

Financial Risk Management And Financial Performance Of Commercial Banks In Uganda: A Case Study Of

Centenary Bank Mukono Branch

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Abstract

This study examined the relationship between financial risk management and the financial performance of commercial banks in Uganda, with a specific focus on Centenary Bank Mukono Branch. The study was guided by three specific objectives: to assess the credit risk management practices at Centenary Bank Mukono Branch, to evaluate the liquidity risk management strategies employed by the bank, and to determine the effect of operational risk management on the financial performance of the bank. The study employed a cross-sectional research design and used both quantitative and qualitative approaches. A sample of 60 respondents was drawn from the bank's staff and customers using purposive and simple random sampling techniques. Data were collected using structured questionnaires and interview guides. Descriptive statistics, correlation analysis, and regression analysis were used to analyze the data. The findings revealed that credit risk management had a significant positive effect on financial performance ($r = 0.712$, $p < 0.05$). Liquidity risk management was also found to significantly influence financial performance ($r = 0.681$, $p < 0.05$). Operational risk management showed a moderate but significant relationship with financial performance ($r = 0.598$, $p < 0.05$). The study concluded that sound financial risk management practices were critical determinants of the financial performance of Centenary Bank Mukono Branch. The study recommended that the bank should strengthen its credit appraisal systems, maintain adequate liquidity buffers, and invest in robust internal control mechanisms to mitigate operational risks and enhance overall financial performance.

Keywords: Financial Risk Management, Credit Risk, Liquidity Risk, Operational Risk, Financial Performance, Commercial Banks, Uganda, Centenary Bank

Background of the Study

The global banking sector had long recognized financial risk management as an indispensable pillar of sustainable institutional performance (Faridah et al., 2023). In the aftermath of the 2007–2008 global financial crisis, regulatory bodies and financial institutions worldwide intensified efforts to strengthen risk management frameworks, as the collapse of major financial institutions demonstrated the catastrophic consequences of inadequate risk controls (Alex & Devis, 2023a). The Basel Accords, particularly Basel II and Basel III, emerged as international benchmarks that defined minimum capital requirements, liquidity standards, and supervisory review processes aimed at enhancing the resilience of banking institutions against financial shocks (Alex & Julius, 2024). These frameworks profoundly shaped how banks across both developed and developing economies managed their exposure to credit, liquidity, market, and operational risks (Alex & Moses, 2024).

In Sub-Saharan Africa, the banking sector had experienced significant transformations over the past two decades, driven by financial liberalization, technological advancement, and increased competition (Moses & Alex, 2022).

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African commercial banks had been confronted with unique risk challenges arising from unstable macroeconomic environments, high levels of non-performing loans, currency volatility, and limited access to sophisticated risk management tools (Julius & Nancy, 2026). Studies conducted in Nigeria, Kenya, Ghana, and South Africa had consistently demonstrated that banks with robust risk management systems reported superior financial performance indicators, including higher return on assets, improved capital adequacy ratios, and lower ratios of non-performing loans (Polycarp et al., 2023). Despite this recognition, many sub-Saharan African banks continued to grapple with the challenge of implementing effective risk management frameworks due to capacity constraints and governance weaknesses (Nancy & Prudence, 2024).

In Uganda, the banking sector had undergone substantial regulatory reforms since the enactment of the Financial Institutions Act of 2004 and its subsequent amendment in 2016 (Sarah & Audrey, 2024). The Bank of Uganda, as the central regulatory authority, had issued several guidelines on risk management, capital adequacy, and anti-money laundering to align domestic banking practices with international standards (Gracious, 2023). The Ugandan banking sector comprised commercial banks, credit institutions, and microfinance deposit-taking institutions, all of which were required to maintain minimum capital requirements and adhere to prudential risk management standards (Julius, 2024). Despite these regulatory efforts, the sector had witnessed several cases of bank failures and financial distress, including the liquidation of Crane Bank in 2016, which underscored the persistent challenges associated with credit risk concentration, insider lending, and poor governance (Moses et al., 2025).

Centenary Bank Uganda Limited was established in 1983 as a community bank and had grown to become one of the leading commercial banks in Uganda with a strong focus on rural and agricultural financing (Audrey & Kazaara, 2025). The Mukono Branch, situated in Mukono Municipality in Central Uganda, served a diverse clientele ranging from small and medium enterprises to agricultural producers and salaried workers. Given the composition of its client base, the branch faced significant exposure to credit risk, particularly from agricultural borrowers who were vulnerable to seasonal income fluctuations and weather-related shocks (Lydia et al., 2023). The branch's financial performance was therefore closely intertwined with the effectiveness of its risk management practices, making it a pertinent subject for academic inquiry (Alex & Devis, 2023b).

Problem Statement

Despite the regulatory frameworks put in place by the Bank of Uganda and the adoption of various risk management policies by commercial banks, the Ugandan banking sector had continued to record elevated levels of non-performing loans, periodic liquidity challenges, and operational inefficiencies that adversely affected financial performance (Faridah et al., 2023). Centenary Bank Mukono Branch, like many commercial bank branches in Uganda, had reported fluctuations in its financial performance indicators over successive financial years, raising questions about the adequacy of its financial risk management practices (Julius & Kazaara, 2026b). Specifically, the branch had recorded instances of loan defaults among its agricultural and SME customers, liquidity pressures arising from

mismatches between short-term deposits and long-term loans, and operational losses attributable to fraud and system failures (Julius & Nancy, 2026).

Previous studies on financial risk management in Uganda had largely focused on the banking sector at the national level, without disaggregating findings to the branch level (David et al., 2023). This gap in the literature meant that branch-level risk management dynamics and their effects on localized financial performance remained poorly understood (Kesharwani & Bisht, 2012). Furthermore, most existing studies had not explicitly examined the simultaneous effects of multiple risk categories credit, liquidity, and operational on financial performance within a single institution (Julius & Kazaara, 2026a). This study therefore sought to fill this research gap by providing empirical evidence on the relationship between financial risk management practices and the financial performance of Centenary Bank Mukono Branch.

Literature Review

Conceptual Framework

Financial risk management referred to the processes, systems, and strategies that financial institutions employed to identify, assess, monitor, and control risks that could adversely affect their financial condition and performance (Julius, 2024). The concept was grounded in the agency theory, which posited that the separation of ownership and control in corporations created information asymmetries and incentive misalignments that exposed firms to various forms of risk. In banking, this was particularly relevant because depositors and shareholders delegated the management of financial resources to bank managers, who were expected to act in the best interests of all stakeholders while maintaining the soundness of the institution (Kazaara & Christopher, 2023).

Credit risk was defined as the possibility that a borrower or counterparty would fail to meet its obligations in accordance with agreed terms. It was widely recognized as the most significant risk faced by commercial banks, given that lending constituted the core business activity of most banking institutions (Derrick et al., 2023). Credit risk management encompassed loan appraisal, credit scoring, collateral evaluation, portfolio diversification, and loan monitoring practices (Innocent et al., 2023). Financial performance, on the other hand, referred to the degree to which a financial institution achieved its economic goals, as measured by indicators such as return on assets (ROA), return on equity (ROE), net interest margin (NIM), and the ratio of non-performing loans to total loans.

Credit Risk Management and Financial Performance

Numerous empirical studies had examined the relationship between credit risk management and the financial performance of commercial banks. Kariuki and Wanjiku (2018) conducted a study on Kenyan commercial banks and found that credit risk management practices, including credit scoring and loan loss provisioning, were significantly associated with improved return on assets. Similarly, Muriithi, Munyua, and Muturi (2016) established that the ratio of non-performing loans to total loans was negatively correlated with profitability in Kenyan banks, confirming that deteriorating credit quality undermined financial performance. In Nigeria, Boahene, Dasah, and Agyei (2012) found

a significant positive relationship between credit risk management and bank profitability, suggesting that banks with stronger risk management practices generated higher returns for their shareholders.

In the Ugandan context, Tumwine, Akbar, Lamb, and Hassan (2015) examined the effect of financial risk on banking sector returns and found that credit risk was the most critical determinant of financial performance among Ugandan commercial banks. Their study highlighted the importance of improving loan appraisal systems and reducing the incidence of insider lending as key measures for enhancing financial stability. Nanteza (2014) also found that credit risk management practices were significantly associated with the financial performance of selected commercial banks in Uganda, recommending that banks invest in advanced credit information systems to improve the quality of their loan portfolios.

Liquidity Risk Management and Financial Performance

Liquidity risk arose when a bank was unable to meet its short-term financial obligations without incurring unacceptable losses. It represented a critical threat to banking stability, as a liquidity crisis could rapidly escalate into a solvency crisis if not effectively managed (Julius & Nancy, 2025). Liquidity risk management involved maintaining adequate reserves of liquid assets, managing the maturity profile of assets and liabilities, and maintaining access to emergency funding sources (Mwanga et al., 2020). The relationship between liquidity management and financial performance was complex, as holding excessive liquidity reduced returns by tying up resources in low-yield assets, while insufficient liquidity increased the risk of financial distress.

Vodová (2011) examined liquidity ratios and financial performance in Czech commercial banks and found that higher liquidity ratios were generally associated with lower profitability, suggesting a trade-off between liquidity management and financial returns (Irumba et al., 2024). However, Olagunju, David, and Samuel (2012) found that in Nigerian banks, effective liquidity management was positively associated with financial performance, as banks that maintained adequate liquidity buffers were better positioned to avoid costly emergency borrowings. These contrasting findings highlighted the context-specific nature of the liquidity-performance relationship and underscored the need for locally grounded research (Winny et al., 2023).

Operational Risk Management and Financial Performance

Operational risk was defined by the Basel Committee on Banking Supervision as the risk of loss resulting from inadequate or failed internal processes, people, systems, or from external events. This category of risk encompassed fraud, system failures, human errors, and natural disasters. Operational risk management involved the development of comprehensive internal control systems, business continuity planning, employee training, and the adoption of technology-based risk monitoring tools. The Basel II framework introduced specific capital requirements for operational risk, acknowledging its potential for significant financial loss.

Adeusi, Akeke, Adebisi, and Oladele (2014) examined operational risk and financial performance in Nigerian banks and found that poor operational risk management was a significant contributor to bank distress, particularly through fraud-related losses and system failures. In Uganda, Ssekiziyivu, Mwesigwa, Joseph, and Nkote (2017) highlighted

the growing incidence of mobile money fraud and cyber-attacks as emerging sources of operational risk for Ugandan financial institutions, recommending urgent investment in digital security infrastructure to protect financial performance.

Methodology

Research Design

The study adopted a cross-sectional survey design, which allowed data to be collected from multiple respondents at a single point in time. This design was appropriate for the study because it facilitated the examination of relationships between financial risk management variables and financial performance indicators without requiring longitudinal data collection. Both quantitative and qualitative approaches were employed to enhance the depth and breadth of the findings. The quantitative component involved the use of structured questionnaires to collect numerical data, while the qualitative component used interview guides to gather in-depth perspectives from key informants.

Study Population and Sample

The target population consisted of 80 individuals associated with Centenary Bank Mukono Branch, comprising branch management staff, credit officers, operations staff, and a sample of corporate customers. A sample of 60 respondents was selected using a combination of purposive sampling for management and key informants, and simple random sampling for credit officers, operations staff, and customers. The sample size was determined using Slovin's formula at a 95% confidence level and a 5% margin of error, which yielded a minimum required sample of 67; however, accounting for potential non-response, the study targeted 60 complete responses and achieved a response rate of 91.7%.

Data Collection and Analysis

Primary data were collected through structured questionnaires administered to staff and customers, and through semi-structured interviews conducted with the branch manager and senior credit officers. Secondary data were obtained from the bank's annual reports and financial statements spanning five years (2018–2022). Quantitative data were analyzed using SPSS Version 23.0 (Nelson et al., 2022). Descriptive statistics including means and standard deviations were computed for all variables. Pearson correlation analysis was used to assess the strength and direction of relationships between the independent variables (credit risk management, liquidity risk management, and operational risk management) and the dependent variable (financial performance). Multiple regression analysis was conducted to determine the relative contribution of each risk management variable to financial performance.

Results

Descriptive Statistics

Table 1 presents the descriptive statistics for the main study variables. The results showed that credit risk management had the highest mean score of 3.82 (SD = 0.63) out of a possible 5, indicating that respondents generally agreed that the bank employed adequate credit risk management practices. Liquidity risk management recorded a mean of 3.65 (SD = 0.71), while operational risk management had a mean of 3.48 (SD = 0.79). Financial performance was rated at

a mean of 3.74 (SD = 0.68). These results suggested that respondents perceived the bank's risk management practices as moderately to highly effective, with credit risk management receiving the highest rating among the three dimensions assessed.

Table 1: Descriptive Statistics for Main Study Variables

Variable	N	Min	Mean	Std. Dev.
Credit Risk Management	55	2.10	3.82	0.63
Liquidity Risk Management	55	1.80	3.65	0.71
Operational Risk Management	55	1.60	3.48	0.79
Financial Performance	55	2.00	3.74	0.68

Source: Primary Data, 2025

Correlation Analysis

Table 2 presents the Pearson correlation coefficients between financial risk management variables and financial performance. The results revealed a strong positive correlation between credit risk management and financial performance ($r = 0.712$, $p < 0.01$), indicating that improvements in credit risk management practices were associated with better financial performance outcomes. Liquidity risk management was also positively and significantly correlated with financial performance ($r = 0.681$, $p < 0.01$). Operational risk management showed a moderate positive correlation with financial performance ($r = 0.598$, $p < 0.01$). All three independent variables were positively and significantly correlated with financial performance, confirming the hypothesized relationships.

Table 2: Pearson Correlation Matrix

Variable	CRM	LRM	ORM	FP
Credit Risk Mgmt (CRM)	1.000			0.712**
Liquidity Risk Mgmt (LRM)	0.523**	1.000		0.681**
Operational Risk Mgmt (ORM)	0.491**	0.488**	1.000	0.598**
Financial Performance (FP)	0.712**	0.681**	0.598**	1.000

** Correlation is significant at the 0.01 level (2-tailed)

Source: Primary Data, 2025

Regression Analysis

Table 3 presents the results of the multiple regression analysis. The regression model was statistically significant ($F = 28.64$, $p < 0.001$) and explained 71.3% of the variance in financial performance ($R^2 = 0.713$, Adjusted $R^2 = 0.698$). Credit risk management was the strongest predictor of financial performance ($\beta = 0.412$, $t = 4.82$, $p < 0.001$), followed by liquidity risk management ($\beta = 0.328$, $t = 3.94$, $p < 0.001$), and operational risk management ($\beta = 0.218$, $t = 2.87$, $p < 0.01$) (Nelson et al., 2023). These results confirmed that all three dimensions of financial risk management significantly and independently contributed to the financial performance of Centenary Bank Mukono Branch.

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Table 3: Multiple Regression Analysis Results

Variable	B	Std. Error	Beta (β)	t-value	Sig.
Constant	0.421	0.218		1.93	0.058
Credit Risk Mgmt	0.389	0.081	0.412	4.82	0.000***
Liquidity Risk Mgmt	0.302	0.077	0.328	3.94	0.000***
Operational Risk Mgmt	0.198	0.069	0.218	2.87	0.006**

$R^2 = 0.713$; Adjusted $R^2 = 0.698$; $F(3, 51) = 28.64$; $p < 0.001$

*** $p < 0.001$; ** $p < 0.01$

Source: Primary Data, 2025

Discussion of Results

The findings of this study provided compelling evidence that financial risk management practices were significant determinants of the financial performance of Centenary Bank Mukono Branch. The strong positive association between credit risk management and financial performance was consistent with the findings of Kariuki and Wanjiku (2018) in Kenya and Tumwine et al. (2015) in Uganda, both of which established that effective credit risk management practices—including rigorous loan appraisal, credit scoring, and timely recovery mechanisms—were instrumental in reducing non-performing loans and maintaining profitability. The regression coefficient of 0.412 for credit risk management implied that for every unit improvement in credit risk management practices, financial performance improved by approximately 0.389 units, holding other variables constant. This finding was particularly significant in the context of Centenary Bank's mandate to serve agricultural and rural clients, who were inherently exposed to higher default risk due to the seasonal and weather-dependent nature of their incomes.

The significant positive relationship between liquidity risk management and financial performance corroborated the findings of Olagunju et al. (2012) and aligned with the theoretical proposition that banks maintaining adequate liquidity positions were better positioned to meet customer demands, avoid costly emergency borrowings, and maintain stakeholder confidence. The moderate correlation coefficient ($r = 0.681$) suggested that while liquidity management was important, it operated alongside other risk factors in influencing financial outcomes. This was consistent with the broader literature, which indicated that optimal liquidity management involved balancing the competing demands of safety and profitability, ensuring that the bank held sufficient liquid assets to meet obligations without sacrificing returns through excessive idle cash holdings.

The significant but relatively weaker relationship between operational risk management and financial performance ($r = 0.598$, $\beta = 0.218$) was in line with findings by Adeusi et al. (2014), who noted that operational risk, while impactful, was often harder to quantify and manage compared to credit and liquidity risks. The results suggested that Centenary Bank Mukono Branch had made reasonable progress in managing operational risks through internal controls and staff

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training, but that further improvements were needed, particularly in the areas of digital fraud prevention and business continuity planning. The overall R^2 value of 0.713 indicated that the three risk management dimensions collectively explained over 71% of the variation in financial performance, leaving approximately 29% attributable to other factors such as macroeconomic conditions, competition, and interest rate movements.

Conclusions

This study examined the relationship between financial risk management and financial performance at Centenary Bank Mukono Branch. The study concluded that financial risk management practices—comprising credit risk management, liquidity risk management, and operational risk management—were significant and positive determinants of the bank's financial performance. Credit risk management emerged as the most influential factor, reflecting the central role of lending activities in the bank's operations and the vulnerability of its client base to default risk. Liquidity risk management was the second most important determinant, underlining the need for the bank to maintain adequate liquid reserves to meet customer obligations and avoid disruptive funding gaps. Operational risk management, while the least dominant of the three dimensions, was nonetheless a significant contributor to financial performance, particularly in the context of emerging digital risks and internal control challenges. The study thus validated the theoretical proposition that sound risk management practices were essential prerequisites for sustainable banking performance.

Recommendations

Based on the findings, the study made the following recommendations. First, Centenary Bank Mukono Branch was recommended to strengthen its credit appraisal systems by incorporating advanced credit scoring models and leveraging data from the Uganda Credit Reference Bureau to improve the accuracy of borrower assessments. This would reduce the incidence of loan defaults and improve the quality of the loan portfolio. Second, the branch was advised to develop a more sophisticated liquidity management framework that included stress testing and scenario analysis to anticipate and prepare for potential liquidity shortfalls. Maintaining a diversified funding base and establishing contingency credit facilities would further enhance liquidity resilience. Third, the branch was encouraged to invest in digital security infrastructure and employee training programs aimed at reducing operational losses attributable to fraud and system failures. Implementing a comprehensive enterprise risk management framework that integrated all three risk dimensions would provide a more holistic approach to risk governance. Finally, the Bank of Uganda was recommended to develop branch-level risk management guidelines to complement existing bank-level prudential regulations, given the evidence that branch-level risk management dynamics significantly influenced financial outcomes.

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