime crisis. Only a total of two respondents either said no or indicated that they were not sure.

Figure 6. Change to risk management systems/policies/procedures



The subsequent objective of the study was to determine what had been changed within the risk management frameworks of the South African banks.

The respondents indicated the following as the main aspects within the risk management framework that had been changed in their institutions since the start of the global financial crisis:

- Firstly, numerous respondents indicated that more financial functions within their businesses were centralized than before. They also indicated that the Risk and Compliance function within their institutions had been expanded. Although this might sound obvious it was seen as a critical step in order to successfully deal with the problems posed by the crisis.
- Stress and scenario analysis have been embedded in the business since the outbreak of the global financial crisis and even more emphasis will be placed on stress and scenario analysis as a risk management tool in the future.
- A much more intense focus has been directed towards liquidity risk management. This aspect has been enhanced to measure and manage liquidity risk on a global basis in addition to a bank solo basis.
- Extensive risk parameters have been created, risk departments have been improved and risk management frameworks are re-designed in order to analyse and "feed" the relevant data into the risk management models on a daily basis. These initiatives culminate in risk reports that regularly go to executive management and to board meetings. Risks are assessed according to likelihood of occurring and the impact it will have on the organization.
- Within the retail banking divisions, loan-to-value ratios have been reduced, with a greater focus being placed on affordability and pricing of products.
- Credit risk is a main concern. Therefore more rigorous analysis, increased revision and restriction of lending criteria have been established.
- Risk policies and procedures have been reviewed and revised, thereby strengthening the independence of the risk function.
- The competence of risk management staff is being upgraded.
- Extensive studies were also based on the lessons of other international institutions that failed or faced challenges, such as Lehman Brothers, Societe Generale and Royal Bank of Scotland. The outcomes and results obtained from these studies were applied and tested against local banks' risk governance policies to ensure they can be avoided.
- Risk appetite and risk tolerance levels were revised and are being re-set.
- The quality of financial risk management is being upgraded to conform to the new SOLVENCY II requirements.
- The above includes vastly improved quantitative measurement of Capital at Risk (CAR), Cash Flow at Risk (CFR), Earnings at Risk (EAR) and Operational Losses.

Another important objective of this study was to determine whether risk management policies and frameworks would even further change within the South African banking environment over the next few years, in addition to the changes already identified.

The overwhelming sentiments among respondents were that risk management systems will even further change within the local banking industry over the next one to three years. The risk management framework will continue to be adjusted and improved in order to manage risks adequately.

The next objective of the study was to discover a basic understanding or idea of how the risk management frameworks of the local banks would change in the near future. Respondents were asked to briefly indicate and describe how they see risk management systems, policies or procedures change within the South African banking environment over the next one to three years.

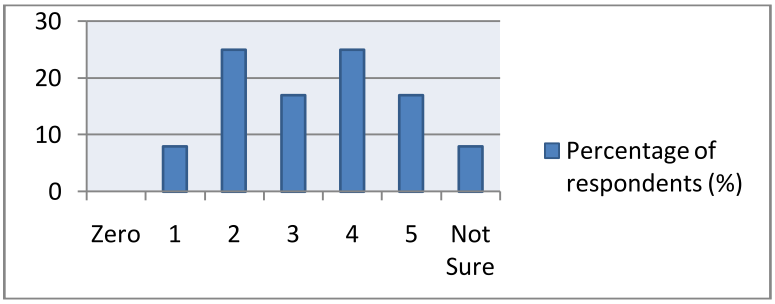
The following aspects were commented on by the respondents:

- Firstly, respondents indicated that risk management systems are likely to change in the near future in response to the requirements of amended regulatory requirements, both globally and locally.
- Liquidity and credit risk was often mentioned. The majority of the respondents indicated that there will be a renewed focus in the future on liquidity and credit risk management within their institutions. Respondents indicated that they expect the creation of a dedicated team of specialist liquidity and capital risk managers within their institutions.
- Pricing correctly for risk was also indicated as a factor which is expected to be at the heart of risk management systems and controls in the nearby future. Respondents indicated that pricing and valuation techniques will come under scrutiny in order to ensure that pricing adequately addresses the various risk factors that banks face.
- Respondents also believe that there will be a renewed focus and emphasis on stress and scenario analysis as a proactive risk management discipline. More severe stress and scenario analysis will be conducted to specifically aid in managing credit risk.
- It is expected that there will be further strengthening of the Risk and Compliance function in all banks. The risk management processes that are already in place will further be adjusted and fine-tuned to ensure that the risk management function is properly implemented. Risk departments will be more prominent and have more profile across all financial institutions. Senior management and directors will also be given increased responsibility.
- A greater emphasis will be placed on using quantitative analysis and specialists, which remain in short supply in South Africa.
- A further point mentioned is that competition for superior risk management professionals within the local banking industry will increase significantly in the near future.
- Reporting of the risk appetite of a bank is likely to become a widespread feature in order to allow potential and current investors in South African banks to properly assess the riskiness of such banks.
- Focus will shift to a better general understanding of sophisticated financial products and structures so as to better assess their impact on the financial standing of an organisation.
- Stricter covenants will be imposed together with a more extensive use of hedges in order to manage credit risk.
- Attention will be given to risk and finance alignment. There will be a focus on better, holistic and timelier risk and finance reporting.
- In order to manage risk better, banks will focus on increasing their capital buffers. Capital adequacy and buffers are also likely to receive attention from regulators.
- Respondents indicated that they believe that there could be a convergence of credit risk, market risk and operational risk over the next one to three years.
- An interesting point that came to light was the use of Value at Risk (VaR) as a risk management tool. Less reliance will in future be placed on this measure due to its inherent weaknesses – especially in times of stress.
- A greater emphasis will be placed on the use of simpler risk management models.
- Greater emphasis will also be directed towards product control, especially new products.
- In order to assist in the improvement of the risk management function, respondents also indicated that corporate structures will have to be simplified and become more transparent in the future.
- Finally, it is expected that good corporate governance and risk management will become more prominent in assessing which are “good” companies to invest in. This will affect stock prices with a premium being paid for good governance and superior risk management capabilities.

The impact of human behavior and emotion on the financial services industry has in recent years enjoyed increased attention. An interesting component of this study was to determine whether human emotion/ behavior have an impact on the riskiness of the South African banking environment. In order to quantify this aspect, senior bankers were asked to identify on a scale from zero to five, to what extent they believe human emotion affects the risk of a bank. A value of 1 means that human behavior has no impact whereas a value of 5 means that it has a material impact on the bank.

Not a single respondent indicated that they believe the human element had no impact on the risk of a bank. Of the respondents, 25% indicated that the influence is not so great whereas 25% indicated that it is quite important. Human emotion/behavior certainly does have an impact on the risks faced by the South African banking environment. Once again the actual impact may be more than the respondents are willing to admit.

Figure 7. How severely respondents felt human emotion/behavior affects the risk of a bank



Respondents were also asked to indicate whether they believe human emotion/behavior should be built into risk management systems in the future. In other words, they were asked to indicate whether they believe risk management systems should in the future somehow cater for the human element in market risk. The results from this question were rather mixed. Approximately 58 percent of respondents indicated that they felt that risk management systems should in the future somehow cater for the human element in market risk. Those that indicated that human behavior should not be built into risk management systems in the future stated that human emotion/behavior cannot be predicted and therefore risk management systems should rather focus on stress and scenario testing, and center its attention on economic barometers that can be predicted. They felt that if limits for risk are developed and approved at appropriate levels and monitored accordingly, it should take away the potential negative impact of human emotion/behavior.

One can conclude that whether it is the behavior of the bank's employees or its clients, human emotion/behavior has, and always will be, a serious threat to any bank. Understanding more about the respond why people take certain decisions and at what time, can help bank managers understand how the market will react events in the market. In banking, the reputation of a bank is of utmost importance and in the past we have seen that where there were questions on the reputation of a bank, human emotion prevailed and it lead to significant withdrawals of deposits and could lead to a resultant liquidity crisis. The human element will always be a risk factor for any bank. How precisely risk management systems will be able to accommodate this risk, is uncertain at this point. At least there is wide conviction within the South African banking environment that risk management systems should at least provide for this risk element in the future.

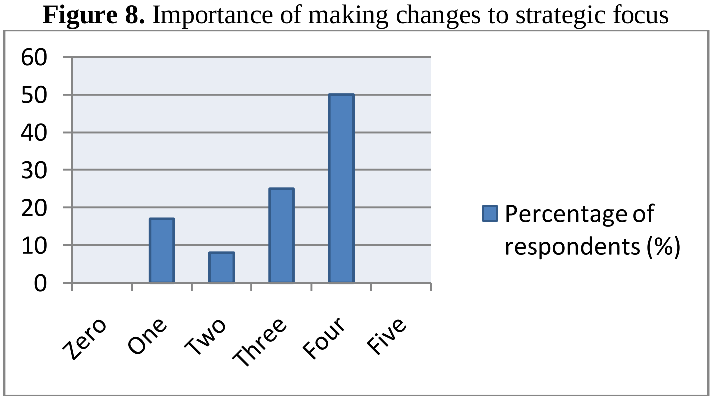
This study also attempted to determine what kind of impact the American subprime crisis has had on the South African banking environment from a strategic perspective.

Respondents were asked to indicate whether strategic issues had been revised in their institution as a direct or indirect result of the subprime crisis. In other words, respondents had to indicate whether their institution had changed/shifted their strategic focus as a result of the subprime crisis. Fifty percent of the respondents indicated that the subprime crisis has led their institution to change/shift its strategic focus.

The subprime crisis definitely caused various South African banks to revise and alter their strategic focus in order for them to remain competitive and profitable in the harsh current economic environment.

In order to quantify how important it was/is for the South African banks to alter/shift their strategic focus in order to successfully deal with the challenges posed by the subprime crisis, respondents were asked to indicate, how important they believe this aspect was/is for their institution. Zero meant that it is absolutely not necessary for the institution to change their strategic focus and five meant that a revision of strategic focus within the bank is absolutely vital for the bank's continued existence.

Figure 8. Importance of making changes to strategic focus



From the figure it can clearly be seen that all of the respondents felt that a revision or change to the strategic focus of the bank is necessary, even if it is just to a minor extent, in order for the bank to successfully combat the threats and challenges ahead.

The implication of these results is that the strategic management function within the South African banking environment will also be faced with challenges and will therefore enjoy increased importance over the next few years.

In order to determine what change the subprime crisis would bring to strategic issues within the local banking environment, respondents were also asked to indicate and describe very briefly the strategic issues/areas on which their institutions will place more emphasis over the foreseeable future.

According to the respondents, the following are the key areas and aspects from a strategic perspective which will enjoy more attention over the next one to three years within the South African banking environment (not in any order of importance):

- Focus again on the basics of banking
- Centralization of the risk management function
- Improve risk management and governance
- Greater focus on the bank's core strengths and less focus on expansion to markets where a competitive advantage does not exist
- Greater focus on board structures and transparency within the bank
- Attention to external banking risks, external scenarios and international developments
- Seeking more sustainable earning streams
- Understand that cycles come and go and thus starting to prepare for the next downturn
- Risk and finance data alignment and timely and integrated reporting in order to make superior business decisions
- Stable fundamental growth will be more important than quick inorganic growth
- Detaching risking from certain product lines – especially products with guarantees where asset and liability matching is not optimal
- Remuneration drivers to be aligned to strategic objectives
- Introducing more incentive to lock in remuneration schemes in order to retain the services of competent staff members
- The efficient and effective use of people within the bank
- Greater interrogation of financial models
- Renewed attention to the concentration of risk
- Capital requirements must be a high priority
- Preservation and allocation of capital must be a high priority
- Funding and improvement thereof should enjoy
- Credit risk must receive more attention
- Searching for ways to ensuring access to liquidity.
- Pricing correctly for risk.

It is also important to note that the financial crisis presented a number of business opportunities in certain countries and the South African banks may increase their focus in order to exploit and take advantage of these opportunities.

All in all one can conclude that in South Africa the increased strategic focus areas will be on tightening credit criteria and improving credit collections. In addition, other strategic issues will focus to improve the liquidity profile, meaning more focus on longer dated deposits and where possible, from alternate funding sources. The South African banks will also focus on increasing their capital adequacy ratios. However, an important issue that will definitely receive renewed attention in the years to come is to direct attention towards total risk of the business meaning that risks will be centralized, or at least the management thereof and banks will be more aware of the collective risk that is present in the market place.

Conclusion

With the global recession, which started in 2009, the next few years will be difficult operationally for banks. The forecasts for the banking sector is not particularly rosy, with analysts expecting headline earnings per share of the four major banks to decrease on average by up to 8 percent which is mainly due to defaults on mortgages and a depressed business environment. Banks' interest income is expected to decline because of fewer loans that are being granted and because of the decreases in the interest rates. Another point of concern for banks is the current level of inflation. High inflation will cause consumers to remain under pressure and this will place even more pressure on bad debts. At all four major banks it is the retail part of their business that is under huge pressure due to high interest rates and lower savings rates.

The greatest danger for banks is to ignore the risks that have been identified in this study and the risks that are associated with a further weakening of the economy. A major, and still a very unfamiliar risk to the South African banks, is what the effects of the economic downturn will be on the corporate sector. It is expected that bad debts in the corporate sector will also increase over the next few months due to the deteriorating economic conditions (van Zyl, 2009). One of the most important points to note is that South Africa lagged the global recession, and that South Africa will also lag the global recovery.

These challenging market conditions hold several challenges for the South African banking industry and for South Africa as an emerging economy. A major concern for the South African economy is that the decreasing credit will suffocate the economy, thereby dampening economic growth and development. As a developing country, this will have severe negative effects on the country as a whole and there are already serious concerns about de-industrialisation, with the latter being seen as a serious threat to the economy. As a result, banks will have to manage their lending activities in such a way as to promote economic growth while protecting their profit margins.

Despite the slumber prospects for the banks, it is very unlikely that a South African bank will go under as a direct effect of the American subprime crisis, since the local banks are affected indirect. This is because of the effective bank management systems which are in place in South Africa, with the National Credit Act being just a single example of this. The capital positions of the South African banks are relatively strong, since they are well above the South African Reserve Bank and Banks Act requirements. In addition to this, the South African banks were also less exposed to the so-called international toxic assets, and this isolated the local banks from the major direct effects of the subprime crisis. All in all, the risk and strategic management processes followed by the local banks have proven to be adequate, but will certainly be revised and adjusted.

The fact that a major South African bank is unlikely to go under, does not mean that the South African banking environment can rest on its laurels. The South African banking environment has certainly been impacted by the subprime crisis and hence, serious thought and efforts had gone into the risk management and strategic management frameworks of the South African banks in an effort to combat the effects of the subprime crisis. This study indicated how these systems and frameworks had been revised and altered within the local banking community and how they will further be altered and adapted over the next one to three years in order to manage the numerous risks which have been identified.

Finally, one positive impact the subprime debacle can have on South Africa as an emerging economy, is a steep increase in foreign investment in the country. Market players would have noted that the country's financial industry escaped the worst of the crisis. Not a single financial institution had to be closed down or bailed out by government. The stock market also did not fall as much as was the case in many developed countries. Investors would have noted this and hence, might be more enthusiastic to invest more funds in South Africa in future. This could stabilize and enhance economic growth over the long term and direct the way to a better and smoother functioning of the financial system in South Africa.

To conclude it is once again important to note that South Africa will lag the global recovery, which many believe has already started. Therefore, only time will tell whether the results and findings of this study, have proven to be successful.

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