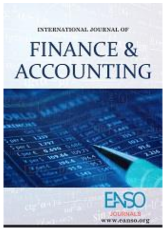

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Original Article

Risk Management Policies and the Financial Performance of Commercial Banks in Mbale City

Mankind Sam Wasike[1], Dr. Johnson Ocan, PhD[1] & Assoc. Prof. Francis Akena Adayanga, PhD[1]*

[1] Kabale University, P. O. Box 317, Kabale, Uganda.
[*] Author for Correspondence ORCID ID; https://orcid.org/0009-0000-8068-8658; Email: swasike@kab.ac.ug

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Financial Performance, Risk Management, Commercial Banks, Credit Risk, Liquidity Risk, Profitability.

ABSTRACT

The effect of risk management practices on the financial performance of commercial banks in Mbale City, Uganda, is investigated in this study. Effective risk management plays a fundamental role in safeguarding financial institutions against market volatility, credit defaults, operational disruptions, and liquidity crises. Banks face various risks that, if unmanaged, can lead to significant financial distress and erosion of profitability. The objectives were to evaluate the specific types of risk that affect banks' financial performance and analyse the relationship between risk management policies and the banks' financial performance. To examine the challenges of implementing risk management policies that affect the banks' financial performance in Mbale City, measured through key financial indicators like Return on Assets (ROA), Return on Equity (ROE), and Non-Performing Loans (NPLs) in Mbale City. A mixed-method research design was adopted, where quantitative and qualitative approaches. Statistical analysis was used to establish correlations between risk management policies and financially stronger financial resilience during periods of market uncertainty. These performance indicators, while thematic analysis helped interpret insights from the interviews. The findings reveal that banks with robust and proactive risk management policies tend to experience better financial outcomes. Precisely, the study found that credit risk management was highly correlated with lower levels of Non-Performing Loans (NPLs), while liquidity risk management was associated with higher levels of stability and profitability. Also, banks that invested in advanced technological systems for risk assessment and management showed research highlights the importance of successively improving risk management frameworks to familiarize with the varying financial landscape. It is recommended the adoption of dynamic risk assessment tools, enhanced regulatory compliance, and regular training of staff involved in risk management processes. Finally, it highlights that effective risk management is not only a regulatory requirement but also a critical factor for ensuring sustained profitability and competitive advantage.

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INTRODUCTION

Muhammad Al Amine, & Muhammad Al Amine (2016) noted that the backbone of the banking sector is to serve as for economic development, particularly in emerging markets like Uganda. However, commercial banks are increasingly confronted with various risks that could jeopardize their stability and financial health. Effective risk management policies are essential to safeguarding these institutions against market volatility, credit defaults, operational disruptions, and liquidity crises. Our study looks at how commercial banks' financial performance in Mbale City, Uganda, is impacted by risk management policies.

The banking sector in Uganda, like many other developing countries, has become a cornerstone of economic development, especially in rapidly growing urban areas like Mbale City. In order to satisfy the increasing financial demands of people, companies, and institutions, commercial banks have increased the scope of their products and services in the area during the past ten years. However, there are certain risks associated with this increase. Risks such as credit, liquidity, market, and operational risk can affect a bank's capacity to sustain long-term financial performance (Ngumi, 2014).

The role of effective risk management has thus become a crucial determinant of a bank's success in maintaining profitability and ensuring financial stability (Nzotta, 2018b). The importance of careful risk management has never been greater in the wake of global financial crises and legislative shifts. The Bank of Uganda has strengthened risk management procedures in the banking sector by enacting laws that are in line with global standards such as the Basel III Framework (Supervision, 2011).

Despite this, some commercial banks in Uganda, particularly those operating in smaller cities like Mbale, struggle to fully implement effective risk management policies. As a result, their financial performance can suffer, affecting profitability, liquidity, and overall stability (Nzotta, 2018). The expanding metropolis of Mbale City in Eastern Uganda provides a distinctive setting for researching the effects of risk management policies. The banking industry in the area faces unique difficulties, including shallow market depth, local and foreign banks' heightened competition, and regional economic swings. This study aims to explore the tactics employed, their efficacy, and the ways in which risk management policies affect sustainability and profitability in order to better understand how these policies affect the financial performance of commercial banks that operate in

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Mbale City. This study aims to close this gap by evaluating the risk management policies used by Mbale City's commercial banks and investigating how these policies affect the institutions' financial performance.

Problem Statement

Although there are many elements that affect financial performance, such as market expansion, operational effectiveness, and capital sufficiency, risk management practices have emerged as a key aspect. Poor risk management practices can lead to high financial losses, lower profitability, and even bank insolvencies, as previous banking crises in Uganda and other countries have shown. The financial performance of Ugandan commercial banks, especially those in developing cities like Mbale, has drawn more attention in recent years.

In Mbale City, commercial banks face particular risks due to the city's relatively small market, fluctuating economic conditions, and competition. Although the significance of risk management is becoming more widely acknowledged, there is little empirical data demonstrating how it directly affects banks' financial performance in this particular setting. Debate still surrounds the efficacy of risk management practices and how they relate to key financial indicators like return on equity (ROE), return on assets (ROA), and overall profitability. It is also vital to look into which specific risk management strategies, including liquidity management and credit risk assessment, have the biggest effects on the financial performance of the area.

In particular, the study will examine the challenges associated with implementing risk management policies that affect the financial performance of commercial banks in Mbale City, Uganda, in order to better understand how risk management policies affect the financial performance of these banks. The researcher intends to close this gap by investigating the risk management frameworks that Mbale City commercial banks have adopted and their impact on financial performance.

Research Questions

The following research questions provided the study's direction:

- What are the specific types of risk that affect banks’ financial performance in Mbale City?
- What relationship exists between Mbale City's commercial banks' financial performance and their risk management policies?
- To what extent do the challenges of implementing risk management Policies affect the commercial banks' financial performance in Mbale City?

Significance of the Study

With an emphasis on Uganda, the study's findings will add to the body of knowledge already available on risk management in the banking industry and assist commercial banks in improving their risk management strategies to improve their financial performance. It will also be useful to other stakeholders including the Bank of Uganda since the findings of the study will therefore form empirical evidence that may help other policymakers in the banking industry. The study will determine the best risk management methods for the commercial banks operating in Mbale City and may offer suggestions for risk management strategies to safeguard company profitability. Additionally, the study will contribute to closing the current gap in the literature on risk management in developing nations, particularly in the banking industry in Uganda.

LITERATURE REVIEW

The degree of stability suggests that risk management is crucial to the stable and effective operation of commercial banks. Because of the growing risks and extreme volatility of the financial environment, strong risk management policies are now necessary to safeguard the bank's future from

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loss and insolvency. With a focus on the banking sector specifically, this chapter presents an overview of the literature on risk management and financial performance. In the context of corporate risk management, credit, market, liquidity, and operational risks are all acknowledged as significant. The role of these risks in relation to important performance metrics for profitability, liquidity, and asset quality will be covered in the review (Ruozi et al., 2013). The chapter also includes a review of the literature on the subject, with a focus on developing nations like Uganda.

According to Banks (2004), risk management has primarily focused on regulatory compliance and control rather than improving financial performance. Nevertheless, since risk control and regulatory compliance enable the organisation to save money, risk management frequently leads to improved financial performance. Additionally, Banks (2004) suggests that by managing risks, managers can raise the firm's value by guaranteeing the firm's continued profitability.

Basel III guidelines state that banks should hold capital and liquidity to help them absorb the impacts of financial and economic crises and therefore reduce the possibility of bank failures (Supervision, 2011). Risk management is not just about meeting the standard rules and regulations but also about having an internal system that keeps a bank profitable in the long run.

The main focus of risk management has mainly been on the minimisation of risks and for legal reasons rather than on the enhancement of financial performance (Banks, 2004). However, this risk management most of the time enhances financial performance because compliance with the regulatory measures and managing risks assist the organisation in reducing costs. Banks (2004) also points out that through risk management, the managers are able to increase the value of the firm by sustaining the profitability of the firm.

(Sporta, 2018) reveals the primary causes of both financial distress and failure among commercial banks which include poor liquidity management, underpricing and underreserving, high risk-tolerance in investment, management and governance problems, and problems emanating from growth pains and/or diversification into non-core businesses. For banks to avoid financial loss and insolvency, these issues must be properly controlled.

Risk management has been a great focus in the 21st century. Babbel, & Santomero (1997) observed that bankers should evaluate the several types of risks that they are exposed to and find out how best to manage them. They also recommend that bankers should only take and retain at the firm level, risks that are inherent in their services. This will reduce risk exposure. Stulz (2024) proposed that risk management is an economic explanation for why firm managers might care about the expected profit and the variability of firm returns around their mean, thus offering an explanation for why firm objective functions should be aligned in order to avoid risk.

Omasete (2014) noted that proper risk management is significant in the daily operations of any insurance company to avoid financial losses and bankruptcy. This is in line with Kokobe, & Gemechu's (2016) contribution that preventing losses through precautionary measures is a key element in reducing risks and consequently, a key driver of profitability. The efficiency of risk management by insurance companies will generally influence their financial performance. Nsambu (2014) asserts that commercial banks could not survive with increased loss and expense ratios.

Meanwhile, risk management has been linked with shareholder value maximization proposition. Fatemi, & Luft (2002) suggested that a firm will only engage in risk management if it enhances shareholder value; Banks (2004) contributed that it is important for each firm to retain and actively manage some level of risk if it is to increase its

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market value or if the probability of financial distress is to be lowered; Pagano (2001) confirms that risk management is a central function of financial institutions in creating value for shareholders and customers.

In general, business operations are risky, and the firm's financial success will be at risk if the risks are not controlled. Firms with effective risk management strategies perform better than competitors since they are prepared for times when related risks will occur.

This study hopes to come up with an expected positive relationship between risk management and the performance of insurance companies.

Risk management is essential to the daily operations of any bank because it reduces the potential losses that could result from unmanaged risk. This is in line with Kokobe, & Gemechu (2016) who contributed those averting losses through risk prevention is an important factor in managing risks and therefore a critical factor in profitability. The effectiveness of risk management by banking firms will in most cases determine their performance. Lee, & Chih (2013) opine that commercial banks could not survive with increased loss and expense ratios.

However, risk management has been linked to the idea of maximising shareholder value. According to Fatemi, & Luft (2002), risk management is only undertaken if it creates value for the firm's shareholders. Banks (2004) added that it is crucial for each firm to retain and manage some level of risk if it is to increase its market value or if the probability of financial distress is to be reduced; Pagano (2001) also supports the view that risk management is a key function of banking institutions in creating value for shareholders.

In general, company operations are exposed to risks and if these risks are not controlled the financial performance of the firm will be at risk. Effective risk management systems help businesses outperform their competitors because they prepare for the times after associated dangers arise. This study anticipates that risk management and insurance company performance will be positively correlated.

Types of Risks Faced by Commercial Banks

Three types of banking risks have been identified by the Basel Committee on Bank Supervision: credit, market, and operating risks. In spite of this, Santomero (1997) classified the following risk categories as operational, legal, and systematic or market risk based on the evaluations mentioned above. In their 2006 study, Crouhy, Galai, and Mark also attempted to categorise bank risk into the following categories: market, credit, liquidity, operational, legal, business, strategic, and reputational risks. The relationship between the financial performance of Nigerian banks and their risk management practices with regard to capital, credit, and liquidity concerns is therefore of particular interest to the researcher. According to Santomero (1997) said that the financial sector has traditionally linked risk management to managing the four risks listed above, which comprise the majority of the banking industry's risk profiles. These risks are credit, interest rate, foreign exchange, and liquidity risk. When counterparty and legal risks are acknowledged, they are viewed as less important to bank customers, and when counterparty risk is deemed significant, it is assessed under the procedures of credit risk management and frequently in the credit department.

Credit Risk

Credit risk is when there is a chance that someone borrowing money might not pay it back as agreed upon terms and this could cause trouble, for the bank involved in the transaction. Commercial banks are especially concerned, about credit risk because their main business involves lending money to customers (Bessis, 2011). If a bank doesn't manage credit risk enough it could lead to a lot of loans not being paid back on time which can hurt the bank's

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earnings and ability to cover its obligations effectively.

Effective credit risk management is crucial for enhancing a bank's financial performance, according to several studies. Adeusi et al. (2014) in Ghana noted that banks with lower NPL ratios had better financial performance in terms of profitability and asset quality. Similarly, Uganda et al. (2023) examined the relationship between credit risk management and profitability in commercial banks and found that strong credit risk policies led to improved financial outcomes.

In Mbale City, commercial banks face unique credit risks due to the local economy's characteristics, including volatile agricultural prices, which may affect borrowers' ability to repay loans. The need for effective credit risk policies in these banks is crucial for minimizing default rates and ensuring profitability.

Market Risk

The possibility of losses in a bank's trading book as a result of unfavourable shifts in market factors including interest rates, currency rates, and equity prices is known as market risk. Banks that trade, deal in foreign exchange, or participate in financial markets are especially vulnerable to market risk (Odumah, & Miroga, 2018). If not well handled, market risk can have a detrimental impact on a bank's liquidity and profitability.

Angbazo (2020) examined the relationship between market risk and financial performance of banks in Nigeria and found that effective market risk management strategies, such as the use of hedging instruments, were associated with improved profitability. Similarly, Olamide et al. (2015) noted that in Uganda, market risk management is critical for commercial banks to maintain liquidity and financial performance, especially in the face of exchange rate fluctuations. Banks in Mbale City, which may engage in limited trading and foreign exchange activities, still face exposure to market risks due to interest rate volatility and foreign currency transactions, particularly as international trade increases in the region.

Liquidity Risk

Adeyanju (2011) noted that liquidity risk arises when a bank is unable to meet its short-term financial obligations due to a lack of liquid assets. Liquidity is crucial for banks to ensure smooth operations, and any liquidity shortfall can lead to solvency issues. The Basel III Liquidity Coverage Ratio (LCR) was introduced to ensure that banks have sufficient high-quality liquid assets to meet short-term obligations (Supervision, 2011).

Ahmad et al. (2019) emphasized the importance of liquidity risk management in enhancing bank profitability, showing that banks with higher liquidity buffers were better positioned to manage crises and sustain profitability. Similarly, in Kenya, Muriithi (2022) found that banks with effective liquidity management frameworks had better financial performance, as they were able to meet sudden withdrawal demands and manage cash flow efficiently. The liquidity risk faced by banks in Mbale City can be attributed to the limited size of the local market and regional economic fluctuations. Ensuring an adequate liquidity buffer is essential for commercial banks to avoid operational disruptions and maintain financial performance.

Operational Risk

Operational risk refers to the risk of losses resulting from inadequate or failed internal processes, people, systems, or external events. This type of risk is often linked to human error, fraud, or systems failures, and is a major concern for banks due to the complexity of their operations (Chernobai et al., 2021). Effective operational risk management involves the implementation of internal controls, fraud detection systems, and disaster recovery plans.

Bülbül et al., (2019) conducted a study on operational risk in United States banks and found

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that banks with strong internal controls and risk management frameworks were able to minimize losses and improve overall profitability. Similarly, in Uganda, Kiiza et al. (2024) highlighted the importance of operational risk management for banks in the digital age, where cyber risks and technological failures are increasingly common. Commercial banks in Mbale City are not immune to operational risks, particularly as they adopt new technologies such as mobile banking and internet banking. Strengthening internal controls and systems is critical to ensure smooth operations and protect against potential losses.

The Relationship Between Risk Management and Financial Performance

Numerous studies have explored the relationship between risk management and financial performance in the banking sector, with most findings indicating that effective risk management positively influences a bank’s profitability, liquidity, and asset quality (Mashamba, 2018). Financial performance in this context is typically measured using key indicators such as Return on Assets (ROA), Return on Equity (ROE), Net Profit Margin, and Asset Quality.

Credit Risk Management and Financial Performance

Several studies have established a positive relationship between effective credit risk management and financial performance. (Bessis, 2011) noted that banks with robust credit risk assessment procedures are more likely to reduce their exposure to Non-Performing Loans (NPLs), leading to higher profitability and improved asset quality. Similarly, Uganda (2020) found out that Ugandan banks with effective credit risk management policies had significantly better Return on Assets (ROA) and Return on Equity (ROE) compared to banks with poor risk management practices.

Market Risk Management and Financial Performance

Market risk management is crucial in protecting a bank’s capital and ensuring stable earnings. Angbazo (2020) found out that banks in Nigeria which employed sophisticated market risk management techniques, such as derivatives for hedging, experienced improved financial performance. Olamide et al. (2015) emphasized that market risk management is necessary for protecting banks from currency fluctuations and interest rate risks, which can erode profitability.

Liquidity Risk Management and Financial Performance

Liquidity management plays a key role in ensuring a bank's solvency and operational efficiency. Ahmad et al. (2019) found that Canadian banks with higher liquidity buffers were able to sustain profitability during periods of economic uncertainty. Similarly, Muriithi (2018) demonstrated that Kenyan banks with strong liquidity management practices had better financial performance, particularly during periods of financial stress.

Operational Risk Management and Financial Performance

Operational risk management is often overlooked but is critical for minimizing unexpected losses. Mohamad, & Saeed (2019) found out that U.S. banks that focused on strengthening internal controls and fraud prevention strategies experienced fewer operational losses and better financial outcomes. Girling (2022) emphasized the growing importance of operational risk management in the digital era, noting that banks with strong operational risk frameworks were more resilient to cyber-attacks and other operational disruptions.

Challenges in Implementing Risk Management Policies in Mbale City

While the importance of risk management is widely acknowledged, its implementation in developing economies like Uganda specifically Mbale City is often fraught with challenges. These challenges stem from both external and internal factors, which

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may affect the effectiveness of risk management frameworks in commercial banks.

Regulatory Challenges

One of the primary challenges facing the implementation of risk management policies in developing economies is regulatory enforcement. Despite the existence of frameworks such as the Basel III Accord, which mandates banks to maintain adequate capital and liquidity buffers, regulatory authorities in Uganda, including the Bank of Uganda, often face difficulties in enforcing compliance due to limited resources and oversight capacity (Supervision, 2011). This challenge is particularly acute in smaller cities like Mbale, where regulatory scrutiny may not be as stringent as in the capital city, Kampala.

Olalekan et al. (2018), on regulatory frameworks in Kenya, found that banks in smaller regions were less likely to comply fully with international risk management standards compared to their counterparts in larger cities. Likewise, Nzotta (2018) argued that in Uganda, resource constraints within regulatory bodies hamper the ability to regularly monitor and evaluate the risk management practices of banks, particularly those operating in regional areas like Mbale.

Technological and Infrastructural Limitations

The advancement of technology is crucial to effective risk management, particularly for operational risk. However, many commercial banks in developing countries, including Uganda, face significant technological and infrastructural limitations. According to Glaessner et al. (2002) said that many Ugandan banks lack the sophisticated risk management software and systems necessary to detect and mitigate risks efficiently. This limitation increases their exposure to operational risks such as system failures, fraud, and cyberattacks. Banks in Mbale City, being located in a smaller urban centre, are often constrained by insufficient investment in technology. Olamide et al. (2015) noted that banks in rural and semi-urban areas in Uganda were lagging in technological adoption, which adversely affected their ability to implement effective operational and liquidity risk management frameworks.

Human Resource and Expertise Limitations

Effective risk management also requires skilled personnel who can develop, implement, and monitor risk management policies. Unfortunately, many banks in developing economies face a shortage of adequately trained staff with expertise in risk management (Nngidi, 2023). In Uganda, this shortage is compounded by the limited availability of specialized training programs that focus on advanced risk management techniques. Nzotta (2018) noted that commercial banks in Nigeria faced similar challenges, with many relying on outdated practices due to the lack of qualified personnel capable of leveraging modern risk management tools. In Mbale City, this challenge is particularly pronounced, as banks operating in smaller cities often struggle to attract and retain highly skilled professionals compared to their counterparts in major urban centres like Kampala.

Economic Volatility and Market Instability

Banks in developing countries are often exposed to higher levels of economic volatility and market instability, which complicates the implementation of risk management policies. According to Angbazo (2020) macroeconomic instability, such as inflation, exchange rate fluctuations, and political uncertainty, makes it difficult for banks to predict and manage risks effectively. In Uganda, the banking sector is vulnerable to economic shocks, particularly in regions that rely heavily on agriculture, like Mbale. Volatility in agricultural prices can lead to increased credit risk, as many borrowers in the region are engaged in agricultural activities. Nzotta (2018) noted that in such environments, banks struggle to apply standard risk management policies effectively due to the unpredictability of local market conditions.

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According to the literature analysis, risk management plays a crucial part in determining how well commercial banks operate financially. Asset quality, liquidity, profitability, and market risk are all significantly impacted by credit risk, market risk, and liquidity risk. According to empirical data, banks that have strong risk management procedures do better financially overall, especially in terms of stability and profitability. However, challenges such as regulatory enforcement, technological limitations, and human resource constraints hinder the effective implementation of risk management frameworks, particularly in smaller cities like Mbale. Resolving these challenges is essential to improving the region's commercial banks' financial performance.

Theoretical Framework

Several theories explain the relationship between risk management and financial performance. The most relevant to this study include:

Agency Theory

According to agency theory, managers (agents) and owners (shareholders) of a business, including banks, have competing interests when it comes to taking risks. Shareholders typically prefer higher-risk projects that offer higher potential returns, while managers may opt for more conservative strategies to protect their careers and reputation (Meckling, & Jensen, 1976). In the context of commercial banks, agency theory suggests that effective risk management policies help align the interests of managers and shareholders, reducing excessive risk-taking behaviours that could jeopardize financial performance (Rashaduzzaman, 2024).

The Risk-Return Trade-Off Theory

This theory is based on the idea that potential returns increase with risk. However, taking on too many risks without using sufficient risk-reduction techniques might result in large losses. Amira (2023) suggests that banks must balance the trade-off between risk and return by adopting risk management policies that optimize returns while minimizing potential losses. In Mbale City, where the banking sector faces multiple risks, understanding the risk-return trade-off is essential for banks to make informed decisions that improve their financial performance without exposing themselves to excessive risks.

METHODOLOGY

A mixed-methods strategy was used in this study, integrating quantitative and qualitative data collection techniques. Analysing the financial performance metrics of Mbale City's commercial banks was the quantitative component, and interviewing bank managers to learn about their risk management procedures was the qualitative component.

Sample Size

The study focused on nine (10) major commercial banks operating in Mbale City, ensuring a comprehensive analysis of risk management policies across different institutions. The sample included a mix of larger banks and smaller community banks to provide a holistic view of the sector.

RESULTS AND DISCUSSIONS

Credit Risk Management and Financial Performance

Adeusi et al. (2014) noted that Since credit risk management directly affects profitability, it continues to be the most researched component of risk management in the banking industry. A bank's profitability and financial stability are significantly impacted by the prevalence of non-performing loans (NPLs), which can be decreased by effective credit risk management. The management of credit risk and profitability are significantly positively correlated. According to the study, banks with lower non-performing loan (NPL) ratios had greater returns on equity (ROE) and returns on assets (ROA).

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Equally, Msuku (2020) explored the relationship between credit risk management and profitability in commercial banks and found that banks that implemented rigorous credit risk assessment frameworks recorded better financial performance, as measured by ROA and ROE. In the context of Mbale City, where banks are exposed to credit risks due to the nature of the local economy, proper credit risk management policies are critical to mitigating loan defaults and enhancing profitability.

Market Risk Management and Financial Performance

Banks that are exposed to changes in interest rates, currency rates, and market pricing must manage market risk. Abu Hussain, & Al-Ajmi (2012) examined the effect of market risk management on the financial performance of banks in Bahrain and noted that banks with sophisticated market risk management systems were better able to navigate volatile market conditions, resulting in improved profitability and liquidity.

Abdiraium (2017) noted that while many banks, mainly in regional cities like Mbale, had limited exposure to international financial markets, they still faced significant market risks due to interest rate volatility and fluctuations in the Ugandan shilling's exchange rate. Banks that implemented robust market risk management strategies were found to have more stable financial performance, particularly in terms of maintaining liquidity during periods of economic instability.

Liquidity Risk Management and Financial Performance

Liquidity management is a fundamental aspect of risk management, as a lack of liquidity can lead to insolvency even in profitable banks. Ahmad et al. (2019) found out that Canadian banks with higher liquidity reserves were more resilient during the global financial crisis and experienced better financial performance post-crisis due to their ability to meet withdrawal demands and manage short-term obligations.

According to Musili (2022), Kenyan banks showed similar results, demonstrating that banks with effective liquidity risk management frameworks were able to maintain profitability and avoid liquidity shortfalls during periods of economic uncertainty. In Mbale City, where liquidity challenges may arise from the smaller size of the local market, maintaining adequate liquidity reserves is crucial for the smooth operation and financial sustainability of commercial banks.

Operational Risk Management and Financial Performance

Operational risk, though often overlooked, can have devastating consequences for banks if not properly managed. Mohamad, & Saeed (2019)) explored the relationship between operational risk management and financial performance in United States banks where it was noted that banks with strong internal control systems and comprehensive operational risk frameworks experienced fewer losses due to fraud, system failures, and other operational disruptions.

Achlison et al. (2024) emphasized the increasing importance of operational risk management as banks adopt more digital technologies. Banks in Mbale City are similarly exposed to operational risks, particularly as they integrate mobile banking and online banking systems, which may be prone to cyber-attacks and system failures. Strengthening operational risk management frameworks is therefore essential to protecting the financial health of banks in the region.

Types of Risks Identified

The study identified several predominant risks faced by commercial banks in Mbale City. Credit Risk is the most significant risk, primarily due to the local economic environment and the nature of borrowers. Many banks reported challenges in assessing the creditworthiness of clients, especially small and medium enterprises (SMEs). Liquidity Risk concerns about maintaining adequate cash flow were also highlighted, particularly in the context of economic downturns and customer withdrawal

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patterns. Operational Risk issues related to system failures and human errors were common across banks, with outdated technology being a recurring theme in discussions.

Effectiveness of Risk Management Frameworks

The analysis revealed that banks with structured risk management frameworks had significantly lower NPL ratios. One important aspect affecting a bank's financial stability and profitability is the prevalence of non-performing loans (NPLs), which can be decreased by effective credit risk management. Profitability and the management of credit risk are significantly positively correlated. Banks with lower non-performing loan (NPL) ratios had greater returns on equity (ROE) and returns on assets (ROA), according to the study. The significance of proactive risk management is highlighted by this discrepancy.

Financial Performance Indicators

The study found a positive correlation between effective risk management practices and key financial indicators. It was revealed that banks that implemented rigorous credit risk assessment frameworks recorded better financial performance, as measured by Return on Assets and Return on Equity In the context of Mbale City, where banks are exposed to credit risks due to the nature of the local economy, proper credit risk management policies are critical to mitigating loan defaults and enhancing profitability.

Technology's Role in Risk Management

The use of advanced technologies for risk assessment, such as machine learning algorithms and predictive analytics, was identified as a game-changer for many banks. Institutions that adopted these technologies not only improved their risk assessment capabilities but also enhanced customer satisfaction through faster and more accurate loan processing.

The findings confirm that effective risk management is crucial for financial stability and performance. Banks that actively engage in risk identification and mitigation strategies tend to have lower NPLs and higher profitability. The investment in advanced risk assessment technologies was particularly beneficial, providing banks with the tools needed to navigate market uncertainties.

Challenges in Implementing Risk Management Policies

While effective risk management enhances financial performance, the study identified several challenges hindering its implementation in Mbale City.

Regulatory Challenges

Compliance with international risk management standards such as Basel III remains inconsistent due to limited regulatory oversight and enforcement. Smaller banks in Mbale City struggle with adherence to these requirements due to resource constraints.

Technological Limitations

Many banks lack access to sophisticated risk assessment tools, making it difficult to implement real-time risk monitoring systems. Cybersecurity threats further compound operational risks.

Human Resource Constraints

There is a shortage of risk management professionals with expertise in modern financial risk frameworks. This limits the ability of banks to develop and implement effective risk management policies.

Economic Volatility

Market instability, inflation, and exchange rate fluctuations make risk forecasting difficult. Banks often find it challenging to apply standard risk mitigation techniques in an unpredictable economic environment.

Addressing these challenges through regulatory support, investment in technology, and workforce

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training will be crucial for enhancing risk management effectiveness and improving financial performance in Mbale City's commercial banks.

Implications for Stakeholders

For Bank Management: There is a clear need for continuous investment in risk management frameworks and technologies. Management should prioritize developing a culture that values risk awareness and proactive decision-making. For Regulators: Policymakers should consider strengthening regulations surrounding risk management practices to ensure that all banks maintain a minimum standard that safeguards the financial system. For Customers: Enhanced risk management can lead to better financial products and services, ultimately benefiting consumers through lower loan costs and improved service delivery.

RECOMMENDATIONS AND CONCLUSION

Recommendations

Dynamic Risk Assessment Tools: Banks should adopt more sophisticated risk assessment technologies that can adapt to changing market conditions. Implementing real-time data analytics can help institutions make informed decisions swiftly.

Regulatory Compliance: Enhanced compliance with local and international risk management regulations is essential. Regular audits and assessments should be institutionalized to ensure adherence to these guidelines.

Training and Development: To guarantee that employees engaged in risk management possess the most up-to-date information and abilities, they must get ongoing training. Enhancing risk awareness at all organisational levels might result from funding professional development.

Customer Education: Banks should also invest in educating customers about responsible borrowing and financial management. This could reduce default rates and improve the overall health of the lending portfolio.

Strengthening operational risk management frameworks by adopting more digital technologies is therefore essential to protecting the financial health of banks in the region, especially Mbale City.

Conclusion

This study emphasises the significance of good risk management practices in improving the financial performance of Mbale City's commercial banks. Banks must upgrade their risk management systems to maintain profitability and stay ahead of the competition in a changing climate. By investing in dynamic assessment tools, regulatory compliance, and continuous training, banks can safeguard their financial health and contribute positively to the economic landscape of Uganda.

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