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Board credit committee intangibles and risk management of banks

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Abstract

The purpose of this paper is to examine the association between Board Credit Committee Intangibles (BCC) and Credit Risk Management (CR) of the Sub-Saharan African banks. Data on 37 Sub-Saharan African (SSA) banks were collected for empirical testing. The result shows a significant association between BCC and CR. In conclusion, the profitability of sub-Saharan African banks is negatively associated with the credit risks of the banks. Statistically, the overall regression result in all three variants of the measurement of credit risk is significant. Thus, there is an association between the explanatory variable and the dependent variable of the study.

Keywords: Board, Credit, Committee, Risk Management, Banks.

Consejo de créditos intangibles y gestión de riesgos de los bancos

Resumen

El propósito de este documento es examinar la asociación entre los Intangibles (BCC) del Comité de Crédito de la Junta Directiva y la

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Gestión del Riesgo de Crédito (CR) de los bancos del África subsahariana. Se recopilaron datos de 37 bancos del África subsahariana (SSA) para pruebas empíricas. El resultado muestra una asociación significativa entre BCC y CR. En conclusión, la rentabilidad de los bancos del África subsahariana está asociada negativamente con los riesgos crediticios de los bancos. Estadísticamente, el resultado general de la regresión en las tres variantes de la medición del riesgo de crédito es significativo. Por lo tanto, existe una asociación entre la variable explicativa y la variable dependiente del estudio.

Palabras clave: Consejo, Crédito, Comité, Gestión de Riesgos, Bancos.

1. INTRODUCTION

Arguably, the US financial crisis of 2007–2009, also known as the global financial crisis exposed the inefficiencies of the banking regulations especially those governing credit risk. Many believed that the financial crisis of 2007 was even more damning than the great depression of the 1930s. During the crisis, the world economy was hit by a severe system breakdown that resulted from credit exposures of banks primarily due to the activities in the housing market. The crisis affected the banking system as well as the world economy, bringing about a huge number of individuals losing their employment, houses, and savings to the crisis. Financial/ banking system is the driver of the economic wheels of any capitalist economy which represents the engine and propellers in which economic growth and developmental thrive. More so, literature abounds with studies on the role of banks in the attainment of the overall developmental objectives of any nation (Almarri et al., 2007).

Among the major casualties in the crisis, includes; Enron, Parmalat, Bear Stearns, Citigroup, Lehman Brothers, Dexia, Transmile, Megan Media and Oilcorp. However, this unpleasant event turned out to be a redefining moment of increased attention for the need of a strict code of corporate governance in a financial/ banking sector. Although board credit committee (BCC)/risk management committee (RMC) performs a strategic role in monitoring risks in the banking industry, there is the only evidence of studies carried out to access the impact of BCC/RMC on credit risk (Athanassopoulos, 1997).

Therefore, the paucity of studies on the impact of BCC on credit risk is the keen motivator of the current research by examining the impact of the intangibles of BCC concerning credit risk management of the sub-Saharan African banks. Specifically, the paper examines the impact of committee independence, independence of the chairperson, size, and financial expertise, number of meetings and diligence of the committee members.

2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Until recently, the board audit committee performs the traditional duty of ensuring efficient risk management functions in financial institutions. However, the events that followed the economic crisis of the 2007/2008 forced regulators all over the world to demand

increased action from the board members. One of such demands was to improve vigor in the management of credit risk in the banking industry and also continue to monitor the market. Moreover, another reason that led to the establishment for a separate risk management committee is the fact that the audit committee tends to be overwhelmed in the day to day assurance services thereby often relegating the risk monitoring in banks (Bates & Leclerc, 2009).

For instance, the Enron audit committee and the entire board, as well as the external auditors, were all found to be negligent and culpable in the discharge of their professional duties of risk management. As a result of the negligence of the audit committee, the financials of the company were overstated for about four years which prompted other stakeholders to suspect insider dealings.

Moreover, the business of banking is all about the creation of risk assets which is unique and requires particular expertise and isolation from other forms of business risks that are generic, i.e., operational political, product, market, and compliance risks, etc. Thus, to safeguard special nature of bank's business some studies have recommended separation of risk from audit committee Burton (2008) With sound oversight of risk committee in place, the board exerts influence on the line managers to ensure that excessive risk-taking that could bring about huge loses to the financial institution are averted. Ntim (2009), suggests that the existence of board committees does not impact on the performance of companies in the South African economy. Meanwhile, Subramaniam et al. (2009) observed that the

existence of a separate risk committee is associated with the size of the boards, risk exposures and organizational organogram and the nature of operations of the firm.

The position of Ntim (2009) is that where risk committee exists in an organization, there is a higher probability that such companies will report higher performance. Thus, they conclude that the size of a risk committee is positively associated with performance. Independence of the committee is determined by the presence of independent and non-executive directors in the composition of the committee. The composition of the board committees is usually made up of the executive, non-executive and independent directors regarded as the proxy shareholders in the affairs of the company. The agency theory and resource-based theory suggests that there should be more of the non-executive and independent directors in the composition of the board committee. It is therefore expected that the larger the proportion of independent and non-executive directors in a committee, the more likely that the committee will be able to monitor the firm's financial performance effectively.

It is firmly believed that such committees will be more active, function better, and well governed. Confirming the position of agency theory, Ntim (2009) believe that audit committee that was hitherto in charge of risk management functions with a higher proportion of independent directors stand a better chance of motivation and free will to supervision and curtailing the excess of the executive management in risk management. Furthermore, Akhtaruddin and Haron (2010) also

believe that a board committee with more independent directors is much freer to take decisions without much interruption from the executive management. Given the above, the following hypothesis is developed;

In their studies, Ntim (2009) observed a positive relationship between the independence of the committee chairman and the committee effectiveness. Similarly, Haniffa and Cooke (2002) reported a result of their study which indicates that the chairperson's independence plays a significant role in the discharge of the board's responsibilities. From the perspective of agency theory and the discussions in 2.1 above, the presence of independent chairperson in the formation of BCC to protect the interest of other shareholders has been established. Thus, the second hypothesis is at this moment developed as follows;

3. RESEARCH METHODOLOGY

The study extracted its data mainly from the Bank scope database limiting its search to only commercial banks in sub-Saharan Africa (SSA) in countries that operate a functional stock market. This is for ease of data collection and standardized financial information disclosures. The ratio of non-performing loans (NPLs) as a proportion of either loan stock or total assets has attracted attention by many studies to represent the credit risk of banks. Some though, used total loans to total assets ratio, while others identified loan loss provision to

total assets as the measure of credit risk. Bhayani (2006) believes that the ratio of net NPLs to net advances is the best indicator for estimating credit risk of banks. Kargi (2011), on the other hand, prefer the use of non-performing loans to loan & advances ratio. The position is similar to that of (Bhayani, 2006). Multivariate regression analysis was used to analyze the association between the dependent and independent variables.

4. RESULTS AND DISCUSSIONS

Spearman correlation is adopted to test the association among the explanatory variables.

Table 3: Spearman Correlation and Variance Inflation Factor of the Variables of Study

	NLA	**NTA**	**CLA**	**RIND**	**RCIN**	**RSIZ**	**RFIX**	**RMEE**	**RDEL**	**FCA**	**PRO**	**GDP**	**VIF**
NLA	1												
NTA	0.86	1											
CLA	0.74	0.68	1										
RIND	0.06	0.14	0.07	1									1.66
RCIN	-0.12	0.01	0.09	0.57	1								1.68
RSIZ	0.14	0.16	0.09	-0.12	0.14	1							1.39
RFIX	-0.26	-0.24	-0.22	-0.19	0.01	-0.10	1						1.14
RMEE	0.06	0.15	0.13	0.02	0.16	0.31	0.08	1					1.12
RDEL	0.00	-0.06	-0.03	0.11	0.14	-0.13	0.04	-0.19	1				1.08
FCA	0.27	0.20	0.21	-0.18	-0.21	0.13	-0.01	0.20	-0.13	1			1.09
PRO	-0.34	-0.37	-0.27	0.06	0.01	-0.47	-0.01	-0.22	0.02	0.05	1		1.22

GDP	0.01	-0.03	-0.03	-0.25	-0.40	-0.21	-0.01	-0.05	-0.08	0.26	0.31	1	1.24

Source: STATA Output 13.0 based on data of the Study

The table 4.3 above presents the correlation coefficients of the association between the dependent variables (NLA, NTA & CLA) and the explanatory variables (committee independence, chairperson independence, size, financial expertise, the frequency of meetings, and committee diligence) the values of the correlation coefficient range from -1 to 1. The sign of the correlation coefficient indicates the direction of the relationship (positive or negative), the absolute value of the correlation coefficient indicates the strength, with more significant values indicating stronger relationships. The test in the table above is required to determine if multicollinearity exists is the variance inflation factor (VIF). Where the result of VIF shows a value of more than 10, there is a considered opinion of the presence of multicollinearity problem. From the table above, it is evident that multicollinearity does not exist as the highest VIF value is 1.68 in respect of RCIN variable.

The result of pool Ordinary Least Square (OLS) was subjected to the post-estimation tests of the regression results of multicollinearity test, heteroscedasticity test, normality test of error and Hausman specification tests in order to ensure reliability and validity of the estimation are tested which led to the use of Generalized Least Square (GLS) estimation model. Finally, the results indicate that random effect GLS estimation is appropriate for NTA while fixed effect GLS estimation is preferred for NLA, CLA models;

Table 4: General Least Square (GLS) Regression Results

Variables	**NLA** $_{FE}$	**NTA** $_{RE}$	**CLA** $_{FE}$
Constant	0.1023**	0.3610**	0.2164**
RIND	-0.0074*	-0.0137***	-0.019***
RCIN	0.02395	0.0071	0.0207
RSIZ	-0.0007	0.0004	0.0075
RFIX	-0.0979***	-0.4027***	-0.1453***
RMEE	0.0026***	0.0008	0.0055***
RDEL	-0.0075	-0.0005	-0.0684
FCA	-0.1935	-0.0064	-0.1172
PRO	-0.0233**	-0.0105**	-0.0354**
GDP	0.0013	0.0002	-0.0004
Observations	259	259	259
Hausman Specification Test p Value	0.0198	0.9509	0.0650
GroupWise Heteroskedasticity	0.0000	-	0.0000
Lagrangian multiplier	-	0.0000	-
OLS R^2	0.2441	0.1522	0.1338
OLS Adj. R^2	0.2168	0.1215	0.1025
OLS F-statistics	8.93***	4.97***	4.27***

Source: STATA Output 13.0 based on data of the Study

From the above table, we can interpret statistically that all the three models for each of the dependent variables (NLA, NTA, and LTA) indicate different significant relationships between Intangibles of BCC and credit risk of banks in SSAC. The coefficient of determination (R2) which is an absolute determinant of a relationship in a regression model is 0.2441, 0.1522 and 0.1338 for NLA, NTA and

CLA respectively. For NLA, the model indicates that 24.41% variation of explanatory variables can explain the changes in the dependent variable (NLA). Similarly, 15.22% variability in the explanatory variables explains the changes in the dependent variable NTA. Finally, the changes in the explanatory variables of 13.38% are attributable to the changes in CLA. The results in Table 4.4 above shows that RIND is inversely associated with the dependent variable NLA, NTA and CLA with a standard coefficient of -0.0074, -0.0137 and -0.019 respectively.

The result is statistically significant at 10% level of confidence for NLA while for both NTA and CLA the result indicates a 1% confidence level. On the other hand, RFIX shows that all the three measurement variables of the dependent variable are statistically significant at 1% confidence level with the standard coefficient of -0.0979, -0.4027, and -0.1453. For the frequency of meetings, the result indicates a positive association between two of the three measures of the dependent variable (NLA and CLA) and RMEE. Finally, it is only PRO among the three control variables that indicate a statistically negative association with all the three measures of the dependent variables at a 5% significance level of confidence. Given the findings in the previous section of this paper, the study answers the hypotheses by tabulating the outcome in the table overleaf;

Table 5: Summary of Hypotheses Testing

Number	Hypotheses	Sign	Final Decision
H1	**Board Risk Committee Independence & Credit Risk**		Reject

	Banks in the Sub-Saharan Africa		the null
H1a	There is no significant association between Board Risk Committee Independence and non-performing loans to total loan & advances ratio	Significant	
H1b	There is no significant association between Board Risk Committee Independence and non-performing loans to total assets ratio	Significant	
H1c	There is no significant association between Board Risk Committee Independence and classified loans to total loan & advances ratio	Significant	
H2	**Board Risk Committee Chairman Independence & Credit Risk Banks in the Sub-Saharan Africa**		Fail to Reject the null
H2a	There is no significant association between Board Risk Committee Chairman Independence and non-performing loans to total loan & advances ratio	Insignificant	
H2b	There is no significant association between Board Risk Committee Chairman Independence and non-performing loans to total assets ratio	Insignificant	
H2c	There is no significant association between Board Risk Committee Chairman Independence and classified loans to total loan & advances ratio	Insignificant	
H3	**Board Risk Committee Size & Credit Risk Banks in the Sub-Saharan Africa**		Fail to Reject the null
H3a	There is no significant association between Board Risk Committee Size and non-performing loans to total loan & advances ratio	Insignificant	
H3b	There is no significant association between Board Risk Committee Size and non-performing loans to total assets ratio	Insignificant	
H3c	There is no significant association between Board Risk Committee Size and classified loans to total loan & advances ratio	Insignificant	
H4	**Board Risk Committee Financial Expertise & Credit Risk Banks in the Sub-Saharan Africa**		Reject the null
H4a	There is no significant association between Board Risk Committee Financial Expertise and non-performing loans to total loan & advances ratio	Significant	
H4b	There is no significant association between Board Risk Committee Financial Expertise and non-performing loans to total assets ratio	Significant	
H4c	There is no significant association between Board Risk Committee Financial Expertise and classified loans to total loan & advances ratio	Significant	

H5	**Board Risk Committee Meetings & Credit Risk Banks in the Sub-Saharan Africa**		
H5a	There is no significant association between Board Risk Committee Meetings and non-performing loans to total loan & advances ratio	Significant	
H5b	There is no significant association between Board Risk Committee Meetings and non-performing loans to total assets ratio	Insignificant	Reject the null
H5c	There is no significant association between Board Risk Committee Meetings and classified loans to total loan & advances ratio	Significant	
H6	**Board Risk Committee Diligence & Credit Risk Banks in the Sub-Saharan Africa**		
H6a	There is no significant association between Board Risk Committee Diligence and non-performing loans to total loan & advances ratio	Insignificant	
H6b	There is no significant association between Board Risk Committee Diligence and non-performing loans to total assets ratio	Insignificant	Fail to Reject the null
H6c	There is no significant association between Board Risk Committee Diligence and classified loans to total loan & advances ratio	Insignificant	

The study rejects the null hypotheses in 1, 4, & 5 and failed to reject hypotheses 2, 3, & 6. Thus, the study finds that BCC independence, financial expertise, and frequency of meetings are statistically associated with the credit risk of banks in the sub-Saharan African countries. While BCC independence and financial expertise of the committee members were found to be negatively associated with credit risk, the frequency of meetings was found to be positively associated with BCC. Conversely, the result also indicates that BCC chair independent, size of the committee and committee diligence are not statistically significant with the credit risk of banks in the sub-Saharan African countries.

5. CONCLUSION

This research work is an attempt to study the impact of Board Credit Committee (BCC) on credit risk of commercial banks in the Sub-Saharan African countries. The result of the association between BCC independence and credit risk of the sub-Saharan African banks supports a previous number of studies, and is also consistent with Agency Theory. On the independence of the committee chair, the study contradicts the findings of (Bedard et al., 2004). Similarly, on the size of the committee impact on BCC, the study supports the view that size does not matter. This result on the size of committee contradicts the findings of Bedard et al. (2004) who have examined the association between audit committee size and performance of 103 listed companies in select sub-Saharan countries of Ghana, Nigeria, Kenya, and South Africa between 1997-2001 founds a positive correlation between audit committee size and company performance.

The position of Abdulrahman & Haneem (2006) that financial expertise of the committee members impact BCC is again yet supported by this study which is also the position of Bedard et al. (2004) that requisite financial knowledge has a higher chance of fraud and errors detection. Furthermore, Bedard et al. (2004) findings support the results of this research work that frequency of meetings does not impact on the credit risk of banks and contravenes the findings of (Waterhouse, 1993).

Barros et al. (2013) posit that the diligence of board members in attending the committee meetings ensures that results are achieved. This position is not supported by the current study as the findings suggest otherwise. The result also indicates that the profitability of sub-Saharan African banks is negatively associated with the credit risks of the banks. Statistically, the overall regression result in all the three variants of the measurement of credit risk is significant, thus, explaining that there is an association between the explanatory variable and the dependent variable of the study.

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