



**MODERATING EFFECT OF RISK GOVERNANCE COMMITTEE BETWEEN
BOARD INDEPENDENCE AND FINANCIAL PERFORMANCE AMONG
NIGERIAN LISTED FINANCIAL INSTITUTIONS**

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Abstract

The risk governance committee establishes risk strategy, reviews risk reports and provides enterprise risk management advice to board members. Though research on board independence is has established the influence on firms' financial performance, there are concerns as to its extent. This study examines the moderating role of risk governance committee on the relationship between board independence and financial performance of listed financial institutions in Nigeria for the period of 2016-2020. The population of the study comprised of 57 financial institutions listed on the Nigerian Stock Exchange as at December 2020 from which a sample of 47 firms was used. Multiple regression technique was employed for data analysis. The results show that board independence and risk governance committee have insignificant relationship with financial performance but significantly moderates the relationship between board independence and financial performance of listed financial institutions in Nigeria. The study recommends that financial institutions in Nigeria should strengthen risk governance committee and encourage more number of knowledgeable outside/independent directors. This is because the presence of a strong risk governance committee could improve the efficiency of the firm's financial performance.

Keywords: Board independence, agency theory, moderating, financial institutions, performance and significance

INTRODUCTION

Corporate stakeholders such as shareholders and creditors largely depend on financial performance of firms to count their benefits or losses. For instance, good returns from investments are essential to investors and signify a well-performing firm. The creditors may be delighted to continue to maintain business relationship with well performing firms. Therefore, the financial performance of an institution is important to its viability implying that any form of performance malfunction may have a negative consequence on liquidity,



and leads to eventual closure or suspension of operations of the firms (Ogbeide & Obaretin, 2018).

Although, the Nigerian economy has suffered considerably due to large dependence on oil and gas activities amongst other reasons, financial institutions seem to survive over time with a few ones being either suspended or closed down. This has also been attributed to their resilient performance under difficult economic circumstances. However, the Central Bank of Nigeria (CBN) acclaimed that corporate governance in the financial sector faced considerable challenges as a result of economic slump connected to corporate governance infractions such as concealed losses and other factors (CBN, 2020). Poor corporate governance has a detrimental impact on firm performance (Ponnu, 2008; Singh & Gaur, 2008).

Board governance is essential, and there is a large body of work on the relationship between board and firms' financial success, (Mishra, 2017; Isik & RizaInce, 2016; Zemichael & Basazinev, 2010). Evidence of inconsistent literature on board and firms' performance led scholars such as Gordon, Loeb and Tseng (2009) and Hafizuddin-Syah, Abdul-Hamid, Janor and Yatim (2014) to suggest the inclusion of contingent variables to strengthen the relationship. On this, Bromiley et al., (2014) and Okoye et al., (2017) recommended risk governance committee in order to improve risk culture and risk architect of the board as it evaluates, tracks and reviews the principles, practices, procedures, systems and regulations of risk management strategies in an institution.

In addition, many researchers argued that risk governance committee attributes and financial performance presented mixed and conflicting results even as theories of risk management are globally becoming more important (Elamer & Benyazid, 2018; Malik, 2017). Interestingly, the contrasting results warrant further research. Meanwhile, studies done in Nigeria seemed to have focused on risk management committee in banking sector (Kakanda, Salim & Chandren, 2017; & Jimoh & Attah, 2017) making it difficult to produce a convincing results, and hence, the need for studies to embrace the entire financial institutions in Nigeria. Therefore, this study examines the relationship between one board governance feature and financial performance of listed financial institutions in Nigeria. It also attempts to unravel the moderating role of risk governance committee on the nexus between board independence and financial performance of financial institutions in Nigeria. In view of the above, therefore, the following research hypotheses are stated in null form:

- i. H_{01} : There is no significant relationship between board independence and performance of listed financial institutions in Nigeria



- ii. H₀₂: There is no significant relationship between risk governance committee and performance of listed financial institutions in Nigeria
- iii. H₀₃: There is no significant moderating effect of risk governance committee between board independence and performance of listed financial institutions in Nigeria

LITERATURE REVIEW

Conceptually, board independence is the ratio of non-executive directors to the total directors on the board (Moghaddam, Shakeri, Amani and Kakhki, 2014). It defines the number of non-executive directors on board divided by the total number of directors (Ibadin et al., 2012). Directors who are independent tend to pay more attention to performance, since they are more concerned with the company than with personal gain (Zabri et al., 2016). They also focus on the company's work for more benevolence and continuity.

As one of the concerned parties, non-executive directors are mainly interested in monitoring behaviour (Higgs, 2003). For this reason, Palaniappan (2017) revealed that the more the number of non-executive directors on the board, the greater its effectiveness in monitoring management decisions. Consequently, the efficiency of firms increases. Furthermore, there may be greater objectivity on the part of the non-executive directors who may consider and take into account different stakeholders when making recommendations in their report (Gao & Kling, 2012).

The risk management committee (RMC) establishes risk strategy, reviews risk reports and provides enterprise risk management advice to board members (KPMG, 2001). In the era of increasing concern about sustainable development, the function of the RMC has gained more recognition for managing sustainability risks and opportunities. It is a governance support mechanism which assists board members to execute risk management duties. Similarly, risk management committee (RMC) is considered to be a sub-committee of the board of directors charged with overseeing the risk management functions of a firm (Halim, Mustica, Sari, Anojira and Sanusi 2017). Accordingly, corporate governance provisions in Nigeria allow board of directors of firms to establish RMCs to assist in exercising oversight risk function. Some academics opine that a strong committee of management may improve the efficiency of a company's operations. The process of risk management plays a significant role in the success of a business (Akindele, 2012; Edogbanya & Kamardin, 2015).



The concept of financial performance does not lend itself to one definition. To Iswatia and Anshoria (2007), performance is the function of the ability of an organization to gain and manage its resources in several ways to develop competitive advantage. According to Demsetz and Lehn (2004), the financial performance measures policies and operations of firms in monetary terms as depicted in their return on investment, return on assets, return on equity and value added. The financial performance measures firm's overall financial health over a given period, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. Rahman and Haniffa (2006) argued that financial performance of a firm determines its operating performance, and provides an overall picture of how a firm is performing over time as well as relative to others.

In measuring the financial performance of financial institutions, profitability measures such as return on asset (ROA) is usually recommended. This is because it combines both assets and equity. The return on assets depicts the map for decision making in investment and management processes (Shehu, 2017). It reflects the true and the most reliable stance and scenario of financial health of the company.

Board Independence and Financial Performance

Sheikh, Wang and Khan, (2013) studied Pakistani's board and found a negative association between the proportion of outside directors and corporate performance. This was attributed to the small number of outside directors on the board. But board independence ensured good corporate governance by companies. However, the study by Leung, Richardson and Jaggi, (2013) showed a positive relationship between board independence and firm performance in non-family firms due to the minority of independent directors in family firms as compared to non-family firms.

Also, Fitriya Fauzi and Locke, (2012)'s study produced a significant negative association between the number of non-executive directors and performance of companies listed on the New Zealand Stock Exchange from the period 2007-2011. This implies that the greater in the number of non-executive directors on the board, the lower the firm performance. The negative association might be connected to high block holders' own which makes non-executive directors become powerless in board discussion. Foo and Zain (2010) studied the sample of 481 Public-Listed firms in Malaysia at the end of the year 2007 for board independence, board diligence and liquidity. They found a significant positive association between the non-executive directors and return on assets. The non-executive directors on the board could ensure that management uses the company's assets efficiently to generate income.



The study in India showed that by having board independence did not guarantee improvement of firm performance due to poor monitoring roles of independent directors (Garg, 2007). One of the vital roles of independent directors is to monitor the company's performance and operation. Effective monitoring mechanism in the firm could reduce agency problems. Thus, the company should appoint independent directors who could exercise proper oversight function in monitoring governance, internal control and risk management. Langat (2006) carried a cross-sectional survey to examine the different governance structures that existed between three categories of companies: poorly performing growing performance stable performance over the period 2001-2005. Langat's study targeted 47 firms listed with the Nairobi stock exchange for a five-year period. The study presented an improved performance for firms that had outsider-dominated boards.

Abdullah (2004) measured the relationship between the percentages of independent directors at 412 Companies in the Main Board of KLSE with the firm's performance. It showed positive and significant correlation with returns on assets, profit margin and earnings per share. From that finding, it showed that the board's independence might contribute to the effective performance of a firm. It showed evidence that the high number of independent directors on the board influenced the company's financial performance. Therefore, it is essential to have independent directors on the board since it resulted in better firm performance. This is parallel to the functions of the independent directors to maximize shareholders' wealth.

From the empirical studies above, it is evident that research on board independence and performance produced somewhat mixed results. There is need therefore to have more studies to validate or point to new direction on this area by introducing moderating element.

Risk Governance and Financial Performance

Empirical study by Elamer and Benyazid (2018) considered the risk committee's impact on the financial performance of UK financial institutions. The sample included 23 listed financial institutions for the period 2010 to 2014. Ordinary least square (OLS) regression model was employed; the explanatory variables comprised risk committee (existence, size, meetings and independence), firm size, liquidity, gearing, audit quality and year dummies whereas the explained variable was the return on assets (ROA) and return on equity (ROE). The results suggested a negative association between the risk committee characteristics and the financial efficiency. The results also indicated that firms with no risk committee performed considerably well in comparison to companies with risk committee. Also, Malik (2017) studied enterprise risk management (ERM) and firms' performance: role of the four year risk committee, 2012 to 2015 in the UK. The test consisted of 260 business- year



evaluation and the application of regression used to analyse the relationship. The study revealed that ERM significantly and positively affects the firm performance. In addition, the presence of size in the risk committee has a positive but weak influence on the performance relationship with ERM.

In addition, Battaglia and Gallo (2015) used data from the Asian financial sector that focused on Indian and Chinese banks to establish the relationship between boards of directors with risk management mechanisms related to CFP during the financial collapse of 2007–08. No substantial link between productivity and RC size was disclosed in the tests. However, study by Kallamu and Saat (2013) who investigated the effect on financial efficiency of the corporate governance system by collecting data from 37 FIs listed in the financial sector in Malaysia, showed that there is a positive relationship between the RC size and CFP. Hoque, Islam and Azam (2013) published another analysis in this respect and found a strong negative correlation between the scale of RC and financial performance (FP).

In Nigeria, Abubakar, Ado, Mohammed and Mustapha (2018) worked on the impact of skills of risk management committee and financial board information on the financial performance of listed banks in Nigeria; The study's population and sample size comprised fourteen (14) banks listed on the Nigerian Stock Exchange floor for a period of three years (2014- 2016).The study used secondary data and random effect was adopted in analysing the data. The results of the study revealed that risk management committee independence and board financial knowledge exhibit a significant negative effect with ROA while risk management committee size has a positive insignificant effect on ROA. The study recommends that the board should include more independence directors and more of board financial knowledge as these lead to banks performance.

Similarly, Jimoh and Attah (2017) studied on risk management committee attributes and bank performance in Nigeria. For the purpose of the study, the sample included 15 listed banks on the floor of the Nigeria Stock Exchange. The evidence was primarily secondary with implementation of multiple regression techniques. The study found that all variable risk governance except the size of a risk committee is positively related to returning on assets as indicators of bank performance. Accordingly, the study advises that risk committee leaders be adequately encouraged, meet more regularly, have more independent directors and more financial and risk experts as all of these contribute to improved bank results.



Kakanda, Salim and Chandren (2017) had investigated the risk committee characteristics and market performance: Empirical Evidence from listed financial service firms in Nigeria. The research statistical population consisted of those Nigeria stock exchange 45 listed financials service firms analysed from 2012 to 2016. By taking RMC characteristics and market performance as variables and to analyse data and test hypotheses of the present research, descriptive statistics method and panel corrected standard errors (PCSEs) regression model was used. They concluded that risk management size has a significant but negative impact on firms' performance while RMC composition and RMC meeting have a significant positive effect on FP as expected by their hypothesis

Theoretical Review

The theoretical basis for this study is the agency theory. The agency theory is concerned with the relationship between the principals and agents. The principals are the shareholders while the agents are the firm's executives and managers. In the theory, shareholders who are the owners or principals of the company, delegate business responsibility to the executives (Abdullah & Valentine, 2009). Therefore, shareholders expect the agents to act and make decisions in their interest as principals. The managers have the duty to take actions that can positively increase returns to the shareholders. On the contrary, due to information asymmetry, the agents may not necessarily make decisions in the best interests of the principal, leading to agency problem (Jensen & Meckling, 2004). There is therefore a need for protecting the interests of owners in order to minimize agency problem. This is by monitoring the activities of CEOs through effective board of directors (Donaldson & Davis, 1991).

In order to mitigate agency issues, the company's supervision management system might be used. According to this theory, conflicts of interest and information asymmetries that emerge inside a firm may be minimized by implementing an appropriate monitoring process that aligns the interests of the many actors within the organization. A decent board structure is one of the instruments that are employed. Agency theorists acknowledge that there is a maximum number of councils that may be formed (Huse, 2007). Jensen (1993) recommends a limit of around eight directors, arguing that a greater number would interfere with group dynamics and reduce the effectiveness of the board of directors' decision-making process.

The number of independent non-executive members of the board of directors, rather than the size of the board, is important in determining success (Dalton, Daily, Johnson & Elstrand, 1999). In line with the argument of agency theory, Byrd and Hickman, (1992) contributed that a board with a higher proportion of outside independent directors



outperforms a board with a lower proportion of outside independent directors because a board with a higher proportion of outside independent directors could be more effective in monitoring and controlling managerial actions. Furthermore, a significant number of independent outside directors tends to increase the board's independence and enable it to properly fulfil its supervisory responsibility (Donaldson & Davis, 1991).

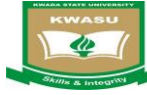
Stronger corporate governance framework promotes management supervision and decision-making, while also reducing managerial expropriation and wastage. As a result, operational performance and market value are both improved (Renders et al., 2010). The logic for this is that independence is more likely to provide greater monitoring of the management team and lead to enhanced overall performance. Independent directors are often regarded as superior managers' monitors since they have a significant interest in the firm's performance value maintaining their personal reputation in the directorship market (Fama & Jensen, 1998).

The agency theory asserts that governance committee assesses and monitors risks identified by management, as well as assures compliance with business policies and plans, and communicates results to the main board of directors (Alles et al., 2005). Boards that create a stand-alone committee to concentrate exclusively on the risk role shows their commitment to strengthening the overall corporate governance structures of their companies and invariably better performance (Yatim, 2010). Based on the above picture, this study aligns with the agency theory by employing governance committee factor as a moderator of influence between board independence and financial performance.

METHODOLOGY

More specifically, this study examines the moderating effect of risk governance committee on the relationship between board independence and performance of financial institutions in Nigeria for the period of 2016 to 2020. The correlational design was adopted because it is appropriate in establishing the extent to which risk governance committee moderate the relationship between board independence on financial performance of financial institutions in Nigeria. The design is informed by the research paradigm of positivism. The population of the study consists of 57 financial institutions listed on the Nigerian Stock Exchange (NSE) as at December, 2020. Based on availability of data, the sample working population was 47 listed financial institutions, which data were documentarily obtained from the annual reports and accounts.

The census sampling technique is used based on such criteria as: the firm must be listed on the NSE one (1) year before 2016; firm must not be delisted during the period of study;



and availability of data in the annual financial reports of the firms for the period under study i.e., 2016-2020.

For data analysis, the research employed panel data multiple regressions. Further diagnostic tests were conducted to ensure the analysis is best linear unbiased estimate and that appropriate techniques were selected for the interpretation (Wooldridge, 2012). The multi-collinearity test is also performed. Thus, the regression is presented in general as follows:

Where Y_i is the dependent variable; is constant of the model when all independent variables are said to be zeros. X_{1i} , X_{2i} and are the independent variables of the model and “i” is individual company for the estimation and finally e_i is residuals of the model.

Based on the model of this study therefore, the study consists of the dependent, explanatory and moderating variables. The dependent variable being financial performance is proxied using return on asset (ROA) as supported by Borlea et al., (2017) and Utama (2017), while the explanatory variables are represented by ; board independence (BIND) (Bhatt & Bhatt, 2017), measured by dividing the total number of non-executive directors by the total number of directors on board; and finally, risk governance committee (RGC) measured using dichotomy of 1 if the firm has risk governance committee and 0 if otherwise (Mourad & Suhaimi, 2020).

Based on these variables, the following regression model has been formulated:

$$ROE_{it} = \beta_0 + \beta_1 BIND_{it} + \beta_2 RGC_{it} + + \beta_3 BIND * RGC_{it} + e_i$$

The regression model was first estimated by the panel regression as technique which provides a consistent estimate as β_0 is the intercept and β_{1-3} are the slopes in the case of this study since the data is panel in nature.

RESULTS AND DISCUSSIONS

This section provides the results from the data analysis carried. Some discussion has been made to also interpret the findings. Therefore, table 1 shows a descriptive statistical result as follows:



Table 1 Summary of Descriptive Statistics

Variables	Mean	Std Dev	Minimum	Maximum
ROA	.019	.06	-.2	.16
BIND	.704	.134	.36	.93
RGC	.463	.499	0	1

Source: Summary of STATA OUTPUT, 2021

Table 1 summarizes the descriptive statistics of the dependent and independent variables for the selected financial institutions. The rate of return on asset (ROA) is roughly 0.02 per cent. This image indicates a bad performance throughout the time period under consideration. The ROA calculates the contribution of net income per naira invested by the firm's shareholders, which is a measure of the efficiency of the owners' invested capital. ROA has a minimum and maximum value of -0.2 and 0.16, respectively. That is, the most lucrative financial institution received N0.16 in net income from a single N1 asset investment, whereas the largest losses experienced by the financial institution are -N0.2 for each N1 asset investment. The standard deviation of ROA is 0.06, indicating a significant level of variability between financial institutions. On the other hand, the average of board independence (BIND) as measured by the number of non-executive directors to total board size is 70.4 per cent, with a standard deviation of 0.134, indicating that the number of non-executive directors to total board size varies little across financial institutions. The lowest and highest proportions are 36% and 93%, respectively. The risk governance committee (RGC) average is 0.463, with a standard deviation of 0.499, as evaluated by the dichotomous of 1 and 0. The lowest and maximum values are one, indicating that some organizations do not have a risk governance committee, and one, indicating that some firms do. The standard deviation of 0.499 indicates that the sampled firms are widely dispersed.



Correlation Matrix

Table 2 shows the summary of correlations between the dependent and independent variables.

Table 2 Pairwise correlations

Variables	(1)	(2)	(3)	(4)	(5)	VIF
(1) ROA	1.000					
(2) BIND	-0.106 -(0.106)	1.000				1.078
(3) RGC	0.048 (0.468)	0.059 (0.365)	1.000			1.652
(4) BIND_RGC	0.021 (0.755)	-0.250* (0.000)	-0.101 (0.122)	1.000		2.894
					Mean	1.874

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

The dependent variable performance and two independent variables BIND have negative correlation. However, RGC and BIND_RGC have positive correlation. From the correlation matrix therefore, relationship among the independent variables tend to have weak correlation thus, prove to be collinearity free. To consider the collinearity issues, this study conducted variance inflation factor (VIF) test, the results of which provide evidence of the absence of collinearity. This is because the results of the VIF test ranges from a minimum of 1.078 to a maximum of 2.894 which are all less than 5 hence the absence of collinearity among the explanatory variables.

The study conducted a panel corrected standard error (PCSE) to overcome possible heteroskedasticity issues. Thus, the results are presented in table 3.

Table 3: PCSE Regression Results

Dependent Variable ROA					
Ind. Vars		Std error	Z	Sig	
Constant	.0025818	.0000108	238.42	0.000	R ² = 0.8970 P= 0.000
BIND	-0.00012	.0000826	-1.57	0.117	
RGC	8.42e-06	.0000106	0.79	0.428	
BIND_RGC	.2532437	.0590362	4.29	0.000	

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$ %



Source: Summary of STATA OUTPUT (2021)

The table 3 shows the results obtained from the PCSE regression. The R-squared coefficient of determination was 0.8970, indicating that approximately 89.70% of the variation in ROA as approximated was caused by variations in the independent variables explained by the model. This means that BIND, RGC, RGC_BIND_ together accounted for 89.70% of change on ROA of Nigerian listed financial institution firms and it is statistically significant at 1% as indicated with a p-value of 0.0000.

From the Table 3 above, there is clear statistical evidence of insignificant relationship between the board independence, risk governance committee, and performance if one considered the p-value 0.832, 0.117, and 0.428 respectively. This means that the variables are statistically insignificant. On the basis, therefore, we fail to reject the null hypotheses which stated that board independence and risk governance committee do not have significant relationship with financial performance of listed financial institution firms in Nigeria.

In respect of moderation, the results provide statistical evidence that risk governance committee moderates the relationship between board independence and firm performance positively. This because, the parameter of the said relationship is positive and statistically significant at 1% as seen in Table 3 above where the parameter is 0.2532437 and the P-Value is 0.000. This implies that, as the number of the non-executive directors increase by one with corresponding increase in risk governance committee, the financial performance of the firms in Nigeria improves with econometric assumption of all things being equal. These results support the study by Imoh and Attah (2017) whose recommendations amongst other include that risk committee heads be sufficiently encouraged, that they meet more often, that they have more independent directors, and that they have more financial and risk professionals on their committees. However, this study clearly contrasts with Elamer and Benyazid (2018) whose results indicated a negative and insignificant influence of risk committee on performance of financial institutions in the United Kingdom.

CONCLUSION AND RECOMMENDATIONS

The objective of this study is to demonstrate that risk governance committee moderates the relationship between board independence and performance of financial institutions in Nigeria for a period from 2016 to 2020. Though board independence negatively and insignificantly relates to financial performance of Nigerian financial institutions, risk governance committee was found to have positive but insignificant moderating the relationship between board independence and financial performance of financial institutions in Nigeria.



Specifically, the results revealed that risk governance committee significantly moderates the relationship between board independence and financial performance. This is due the fact that effective risk governance committee is believed to place more pressures and controls on financial institutions management in order to improve the quality of risk management procedures and policies, as well as improve risk management communication among various stakeholders, including management and the board, so as to reduce agency conflicts. This means that firms that are limited by excessive risk are less lucrative, and they are also more likely to have a separate, larger, and risk committee. Hence, this study concludes that board independence influence firms' performance due to the presence of risk committee which is same as board independence. The study further concludes that risk governance variables are likely to increase and enhance the performance of firms used in this study. The study therefore recommends that, there should be considerable increase in the number of risk governance committee along with the number of non-executive independent directors. This is because with a strong risk committee in place, it is possible to improve the efficiency of the company. The process of risk management plays a significant role in the success of a business.

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