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Effect of risk management on the financial stability of quoted commercial banks in Nigeria

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Abstract

The study examined the effect of risk management on the financial stability of quoted commercial banks in Nigeria, with a focus on credit, market, operational, and liquidity risk management. Using a dynamic panel data approach, the study analyzes data from 150 observations across listed banks to determine how different risk management influence financial stability, measured through capital adequacy, asset quality, liquidity ratios, and earnings performance. The lagged financial stability variable is included to account for the persistence of past performance on current stability outcomes. The results indicate that past financial stability positively and significantly affects current stability, highlighting the cumulative nature of bank performance. Credit risk management and operational risk management exhibit negative and statistically significant effects on financial stability, suggesting that inadequate credit assessment, high non-performing loans, and weak operational controls undermine banks' financial resilience. Conversely, market risk management shows a positive and significant effect, indicating that effective management of interest rate and foreign exchange exposures strengthens stability. Liquidity risk management, though positive, is not statistically significant, implying that its influence may depend on specific institutional and macroeconomic conditions. Based on these results, the study recommends strengthening credit and operational risk frameworks, adopting proactive market risk strategies, continuous risk monitoring, and reinforcing regulatory oversight. These measures can enhance banks' resilience, protect depositor funds, and promote the stability of the Nigerian banking sector.

Keywords: Risk management, Financial Stability, Credit Risk, Market Risk, Operational Risk, Liquidity Risk,

Introduction

The financial stability of deposit money banks in Nigeria has come under increasing pressure in recent years as a result of adverse macroeconomic conditions, heightened credit exposures, operational vulnerabilities and evolving market risks. In March 2024 the Central Bank of Nigeria (CBN) introduced a revised recapitalisation regime that raised the minimum paid-up capital thresholds for banks setting the minimum for commercial banks with international authorisation at ₦500 billion and for national banks at ₦200 billion thereby signalling regulatory concern about the sector's capacity to absorb shocks (Central Bank of Nigeria,



2024). While this regulatory tightening has stimulated capital-raising efforts by several banks, it also exposed underlying weaknesses in risk controls: despite capital injections and recapitalisation plans, industry data show that asset-quality pressures persisted into 2024–2025, with the aggregate capital adequacy ratio improving but non-performing loans rising to levels that exceeded prudential benchmarks (CBN, 2025). Specifically, supervisory reporting indicated that the non-performing loan (NPL) ratio increased to approximately 5.62 percent in April 2025, a level above the conventional 5 percent prudential threshold and indicative of persistent weaknesses in credit origination, monitoring and provisioning (Central Bank of Nigeria, 2025).

These trends point to a significant problem: capital buffers alone may be insufficient to sustain bank resilience where risk management particularly in credit, market, liquidity and operational domains are inadequate or poorly implemented. Credit risk remains a core concern because elevated NPLs erode earnings and capital buffers, increase provisioning needs and raise the probability of bank distress. Concurrently, market risk exposures driven by exchange-rate volatility and adverse interest-rate movements have amplified Treasury and trading vulnerabilities for banks engaged in significant foreign-currency operations and interest-sensitive activities (Reuters, 2024). Liquidity risk is also material: deposit concentration, short-term wholesale funding needs and episodic funding stress can quickly transform a solvency problem into a liquidity crisis when contingency planning and liquidity buffers are weak (Reuters, 2024). At the same time, operational risks such as cyber-fraud, internal control failures and systems downtime have produced direct financial losses and damaging reputational effects; recent industry reports recorded large fraud and cyber-related losses that underscore the growing importance of operational-risk management in a rapidly digitalising banking environment (IJSRA, 2025; CBN, 2024).

Existing empirical research has largely examined individual risk categories or relied on pre-recapitalisation datasets, limiting their relevance to current banking realities. Studies such as Aruwa and Musa (2014) and Onyabe et al. (2018) focused mainly on credit risk, while Olagunju, Adeyanju and Olabode (2011) restricted their analysis to liquidity risk without integrating credit or market risk dimensions. Market-risk research by Nwankwo and Osho (2010) and operational-risk evidence from Okoye and Egbunike (2016) also failed to combine multiple risk factors in a unified model. Even recent works like Owolabi and Ajayi (2021)



continued to treat risk categories separately. The few multi-risk studies Olalekan and Adeyinka (2013) and Ogege and Shiro (2013) relied on outdated pre-2016 or pre-2012 datasets that do not reflect the post-2024 recapitalisation and supervisory environment. These limitations reveal a critical gap: existing studies neither integrate credit, market, liquidity and operational risks nor capture the contemporary regulatory, macroeconomic and governance dynamics shaping the financial stability of quoted commercial banks in Nigeria.

This study therefore filled the gap by examined the direct effects of those four risk-management practices on financial stability of listed Nigerian deposit money banks.

Hypotheses

H₀1: Credit risk management has no significant impact on financial stability of quoted commercial banks in Nigeria.

H₀2: Market risk management has no significant influence on financial stability of quoted commercial banks in Nigeria.

H₀3: Operational risk management has no significant effect on financial stability of quoted commercial banks in Nigeria.

H₀4: Liquidity risk management has no significant effect on financial stability of quoted commercial banks in Nigeria

Literature Review

Concept of Risk Management

According to Tapiero (2004), risk management refers to the practice of creating economic value in a firm by using financial instruments to manage exposure to risks, particularly risks such as credit and market risk. Managing risk involves setting appropriate risk environment, identifying and measuring the risk exposure, mitigating risk exposure, monitoring risk and constructing controls for protecting the financial institution from financial risks. Risk management is an important aspect among financial institutions as it is the factor that informs financial decisions (Shukla, 2016). Without risks, financial transactions would be simplified but this would also imply low returns on investments as higher risk is associated with better proceeds.



Risk Management in Banks As posited by Zakaria (2017), risk in banking organisation refers to uncertainties resulting in adverse impacts on profitability that can give rise to outright losses. Banks are exposed to a whole lot of risks in the course of carrying out their financial intermediation role and according to OECD (2014), the risks that companies face are both financial and non-financial and in the case of financial institutions, the focus naturally tends to be on financial risks, such as credit, liquidity or market risks, although there is also an increasing emphasis on operational risk.

Concept of Financial Stability

The concept of financial stability has been extensively studied by scholars in finance and economics, with definitions evolving to reflect changing economic conditions, regulatory frameworks, and financial system dynamics. Financial stability generally refers to the ability of a banking institution or system to function effectively, withstand financial shocks, and prevent systemic crises. Ini, et al. (2018) explained that maintaining financial stability in the financial system in Nigeria has been a major macroeconomic policy objective and this, to some extent, is due to aftermath effect of the series of financial crisis the country has witnessed in the past. As shown in the work of Gadanez and Jayaram (2009), giving a specific definition to financial stability is difficult while it is even more difficult measuring it but they went ahead to give the characteristics of a stable financial system as absence of excessive volatility, stress or crisis. This was supported by Healey, Mosser, Rosen and Tache (2018) when they posited that there is no single comprehensive definition of “financial stability but in general, it refers to the ability of the financial system “to facilitate and enhance economic processes, manage risks, and absorb shocks.

Empirical Review

Le and Nguyen (2022) investigated the relationship between a shift in lending toward households`, credit information sharing, and bank stability and eighty countries were examined from 2005 to 2015 using generalized method of moments as research design. The study concluded that financial instability of banks would increase due to shift in lending strategy toward household sector and sharing of credit information has positive effect on bank stability.

Moslehpour et al. (2022) investigated impact of financial risks on international financial markets. In order to pinpoint systemic crises, the paper examines how the COVID-19



epidemic has affected both the international and Vietnamese stock markets. The empirical results show that the volatility transmission of systemic risks across the global stock market and different exchanges evolves and becomes more significant over time as the COVID-19's global spread deepens. The worldwide industrial market was broader than the Vietnamese stock market at the time of COVID-19, and the Vietnamese stock market constituted less of a threat to the international market. A closer look at the relationship between the world stock index and the Vietnam value-at-risk range index sample reveals a significant level of downside risk integration in important monetary systems, especially during the COVID-19 era. The results of this study cannot be generalized because it was conducted in a place with a social and economic structure distinct from Kenya.

Orichom and Omeke (2020) examined how capital adequacy, efficiency, CRM and performance of microfinance institutions (MFIs) in Uganda were related with a focus on the agency theory. A cross-sectional was used in examining 64 MFIs in the country. Correlation and multiple regression were useful in the analysis of the data. Findings showed that CRM improves performance. Hence, credit risk appraisal, monitoring and mitigation were crucial in the achievement of performance of the institutions. The recommendation was that managers should institute risk preventive as well as control methods to lower credit risks and attain positive performance among DT-SACCOs.

Munangi and Sibindi (2020) undertook an empirical analysis on the impact of credit risk on financial performance of banks in South Africa for the period 2008 to 2018. The measure of credit risk for the study were non-performing loans, growth, capital adequacy, size and bank leverage. On the other hand, ROA and ROE were the proxies of financial performance of banks in South Africa. The overall results of the study indicated that credit risk had a negative relationship with financial performance. The study recommended adoption of stringent credit policies so as to reduce the occurrence of non-performing loans. Further, the study recommended enhanced supervision by regulators so as to ensure banks properly manage their credit risk and in turn reduce chances of bank failure due to credit risk.

Theoretical Framework

Financial Intermediation Theory: Financial Intermediation Theory, proposed by Diamond (1984), explains how banks reduce information asymmetry between borrowers and lenders



through delegated monitoring, producing credible credit-worthiness information that improves lending decisions. Modern contributions argue that financial intermediation operates under persistent economic imperfections (Jappelli & Pagano, 2006), while Tripe (2003) emphasises that intermediaries exist because they minimise transaction and information costs created by asymmetries. Through maturity transformation, liquidity provision, and risk transformation, banks channel funds from surplus to deficit units, thereby supporting macroeconomic stability and economic growth.

In performing these intermediation roles, banks inevitably assume credit, liquidity, market, and operational risks which, if poorly managed, can threaten both institutional solvency and systemic stability. In Nigeria's volatile banking environment, effective risk management is essential for maintaining capital adequacy, asset quality, liquidity soundness, and earnings performance. Criticisms of the theory highlight its limited recognition of lenders' roles in risk management (Levine et al., 2000) and its insufficient incorporation of credit risk in the intermediation process (Scholtens & Van Wensveen, 2000). Nonetheless, the theory remains relevant, as intermediaries increasingly use technology to collect, screen, and monitor borrower information thereby reducing transaction costs and linking risk management to organisational performance (Jappelli & Pagano, 2006).

Methodology

The study employed an ex post facto research design because this type of research method is particularly effective in evaluating the effect of risk management on financial stability of quoted deposit money banks in Nigeria. The study focuses on the fifteen (15) quoted deposit money banks operating within Nigeria's financial sector. Including all fifteen (15) banks ensured comprehensive coverage and facilitated a complete understanding of the impact of risk management committee attributes on financial stability. The study employed the Generalized Method of Moments (GMM) estimation technique for data analysis.

Stochastically, the models are written as follows:

$$FSB_{it} = \beta_0 + \beta_1 FSB_{it-1} + \beta_2 CRISKD_{it} + \beta_3 MRISKD_{it} + \beta_4 OPRISKD_{it} + \beta_5 LQRISKD_{it} + \epsilon_{it}$$



Where:

FSB = Financial stability

CRISKD = Credit Risk management

MRISKD = Market Risk management

OPRISKD = Operational Risk management

LQRISKD = Liquidity Risk management

Results and Discussion of Findings

Table 1: Descriptive Statistics

	Mean	Maxi	Mini	Std.Dev.	Skew	Kurt	Obs
FSB	2.343254	5.100000	1.056395	0.670746	1.340447	5.263519	150
CRISKD	4.376923	5.000000	3.000000	0.638134	-0.51993	2.344844	150
LQRISKD	5.838462	6.000000	5.000000	0.369451	-1.83933	4.383137	150
MRISKD	5.476923	6.000000	3.000000	0.882345	-1.56101	4.293032	150
OPRISKD	4.930769	6.000000	4.000000	0.612385	0.036957	2.661175	150

Source: Eviews Output 2025

Table 1 presents the descriptive statistics for the study variables, including financial stability (FSB) and the various risk management: credit risk (CRISKD), liquidity risk (LQRISKD), market risk (MRISKD), and operational risk (OPRISKD) of quoted commercial banks in Nigeria. The mean value of financial stability (FSB) is 2.34, with a standard deviation of 0.671, indicating moderate variability in the financial stability scores across the sampled banks. The minimum and maximum values of 1.06 and 5.10, respectively, suggest that while some banks demonstrate relatively low financial stability, others perform considerably better, reflecting heterogeneity in institutional performance and risk resilience. The positive skewness of 1.34 and high kurtosis of 5.26 indicate a distribution that is moderately skewed to the right with a leptokurtic pattern, suggesting that a few banks exhibit exceptionally high financial stability relative to the majority.



For credit risk disclosure (CRISKD), the mean is 4.38, with a standard deviation of 0.64, implying low variability and generally high adherence to credit risk management among the banks. The negative skew of -0.52 indicates a slight tendency toward higher disclosure scores, while the kurtosis of 2.34 shows a distribution that is relatively close to normal. Liquidity risk disclosure (LQRISKD) exhibits the highest mean of 5.84 and the lowest standard deviation of 0.37, suggesting that Nigerian banks consistently maintain strong liquidity risk management. The pronounced negative skew of -1.84 and kurtosis of 4.38 reveal that most banks have very high liquidity risk disclosure scores, with a few banks showing marginally lower values.

Market risk disclosure (MRISKD) has a mean of 5.48 and a standard deviation of 0.88, indicating generally strong management of market risk but with some variation across banks. The negative skew of -1.56 and high kurtosis of 4.29 suggest a concentration of high disclosure scores, similar to liquidity risk practices. Operational risk disclosure (OPRISKD) has a mean of 4.93 with a standard deviation of 0.61, reflecting moderate to high operational risk management. Its near-zero skew (0.04) and kurtosis of 2.66 indicate a fairly symmetric distribution that is slightly leptokurtic, meaning most banks cluster around the mean with few extreme values.

Multicollinearity Test

Table 2: Variance Inflation Factors

Variable	Coefficient Variance	Centered VIF
CRISKD	0.004524	1.110666
LQRISKD	0.021037	1.731091
MRISKD	0.003370	1.581773
OPRISKD	0.009720	2.197607

Source: Eviews Output 2025

Table 2 presents the Variance Inflation Factors (VIF) for the independent variables, which include credit risk disclosure (CRISKD), liquidity risk disclosure (LQRISKD), market risk disclosure (MRISKD), and operational risk disclosure (OPRISKD). VIF is a diagnostic measure used to detect multicollinearity among explanatory variables in regression analysis. A VIF value exceeding 10 generally signals problematic multicollinearity, while values below 5 indicate low to moderate correlation among predictors (Hair et al., 2019).

From the table, all the independent variables exhibit VIF values well below the threshold of 10. Specifically, CRISKD has a VIF of 1.11, LQRISKD has 1.73, MRISKD has 1.58, and OPRISKD has 2.20. These low VIF values indicate that there is minimal multicollinearity



among the risk management variables, suggesting that each predictor contributes unique information to the regression model.

Regression Analysis

Table 3: Dynamic Panel-Results

Variable	Coefficient	Std. Error	z-value	P> z
L.FSB	0.2164	0.1090	1.99	0.047
CRISKD	-1.3647	0.6622	-2.06	0.039
MRISKD	2.4765	0.9714	2.55	0.011
OPRISKD	-2.8646	1.5290	-1.87	0.061
LQRISKD	2.9090	2.0363	1.43	0.153

Source: Eviews Output 2025

Table 3 presents the dynamic panel regression results examining the impact of risk management on the financial stability (FSB) of quoted commercial banks in Nigeria. The lagged dependent variable (L.FSB) has a positive and significant coefficient of 0.2164 ($p = 0.047$), indicating that past financial stability positively predicts current stability. This persistence aligns with the Financial Intermediation Theory (Diamond, 1984; Jappelli & Pagano, 2006; Tripe, 2003), which posits that banks' ability to manage risks consistently over time is crucial for sustaining financial intermediation and macroeconomic stability.

Credit risk management (CRISKD) has a significant negative effect (-1.3647, $p = 0.039$), suggesting that inadequate credit risk practices or high non-performing loans reduce financial stability. This finding is supported by recent studies, which show that poor credit risk management erodes bank performance (Natufe & Evbayiro-Osagie, 2023; Fadun & Silwimba, 2023). Market risk management (MRISKD) shows a positive and significant effect (2.4765, $p = 0.011$), implying that effective handling of interest rate and foreign exchange exposures strengthens financial stability (Modu, Umar & Aliyu, 2024). Operational risk management (OPRISKD) has a negative coefficient (-2.8646, $p = 0.061$), indicating that operational failures or weak internal controls can undermine stability (Okoro, Rufus & Temitope, 2023). Liquidity risk management (LQRISKD) has a positive coefficient (2.9090) but is not statistically significant ($p = 0.153$), suggesting that while theoretically important, liquidity risk management's effect on stability may depend on external market conditions or bank-specific factors.



These results reinforce the Financial Intermediation Theory by showing that banks' intermediation role depends on their ability to manage multiple categories of risk effectively. The negative impact of credit and operational risk highlights the criticality of proper risk assessment and internal controls, while the positive effect of market risk management demonstrates the value of proactive market-risk strategies for sustaining financial stability. For bank management and regulators, these findings underscore the need to strengthen credit and operational risk controls, including stringent loan appraisal, monitoring, and fraud prevention mechanisms. Market risk should be actively managed through hedging strategies and asset diversification. The significant lagged FSB coefficient also emphasizes that financial stability is cumulative, requiring consistent, disciplined risk management over time. Policymakers can leverage these insights to design supervisory frameworks that encourage banks to maintain robust risk-management systems, thereby safeguarding systemic stability (Obayagbona & Osagiende, 2023).

Conclusion and Recommendations

The study examined the impact of credit, market, operational, and liquidity risk management on the financial stability of quoted commercial banks in Nigeria. The dynamic panel results reveal that past financial stability positively influences current stability, reflecting the cumulative and persistent nature of financial performance. Among the risk categories, credit and operational risk management have a negative impact on financial stability, suggesting that inadequate credit assessment, high non-performing loans, and weak operational controls can significantly undermine bank performance. In contrast, market risk management positively contributes to stability, highlighting the importance of proactive management of interest rate, foreign exchange, and other market exposures. Liquidity risk management, although positive, was not statistically significant, indicating that its impact may be conditional on broader institutional or macroeconomic factors. These findings underscore the need for banks to adopt comprehensive and continuous risk management strategies to maintain financial resilience.

Based on the findings and conclusion, the study recommends that:

1. Banks should implement robust credit appraisal and monitoring systems, including rigorous loan screening, timely identification of non-performing loans, and adequate provisioning, to mitigate credit-related vulnerabilities.



2. Management should adopt advanced internal controls, fraud detection mechanisms, and process optimization to reduce operational failures that could negatively impact stability.
3. Banks should employ hedging techniques, diversify portfolios, and monitor interest rate and foreign exchange exposures to ensure market risks positively contribute to financial stability.
4. Although liquidity risk was not statistically significant, banks should continue monitoring liquidity ratios, maintain sufficient buffers, and prepare contingency plans for potential liquidity shocks.
5. Financial stability is cumulative; therefore, banks should implement ongoing risk assessment frameworks, regularly review risk policies, and ensure alignment with regulatory requirements and best practices.
6. Policymakers and regulators should strengthen supervisory frameworks that encourage banks to adopt comprehensive risk management, including stress-testing scenarios for credit, market, operational, and liquidity risks.

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