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RISK MANAGEMENT, FIRM CHARACTERISTICS, CORPORATE GOVERNANCEAND BANK PERFORMANCE: A CRITICAL LITERATURE REVIEW

Herick Ondigo

Department of Finance and Accounting, University of Nairobi, Kenya

Email: hondigo@uonbi.ac.ke

ABSTRACT

Effective risk management is accepted as a major cornerstone of bank management by academicians, practitioners and well as regulators. Acknowledging this reality and the need for a comprehensive approach to deal with bank risk management, the Basel Committee on Banking Supervision adopted the Base I Accords, followed by the Basel II Accords and more recently, the Basel III accords, to attempt to deal with the critical matter in the banking industry. This study aims to undertake a critical theoretical literature review on risk management, firm characteristics, corporate governance and performance of commercial banks. The paper starts from the theoretical and empirical proposition that the risk management, firm characteristics as well as corporate governance effectively leads to improved bank performance. The paper argues that risk management coupled with theexternal demands for efficiency in banks (external corporate governance) translates to internal, organizational arrangements for performance management and incentive system design (internal governance), leads into better performance of banks. Further it proposes that firm characteristics such as ownership structure, size and financial architecture can influence the nature of the relationship among risk management, corporate governance and bank performance.The most common firm characteristics being included as variables in corporate governance or risk management researches arefirm size,leverage and industry type. The influence of these firm characteristics on the relationship between risk management and firm performance however is not well documented.The study presents a conceptual framework guided by the following theories: enterprise risk management framework, agency theory, the stewardship theory, the stakeholder theory. The study concludes by identifying and discussing the knowledge gaps and documenting four possible areas for researches including: the effect of risk management on bank performance; the mediating effect of corporate governance on the relationship betweenrisk management;the moderating effect of firm characteristics on the relationship between risk management and corporate governance as well as the moderating effect of firm characteristics on the relationship between corporate governance and firm performance; further, many studies have assumed that the efficient performance of banks' relies on either risk management, corporate governance and firm characteristics in isolation or in combinations, however future research could focus on the effect of macroeconomic variables such as, financial crisis, exchange rate, inflation rates, money supply and Gross domestic product as well micro economic variables such as corporate strategy and management quality on the relationship between risk management, corporate governance and bank .performance. Finally, future research could focus on the effect of risk management and corporate governance on shareholder return for listed firms.

Key Words: Risk Management, Corporate Governance, Firm Characteristics, Bank Performance

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Introduction

Financial institutions exist to improve the efficiency of the financial markets. If savers and investors as well as buyers and sellers, could locate each other efficiently, purchase any and all assets at no cost, and make their decisions with freely available perfect information, then commercial banks would have little or no scope for replacing or mediating these direct transactions. In the real world, market participants seek the services of commercial banks because of the banks' ability to provide market knowledge, transaction efficiency, and contract enforcement. Commercial banks discover, underwrite, and service investments made using their own resources, or merely act as agent for market participants who contract with them to obtain some of these same services. In the process of undertaking such noble duties banks face a number of risks that must be managed prudently to ensure sustainability and success (Oldfield & Santomero, 1995).

By virtue of the relationship that exists between a bank and its stakeholders, the stakeholders have a duty to ensure that the bank is managed well. Stakeholders must exert influence in all areas of the health of a bank. Empirical findings on the effect of corporate governance and the management of bank risks have received different answers from researchers. For example, Jensen (1993) hypothesize that stakeholders in the corporate governance of banks impact how banks manage risks, while Simpson and Gleason (1999) and Prowse (1997) argue that stakeholders in the corporate governance do not have significant impact on risk management.

The issue of corporate governance in banking has been analyzed very extensively in the context of conventional banking markets. By contrast, little research has been undertaken on corporate governance from Islamic perspective particularly the governance structures of Islamic finance sector, despite its rapid growth since the mid 1970s and their increasing presence on world financial markets (Yunis, 2007). Undeniably, corporate governance is one of the vital elements of any corporation development and it is even bigger challenge to Islamic finance system due to its additional risk as compared to the conventional banking system. For instance the depositors becomeexposed to various kinds of risks due to the various Islamic banking products geared towards risk-sharing modes rather than pure interest(Chapra, 2007).

Risk Management

Risk management refers to the process of identification, analysis and either acceptance or mitigation of uncertainty in investment decision-making. Essentially, risk management occurs anytime an investor or fund manager analyzes and attempts to quantify the potential for losses in an investment and then takes the appropriate action (or inaction) given their investment objectives and risk tolerance. Poor or inadequate risk management can result in severe consequences for companies as well as individuals. For financial institutions therefore,risk management refers to "the overall process that a financial institution follows to define a business strategy, to identify the risks to which it is exposed, to quantify those risks, and to understand and control the nature of risks it faces" (Cumming &Hirtle, 2001).

Parreñas (2005) states that robust risk management practices in the banking sector are important for both financial stability and economic development. Unsound risk management practices governing bank lending greatly contributed to recent episodes of financial turmoil. The development of adequate capacity to measure and manage risks is therefore important for banks

to effectively perform their roles in financing economic activities, most especially the task of continuously providing credit to a large number of enterprises whose activities underpin economic growth. The banking industry has viewed the problem of risk management as the need to identify measure and control credit risk, interest rate risk, foreign risk as well as liquidity risk, counterparty risk as well as legal risk. Studies of bank risk management processes is essentially involve an investigation how banking institutions standardize, measure, constrain and manage each of these risks (Santomero, 1997).

Firm Characteristics

Studies have identified various firm characteristics either as determinant of corporate governance disclosure, corporate governance compliance, Corporate Disclosures, Risk management tools used, or as control variables of such empirical research. The most common firm attributes include size (Bauwhede and Willekens, 2008; Beasley, et al., 2005; Eng and Mak, 2003; Gul and Leung, 2004; Hassan, 2009; Ho and Shun Wong, 2001; Linsley and Shrives, 2006), leverage (Amran, et al., 2009; Bauwhede and Willekens, 2008; Eng and Mak, 2003; Gul and Leung, 2004; Hassan, 2009; Ho and Shun Wong, 2001), and industry type (Beasley, et al., 2005; Eng and Mak, 2003; Hassan, 2009; Ho and Shun Wong, 2001)

Other firm characteristics include, growth opportunities, analyst following, stock price performance, profitability, stock volatility, audit fee, audited by Big5/ Big4 audit firm, overseas listing, equity market liquidity, firm issued new share capital following year, short term accrual, non common law, change in stock price, political connection , reserves, product diversification, geographical diversification, market to book equity ratio, listing status, equity financing, liquidity, and high quality of accounting standard have been found on form profitability (Eng and Mak, 2003) . In addition ownership structure has been suggested as a key firm characteristic Jensen and Meckling (1976) that influences corporate governance in firms.

Corporate Governance

Corporate governance is, "the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations". It encompasses the mechanisms by which companies, and those in control, are held to account. Effective corporate governance structures thus encourage companies to create value, through entrepreneurialism, innovation, development and exploration, and provide accountability and control systems commensurate with the risks involved (Council, 2007).A number of mechanisms areused to align the interests of the executives and those of the shareholders including, but not limited to, boards of directors, executive compensation, and active use of ownership prerogatives by large shareholders like institutional investors and the market for corporate control like acquisitions (Nambiro, 2007).

Corporate governance in the banking sector is significantly different from corporations in other economic sectors (Prowse, 1997). Whether regulation substitutes or complements traditional governance mechanisms and controls is a subject of debate, but it is generally agreed that the external controls coming from takeovers and product-market competition turn out to be weaker in banks than in other firms (Prowse, 1997).

Corporate governance in the banking sector is significantly different from corporations in other economic sectors (Prowse, 1997). For example, there is a clear conflict inside the banks between

the interests of the shareholders and the interests of the depositors, with the former being willing to take high-risk projects that increase share value at the expense of the increased risk for depositors. Small deposits are insured and banks are regulated to avoid crisis of confidence and bank runs, although it increases the moral hazard problem. Whether regulation substitutes or complements traditional governance mechanisms and controls is a subject of debate, but it is generally agreed that the external controls coming from takeovers and product-market competition turn out to be weaker in banks than in other firms (Prowse, 1997). The regulatory environment of banks will have implications for the effectiveness of internal governance mechanism and in shaping the nature of top management accountability.

Bank Performance

Measuring firm performance has been a major challenge for scholars and practitioners as well (Simerly&Li, 2000). Performance is a multidimensional construct and thus, any single index may not be able to provide a comprehensive understanding of the performance relationship relative to the constructs of interest (Chakravathy, 1986). Kaplan and Norton (1996) argues in their balanced score card (BSC) model that financial metrics is the ultimate outcome measures for company success, but also supplement these with metrics from three additional perspectives – customer, internal process, and learning and growth, that are proposed as the drivers for creating long-term shareholder value. Kaplan and Norton (1996) suggest a frameworkof translating vision and strategy into shareholder value by focusing on the four drivers of value: financial,customer,learning &growth andfinally internal business processes.

Although banking institutions have become increasingly complex, the key drivers of their performance remain earnings, efficiency, risk-taking and leverage. While it is clear that a bank must be able to generate “earnings”, it is also important to take account of the composition and volatility of those earnings. “Efficiency” refers to the bank’s ability to generate revenue from a given amount of assets and to make profit from a given source of income. “Risk-taking” is reflected in the necessary adjustments to earnings for the undertaken risks to generate them (e.g. credit-risk cost over the cycle). “Leverage” might improve results in the upswing – in the way it functions as a multiplier – but, conversely, it can also make it more likely for a bank to fail, due to rare, unexpected losses. There are a multitude of measures used to assess bank performance, with each group of stakeholders having its own focus of interest (Baele et al., 2004)

The Commercial Banking Sector

Banking occupies one of the most important positions in the modern economic world. It is necessary for trade and industry. Modern banking is one of the results of the industrial revolution and the child of economic necessity.Banks can bebroadly classified into commercial banks (those which provide banking services for profit) and central bank (for controlling commercial banks and various other economic activities). There are many types of commercial banks such as deposit banks, industrial banks, savings banks, agricultural banks, exchange banks, and miscellaneous banks (Leaf, 1902).The integral role that banks play in the national economy is demonstrated by the almost universal practice of many countries regulating the banking industry and providing, in many cases, a government safety net to compensate depositors when banks fail. The large number of stakeholders (such as employees, customers, suppliers), whose economic well-being depends on the health of the banking industry, depend on appropriate regulatory practices and supervision.

It is imperative that financial regulators ensure that banking and other financial institutions have strong governance structures, especially in light of the pervasive changes in the nature and structure of both the banking industry and the regulation which governs its activities (Hawkins & Turner, 2000).Instability in the banking sector will lead to contagion effect, which would affect a class of banks or even the entire financial system and the economy. This can result into a financial crisis as has been witnessed in the past including the Asian financial crisis as well as the global financial crisis. Further, in some economies, especially the developing countries, banks are used as an instrument of public policy. Competitive environment in banking sector is, in some countries, less demanding than in other sectors of the economy, and the government often condones anti-competitive behavior that would not be accepted in other parts of the economy (Llewellyn and Sinha 2000).

The Banking industry has a significant impact on the economy, facilitating the transmission of monetary policy by making credit and liquidity available in difficult market conditions.The integral role that banks play in the national economy is demonstrated by the almost universal practice of countries in regulating the banking industry and providing, in many cases, a government safety net to compensate depositors when banks fail. Financial regulation is necessary because of the multiplier effect that banking activities have on the rest of the economy. The large number of stakeholders,whose economic well-being depends on the health of the banking industry, depends on appropriate regulatory practices and supervision. The primary function of regulators is to develop substantive standards and other risk management procedures for financial institutions in which regulatory risk measures correspond to the overall economic and operational risk faced by a bank. Accordingly, it is vital that financial regulators ensure that banking and other financial institutions have strong governance structures, especially in light of the pervasive changes in the nature and structure of both the banking industry and the regulation which governs its activities(Alexander, 2006).

Research Problem

Corporate governance, risk management, characteristics and performance and are important concepts in commercial banks due to their involvement in the financial intermediation process. Banking is a risky business and several risk factors such as credit, liquidity, operational and market risks have been identified as critical to ensure that the banks position remain intact amid the intense competition in the industry. The survival and success of a financial organization depends critically on the efficiency of managing these risks (Khan and Ahmed, 2001). Poor risk management and weak corporate governance systems in the banking sector will lead to contagion effect, which would affect a class of banks or even the entire financial system and the economy.

Effective risk management is accepted as a major cornerstone of bank management by academicians, practitioners and well as regulators. Acknowledging this reality and the need for a comprehensive approach to deal with bank risk management, the Basel Committee on Banking Supervision adopted the Base I Accords, followed by the Basel II Accords and more recently, the Basel III accords, to attempt to deal with the critical matter in the banking industry. A clear

outcome of weaknesses in corporate governance and risk management was witnessed in the past financial crisis including the Asian financial crisis as well as the global financial crisis. In addition several corporate failures have been documented in this regard including Worldcom, Pamalat, Enron ,Uchumi Supermarket, CMC and more recently Mumias Sugar. In the Banking sector cases of The Government taking over statutory management or even winding up are widespread both locally and internationally.

The studied conducted on these concepts pose theoretical, methodological as well as contextual gaps. Theoretically, while agency theory proposes that separation of ownership from control naturally creates conflicts of interest that must be managed in the interest of the principal, stewardship and stakeholder theories argue that no such conflicts arise. Methodologically the concepts have been studied in isolation with contradictory results. Contextually, most studies have been conducted in developed markets that differ in terms of efficiency regulatory as well legal environments. Studiesrelating risk management practices and performance have provided mixed results with documenting negative effects (Brinkmann and Horvitz, 1995; Furlong, 1992) while others have reporting positive relationships (Peek and Rosengren, 1995; Berger and Udell 1994; Angbazo, 1997; Smith Jr., 1995; & Schlock, 2002; Ndung'u, 2013). Further, studies on the relationship between corporate governance and firm performance are inconclusive. While some researchers find that the composition of the board of directors is related to firm performance (Baysinger and Butler (1985), Rosenstein and Wyatt (1990), Yermack (1996), others do not find such relationships (Fosberg, 1989); Hermalin and Weisbach, 1991; Bhagat and Black, 2001).

The influence of firm characteristics on firm performance is also another area that is not fully resolved in academic literature with some researchersfinding that firm characteristics are related to better performance (Morck et al., 1988; McConnell and Servaes, 1990; & Hermalin and Weisbach, 1991, Chantapong, 2005) while others disagree and contend that there no such effect exits (Demsetz and Lehn, 1985; Himmelberg and Weisbach, 1991; Demsetz and Villalonga, 2001). Locally, (Ongore & Kusa 2013; Olweny& Shipho 2011) found out that bank specific factors significantly affect the performance while studying the effects of bank-specific factors and market structure factors on the profitability of commercial banks in Kenya, on the contrary, Mang'unyi (2011) found out that there was no significant difference between type of ownership and financial performanceof selected Banks in Kenya. In academic literature there is unresolved debate concerning the direction of sequential interactions between risk management, corporate governance, firm characteristics, and firm performance, hence the need for the current and further studies.
This study paper attempts to answer the following research questions: What are the relationshipsamong risk management,corporate governance firm characteristics and the performance of commercial banks? The study objective was to document research gaps and guide future researches on risk management, firm characteristics, corporate governance and performance of banks.

Theoretical literature review

Enterprise Risk Management Framework

Enterprise Risk Management (ERM) is a framework that focuses on adopting a systematic and consistent approach to managing all of the risks confronting an organization Tseng (2007). Gordon, Loeb, & Tseng (2009) define ERM as the overall process of managing an organization's exposure to uncertainty with particular emphasis on identifying and managing the events that could potentially prevent the organization from achieving its objective. ERM is an organizational concept that applies to all levels of the organization. By adopting ERM , the risk manager is constantly aware of the risks it faces and therefore constantly monitors its exposure and be positioned to change strategy or direction to ensure the level of risks it takes is acceptable, COSO's (2004).

Enterprise risk management is a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives (COSO, 2004). In conducting ERM, the following are listed as some of the areas or aspects of the organization that a risk manager needs to look into namely: the people, intellectual assets, brand values, business expertise and skills, principle source of profit stream and the regulatory environment. This will help organization to balance the two most significant business pressures; the responsibility to deliver succeed to stakeholders and the risks associated with and generated by the business itself in a commercially achievable way. The framework is relevant to this study as it focuses on adopting a systematic and consistent approach to managing all of the risks confronting an organization and incorporating corporate governance mechanisms that maximize Shareholder wealth.

Agency Theory

The separation of ownership from control leads to an agency problem whereby management operates the firm aligning with their own interests, not those of shareholders (Jensen and Meckling 1976). This creates opportunities for managers to spend firm resources maximizing their utilities rather than maximizing the shareholders wealth. Other than the relationships between shareholders and managers, agency conflicts also arise among shareholders versus bondholders, Shareholders and independent auditors, shareholders and Government ,major (dominant) shareholders versus minority shareholders, as well Management and subordinates.

In the field of corporate risk management, agency issues have been shown to influence managerial attitudes towards risk taking and hedging (Smith & Stulz, 1985).The theory also explains a possible mismatch of interest between shareholders, management and debt holders due to asymmetries in earning distribution, which can result in the firm taking too much risk or not engaging in positive net value projects (Mayers & Smith, 1987).Consequently, agency theory implies that defined hedging policies can have important influence on firm value, Klimczak (2007). Jensen (1986) argues that the role of managers as agents for stakeholders is full of conflict of interest which can affect asset selection, firm behavior, efficiency and performance. Agency theory is relevant to the study as separation of ownership from control creates conflicts that can be managed though corporate risk management as well as corporate governance to align interests of directors and managers with those that maximize shareholder wealth.

Stewardship Theory

This theory holds that there is no conflict of interest between managers and owners, and that the goal of governance is, precisely, to find the mechanisms and structure that facilitate the most effective coordination between the two parties (Donaldson, 1990). Stewardship theory is mainly concerned with identifying the situations in which the interests of the principal and the steward are aligned (Donaldson and Davis, 1991& 1993). According tothis theory, there are situational and psychological factors that predispose individuals to becomeagents or stewards.

Researchers, in general, have tended to ignore the principal as the agent and have overemphasized the role of the manager as the agent. The ‘model of man’ in Stewardship Theory is someone whose behavior is ordered such that pro-organizational behaviors have higher utility than individualistic behaviors (Davis et al., 1997). This model of man is rational as well, but perceives greater utility in cooperative behaviors than in self-serving behaviors. A steward’s utility function is maximized when the shareholders’ wealth is maximized. The steward perceives that the utility gained from interest alignment and collaborative behavior with the principal is higher than the utility that can be gained through individualistic, self-serving behaviors (Davis et al., 1997). Therefore, the major difference between the Agency and Stewardship both theory lies on the nature of motivation. Agency Theory places more emphasis on extrinsic motivation, while Stewardship Theory is focused on intrinsic rewards that are not easily quantified, such as growth, achievement, and duty.

Stakeholder Theory

According to the stakeholder theory, shareholders are but one of a number of important stakeholder groups (Freeman, 1989). According to stakeholder theory, “Just likebusiness owes special and particular duties to its investor; it also has different duties to the various stakeholder groups. The firm and its managers have special obligations to ensure that the shareholders receive a “fair” return on their investment; but the firm also has special obligations to other stakeholders, which go above and beyond those required by law.The most promising contribution to risk management is the extension of implicit contracts theory from employment to other contracts, including sales and financing (Cornell &Shapiro, 1987).Therefore stakeholder theory provides a new insight into possible rationale for risk management.

Naturally, this idea of “shareholders as just another stakeholder group” is not one that underlies corporate law in most market economies. In the company’s act law, shareholders are given preeminent status as the owners of the firm. They are able to elect all or most of the members of

Board of Directors, which in turn has the right to hire and fire senior executives and approve or reject important policies and strategies of the firm. In effect, the shareholders have the right to treat the firm as a vehicle to maximize the return on their investment. While the board is supposed to ensure that the firm respects its legal and contractual obligations to other stakeholder groups, it is also fully within its rights to instruct managers to consider the ultimate purpose of the firm to be the maximization of profits and shareholder value, Freeman (1989).

Empirical literature review

Relationship between RiskManagement and Firm Performance

Hakim and Neamie (2001) examined the relationship between credit risk and bank's performance of Egypt and Lebanon bank in 1990s. Using data for banks from the two countries over the period 1993-1999, the study estimates a fixed effects model of bank return with varying intercepts and coefficients. The findings showed that credit variable is positively related to profitability, while liquidity variable is insignificant across all banks and have no impact on profitability. As a policy implication, the study provided important input for the policymakers to set better performance targets, and enable bank managers to allocate capital more efficiently across their business units.

Pagach and Warr (2007) examined the factors that influences the firm level of ERM and found that the more leveraged the firms are, the more volatile are their earnings. Using the hazard model to examine factors that influence firms' adoptions of the ERM, the study documented that firms that are more levered, more volatile earnings, and poorer stock performances, were more likely to adopt ERM. In addition, greater CEO's option and increasing stock portfolio volatility also increase the likelihood for the adoption of ERM.

Ellul and Yerramilli (2013) investigated whether a strong and independent risk management was significantly related to bank risk taking and performance during credit crisis in a sample of 74 large U.S banks. They constructed a risk management index (RMI) which was based on five variables related to the strength of a bank's risk management: a dummy variable whether the bank has a designated credit risk officer (CRO) who is a member of the executive board, a dummy variable whether the CRO is among the top five highly paid executives, the ratio of the CROs total compensation to the chief executive officers (CEO) total compensation, a dummy variable whether at least one of the non executive directors on the banks risk committee met more frequently in the respective year as compared to the average value across the other sample banks. Their findings indicate that banks with a high RMI value had lower exposure to private label mortgage backed securities, were less active in trading off balance sheet derivatives and had a smaller fraction of non-performing loans, a lower downside risk and a higher Sharpe ratio during the crisis year 2007-2008.

Ndung'u (2013) conducted a study on the effect of financial risk management on financial performance of oil companies in Kenya. The study adopted causal research design. Semi-structured questionnaires were used to obtain primary data on risk management while financial statements were used to obtain data on financial performance. A linear regression model of financial performance versus financial risk management techniques was applied to examine the relationship between the variables. The study found that most oil companies had highly adopted

financial risk management practices to manage financial risk and the financial risk management practices had a positive correlation to the financial performance of oil companies in Kenya.

Relationship between Risk Management and Corporate Governance

Prowse (1997) investigated the unique factors in commercial banks' legal and regulatory environment may influence their mechanisms of corporate control. He analyzed sample of U.S. bank holding companies (BHCs) by evaluating how many underwent a change in corporate control by hostile takeover, friendly merger, management turnover by the board, or intervention by regulators and compared the relative importance of these methods with those in nonfinancial firms. He finally related the use of these methods to BHC board and ownership structure and performance. The finding of the study was that the most important corporate control mechanism in banks is regulatory intervention, and that the primary market-based corporate control mechanism is action by the board of directors. Overall, however, BHC boards are much less assertive than their counterparts at nonfinancial firms. He argues that stakeholders in the corporate governance do not have significant impact on risk management

Kirkpatrick (2009) analyzed the impact of failures and weaknesses in corporate governance on the financial crisis, including risk management systems and executive salaries. He noted that financial crisis could be attributed to failures and weaknesses in corporate governance arrangements. He concluded that qualified board oversight and robust risk management was not limited to financial institutions.

Relationship between Corporate Governance and Firm Performance

Rechner & Dalton (1991) examined the relation between CEO duality and organizational performance in a random sample of corporations from the Fortune 500. They identified corporations which had remained as either dual or independent chair- CEO structures for each year of a six-year period (1978–1983). They found that corporations which had independent chair-CEO structures had higher return on equity (ROE), return on investment (ROI) and profit margins. Their study supports agency theory expectations about inferior shareholder returns from CEO duality. Earlier, Rechner and Dalton (1989) had examined the effect of CEO duality on risk adjusted shareholder returns using stock market data for the same sample and period. They found no significant difference between structures.

Pi and Timme (1993) in a study on corporate control and bank efficiencyexamined the role of the chairman of a bank’s board and found that cost efficiency and return on assets are lower for banks that have the same person serving as chairman of the board and chief executive officer (CEO) than for banks without such duality. They also found out that the proportion of insiders/outsiders on the board of directors is unrelated to bank performance. These results suggest top management team structure affects performance and internal monitoring devices may not be as effective as envisioned in the theoretical literature.

Brown and Caylor (2004)conducted a study to examine whether firms with weaker corporate governance performed more poorly than firms with stronger corporate. Further, they investigated whether the firms with weaker corporate governance are less profitable compared to those firms with stronger corporate governance. They found that firms with weaker corporate governance to be less profitable. Further the researchers examined whether firms with weaker corporate

governance were riskier and pay out fewer dividends, than firms with stronger corporate governance. They found that firms with weaker corporate governance to be riskier and have lower dividend payouts and lower dividend yields than do firms with stronger corporate governance.

Chiang& Chia(2005) conducteda study on the relationship among indicators of corporate governance, including transparency and operating performance measures, and whether or not the indicators could be predictors of operating performance. The results indicated that corporate transparency had a significant positive relationship with operating performance and it was one of the most important indicators for evaluating corporate performance. The study found that board size, board ownership, institution ownership, information disclosure, and board and management structure and process had significant relationships with operating performance.

Kyereboah-Coleman (2007) did a study on corporate governance and shareholder value maximization: An African perspective. The study targeted 103 listed firms on Ghanaian, Nigerian, Kenyan and South African stock exchanges covering the period 1997–2001 and analysis done within the panel data framework. The Results showed that, corporate boards in the selected countries were relatively not independent. The regression result showed that large board sizes enhance corporate performance and shareholder value maximization. The study also found that both sector and country-specific effects have an impact on shareholder value maximization.

Aluchna (2009) investigated the relationship between compliance with corporategovernance best practice and corporate performance within Poland. The analysis is based on theregression of corporate governance compliance rating and corporate performance on a sample ofPolish public listed companies for years 2004-2006.The researcher found that complying with corporate governance best practice in Poland was associated with lower return on investment (the whole sample). However, the tendency changed into negative but statistically insignificant for the second and third years and positive butstatistically insignificant when only rated companies were included in the research sample. Therelationship between proxy of Tobin's q and corporate governance rating was statisticallyinsignificant and negative for the whole sample and positive for first and third year as well asfor rating companies.

Aboagye and Otieku (2010) studied 30 rural and community banks in Ghana using data over the period 2000 – 2005. The purpose of the study was to determine whether in Ghana, corporate governance, outreach to clients, reduced dependence on subsidies and use of modern technology were associated with the performance of rural and community banks (RCBs), which were microfinance institutions (MFI).A total of 30 randomly sampled RCBs were categorized into four groups based on analysis of several dimensions of financial performance. Next, RCBs were again categorized into four groups based on their corporate governance plus. A chi-squared test of independence between the two groupings was performed. The study found no association between RCBs' categories based on corporate governance plus and their categories based on financial performance.

Minton et al. (2011) investigated how risk taking and U.S. banks performance in the crisis are related to board independence and financial expertise of the board. The study used all U.S. banks and specialty and other finance firms from BoardEx which total 652 individual firms from 2003

to 2008. The study examined how financial expertise and independence of the board relate to the financial performance of commercial banks during the financial crisis. They found that financial expertise of the board was positively related to risk taking and bank performance before the crisis but is negatively related to bank performance in the crisis.

Beltratti and Stulz (2012) investigated the relationship between corporate governance and bank performance during the credit crisis in an international sample of 98 banks. They found that banks with more shareholder-friendly boards as measured by the "Corporate Governance Quotient" (CGQ) obtained from Risk Metrics per-formed worse during the crisis, which indicates that the generally shared understanding of "good governance" does not necessarily have to be in the best interest of shareholders.

Erkens et al. (2012) investigated the influence of corporate governance on financial firms' performance during the 2007–2008 financial crises. The study used a unique dataset of 296 financial firms from 30 countries that were at the center of the crisis. The study found that firms with more independent boards and higher institutional ownership experienced worse stock returns during the crisis.

Relationship between FirmCharacteristics and FirmPerformance

Claessens et al. (1998) examined the separation of ownership and control for 2,980 corporations in nine East Asian countries. In all countries, they found that voting rights frequently exceed cash-flow rights via pyramid structures and cross-holdings. Further, the separation of ownership and control was most pronounced among family-controlled firms and small firms. Their findings were that managers of closely held firms tended to be relatives of the controlling shareholder's family and older firms were generally family-controlled, dispelling the notion that ownership becomes dispersed over time. Finally, they found that significant corporate wealth in East Asia was concentrated among a few families. Although domestic banks' performance is superior compared to their foreign counterparts in developed countries, the scholars found the opposite to be is true in developing countries.

Demsetz and Villalonga (2001)investigated the relationship between ownership structure and performance of corporations if ownership is made multi-dimensional and also is treated as an endogenous variable.The study found no statistically significant relation between ownership structure and firm performance. They concluded that for data that reflect market-mediated ownership structures, no systematic relation between ownership structure and firm performance is to be expected.

Wahab et al. (2007) studied the impact of the Malaysian Code on Corporate Governance: Compliance, Institutional Investors and Stock Performan**ce**. They used a panel analysis of 440 firms from 1999 to 2002. They found that corporate governance reform in Malaysia has been successful, with a significant improvement in governance practices. The relationship between ownership by the Employees Provident Fund (EPF) and corporate governance had strengthened during the period subsequent to the reform. The implementation of corporate governance had a substantial effect on shareholders' wealth, increasing stock prices by an average of about 4.8%. Although there was no evidence that politically connected firms perform better, political

connections had a significantly negative effect on corporate governance, which was mitigated by institutional ownership.

Mang'unyi (2011) explored ownership structure and corporate governance and its effects on performance of banks in Kenya. The study found that there was no significant difference between type of ownership and financial performance, and between banks ownership structure and corporate governance practices. Further results revealed that there was significant difference between corporate governance and financial performance of banks. However, foreign-owned banks had slightly better performance than domestically-owned banks.

Relationship between Firm Characteristics and Risk Management

Hassan (2009) studied the degree to which the Islamic banks in Brunei Darussalam implemented risk management practices and carried them out thoroughly by using different techniques to deal with various kinds of risks. The study found that, like the conventional banking system, Islamic banking was also subjected to a variety of risks due to the unique range of offered products in addition to conventional products. Further, there was a remarkable understanding of risk and risk management by the staff working in the Islamic, which showed their ability to pave their way towards successful risk management.

Hanim Tafri et al. (2011) carried out a study on the empirical evidence on the risk management tools practiced in Islamic and conventional banks in Malaysia and selected banks outside Malaysia. The study also examined the level of adequacy of risk management tools and systems of these banks. The study used primary data collected using a questionnaire survey.The study established that there were significant differences in the level of extensiveness of the usage of market value at risk (VaR), usage of stress testing results, the usage of credit risk mitigation methods and also the level of extensiveness of the usage of operational risk management tools between Islamic and conventional banks in Malaysia. The study found that risk management tools and systems for Islamic banking are inadequate, particularly in the critical areas of "IT professionals with relevant expertise in process integration and risk analytics", "IT systems to cater for each Islamic instrument" and also the "capacity of human capital in the highly technical areas of risk measurement."

Akhtar et al. (2011)investigated the significance of Size of the firm, Networking Capital, Return on Equity, Capital Adequacy and Return on Assets (ROA), with liquidity Risk Management in conventional and Islamic banks ofPakistan. The study was based on secondary data that covered a period of four years from 2006 to 2009. The study found positive but insignificant relationship of size of the bank and net-working capital to net assets with liquidity risk in both models. In addition Capital adequacy ratio in conventional banks and return on assets in Islamic banks was found to be positive and significant at 10% significance level.

Hussain and Al Ajmi (2012) carried out a study on Risk management practices of conventional and Islamic banks in Bahrain. They found out that the Banks had a clear understanding of risk and risk management, and had efficient risk identification, risk assessment analysis, risk monitoring, and credit risk analysis and risk management practices. In addition, they established that credit, liquidity and operational risk were the most important risks facing both conventional and Islamic banks. Islamic banks were found to be significantly different from their conventional

counterparts in understanding risk and risk management. The levels of risks faced by Islamic banks were found to be significantly higher than those faced by conventional banks. Similarly, country, liquidity, and operational, residual, and settlement risks were found to be higher in Islamic banks than in conventional banks.

The Relationships among Risk Management, Corporate Governance, Firm Characteristics and Bank Performance

Klein et al. (2005) conducted a study on the relationship between firm value as measured by Tobin's Q, and newly released indices of effective corporate governance as measured by reports on business (ROB) for a sample of 263 Canadian firms. The study used four control variables; size, advantage, growth, profit variability. The results indicated that corporate governance does matter in Canada, and that size was consistently negatively related to performance, as was advantage, growth and performance were positively related. However, they found no evidence that a total governance index affected firm was performance, because they found no evidence that board independence had any positive effects on performance, and it was negatively related for family owned firms.

Rogers (2006) conducted onrelationship between the core principles of corporate governance and financial performance in commercial banks of Uganda. The study found that corporate governance predicts 34.5 % of the variance in the general financial performance of commercial banks in Uganda. However the significant contributors on financial performance include openness and reliability. Openness and Reliability are measures of trust. On the other hand credit risk as a measure of disclosure has a negative relationship with financial performance. It was obvious that trust has a significant impact on financial performance; given that transparency and disclosure boosts the trustworthiness of commercial banks. The study recommended that banks both local and international should enforce full disclosure practices and transparency practices thereby enhancing trust in order to survive in the competitive financial landscape.

Barbu and Bocean (2007) conducted a study on the effect of corporate governance on corporate performance and economic performance. They found that corporate governance matters for economic performance, insider ownership matters the most, outside ownership concentration destroys market value, and direct ownership being superior to indirect. The study further found that Large outside owners destroy market value, while inside owners create it unless the stakes are unusually big, and that direct ownership is more beneficial than indirect.

Tandelilin et al. (2007) investigated the relationships among corporate governance, risk management, and bank performance in Indonesian banking sector. The study examined whether the type of ownership has moderating effect on these relationships, and whether ownership structure is a key determinant of corporate governance. The research utilized the Generalized Methods of Moments both primary and secondary data in the analyses. The study found that the relationships between corporate governance and risk management and between corporate governance and bank performance were sensitive to the type of bank ownership. However, ownership structure showed partial support as a key determinant of corporate governance. Foreign-owned banks had better implemented good corporate governance than have joint venture-owned banks, state-owned banks, and private domestic-owned banks. Foreign-owned banks also incorporated significant relationship between corporate governance and risk

management. They also found that state-owned banks underperformed the other types of bank ownership in implementing good corporate governance. This study also found an interrelationship between risk management and bank performance.

Gordon et al. (2009) did a study on the relation between enterprise risk management *(ERM)*and firm performance: A contingency perspective. Using a sample of 112 US firms that disclosed the implementation of their ERM activities within their 10Ks and 10Qs filed with the US Securities and Exchange Commission, they found that the relation between ERM and firm performance was contingent upon the appropriate match between ERM and five factors affecting a firm: environmental uncertainty, industry competition, firm size, firm complexity, and board of directors' monitoring. The implication of these findings is that firms should consider the implementation of an ERM system in conjunction with contextual variables surrounding the firm to influence performance.

Summary of Empirical Literature Review and Research Gaps

The empirical analysis of relationship between risk management, corporate governance and bank financial performance have not provided uncontested causal link between these variables.While some scholars argue that risk management affects bank performance others document contradictory findings. The influence of firm characteristics on bank performance is also an area that is not fully resolved. While some scholars find empirical support that firm characteristics do influence bank performance others document that no such influence exists. Given the inconclusive and sometimes conflicting relationship, it is clear this is an area that requires further research. It is possible that the conflicts could arise due to methodological and contextual differences in the studies

Summary

This paper has provided a critical literature review on risk management, firm characteristics, corporate governance and bank performance. The study has reviewed theoretical as well as empirical literature on the concepts in isolation and in combinations. Previous empirical studies relating risk management and bank financial performance have provided inconclusive results. While some studies have concluded a negative effect, others have concluded a positive relationship among the two variables. Further studies on the effect of firm characteristics on either corporate governance or firm performance have equally yielded inconclusive results.

The previous empirical studies have not provided a conclusive causal relationship between risk management and financial performance, risk management and corporate governance, risk management and firm characteristics, corporate governance and firm characteristics or corporate governance and financial performance .This paper argues that the moderating and/or the intervening effect of corporate governance and firm characteristics on the relationship between risk management and commercial bank performance should be investigated.

This paper has established the complexity of the relationship between risk management, firm characteristics, corporate governance and bank performance. There are several issues raised in the review including conflicting results on the nature of the relationship between risk management and bank performance. Severalissues can be raised from the results of the previous studies. First the relationship between risk management and financial performance is not

conclusive but can be mediated or moderated by other variables not included in the past empirical studies. Such variables may be micro (firm characteristics) or macro economic variables.

The paper further concludes that the relationship between risk management, corporate governance and bank performance explained by several theories including enterprise risk management framework, agency theory, contingency planning theory, risk management model, the stewardship theory, transaction economic theory, the stakeholder theory, and the new institutional economic theory.The paper concludes that the conflicting results from the previous empirical studies could be caused by the fact that the relationship between risk management and bank performances is not direct but is moderated by firm characteristics and mediated by the corporate governance mechanisms in the institutions themselves.

Knowledge Gaps Identified

The variables in the study are contemporary and significant as well as necessary for the stability and sustainability of the banking industry and the economy as a whole. Prior empiricalhave evaluated then in isolation and are yet provide a persuasive causal link among the variables. Some examine only the impact of one variable on the other, while others investigate the influence of several variables together,a reasonable conclusion, based on the prior research, is that there are other factors that come to play in determining the link between these variables. There is therefore the need to investigate theintervening and moderating effects the variables so that the link can be clearly explained. Secondly, studies have not conclusively documented the interrelationships among the explanatory variables.

Thirdly, researchers that have investigated the joint effect of the variables have documented mixed and contradictory results. This could be due methodological differences or the exclusion of other explanatory variables in the analysis. It is possible that different results could be better documented should intervening and moderating variables be included in the analysis. Finally a number of studies have been conducted in developed economies with differences in environmental, legal and institutional differences.Most studies on the studies have also not controlled for the intervening and moderating variables, both macro and macro. If such variables are introduced into the analysis, it is possible more conclusive evidence can be achieved.

Limitations of the Study

The study is limited by several factors. First the existing studies on risk management, firm characteristics, corporate governance and financial performance have adopted mainly a descriptive empirical approach whereby the variables are measured in terms of their increases and decreases. Empirical literature using casual and correlation analysis have generally been lacking. Secondly the literature reviewed on the above four variables have been mainly secondary data obtained from the financial statements as well as primary data generated using questionnaires. There are possible challenges relating to the reliability, validity and quality of the data. Furthermoremost of the previous studies generally evaluated two variables at a time without an attempt to include intervening and moderating variables. Finally, the existing literature are mainly from developed financial markets with very few from the emerging markets.

The contextual differences in the developed financialmarkets may explain the differences inresults obtained. Such differences have not been explored in the empirical studies.

Possible Areas for Further Research

A research can be developed to empirically test the causal or correlation effect among the risk management, corporate governance, firm characteristics and firm performance. Such a study will further document and provide more conclusive evidence on the nature of relationship (s) among the four variables. It is also not clear from empirical literature whether it is corporate governance that leads to better risk management or vice versa. The effects of firm characteristics on the two variables as well as firm performance is also inconclusive, hence the need for further research.

Secondly, there is need to conduct a study on the effect of risk management and bank performance that incorporates intervening and moderating variables.Studies could also be conducted on the effect corporate strategy,investment strategies and management quality on the relationship between risk management, firm characteristics, corporate governance and performance.

Future research could focus on the effect of macroeconomic variables on risk management, bank characteristics, and corporate governance and bank performance as well as conditions necessary to promote maximum performance within the banking system or firms in other industries. Such macroeconomic variables may includefinancial crisis, exchange rate, inflation rates, money supply and Gross domestic product.Finally, future research can be conducted to incorporate the four drivers of shareholder returns as suggested in the balanced score card model. This may document the effect of risk management, corporate governance, and firm characteristics on financial as well as other non financial drivers of shareholder returns like customer perspective, learning and growth as well as internal business processes. This will allow firms to align their visions and strategies to motivate, measure, and evaluate company performance.

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