RISK MANAGEMENT COMMITTEE CHARACTERISTICS AND MARKET PERFORMANCE: EMPIRICAL EVIDENCE FROM LISTED FINANCIAL SERVICE FIRMS IN NIGERIA

[1]MOHAMMED MAHMUD KAKANDA, [2]BASARIAH SALIM, [3]SITRASELVI A/P CHANDREN

[1,2,3]Modibbo Adama University of Technology Yola, Universiti Utara Malaysia, Universiti Utara Malaysia
E-mail: [1]manga4m@gmail.com, [2]basa1189@uum.edu.my, [3]sitraselvi@uum.edu.my

Abstract - Recently, there is an increased demand from various corporate stakeholders on the need for public companies to have risk management frameworks as well as a stand-alone risk management committee in order to mitigate risks and simultaneously improve performance. Consequently, based on the requirement of the revised Nigerian Code of Corporate Governance (NCCG) 2011 on risk management structure, this study examines the impact of risk management committee characteristics (risk management committee size, risk management committee composition, risk management committee meeting) on the market performance (market-to-book value ratio, (MTB)) of listed financial service firms in Nigeria. In the quest to achieve the objective of this study, data were obtained from a sample of 45 financial service firms (banks and nonbanks) for the period of 2012 to 2016. However, the Panel Corrected Standard Errors (PCSEs) regression model is used in testing the hypotheses developed in this study. In essence, the regression result reveals that risk management committee size has a significant, but negative impact on firm performance, while risk management committee composition and risk management committee meeting have a significant positive effect on firm performance as expected by their hypotheses. Thus, the finding of this study has significantly contributed to the regulators of corporate governance code in Nigeria alongside shareholders, and corporate managers. The study concludes by offering policy recommendation.

Keywords - Market-to-book value ratio, Risk management committee composition, Risk management committee meeting, risk management committee size.

I. INTRODUCTION

The notion of risk management has recently become a dominant idea to several corporate stakeholders (shareholders, directors, creditors, government agencies, and the hosting communities) in both industrialized and evolving economies. Fairly, the intensive responsiveness to risk management by various stakeholders is predominantly owed to many recent corporate catastrophes and unpredicted business deficiencies [1], and has become a central theme of corporate governance (CG) and is connected to the internal control [2]. However, risk management involves identifying, analyzing, and control of all related risks which may likely threaten a firm's resources, assets, or its earnings capacity [3]. As such, risk management is regarded as one of the major phases of CG particularly in the case of financial institutions [4]. Consistently, [4] added that numerous financial institutions globally do not longer exist, have been taken over, or merged due to their disregard to the basic guidelines of risk management and control.

Moreover, [5] upheld that corporate governance is generally accepted as a significant element in refining economic efficiency, that eventually standardized a company's relationship with its board, its management, its investors, and other stakeholders. The authors added that "Enterprise risk management (ERM) is a key component of corporate governance. It provides a means of realizing a company's objectives and monitoring performance of an agent by a principal. ERM can reassure the principal that their interests are being netted through the diligent and efficient behavior of the agent" (p. 803).

Nevertheless, [2] argues that several corporate deficiencies have forewarned stockholders and promoters of CG reforms to the essentials of risk and uncertainty sources, and, hence, required corporate directors to make available all matters thereof. In addition, [6] contend that within a framework involving limited competition, greater information asymmetries, and intense regulation, the board turn into a significant way element to oversee managers' behavior and to offer advice on strategic identification, risk management, and implementation.

Case in point, [7] reports that one of the new issues in its revised code of CG is the function of the board of directors in areas of risk management, internal audit, and tax planning. Moreover, the code suggests that the board of directors should maintain final oversight function of the firm's management system, and guarantee the effectiveness of the reporting system. In the same vein, in the year 2004, [8] has issued its *Enterprise Risk Management-Integrated Framework* for the reason that over the years, there has been intense concern and emphasis on risk management and the need to have a rigorous framework to effectually recognize, evaluate, and manage risk.

Concurrently, the Nigerian Stock Exchange (NSE) has revised the 2009 code of CG and issued a new one in 2011 (hereinafter, the revised CG code of 2011) due to corporate fiascos associated with inadequate transparency in reporting and unsatisfactory risk management frameworks to identify, quantity, and control risk and their related activities [9]. In this regard, the revised code of 2011

has required all publicly trading companies in Nigeria to establish a risk management framework in order to improve their performances. For this reason, this study aims to examine the impact of risk management characteristics (risk management committee size, risk management committee meetings, and risk management committee composition) on the market performance of listed financial service firms in Nigeria.

II. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Risk management committee structure has now become an important issue with a lot of emphases, and activities on risk management are regarded as part of the significant audit committee functions [10]. However, various corporate failures like that of Enron and WorldCom have become a challenge to the trust that shareholders placed on auditor's report, and this has cast doubt on the integrity of audit committees in monitoring and implementing programs on risk management [11]. Therefore, this prompts the need for risk management committee (RMC) (which has some characteristics that encompass RMC size, RMC composition [Independence], and RMC meetings) to oversee and implement risk management programs of firms [10]. [3] states that "boards that establish a stand-alone committee that focuses solely on the risk management function demonstrates their commitment to improving the overall corporate governance structures of their firms" (p. 18).

According to agency theory, one of the ways to determine the efficacy of board of directors' information is through its subcommittees. Equally, an important mechanism that seems to enhance the oversight function of the board in order to ensure that shareholders' interests are achieved is the risk management committee, because it will add to the usefulness and greatness of boards' information [12]. The risk management committee include elements such as; size, composition, and meetings [13]. The efficiency of risk management committee characteristics to corporation performance has been noted by prior studies, for instance[3, 4, 10, 14].

Worthy to mention, studies on the risk management committee are limited and remain inconclusive [10]. However, [14] submits that there is a positive relationship between strong board monitoring and bank risk-taking because bank shareholders are with incentives for more risk. Specifically, [10] found that risk management committee size (RMCS) is negatively associated with underwriting risk of insurance companies in Malaysia. Consistently, risk management committee size has significant negative relation with corporate social responsibility disclosure in the Nigerian petroleum and marketing firms as reported by [15]. Albeit, the revised CG code of 2011 inspires corporate board of directors in establishing a risk management committee separate from the audit committee, yet, it does not specify the exact required size of a RMC, but advocates for a reasonable size.

In consideration of risk management committee composition (RMCC), the revised CG code of 2011requires that board committees of publicly trading companies Nigeria to compose of a majority of non-executive directors, and also be chaired by a non-executive director for the independence of the board. Likewise, the influence of decisions by management becomes less when members of a committee seem to be more independent [16]. In an empirical sense, despite the scant studies on the relationship between risk management committee composition and firm performance, still, Tao and Hutchinson (2013) have documented that risk committee composition is positively related to risk and performance of financial firms in Australia. More so, [15] finds that RMCC is positively associated with corporate social responsibility disclosure in the Nigerian petroleum marketing industry. Whereas, [10] found that risk management committee independence (composition) is negatively associated with underwriting risk of insurance companies in Malaysia.

To risk management committee meeting (RMCM), [17] and [18] contend that various issues of a firm a discussed during a board meeting and the more frequent of board meetings the favorable a firm performance. The revised CG code of 2011 does not specifically state the number of meetings to be held by a publicly trading company in Nigeria but has encouraged for a considerable number of meetings for better decisions of the firms. Empirically, [19] report that frequency of meetings of the risk management has a significant positive effect on the performance of banks in U.S. Consequently, this study proposes the following hypotheses:

H_1: *RMCS has a positive relationship with market performance*

H_2: *RMCC has a positive relationship with market performance*

H_3: *RMCM has a positive relationship with market performance*

III. DATA AND METHODS

For the purpose of this study, data were extracted from the annual reports and accounts of the financial service firms (banks and nonbanks financial firms) listed on the Nigerian Stock Exchange for the period of 2012 to 2016. However, to analytically test the hypotheses developed in this study, the following multivariate model is used which is analysed using STATA package version 14:

$$MTB_{it} = \beta_0 + \beta_1 RMCS_{it} + \beta_2 RMCC_{it} + \beta_3 RMCM_{it}$$

$$+ \beta_4 LEV_{it} + \beta_5 FSZ_{it} + \beta_6 FAG_{it} + \varepsilon$$

Based on the foregoing multivariate model, the MTB=market-to-book-value ratio is the dependent variable that proxied market performance (a performance that is determined by the forces of demand and supply in the stock market) and is measured as the ratio of firm's total market value divided by its total assets [20]. There are 3 independent variables including RMCS=risk management committee size measured as the number of directors serving on the RMC [10]; RMCC=risk management committee composition measured as the number of nonexecutive directors on the RMC [13]; and RMCM=risk management committee meeting measured the number of meetings held by the RMC during an accounting period [19]. While the control variables in this study are: LEV=leverage (ratio of total debts to corporate total assets); FSZ=firm size (measured as the natural logarithm (L_n) of a firm's total assets); FAG=firm age (number of years from incorporation) [21, 22].

DISCUSSION OF RESULTS

The results of analysis from this study include: descriptive statistics, Pearson correlation, and Panel Corrected Standard Errors (PCSEs) regression. From the descriptive statistics result in Table I, it becomes apparent that the average of MTB is 0.13, a minimum and maximum values of 0.01 and 0.38, with a standard deviation of 0.11, depicting that financial service firms in Nigeria are averagely doing well. The mean for RMCS is 6, and ranges from 3 to 14, indicating a reasonable size of the committee. For RMCC, the mean, minimum, and maximum scores 61%(0.61), 20%(0.20), and 86%(0.86) respectively, signifying that the committee is dominated by a large proportion of nonexecutive directors. On average, the RMC meets 4 times in a year and ranges from 1 to 7 meetings on lower and upper bounds. However, the average score of leverage (LEV) is 62%(0.62), demonstrating a high level of debt and peril of insolvency. The average value of firm size (FSZ) is 24.58, while firm age (FAG) is 34 years.

Variables	Mean	Std. Dev.	Min.	Max.
MTB	0.13	0.11	0.01	0.38
RMCS	6.00	1.71	3.00	14.00
RMCC	0.61	0.11	0.20	0.86
RMCM	4.00	1.13	1.00	7.00
LEV	0.62	0.40	0.01	3.03
FSZ	24.58	2.19	21.49	29.18
FAG	34.00	16.08	9.00	94.00

Table I
Descriptive Statistics

On the other hand, Pearson correlation is used to test for the level of association between all the variables in this study, where only LEV and FSZ have a significant negative relationship with MTB and FAG has a significant positive association with MTB at the 0.01 significant level. There is no presence of multicollinearity since none of the explanatory variables has a correlation coefficient above 0.6. The result of the Pearson correlation is displayed in Table II as thus:

	Variables	1	2	3	4	5	6	7
1	MTB	1.00	-0.086	0.069	0.038	-0.223***	-0.199***	0.279***
2	RMCS		1.00	0.193***	0.351***	0.151**	0.0610***	0.135**
3	RMCC			1.00	0.136**	-0.193**	0.055	0.163**
4	RMCM				1.00	0.010	0.390***	-0.064
5	LEV					1.00	0.224***	-0.094
6	FSZ						1.00	-0.056
7	FAG							1.00

**** and ***** is a significant level at 5% and 1% (two-tailed).**
Table II
Pearson Correlation Matrix *(N=45; Observations=225)*

Equally important, the multivariate regression result of this study is presented in Table III. However, multiple regression checks are conducted and some of the conditions (for instance, model specification test, functional form of the model, normality, and multicollinearity (see VIF) are met, only that heteroscedasticity (χ^2=5.31, p<0.05) and autocorrelation (F=20.05, p<0.05)problems are present. For this reason, the Panel Corrected Standard Errors (PCSEs) regression is used [23, 24]. From the PCSEs regression result in Table III, the R^2 value is 0.1561, explaining 15.61% variations in MTB and the model is also considered fit and significant (waldχ^2 =1598.40, p<0.01).

Variables	Expected sign	Coefficient	t-stats.	*p*-value	VIF
Intercept	?	0.270	5.98	0.000***	
RMCS	+ve	-0.028	-1.69	0.091*	1.77
RMCC	+ve	0.008	3.55	0.000***	1.12
RMCM	+ve	0.042	2.88	0.004***	1.24
LEV	-ve	-0.040	-2.63	0.008***	1.12

FSZ	+ve	0.008	0.02	0.985	1.78
FAG	+ve	0.002	16.35	0.000***	1.08
Mean VIF					1.35
N		45			
Observations		225			
R^2		0.1561			
Wald (χ^2)		1598.40***			

*** and *** is a significant level at 10% and 1% (two-tailed). Note that VIF=Variance Inflation Factor.**

Table III

Panel Corrected Standard Errors (PCSEs) Regression

Further, the result from Table III depicts that RMCS has a significant negative effect on MTB (β=-0.03, p<0.10), not supporting hypothesis 1, meaning that the larger the size of the committee, the lower the market performance. The plausible reason for this might be due to the high administrative cost associated with committee members. Contrastingly, RMCC has a significant positive influence on MTB (β=0.01, p<0.01). This supports hypothesis 2 and consistent with the findings of [13], as such, it signifies that the more a risk management committee is dominated by nonexecutive directors, the better the market performance of financial service firms in Nigeria. Moreover, RMCM has a significant positive effect on MTB (β=0.04, p<0.01), hence, supports hypothesis 3 which is also consistent with [19]. This indicates that frequency of meetings of the risk management committee adds value to the market performance of the sampled firms as presumed by the revised CG code of 2011. In relation to control variables, LEV has a significant, but negative impact on MTB (β=-0.04, p<0.01), denoting that sampled firms with a higher debt will have lower market performance or even incur a loss. There is no significant relationship between FSZ and MTB (β=0.01, p>0.10), while FAG has a significant positive influence on MTB (β=0.00, p<0.01).

CONCLUSION

This study examines the effect of risk management committee characteristics (size, composition, and meeting) on the market performance (market-to-book value ratio-MTB) of listed financial service firm in Nigeria. Firstly, the study finds that risk management committee size has a significant negative impact on firm performance. Whereas, risk management committee composition and risk management committee meeting have a significant positive influence on firm performance. Therefore, the finding of this study has significantly contributed to the regulators CG code in Nigeria alongside stockholders, and corporate managers in having an insight on the level of application of the revised CG code of 2011 in the listed financial service firms. This study recommends that the size of risk management committee should be more reasonable since it negatively affects performance, and literature has document that increases in board and its committee size results to interruption and delay in decision-making process, communication, and increases conflict of interest between shareholders and executives, which ultimately affects firm performance [25, 26].

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