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Enterprise-Wide Risk Management and Risk Governance of Microfinance Banks in Nigeria

Dr. Ishaya John Dabari

Senior Lecturer, Department of Accounting, MAU, Yola, Adamawa State, Nigeria

Dr. El-Maude, Jibreel Gambo

Senior Lecturer, Department of Accounting, MAU, Yola, Adamawa State, Nigeria

Abstract:

Purpose: Proactive risk management is indispensable to the long-term growth and sustainability of a business, however the practice of enterprise-wide risk management (EWRM) among microfinance banks is limited by its knowledge. Hence, the motivation of this study to examine the effect of current practices of EWRM on risk governance in MFBs in Nigeria.

Design/Methodology: The study adopted survey research design to define the structure and strategy of the study. Targeting microfinance banks in the north east region of Nigeria, 222 MFBs were selected as at 31st December, 2020. The required data were collected from respondents using structured questionnaire and financial statement of the banks. The data collected were analyzed using both descriptive and inferential statistics.

Findings: The analyses of the study revealed that board of directors' oversight, human resources competence, internal audit effectiveness, and top management commitment have positive and significant effect on risk management effectiveness of the microfinance banks in Nigeria. Furthermore, regular risk compliance was found to have positively moderates the relationship between human resource competence and risk management effectiveness, and the relationship between top management commitment and risk management effectiveness. However, the results indicates that regular risk management negatively moderates the relationship between internal audit effectiveness and risk management effectiveness and the relationship between board of directors' oversight and risk management effectiveness.

Implications: The current enterprise-wide risk management practices among MFBs in the North East Nigeria has a positive and significant effect on risk governance of the banks, which invariably enhance the performance of the banks. Furthermore, the internal control mechanism instituted by the regularity authority and the Board of Directors has enhance EWRM practices and MFBs performance. Hence, the study recommended the effective implementation of CBN Risk Management Framework for Microfinance Institutions to assist the MFIs identify their risk exposures with a view of monitoring and controlling them.

Keywords: Corporate governance, enterprise-wide risk management, microfinance banks, Nigeria

1. Introduction

The rapid change in the business world provide both high benefits and risk that a prudent manager needs to observe carefully. According to Jalal-Karim (2013), such risk includes compliance risk, competitiveness, financial risk, operational risk, and strategic risk, which manifest as the result of technological advancement, globalization, and increase in terrorism, diversification, and information security. Hence, effective and efficient management of these risk factors could be and an advantage and at the same time a challenge to a business (Gatzert & Martin, 2015).

Consequently, several businesses are adopting the approach of enterprise-wide risk management (EWRM). The EWRM redefines the value proposition of risk management by elevating its focus from tactical to the strategic. It is about designing and implementing capabilities for managing the risks that matter. The greater the gaps in the current state of ERM practices and the expected future state of the banks risk management capabilities, the greater the need for EWRM infrastructure to facilitate the advancement of risk management capabilities over time (Ahmad, 2014).

As the result of corporate scandals and the creation of corporate governance codes, ERM has been considered as a valuable element of the corporate governance structure and internal control mechanisms (Renn, & Walker, 2008). Proactive risk management is indispensable to the long-term growth and sustainability of microfinance Banks, but various microfinance stakeholders are ignorant of the different components and importance of this concept, hence the need for more research to create awareness in this area (Beasley et al., 2015).

Microfinance Risks Governance implies risks and challenges facing Microfinance Banks (MFBs). Risks are significant if the likelihood of occurrence or the severity of the potential impact is high (Renn, 1998). While the individual priorities of each MFB may vary to some extent, many potentially catastrophic risks such as financial risk, liquidity risk, credit risk, interest rate risk, or strategic risk, top the list. According to Clementine and Gabriel (2015), specifically to

microfinance Banks are governance risk, operational risk and new product development which affects management and performance of the banks.

In compliance with the code of corporate governance principles by MFBs, it prepares ground for full deployment of the Central Bank of Nigeria EWRM framework (Adeyemi, 2008) that provides for a robust, proactive and sophisticated supervisory process, essentially based on the risk profiling of a bank; forward looking process, placing greater emphasis on the early identification of emerging risks and system-wide issues.

As the result of corporate failures, Central Bank of Nigeria introduced code of corporate governance for Banks and their implicit effectiveness in the significant implementation of enterprise-wide risk management (EWRM) and risk governance. Several studies such as Acha (2012); Gatzert and Martin (2015) and Jalal-Karim (2013) have been conducted on risk governance and EWRM in Banks but there is a scarcity of studies on the current practices of EWRM in MFBs in Nigeria. Furthermore, there is dearth of knowledge and awareness on the EWRM processes especially by staff of the MFBs despite the CBN Code of Corporate Governance directing the full implementation of EWRM Framework in all MFBs. Hence, the motivation of this study to examine the moderating effect of corporate governance on the relationship between EWRM practices and risk governance.

In order to achieve the objective of the study, the hypotheses were formulated and tested using appropriate statistical techniques.

The significance of this research lies in its contributions to knowledge in the area of corporate governance and risk management among the microfinance banks in Nigerian context, since there is dearth of empirical analysis on the concepts in developing countries. It also important as a response to the need for more empirical studies on risk management in developing countries. More so, the study will inform policy makers especially the Central Bank of Nigeria and the management of microfinance banks in policy formulations.

The remaining part of the study is structured as follows: Section 2 presents relevant literature reviewed. Section 3 described the methodology adopted for the study. Section 4 discusses the results of the empirical study, while section 5 presents conclusion and recommendations.

2. Literature Review

2.1. The Concept of Risk

According to Sadgrove (2015), risk can be defined as an unexpected result on the probability of the occurrence or non-occurrence of an event. In the words of DeLoach (2000), risk is a distribution of possible outcomes within the organizational structure and a system over a period as a result of increasing changes within the critical control variables. Hence, Bernstein and Peter (1996) stated that, risk management is not a new idea as it has been in existence for thousands of years, but the rise of formal risk management came with its publication in Business Harvard Review in 1956 by Russell Gallagher. In this respect, Dickinson (2001) noted that in the 1970s, business enterprises started exploring how best to manage financial risks and the development of financial risks management as a formal system. The management of these risks is meant to reduce its impact on the business. Hence, D'Arcy (2001) define risk management as the process that involves the system of identifying, evaluating, planning, and managing risks.

2.2. Enterprise-Wide Risk Management (EWRM)

According to Dabari and Saidin (2014), the concept of EWRM, holistic risk management (HRM), integrated risk management (IRM), effective risk management and enterprise risk management are used synonymously by different researchers. Hence, Ahmad (2014) define EWRM as the value proposition of risk by elevating its focus from tactical to the strategic. Risk is associated with advancement in technology, human capital, goodwill, regulatory power, globalization, and diversification (Carey, 2001). These factors cause both pure and speculative risks that may have an impact on business performance. Thus, to attain the company's objectives, the risk has to be managed or controlled in a systematic way across the firm (Beasley et al., 2017). However, many organizations are not adopting ERM process and little is known about why they are not effectively implementing it despite the government policy through the code of corporate governance (Fadun, 2013). Golshan and Rasid (2012) suggest that the decision to implement EWRM commences in the boardroom and gains support and commitment from top management in order to influence the manner firms should think positively about risk and plan for eventualities. Failure to develop the risk management process can result in a severe financial loss and consequently business failure (Owojori et al., 2011).

2.3. Risk Governance

The concept of risk governance illuminates a risk's context by taking account of such factors as the historical and legal background, guiding principles, value systems and perceptions as well as organizational imperatives (CBN, 2011). It is the various ways in which many actors, individuals, and institutions whether public or private dealing with risks surrounded by uncertainty, complexity and/or ambiguity. It includes, but also goes beyond, the three conventionally recognized elements of risk analysis such as risk assessment, risk management and risk communication. Risk governance highlights that not all risks can be calculated as a function of probability and effect (CBN, 2011).

2.4. Corporate Governance

Kwakwa and Nzekwu (2003) define governance as a vital ingredient in the balance between the need for order and equality in society that stimulates the efficient production and delivery of goods and services and ensuring accountability in the realms of power and the protection of human right and freedoms. Governance is, therefore, concerned

with the processes, systems, practices and procedures that govern institutions. Corporate governance, on the other hand, refers to the manner in which the power of a corporation is exercised in accounting for corporate assets with the aim of maximizing stakeholders' value while attaining the corporate mission. In this vein, Magdi and Nadereh (2002) emphasize that corporate governance is about ensuring that the business is properly managed and investors receive a fair return. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs (Akinsulire, 2006).

2.5. Microfinance Bank

Microfinance bank is a type of bank that gives small loans or microloans to individuals, entrepreneurs and small businesses. These banks typically function to provide opportunities to low-income people where small amounts of money can go a long way. It can be deduced from the foregoing that microfinance is a poverty alleviation strategy which operates by providing credit and other financial services to economically active and low-income households and their businesses. To achieve this poverty alleviation objective, microfinance helps the poor increase their income, build viable business, reduce vulnerability to shocks and create employment (Yunus & Alan, 1999). To this extent, Akanji (2006) stated that, previous policies made limited risks impact on the micro enterprises sector, hence CBN in 2005 launched the Microfinance Policy Guidelines, which seeks to commercialize the business of microfinance. Based on this policy document, its aim is to provide a microfinance framework that would enhance the provision of diversified microfinance services on a long-term sustainable basis for the poor and low-income groups, create a platform for the establishment of microfinance banks and improve CBN's regulatory/supervisory performance in ensuring monetary stability and liquidity management (CBN, 2011).

This guideline among other things provided for the entrenchment of enterprise-wide risk management (EWRM) practices in microfinance banks. Some of the challenges microfinance banks in Nigeria face are, regular changes in government policies, lack of requisite human capital, infrastructural inadequacies and socio-cultural misconceptions. In addition to these, the banks are further subdued by corruption, frauds and forgeries and poor corporate governance. To address these issues concerted efforts on the part of regulators, promoters, practitioners and other stakeholders in the microfinance banking subsector is required. This is to ensure that they do not drag the subsector under as was the case of previous microfinance schemes of government. It is expedient that these banks succeed and grow considering their poverty amelioration potentials. Deutsche et al. (2000) investigated the three major categories of risk facing microfinance operations. These include: Financial risks; credit, liquidity, and market risks; Operational risks; transactional, fraud/integrity, legal, and compliance risks and Strategic risks; governance, reputation, and external business event risks.

According to Adeyemi (2008), Ayayi (2012), and Asare-Bekoe, (2010), there are limited studies that examine the relationship between these risks and risk governance. This justifies the need for further research in Microfinance institutions especially with respect to assessing the level of current risk management practices in MFBs since none of these studies addressed this gap. Hence, the motivation of this study. The few studies that examine this relationship such as Deutsche et al. (2000) revealed a contradicting result, thus, it is also necessary to test the moderating effect of the CBN Code of corporate governance on the implementation of EWRM framework and the risk governance in Microfinance banks. Hence the adoption of corporate governance code to examine its interactive effect on the relationship between enterprise-wide risk management and risk governance of microfinance banks in Nigeria. This is indeed a landmark contribution to the body of knowledge by this study.

2.6. Theoretical Review

Theories are required to guide an empirical study of this nature. Theories guide their design and provide a plausible explanation in terms of interpretation of results and implication of findings. Different theories are related to this study. However, only two theories are considered in this study. The underpinning theory for the research study is the Agency theory which is also the theory commonly used in corporate governance research studies. This is also supported by institutional theory to explain the role of government in formulating policy to enhance internal control mechanism in Microfinance Banks with respect to the deployment of risk governance and risk-based regulation and supervision. The theoretical framework for this study is reflected in figure 1.

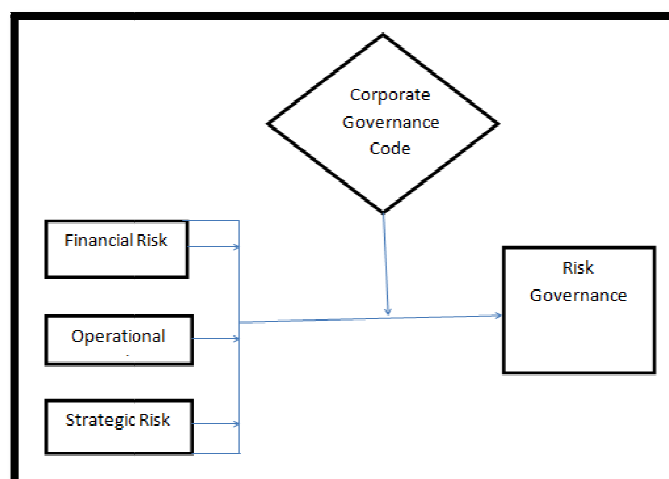


Figure 1: Theoretical Framework

3. Methodology

Survey research design was adopted to define the structure and strategy of the study. The target population was registered microfinance banks in the northeast region of Nigeria as at December, 2020 out of which 222 were selected as sample. The required data were obtained from the respondent through structured questionnaire. The questionnaire to solicit information from the respondents were based on five Likert scale that ranged from 'strongly disagree' to 'strongly agree.' Additionally, for the assessment of content validity of the variables, individual items of the instrument were verified from the financial statement of the banks. Amendment of the original instrument was made based on expert observations to suit the context and purpose of the study.

For the purpose of determining the relationships between the predictor variables and the outcome variables, mean, SD, correlations, β , t-test and p-value were assessed during the hypotheses testing. Fisher and Yetes (1963) posited that t-test values for one-tailed are significant at 2.326 (1 %), 1.645 (5 %) and 1.282 (10 %) if the samples are more than 120. The sample of this study is 222, hence, this study settled for Fisher and Heyes t-test values threshold in testing the formulated hypotheses herein.

Label	Variables
BDO	Board of directors' oversight
HSC	Human resource competence
IAE	Internal audit effectiveness
RRC	Regular risk compliance
RME	Risk management effectiveness
TMC	Top management commitment

Table 1: Variable's Identification

Source: Researcher (2021)

4. Results and Discussions

To ascertain the validity of the measurement model, discriminant validity was examined as reported in Table 2.

	BDO	HSC	IAE	RRC	RME	TMC
BDO	0.993					
HSC	0.986	0.998				
IAE	0.901	0.980	0.997			
RRC	0.988	0.968	0.991	0.995		
RME	0.990	0.990	0.989	0.984	0.977	
TMC	0.991	0.986	0.984	0.985	0.762	0.974

Table 2: Discriminatory Validity

The result of the discriminant validity in Table 2 suggests that the square root of the AVE for the individual variables was used (Fornell, & Larcker, 1981). Diagonally, Table 2 depicts square roots of AVE for all the variables indicating square roots of AVE that stood at (0.998) for the highest score, as well as (0.974) for the lowest score. Nevertheless, the roots of AVE for the constructs are greater than the off-diagonal elements in the corresponding rows and columns, hence showing evidence of discriminant validity. Again, more reliabilities of the measures were further tested during the pilot study on 48 respondents as well as on 222 responses in the main study.

Results from further reliability diagnostics in Table 3 equally suggest that all the alpha values are above the threshold of 0.60 (Hair et al., 2006). Accordingly, Cronbach's α of 0.60 is considered averagely reliable, but Cronbach's α of 0.70 and above was regarded as highly reliable (Sekaran & Bourgie, 2016).

Variables	Items	Loadings	AVE	CR	Cronbach's Alpha
BDO	BDO10	0.959	0.947	0.995	0.994
	BD01	0.964			
	BD02	0.982			
	BD03	0.982			
	BD04	0.967			
	BD05	0.981			
	BD06	0.979			
	BD07	0.982			
	BD08	0.975			
	BD09	0.955			
HSC	HRC1	0.974	0.95	0.993	0.991
	HRC2	0.964			
	HRC3	0.946			
	HRC4	0.953			
	HRC5	0.947			
	HRC6	0.980			
	HRC7	0.965			
IAE	IAE1	0.965	0.956	0.993	0.992
	IAE2	0.974			
	IAE3	0.943			
	IAE4	0.955			
	IAE5	0.977			
	IAE6	0.981			
	IAE7	0.978			
RRC	RRC1	0.936	0.932	0.991	0.989
	RRC2	0.888			
	RRC3	0.966			
	RRC4	0.976			
	RRC5	0.968			
	RRC6	0.971			
	RRC7	0.964			
	RRC8	0.954			
RME	RME1	0.980	0.954	0.993	0.992
	RME2	0.970			
	RME3	0.973			
	RME4	0.981			
	RME5	0.974			
	RME6	0.963			
	RME7	0.975			
	RME8	0.977			
TMC	TMC10	0.966	0.949	0.995	0.994
	TMC1	0.978			
	TMC2	0.981			
	TMC3	0.985			
	TMC4	0.964			
	TMC5	0.978			
	TMC6	0.981			
	TMC7	0.969			
	TMC8	0.937			
	TMC9	0.968			

Table 3: Items Loadings, AVE, Campsite Reliability and Alpha Values

In furtherance of the interpretation, the results in Table 3 show that all of the adapted items have attained higher loadings (indicator reliability) of above 0.50, standardized AVE of above 0.50 (i.e., internal consistency reliability). Going

by this, it's now safe to conclude that the measurement model is suitable for structural modeling in order to test the study hypotheses.

4.1. Assessing the Structural Model

The assessment of the structural modeling was conducted by ascertaining the path coefficient of the tested hypotheses. The result of the analyses is presented in Table 4 and Figure 3 and 2.

Hypotheses	Std β	SD	t-value	P-Values	Decision
BDO -> RME	0.321	0.121	2.649	0.008	Supported
HRC -> RME	0.218	0.058	3.774	0.000	Supported
IAE -> RME	0.236	0.104	2.261	0.024	Supported
TMC -> RME	0.278	0.084	3.326	0.001	Supported
BDO -> RRC -> RME	0.000	0.127	0.003	0.998	Not Supported
HRC -> RRC -> RME	0.251	0.067	2.255	0.025	Supported
IAE -> RRC -> RME	-0.032	0.051	0.621	0.535	Not Supported
TMC -> RRC -> RME	0.173	0.084	2.051	0.041	Supported

Table 4: Hypotheses Testing for Direct and Indirect Relationship

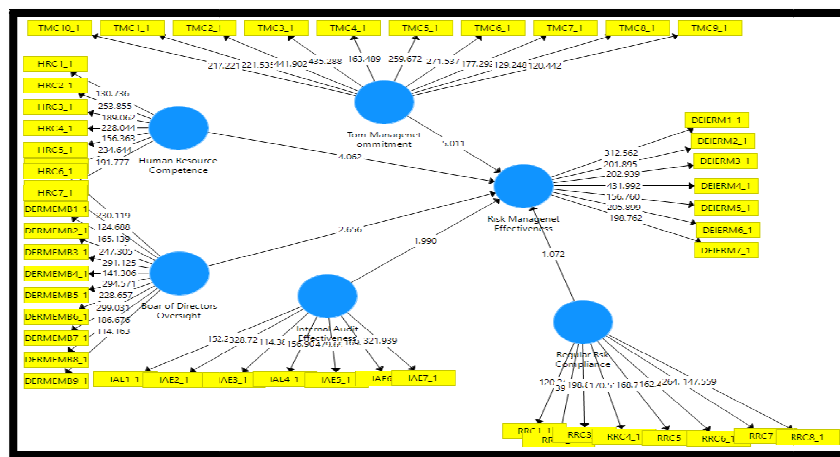


Figure 2: Path Coefficient of the Direct Relationships

Hypothesis 1 posited that board of director oversight (BDO) has positive effect on risk management effectiveness (RME). This was confirmed as shown in Table 4 where $\beta = 0.321$, $t = 2.649$ and $p < 0.008$. On the other hand, hypothesis 2 proposed that human resource competence (HRC) is positively related to risk management effectiveness (RME). The result in Table 4 supported this preposition with values $\beta = 0.218$, $t = 3.774$, and $p < 0.000$. Further, hypothesis 3 proposed that internal audit effectiveness is positively related to risk management effectiveness (RME). This result also supported this hypothesis positively with values of $\beta = 0.236$, $t = 2.261$, and $p < 0.024$. Again, Hypothesis 4 suggest that top management commitment (TMC) is positively related to risk management effectiveness (RME). This was equally supported with the values of $\beta = 0.278$, $t = 3.326$, and $p < 0.001$.

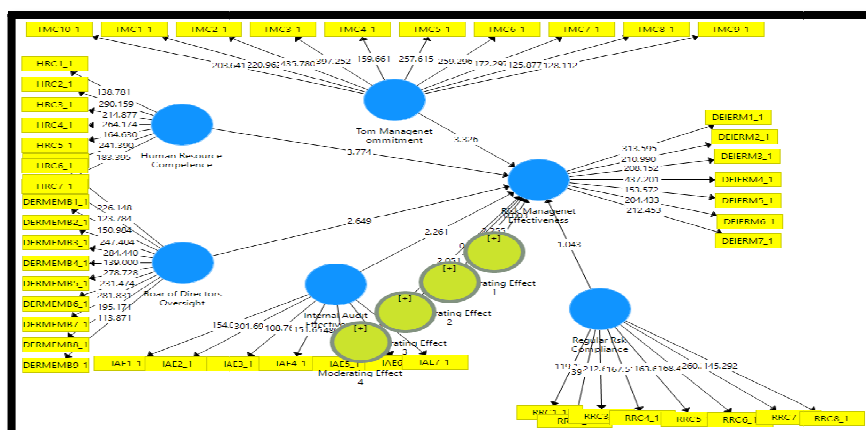


Figure 3: Path Coefficient of the Moderating Relationships

On the other hand, the results of the indirect relationships, show only two out of the four hypotheses were positive. The remaining two hypotheses suggest negative moderations. Hypothesis 5 postulated the moderating effect of regular risk compliance (RRC) on the relationship between board of directors' oversight (BDO) and risk management effectiveness (RME). The results from the calculations suggest negative findings for this hypothesis with the following values $\beta = 0.000$, $t = 0.003$, and $p < 0.998$. On the contrary, Hypothesis 6 that hypothesized regular risk compliance (RRC) moderates between human resource competence (HRC) and risk management effectiveness (RME) was found to be supportive with $\beta = 0.251$, $t = 2.255$, and $p < 0.025$.

Furthermore, Hypothesis 7 predicted that regular risk compliance (RRC) moderates the relationship between internal audit effectiveness (IAE) and risk management effectiveness (RME). However, the results in Table 4 shows negative effect of moderation of regular risk compliance (RRC) on the relation between the two variables, with values $\beta = -0.032$, $t = 0.621$, and $p < 0.535$. Lastly, preposition 8 hypothesized that the relationship between top management commitment (TMC) and management effectiveness (RME) could be moderated by regular risk compliance (RRC). The results in Table 4 supported this proposition with the values of $\beta = 0.173$, $t = 2.051$, and $p < 0.041$.

5. Conclusion and Recommendations

The results of the analyses revealed that there is a positive relationship between board of directors' oversight and risk management effectiveness, human resource compliance and risk management effectiveness, internal audit effectiveness and risk management effectiveness, and top management effectiveness and risk management effectiveness of the banks. Furthermore, the moderating results shows that, regular risk compliance has positively moderated the relationship between human resource competence and risk management effectiveness and top management commitment and risk management effectiveness of the banks. However, regular risk compliance has negatively moderated the relationship between board of directors' oversight and risk management effectiveness, and internal audit effectiveness and risk management effectiveness. Therefore, the study concludes that the current enterprise-wide risk management practices among MFBs in the North East Nigeria has a positive and significant effect on risk governance of the banks, which invariably enhance the performance of the Microfinance institutions (MFIs) at large. Furthermore, the internal control mechanism instituted by the regularity authority and the Board of Directors has enhance EWRM practices and MFBs performance. The study therefore recommends the effective implementation of CBN Risk Management Framework for Microfinance Institutions to assist the MFIs identify their risk exposures with a view of monitoring and controlling them.

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