



EFFECT OF RISK MANAGEMENT ON PERFORMANCE OF DEPOSIT MONEY BANKS IN KADUNA STATE, NIGERIA

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Abstract

This study investigated the effect of risk management on financial performance of deposit money banks in Kaduna state. Data were collected from primary source through the administration of questionnaire to the target respondents under study and the data were analyzed using SmartPLS-SEM. Risk management as the independent variable was proxy by credit risk, liquidity risk, operating risk and interest rate risk while using performance as dependent variable. The findings reveal that credit risk, liquidity risk and interest rate risk significantly and positively affected the performance of the studied banks, while the operating risk has a negative and insignificant effect on the performance of deposit money banks in Kaduna state. It is recommended that banks should encourage an increase in the loans and advances given to customer as this will enhance bank profitability and establish a mechanism to monitor market movement of interest rate, as any rise in interest rates pose challenges to the banks.

Key words: Risk Management, Performance and Deposit Money Bank.

1. Introduction

Banks' performance is one of the most crucial factors to be considered by investors and other stakeholders in their decision making. Investors are interested in the returns to their investment. According to Okpu and Obiora (2015), firms' performance is the outcome of a firm's strategy or an assessment of how well a firm achieved its business objectives. Financial Performance on the other hand, is one of the administrative key capacities pointed toward fulfilling the interest of investors and other partners, and as a result of this, it is of crucial importance to bank directors and management to know those variables that impact an organization's performance.



Achieving bank's business objectives comes with various risks which threaten their performance and even survival (Muhammad & Khan, 2018). This is because, intermediary functions involves risk but these risks ought to be effectively managed in order to increase shareholders returns, which on the long run will fundamentally affect both a bank performance and stability. The active issue that attracted different scholars and researchers are risk management and its effect on performance due to pervasive implications that poor risk management can have on a wider number of stakeholders such as depositors, managers and shareholders of the banks. Therefore, managing risk is an essential skill of all modern financial corporations, because those who manage risk well, are expected to perform better (Ebenezer Ahmad & Omar, 2016). According to Olayinka, Emoarehi, Jonah and Ame (2017), risk management is a detailed process that entails identification of threats or disruptive elements, critically examining alternatives as to whether to eliminate or mitigate the identifiable threats which will help an organization to understand a wide set of risks facing today's businesses.

Nigerian deposit money banks are confronted with various kinds of threats such as poor risk management that if well managed will turn to be golden opportunity, otherwise it will bring down the corporate survival of the bank (Mukanzi & Musiega, 2016). As a result of competitiveness, the survival instinct led financial institutions to avoid risk that threatened their existence. These risks will affect the performance of banks because risk is the likelihood that the genuine profit from a speculation or advance extended will go astray from that which was normal (Yimka, Taofeek, Abimbola & Olusegun, 2015).

Credit creation is the primary source of income for banks, and the credit role of banks increases investors' willingness to leverage desired successful projects (Maniagi, 2018). However, this does expose banks to credit risk. Failure of banks to fulfill customer obligations would leave customers with a negative opinion of the banks, which would be caused by liquidity problem, and would have an impact on their financial performance (Olalere & Feyitimi, 2017). Also, Banks are in the risk-taking business, but it is critical for them to take reasonable risks in their operations (Appiah, 2017). When a bank's interest-sensitive assets and liabilities are distorted in terms of size or maturity dates, the bank is exposed to interest-rate risk, which may also result in potential losses which will have a negative effect on the bank financial performance (Olumayokun, 2020). Due to the aforementioned issues, it is therefore, critical to evaluate Nigerian banks' risk profiles, as well as the adequacy of their risk control structures, in order to mitigate the various risks to which they are exposed, which may have a significant impact on the overall performance of Nigerian banks. Despite the measures that have been taken by the aforementioned authorities, banks in Nigeria keep failing even to the most recent ones between (2006 to 2011). Banks continued to fail and this has been attributed to the incidences of high non-performing loans, poor corporate governance, lax credit administration and failure to meet prudential ratios of liquidity and capital ratio (Ebenezer and Omar 2016). Some of these banks include among others Intercontinental Bank Plc, Afribank, Spring Bank, Oceanic bank Plc, Finbank Plc, etc with capital adequacy ratios of -84%, -106%, -55%, -13%, -106% respectively as against the requirement for the banks in Nigeria for (CAR) set at 10% and 15% set for regional/national banks and banks with international banking licenses, respectively (Ebenezer & Omar 2016).

Diverse studies have been conducted on risk management and financial performance through numerous researchers including; Olayinka, Emoarehi, Jonah and Ame (2017); Chukwunulu,



Ezeabasili and Igbodika (2019); Adeusi, Akeke, Simeon and Oladunjoye (2013); Bagh, Asif, and Razzaq (2017); Isiaka, Olumide and Irom (2018); Olamide, Uwalomwa and Ranti (2015); Paulinus (2017); Wisdom, Isiaka and Akindele (2018); and Ebenezer, Ahmad and Omar (2016) but their main focus was the use of secondary method in data collection. The aforementioned researchers were constrained to the following variables to measure risk which include; credit risk, liquidity risk, market risk, and operational risk, but failed to use variable like interest rate risk. The ones that used interest rate risk only used it to determine market risk as a result of changes in the market volatility.

The above mentioned researchers also concentrated in measuring financial performance based on the figures in the financial report of banks which can be manipulated and so be misleading, but failed to look at performance based on the consistency of increase or decrease in their yearly profit, sales growth, financial performance target and stability of earnings. According to Harahap, (2018) Banks have a goal of achieving high profitability which is one indicator to assess the company's financial performance as high profitability shows good company prospects, so that investors will respond positively to these signals which will increase the value of the company. This implies that increase and decrease in banks earnings will affect their financial performance either positively or negatively as such the need to study the consistency of increase or decrease in their yearly profit, sales growth, financial performance target and stability of earnings.

Above all, however, none of the aforementioned studies was conducted using primary data and making use of primary data is seen as more reliable, accurate and relevant as it gathers firsthand information, following its careful operationalisation of variables and using carefully chosen procedures and it brings about real life situation rather than secondary data that have the potential of being altered. As opined by Ajayi, (2017) that data that is obtained secondarily is usually gathered by someone other than the individual who may use it. As a result, secondary data is usually skewed in favour of the person who obtained it, and it may or may not meet the needs of another researcher. As a result of the above discussion, it is clear that further research into the issues posed is needed. The intention of this study is to look into the results of risk management on the overall performance of Kaduna state deposit money banks. In addition, the analysis intends to use primary data to establish the relationship in question which is aimed at bridging the gap. Based on aforementioned issues raised, this work seeks to answer the striking question 'does risk have influence on the Dosit Money Banks (DMBs)' performance in Nigeria?' and the main objective is to established whether credit risk, liquidity risk, operational risk and interest rate risk have significant effect on banks performance. In order to achieve the objective the following null hypothesis is also used, there is no significant relationship between credit risk, liquidity risk, operational risk and interest rate risk and DMBs performance.

2. Literature Review

Performance is conceived to be the ability to perform successfully, profitably, survive, grow, and respond to environmental opportunities and threats respectively (Rennox, 2017). Performance can be used to demonstrate an entity's strength, prosperity, and dominance in its field of operation (Mutuku, 2016). Organizational performance is measured through their talents. In order to achieve their specific organizational set objectives and reap its rewards, they must be able to carry out their operations correctly and efficiently. Performance is also seen as the measure of the financial health of the organizations and shows the performance of the executive leadership of a company, the



higher the performance of the company, the more effective and efficient the company in using its resources and later contributes at the macro level in a country's economy (Wanjohi, Wanjohi & Ndambiri, 2017). In line with the above definition, we will look into performance from the perspective of how banks use assets from its primary mode of business and generate revenues in connection with the banks' yearly profit, sales growth, return on asset, return on equity, financial performance target and stability of earnings.

Risk management entails creating an acceptable risk environment in order to protect banks from negative outcomes or risk exposure (Vimalakumaran & Karim, 2020). These can be achieved by categorizing incidents into one or more broad categories of business, credit, liquidity, operational, and other threats, assessing risks using data and risk measures, reviewing and reporting them on a timely basis, with the senior management controlling these risks.

Agencies are confronted with risks that have the ability to affect their enterprise. Risk control in financial services, particularly in the banking industry, focuses on detecting, assessing, and evaluating threats in order to minimize content, reputational, opportunity, and other costs. In order to explain further, Atoi, (2018) viewed bank risk as that part of unforeseen circumstances that are inherent in the operation of banking practice; these include credit risk, liquidity risk and operational risk. According to Yüksel and Zengin, (2016), Credit risk, market risk, and operating risk are the three major threats in the banking industry (Yüksel & Zengin, 2016). Since financial institutions are confronted with different forms of risk that threaten their survival, and risk mismanagement or poor management has a greater impact on every financial institution's performance, the bank should therefore prioritize their business operations in the modern world of business in order to mitigate against its effect on banks profitability (Olalere & Feyitimi, 2017). According to Aganoke (2018), risk management is the most influential field in which the banking industry's benefit is eroded (credit, liquidity and operational). These elements have been proven and widely used as standard measurement for risk management practices. Risk management is the systematic application of organizational-wide processes to define, analyze, handle, and track risks in order to use aggregated data to secure, release and generate value (Ahmed & Manab, 2016). The effect of risk management on bank financial performance is a mixed bag, according to empirical evidence and the findings of numerous studies. While some researchers discovered risk management and bank performance to have a negative relationship, others discovered a positive relationship.

Similarly, Kingdom, John, Simamora and Oswari (2019), explained the effect of credit risk, operating risk, and liquidity risk on the financial performance of Indonesian stock exchange-listed banks. From 2009 to 2017, secondary data was derived from the annual reports of five sampled listed banks on the Indonesia stock exchange. They found that credit was negatively related to performance while other variable were positive. However, the study is based on a limited scope; therefore, a larger sample size may be more appropriate for better generation of the finding. In the same way, Lelgo and Obwogi (2018) investigated the effect of financial risk on the financial performance of Kenyan microfinance institutions, for five years period between 2013 and 2017, secondary data was collected from the MFIs' annual financial reports. The 13 registered Micro Finance Institutions licensed by the Central Bank of Kenya as of 2018 were the target population. It was revealed that credit risk negatively affect the value of the micro finance institutions. Therefore, the five years used in the study is relatively small in determine the true state of event.



In like manner, Ekinci, (2016) investigated the effect of credit and market risk on Turkish bank performance for the period 2002-2015, secondary data was derived from the weekly data report of major banks in the Turkish banking system listed on the Istanbul stock exchange. Furthermore, the study was conducted in a country different from Nigeria and the period covered have been overshadowed with series of economic and political events.

Olumayokun, (2020) looked into the effect of financial risks on profitability of selected Nigerian Deposit Money Banks. Data was collected using a secondary method from the sampled Deposit Money banks' annual financial reports from 2008 to 2017, and the data was analyzed using descriptive and inferential statistics. The results revealed that liquidity risk has positive but insignificant relationship on profitability of Banks. Also, Isiaka, Olumide and Irom, (2018) looked at the effect of financial risk management on profitability in Nigerian commercial banks. However, secondary method was used for data collection which may not cover those samples of the population researchers want to examine, therefore lacks sufficient detail. In the same vein, Kingdom, John, Simamora and Oswari, (2019) explore the effects of operational risk, credit risk, and liquidity risk on the financial performance of Indonesian banks listed in Indonesian stock exchange from 2009 to 2017. The study was based on a limited scope which cannot be used to compare the Nigerian situation that has 14 listed banks. Again, Fadun and Oye, (2020) examined the impact of operational risk management practices on the financial performance of commercial banks in Nigeria for the period 2008-2017. The findings revealed that operational risk and bank financial performance have a positive relationship.

Endaweke, (2015) looked into risk management and its impact on financial performance of Ethiopian Commercial Banks. The audited balance sheets of eight carefully chosen banks were used to collect secondary data. According to the findings, operational risk has a statistically significant negative effect on banks performance. Similarly, Bagh, Khan, and Razzaq (2017) looked into the underlying impact of Risk Management Practices on Banks Financial Performance in Pakistan. Secondary data for the study was gathered from the annual published audited financial results of 18 top-performing banks over the years 2004-2016. According to the finding, the study results showed that operational risk has significant impact on financial performance of small, medium and large banks. However, using only top performing banks will limit finding, as such, the need to use both performing and non-performing banks.

Similarly, Muriithi, Muturi and Waweru (2016) looked into the impact of market risk on the financial performance of Kenyan commercial banks Between 2005 and 2014, Using panel data techniques such as random effects estimation, fixed effects estimation, and generalized system of moments, financial ratios and balance sheets of 43 Kenyan commercial banks with a license were purged, for the purpose of avoiding possible endogeneity issues. It was also discovered that interest rate risk has a substantial negative effect on bank profitability, according to the findings. However, interest rate risk was used as a measure of market risk the argument is that change in interest rate could lead to a mismatch between interest paid on deposit and the interest received on loans, but examining interest rate risk on banks performance might give a different result.

The existing literature provided comprehensive evidence on the effect of risk management on bank financial performance of banks. However, the methodological findings differ significantly.



The method of data collection in Nigeria by researchers was mainly secondary sources of data which will not give relatively accurate evidence on bank performance to be relied on because data that is gathered in a secondary manner is normally obtained by someone other than the person who would use it. Therefore, primary data will be used to satisfactorily answer the above issues in order to gain a better understanding of the effect of risk management on deposit money bank financial performance in Nigeria.

Several hypotheses have been proposed by various academics to explain the relationship between risk management and financial performance in the banking sector. This research adopted risk management theory and financial distress theory to underpin the study, due to its relevance which emphasizes the need for risk management in financial institution such as banks and its importance in improving the value of the company most especially banks performance. According to David (2014), the aim of this theory is to understanding why risk management is essential, and it explains the theories that underpin contemporary bank risk management, with a focus on market and credit risks. According to the theory, business and credit risks have a direct or indirect effect on a bank's survival because a bank which persistently had poor performance as a result unsound risk management will eventually experience distress. If there is no effective and efficient credit risk management, one would expect credit risk indicators to have an impact on bank profitability (Sporta, 2018). Market risk, defined as a change in the net value of an asset as a result of changes in interest rates, exchange rates, equity, and commodity prices, is a major source of value loss according to this theory (Maniagi, 2018).

According to Isiaka (2018), a company is said to be in financial distress when its business has deteriorated to the point that it can no longer fulfill its financial obligations. Many factors contribute to financial distress, including inability to pay debts on time, reduced or non-payment of dividends, current liabilities maturing faster than current assets, and these events occurring shortly before payments due for unpaid debts (Olumayokun, 2020). Muriithi (2016) says financial distress is described by bad economic conditions combined with weak financial risk management.

3. Methodology

This research employed survey research design and primary data were collected using personally administered questionnaires. The questionnaire was adapted from Mutuku (2016) and Ishtiaq (2015). The PLS-SEM techniques was adopted in analyzing both the assessment of measurement and structural model. The measurement model establishes the reliability and validity of the construct and the structural model ascertains the significance of the hypothesized relationship. The target population of this study is all deposit money banks with national authorization, international authorization and one interest free bank with national authorization in Kaduna state as mentioned below, consisting of 448 respondents, and to pick respondents from each stratum, a stratified random sampling technique was used as shown in the table below. So the population was adjusted to sample using simple random probability sampling techniques and the size of the sample will be 210 respondents out of 448 respondents which was determined using Krejcie and Morgan sampling techniques. To reduce non-response rates as suggested by Groves and Peytcheva (2008) that 40 percent of the study sample size which is 84 will be added to the original sample size of 210. Thus, the new sample size that will be used for the study population of 294 respondents.

Table 1 Bank Branches

Name of Banks	No. of Branches	No of Respondent	Sample Size
Access Bank	9	36	the sample size is as per calculation from Krejcie and Morgan’s table.
Ecobank	4	16	
FCMB	5	20	
Fidelity Bank	5	20	
First Bank	11	44	
GTBank	4	16	
Heritage Bank	2	8	
Jaiz Bank	4	16	
Keystone Bank	11	44	
Polaris Bank	3	12	
Stanbic Bank	11	44	
Sterling Bank	5	20	
Standard Chartered Bank	1	4	
UBA	12	48	
Union Bank	10	40	
Unity Bank	15	60	
Wema Bank	1	4	
Zenith Bank	8	32	
Total	121	448	210

Source: Banks Websites and Researcher Calculation.

4. Data Analysis, Results and Discussions

This section presents the results of analysis conducted using the techniques discussed in section three. The PLS-SEM analyses includes the assessment of measurement and structural model. The measurement model establishes the reliability and validity of the construct and the structural model ascertains the significance of the hypothesized relationship. Different hypotheses were proposed to evaluate the relationship of predictors on the outcome.

The study used a descriptive analysis where the research hypotheses are presented and tested using PLS SEM. This notion assumes that both latent and convergent variables serve as proxies for behavioral concept (Ringles & Sarstedt, 2015). Following this reasoning, the validity gap occurs between the concept and the construct (Al-dalahmeh, Khalaf & Obeidat, 2018).

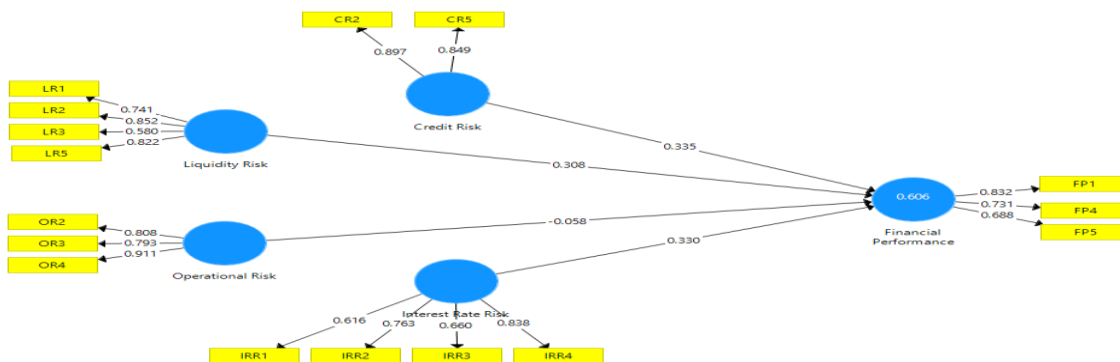


Figure 1. PLS Algorithm



The study targeted 18 Deposit Money Banks in Kaduna state; comprising of 8 licensed with international authority, 9 out of 14 licensed with national authority and 1 non interest bank licensed with national authority. Out of the target population, only 232 respondents filled the questionnaire and returned representing a response rate of 79% which is within the recommended rates (Mutuku, 2016).

Table 3 *Validity and Reliability Test Result*

Variables	Cronbach’s Alpha	Composite Reliability	AVE
Credit Risk	0.691	0.865	0.763
Liquidity Risk	0.767	0.840	0.572
Operational Risk	0.788	0.876	0.704
Interest Rate Risk	0.715	0.813	0.525
Financial Performance	0.617	0.796	0.567

Table 3 shows that the CR of each of the construct for this study ranges from 0.796 to 0.876. This result indicates that the items used to represent the construct poses satisfactory internal consistency reliability. Based on the analyses, all items in the measurement model estimated loading exceeding 0.5, ranging from 0.617 to 0.788 as stated on table 3 which indicate satisfactory indicator reliability,

Table 4 *Discriminant validity*

	CRTR	FP	INRR	LQTR	OPLR
Credit Risk	0.873				
Financial Performance	0.630	0.753			
Interest Rate Risk	0.450	0.636	0.724		
Liquidity Risk	0.533	0.644	0.544	0.756	
Operational Risk	0.304	0.235	0.220	0.385	0.839

In this study, square root of AVE for a construct was found greater than its correlation with other construct. Table 4. Hence providing strong support for establishment of discriminant validity.

Table 5 *Discriminant validity using the heterotraitsmonotraits*

	CRTR	FP	INRR	LQTR	OPLR
Credit Risk					
Financial Performance	0.901				
Interest Rate Risk	0.607	0.853			
Liquidity Risk	0.765	0.874	0.669		
Operational Risk	0.437	0.333	0.411	0.574	

Similarly, the result of the Table 5 shows the discriminant validity using the heterotraitsmonotraits, the threshold as indicate by (Hair, Hult, Ringle, & Sarstedt, 2014) informed that none of the loadings should be above 0.9. Looking at the value, the highest is 0.9, which indicates that the discriminant validity using the heterotraitsmonotraits is also achieved.



Test of Hypotheses

	Original Sample	Sample Mean	Standard Deviation	T Statistics	P-Value	Decision
CRTR ->FP	0.422	0.417	0.059	7.207	0.000	Rejected
INRR -> FP	0.326	0.327	0.060	5.469	0.000	Rejected
LQTR -> FP	0.269	0.258	0.073	3.682	0.000	Rejected
OPLR -> FP	-0.034	-0.005	0.106	0.320	0.749	Fail to Reject

The hypotheses testing through the use of bootstrapping procedure evaluate the significance between the construct (Hair *et al.*, 2014). The table further elucidates that all constructs in the model are with a critical value of 1.65 for the two tailed test at significant level $p < 0.05$ therefore it supports the hypotheses. The result therefore summarizes that credit risk, interest rate risk and liquidity risk has a positive and significant effect on financial performance of deposit money banks in Kaduna state while operational risk has no effect on the financial performance of deposit money banks in Kaduna state.

This study assesses the effect of risk management on financial performance of deposit money banks in Kaduna State. The result supports the postulated model. Specifically, the PLS approach yielded support of the null hypotheses, where it was found that credit risk, interest rate risk and liquidity risk has a positive and significant effect on financial performance on deposit money banks in Kaduna State. This is in accordance with the results of the previous and recent research found in Olayinka *et al.* (2017); Chukwunulu *et al.*, (2019); Adeusi, Akeke, Simeon and Oladunjoye (2013); Bagh, Asif and Razzaq (2017); Isiaka, Olumide and Irom (2018); Olamide, Uwalomwa and Ranti (2015); Paulinus (2017); and Wisdom, Isiaka and Akindele (2018) which used secondary data. This indicates that credit risk, interest rate risk and liquidity risk has been viewed as important factor for banks in enhancing their financial performance and achieving the organizational success. As the financial performance is the measure of the financial health of the organizations and shows the performance of the executive leadership of a company, the higher the financial performance of the company, the more effective and efficient the company in using its resources and later contributes at the macro level in a countries economy (Wanjohi, Wanjohi & Ndambiri, 2017).

The research advances understanding of the effect of credit risk, interest rate risk and liquidity risk in enhancing banks profitability as their positive effect will determine bank financial performance. Additionally, the finding of this qualitative research proves a significant positive effect on financial performance of banks, hence, the null hypotheses is not supported.

5. Conclusion

In this study, credit risk, interest rate risk and liquidity risk are considered to be the most important elements that affect the financial performance of corporate organizations especially deposit money banks in Kaduna State. This was supported by the main hypotheses of this study of having a relationship with financial performance. The study suggests that credit risk, interest rate risk and liquidity risk of $\beta=0.422$, 0.326 and 0.269 respectively with positive and significant effect to the financial performance, while operational risk has an insignificant negative effect on financial performance of deposit money banks in Kaduna State. Therefore, this study concluded that credit risk, interest rate risk and liquidity risk has a relationship with financial performance of Kaduna State banks. It is recommended among others that the management and owners of listed deposit



money banks in Kaduna state should encourage an increase in the loans and advances given to customer as this will enhance bank profitability. It is also recommended that the bank should venture into business with higher interest rate but should establish a mechanism to monitor market movement of interest rate, as any rise in interest rates causes banks problems. The bank management should also pay less attention to operational risk though not completely as the result revealed that operational risk has a significant negative effect on the performance of banks.

The study also recommends that the banks in Kaduna should increase concentration on strategies to increase customer deposit and the banks should use scientific methods in detecting the strengths and weaknesses points of liquidity, especially in light of the bank's unexpected circumstances as the outcome of the result showed that liquidity risk has a positive effect on bank performance in Kaduna State.

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