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Risk Management In Nigeria Banking Industry

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ABSTRACT
The research paper examined the risk management in the Nigerian banking industry. First bank of Nigeria PLC was used as the case study being the oldest and the biggest bank out of the twenty- three (23) banks currently operating in Nigeria economy.
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.
The analysis revealed that risk in the likelihood of fraud and forgery, operational risk, market risk and system risk abound in the Nigeria banking operations which needed to be managed appropriately in order to improve performances and profitability of the banks.
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. And that financial regulator must adopt risk management approach that is in complete compliance with international standards focusing on the financial and operational risks faced by banks so as to guide against any risks associated with the banking operations and existence.

1. 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.
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.
However, 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.
Another problem is operational risks. These are the risks of direct and indirect loss resulting from inadequate or failed internal processes, people and systems or external threats. The manifestation of high operational risk in Nigerian banks is the volume of fraud and forgeries.
Furthermore, Ogunleye (2001) observed that ignorance and neglect of regulatory guidelines meant to mitigate these risks by bank management contribute to risk. Some of the management teams in the Nigerian banks are either ignorant of risks inherent in banking operations or have total neglect for regulatory guidelines that insulate the banking operations from potential losses.

Therefore, based on the foregoing, this study is out to give an insight on how effectively risk management can be put in place in Nigeria banking industry and how various risks associated with Nigeria banks' performances can be reduced in order to guide against the perennial distress syndrome plaguing Nigerian banks.

2. **THEORETICAL FRAMEWORK**

2.1. The Concept of Risk Management.

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.

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".

According to Soludo (2007), approaches to risk have apparently changed across organizations and the whole globe in recent times. This involves the recognition by many business leaders that risks are no longer mere hazards to be avoided but they also in many cases, constitute opportunities to be embraced. Soludo (2007) further cited the chief risk officer of Royal Bank Canada who observed that "risk itself is not bad, what is bad is risk that is mismanaged, misunderstood, mispriced or unintended". He therefore described risk management as a discipline at the core of every financial institution and encompasses all the activities that affect its risk profile. It involves identification, measurement, monitoring and controlling risks to ensure that:

(i) The individuals who take or manage risks clearly understand it.
(ii) The organization's risk exposure is within the limits established by Board of Directors.
(iii) Risk taking decisions are in line with the business strategy and objectives, set by Board of Directors.
(iv) The expected pay offs compensate for the risks taken.
(v) Risk taking decisions are explicit and clear.
(vi) Sufficient capital as a buffer is available to take risk.

2.2. Banking Risk Characteristics

Nwankwo (1991), explained that 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.

(i) 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.

(ii) 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.

(iii) 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.

(iv) 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.

2.3. Management of Inherent Risks in Banking Operations.

Risk as defined by Olowe (1998), as the possibility of loss, injury, damage or peril in life. It is inherent in every day's life especially in the life of a banker. An effective management of banking risk requires a well articulated risk management policy and strategy. This assists the bank manager to think through the totality of its operations and the risks associated with the operations, see the risks in totality as affecting the bank as a corporate entity rather than as the individual risks affecting separate departments and units of the bank, assign responsibility and establish the machinery for implementation, appraisal and review. Therefore the bank management should pay proper attention to the following.

(i) Credit Risk Management.

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.

(ii) Market Risk Management.

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.

(iii) Liquidity Risk Management.

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.

(iv) Operations Risk Management.

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.

(v) Systems Risk Management.

System risk is inherent in computer systems, and losses as well as damages may be incurred owing to malfunctions and unethical conduct. For financial institutions, which are highly dependent on these systems, there is a possibility that systems risk may have impact on management. The management of systems risk should not be regarded as simply a systematic or technological issue, but as one form of management risks which should be well supervised and controlled.

3. Methodology

The population of the study comprises the total number of commercial banks in Nigeria, which is currently put at twenty-three (23). However, First bank of Nigeria Plc was taken as the sample to be used being the oldest and the biggest bank in Nigeria at present.

3.1. **Sources of data.**

The major source of data used for this study was primary source, though supported with secondary source. The data were sought through the use of questionnaires served on 55 workers of First Bank Nig PLC at the headquarters on Broad street, Lagos. Only 50 were received from the served respondents and the analysis was based on the 50 questionnaires.

4.0. Analysis of data.

The data collected through the questionnaires were analyzed through the use of simple percentages. The hypothesis of the study was tested with the use of chi-square (x^2) method using the significance level of 5%. Analysis of variance statistical technique (ANOVA) was also used to test the hypothesis formulated. The analysis is as shown below.

Table 1.1: The type of risk the first bank is prone to.

Types	Frequency	Percentage	Cum. percentage
Valid credit risk	20	40.0	40.00
Interest rate risk	02	04.0	44.00
Liquidity risk	02	04.0	48.00
Operations risk	14	28.0	76.00
Systems risk	12	24.0	100.00
Total	50	100	

Source : Field survey, 2012.

From the table above, 20 respondents ranked credit risk as the major risk confronting the bank's activities. This is followed by operations risk and system risk having 28% and 24% of the respondents respectively. The interest rate risk and liquidity risk have low effect on the banks because banks benefit more during high interest rate regime and may decide to reduce loan and advances during low liquidity level. Hence, the percentage of respondents who believe the bank is prone to them is very low.

Table 1.2: Whether Fraud and Forgeries contribute to risk exposures in banks. SD= Strongly disagree, D= Disagree, I= Indifferent, A= Agree, SA= Strongly agree

Response	Frequency	Percent	Valid percent	Cumulative percent
Valid SD	03	6.0	6.0	6.0
D	11	22.0	22.0	28.0
I	07	14.0	14.0	42.0
A	17	34.0	34.0	76.0
SA	12	24.0	24.0	100.0
Total	50	100.00	100.0	

Source: Field survey, 2012.

The information above shows that 24% of the respondents strongly agree that fraud and forgeries contribute to risk exposures in the banking industry while 34% also backed the preposition. Only 22% and 6% of the respondents disagreed and strongly disagreed with the notion respectively and 14% of the respondents were neutral. Hence, we can conclude that fraud and forgeries contribute to risk exposure in Nigeria banking industry.

Table 1.3: Whether attitude of borrowers towards loan repayment constitute a risk factor in the bank.

Response	Frequency	Percent	Valid percent	Cum percent
Valid SD	0	0	0	0.00
D	13	26.0	26.0	26.0
I	06	12.0	12.0	38.0
A	19	38.0	38.0	76.0
SA	12	24.0	24.0	100.0
Total	50	100		

Source: Field survey 2012.

The table above revealed that 24% of the respondents strongly agreed with the statement that attitude of borrowers towards loan repayment constitute a risk factor in the banks and 38% of the respondents also agreed with the statement. However, 26% of the respondents disagreed with the statement while 12% of the respondents remained indifferent.

Table 1.4: Various methods used by banks to hedge against risk.

Response	Frequency	Percent	Valid percent	Cum percent
Valid:Risk avoidance	22			
Risk retention	07	44.0	44.0	44.0
Loss prevention	17	14.0	14.0	58.0
Loss reduction	02	34.0	34.0	92.0
Indifferent	02	04.0	04.0	96.0
		04.0	04.0	100.0
Total	50	100.0	100.0	

Source: Field survey 2012.

Based on the exposition above, 44% of the respondents chose risk avoidance method, 14% chose risk retention method and 34% chose loss prevention method as the various methods used in hedging against risk in the bank. Only 4% of the respondents chose loss reduction method for hedging against risk. Therefore risk avoidance method is the most popular method used in hedging against risk in the banking industry followed by loss prevention method.

Table 1.5: Whether the risk management techniques put in place have curbed the various operational risk in the bank.

Response	Frequency	Percent	Valid percent	Cum. percent
Valid:Very effectively				
Effectively	30	60.0	62.5	62.5
Ineffectively	17	34.0	35.4	97.9
	01	02.0	02.1	100.0
Total	48	96.0	100.0	
Missing system	02	04.0		
Total	50	100.0		

Source: Field survey 2012.

Analysis from table 1.5 above, revealed how effectively the various risk management techniques used by the bank have been able to curb the various operational risks confronting the bank. 60% chose very effectively, 34% chose effectively and only 2% chose ineffectively. This shows that the various risk management techniques put in place by the management of first bank have been helping to curb the operational risks confronting the bank.

Hypothesis Testing

The hypothesis tested in the study as stated below was tested using the chi-square (x^2) and F- statistic.

Ho: Risk management techniques put in place have not been able to curb the various operational risks in the bank.

H1: Risk management techniques put in place have been able to curb the various operational risks in the bank.

Table 1.5 replicated: Whether the risk management techniques put in place have curbed the various operational risk in the bank.

Response	Observed N	Expected N	Residual
Very effectively	30	16.0	14.0
Effectively	17	16.0	1.0
Ineffectively	01	16.0	-15.0
Total	48		

Test statistic

	Whether the risk management techniques put in place have curbed the various operational risk in the bank.
Chi- square	26.375
Df	2
Asymp. sig.	.000

Decision rule.

Where the computed value of chi-square (x^2) is less than the tabulated value at 5% level of significance, we accept the null hypothesis (Ho) while we reject the alternative (H1) and vice versa.

From the calculation above through the use of statistical packages for social science (SPSS), the calculated chi-square (x^2) value of 26.375 is greater than the tabulated chi-square (x^2) which is 4.61. Therefore we reject the null hypothesis and conclude that risk management techniques put in place have been able to curb the various operational risks in the bank.

ANOVA.

Whether the risk management techniques put in place have curbed the various operational risk in the bank.

	Sum of square	Df	Mean square	F	Sig
Between groups	2.935	3	0.978		0.012
Within groups	10.545	44	0.240	4.082	
Total	13.479	47			

5.CONCLUSION.

From the findings of this research work, it can be deduced that fraud and forgeries in banks constitute a risk factor to banks' performance and is therefore playing an adverse role in its activities. It was also discovered that among the various types of risk confronting banks' performance, operations risk and credit risk are the commonest. These risks revolve around the activities of the management and workers in the banking industry.

However, the study showed that some risk management techniques put in place have been able to check or curb the various operational risks in the bank. This can be observed as there is a peaceful atmosphere currently surrounding the Nigeria banking industry unlike few years ago which can be called liquidation period in banking system, though the managements of various banks have not risen to the task of avoiding totally the avoidable risks inherent in the system.

Based on the above, it is therefore recommended among other things that:

- Apart from the operational risk as a result of human error or inefficiency in the banking hall, there are still other types of risk that should be paid attention to. The one that stood out is the credit risk which is still having adverse effect on banks' performance.
- Nigerian government should strengthen the legal framework for the enforcement of loan repayments from borrowers to banks.
- Every bank should update its infrastructure so as to curb the system risk confronting the Nigerian banks. This would also prevent system failure.
- The financial market regulator should adopt a risk based management approach that is in complete compliance with international standards focusing on the financial and operations risk faced by banks. Banks should also set up inspection departments to perform internal checking functions to guide against operations problems.
- The Nigerian government should create conducive environment for the smooth operations of the banks. This comprises regular power supply and safe distribution of funds in the economy.

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