Financial Risks Management and Bank Profitability in Nigeria: Case of Access Bank of Nigeria Plc

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Abstract: **The study examined financial risk management and bank profitability in Nigeria. With the aid of a well-structured questionnaire data were drawn from a convenient sampling technique; a sample size of 56 management staff of Access Bank of Nigeria Plc. Simple linear regression was used for the test of hypotheses using statistical package for social science software version 20. The study revealed that; there exist a significant positive effect of liquidity risk, credit risk, interest risk and inflation risk on return on assets of Access Bank Nigeria Plc. Based on the findings, it was recommended among others that banks should take proactive measures aimed at curbing financial risks as this will have a positive effect on their profit.**

Keywords**: financial risk, risk management, bank profitability.**

I. INTRODUCTION

Over time, individuals, organizations and governments have been confronted with different unfortunate events occasioned by fire, burglary, social disruptions, environment degradation and life itself, all this, are examples of the risks which we faced and banks are not exceptions. It is not often possible to eliminate these risks, but the possibility of a loss can be mitigated by changing some of the circumstances relating to the loss. Because of the peculiarity of financial institutions as engine growth of a country's economy, it has become more germane for banks to manage effectively the various types of risks which they confront, including but not limited to market risk, credit risk, liquidity risk, interest rate risk and inflation risks. In a bid to reduce this risk, banks should develop risk management strategies through an effective risk management framework. A risk management framework as defined by ISO Guide 73 is a set of components that provide the foundations and organizational arrangements for designing, implementing, monitoring, reviewing, and continually improving risk management throughout the organization. From the foregoing definition, strategic planning and organization operational policies should be enclosed with its risk management framework to enhance smooth decision making and actualization of the organization goal. According to Pandey (2004), to effectively manage risk does not mean to completely eliminate the different inherent risks common to an organization. For instance, the function of banks in advancing credit to customers has an inherent risks of possible default in repayment (credit risk) or loan delinquency but by accepting to take the risk, banks are able to charge interests for their risk taking activities which signals a profits to them. Imona (2012) stresses that exposing banks to financial risk is between acceptable limit enabling the bank to achieve a high income at the same time. Sequel to the above, risks are therefore, a necessary pathway for profits to bankers.

In the Nigeria financial system, risk management has not yielded much result to increase profitability; this is due to challenges manifesting from bad judgment, insider loans and advances, insensitivity of economic trend and environmental trend, and inadequate risk management policy (Christopher, 2019) put in place by the banking operators. It has become a norm in Nigerian banks to extend loans and advances to family relations, politician, friends and directors without proper appraisals. This unethical misconduct has led to series of bad debts caused by inadequate recovery procedures which has led to the inability of these banks to collect loans and advances extended to these categories of stakeholders hence leading to banking distress. Furthermore, Ogunleye (2001) observed that ignorance and negligence of regulatory guidelines and frameworks required to mitigate these risks by bank management contribute to risk. In Nigerian banks, some management teams, board member inclusive are either ignorant of risks inherent in banking operations or have total neglect for regulatory guidelines that isolate the banking operations from potential losses.

The most relevant issues in banking industry are performance and risk issues. Risk management does not stand in isolation, because risk is a parameter that can Influence other conditions in firm such as profit and efficiency (Hoseininassab, Yavari, Mehregan, & Khoshsima, 2013). Since banks represent a major player in the Nigeria economy, its risk management practices are crucial issues that need to be examine. Therefore, based on the foregoing, this study is out to give an insight on how effectively financial risk management can be put in place to increase profitability in Nigeria banking industry.

The major objective of this study was to examine the effect of financial risks management on the performance of Access Bank of Nig. Plc. while the specific objectives are to:

i) To investigate the effect of liquidity risk on ROA of Access bank Nig plc.
ii) Examine the effect of credit risk on ROA of Access bank Nig. Plc.
iii) Investigate the rate at which interest rate risk affect ROA of Access bank Nig. plc.
iv) Evaluate the extent at which inflation risk affect ROA of Access bank Nig. plc.

II. LITERATURE REVIEW

2.1 Theoretical framework

Finance distress theory

This theory is proposed by Baldwin and Scott (1983) who state that when a firm business deteriorates to the point where it cannot meet its financial obligation, the firm is said to have entered the state of financial distress. The first signals of financial distress are violations of debt payments and failure or reduction of dividends payouts. Wruck (1990) stated that firms enter into financial distress as a result of economic distress, declines in their performance and poor management especially on risks. In the case of deposit money banks, the bank inability to provide cash to depositors and loans to borrowers as and when demanded may constitute a liquidity crisis and poor asset. Thus this theory emanates from the liquidity and credit risk facing a firm. This theory provides for an unprejudiced view on the relationship between financial risk management and profitability variables employed by the study. By providing information that the effects of financial distress occurs prior to risk, the theory offers an unbiased avenue to undertake a clear-cut empirical analysis of this relationship within the commercial banks.

2.2 Conceptual framework.

2.2.1 Bank profitability

Bank's profitability is of vital importance for investors, stakeholders and the economy at large. The profitability of banks lies in their ability to achieve its objectives using its available resources. The available resources such as money, men, machines, capabilities and skills needs proper appraisal and evaluation which is done systematically in determining the achievements of the company's objectives (Amelia, 2002). For, banks, the indicators of its profitability are cost-to-income ratio, return on asset (ROA), return on equity (ROE), interest rate spread etc, in this study, our focus on bank profitability will be ROA. This is because ROA is the most sustainable measure of efficiency and it is also suitable in revealing how effectively and efficiently a bank utilizes the total asset at its disposal. Bank profitability of an organization does not just plays the function to raise the market value that particular organization but also direct development of the financial sector which finally leads to success of market specifically for banking business and its function as an engine of financial development. In relation to this work, ROA is used to represent profitability.

2.2.2 Financial risk management

Risk management are coordinated activities aim at controlling risk. Risk management according to Res, Sa, & Gemechu (2016) consists of a series of steps, which allows for continuous improvement of decision making by establishing the context, identifying and analyzing deviations, monitoring and communicating risks in an organization. The primary goals of managing financial risk are to identify measures to mitigate the risk and more importantly monitor the profile of the bank (Soyemi, 2014).

Kambi & Ali, (2016), Stephen & Akele, (2014), Yousfi, (2014), Ghani, (2015), Res, Sa, & Gemechu (2016), Oluwafemi, Israel & Simeon (2013), Olamide, Uwalomwa, & Ranti, (2015) posited that risk management play an important role in determining the overall profitability of banks. According to Yousfi (2014), the risk arising from the bank's inability either to meet its obligations or to invest fund increases in assets as they fall due is known as liquidity risk. Form this definition it's obvious that liquidity risk doesn't mean just the shortage in financial resources but also the excess of these unused funds. Thus, with a proper risk management, a bank should be able to effectively undertake 'gap management' that is maintaining a reasonable match between the average maturities of the sources and uses of funds (Christopher, 2019). Further, banks are confronted with the risk of repayment default of loan; also known as credit risk. Credit risk may arise from either an inability or unwillingness on the part of the borrower to perform its obligations (Anthony & David, 1997). Gray, Cassidy, & RBA (1997) state that credit risk is the biggest risk faced by banks and financial intermediaries. The indicators of credit risk include non- performing loans, problem loans or provision for loan losses (Jiménez & Saurina, 2006). Additionally, Yimka, Taofeek, Abimbola & Olusegun (2015) state that credit risk is caused by, low capital and liquidity levels, directed lending, massive licensing of banks, poor loan underwriting, reckless lending, poor credit assessment, no non-executive directors, poor loan underwriting, laxity in credit assessment, poor lending practices, government interference and inadequate supervision by the central bank. Other types of risk which are external to a bank may include inflation risk, market risk, exchange rate risk, political risk etc.

2.2.3 Profitability and risk in commercial banks

Bank profitability from the shareholders perspective is the difference between revenue and costs, this indicates that the goals of bank management is to obtain profit by maximizing revenue and minimizing costs. However, profitability in banks inclined by risk can face certain impediment such as changes in the regulatory framework, economic upheavals, political disturbance and other bank specific factors; that would affect banks from obtaining desired performance (Bikker & Boss, 2008). The performance of banks globally is characterizes by its overall profitability which is correlated with the risks taken by the bank concerned (Olteanu, 2003). The global performance of a bank is given by relationship between profit and risk. In the financial statements of a bank, they are financial indicators calculated that are closely related to the risk assumed by the bank such as CAR. Because the control of banking risk is a factor that depends on bank's profitability (Stoica 1999), banks grant special attention to permanent monitoring indicators which expresses efficiency of banking activities and analyzing their effectiveness in close interdependence with the bank's exposure to risks or potential risk that can jeopardize the activity.

2.3 Empirical review

Empirical studies exist on the nexus between financial risk management and the profitability of commercial banks. In Nigeria, empirical literature by Lasisi and Mustapha (2008) investigated financial risk management and profitability of banks in Nigeria. The study adopt ex-post facto research design using 14 Commercial Bank for the analysis. Findings reveals that return on asset (ROA) has a significant relationship with liquidity risk and capital adequacy risk while credit risk is negatively related to (ROA). It is concluded that if liquidity and capital adequacy risk is properly managed it has the tendency of increasing commercial bank profitability. Also, Thomas and Oladele (2014) carried out a research on risk management in Nigeria banking industry using the population of 23 commercial banks in Nigeria and a sample of one commercial bank (First Bank of Nig. Plc.). The questionnaire descriptive research design was adopted using a sample of 88 respondents. Findings reveals that fraud and forgeries in banks constitute a risk factor to banks performance and is therefore playing an adverse role in its activities.

International literature by Anthony and Shence (2018), investigated the impact of risk factor on financial performance of the commercial banks in Barbados using multiple regression model as the analytical tool. Findings reveal that capital risk and interest rate risk has a strong positive relationship with Return on Asset (ROA), while credit risk, liquidity risk and operational risk is negatively related to dependent variable (ROA). Based on the findings it was concluded that the influence of risk factors is generally stronger than that of the external variables as a result the manager must improve on it risk management practices in order to enhance its profitability. Additionally, Imona (2012) examine financial risk analysis for commercial banks in Romania banking industry using descriptive research analysis as the research design. The result from the analysis show that credit risk has a positive relationship with return on asset (ROA), liquidity risk has a negative relationship with ROA and also interest rate risk was negatively related to return on asset (ROA). It was concluded that the exposure of banks to the man type of financial risk is between acceptable limit enabling the bank to achieve a high income at the same time. Thus credit risk having a positive relationship invariable increase the shareholders dividend since it profitability is increased. Yuosif (2014) assessed the impact of risk management practices on Jordian. Islamic banks performance for the period of 15 years from 1988 – 2012. A cross sectional data was analysed using descriptive statistics to default pattern and robust standard errors OLS regression to estimate the significant influence between bank risk management practices (credit, liquidity, operating and capital risk) and their financial performance (ROA and ROE) finding reveal that liquidity, credit and operational risk management practices have a significant and negative statistical impact on performance and capital risk management practices have a positive and significant statistical impact on bank performance (ROA and ROE).

III. MATERIALS AND METHODS

The study employed the survey research design in examining the relationship between financial risk management and bank profitability in Nigeria: case of Access Bank Nigeria Plc. The survey research design was appropriate for the study since it allows for the use of survey tool such as questionnaire in data collection for the study. The population of 23 commercial banks in Nigeria and a sample of one commercial bank (Access Bank Plc.) was used. A sample size of 56 management staff was selected using the Taro Yamane formula.

Data for this study were gathered from both primary and secondary sources. Primary data were sourced with the aid of structured questionnaire while the secondary data for the study were sourced from bank financial statement. With a well-structured questionnaire titled: Financial risk and bank profitability in Nigeria (A case study of Access Bank Plc). This study employed tables and percentages as the analytical techniques. Data were analyzed and test of hypothesis were carried out using simple linear regression. The hypotheses formulated for the study was tested and validated and using the simple linear repression technique with the aid of Statistical Package for Social Science (SPSS) software version 20.

3.1 Model Specification

The regression model is specified below:

$ROA=\boldsymbol{\alpha}_0+\boldsymbol{\alpha}_1LQR+ e$………………………………. (i)
$ROA=\boldsymbol{\alpha}_0+\boldsymbol{\alpha}_1CR+ e$ ………………………….…….(ii)
$ROA=\boldsymbol{\alpha}_0+\boldsymbol{\alpha}_1INTR+ e$ ………………...…………(iii)
$ROA=\boldsymbol{\alpha}_0+\boldsymbol{\alpha}_1INFR+ e$ ……………………………(iv)
Where,
ROA= Return on Asset
LIQR=Liquidity risk
INTR=Interest rate risk
INFR= Inflation risk
$\boldsymbol{\alpha}_{0=}$ Constant
$\boldsymbol{\alpha}_1$= Coefficient parameter
e =Standard error

IV. ANALYSIS AND INTERPRETATION

4.1 Data analysis

Test of Hypotheses

Hypothesis one:

Ho: There is no significant effect of liquidity risk on return on assets of Access Nigeria Plc.

H_1: There is significant effect of liquidity risk on return on asset of Access Bank Plc.

Table 1: Regression analysis for the effect liquidity risk on return on Asset of Access Bank Nigeria Plc

		Unstandardized	Std.	Std.	T	F	Sicg
Model		Coefficient	Error	Coefficient			
		13					
		3.184	0.073	0.944	40.307	1624.627	0.00
R	0.944	0.911	0.023				
R-square	0.901						
Adjusted R-square	0.891						
Constant (B)	0.911						
Durbin Watson	0.315						
df_1	1						
df_2	1.99						
Int. F-ratio	3.82						

Dependent variable = Return on Asset

The coefficient of determination R-square of 0.901 implies that 90.1 percent of variation in the dependent variable – return on asset was influenced by explanatory variable – liquidity risk while the remaining nine (9) percent was not explained by explanation variable.

The value of R-square is an indication of positive effect of liquidity risk on return on assets of Access Bank Nig. Plc. The adjusted R-square of 0.891 implied that the data fit the regression model. Durbin-Watson value of 0.315 revealed evidence of serial positive autocorrelation between the residual values. Based on the above estimates, the F-ratio value of 1624.621 was compared to critical value of (3.82) of 1 and 199 degree of freedom. The calculated F – ratio (1624.621) was significant greater than the critical F-table value (3.32), so the null hypothesis which stated that there is no significant effect of liquidity risk on the rate of return on asset of Access Bank Nig. Plc was rejected and alternative hypothesis which stated that there is significant effect of liquidity risk on return of asset of Access Bank Nig. Plc. was accepted. It was concluded that liquidity risk has significant effect on return of assets of Access Bank Nig. Plc.

Hypothesis Two

Ho: There is no significant relationship between credit risk and return on assets of Access Bank Nig. Plc.

H_1: There is significant relationship between credit risk and return on assets of Access Bank Nig. Plc.

Table 2: Regression analysis for credit risk on return on Asset of Access Bank Nigeria Plc

		Unstandardized	Std.	Std.	T	F	Sicg
Model		Coefficient B	Error	Coefficient			
		3.107	0.048	0.977	2.245	424.54	0.026
R	0.977	0.981	0.015		65.15		0.00
R-square	0.955						
Adjusted R-square	0.955						
Constant	3.107						
Slope (B)	0.981						
Durbin Watson	0.625						
df_1	1						
df_2	1.98						

Dependent variable = Return on asset.

The coefficient of determination R-square of 0.955 implied that 95.5 percent of variation in the dependent variable – return on asset was influenced by explanatory variable – credit risk while the remaining five percent was not explained by explanatory variable. The value of R-Square was an indication of a significant positive effect of credit risk and return on asset. The adjusted R-square of 0.953 shows that the data fits the regression model. The slope of 0.981 indicates that credit risk will affect return on capital. Durbin – Watson value of 0.625 reveals evidence of serial positive autocorrelation between the residual values. Based on the above estimates, the F-ratio value of 424.58 was compared to critical F-table value of 4.97 at 1 and 199 degree of freedom. The calculated F-ratio (424.58) was significantly greater than the critical F-table value (3.82), so the null hypothesis (Ho) which stated that credit risk does not have significant effect on return on asset of Access Bank of Nigeria Plc was rejected. Hence, the alternative hypothesis which stated that credit risk has significant effect on return on asset of Access Bank Plc was upheld. It was concluded that credit risk has significant effect on return on asset of Access Bank of Nigeria Plc.

Hypothesis 3:

Ho: There is no significant relationship between interest rate risk and return on assets of Access Bank of Nigeria Plc.

H_1: There is significant relationship between interest rate risk and return on assets of Access Bank of Nigeria Plc.

Table 3: Regression analysis for interest rate risk and return on asset

		Unstandardized	Std.	Std.	T	F	Sicg
Model		Coefficient B	Error	Coefficient			
		1.095	0.078		14.110	9855.313	0.000
R	0.901	0.718	0.025	0.901	29.246		0.000
R-square	0.812						
Adjusted R-square	0.811						
Constant	1.095						
Slope (B)	0.718						
Durbin Watson	0.205						
df_1	1						
df_2	1.99						
Int. F-ratio	3.82						

Dependent variable = Return on Asset

The coefficient of determination R-square of 0.812 indicated that 81.2 percent of variation in the dependent variable – return on assets was caused by explanatory variable-interest rate risk while the remaining 18.8 percent was not explained by explanatory variables. The value of R-square was an indication of a positive significant effect of interest rate risk on return of assets of Access Bank Nigeria Plc. The adjusted R-square of 0.811 shows that the data fits the regression model. Durbin-Watson value of 0.205 shows evidence of serial positive auto-correlation between the residual values. Based on the above estimate the F-ratio value of 855.313 was compared to critical F-value (3.82). So the null hypothesis (Ho) which stated that there is no significant relationship between interest rate risk and the return on assets of Access Bank of Nigeria Plc was rejected and alternative hypothesis which stated that interest rate risk has a significant relationship with return on assets was upheld.

Hypothesis 4:

Ho: There is no significant relationship between inflation risk and return of assets of Access Bank of Nigeria Plc.

H_1: There is significant relationship between inflation risk and return of assets of Access Bank of Nigeria Plc.

Table 4: Regression analysis for inflation risk and return on assets of Access Bank of Nigeria Plc

		Unstandardized	Std.	Std.	T	F	Sig.
Model		Coefficient B	Error	Coefficient			
		1.075	0.068		12.110	9234.56	0.000
R	0.781	0.598	0.023	0.801	23.231		0.000
R-square	0.663						
Adjusted R-square	0.661						
Constant	1.081						
Slope (B)	0.514						
Durbin Watson	0.101						
df_1	1						
df_2	1.99						
Int. F-ratio	3.73						

Dependent variable = Return on Assets

The coefficient of determination R-square of 0.66 indicated that 66 percent of variation in dependent variable in return on assets caused by explanatory variable – inflation risk while the remaining 34 percent was not explained by explanatory variable. The value of R-square was an indication of a positive significant effect of inflation rate on return of capital of Access Bank of Nigeria Plc. The adjusted R-square of 0.661 shows that the data fits the model.

Durbin-Watson value of 0.101 shows evidence of serial positive autocorrelation between the residual values. Based on the above estimate the F-ratio value of 755.21 was compared to critical F-value (3.73). So the null hypothesis (Ho) which stated that inflation risk does not have significant effect on return of assets of Access Bank of Nigeria Plc was rejected of alterative hypothesis which stated that inflation risk has a significant effect on the return of assets of Access Bank of Nigeria Plc was upheld.

V. DISCUSSION OF FINDINGS

The major objective of this study was to determine the effect of financial risks management and profitability of Access Bank of Nigeria Plc. The efficacy of banks in contributing to the productivity of the economy affects its overall profitability and economic growth. Due to financial risk in Nigerian banks, many banks had difficulty in meeting their short term obligations. This has led to depositors' loss of confidence in the banking sector. Additionally, the increment of non-performing loan has caused a gross decline in the profitability of banks and invariably results into panic as they seemingly approach distress. When banks are aware of their financial risks, they will be able to minimize their losses.

From the test of hypothesis one, it was found that liquidity risk has significant effect on return of assets of Access Bank of Nigeria Plc. This implies that Access Bank Nigeria Plc finds it difficult to generate enough funds to meet up with short term financial obligation as at when due. This findings in line with that of Yousif (2014) and Thomas & Oladele (2014) who discovered that liquidity, credit and operational risk management practices have a significant and negative statistical impact on performance of banks in Nigeria. However, data analysis and test of hypothesis two revealed that credit risk has significant effect on return of asset of Access Bank of Nigeria Plc. This implies that there is risk of default on debts that may arise from borrower failing to redeem payments. This findings is not in line with Lasisi & Mustapha (2018) who found out that return on assets has a negative relationship with credit risk of banks.

Table 3 found that interest rate risk has a significant relationship with return on assets. This implies that the rate of interest that banks offer to customers has an element of risk, especially when interest are due for payment. High interest rate charged by bank(s) may pose a great risk to customers of banks. This findings is not in line with the findings of Anthony & Shence (2018) who investigated the impact of risk factor on financial performance of the Commercial banking sector in Barbados. The findings revealed that credit risk, interest rate risk and liquidity risk were negatively related to return on asset.

Finally, from the test of hypothesis four (4), it was concluded that inflation risk has a significant effect on the return of assets of Access Bank of Nigeria Plc. This implies that the rise in prices of commodities and service could also pose a risk of inflation to the operations of banks and customers. This will in turn affects return on profit for banks. This risk in the risk that cash from investment will not be worth in the future due to inflation changes. This is in line with Imona (2012) who discovered that inflation risk and operational risk affect banks profitability positively.

VI. CONCLUSION AND RECOMMENDATIONS

The study revealed that there was significant positive relationship between liquidity risk and performance of Access Bank of Nigeria Plc. Again, credit risk has significant positive effect on return on assets of Access Bank. Moreover, the interest role risk and inflation risk have positive relationship with the return on assets of Access Bank Nigeria Plc. The study concluded that the four variables used as independent variables – liquidity risk, credit risk, interest rate risk and inflation risk had a positive significant effect on return of assets of Access Bank Nigeria Plc. Based on the findings, the study recommended that:

1. That banks should developed stringent measures aimed at curtailing the problem of liquidity risk as this will have a positive effect on their profits.
2. Banks should focus momentously on loans and advances by developing strategies and adhering to monetary policies and framework that will curb the problem of non-performing loan.
3. Banks also should intensify efforts in establishing measures that are less disheartening and focuses on moderate interest rate issues to ensure minimum risk taken.
4. Banks should incorporate the risk of inflation (in terms of purchasing power) in their operational activities to enable them make returns.

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