

Modeling Risk Management in Banks: Examining Why Banks Fail

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Abstract

The aim of this research was to determine why there have been persistent bank failures in Nigeria and to investigate whether ineffective risk management in banks, coupled with poor corporate governance practices and nonadherence to regulations (independent variables), play a significant role in the banks' performance (dependent variable).

Problem

In view of the roles banks play in the economy, the persistency of bank failures in Nigeria, (almost in every decade) has been a major concern to government, depositors, shareholders, and the general public.

With the incessant bank failures in Nigeria, depositors are always losing part or all of their deposits. Shareholders lose their investments. Nigerian banking industry witness huge losses during the periods. The Government and Tax-Payers lose funds used in bailing out ailing banks. The threat on liquidity often cause systemic risk which is a threat to the payment system.

Some of the earlier identified problems associated with bank failures in Nigeria were: **capital inadequacy**, **lack of transparency** and **huge nonperforming loans**. These failures are not well understood, however.

Purpose

The purpose of the study was to determine why there have been persistent bank failures in the Nigerian banking industry and to know whether ineffective management of the inherent risks associated with banking operation, coupled with poor corporate governance practices and nonadherence to regulations, were the main reasons for banks' failures.

This can be achieved by Banks adopting the **Bow-Tie Technique** in managing the inherent risks in banking operation under an **ERM** environment.

Relevant Literature

These bank failures are mainly caused by **poor risk management** and **corporate governance issues** (Nanab et al., 2012).

Rosen and Zenios (2001) emphasized that corporate governance is vital for effective **enterprise risk management (ERM)** and few of the **ERM** components can be achieved without corporate governance compliance.

Corporate governance and risk management are interrelated and interdependent (Quon, Zeghal, & Maingot, 2012). The **stability** and **improvement** of any bank's performance are highly dependent on the effective role of both components (Manab et al; 2010; Sabel & Reading, 2004).

ERM has become increasingly relevant for managing corporate risks. In contrast to the traditional silo-based risk management, **ERM** looks at the bank's **entire risk portfolio** in an integrated and holistic manner. (Meulbroek, 2014).

Research Questions

RQ1: What are the major factors accounting for the consistent bank failures in Nigeria?

RQ2: What are the levels of contributions of ineffective risk management in banking operation, poor corporate governance and nonadherence to bank regulations as major factors accounting for the persistent bank failures in Nigeria?

RQ3: What is the relationship between risk management, corporate governance, regulation, and bank performance in the management of banks?

RQ4: What other silent factors—other than ineffective risk management, poor corporate governance and nonadherence to regulations—contribute to the persistent bank failures?

Committee

Chair: **Dr. Mohammed Sharifzadeh**,
Member: **Dr. Robert Aubey** and URR: **Dr. William Brent**

Procedures

Design: In view of the nature of the data, a **survey design** was chosen.

Participants: **300 senior Banks' Executives** completed the questionnaires. They were randomly selected from the **24 operating banks in Nigeria**.

Instrumentation:

• Questionnaires which I created, were the major instruments for collecting data, using both web-based and direct distribution channels. The questionnaires enquired about the bio-data of the participants and asked questions to fulfil the objectives of the study, covering the research questions and the variables.

• The databases of **CBN**, the Nigerian Deposit Insurance Corporation and that of **SEC** were relied upon for the basic secondary data used in the study.

Data Analysis

Linear multiple regression model was used for the study. The **SPSS** generated tables and figures gave leads on the relationship between the output variable **Y = ROE** and the other independent variables **VAR, CAR, CRO** and **NPM**. The task was to find whether the independent variables correlated with the outcome variable (**ROE**).

Findings

Ineffective management of the inherent risks associated with banking operation, coupled with poor corporate governance practices and nonadherence to regulations, were the main predictors of the persistent bank failures.

The major risks faced by banks in their operation can be grouped into five classes, which could assist banks in identifying these risks in their operations, measure them appropriately and put in place adequate control measures in managing them. **credit risk, liquidity risk, market risk, operational risk** and **solvency risk**.

A positive relationship was found between effective risk management, adequate corporate governance, adherence to regulations and bank performance in banking operations with the effect that any positive increase of any of the independent variables would have a positive effect on bank performance (**ROE**) as the dependent variable.

Limitations

The major limitation of the study was with data collection. For the primary data **80%** of the data were expected from Nigeria as the focal point of the study. The remaining **20%** expected from the foreign bankers in the **United Kingdom and United States** came also from **Nigerian bankers** working in those developed countries.

The expected benchmarking based on the experience of foreign bankers could not be achieved.

The trustworthiness, validity and reliability of the secondary data used in the study were the other major limitations.

Conclusions

Although other silent factors were observed, the combination of ineffective risk management in banking operation, poor corporate governance practices, and non-adherence to regulations appeared to be the root causes of the persistent bank failures in Nigeria.

A solution therefore lies in banks adopting contemporary risk management techniques (e.g., the Bow-Tie Technique) under an **ERM** environment, and allotting their available capital appropriately as a cushion against possible losses.

Social Change Implications

The positive social change implications of the study are

- the creation of effective risk management process in Nigerian banks to avoid their incessant failures and to guarantee the safety of depositors' funds in banks
- equally, to save the tax payers funds used in bailing out ailing banks by Central Bank of Nigeria.