Risk Management and Financial Performance of Financial Institutions in Rwanda; A Case Study of Urwego Bank PLC

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Abstract: The general objective of this study was to assess the effect of risk management on financial performance of financial institutions in Rwanda. Its specific objectives were to determine the effect of risk identification on the performance of Urwego Bank Plc, to identify the effect of risk analysis and assessment on the performance of Urwego Bank Plc and to analyze the effect of risk monitoring and control on the performance of Urwego Bank Plc. In this study, a descriptive survey has been carried out. The target population in this study equaled to 30 staff of Urwego bank who are concerned with risk management and the researcher will focus staff involved in executive level, senior leaders, risk management and compliance department and internal audit department. The total population was considered as sample. The questionnaires were administered by multiple approaches that include drop and pick later basis and use of emails to contact the respondents. The collected data were firstly captured in Microsoft Excel, checked for completion and coded. The data for this study were analyzed quantitatively using percentages, frequencies and linear regressions. Descriptive and inferential statistics were used to find out the effect of risk management on financial performance of financial institutions in Rwanda, considering Urwego Bank Plc as the case study. Statistical Package for Social Scientists was used to execute multiple linear regressions. The results are presented using tables for ease of understanding. The researcher concluded that adequate risk identification measures in Urwego Plc would lead to its positive financial performance. This has been concluded from the correlation analysis of the variables in the study. The beta coefficients realized in the regression equation were all positive which is a clear indication that an increase in risk identification practices including identification of credit risks, market risks, operational risks and reputational risks would lead to positive results in growth of sales volumes, growth in market share and return on equity. The researcher further concluded risk analysis and assessment have positive effect on financial performance of Urwego Bank Plc. Therefore the amount of money invested in risk analysis and assessment would increase the financial performance of Urwego Bank Plc. Hence banks have to increase their efforts in risk analysis and assessment by prioritizing risks, using historical & forecasted information for risk assessment and performing qualitative risk analysis. Finally, the study established a positive and high effect of risk monitoring and control and financial performance of Urwego Bank Plc. Therefore the researcher concluded that the study variables are highly correlated. The researcher recommended that managers of banks especially the ones dedicated for risk management should put many efforts in risk identification, risk analysis and assessment and risk monitoring so that they are aware of the risks that may hinder the financial performance of the banks under their management.

Keywords: Risk Management, Financial Performance, Financial Institutions

1. Introduction

Worldwide risk management is the logical development and implementation of a plan to deal with potential losses. It is important for an organization to put in place risk management programs so as to manage its exposure to risks as well as protect its assets. The essence is to prepare ahead of time on how to control and finance losses before they occur. It is a strategy of pre-loss planning for pre-loss resources. Risk Management is the process of identification, measuring, controlling and monitoring of potential risks that may negatively affect the returns of an organization. Risk Management Practices are vital for an organization’s strategic management (Kimuru, 2018). A firm’s strategic management uses it in order to make positive contribution to the goals, objectives and the portfolio of almost all its activities.

2. Statement of the Problem

Across the banking industry, the most prominent area that erodes the mass of their profit is risk management (credit, market and operational). The problem of this study is to gather the causes of risk and how this can be anticipated and managed to improve performance of financial institutions. The industry however witnessed worsening asset quality of banks largely because of weak macro-economic factors like depreciating local currency, high inflation rates and interest rates resulting in high default rates. In addition, the supervisory and regulatory bodies did not find any of the banks in Rwanda culpable of flouting prudential arrangements aimed at protecting the interests of clients and shareholders as was experienced in some of African countries like Nigeria. There has, however, not been any major test to ascertain the resilience of the banking industry to withstand major shocks. There is therefore a vacuum between the general belief on the risk position of the Rwandan banking industry and the evidence to back this belief. To do this, it requires thorough assessment of the risk profiles of financial institutions especially banks in Rwanda as well as evaluate the adequacy of the risk management frameworks employed by the banks to handle the various risks they are exposed to. It is against this background that this study sought to assess the effect of risk management on financial performance of financial institutions in Rwanda.
3. Objectives of the Study

The general objective of this study was to assess the effect of risk management on financial performance of financial institutions in Rwanda. Its specific objectives were:

a) To determine the effect of risk identification on the performance of Urwego Bank

b) To identify the effect of risk analysis and assessment on performance of Urwego Bank

c) To analyze the effect of risk monitoring and control on performance of Urwego Bank

4. Conceptual Framework

The results in above Table 1 illustrate that the mean values for the first, second, third and fourth statements are respectively rounded off to 4 (the code for disagree) on risk identification. The standard deviation of all statements is above 0.5 meaning that respondents' answers on these statements were far different from the mean, in other words, their answers to the statement were heterogamous.

The results from Table 2 show that the correlation between risk identification and financial performance of Urwego Bank Plc at 0.846 which meaning that risk identification affects performance of Urwego Public Limited Company at the level of 84.6% which proved a significant relationship between these variables. Therefore if the researcher considers the level of significance which is 0.01, hence there is a significant relationship between risk identification and financial performance because the p-value (0.000) is statistically significant at 1% level of significance.

6. Summary of Research Findings

6.1 Determination of the effect of risk identification on performance of Urwego Bank Plc

Table 1: Descriptive statistics on risk identification and performance of Urwego Bank Plc

<table>
<thead>
<tr>
<th>Indicators</th>
<th>N</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit risks</td>
<td>30</td>
<td>4.10</td>
<td>1.155</td>
</tr>
<tr>
<td>Market risks</td>
<td>30</td>
<td>3.70</td>
<td>1.264</td>
</tr>
<tr>
<td>Operational performance</td>
<td>30</td>
<td>4.07</td>
<td>.691</td>
</tr>
<tr>
<td>Reputational risks</td>
<td>30</td>
<td>4.23</td>
<td>1.006</td>
</tr>
<tr>
<td>Valid N (listwise)</td>
<td>30</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Field Data (2019)
The results from Table 3 demonstrate that the mean values of 2.43 and 1.60 are respectively rounded off to 2 (the code for agree) of possible risks and historical and forecasting on risk analysis and assessment and is followed by the mean values for 2.97 and 2.70 which are round off to 3 (the code for undecided). The standard deviation of all statements is greater than 0.5 meaning that respondents’ answers on these statements were far different from the mean and their answers were heterogamous.

Table 3: Descriptive statistics on risk analysis and assessment on performance of Urwego Bank Plc

<table>
<thead>
<tr>
<th>Indicators</th>
<th>N</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Possible risks</td>
<td>30</td>
<td>2.43</td>
<td>1.194</td>
</tr>
<tr>
<td>Potential risks</td>
<td>30</td>
<td>2.97</td>
<td>1.903</td>
</tr>
<tr>
<td>Historical and forecasted information</td>
<td>30</td>
<td>1.60</td>
<td>.498</td>
</tr>
<tr>
<td>Quantitative risk analysis</td>
<td>30</td>
<td>2.70</td>
<td>.877</td>
</tr>
<tr>
<td>Valid N (listwise)</td>
<td>30</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Field Data (2019)

The analysis of correlation in Table 4 revealed that the correlation between risk analysis, assessment and financial performance of Urwego Bank Public Limited Company was at 0.868 meaning that risk identification influences financial performance of Urwego Bank Public Limited Company at the level of 86.8%, which proves a significant relationship between the two variables. If the researcher considers the level of significance which is 0.01, there is therefore a significant relationship between risk analysis, assessment and financial performance of Urwego Bank Plc because their p-value (0.000) is statistically significant at 1% level of significance.

Table 4: Correlation between risk analysis, assessment and financial performance of Urwego Bank Plc

<table>
<thead>
<tr>
<th>Variables</th>
<th>Risk Analysis &amp; Assessment</th>
<th>Financial Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk Analysis &amp; Assessment</td>
<td>Pearson Correlation 1 .868**</td>
<td>Sig. (2-tailed) .000 N 30 30</td>
</tr>
<tr>
<td>Financial Performance</td>
<td>Pearson Correlation .868** 1</td>
<td>Sig. (2-tailed) .000 N 30 30</td>
</tr>
</tbody>
</table>

Source: Field Data (2019)

The findings from Table 7 revealed that the results of correlation between risk monitoring, assessment and financial performance of Urwego Bank Plc is at 0.703 mean that risk monitoring and assessment affect the financial performance of Urwego Bank Plc. 70.3% which proves a significant relationship between risk monitoring and assessment and financial performance. If the researcher considers the level of significance, which is 0.01, there is therefore a significant relationship between them because their p-value (0.000) is statistically significant at 1% level of significance.

6.4 Estimated parameters for RI, RAA and CMC with the Financial Performance

Table 7: Model Summary

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.908a</td>
<td>.825</td>
<td>.804</td>
<td>.589</td>
</tr>
</tbody>
</table>

a. Predictors: Risk Identification, Risk Analysis and Assessment and Credit Monitoring and Control

The findings in Table 8 show that predictors: risk identification, risk analysis and assessment and credit monitoring and control have an effect on dependent variable which is financial performance of Urwego Bank Plc. This is statistically significant with a p-value (.000).
controls and close ongoing risk monitoring would have high impact on the financial performance of Urwego Bank Plc because the study variables are highly correlated.

7.2 Recommendations

Based on the research findings and specific objectives of the study, it is recommended that financial institutions of Rwanda should develop and establish adequate risk management techniques that would enable them to efficiently and effectively manage risks that may affect their financial performance. Furthermore, the banking industry should deploy strong controls to mitigate their financial and asset risks to achieve high returns and become operational and financial sustainable and gain market niche in the sector. Every financial institution should have a comprehensive enterprise risk management framework that will facilitate it to carry out comprehensive risk assessment and identify emerging risks as well as manage them to improve their financial performance. Finally, financial institutions should establish a risk management function and sufficient resources in order to accommodate risk management evolutions. This will enable the management team to manage credit, operational, and market risk within their risk appetite statements and consequently improve financial performance.

References


Table 9: Coefficients*

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>Constant</td>
<td>.557</td>
<td>.512</td>
<td>1.088</td>
</tr>
<tr>
<td>RI</td>
<td>.499</td>
<td>.154</td>
<td>.433</td>
<td>3.233</td>
</tr>
<tr>
<td>RAA</td>
<td>.338</td>
<td>.129</td>
<td>.483</td>
<td>2.621</td>
</tr>
<tr>
<td>CMC</td>
<td>.054</td>
<td>.138</td>
<td>.055</td>
<td>.390</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Financial Performance

Source: Field Data (2019)

The results in Table 9 indicate that Risk Identification, Risk analysis and assessment and Credit Monitoring and Control have statistically significant effect on Financial Performance of Urwego Bank Plc with a positive coefficient of determination of 0.908 which indicates that there is a strong positive correlation between predictors values and dependent variable. The coefficients of independent variables (RI, RAA and CMC) $\beta_1$, $\beta_2$ and $\beta_3$ are respectively 0.499, 0.338 and 0.054 with a statistically significant $(p = 0.00)$. Therefore, the model equation derived is: $y = 0.557 + 0.499x_1 + 0.338x_2 + 0.054x_3 + e$. The positive coefficient further demonstrates that a 1% increase in the Risk Identification attributed to 0.499% improvement in financial performance, the t-statistic value (3.233) indicates that the effect is statistically significant at 99% confidence level. An increase of 1% on Risk analysis and Assessment will increase financial performance given by 0.338% at the t-statistic value (2.621) indicates the effect is statistically significant at 99% confidence level while a positive coefficient demonstrates that a 1% increase in Credit Monitoring and Control causes an increase of 0.054 on financial performance with t-statistic value (0.390) indicates the confidence level of 99% the effect is statistically significant.

7. Conclusions and Recommendations

7.1 Conclusions

Through the research study, it is evident that adequate risk identification measures in Urwego Bank Plc would lead to positive financial performance. This has been concluded from the correlation analysis of the variables in the study. The beta coefficients realized in the regression equation were all positive which is a clear indication that an increase in risk identification practices including identification of credit risks, market risks, operational risks and reputational risks would lead to positive results in growth of sales volumes, growth in market share and return on equity.

The researcher further concluded that risk analysis and assessment have positive effect on financial performance of Urwego Bank Plc. Therefore, the amount of money invested in risk analysis and assessment would increase the financial performance of Urwego Bank Plc. Thus, banks have to increase their efforts in analyzing and assessing risks by using historical data, current and future information to perform both qualitative and quantitative risk assessment.

Lastly, the study has confirmed that establishing strong controls and close ongoing risk monitoring would have high positive financial performance. This has been concluded through comprehensive risk assessment and i...


