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SYNERGISTIC EFFECTS OF TOTAL QUALITY MANAGEMENT AND OPERATIONAL RISK MANAGEMENT IN CENTRAL BANKS

Abstract: *This paper focuses on two very important and current approaches to management: Total Quality Management (TQM) and Operational Risk Management (ORM). As a paradigm of business success, TQM provides the key assumptions for survival, development and success of an organisation, regardless of any limitations whatsoever. ORM, on the other hand, is predetermined to be an irreplaceable managerial tool that enables organisations to survive in any environment. In times of accelerated political, economic and technological changes, frequent natural disasters, acts of terrorism and other external events, a successful risk management has been gaining importance and becomes one of the key competitive advantages of an organisation. The ultimate objective is to make TQM and ORM, as two rather compatible and complementary approaches to risk management, harmonized, efficient and functional in order to get their synergistic effects in an organisation in full swing and practice. Various organisations, and thus central banks as conservative institutions, have an innovative opportunity to timely minimize their operational risk through preventive, comprehensive and synergistic operation of TQM and ORM and thus significantly contribute to improving their business performance.*

Key words: *QMS, TQM, ORM, process approach, continual improvements, synergistic effects, central banking*

1. INTRODUCTION

TQM is a philosophy whose underlying premises are continual improvements and efforts to be made by all employees in an organisation to understand, meet and exceed requirements, needs and expectations of clients. It is also a learning system and a set of methods, techniques and tools aimed at achieving the satisfaction of users, employees, business partners and

stakeholders.

The pillar around which the entire corpus of approaches and participants in the system gather is quality, which, in addition to other management systems, specifically complements the risk management. TQM relies on several approaches, but research presented in this paper indicates that it primarily depends on the efficiency of the process approach implementation and employees' engagement. TQM relies on several approaches, but research presented in

this paper indicates that it primarily depends on efficiency of the process approach and employees` engagement. As Rentzhog (2000) stresses, “the process itself is the one that actually generates the result that primarily has to be managed and improved”. Where employees manage processes on the principles of total quality and simultaneously successfully manage operational risks, an organisation can achieve the desired synergistic effect.

2. QMS AND TQM - PROCESS APPROACH

TQM is a managerial philosophy and a program of changes aimed at continual improvement of business processes with a view to improving the quality of client-tailored products and services. This is a system of activities aimed at user satisfaction, employee qualification, higher total income, and lower costs (Franzetti, 2011).

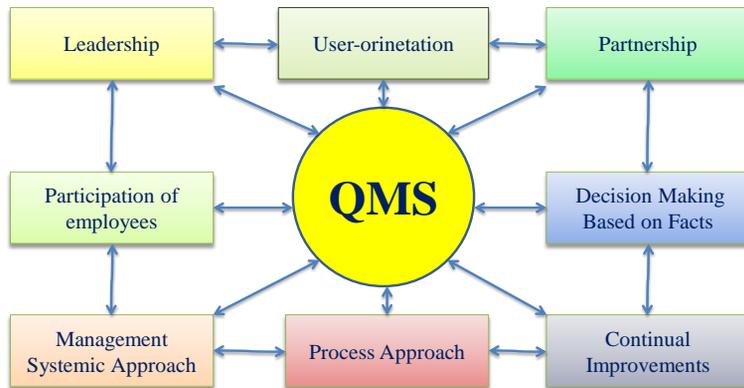


Figure 1. Principle structure of the QMS as the use of the TQM

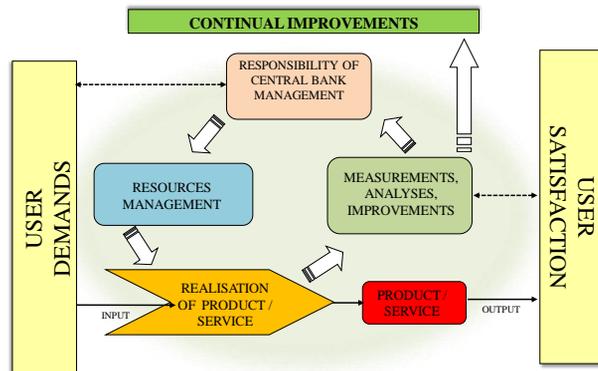


Figure 2. QMS model based on process approach

The TQM base consists of eight QMS principles that also apply to other management systems.

They comprise a consistent network system that generates full effectiveness and

efficiency. Disregard of no more than one principle and its requirements jeopardizes the entire management system. As clearly shown in Figure 1 above, the principle network establishes a polycentric system

where the focus changes – one time it is user-orientation, another time it is leadership, then participation of employees, management systematic approach, process approach, continual improvements, decision-making based on facts, and sometimes the focus is on partnership. As a consistent network system, all listed principles are both individually and collectively very important for the management success (Rampersad, 2010).

Figure 2 illustrates the QMS process model on the example of a central bank. This

model points to a significant role of defining requirements that ultimately should lead to user satisfaction in terms of meeting their demands. This model was prepared in the spirit of the Deming's PDCA cycle of continuous improvement (Plan – Do – Check – Act) which aims for user satisfaction that is to be achieved through four modules: responsibility of the central bank management, resource management, realisation of product/service, and measurement, analyses, and improvements (Perović and Krivokapić, 2007).

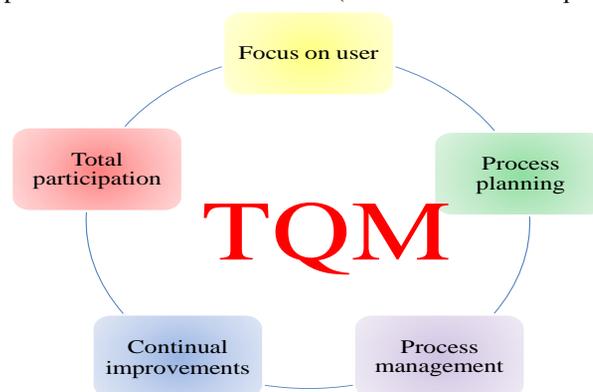


Figure 3. TQM model based on process approach

Figure 3 shows the process approach-based TQM model that focuses on a user. The model starts with the process planning and management and through continual improvements and total participation of all participants in the process it is supposed to lead to user satisfaction (Luburić, 2010). TQM is visible on the basis recognisability of an organisation that is all-embracing, relies on everything, especially on educated employees, acknowledges leaders and nourishes teamwork, ensures integrity, observes ethics and, which is the most important thing, has a completely open communication (Krivokapić, 2011).

Relying on the QMS principles, TQM power lies in its comprehensiveness that also includes total management, full participation of everyone in such a management, and all quality aspects. Creative energy that is

drawn from this totality is the prerequisite of survival, development and success.

The power of total quality management also reflects in that it shows the way to a synergistic model both in normal and crisis environment, professionally and scientifically, by applying certain methods and techniques, and ongoing improvements and participation of employees, simultaneously enabling the attaining of the required quality level on one hand, and the required efficiency level on the other hand.

3. PROCESS APPROACH TO OPERATIONAL RISK MANAGEMENT

Unlike operational risks in the real and public sectors, operational risks in financial

institutions, especially those in central banks, have their own peculiarities. There are many types of risks inherent in the financial sector.

The Basel Committee on Banking Supervision defines operational risk to be *the risk of direct or indirect loss resulting from inadequate or failed internal processes, people, and systems, or from external events*. Basel II gives a list of seven categories of

operational risks in the banking sector that more or less apply to central banks. These are: internal fraud, external fraud, employment practices and workplace safety, clients, products and business practice, damage to physical assets, business disruption and system failures, as well as execution, delivery and process management (Luburić, 2010).



Figure 4. Risk categorisation Model in the case of the Bank of Canada

Figure 4 shows a model of risk categorisation in the Bank of Canada in which risk management, and in particular operational risk management, are highly developed (Krivokapić, 2011). Such a

categorisation of operational risk is practically the same in all central banks. The Figure clearly shows that reputational risk is stationed around the universe of other risks and the latter are subject to its influence.

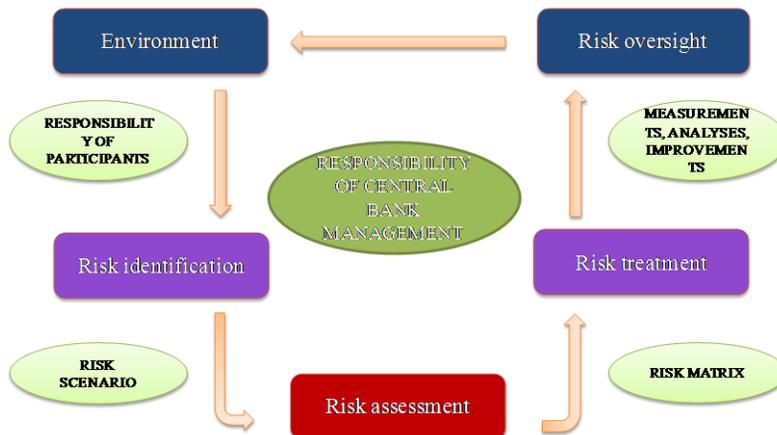


Figure 5. ORM model based on process approach

Risk management in central banks, especially operational risk management, plays a very important role in dictating both success and failure of planned projects which are the primary responsibility of those managing them, but not an insignificant responsibility rests with other participants in the process – the employees and internal audit. The highest risk in any business is to ignore risks as they are, as we all know, an integral part of every process. For an organisation to be sustainably successful, it is necessary to develop the process safety, operational integrity, and operational excellence programs, go further beyond traditional risk analysis and risk management programs (Pitinanondha, 2010). Figure 5 shows the process approach-based ORM model where risk identification, assessment, treatment and oversight comprise an integrated system of process management based on the quality management principles (Draft International Standards ISO/DIS 31000 2008). On the other hand, a central bank management should not, at any time, neglect the impact of environment that is often fickle, unfavourable, and unpredictable (Cosier, 2011).

4. SYNERGISTIC OPERATION MODEL OF TQM AND ORM IN CENTRAL BANKS

The main approaches to the impact on efficiency of the operational risk management point to their significant similarity with the approaches underlying the TQM philosophy (Sutton, 2010). Figure 6 shows the potential areas of synergistic effect of TQM and ORM. The approaches that particularly stand out are: process approach to management, approaches related to ability and engagement of employees, approaches to continual improvements. Other approaches that affect both the ORM and TQM efficiency are the subject of research presented in this paper. Development of management of these two principles can provide for synergistic effect on both ORM and TQM efficiency. The paper also points to the TQM contribution to the ORM development and vice versa. The synergy can be additionally increased with an inclusion of new approaches to total quality management and operational risk management.

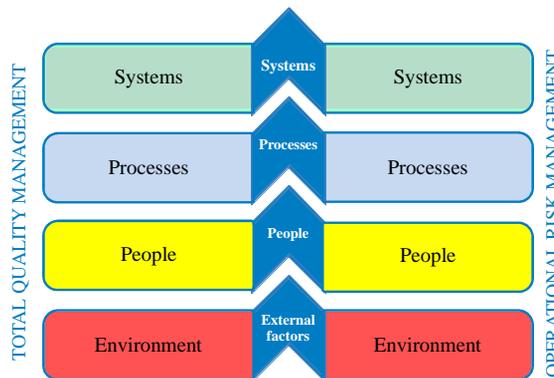


Figure 6. Potential areas of synergistic operation of TQM and ORM in central banks

There are three fundamental principles that have very significant impact on operational risk management and which positive influence can diminish the risk. These are systemic approach, process approach, and external event influences.

These three principles, that is, approaches to total quality management, indicate that business performance can be improved, as can the existing model of operational risk management (Apostolik *et al.*, 2009). The principles of total quality and synergistic

operation in central banks can provide for the creation of an innovative, comprehensive, and more efficient model of operational risk management that could, using the generalisation principle, be applied by other organisations (Krivokapić, 2011). The creation of a synergistic model of operational risk management on the principles of total quality provides organisations with an opportunity to timely diminish their operational risk through preventive actions and thus significantly

improve the business performance. When it comes to central bank, its primary function of financial stability maintenance should also be taken into account. That is why besides user satisfaction, Figure 7 should also define the stability function as the ultimate goal (Tarantino and Cernauskas, 2011). The synergistic operation model shown in Figure 7 is open and free for continual improvements in new principles and approaches, which again create room for further improvements.

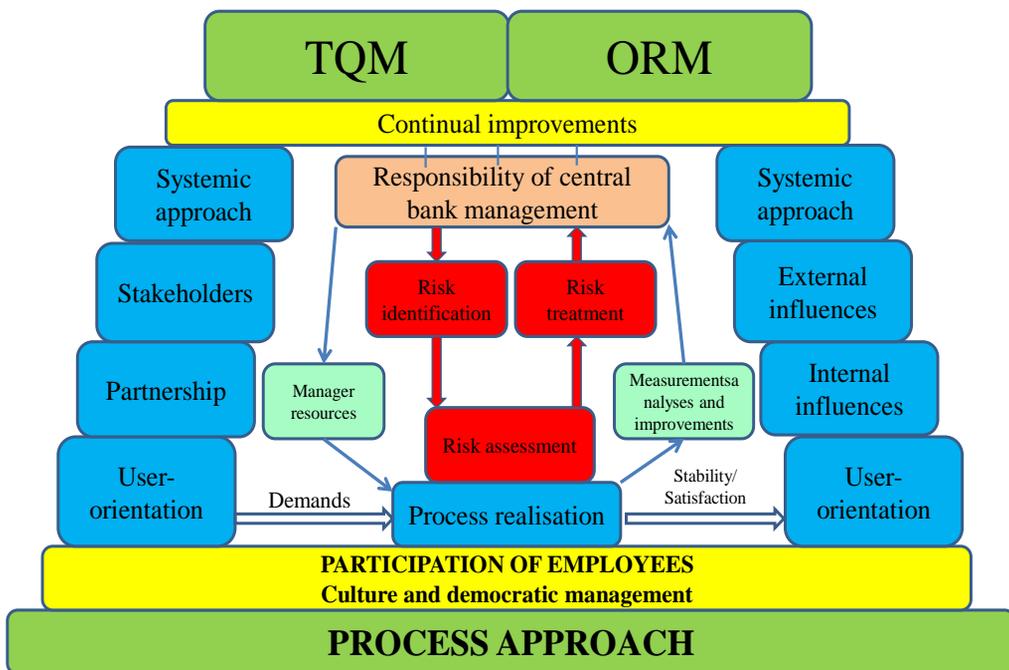


Figure 7. Model of synergistic operation of TQM and ORM based on process approach

The model of TQM and ORM synergistic operation based on process approach is efficient both in stable and transitional environment. The synergistic operation of these principles and approaches gain in importance against the background of the financial crisis. Krugman (2010) claims that everything that needs to be regulated in a financial crisis, because it plays the key role in financial mechanisms, should be subject to regulations normal times with a

view to preventing excessive risk-taking. The crisis risk management should also pursue the same logic. Therefore, in order to ensure successful risk management during a crisis, the same has to be managed much better in a stable environment. As Kaplan and Mikes (2012) vividly explain, “a firm’s ability to weather storms depends on how seriously executives take risk management when the sun is shining and no clouds are on the horizon.”.

5. CONCLUSION

The paper shows that the total quality principles comprise of numerous elements which, when incorporated in the operational risk management system, can significantly contribute to a successful and timely diminishing of risks. The assumption to start with here is that total quality management is a comprehensive philosophy based on continuous changes aimed at improving business processes. The human factor takes a special place in process improvements. It cannot be expected that processes will

function better if people managing them do not do the same because they are the ones that are able to blow wind in the sails of tacit creative abilities and energy, balance the systems and processes, and be more efficient in ensuring continuous improvements. Central banks, and by applying the generalisation principle other organisations as well, are presented with an innovative opportunity to diminish their operational risk through preventive, comprehensive and synergistic operation of TQM and ORM and thus significantly contribute to their business success.

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