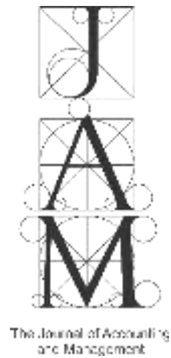

Risk Management Committees' Characteristics and the Financial Performance of Deposit Money Banks (DMBS) in Nigeria

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Abstract: This paper examines the characteristics of risk committees as well as their effects on the financial performance of deposit money banks (DMBs) in Nigeria. The study made use of secondary data gathered from the bank's annual reports, and 13 deposit money banks were chosen as a sample using the purposive sample technique. The data was analysed using the panel regression approach. Using a fixed effect model, the study discovered that the size and independence of risk management committees have a negative impact on the financial performance of deposit money banks in Nigeria, while the size of the committees is insignificant. Gender diversity and meetings have been shown to have a positive impact on the financial performance of DMBs in Nigeria. This study suggested that more women be included on the risk management committee, as well as that more frequent meeting be held to facilitate this participation.

Keywords: financial performance; risk management committee; deposit money banks

JEL Classification: M4

1. Introduction

Companies are confronted with a variety of issues that pose major dangers to their ability to achieve their objectives in an environment marked by increased environmental instability and competitive competitiveness. Companies must be properly managed in order to reduce risk-related losses, and this may be accomplished through risk management policies and practises. The seamless operation of financial institutions has a tendency to make or break the economy of a country. It is impossible to overstate the importance of financial institutions in a society, which is why the laws and regulations that govern these organisations are so stringent. Financial institutions are exposed to a variety of hazards, including credit, market, and operational risks. Abuse of authority, fraud, and other criminal activities caused significant suffering in the Nigerian banking system during the time leading up to the consolidation process (2004-2005). As a result, the Central Bank of Nigeria (CBN) implemented a number of measures to guarantee that financial institutions in Nigeria performed better than they did previously. These laws include, among other things, the raising of the capitalisation of banks to N25

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billion and the establishment of a code of corporate governance for banks and other financial institutions. The formation of a risk management committee to oversee and monitor the activities of banks is a key component of the Nigerian Code of Corporate Governance for Banks, which is an essential component of the Code (CBN Code, 2014). However, even after the CBN established governance codes and regulations, banks continued to experience losses due to operational and credit default risks in the post-consolidation period, despite the implementation of these policies and codes (Owojori, Akintoye & Adidu, 2011).

It is certain that a poorly functioning risk management system would result in losses for a company, either directly or indirectly. For example, the global economic slump, high production costs leading to a drop in production activities, and an increase in inflation, which reduces customers' buying power, among other factors, have resulted in falling company performance and discontinuity in the operations of businesses (Halim, Mustika, Sari, Anugerah & Mohd-Sanusi, 2017). As a result, with the threat of bankruptcy on the horizon, businesses must factor risk into their planning, management, and decision-making processes. Managers are required to identify and manage risks inside their organisations, which necessitates the implementation of an enterprise risk management system within the organisation. Subramaniam (2009) argued that an effective and efficient risk management system helps organisations achieve their business objectives, increase the quality of corporate reporting and protect their goodwill by reducing their exposure to risk. For a risk management system built by an organisation to be effective, it must be subjected to appropriate oversight. Companies, as a result, tend to establish a Risk Management Committee (RMC), which is separate from the audit committee and is responsible for managing the risks of the organization.

The Risk Management Committee (RMC) is an independent committee whose major and sole function is the establishment of policies relating to risk in the company's operations as well as the execution of such rules. The committee assists the board of directors in the performance of its regulatory responsibilities with respect to the corporation's risk tolerance, risk control, and enforcement procedures, among other things. Tolerance for risk refers to how much and what kind of risk an organisation is willing and able to tolerate in its market activities, regardless of the company's corporate goals or stakeholder responsibilities.

In recent years, some companies in Nigeria, particularly banks, have encountered business disasters that have resulted in bankruptcy, mergers, and acquisitions. It is important to remember that the inability of financial institutions to retain enough liquidity will eventually result in a financial crisis, regardless of how profitable they are, how large their capital base is, or how good their asset quality is (Akhtar, Bakhsh, Ali & Kousar, 2019). As a result, it is critical that financial institutions in Nigeria take steps to assist them in dealing with the issues posed by shifting monetary policies. Good corporate governance procedures, such as board committees, should, in an ideal world, have an influence on the performance of a firm and will be crucial in controlling liquidity risks (Ayodele & Alabi, 2014; Chukwunulu, Ezeabasili & Igbodika, 2019). As a result, the purpose of the study is to explore the effect of risk management committee characteristics on the financial performance of deposit money banks (DMBs).

2. Literature Review

2.1. Conceptual Review

Firm Financial Performance

In order to assess financial performance, banks and other financial institutions are being evaluated using a combination of financial ratios and benchmarking as indicators of performance relative to objectives (Ashbaugh-Skaife Collins, Kinney & Lafond, 2009). There are several elements that influence the advancement of a company's financial performance, and most studies have divided the variables that influence the performance of banks into categories. In addition to the state of various subsidiaries or divisions (for example, small or associated with support units, unit subsidiaries, or numerous divisions), the situation and size of the bank are examples of non-financial aspects to take into consideration.

There is increasing competition in the national and international banking markets, and developments in the banking system, as well as new technological developments, indicate significant revolutions in the banking environment, which place a burden on all banks to make appropriate arrangements in order to compete in the new competitive financial environment. Qarri (2010) claimed in their study that the majority of previous studies on organisational performance evaluation have focused solely on operational effectiveness and operating efficiency, which can have a negative influence on an organization's ability to continue to exist. The study discovered that, when using an advanced two-stage data creation analysis model, an organization's greater effectiveness does not necessarily mean that it has greater efficiency. As a result, it is necessary to evaluate aspects that influence organisations' financial performance in addition to financial metrics, such as effective governance structures.

Measures of financial performance comprise but are not limited to return on assets (ROA) and return on equity (ROE). For the purpose of this study, financial performance is measured using the share price divided by sales per share.

Risk Management Committee (RMC)

Advisory and suggestions to the Board of Directors on risk management governance are the responsibilities of the Risk Management Committee (RMC). The risk management committee has a supervisory role in the development, implementation, and monitoring of risk management policies on behalf of the Board of Directors, among other things. This committee reports to the risk management committee on a regular basis on the condition of the entity's operational and financial practises (Sufi & Qaisar, 2015).

According to the Securities and Exchange Commission [SEC] (2011) Nigerian code of corporate governance, a company's board of directors may establish a risk committee to assist the board in fulfilling its role to ensure effective risk management for the firm. Many studies have claimed that having an effective committee of management in place may improve a company's performance and that economic success is primarily dependent on the process of risk control (Edogbanya & Kamardin, 2015). Because of this, according to the SEC Code of 2011, the risk committee is an important committee on the board of directors.

2.2. Theoretical Framework

The agency theory establishes a contractual relationship between the principal (owner/shareholders) and another agent (managers) to act on behalf of the owners (Jensen & Meckling, 1976). Agency issues arise between the principals and their agents from varying problems with asymmetric information and differences in sensitivity to firm-specific hazards. Also, the problem of risk sharing arises from the different risk preferences of the principal and agent. Many a time, managers are risk-seekers and take actions that affect the firm’s financial performance based on their desire for increased compensation.

Corporate governance mechanisms were established to reduce the agency problem that occurs in companies (Harrison & Harrell, 1993). In general, from the viewpoint of agency theory, the risk committee acts on behalf of the shareholders in order to manage risk exposure. Thus, the risk management committee's primary responsibility is to monitor management's participation in riskier activities that may have affected the firm's objectives and to inform management when such activities reach an unacceptable risk level that may impede the firm's financial performance. A risk management committee can also enhance the performance of the board of directors in performing its oversight responsibilities, particularly when it comes to harmonising the interests of the agent and principal (Jiraporn, Singh & Lee, 2009). Due to the fact that creating a risk management committee may boost the transparency of a firm by exposing more information about risk and providing better insight into risks to shareholders, a risk management committee is recommended.

As a result, having an effective committee in a firm not only helps the board of directors, but it also helps to limit the number of agency problems that emerge in the organisation. Committees that are regarded as effective are those that have a high level of independence, as well as diversity in terms of gender, ethnicity, and competence. Because it allows members to bring diverse traits to the table and provide ideas that are not seen or justified by internal directors, diversity in the board's membership fosters a high degree of financial performance for the company (Arfken, Bellar & Helms, 2004).

2.3. Empirical Review

Risk Management Committee Size and Financial Performance

The greater the number of directors on a board, the greater the number of directors that are available to establish committees. As a result, the formation of a risk management committee may be tied to the size of the board of directors. Additionally, the size of the risk committee is used as an indicator of an entity's readiness to contribute capital in order to increase the wealth of its shareholders. As Bédard, Chtourou, and Courteau (2004) pointed out, not only does a board committee have monitoring authority, but the ensuing multiplicity of perspectives within a committee makes it more successful in resolving potential issues. The size of the committee has a considerable influence on the performance and functioning of the committee. According to the findings of research done by Bedard, Chtourou, and Courteau (2004), a larger committee provides greater variety and experience, which results in more efficient recommendations to the board. However, research conducted by Ellul and Yerramilli (2011), Ng et al. (2012), and Zemzem and Kacem (2014) discovered a negative association between the size of the risk committee and the performance of the organisation. In spite of the fact that the risk committee must have a minimum of three members in order to function effectively, the agency theory proposes that an increased size of risk management committees with diverse knowledge and expertise

would enhance the monitoring of managers' behaviour toward risk management, thereby ensuring optimum performance (Aebi, Sabato & Schmid, 2012; Jensen & Meckling, 1976). Therefore, this study proposes the hypothesis that:

The size of the risk management committee is significantly related to financial performance of deposit money banks.

Risk Management Committee Gender Diversity and Financial Performance

Another attribute of the risk committee that may affect the performance of a corporation is gender diversity. Gender diversity here refers to male or female committee members. Existing studies have linked managerial gender diversity to financial reporting quality, firm value, firm growth, and other firm characteristics. It is objectively true that women are more vigilant than men (Khlif & Achek, 2017). Females are seen as risk averse and able to tolerate risk to an acceptable level (Huang & Kisgen, 2013; Hutchinson, Mack & Plastow, 2015). Jia (2019) revealed that women are likely to be assigned to the risk management committees as a result of their skills in delivering firm-wide risk management benefits. The inclusion of females in a risk management committee would bring a balance in the committee and ensure the quality of decision-making which would result into optimum performance. Thus,

Gender diversity of RMC significantly affects the financial performance of deposit money banks in Nigeria.

Risk Management Committee Independence and Financial Performance

Various studies have documented the importance of board independence. Board independence is a key component of governance (Abdul Rahman & Salim, 2010). Independent directors oversee management actions (Fama & Jensen, 1983) because they do not have personal interests in the firm and make fair judgments without any bias (Beasley, Carcello, Hermanson, & Lapides, 2000). The participation of a considerable number of non-executive board members is widely viewed as a strong indicator of the board's independence from management and governance (Abubakar et al. 2018). One of the things Protiviti (2011) said is that having independent non-executive directors is a must for working well with the people in charge of the company's risk management activities.

Zemzem and Kacem (2014) investigated the relationship between the risk management committee and the financial performance of a Tunisian lending company between 2002 and 2011. The results of the study revealed a statistically significant positive relationship between the variables between 2002 and 2011. Statistically, Kallamu and Saat (2013) found that there was a strong link between the percentage of independent directors on the risk committee and financial performance, and that there was a strong link between the percentage of independent directors on the risk committee and firm value, too.

Hence, the hypothesis:

RMC independence significantly influence financial performance of DMBs in Nigeria.

Risk Management Committee Meeting and Financial Performance

Various issues affecting a company are raised and disclosed in a meeting, and the number of board meetings signals the financial performance (Kakanda, Salim & Chandren, 2018). Thus, the frequency of board meetings is a significant attribute that affects firm growth, which is a result of financial performance. A meeting is a good venue for members of RMC to communicate openly and discuss policies that result in improving the firm’s risk control. More so, the frequency of meetings makes

members of a committee more active in the affairs of the company (Raghunandan & Rama, 2007). The number of meetings demonstrates the level of effort made by board members to perform their roles (Sori, Ramadili, & Karbhari, 2009) and allows board directors to gain a better understanding of the factors affecting a firm (Ng, Chong, & Ismail, 2013).

RMC meeting has a significant relationship with financial performance of DMBs in Nigeria

3. Methodology

The research design used in this study is an ex-post facto research design, which indicates that the data was collected after the event took place, rather than before. A total of all deposit money banks (DMBs) that are publicly listed on the Nigerian Stock Exchange are included in the study's population, and the sample comprises of thirteen (13) listed deposit money banks, purposively selected under the financial services firms in Nigeria, with a ten-year time frame from 2010 to 2019. The data for the study was gathered from the annual reports of the companies involved. The data were analysed using the ordinary least square (OLS) regression method, and pre-estimation tests such as the Hausman test, normality, heteroskedasticity, multicollinearity, and correlation tests were run to gain insight into the data and determine the suitability of the regression method. Table 1 shows the measurements of variables as well as the sources of those measurements.

Table 1. Measurement of Variables

Variables	Definition	Measurement	Source
PSAL	Financial Performance (DV)	Share price divided by sales per shares	Nguyen, Locke & Reddy (2014)
RCMS	Risk Committee Size	The number of members/ directors in the risk management committee	Erkens et al. (2012)
RCID	Risk Committee Independence	Percentage of non-executive directors and shareholders in risk committee to total risk committee members size	Ibrahim, Okika, Yunusa & Janada (2020)
RCGD	Risk Committee Gender Diversity	Percentage of female risk committee members to total risk committee members	Fondas & Sassalos (2000)
RCTM	Risk Committee Meeting	Number of meetings held by the risk committee members in a year	Kakanda, Salim, & Chandren, (2018)
FSIZ	Firm Size	Log of total assets	Elamer & Benyazid (2018)

Source: Authors' Compilation (2021)

4. Results and Discussion

4.1. Descriptive Statistics

Based on descriptive results from Table 2, the mean value and standard deviation of the financial performance (PSAL) for the firms are 1.623813 and 1.558976, respectively, while 0.0715 and 7.6411 are the minimum and maximum values, respectively. It implies that while some banks' share prices are low, others maintain a steady growth in their share prices. Risk Committee Size has an average value of 6.946154, which indicates that the size of the committee in many deposit banks is within a considerable range. The lowest and highest values of committee size are 0 and 14. This implies that some deposit money banks have no risk committee. Risk Committee Independence (RCID) has an average value of 64.50224 and a standard deviation of 18.61533 while the minimum and maximum values are 0 and 100, respectively. This result reveals that independence needs to be considerably maintained in the establishment of the risk committee in Nigerian deposit money banks. In addition, Risk Committee Gender Diversity has an average and standard deviation values of 15.71242 and 15.91284 respectively. However, the least and highest values are 0 and 66.6667, respectively, which shows that females are not included in the risk committees of some banks and could also result from the absence of a risk committee in some firms. Furthermore, Risk Committee Meeting (RCTM), with a mean value of 4.123077, shows that meetings are on average held by members of the committee, while the maximum and minimum values are 9 and 0 respectively. The minimum value must be as a result of the non-existence of a separate committee on risk management. The control variable, firm size (FSIZ), has an average value of 8.960535 with a standard deviation of.6598572, while the maximum and minimum values are 9.8541 and 7.0582, respectively.

Table 2. Descriptive Statistics

Variables	Mean	Standard Deviation	Max	Min	Obs
PSAL	1.623813	1.558976	7.6411	.0715	130
RCMS	6.946154	2.313799	14	0	130
RCID	64.50224	18.61533	100	0	130
RCGD	15.71242	15.91284	66.6667	0	130
RCTM	4.123077	1.604332	9	0	130
FSIZ	8.960535	.6598572	9.8541	7.0582	130

Note: PSAL = Price to Revenue, RCMS = Risk Committee Size, RCID = Risk Committee Independence, RCGD = Risk Committee Gender Diversity, RCTM = Risk Committee Meeting.

4.2. Correlation Matrix and Multicollinearity Test

The Pearson correlation analysis matrix and multicollinearity test are shown in Table 3. Correlation helps in deducing the degree or extent of the relationship among variables, as excessive correlation among independent variables could lead to multicollinearity, which could consequently lead to misleading results.

Based on the results of the correlation matrix in Table 2, it is worthy to note that the risk committee size (RCMS) and independence (RCID) are negatively correlated with the financial performance, while risk committee gender diversity (RCGD) and risk committee meeting (RCTM) maintain a positive correlation with financial performance. Furthermore, firm size (FSIZ), which is the control variable, has a positive correlation with financial performance among deposit money banks in Nigeria. Correlation exceeding 0.8 or 0.9 signifies the presence of multicollinearity. As revealed in Table 3,

VIFs are not beyond the threshold of 10. This indicates the non-existence of the multicollinearity problem.

Table 3. Correlation Matrix and Multicollinearity Test

Variable	PSAL	RCMS	RCID	RCGD	RCTM	FSIZ	1/VIF	VIF
PSAL	1.0000							
RCMS	-0.1402	1.0000					0.856656	1.17
RCID	-0.0645	-0.2962	1.0000				0.734441	1.36
RCGD	0.1209	0.1077	0.0142	1.0000			0.898388	1.12
RCTM	0.1038	-0.0692	0.4409	0.1322	1.0000		0.786967	1.27
FSIZ	0.4056	0.2443	-0.0624	0.2936	0.0355	1.0000	0.867746	1.15
Mean VIF								**1.21**

Note: PSAL = Price to Revenue, RCMS = Risk Committee Size, RCID = Risk Committee Independence, RCGD = Risk Committee Gender Diversity, RCTM = Risk Committee Meeting, 1/VIF = Tolerance, VIF = Variance Inflation Factor

4.3. Regression Analysis

Regression results and a summary of other estimation tests (Hausman tests, Wooldridge Test, Breush-Pagan/Cook-Weisberg for heteroskedasticity, normality test using Shapiro-Wilk W) are presented in Table 4. Based on the significance of Hausman test results in Table 4, it can be deduced that the fixed effect regression analysis is more suitable for the study. It can also be noted that the non-significance of autocorrelation tests confirmed the absence of serial correlation. Also, Table 4 shows that the result of Breush-Pagan/Cook-Weisberg for heteroskedasticity is significant, confirming the presence of heteroskedasticity in our data. Hence, the need to conduct robust regression analysis. The significance of the Shapiro-Wilk W test indicates that our data is normally distributed.

Table 4 reveals the coefficient of regression result, which shows the relationship between independent and dependent variables. Results in Table 4 show that there is a negative relationship between risk committee size (RCMS) and risk committee independence (RCID) and banks' financial performance (PSAL). It implies that the size of the risk committee has no significant effect on firms' performance. This could be related to having many members in the committee, which might slow down decision-making and coordination as compared to having a few members in the committee. Moreover, having many independent and non-executive directors in the committee negatively affects firm performance. This could be linked to the notion that independent directors are not too involved in the operations of the business, which may affect their knowledge of relevant information on the operations of the business. Without adequate knowledge of the business and its operations, policies on risk management may negatively affect the growth and performance of the firm. These results are in line with the findings by Fali, Philomena, Ibrahim, and Amos (2020), which document that risk committee independence has a negative relationship with the financial performance of listed insurance companies

in Nigeria. However, this contradicts the findings by Abubakar et al. (2018) and Kallamu and Saat (2013), which found a positive influence of risk committee independence and financial performance.

Furthermore, the results from Table 4 show that risk committee gender diversity has a positively significant relationship with financial performance. The results imply that having some proportion of female directors among the risk management committee would lead to an increase in the performance of deposit money banks in Nigeria. Table 4 further shows that the association between the number of meetings held by the committee and the financial performance of banks in Nigeria is significantly positive. In other words, the more risk committee members hold meetings, the more they are able to make judgments that improve the performance of their respective companies. The results support the findings of Ellul and Yerramilli (2011) and Yatim (2010), which discovered that increasing the frequency of meetings reduced the prevalence of financial reporting irregularities. In addition, Table 4 also shows that firm size has a positively significant relationship with the financial performance of deposit money banks in Nigeria. This implies that the high proportion of assets maintained in assets would contribute favourably to the financial performance of deposit money banks in Nigeria.

Table 4. Result of Regression Analysis

Variables	Coefficient	z-value	p-value
RCMS	-.0670914	-1.20	0.231
RCID	-.0168987	-2.25	0.024**
RCGD	.0246067	3.09	0.002*
RCTM	.1646373	1.95	0.051***
FSIZ	1.118981	5.74	0.000*
Number of Obs	130		
R Squared	0.2670		
F(4, 9)	11.00		
Prob > chi2	0.0000		
Hausman Test	7.92		0.1610
Wooldridge Test (Autocorrelation)	8.227		0.0185
Breush-Pagan / Cook-Weisberg (Heteroskedasticity)	14.01		0.0002*
Shapiro-Wilk W (Normality Test)	0.6338		0.0000*

Note: PSAL = Price to Revenue, RCMS = Risk Committee Size, RCID = Risk Committee Independence, RCGD = Risk Committee Gender Diversity, RCTM = Risk Committee Meeting.

5. Conclusion

According to the findings, RMC features such as gender diversity, independence from the bank's board of directors (BOD), size, and meetings had an impact on the financial performance of listed deposit money banks in Nigeria between 2010 and 2019.

In accordance with the results of the panel regression analysis, the study concluded that committee size has no significant relationship with financial performance, whereas risk committee independence has a negative impact on financial performance; gender diversity and meeting frequency have a positive relationship with financial performance; and risk committee independence has a negative relationship with financial performance. As a result, the study recommends that the risk committee be enhanced by increasing the proportion of women on its membership committee and that the committee meet on a regular basis to guarantee that risks are handled in order to fulfil the company's objectives and improve its performance.

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