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EMPIRICAL ASSESSMENT OF RISK MANAGEMENT COMMITTEE IN THE CONTEXT OF FINANCIAL DISTRESS: EVIDENCE FROM LISTED CONSUMER GOODS FIRMS IN NIGERIA

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Abstract

The study investigates risk management committee in the context of financial distress in Nigeria drawing samples from listed consumer goods firms on the floor of the Nigerian Exchange Group market. While financial distress proxied by Altman Z-score is the dependent variable, the independent variables adopted for this study includes risk management committee size and risk management committee interlock. Furthermore, in line with related extant literature, we employed the variable of profitability (return on asset) to control our model's goodness of fit. Data set employed in this study spans through the periods between 2011 and 2020. We test our hypotheses using the panel random effect regression. The empirical result of this study leads to the conclusion that while an increase in the number of risk committee members will significantly increase financial distress, we conclude that the higher the number of risk committee members who are also part of other committees of the company the lower the financial distress for such companies. Succinctly, we recommend that concerned policy makers should come up with a framework of risk management committee size that fits a firm's operations. By so doing, the question of what is the optimal number of risk committee members of a firm would have been answered. Specifically this foregoing recommendation is due for predicting the likelihood of the firm going into finnacial distress.

Keywords: **Risk Management Committee Size, Risk Management Committee Interlock, Altman Z-Score, Panel Regression**

1.0 Introduction

Risk Management Committee (RMC) is an autonomous board of directors committee which, as its primary and exclusive role, is responsible for the risk management policies of the global operations of the company and oversees the implementation of the global risk management system of the organization. The committee will help the board of directors in carrying out its regulatory duties regarding the corporation's risk tolerance and the risk control and enforcement process and the governance system that governs it. Risk tolerance is the amount and type of risk that a company is capable of and ready to bear in its risks and market practices, despite its corporate priorities and stakeholder responsibilities. The prediction of financial distress is absolutely vital for traders, creditors, and suppliers. To avoid any financial loss, they need to assess the financial risk of a firm before they make any decisions. Financial distress is not the same as bankruptcy. The former occurs while the firm is not able to meet its financial obligations due to a decrease in the firm's operations and excessive costs, while the latter is a very last state in which corporations stop doing commercial enterprise due to financial distress. The bankruptcy needs to be confirmed by a courtroom determination; then, its assets are bought to pay and cover all obligations of creditors. Thus, financial distress does not necessarily lead to bankruptcy.

The aim of this study is to analyze risk managementcommittee and financial distress of listed consumer goods firms in Nigeria. A review of several empirical studies from continents in the world showed different results of risk management and financial distress. Most past studies were done in Asia especially in Jordan and India (Petkovski, Kjosevski&Jovanovski, 2018; and Al-Zobi, Shubita, Alomari, Almatarneh&Alrawashdeh, 2019) while in Africa the few studies were in Tunisia, Kenya, and Nigeria but all the studies in Africa and Nigeria in particular ignore consumer goods firms. We also observed that most of the studies (Abobakr&Elgiziry, 2017; Amos, Sharon, & Anita 2016; Zemzem&Kacem 2014; Bourakba, &Zerargui, 2015; Akbarian, Rostamy, Rezaei, &Abdi 2019; Zheng, Sarker, &Nahar 2018; Ojeka, Adegboye&Dahunsi (2021); and Sameera&Wijesena 2018) were done using OLS estimation method which is not capable of capturing heterogeneity effects of the firms or banks as the case may be. This study therefore seeks to address these research problems by first ensuring the inclusion of variables like risk committee sizeand risk committee members interlock in our study as proxies for risk managementcommittee. Second, we employ a panel regression technique of within effect estimator that is capable of capturing the heterogeneity effect present in the firm. More than this, the study to the best of our knowledge will be the first in the context of Nigeria to use most recent data including the financial crisis period of 2012 and 2013 to investigate risk management committee and financial distress in Nigeria.

2.0 Conceptual Literature

Financial Distress

Financial distress is a situation in which companies' cash flow becomes insufficient to cover their obligations. These obligations can include unpaid debts to suppliers and missed principal or interest payments under borrowing contracts, which signifies that distress is imminent. Zaki, Bah and Rao (2011) defined financial distress as a state where a borrower is unable to meet payment obligation to lenders and creditors due to reputation, leverage, volatility of earnings, collateral, economic condition, or interest rates. Financial distress itself is a condition in which the company is unable to maintain its going concern, which brings about consequences in the form

of bankruptcy, delisting, or organizational restructuring (Muller, Steyn-Bruwer&Hamman., 2009).

Risk Management Committee

The Corporate Governance Code (2020) in Nigeria provides that the risk management committees shall meet at least twice every financial year. This code unlike the 2018 Code, delves deeper into the extent of its functions as regard information technology. Within this provisions, the committee is required to review and recommend for approval of the Board, at least annually, the company's information technology (IT) data governance framework which may include the following: development of IT strategy and policy; proactive monitoring and management of cyber threats and attacks as well as adverse social media incidents; management of risks relating to third-party and outsourced IT service providers; assessment of value delivered to the company through investments in IT; and periodic independent assurance on the effectiveness of the company's IT arrangements.

Risk Management Committee Size

Corporate Risk Committee size is the number of directors appointed to serve on the risk management committee in a particular point in time. This is to adhere to the objective of code of conduct and provisions and recommendation of the Nigerian revised corporate governance code of 2020, which stipulates that the board of directors should establish a risk management committee, though it did not specify the number that is sizeable. Risk management committee size can be used to proxy a company's willingness to invest firm's resources in order to increase corporate risk mitigation stature and influence of the committee (Khalik& Md. Sum, 2019).

Risk Management Committee Interlock

When two committees share a common director, the director is often referred as an interlocking director; the tie or connection that he/she creates is also referred as a committee interlock (Burt, 1980; Mizruchi, 1996). Interlocking directors are an important topic in organizational studies. They are found to be meaningful mechanisms, and rather than random activities (Hallock, 1997). Many scholars argue that risk committee interlocking directors are a creditable and relatively low-cost source for firms to manage environmental uncertainty (Useem, 1984), can gain access to diverse and unique information (Beckman &Haunschild, 2002; Haunschild& Beckman, 1998), learn new corporate practices (Palmer, Jennings, & Zhou, 1993), and serve as a signal of the quality of the firm (Higgins &Gulati, 2003).

Hypotheses Development

Risk Management Committee size and Financial Distress

Subramaniamet .al (2009) explains that large RMC size exists due to the likelihood of high agency costs because of high leverage and greater complexity in a company's operation. It has been argued that "Boards that establish a stand-alone committee to focus solely on the risk management function demonstrates their commitment to improving the overall corporate

governance structures of their firms" (Yatim, 2010). Despite limited literature on the association between RMC and performance of the firm, few studies have found conflicting results regarding it. In this manner, Pathan (2009) submits that small firm's boards have a positive relationship with more risk-taking in the United States holding companies. Hutchison and Ngoc (2012) substantiate that "the effectuality of the risk committee (RC) and compensation committee (CC) mutually handled and controlled excessive risk-taking factors which lead towards the higher performance of the firm. For a board to be efficient, it is suggested that the risk management committee size should be appropriate neither large nor small. In regard of the risk management committee size, Hutchison, and Ngoc (2012) explained that an ideal size should be comprised of seven or more than seven executives' members in the board committee which maintain the effectiveness and efficiency in the board (Jensen, 1993). From the foregoing, we state our first hypotheses as;

$H0_1$: Risk management committee size has no significant effect on the financial distress of listed consumer goods firms in Nigeria.

Risk Management Committee interlock and Financial Distress

Interlocked committees can obtain more information through their external networks and are therefore better positioned to formulate and implement stable strategies (Pfeffer and Interlocking directorships and firm performance. Finally, interlocks help reduce incentives for opportunism by increasing mutual flow of information between exchange partners. Overall, as a form of inter-committee connectedness, interlocking directorates can greatly facilitate the performance of the board tasks of service and strategy (Zahra and Pearce, 1989), of resource provision (Hillman and Dalziel, 2003), and of resource-dependency/boundary-spanning (Johnson, Daily and Ellstrand, 1996). Other theoretical lenses provide complementary insights on the potential benefits of interlocks. Multiple external board appointments can be a source of organizational learning, innovation and obtaining insights into the policies and practices of other organizations (Beckman and Haunschild, 2002; Barringer and Harrison, 2000). From the foregoing, we state our final hypotheses as;

$H0_2$: Risk management committee interlock has no significant effect on the financial distress of listed consumer goods firms in Nigeria.

Theoretical Review

Resource Dependency Theory

From resource dependence dimension, a firm is an open system, dependent on external organizations and environmental contingencies that a firm's survival is dependent on its ability to establish control over resources (Pfeffer&Salancik 1978). The core insight of resource dependence theory is that firms are dependent upon actors outside the firm for critical resources. The reliance of the firm on these external stakeholders is due to a disparity of power between the firm and these stakeholder groups (Altman, Iwanicz-Drozdowska, Laitinen&Suvas 2017). Since companies are not internally self-sufficient, they must acquire resources from other companies and that the need for resource acquisition renders the acquiring company dependent upon the

supplying company (Peng& Beamish 2014). The external dependency creates uncertainty for the acquiring company which is harmful because it obscures the firm's control of resources and choice of strategies obstructing everyday functioning which affect the firm's financial health (Rivas 2012). Since firm interdependence with the environment can lead to a reduced firm's autonomy and to a less certain future for the firm, the acquiring company is motivated to enhance its autonomy by avoiding external dependence (Rivas 2012). Thus, firms seek to minimize uncertainty linked with the acquisition of significant resources by attempting to control the external environment and that when firms can cope effectively with uncertainty, it leads to power (Pfeffer&Salancik 1978) and increased firms' survival likelihood.

Empirical Review

Girangwa, Rono, and Mose (2020) determine enterprise risk management effect on organizational performance of state corporations in Kenya. This study was guided by agency theory. The study used explanatory cross sectional survey design. Primary data was collected from structured questionnaires. A survey was carried out on 218 state corporations in Kenya. Data collected was analyzed by use of descriptive and inferential statistics. The research hypotheses were tested using multiple regression analysis. The results revealed that risk structure, governance and process practices had positive and significant effect on organizational performance. This study contributes to theory by centering enterprise risk management on the empirical testing of agency theory on the relationship between enterprise risk management practices and organizational performance. The study recommends that policy makers in state corporations should integrate risk management practices across all functions and business units for the purpose of addressing risks before they even occur.

Fali, Philomena, Ibrahim, and Amos (2020) evaluates the effect of risk management committee size, independence, expertise on financial performance of listed insurance companies in Nigeria from 2012 to 2018. The study used a sample size of (24) insurance companies from population of 27 insurance firms. The study used secondary data obtained from annual report of the firms. The dependent variable was measured by return on asset (ROA) The study employed Random Effect regression model and find evidence that risk management committee expertise has negative and significant effect on financial performance while risk management committee size and independence does not influence financial performance. The study concludes that risk management committee constrain on management excess risk undertaking will lead to poor financial performance of insurance firms. The study recommends that the risk management committee should be made effective by inclusion of more members with background on finance and actuarial sciences into risk management committee structures.

Abubakar, Ado, Mohamed, and Mustapha (2018) investigates the effect of risk management committee attributes and board financial knowledge on the financial performance of listed banks in Nigeria. Furthermore, the research used secondary data obtained from the annual report of fourteen (14) banks listed in the Nigerian stock exchange for the year 2014-2016 with 42 firm-year observations and based on panel data approach. Furthermore, the regression estimates are based on random effect. The result indicates that risk management committee independence, and board financial knowledge exhibit a significant negative relationship with ROA. Meanwhile, risk management committee size has a positive insignificant relationship with ROA. Besides

providing suggestion for future research work, this study provides several recommendations for regulators and the Nigerian banking industry

Luqman, Hassan, Tabasum, Khakwani and Irshad, (2018) examines the role of voluntary adoption of corporate governance mechanisms in mitigating the financial distress status of firms. Using the sample of 52 firms from non-financial sector listed at Karachi Stock Exchange and selecting time period of 10 years from 2006 to 2015, the study adopted financial distress as the dependent variable is used as both continuous and dichotomous representations, and it is coded as 1 or 0 on the basis of its operating performance. Outside directors, Non-director, CEO-chair duality, and Audit committee were the independent variables. Furthermore, the study was controlled by audit opinion, leverage, size of a firm and management efficiency. To check the relationship between corporate governance practices and probability of financial distress, logistic regression is used. The results of the study show that there is a negative significant relationship of block holder ownership, director ownership and audit committee with the probability to financial distress. The study concluded that voluntary adoption of corporate governance structures leads towards lower level of financial distress.

3.0 Methodology

This study is longitudinal covering a period of ten (10) years. That is, from 2011 to 2020 employing listed consumer goods firms on the floor of the Nigerian Exchange Group (NGX). The sampling technique employed is purposive since firms were included in the sample on certain selection criteria. These criteria were based on the view that the firms are listed on the Nigerian Exchange Group (NGX) market from 2011-2020; there were access to their annual financial reports within the period and they were not firms operating subsidiaries in Nigeria that are not listed in the Nigerian Exchange Group (NGX). Newly listed firms and delisted firms were excluded from the study. Thus, only consumer goods firms that had all relevant data due to continuous existence were included in the sample. Our final sample size consists of 16consumer goodsfirms that was arrived at based on the availability of data for ten years for all the research variables. To examine the effect of risk management committee on financial distress, we adopted and modified the model of Jia (2019) to express our econometric model as

$$\boldsymbol{ZSCO_{it} = \beta_0 + \beta_1 RCMS_{it} + \beta_2 RCDI_{it} + \beta_3 RETA_{it} + \mu_{it}}$$

Where:

ZSCO	=	Altman Z-score (Measure of Financial Distress)
RCMS	=	Risk management committee size
RCDI	=	Risk management committee interlock
RETA	=	Profitability (Control Variable)
β_0	=	Constant
β_1- β_4	=	Slope Coefficient
μ	=	Stochastic disturbance
i	=	i^{th} firm
t	=	time-period

Thus, our apriori expectations are stated as; X_1-X_3>0: which means that a reduction in the determinant variables of risk management committee size and risk management committee interlock will lead to a rise in financial distress of listed consumer goods firms in Nigeria. The econometric techniques adopted in this study are the panel fixed and Random effect regression techniques. The rationale for its usage is based on the following justifications: the data that will be collected may have time and cross-sectional attributes as well as across the sampled firms (cross-section); panel data regression provides better results since it uses large observation and reduces the problem of degree of freedom (Muhammad, 2012); it avoids the problem of multicollinearity and help to capture the individual cross-sectional (or firm-specific) effects that the various pools may exhibit with respect to the dependent variable in the model.

Variable Measurement

In this study, the dependent variable is financial distress. This study identified financially distressed firms using the Altman's (1983) Z-Score model which he revisited in 2002 in his study of 'revisiting credit scoring models in Basel two environments. This revised model is intended for both privately held and publicly listed firms and for both manufacturing and non-manufacturing firms (Altman et al. 2017). The independent variable is risk management committee which is proxied in terms of risk management committee size and risk management committee interlock. We measure risk management committee Size in numbers as the total directors and non-directors in the risk committee. In the same vein, we measure risk management committee interlock as members in risk committee who are also members in other committees following the studies of Beckman and Haunschild, (2002); Barringer and Harrison, (2000).

4.0 Empirical Results and Discussion of Findings

The study investigates risk management committee in the context of financial distress in Nigeria drawing samples from listed consumer goods firms on the floor of the Nigerian Exchange Group market. While financial distress proxied by Altman Z-score is the dependent variable, the independent variables adopted for this study includes risk management committee size and risk management committee interlock. Furthermore, in line with related extant literature, we employed the variable of profitability (return on asset) to control our model's goodness of fit. Data set employed in this study spans through the periods between 2011 and 2020. Table 4.1 below describes the data in terms of the companies which they belong. Overall, the descriptive statistics provides some insight into the nature of the selected Nigerian listed consumer goods companies that were employed in this study.

Descriptive Analysis

In this section, we examine the descriptive statistics for both the explanatory and dependent variables of interest. Each variable is examined based on the mean, standard deviation, maximum and minimum. Table 1 below displays the descriptive statistics for the study.

Table 1: Descriptive Statistics

VARIABLES	MEAN	SD	MIN	MAX	NO OBS
ZSCO	3.29	2.45	-2.33	14.81	160
RCMS	2.70	2.60	0	7	160
RCDI	0.99	1.27	0	5	160
RETA	5.78	8.87	-43.34	26.49	160

Source: Author (2022)

The table above shows the summary of the descriptive statistics of the study. From the table it is observed that financial distress as measured by Z-score (ZSCO) had a mean of 3.29 with a standard deviation of 2.45. In the case of the independent variable, we find that the mean of risk management committee size (RCMS) was 3 members. This implies that on the average, the risk management committee size of the firms in our sample was 3 members. In the same vein, we find that the mean of risk management committee interlock (RCDI) was 1 and a standard deviation of 1.27. This implies that on the average, at least 1 member of the risk management committee of our sample firms was also part of another board committee of the firm. In the case of the control variable, the table shoes that profitability (RETA) had a mean of 5.78 and a standard deviation of 8.87.

Correlation Analysis

In examining the association among the variables, we employed the Pearson correlation coefficient (correlation matrix), and the results are presented in the table below.

Table 2: Correlation analysis

	ZSCO	RCMS	RCDI	RETA
ZSCO	1.00			
RCMS	-0.03	1.00		
RCDI	-0.17	0.84	1.00	
RETA	0.75	-0.04	-0.07	1.00

Author's computation (2022)

In the case of the correlation between the variables of interest, the above results show that there exists a negative and weak association between risk management committee size and financial distress (-0.03). There exists a **negative and weak a**ssociation between risk management committee interlock and financial distress (-0.17). In terms of the control variable, we find that there exist a positive and weak association between profitability and financial distress (0.75). To test our hypotheses a regression results will be needed since correlation test does not capture cause-effect relationship.

Regression Results

Specifically, to examine the cause-effect relationships between the dependent variables and independent variables as well as to test the formulated hypotheses, we present a panel data regression and an OLS pooled results in the table below.

Table 2: Regression Result

	ZSCO Model (Pooled OLS)	ZSCO Model (FIXED Effect)	ZSCO Model (RANDOM Effect)
C	2.21 {0.000} ***	2.03 {0.000} ***	2.14 {0.000} ***
RCMS	0.30 {0.001} **	0.29 {0.010} **	0.28 {0.005} **
RCDI	-0.79 {0.000} ***	-0.52 {0.011} **	-0.61 {0.001} **
RETA	0.18 {0.000} ***	0.18 {0.000} ***	0.17 {0.000} ***
F-statistics/Wald Statistics	49.10 (0.00) ***	33.02 (0.00) ***	120.39 (0.00) ***
R- Squared	0.49	0.41	0.41
VIF Test	2.20		
Heteroscedasticity Test	7.66 (0.0056) **		
Hausman Test			5.30 (0.1513)

Note: (1) bracket {} are p-values
(2) **, *, implies statistical significance at 5% and 1% levels respectively**

In the table above, we observed from the OLS pooled regression that the R-squared value of 0.49 shows that about 49% of the systematic variations in financial distressproxied by Altman Z-score in the pooled consumer goods firms over the period of interest was jointly explained by the independent and control variables in themodel. The unexplained part of financial distresscan be attributed to exclusion of other independent variables that can impact on financial distressbut were captured in the error term. The F-statistic value of 49.10and the associated P-value of 0.00 shows that the OLS regression on the overall is statistically significant at 1% level, this means that the regression models is valid and can be used for statistical inference. The table above also shows a mean VIF value of 2.20which is within the benchmark value of 10, this indicates the absence of multicollinearity in the models, and this means no independent variable should be dropped from the model. Also, from the table above, it can be observed that the OLS results had heteroscedasticity problems since its probability value was significant at 5% [7.66 (0.0056)]. The presence of heteroscedasticity in the model clearly shows that our sampled firms are not homogeneous. This therefore means that a robust or panel regression approach will be needed to capture the impact of each firmheteroscedasticity on the results. In this study we adopted the panel regression method using both fixed and random effect models.

The F-statistic and Wald-statistic value [{33.02 (0.00)}] and [{120.39 (0.00)}]for fixed and random effect regression respectively shows that both models are valid for drawing inference since they are both statistically significant at 1%. In the case of the coefficient of determination (R-squared), it was observed that 41%systematic variations in financial distressproxied by Altman Z-score was explained jointly by the independent and control variables in both models respectively. This therefore implies that less of the variation in financial distress were explained when compared to the OLS pooled regression. In selecting from the two panel regression estimation results, the Hausman test was conducted, and the test is based on the null hypothesis that the random effect model is preferred to the fixed effect model. Specifically, a look at the p-value of the Hausman test (0.1513), implies that we should accept the null hypothesis and reject the alternative hypothesis at above 5% or 1% level of significance. This implies that we should

adopt the random effect panel regression results in drawing our conclusion and recommendations. This also implies that the random effect results tend to be more appealing statistically when compared to the fixed effect.Following the above, the discussion of therandom effect results became imperative in testing our hypotheses. The below is a specific analysis for each of the independent variables using the random effect regression.

Discussion of Findings

Since, the study is an extension of existing studies, only few findings in literature are not in agreement with the current positions of this study. Specifically, we find that risk management committee size (Random effect regression = 0.28 (0.005)) as an independent variable to financial distress appears to have a positive and significant influence on financial distress. This therefore means we should reject the null hypothesis {$H0_1$: risk management committee size has no significant effect on the financial distress of listed consumer goods firms in Nigeria}. This suggests that an increase in the number of risk committee members will significantly increase financial distress. We contradict researchers like Rashid, Ibrahim, and Othman (2012) who said that large committee size would facilitate more skills, vast experiences, and diverse knowledge in handling the enterprise wide-away of risks. More so, Dalton, Daily, Johnson &Ellstand (1999) established that large boards offer better advice to management. While Pearce and Zahra (1992) are of the opinions that a larger board size enhances a company's ability to understand and respond to diverse stakeholders and are tougher to manipulate as compared to boards with small size.

Our results also shows that risk management committee interlock (Random effect regression = -0.61 (0.001)) as an independent variable to financial distress appears to have a negative and significant influence on financial distress. This therefore means we should reject the null hypothesis {$H0_2$: risk management committee interlock has no significant effect on the financial distress of listed consumer goods firms in Nigeria}. This suggests that the higher the number of risk committee members who are also part of other committees of the company the lower the financial distress for such companies. Resource-dependence theory stipulates the benefits of interlocking in terms of serving to coordinate inter-committee exchange of resources (capital, information, and market access) and buffering the effects of environmental uncertainty (Pfeffer and Salancik, 1978). Moreover, boards in general as well as their interlocked directors in particular play an important role in securing external resources through their linkages to the external environment (Filatotchev and Toms, 2003; Hillman, Cannella and Paetzold, 2000; Johnson, Daily and Ellstrand, 1996; Pearce and Zahra, 1992), in counteracting environmental uncertainty (Pfeffer, 1972), and in reducing transaction costs associated with environmental interdependence (Williamson, 1984).

Conclusion and Recommendation

Risk Management Committee (RMC) is an autonomous board of directors committee which, as its primary and exclusive role, is responsible for the risk management policies of the global operations of the company and oversees the implementation of the global risk management system of the organization. The committee will help the board of directors in carrying out its regulatory duties regarding the corporation's risk tolerance and the risk control and enforcement process and the governance system that governs it. In the light of the above, the empirical result of this study leads to the conclusion that while an increase in the number of risk committee

members will significantly increase financial distress, we conclude that the higher the number of risk committee members who are also part of other committees of the company the lower the financial distress for such companies. Succinctly, we recommend that concerned policy makers should come up with a framework of risk management committee size that fits a firm's operations. By so doing, the question of what is the optimal number of risk committee members of a firm would have been answered. Specifically this foregoing recommendation is due for predicting the likelihood of the firm going into finnacial distress. We also recommend that committees that grapple with uncertainty arising from technological shifts, deregulation, globalization of capital and product markets, and political reform, can more efficiently avail themselves of resources by coordinating their efforts through the committee interlock to reduce financial distress.

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