RISK MANAGEMENT AND CORPORATE ORGANIZATIONAL PERFORMANCE IN THE FINANCIAL INSTITUTE

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Abstract

This study focused on risk management and corporate organizational performance in the financial institute. To ensure that the researcher was properly guided, two research questions were raised and one hypothesis was tested. The data used in the study were generated mainly through questionnaire administered on the respondents. Simple percentage (%) and chi-square (X^2) was the instrument of data analysis. From the analyses of the data gathered, the researcher discovered the credit risk management can lead to high profitability of banks, and its patronage. It was concluded that the risks faced by banks are endogenous, associated with the nature of banking business itself, whilst others are exogenous to the banking system.

Introduction

The effective management of business organizations and the occasional disasters associated with life itself, together with political and social disruptions, are examples of the risks which a society is exposed to. It is not often possible to totally eliminate these risks, but the probability of a loss can be reduced by changing some of the circumstances relating to loss (Ayodele & Alabi, 2014). Applying this to the financial institutions, it has become more important than ever for banks to manage effectively the various types of risk they confront, including market, credit, liquidity, operations and computer system risks. These changing circumstances often create new set of risk in whose answers lie in better planning and well organized risk management techniques. According to Pandey (2004), the key to effective risk management is not to do away totally with the various inherent risks. For example, lending operations of banks have the inherent risks of possible loan losses (credit risk) but by taking the risk, banks are able to charge a premium for their risk taking activities and earn profits. Risks are therefore, a source of profits to the bankers.

Statement of the Problem

Risk management in the Nigeria financial system has not yielded much result as desired due to challenges ranging from insider loans and advances to inadequate risk management policy put in place by the banking operators. It has become a common phenomenon in Nigerian banks to extend loans and advances to family relations, friends and directors without due process. This has led to bad debts caused by inadequate recovery procedures leading to inability of these banks to collect loans and advances extended to these categories of stakeholders ultimately leading to banking distress.

Objectives of the Study

The main objective of this study is to examine risk management corporate and organizational performance in the financial institute. The specific objectives are to:

1. Identify the effect of risk management on corporate profitability.
2. Evaluate the extent risk management affects patronage.

Research Questions

Based on the objectives of the study, the following research questions were posed for the study.

1. What are the effects of risk management on corporate profitability?
2. To what the extent does risk management affect patronage?

Research Hypotheses

Based on the objectives of the study and research questions, the following research hypotheses were formulated for the study.

H_o1: Risk management does not affect profitability and patronage.

H_i1: Risk management affects profitability and patronage.

Conceptual Issues

The Concept of Risk Management

According to (Ayodele & Alabi, 2014), the word risk, which is the centre point and target of risk management is defined as a chance of loss, chance of mishap, an unwanted and uncertain event, uncertainty of financial loss, objective doubt, concerning the outcome in a given situation or a combination of hazards. Risk is the exposure to loss arising from the variation between the expected and actual outcomes of investment activities (Nzotta, 2002; Owualla, 2000). Therefore, in a broad term, risk management can be related to a mechanism which embraces planning, organizing and controlling resources and operational activities of business for effective reduction or elimination of risk or the adverse effects of risks. Risk management is also viewed as a multi-disciplinary function. Hence, it is all embracing in the implicit actions taken by housewives, farmers, and artisans to the corporate managers. Such actions involve, consciously putting a risk management process in place to mitigate disasters such as injuries, incapacitation, and even death. It involves a management process aimed at "the effective reduction of the adverse effects of risks".

In view of Umoh (2002), risk management is very significant to the operations of any business entity due to serious consequences that the occurrence of risk portends. It implies that for a business organization to be rest assured of the achievement of its objectives besides survival and growth, risk management becomes imperative (Nwankwo, 1991). Risk management as commonly perceived does not mean minimizing risk totally; rather the goal of risk management is to optimize risk- reward trade off.

Corporate Performance

This concept is based on the idea that an organization is the voluntary association of productive assets, including man power, physical and capital resources for the purpose of achieving a shared goal (Ferguson, 2003). Corporate performance indicates the effectiveness of an organization. Various indicators such as effectiveness, efficiency, financial viability and relevance to stakeholders can be used to measure corporate performance. Gan et al (2006) have unanimously agreed that, measuring organizational performance is challenging because it is a multidimensional theoretical construct hence there is no single operational measure.

The existence of these multiple considerations means that, it is unclear that organizational purpose can be portrayed as unitary or that the multiple purposes of an organization are reliably consistent (Pandey, 2004). Richard (2009) further argued that a failure of measures to reflect an organization's multiple constituencies may lead the organization to treat the satisfaction of others as pathology, rather than maintaining a healthy tension between them. The common measures used include financial measures such as return on assets, return on equity, amongst others.

Risk Management and Bank Performance

Increasing shareholders' return epitomizing bank performance is one major objective of bank management. The objective often comes at the cost of increasing risk. Bank faces various risks such as interest risk, market risk, credit risk, off balance risk, technology and operational risk, foreign exchange risk, country risk, liquidity risk, and insolvency risk (Tandelilin, Kaaro, Mahadwartha, and Supriyatna, 2007). The bank's motivation for risk management comes from those risks which can lead to bank underperformance. Issues of risk management in banking sector have greater impact not only on the bank but also on the economic growth (Tandelilin et al, 2007). Ogunleye (2001) concludes that some empirical evidence indicates that the past return shocks emanating from banking sector have significant impact not only on the volatilities of foreign exchange and aggregate stock markets, but also on their prices, suggesting that bank can be a major source of contagion during the crisis.

Banks which better implement the risk management may have some advantages: (i) It is in line with obedience function toward the rule; (ii) It increases their reputation and opportunity to attract more wide customers in building their portfolio of fund resources; (iii) It increases their efficiency and profitability. Cebenoyan and Strahan (2004) find evidence that banks which have advanced in risk management have greater credit availability, rather than reduced risk in the banking system. The greater credit availability leads to the opportunity to increase the productive assets and bank's profit.

Banking Risk Characteristics which Affects performance

According to Nwankwo (1991) and (Ayodele & Alabi, 2014), bank management is conterminous with risk management. That is to say that bank management is nothing other than managing risks. Bank management is always trying to reduce the level of risks associated with: (i) credit (default), (ii) interest rate and foreign exchange, (iii) liquidity and (iv) operations. These four specific kinds of risk form the core risks associated with banking. There are however, other types of risk such as capital risk, concentration risk, ownership risk, fraud risk, actual risk, off balance sheet risk, reputation risk, environmental risk etc. The major four types are described below:

1. **Credit risk:** This is also known as default risk. It is associated with the repayment of a credit advances made by a bank. Credit risk is the potential that a bank borrower fails to meet the obligations on agreed terms. Credit risk is inherent to the business of lending funds and to the operations linked closely to market risk variables. The objectives of credit risk management is to minimize the risk and maximize bank's risk adjusted rates of return by assuming and maintaining credit exposure within the acceptable parameters (Ayodele & Alabi, 2014).
2. **Interest rate risk and foreign exchange risk:** This refers to the change in value of a financial asset or liability occasioned by a change in the general level of interest rates. Interest rate risk also entails reinvestment risk which is the probability that the bank will not be able to reinvest its interim cash flows at interest rates that are required to meet its liabilities. Foreign exchange risk is analogous to interest rate risk. It measures the change in equity value due to variations in the level of the exchange rate.
3. **Liquidity risk:** This is the probability that there will be a sudden call upon the resources of the bank that will strain its financial capacity (Pandey, 2004). It is the type of risk which may arise from the fact that the firm may find it difficult to generate enough quantum of funds with which short-term financial obligations can be met. Liquidity risk is the most often thought of as a sudden liability short fall that is associated with a deposit withdrawal or with a decline in borrowing capacity.
4. **Operational risk:** The concern here is that system failure or human error will result in losses to the bank that could substantially affect its viability. The operational risk is conceptualized as the risk of loss arising from failed processes, people and systems as well as external events. In other words, operational risk refers to the possibility that transactions or processes can fail as a result of poor design, inadequately trained personnel and external disruptions. These failures could be sudden, such as a computer breakdown, it could be cumulative, such as the inability to bring on line a new computer application. Also inability to balance ledger accounts including dormant and special ledger accounts could lead to losses that could weaken the ability of a bank to continue in operations (Ayodele & Alabi, 2014).

Theoretical Review

Credit Risk Management Theory

Credit risk may lead to losses when banks' customers experience deterioration in financial condition, making it impossible to recover principal and interest on loans, securities and other monetary claims outstanding (Ngwu, 2006). Management of this type of risk is the most fundamental task in banking operations. Therefore, under a business ideal of maintaining reliable and sound banking operations, banks must place the highest priority on ensuring the soundness of its assets and workers to continually enhance its credit management capabilities.

Market Risk Management Theory

Market risk refers to the possibility that banks may incur losses due to movements in interest rates, foreign currency exchange rate, stock prices and/ or market related indicators. Redja (2006) opined that the bank should conduct strict management and control of market risk based on the awareness that the possibility of substantial losses is inherent in the nature of market transactions.

Liquidity Risk Management Theory

Banks should recognize the management of liquidity risk as a vital aspect of its operations and should develop effective systems to ensure sufficient liquidity to meet its needs. To manage liquidity risk, the banks must periodically examine the structure of fund sources and uses; implement measures needed to improve this structure (Ayodele & Alabi, 2014).

Operations Risk Management Theory

Operations risk inherent in the handling of customer transactions and errors, unethical conduct and certain other circumstances may lead to losses. Typical examples are disparities between actual cash and cash balances and customer complaints covering transactions. Accurate and rapid fulfillment of transactions requested by customers is the foundation of trust in the services of banks, and as banking activities become more diverse, proper management of these activities is essential to lessen and minimize operations risk (Ayodele & Alabi, 2014).

Empirical Studies

Ihedi (2019) wrote on banking risk in Nigeria. Secondary data sourced was based on a 4year progressive annual reports and financial statements of 10 banks and a panel data estimation technique adopted. The result implies an inverse relationship between financial performance of banks and doubt loans, and capital asset ratio was found to be positive and significant. Similarly it suggests the higher the managed funds by banks the higher the performance. The study concludes a significant relationship between banks performance and risk management.

Madu (2018) examined the risk management in the Nigerian banking industry. The data used for the study were collected majorly from primary source through the distribution of questionnaires to respondents in the bank. Simple percentages were used to analyze the respondents' responses to each of the question while Chi- square (x^2) and the Analysis of Variance statistic (ANOVA) were used to test the stated hypothesis. Based on the research findings, it was discovered that Nigeria banking operations are affected more by credit risk and operational risk than market risk. Fraud and forgeries also play adverse role in banking daily operations. However, the risk management techniques put in place by the banks have really curbed or reduced the various risks confronting Nigeria banks. It was therefore recommended among others that Nigeria government should strengthen the legal framework for the enforcement of loans repayment from borrowers to banks upon loan maturity.

Research Methodology

- **Research design:** The design of this study is survey research design.
- **Population of the study:** The population of this study is 200 staff of UBA, and First Bank Owerri.
- **Sample and sampling technique:** Sample is the entire number of elements studied from the entire population. Here, simple

random sampling technique was used to select 120 staff.

- **Instrument for data collection:** In this study, the researcher used questionnaire scale as the instrument of data collection.
- **Validation of the Instrument:** Face and content validity methods were used for the study.
- **Method of data analysis:** For the purpose of this study, table, frequencies, simple percentage, and chi-square were employed.

Data Analysis and Results

Out of 120 copies of the questionnaire distributed, only 109 were properly filled, retuned and used.

Question1: Risk management enhances profitability.

Table 1: Responses on if risk management enhances profitability.

Options	No of response	% of percentage
Strongly Agree	20	18.36
Agree	47	43.11
Strongly Disagree	8	7.34
Disagree	19	17.44
Undecided	15	13.77
Total	109	100

Source: field survey 2021

The analysis of the table above shows that 20 or (18.36%) strongly agree that risk management enhances profitability, 42 or (43.11%) agree, 8 or (7.34%) strongly disagree, 19 or (17.44%) disagree while 15 or (13.77%) were undecided.

Question 2: Risk management encourages patronage.

Table 2: Responses on if risk management encourages patronage.

Options	No of response	% of percentage
Strongly Agree	21	19.27
Agree	48	44.03
Strongly Disagree	9	8.26
Disagree	14	12.84
Undecided	14	12.84
Total	109	100

Source: field survey 2021

The analysis of the table above shows that 21 or (19.27%) of the respondents strongly agree that risk management encourages patronage, 48 or (44.03%) agree, 9 or (8.26%) strongly disagree, 14 or (12.84%) disagree while 14 or (12.84%) were undecided.

Testing of Hypothesis

H_o1: Risk management does not affect profitability and patronage.

The hypothesis will be tested with response from table 1.

Response	Management staff	Subordinate staff	Total
Strongly Agree	5	15	20
Agree	29	18	47
Strongly Disagree	2	6	8
Disagree	15	4	19

Undecided	-	15	15
Total	**51**	**58**	**109**

Source: field survey 2021

To test the hypothesis with chi-square (X^2) the expected frequency (fe) was obtain using the formula.

$$\frac{RT \times CT}{GT}$$

Where

RT = Row Total
CT = Column Total
GT = Grand Total

Contingency table

Fo	**Fe**	**Fe-fe**	**Σ(fo-fe)^2**	**Σ(fo-fe)^2/fe**
5	9.37	-4.37	19.10	2.04
15	10.64	4.37	19.01	1.79
29	21.99	7.01	49.14	2.23
18	25.01	-7.01	49.14	1.96
2	3.74	-1.74	3.03	0.81
6	4.27	1.73	2.29	0.70
15	8.89	6.11	37.33	4.19
4	10.11	-6.11	37.33	3.69
0	7.02	-7.02	49.28	7.02
15	7.98	7.02	49.28	6.18
				30.61

Source: field survey 2021

From the contingency table above the chi-square (X^2) calculated = 30.61. To obtain chi-square tabulated (X^2_{tab}), the formula is gives as:
Df = (R - 1) (C - 1)

Where

Df = degree of freedom
R = No. of Rows
C = No. of Columns
Df = 4 and level of significance = 0.05. Therefore the chi-square tabulated (X^2_{tab}) = 9. 488.

Decision Rule

Since the $X^2_{cal} > X^2_{tab}$ i.e. (30.61 > 9.488), we reject the null hypothesis (Ho) and accept the alternative hypothesis (H1) which states that risk management affects profitability and patronage.

Conclusion

The banking business by its nature is a high risk environment. It is risky in the sense that it is the only business where the proportion of borrowed funds is far higher than the owners' equity. A high level of financial leverage is usually associated with high risk. This can easily be seen in a situation where adverse rumors, whether founded or precipitated financial panic and by extension a run on a bank. As depositors take out their funds, the bank hemorrhages and in the absence of liquidity support, the bank is forced eventually to close its doors. Thus, the risks faced by banks are endogenous, associated with the nature of banking business itself, whilst others are exogenous to the banking system.

The risks that arise in the course of business which bankers should be able to control include, amongst others, credit risk, liquidity risk, reputation risk, legal risk, operational risk, customer satisfaction risk, leadership risk and information technology risk. On the other hand, the risks that are exogenous to the banking system which tend to pose the greatest control problem to bankers include regulatory risk, industry risk, government policies risk, sovereign risk and market risk.

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