CAPITAL, LIQUIDITY AND BANK RISK TAKING: EVIDENCE FROM NIGERIAN BANKING FIRMS

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Abstract

This study examines the combined effect of liquidity and capital on the credit risk of Nigerian banks between 1998 and 2014. The choice of variables were guided by literature and include the ratio of risk weighted assets to total assets (credit risk), while bank capital and liquidity were proxied by the ratio of capital to risk weighted assets and the ratio of total deposits to total assets as our primary proxy for bank liquidity respectively. Other potential determinants of bank risk were introduced as control variables. Preliminary results show a negative relationship between bank capital and risk taking and a positive relationship between credit risk and liquidity. The results were robust even when different proxies of the key variables were introduced. Our findings provide new insight into the effect of capital and liquidity on credit risk and would definitely be of interest to bank regulators advocating greater liquidity and capital requirements for banks. Further research should focus on introducing even more bank specific determinants of risk to obtain a better understanding of the relationship that exists between liquidity, capital and credit risk.

Keywords: credit risk, liquidity, capital, risk taking