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4 authors:

Ahmad Abubakar
Management and Science University

Abdullahi Bala Ado
Al-Qalam University, Katsina

Mohamed Ismail Mohamed
SIMAD University

Umar Aliyu Mustapha
Universiti Teknologi MARA

American International Journal of Business Management (AIJBM)
ISSN- 2379-106X, www.aijbm.com Volume 1, Issue 5 (December- 2018), PP 07-13

The Effect of Risk Management Committee Attributes and Board Financial Knowledge on the Financial Performance of Listed Banks in Nigeria

Ahmed Haruna Abubakar[1], Abdullahi Bala Ado[2], Mohamed Ismail Mohamed[3], Umar Aliyu Mustapha[4]

[1](Department of Accounting, Al-Qalam University, Katsina 820221, Nigeria)
[2](School of Accounting TISSA, Universiti Utara Malaysia)
[3](SIMAD University, Faculty of Management Science, Mogadishu Somalia)
[4](School of Accounting, Finance and Quantitative Studies, Universiti Sultan Zainal Abidin, Malaysia)

ABSTRACT : *The issue of corporate governance and financial performance has always been an essential and critical element for banking sector in Nigeria. Good corporate governance practices and establishing a risk management committee are regarded as important in reducing risk for investors and improving performance. This study investigates the effect of risk management committee attributes and board financial knowledge on the financial performance of listed banks in Nigeria. Furthermore, the research used secondary data obtained from the annual report of fourteen (14) banks listed in the Nigerian stock exchange for the year 2014-2016 with 42 firm-year observations and based on panel data approach. Furthermore, the regression estimates are based on random effect. The result indicates that risk management committee independence, and board financial knowledge exhibit a significant negative relationship with ROA. Meanwhile, risk management committee size has a positive insignificant relationship with ROA. Besides providing suggestion for future research work, this study provides several recommendations for regulators and the Nigerian banking industry.*

KEYWORDS - Risk, management, size, independence, firm, performance

I. INTRODUCTION

Banks are important for economic development because of the various services they offer. Their intermediation function is said to be an incentive for economic development. The financial strength in any country depend on the efficient and effective performance of the banking industry over time. The level to which a bank give credit to the public for productive activities accelerate the speed of a nation's sustainability and economic Growth [1].

Financial scandals and the recent corporate failure across the globe have reinforced the need for corporate governance mostly in developing and developed countries [2]. The issue of many breakdown of high-profile institutions such Enron and Anderson have stunned the business world with scale of their illegal and unethical dealings, corporate governance bounced to global business attention.

The rules and procedure for making decision on company affairs are stated by corporate governance and define how responsibilities in the organisation are distributed among the shareholders, board, managers and other stakeholders [3]. Consequently, the objective of corporate governance is to protect the shareholders with regards to opportunistic behaviour, to make managers work hard to accomplish shareholders interest in the organisation [4].

[5] discovered that risk committee members independence decreases insiders risk taking activities resulting to a decline in losses specifically in financial crisis. One of the advantages of having risk management committee in a company is to assess and manage any potentially catastrophic risks and operational risks. This has created a proper communication channel relating to risk assessment and avoidance whether horizontal or vertical. It provides guidelines and policies to govern the processes by which evaluation and supervision is handled by having an expert with experience in identifying, assessing and managing risk coverage oversight, and complicated organisational risk committee. This help to avoid any risk which have portent and undesirable efforts on the corporation's performance.

1.2 Problem statement

In Nigeria poor management result to excessive risk taking, inadequate administration of loans portfolio and distorted credit management, was among the major causes of banking depress [6]. The issue of corporate governance is key in the banking sector and has turned into a topic of global concern, it is essential in other to improved services and strengthening of financial intermediation with respect to banks and enables appropriate banking operations.

Boards of directors are the focus of attention for most fraud cases that result to collapse of many companies, also blamed for corporate failure and the decrease in shareholders‟ wealth. In 2009, the banking sector in Nigeria widely reported many accounting irregularities. Such as, spring Bank, Fin Bank, Afri Bank, Union Bank, Oceanic Bank and Intercontinental Bank was because of lack of good supervision roles by the board, the board give control to executive management who were after their own self-interests [7].

However, the central bank of Nigeria (CBN) removed corporate executives because of taking excessive risk, as the banks financial executives do not align with the risk management goals. [8]. [9] stressed agency problem make the financial industry shows severe market failure arising from too much risk-taking. Inadequate corporate governance in banks is the main concern of regulators in protecting banking funds [10].

There has been emphasis for separate risk management committee because of increase in the audit committee task by the regulatory bodies and lack of expertise and time essential to deliver supervision of the risk monitoring activities for the organisation [11]. The central bank of Nigeria (CBN) code of corporate governance 2014, each bank should have a Risk management framework identifying the governance structure, procedure, policies, and process for the monitoring, and control of the risk contain in its operations. One of the benefits of having risk management committee in a company is to evaluate and manage any potentially catastrophic risks and operational risks.

As a result of the foregoing statements, this study examines the effect of risk management committee attributes and board financial knowledge on the financial performance of listed banks in Nigeria. The study is motivated by the recent code of corporate governance on risk management committee and financial knowledge impact on the performance of banks in Nigeria has remained a debatable issue.

This paper is divided into five sections. Section one provides the introduction and problem statement, section two reviews various literatures and hypothesis, section three explains the methodology and measurement of variables, followed by results and discussions in section four, conclusion and recommendations in section five.

1.3 Research Hypothesis

H1: there is a negative relationship between risk management committee size and financial performance of listed banks in Nigeria.

H2: there is a positive relationship between risk management committee independence and financial performance of listed banks in Nigeria.

H3: there is a positive relationship between board financial knowledge and financial performance of banks in Nigeria.

II. LITERATURE REVIEW

2.1 Evolution of Corporate Governance in Nigeria

Corporate governance developed after the study of corporate control and ownership separation, they recognise components of corporate governance importance. The divergence increases, and performance diminishes when the degree of separation between ownership and control increases [12].

Nigeria has a change of power in the year 1999 which resulted to new administration into power with the aim of adopting a strategy to pull in new and feasible foreign investment which are needed for reform in all sectors of the economy. In Nigeria a commission was set up to study the adequacy, and importance of corporate governance in relation to the global best practices [13].

The Securities and Exchange Commission (SEC) is charge with the responsibility for issuing and revealing any weaknesses with regards to corporate governance code 2003 and 2008 and arrive at revised codes of corporate governance 2011 which is assumed will guarantee uppermost ethics of good governance mechanism and which will increase transparency and accountability in operations of corporations in Nigeria. The code was developed particularly to be applied by the public limited companies; however, the board of the commission security and exchange commission (SEC) has included all other business venture such as private corporations, small and medium industries to implement the new set standards and ethics.

2.2 Corporate Governance Structure

2.2.1 Risk management committee size

Risk management committee existence may be related with board size. The existence of large board size gives more opportunities to discover directors with needed expertise to organise and be in charge in a sub-committee dedicated to risk management.

The boards of directors set up monitoring committees that mitigate the cost related with larger boards [14] thus, larger boards have been associated with both improved performance [15], and greater bank risk taking

(IMF, 2014). Consistent with prior studies [16; 17] examination of a sample of financial institutions indicated that firms with shareholder-focused boards are associated with greater levels of systemic risk or lower returns

A board primary responsibility is to deliver an effective monitoring function [18]. According to [19], a big committee offer strength, expertise and diversity of view which is effective in terms of resolving potentials problems. Risk oversight arrangement seek to mitigate structural features that can hamper external shareholders' ability to monitor banks effectively, given the complexity and opaqueness of their activities [20]. Banks boards of directors play a key role in overseeing risk controls to mitigate misconduct in financial institutions [21]. Precisely, they report reduced bank misconduct levels when monitoring quality is high.

2.2.2 Risk management committee Independence

Board independence from management is important for a board's monitoring ability. The presence of large number of non-executive directors sitting on the board is recognised as a good pointer of the independence of the board from management. Prior research [22; 23] shows that boards cannot enquire and resist the power of the executive management if they are not sufficiently independence from management. The responsibility of independent executive directors is to control the manger's behaviour that are related to risk taking activities. Thus, it is argue that non-executive care more about their status, so they will demand higher quality governance than executive directors. [24] states that organisation with a greater number of non-executive directors have good governance and fewer fraud accusations.

According to [25] RMC independence means the number of independent non-executive directors' members sitting on the RMC. [26] stated that boards with higher number of non-executive directors are able vigorously investigate about risks, and they see the setting up of a risk management committee as a vital means of support to assist them achieve their risk management oversight function compare to those with a small number of non-executive director. [27] explain, when a committee is comprise of independent directors they will be able to monitor and control management risk taking activities and ensure all the strategies are working.

However, [5] discover that independence of risk committee members' reduces insiders risk taking activities resulting to reduction in losses particularly in financial crisis. In Nigeria the CBN 2014 code of corporate governance states that the risk management committee board composition shall contain at least two non-executive directors and the executive director in control of the risk management, however it has to be chaired by a non-executive director.

2.2.3 Board Financial Knowledge

Better educational levels are recognized as assisting in the better management of firms and also with greater receptiveness to innovation, as highlighted by [28]. It is believed that individual education has relationship with conflict over money, and strategic vision and management control, where those who have achieved a greater level of education are recognized as having a good grasp of fiscal issues more so than those who have not sought educational attainment.

[29] recognised that most directors' occupations are business executives, with consultants, lawyers and school professors following. The directors' expertise, such as accounting, financing, consulting, and law, all support management in decision making. [30] suggested that a greater level of education can be related with higher data-processing capability and the capacity to discriminate amongst alternate stimuli.

[31] Directors with accounting, finance, economics and business education background are also an important person to be appointed as part of board members. Their presence will help the companies to ensure financial matter being managed effectively and efficiently.

III. METHODOLOGY

This study collects and utilize secondary source of data acquired from the annual reports and accounts of listed banks in Nigeria for the period under study. From population of the study, there are fifteen (15) banks listed on the Nigerian Stock Exchange from 2014-2016 which are sampled out for the study, but only 14 banks have complete data. In this study, due to the potential benefits provided by this approach panel data structure rather than cross sectional or time series is utilized. Multiple regression method is used to study the relationship between the financial performance of listed banks in Nigeria and risk management committee size, risk management committee independence, board financial knowledge.

The result from the regression analysis is an equation that indicate the prediction of a dependent variable from many independent variables. This method is employing when the independent variables are related with one another and with the dependent variable this method is used.

The regression equation is estimated as follow:

$$\mathbf{FP = \alpha 0 + \beta 1\ RMCSIZE + \beta 2\ RMCINDE + \beta 3\ BOARDFINKNOW + \beta 4\ FIRMSIZE + \beta 5\ BANKAGE + \beta 6\ LEVG + \varepsilon\ it}$$

Where:

FP = Financial Performance
RMCSIZE = Risk management committee size
RMCINDE = Risk management committee independence
BOARDFINKNOW = Board financial knowledge
FIRMSIZE = Firm size
BANKAGE = Bank age
LEVG= Leverage
ε it = Error term

2.3 Measurement Of Variables

Table 1 below show the variables and their measurement as used in this study.

Table3. *Summary of the Operationalization of Research Variables*

No	Variables	Acronym	Operationalization	Source
	Dependent variable:			
1.	Return on Assets Ratio	ROA	Net profit divided by total assets (NP/TA)	[32]
	Independent Variable:			
1.	Risk management committee size	RMCSIZE	Number of directors sitting on the risk management committee.	[33]
2.	Risk management committee independence	RMCINDE	proportion of non-executive directors' divided by total directors on the risk committee	[25]
3.	Board financial knowledge	BOADFINKNOW	Proportion of directors with educational background in accounting, finance, economics, and business administration divided by total directors	[34]
	Control variable:			
1.	Firm Size	FIRMSIZE	Natural log of total assets	[35]; [36]
2.	Bank Age	BANKAGE	Number of years since the company start incorporation	[35]; [37]
3.	Leverage	LEVG	Total debts divided by total asset	[38]

IV. RESULT AND DISCUSSIONS

2.4 Descriptive Statistics;

Table 4.1 *Summary of Descriptive Statistics*

Variable	Mean	Std. dev.	Min	Max
ROA	2.120	1.219	0.360	4.660
RMCSIZE	6.119	1.978	3.000	10.000
RMCINDE	0.748	0.180	0.500	1.000
BOARDFINKNW	0.405	0.101	0.235	0.600
BANKAGE	42.190	33.100	3.000	120
LEVERAGE	14.277	3.891	9.01	22.070
FIRMSIZE	9.202	0.356	8.556	9.794

ROA = return on asset; RMCSIZE = risk management committee size; RMCINDE = risk management committee independence; BOARDFINKNW = Board financial knowledge = Risk management committee

From the descriptive analysis the overall average mean for return on asset (ROA) is 2.120 with maximum 4.660 and minimum of 0.360. With regards to the CG variables, the result from the descriptive statistics of risk management committee size (RMCSIZE), shows that the mean value for board size is 6.119 with a minimum of 3 members and the maximum of 10 members.

Also the result reveal that the mean for Risk management committee independence (RMCINDE) is 0.748 with the minimum number of 0.500 members and the maximum of 0.1000 members in the Nigerian banks. The statistical outcome relating to the board financial knowledge (BOARDFINKNW) ranges indicate the mean of 0.405 with a minimum of 0.235 members and maximum of 0.600 members.

2.5 Correlation Analysis

Table 4.2

	roa2	rmcsize	rmcinde	bfkr	lnta	tdta2	agecorp
roa2	1						
rmcsize	0.154	1					
rmcinde	-0.279	-0.708***	1				
bfkr	-0.353*	-0.323*	0.097	1			
lnta	0.160	-0.400**	0.143	0.308*	1		
tdta2	0.030	0.238	0.033	-0.504***	-0.337*	1	
agecorp	-0.317*	0.290	-0.327*	0.152	0.0425	-0.150	1

ROA = return on asset; BOARDSIZE = Board size; BOARDFINKNW = Board financial knowledge; BOARDINDE = Board independence; BANKAGE = Bank age; LEVERAGE = Leverage; FIRMSIZE = Firm size.8, ** p<0.05* p<0.01***p<0.001

Table 4.2 above shows significant correlation, positively weak, and negative significant correlation concerning dependent variable (ROA) and independent variables. The correlation between firm size, and risk management committee size with ROA is 0.160, and 0.154 respectively, which shows they are positively correlated. However, the ROA is positively correlated with leverage with a weak value of 0.030. A weak and negative correlation was found between board financial knowledge, bank age and risk management committee independence, with ROA of -0.353, -0.317, and -0.279 respectively.

Also, risk management committee size is positively correlated with leverage and bank age with a weak value of 0.238 and 0.290 Also board financial knowledge, and firm size has a weak negative correlation with risk management committee size with a value of -0.323, -0.400 respectively. Lastly, risk management committee size have a negative significant correlation with board independence with a value of -0.708 at 1% level of significant.

A weak and positive correlation was found between board financial knowledge, firm size, and leverage with risk management committee independence of 0.097, 0.143 and 0.033 respectively. Risk management committee independence have a negative significant correlation with bank age with a value of -0.327. Board financial knowledge have a weak positive correlation with firm size and bank age with a value of 0.308, and 0.152 respectively. Leverage have a negative correlation with board independence with a value of –0.504.

Moreover, firm size have a weak positive correlation with bank age with a value of 0.0425. Also firm size have a weak negative correlation with leverage with a value of -0.337. Leverage have a weak negative correlation with bank age with a value of -0.150.

2.6 Linear Regression Analysis

Table 4.3 *Result of the Estimated Regression*

	RANDOM				**RANDOM ROBURST**			
ROA	**Coef**	**Std. Err.**	**Z**	**P>|z|**	**Coef**	**Std.Err**	**z**	**P>|z|**
RMCSIZE	0.708	0.136	0.52	0.602	0.708	0.120	0.59	0.555
RMCINDE	-2.222	1.243	-1.79	0.074	-2.222	1.189	-1.87	0.062
BOARDFINKNW	-5.351	1.759	-3.04	0.002	-5.351	1.939	-2.76	0.006
BANKAGE	-0.021	0.006	-3.35	0.001	-0.021	0.004	-5.00	0.000
LEVERAGE	-0.073	0.039	-1.88	0.060	-0.073	0.036	-2.02	0.043
FIRMSIZE	1.089	0.587	1.86	0.064	1.089	0.521	2.09	0.037
Cons	-2.563	5.904	-0.43	0.664	-2.563	5.823	-0.44	0.660
Wald chi2				21.78				63.12
Prob > chi2				0.001				0.000
R-Sqr				0.583				0.583
Number of groups				14				14
Obs.				42				42

ROA = return on asset; RMCSIZE = risk management committee size; RMCINDE = risk management committee independence; BOARDFINKNW = board financial knowledge; BANKAGE = Bank age; LEVERAGE = Leverage; FIRMSIZE = Firm size. ** p<0.05* p<0.01***p<0.001

Table 4.3 shows the result of risk management committee size and banks performance as measured by return on asset (ROA). H1 states that there is a negative relationship between risk management committee size and financial performance of listed banks in Nigeria. The study found a positive and insignificant relationship. Hence the hypothesis is rejected. This finding is similar to [39] that also discovered a positive relationship between risk committee size and ROA.

Hypothesis 2 states that there is a positive relationship between risk management committee independence and financial performance of listed banks in Nigeria. The study found a negative and significant relationship between risk management committee independence and financial performance of listed banks in Nigeria. This negative value indicates that when there is a decrease in risk management committee independence, financial performance (ROA) will increase and reverse is the case. [40] also found similar result that risk management committee independence is significantly negatively linked with ROA.

Hypothesis 3 states that there is a positive relationship between board financial knowledge and financial performance of listed banks in Nigeria. The study found a negative and significant relationship between board financial performance and financial performance of listed banks in Nigeria. The negative value show that when there is decrease in board financial knowledge, financial performance will increase and vice versa. A similar result was found by [41] that educational backgrounds do not matter to firm profitability. There may be other factors apart from educational background such as experiences, training, and managerial skills that lead to better firm profitability.

V. CONCLUSION AND RECOMMENDATIONS

The objective of the research which is to investigate the effect of risk management committee attributes and board financial knowledge on financial performance of listed banks in Nigeria. The study examines the relationship between the three independent variables risk management committee size, risk management committee independence, board financial knowledge. Based on the outcome of the panel data analysis, only one variable namely risk management committee size was found to be insignificant relationship with banks financial performance which was measured using return on asset (ROA).

The study recommend that future research should incorporate other corporate governance variables like risk management expertise, ownership concentration, director remuneration, management ownership and board meetings.

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***Corresponding Author: Abdullahi Bala Ado [2]**
[1](Department of Accounting, Al-Qalam University, Katsina 820221, Nigeria)*