RISK MANAGEMENT COMMITTEE ATTRIBUTES AND FINANCIAL PERFORMANCE: EMPIRICAL EVIDENCE FROM LISTED NIGERIA BANKS

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Abstract

The risk of the enterprise were becoming burdensome that audit committee of the board of directors could not handle, which necessitated the establishment of separate risk management committee to be responsible for the control of all the risks of the organisation. Hence this study investigated the effect of risk management committee attributes on the financial performance of listed banks on Nigeria stock exchange for the periods 2009 to 2018. The study formulated three specific objectives which are to ascertain the effect of risk management committee size, risk committee composition and risk committee gender diversity on the performance of banks in Nigeria, which synchronized with the hypotheses of the study as well. Ex-post facto research design was adopted which allowed secondary data to be generated from the annual report of the banks. The panel data were analysed with descriptive statistics, correlation analysis and Ordinary least square regression estimation technique. The results indicate that risk management committee size and composition have both negative and no significant effect on financial performance of banks, while committee gender diversity has positive statistical significant effect on financial performance of banks in Nigeria at 1% level. The study recommends amongst others that more women with right knowledge should be included in the risk committee for improved performance and leadership of a woman should be allowed to assess the rate of performance improvement for banks in Nigeria.

KEYWORDS: Risk Management, Risk Appetite, Risk Committee, Financial Performance

SECTION 1 – INTRODUCTION

Risk management is regarded as one of the major phases of Corporate Governance, and corporate governance is a function of the board of directors. A reason that prompted Ramlee and Ahmad (2015) to believe that risk management is designed to increase the ability of the board of directors to oversee the risks bedeviling the organization. Hence, risk management committee is the committee of the board of directors that is responsible for the formulation, enforcing, regulating and evaluating the system of risk policy framework of the organisation and also to set the risk appetite for the firm, which will invariably reduce the risk and improve the firm performance. However, poor risk management and corporate governance were underscored to be the major factor behind the series of company scandals and corporate failures (Quon, Zenghal & Maingot, 2012). Such failures include Barings Bank, Metallgesellschaft, Orange Country, Long Term Capital Management Fund (LTCM) of 1990's and Enron, Parmalat, Worldcom of 2000's (Onder & Ergin, 2012), these failures are among the reasons for companies to effectively implement risk management programs (Quon, Zenghal & Maingot, 2012). In line with the point emphasized above, it becomes clearer that inadequate risk framework in Nigerian banks was part of the major cause of wider arrays of accounting irregularities in 2009. For instance, there was reported excessive taking of risk, inadequate administration of loans portfolio and distorted credit management in Nigerian banks (Ahmed, Abdullahi, Mohamed & Umar, 2018). Moreover, the risk management of banks in Nigeria was directly saddled by the audit committee of the board, who were reported to have little or no skill and expertise needed to confront the emerging complex risk environment of banks. There came a recommendation by the Central Bank of Nigeria (CBN) code of corporate governance 2014 that each bank should establish a separate and autonomous risk management committee to holistically identify, formulate and regulate risk framework of the entity. This scenario left both practitioners and researchers in doubt if separate risk management committee is a leeway to reducing associated risks of firm as well as improve its performance. Among the studies by previous researchers include; Elamer and Benyazid (2018), who assessed the magnitude of effect of risk committee on financial performance of financial institutions in UK. Zemzem and Kacem (2014) did similar study on Tunisian Lending Institutions. Few studies in literature were found to relate to Nigeria economy, Ibrahim, Okika, Yunusa and Janada (2020) concentrated their study of influence of risk committee on the Nigerian Insurance industry, while Ahmed, Abdullahi, Mohamed and Umar (2018) conducted the same study on banks in Nigeria, though using data from 2014 to 2016. Hence this study is set to expand the time scope of the study to cover 2009 to 2018 financial year, on the same mission of investigating the attributes of the risk committee that will reduce risk of the banks and improve its financial performance. Therefore, the specific objectives are to;

1. Investigate the effect of risk management committee size on the financial performance of banks in Nigeria,
2. Ascertain the effect of risk management committee composition on the financial performance of banks in Nigeria,
3. Investigate the effect of risk committee gender diversity on the financial performance of banks in Nigeria.

Hypotheses

The study hypotheses synchronized with its objectives and are presented in null form thus;

Ho1 – risk management committee size has no significant effect on financial performance of banks in Nigeria.

Ho2 – risk management committee composition has no significant effect on financial performance of banks in Nigeria.

Ho3 – risk management committee gender diversity has no significant effect on financial performance of banks in Nigeria.

This paper is partitioned in a way that section one is the introductory segment, the next section contains the review of the related literature, methodology is contained in section three while data analysis & interpretations and conclusion & recommendations are contained in section four and five respectively.

SECTION 2 – REVIEW OF RELATED LITERATURE

Risk management committee - Risk management committee is a committee of the board of directors that is charged with the responsibility of monitoring, controlling and formulation of policies, for the administration of the risks of the organisation. Its establishment was necessitated by the fact that audit committee who was initially responsible for risk management, is overwhelmed with the task of maintaining internal control and financial reporting, thereby was found inefficient (Clark, De Martinis, & Krambia-Kapardis, 2007; Choi, 2013). Meanwhile, the attributes of risk management committee considered in this study includes risk management committee composition, risk management committee gender diversity and risk management committee size.

Risk management committee size- this is the members that composed of the risk management committee of the board of directors. Pearce and Zahra (1992) posit that a larger board size enhances a company's ability to understand and respond to diverse stakeholders and are tougher to manipulate as compared to boards with fewer seats.

Risk management committee composition - Risk management committee composition is a term that denotes the proportion of non-executive or outside directors to the totality of the directors appointed and are serving on the risk management committee of the enterprise. Dionne and Triki (2005) affirm that since the outside directors do not have their careers tied to the company, they can make decisions in a more efficient way without fear of their career being jeopardized.

Risk management committee gender diversity - emphasizes on inclusion of female in the risk management committee of a firm. Stephenson (2004); Huse and Solberg (2006) posit that inclusion of female director increases board effectiveness because they are more committed, diligent, well prepared, able to give different views during discussions and give more attention to audit, risk and oversight controls.

Ibrahim, Okika, Yunusa and Janada (2020) sampled insurance firms listed on the Nigeria Stock Exchange as they examined the effect of risk committee size, risk committee independence and expertise on financial performance. They adopted *ex-post facto* design and used from annual reports for the period 2012 to 2018. The panel data result shows that risk committee size and independent have negative and no significant effect on return on assets. While risk management committee expertise has inverse and significant effect on return on assets of listed insurance firms in Nigeria. Chou and Buchdadi (2017) found that independent board member has a positive impact on net interest margin among the big scale bank. However, they maintained that among the small scale bank, the independent board of directors has positive impact on the market value. Elamer and Benyazid (2018) present that firms without risk management committee perform better than firms with risk management committee, hence his result show that independent director in risk committee has negative relationship with financial performance of UK firms. Ahmed, Abdullahi, Mohamed and Umar (2018) examined risk management committee attributes and board financial knowledge on the financial performance of listed banks in Nigeria from 2014 to 2016. Secondary data were extracted from annual report of the fourteen (14) banks sampled. Ordinary least square regression analysis was employed for the estimation of the panel data and the results show that risk committee size has positive and no significant effect on ROA, risk committee independence has negative and no significant effect, while board financial knowledge has negative and statistical significant effect at 1% level on the return on assets of banks in Nigeria. They recommend that other corporate governance attributes be incorporated in further studies. Zemzem and Kacem (2014) sampled 17 Tunisian lending institutions listed on its Stock Exchange to investigate the relationship between risk management, corporate governance and financial performance from 2002 - 2011. Data were collected from the annual reports and firms' websites and were analysed with ordinary least square regression analysis. The result indicated that board independent and board diversity have positive and insignificant effect on return on assets, CEO duality is negatively insignificant, and risk management committee has negative and significant effect on return on assets.

SECTION 3 – METHODOLOGY

This study adopted *ex-post facto* research design and sourced secondary data from the annual reports of the banks sampled from 2009 – 2018 financial years. The study covered the eighteen banks listed on the Nigeria stock exchange, and judgmental sampling technique was applied in sample selection, hence all the banks that were not in operation from the base year 2009 were filtered out, and those that did not disclose risk management committee report were believed to have audit committee discharging the risk control activities of the bank and were filtered out. Finally, we had seven banks with complete and no missing data which then formed our sample size. Panel regression analysis were used for the analysis and Hausman test was used to select the best out of fixed effect and random effect models that was interpreted. The regression estimation model is presented thus;

$$ROE_{it} = \beta_0 + \beta_1 RMCS_{it} + \beta_2 RMCC_{it} + \beta_3 RMCG_{it} + \beta_4 LEVR_{it} + \beta_5 FSIZE + \varepsilon_{it} \text{--------} (1)$$

Where; ROE = Return on Equity, RMCS = Risk Management Committee Size, RMCC = Risk Committee Composition, RMCG = Risk Committee Gender Diversity, LEVER = Leverage, FSIZE = Firm Size, B = constant, ε = Error term.

Operationalization of variables-

Return of Equity measured as Net income divided by shareholders equity

Risk management committee size measured as Total number of directors in risk management committee

Risk management committee composition measured as the percentage of non-executive directors to total of directors in the risk management committee.

Risk management committee gender diversity marked 1 where female director exists otherwise 0.

Firm size measured as log of total assets.

Leverage measured as total debt divided by total equity.

SECTION 4 – DATA ANALYSIS AND INTERPRETATION

4.1 – Descriptive Statistics table

stats	ROE	RMCS	RMCC	RMCG	LEVER	FSIZE
mean	.0666286	6.685714	.6009751	.8571429	6.746429	27.675
p50	.11	7	.6	1	6.455	27.88
max	1.094	8	1	1	19.21	29.35
min	-2.207	4	.3333333	0	-4.14	25.68
sd	.3489367	1.313727	.1285777	.3524537	3.46436	.9912072
skewness	-4.023726	-.6795193	1.049408	-2.041241	.2070999	-.2704266
skewness	-4.023726	-.6795193	1.049408	-2.041241	.2070999	-.2704266
N	70	70	70	70	70	70

The above table shows that Nigerian banks were able to generate on the average, 6% return on the equity (ROE=0.06) to its shareholders. So, any bank which ROE of the period is not up to the 6% is deemed to have underperformed. The risk committee of the banks sampled have an average of 7 members (RMCS, mean=6.68), the least constituted risk committee was made up of 4 members while banks with 8 members in the committee had the highest membership. More so, the table indicates that 60% of the directors in the risk management committee are independent directors.

4.2 – Normality test –

The study used Skewness and Kurtosis test to determine the normalcy distribution of data as presented below;

Skewness/Kurtosis tests for Normality

Variable	Obs	Pr(Skewness)	Pr(Kurtosis)	joint adj chi2(2)	joint Prob>chi2
ROE	70	0.0000	0.0000	65.86	0.0000
RMCS	70	0.0190	0.2560	6.32	0.0425
RMCC	70	0.0008	0.0075	14.63	0.0007
RMCG	70	0.0000	0.0071	26.15	0.0000
LEVER	70	0.4454	0.0015	9.20	0.0100
FSIZE	70	0.3216	0.0001	13.75	0.0010

The normality table above shows that return on equity (ROE), risk management committee composition (RMCC), risk management committee gender diversity (RMCG), leverage (LEVER) and firm size (FSIZE) were normally distributed at 1% significant level except for risk management committee size (RMCS) that was normally distributed at 5% significant level.

4.3 – Correlation Analysis

	ROE	RMCS	RMCC	RMCG	LEVER	FSIZE
ROE	1.0000					
RMCS	0.0326	1.0000				
RMCC	-0.0370	-0.3804	1.0000			
RMCG	0.2504	0.4650	0.0671	1.0000		
LEVER	-0.3601	0.0147	0.0695	-0.1597	1.0000	
FSIZE	0.2834	-0.0738	0.2847	0.2568	-0.0943	1.0000

The correlation table above actually provided the fact that all the variables are not strongly related with one another. However, risk management committee size (RMCS) and risk management committee composition (RMCC) have very weak positive and very weak negative correlation with return on equity (ROE) on a coefficient of 0.0326 and -0.037 respectively. More so, risk management committee gender diversity (RMCG) and firm size (FSIZE) have weak correlation with ROE at the coefficient 0.250 and 0.283 respectively. While leverage (LEVER) is inversely relating with ROE with coefficient -0.36.

4.4 - Multicollinearity Test

Variable	VIF	1/VIF
RMCS	1.69	0.591895
RMCG	1.57	0.636092
RMCC	1.37	0.729930
FSIZE	1.18	0.847465
LEVER	1.06	0.939736
Mean VIF	1.38	

The multicollinearity test which was done with variance inflation factor has shown that the independent variables are not highly correlated, since the mean VIF of 1.38 is less than the acceptable bench mark of 10.

Table 4.5 Nigeria Panel Regression

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	ROE Model (Fixed Effect Result)	ROE Model (Random Effect Result)
Cosize	-0.06 (0.17)	-0.041 (0.31)
Cocomp	-0.64 (0.134)	-0.48 (0.20)
Cogend	0.27 (0.057)*	0.254 (0.05)*
Lev	-0.046 (0.000)***	-0.038 (0.001)***
Fs	0.172 (0.10)*	0.096 (0.11)
F-statistics	4.46 (0.0017)***	21.11 (0.0008)***
R-squared	0.28	0.27
Hausman Test	Prob>chi2 = 0.615	

Source: Author's compilation (2020)

Remarks: (1). *, **, *** means – statistical significance at 10%, 5% and 1% level respectively.

(2). Brackets () – represents P-values.

From the result in table 4.5, we observe that F-statistics values 4.46(0.0017) and 21.1(0.0008) for fixed effect and random effect models respectively indicate that the models are valid for drawing inferences since they are both highly statistically significant at 1% level. The coefficient of determination (R^2) is observed to be 28% and 27% for fixed effect and random effect models respectively, showed that our models are fit for explaining the changes in the dependent variable. The Hausman Test value (Prob>Chi^2 = 0.615) indicates the Hausman Test is not significant and according to its rule, random effect result is preferred over fixed effect result. Hence we selected random effect for our interpretation.

HYPOTHESES TESTING

Hypothesis one - Risk management committee size has no significant effect on financial performance of banks in Nigeria.

The table shows that risk committee size (COSIZ) has coefficient of –0.041 and P-value of 0.31 which means that risk committee size has positive but no significant effect on return on equity (ROE) of banks in Nigeria. It proves that ROE will reduce by 0.041unit if the size of the risk committee is increased by one unit if all other variables are held constant. The finding is in agreement with that of Ibrahim, Okika, Yunusa and Janada (2020) whose result indicated that risk committee size has negative and no significant effect on ROA of listed insurance firms in Nigeria, and Ahmed, Abdullahi, Mohamed and Umar (2018) who's finding indicate that risk committee size has statistical significant effect on ROA of banks in Nigeria.

Hypothesis two - Risk management committee composition has no significant effect on financial performance of banks in Nigeria.

The result in table 4.5 above indicates that risk committee composition has coefficient of determination -0.48 which implies that risk committee independence has negative effect on ROE of banks in Nigeria. As the independent members of the committee increases, the performance reduces meaning they have inverse association. The P-value (0.2) which is greater than critical value at 10% shows that risk management committee composition has no significant effect on ROE of banks in Nigeria. In which case, the study accepts null hypothesis and uphold that risk management committee has negative and no significant effect on the return on equity of banks in Nigeria. The result of this study agrees with the findings of the prior study of Ibrahim, Okika, Yunusa and Janada (2020); Ahmed, Abdullahi, Mohamed and Umar (2018) who found that risk committee independence has negative and no significant effect on ROA of Nigerian insurance firms and Nigerian banks respectively.

Hypothesis three - Risk management committee gender diversity has no significant effect on financial performance of banks in Nigeria.

The result in the above table 4.5 indicates that risk committee gender diversity (COGEND) has coefficient of 0.25 which implies that involvement of women in the risk committee has positive effect on the performance of banks in Nigeria. Women are believed to be more committed and diligent in service thereby, the inclusion of additional woman in the risk management committee will increase the ROE of the banks by 0.25 units if other variables are held constant. The P-statistics is 0.5 which means that women inclusion in risk management committee is significantly affecting return on equity of banks in Nigeria at 5% level. Hence we reject null hypothesis and uphold that risk committee gender diversity has statistical significant positive effect on return on equity at 5% level. The result concurs with the finding made by the study of Zemzem and Kacem (2014) which maintains that board diversity has positive and significant effect on ROA of Tunisian lending institutions.

Additionally, the control variables the study; leverage (LEV) has negative and statistical significant effect on return on equity at 1% level. The result shows that a unit increase in leverage of the firm will cause a 0.046-unit decrease on the return on equity of banks in Nigeria. The coefficient for the firm size (FS) also shows that firm size has positive but no significant effect on ROE.

SECTION 5 - CONCLUSION AND RECOMMENDATION

Conclusion

The study has successfully completed the quest to ascertain the attributes of the carved out autonomous risk management committee that foster improved financial performance of banks in Nigeria. The empirical study came out strong that inclusion of women to participate in the risk management committee allow a robust and more committed deliberation thereby increases chances of improved financial performance. That is to say that out of the three variables used as proxy for risk management committee namely; risk committee size, composition and gender diversity, only gender diversity proved significant in determining banks performance.

Recommendations

1. Moderate size for risk management committee should be constituted by the banks according to their peculiarities.
2. Skilled and experienced directors should be included into the risk management committee not minding if they are executive or non-executive directors, though executive directors must form the membership as well.
3. More number of women with right knowledge should be included in the risk committee for improved performance and leadership of a woman should be allowed to assess the rate of performance improvement for banks in Nigeria.

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