



RISK GOVERNANCE MECHANISMS AND FINANCIAL PERFORMANCE OF LISTED DEPOSIT MONEY BANKS IN NIGERIA

By

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Abstract

The main objective of the study is to examine the relationship between risk governance and financial performance of listed deposit money banks in Nigeria. The population of the study consists of all deposit money banks listed on the floor of Nigerian Exchange Group as at 31st December, 2022. The study used census approach to arrive at the sample size of twelve listed deposit money banks after excluding Jaiz bank and First bank of Nigeria which have incomplete financial statements. The study employed a unilateral convergent unparalleled mix design which was influenced by the philosophy the study is aligned with while the method of data collection is post action multiple case study. The secondary data collected from financial statements was subjected to descriptive analysis, post estimation tests (normality tests, multicollinearity test, hetokedasticity test). Multiple regression was conducted to find out the relationship between dependent and independent variables. The results of the study reveal that Chief Risk Officer (CRO) and Board risk committee size have a positive and significant impact on financial performance of listed deposit money banks in Nigeria. The study also found out that board risk committee meetings show an insignificant effect on financial performance. Moreover, the study revealed that Enterprise Risk Management (ERM) framework and board risk committee independence show a positive and significant impact on financial performance. Based on the findings, the study concludes that Chief risk officer and board risk committee size positively influence financial performance of Nigerian listed deposit money banks and also enterprise risk management framework is an important risk monitoring and control device. Therefore, it is recommended that the management of the listed deposit money banks should always maintain the designation of chief risk officer as this strengthens the financial performance of listed deposit money banks and also deposit money banks should focus on well-being and development of their workforce to enhance their skills and performance.

Keywords: chief risk officer, deposit money banks, financial performance, risk governance mechanisms

1. Introduction

In recent years, organizations are faced with so much competition due to demand by shareholders to derive a higher return without recourse to the risk and consequence on the future value of the firms. The firm's financial performance has become a major yardstick and precedent by many stakeholders to either invest or disinvest in their course to maximize a higher return on their investment (Odubuasi et al., 2022). This demand compels the managers to shoot up their performance in order to withstand incessant competition and technological changes. It is also suggested that managers may choose to accelerate their sales to meet performance benchmarks; analyst forecast or avoid credit downgrade. The occurrence of risks and mismanagement directly results in decrease in the financial performance of



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banks (Ofurum & Aliyu, 2018). To ensure stability in financial performance, banks need to deal with risks by identifying their various sources (Hanssen et al., 2018). This will require banks to have better information about the current and potential customers and their financial conditions. Banks may need to implement risk governance mechanisms to evaluate money flow and minimize risks that the money is facing (Erin, 2018).

The risk governance assists the board in carrying out its duties by providing independent and objective reviews, advice and assistance in developing board policies, monitoring corporate activity and making recommendations to the board for their resolution. It is not a policy-making body, nor does it have a substantive executive function in its own right. The role of the risk governance includes assisting the board with the company's governance and the exercise of due care, diligence and skills about risk assessment, treatment strategies and monitoring. Consistent with the level of risk that is acceptable to the firm, it is the responsibility of the board to identify obstacles that may prevent the company from achieving goals that impact negatively on the company's financial performance or threaten compliance with the organization's regulatory and legal obligations (Sani, Latif & Al-dhamari, 2019).

To perform its function, a board risk committee should be supported with adequate resources and authority (Wu et al., 2016). Previous studies have suggested that risk committee size impacts financial performance. A large committee is recommended in order to create a good intensity level and to be capable of providing a diversity of opinions and expertise. This is because a larger risk committee size could offer more skills, knowledge, controls and various experiences. However, arguably, a larger committee would be more likely to promote a free rider problem (Kamal et al., 2020).

Fairly, having the right boards ensure effective corporate governance which influences related organizational outcomes (Abubakar et al, 2018). Also, the main duty of board of directors is to direct the overall activities of the corporation in a more cautious and proactive way because they are the apex authority in decision making process, and their directive to the corporation enables a continuous profit to the shareholders in the long-run. Board of directors is considered as the most important mechanism of organizational governance that is responsible for overseeing the decisions of the executives (Alhossini & Ntim, 2020). Nevertheless, the issue of corporate failure and its associations with weak governance that leads to poor performance is also experienced by Nigeria.

Statement of the Problem

In Nigeria, Deposit money banks play a significant role in the economic development by providing financial access and savings. Over the years, deposit money banks have undergone a series of reforms with the aim of improving their efficiency and performance. They are expected to report good financial performance and stability for the interest of the shareholders and all the stakeholders. Despite the growth and expansion, banks are exposed to risks, hence reporting poor financial performance and subsequently collapse (Adabenege et al., 2015)

Moreover, in the quest to mitigate the risk of failure in the Nigerian financial sector, the Central Bank of Nigeria (CBN) has in 2005 requires all commercial banks to have a minimum capitalization base of \$193.8m (N25b) in order to continue operating (CBN, 2005). Other measures taken by CBN from 2005 to date include; establishment of the financial stability committee, establishment of the Asset Management Corporation of Nigeria (AMCON), review of supervisory procedures and methodology,



renewed collaboration with other regulators, adoption of a common year-end for banks, and revision of corporate governance that include risk management framework and its reporting among others. A global survey shows that in 2010, 85% of financial institutions indicated that their board of directors had conducted regular reviews of entity asset management reports, and this figure increased by 12% compared to 2008 (Delloite, 2013). It also indicated that more board members are currently active in risk management actions within the company.

The high expectations of various parties for risk management actions within the company create demand for senior corporate executives to increase their involvement in the risk monitoring practice. To deal with this issue, the company's board members begin to form new structures within the organization to assist the company's risk monitoring process (Malik et al., 2020). In most countries, including Nigeria, the formation of risk management committee is mandated in the banking sector since the sector has more complex risks compared with other sectors.

Based on the reviewed literature, there is no study in Nigeria on risks governance that covers the period ending at 2021. For instance, most of them used period of 2005-2011, 2005-2013, 2006-2015, 2009-2015, 2012-2018 respectively. However, there are certain events that took place after 2018 such as Covid 19 lockdown, introduction of the harmonized code of corporate governance 2018, Finance Act 2019, 2020, 2021 as amended, Companies and Allied Matters Act 2020 (as amended), amendment of Banks and Other Financial Institution Act (BOFIA) and other changes in regulatory policies that have a significant effect on the banks' performance and the economy at large. This study extended the period of prior studies on risk governance and financial performance in Nigeria by extending it to 2021 data. In addition to that, Human Capital Theory was used in linking intellectual capital variable as explanatory and moderator which were neglected by previous studies.

2. Literature Review

This section presents a review of relevant literature on the conceptual issues related to the topic understudy, empirical evidenced, and theoretical framework underpinning the study.

Conceptual Issues

Concept of Financial Performance

Financial performance is metric to assess the overall financial health of a corporate entity. It's defined as the subject measure on how well a firm use its assets to generate revenues. Alternatively, financial performance is complete appraisal of a firms standing in groupings such as assets, liabilities, equity, expenses, revenue and overall profitability. Weber (2009) defined financial performance as a blend of financial statement of affairs along with the firm's ability to most of its policy business compulsions and commitments. According to Nguyen (2022), financial performance is the selection of specific metrics that can gauge a company's success in turning a profit.

Financial performance is a subjective measure of how well a company can harness assets from its primary business mode and generate revenue. Often, the term is used as a general indicator of the overall financial performance of a company over a given time frame (Boniface & Ibe, 2012). Analysts and investors use financial performance to compare similar companies across the same industry, or to aggregate industries or sectors. Financial achievement calls for concrete consequences in the strategies and practices of a company. Those results are reflected in the company's return on investment, asset



benefit, value added, etc. A comparative measure of how easily a company can maximize and deliver revenue from its primary business type inventory (Gaduru & Nichol, 2018). This term is also used as a general measure of a company's average financial output over a given period of time, and can be used to align similar firms within the same industry or to compare aggregated industries or sectors.

Alamer and Benyazid (2018) argued that examination of the financial statements is undertaken primarily for decision-making purposes. The specifics found in the financial report are of great value when analyzing and assessing the financial statements before making decisions. Financial analysis is the process of assessing the financial performance and failure of a company by accurately creating a relationship between the balance sheet and the profit-and-loss account (Mantha, Suresh, Nandyal, & Ravindranath, 2020).

Risk governance mechanisms

Risk Governance mechanisms refers to various ways through which a firm manages its risk exposure. It involves identification, analysis and implementing strategies of reducing and eliminating risk faced by firms (Cetina & Preda, 2005). Commercial banks can adopt risk management mechanisms such as establishing risk committee, audit committee, credit committee and board of governance that does the oversight role. According to Kallamu (2015), good returns are attributed to the existence of risk committee in the organization. Audit committee does the role of ensuring effective financial reporting, effectiveness in the internal audit, integrity of the financial statements and providing oversight on external report from auditors.

Concept of Intellectual Capital

Intellectual capital (IC) is an intangible asset that involves collection of all informational resources a company has at its disposal that can be used to improved firm performance. Grimaldi et al., (2015) posited that in the knowledge-based economy intellectual capital assets are increasingly considered as the main engine of value creation process. Also, Anugerah Pradana et al., (2018) added that IC is an important as it creates sustainable benefits in business competition and makes a company different as compared to competitors. Equally, IC is crucial due its ability to create sustainable competitive advantage (Feimianti & Anantadjaya, 2019).

Previous scholars gave different definition of intellectual capital; for instances Isa & Ismail (2015) describe IC as the sum of intangible assets of an organization including human capital, structural capital and customer capital. Similarly, Anifowose, Rashid, Annuar, and Ibrahim (2018) defined IC as a measurement of knowledge that focuses on various fields, such as management, information technology, sociology, and also, accounting. In the words of Bolarinwa & Adegboye (2020) intellectual capital is the knowledge-based assets which the organization focuses on to increase its efficiency of the firm financial performance. Additionally, a well investment in intellectual capital would not only increase the firm's financial performance but also, the firm's overall performance which is the shareholders wealth maximization.

Empirical Review

This sub-section provides an empirical review of previous studies based on the relationships between the variables of the study. Nahar et al., (2016) investigated the association between risk governance and bank performance in a developing country where disclosure of risk information is virtually voluntary.



Data was collected for the period 2006-2012 using 210 bank-year observations. Data was analyzed using regression analysis to test whether a significant relationship exists between risk governance and banks' accounting- and market-based performance. The results showed that there is a significant relationship between risk governance and bank performance.

Erin et al. (2018) investigated the influence of risk governance on performance of money deposit banks in Nigeria. Panel data was collected from a sample of eleven listed Nigeria banks for the period of 2012 to 2016. The study found that all the risk governance variables except Centrality of CRO had a positive and significant impact on the performance of listed banks in Nigeria. The results of this study are consistent with those of (Nahar et al., 2016). Similarly, Malik et al., (2020) did a study on the impact of ERM on firm performance of public listed companies in Bursa Malaysia. The study also investigated the moderating role of Board of Directors' monitoring, firm complexity and firm size of the implementation of ERM on firm performance. Data on ERM implementation was collected was by using a five-point likert questionnaire. The yardstick for firm complexity was the number of business segments and firm size was measured using the number of employees. Board of Directors' monitoring was measured using a likert scale while performance was measured using financial and non-financial indicators.

Haron, (2019) determined the impact of risk management committee on performance of firms in Nigeria. They sampled size of five (5) out of eighteen (18) listed banks for a period of eleven years (2009 – 2019). The result show that risk committee size is positive and statistically significant to ROE, while insignificant to ROA. Equally, Odubuasi et al (2022) studied risk committee effectiveness and financial performance among selected countries among African countries. They sampled 17 banks out of 32 listed banks across Nigeria, Ghana and South Africa countries for a period of ten years (2009 – 2018). The results show that risk committee size has positive and significant impact on ROE. This implies that large committee size enhances financial performance. However, results could be difference if results were considered individually for the countries selected. Likewise, Bourib & Boudiab, (2021) examined the impact of risk management committee characteristics on firm performance of non-financial listed firms quoted on Malaysian stock exchange. The result show that risk management committee size has positive and significant influence on financial performance measure using return on equity (ROE). This suggests that the large members mitigate risk and improved financial performance of Malaysian non-financial listed firms. However, other measures of financial performance could yield different results.

Theoretical Review

The present study is anchored on Agency theory that evolved from the agency relationship, which exists between managers (agents) and shareholders (principles). Shareholders employ managers to act in their best interest and managers have ethical and legal duties to fulfil shareholders' expected increases in value. However, due to the self-interested behaviour of managers, this may not always be the case. According to agency theory, there are conflicts of interest between managers and shareholders (Mojtaba, & Davoud, 2007). Managers may have incentives to act opportunistically in order to maximise their own wealth at the expense of shareholders' value (Deogratias et al., 2020).

Agency theorists suggest that due to incomplete contracts, agency costs of monitoring and bonding are borne by the principle. Managers are likely to engage in opportunistic behaviors, such as risk avoidance or excessive risk-taking, to generate returns for themselves instead of for shareholders. Specifically, this agency problem arises from information asymmetry between ownership and management



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(Bertinetti et al., 2013). Managers have greater knowledge about the firms' operations, finances, and the exposed risks of firms than shareholders.

3. Methodology

The design for this study is unilateral convergent unparalleled mix design (Kwanbo, Tanko, Akanet & Baba, 2023). The choice of the design is influenced by the philosophy. The population of the study consists of all deposit money banks listed on the Nigerian Exchange Group (NGX) as at 31st December 2022. The study used census population. However, Jaiz bank and First bank were dropped from the sample size and arrived at twelve (12) banks because of incomplete financial statements covering the period 2010 to 2022. Jaiz bank has no 2010 & 2011 statements because of its listing in 2012; while First bank Holding Plc was listed in 2012. The study used three techniques of data analysis to analyse the data, namely descriptive statistics, correlation matrix and multiple regressions analysis. The models built up to empirically test the hypotheses of this study to investigate the impact of RM on financial performance. The model is represented as:

$$ROA_{it} = \beta_0 + \beta_1 CRO_{it} + \beta_2 BRCS_{it} + \beta_3 BRCM_{it} + \beta_4 ERM_{it} + \beta_5 BRCI_{it} + \beta_6 Bsize_{it} + \beta_7 LEV_{it} + \epsilon_{it}$$

4. Results and Discussion

This sub-section presents the regression results the relationship between risk governance and financial performance. The regression result is presented in table 1.

Table 1
Regression Results

ROA	Coeff	Std. Error	Z-Value	P-Value
Cons	0.1517	0.0506	3.00	0.003***
CRO	0.0677	0.0167	4.06	0.000***
BRCS	0.0054	0.0009	5.46	0.000***
BRCM	0.0024	0.0023	1.04	0.297
ERM	0.0838	0.0179	4.66	0.000***
BRCI	0.0191	0.0091	2.09	0.037***
BSIZE	0.0096	0.0044	2.18	0.029***
LEV	0.0881	0.0143	6.13	0.000***
R-Square	0.445			
Wald Chi ²	118.19***			
Hausman	3.83**			
Modified Wald Test	575.76***			
Wooldridge test	17.276***			

Source: Stata Output

Table 1 presents the regression estimates of independent variables and control variables on the dependent variables. From the regression estimates, the Hausman specification test favored GLS regression (FE), however, the data for the study is characterized with the problem of heteroscedasticity and auto correlation, thus the traditional GLS Random Effect (RE) and FE would be bias (Moundigbaye et al., 2018). Therefore, the study opted for Panel Corrected Standard Error Regression



results (PCSEs). PCSE regression estimates have the power to handle the problems of heteroscedasticity in the panel data and produce efficient coefficient for hypothesis testing (Moundigbaye et al., 2018).

The regression estimates in table 1 shows that Chief Risk Officer (CRO) is positive and statistically significant to financial performance of listed deposit money banks in Nigeria ($\beta=0.0677$, $z= 4.06$, $p<0.000$). This implies that the relationship between the presence of chief risk officer and financial performance moves in the same direction. This indicate that, the higher the CEO presence the higher the financial performance of listed Nigerian deposit money banks. The results also revealed that board risk committee size has positive and significant effect on the financial performance as indicated in table 1 which shows that beta, z-value and p-value ($\beta=0.054$, $z= 5.46$, $p<0.000$). Based on the result, it indicated that a 1% increase in the board risk committee size will lead to an increase in financial performance proxied by return on assets by 0.54%, and the relationship is significance as indicated by the p-value which is less than 0.005. This finding is consistent with Bunea et al (2018) and Odubuasi et al (2022), but contradict the work of Ugwu et al (2021), Fali, et al (2020) and Atoyebi (2018).

Further, the results show that Board risk committee meeting (BRCM) is positive and statistically insignificant to financial performance ($\beta=0.0024$, $P=0.297$). This suggests that the number of meetings held by the risk committee does not influence financial performance of listed Nigerian deposits money banks. The finding agreed with the work of Elamer and Benyazid (2018) but contradict the finding of Kakanda et al (2018). However, the regression result in Table 4.3 shows that ERM has positive and significant influence on the financial performance of listed deposit money banks ($\beta= 0.0838$, $p<0.000$). This implies that ERM determines the financial performance of listed deposit money banks in Nigeria. Moreover, the results show that Board risk committee independent (BRCI) is positive and statistically significant to the financial performance of listed deposit money banks in Nigeria ($\beta=0.0191$, $P=0.000$). This indicates that the presents of non-executive's directors in the risk committee influence the financial performance of deposit money banks in Nigeria. The finding is in line with the work of Fajembola et al., (2019), but disagreed with the position of Kallamu (2015) and Abubakar et al (2018).

5. Conclusions and Recommendations

The following are the conclusions drawn from the results presented in table 1 of the study. The financial performance of listed deposit money banks in Nigeria is positively influence by the present of CRO. Thus, Chief risk officer increases the financial performance of Nigerian deposit money banks. The large risk committee size improves the financial performance of Nigerian deposit money banks. Number of meetings by board risk committee does not affect the financial performance of listed deposit money banks in Nigeria.

Enterprise risk management increases the financial performance of listed deposit money banks in Nigeria. Board risk committee independence is positively associated with financial performance of listed deposit money banks in Nigeria. The study concludes that the number of independent (non-executive) directors on the board risk committee is an important monitoring and control device that influence financial performance of listed deposit money banks.



The following are the recommendations that are made based on the conclusions of the study. The management of the banks should appoint chief risk officer with financial expertise as this will strengthen the financial performance of deposit money banks. The regulatory bodies should consider reducing the size of the board as the larger size does not guarantee the increase in financial performance. Emphasis on the number of meetings by the risk committee should be discouraged as it does not have any impact on financial performance. However, the management should be concern with what transpired during the meetings on issues that affects financial performance particularly.

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