Corporate Governance and Financial Performance of Deposit Money Banks in Nigeria

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Abstract:

This paper examined the effect of Corporate Governance on Financial Performance of Deposit Money Banks in Nigeria. Secondary data were sourced from audited annual financial statements of five deposit money banks in Nigeria covering the period 2013 – 2017. Both Descriptive statistics and Panel Least Square regression were employed to analyse the data. The regression result revealed that Board Size, Board Composition and CEO Duality have positive effect on financial performance. The Audit Committee has a negative effect on Financial Performance. The P-value of F-statistic in the regression result is 0.000002 < 0.05 significance level. This indicates that the indices of corporate governance used in this study have overall significant effect on deposit money banks in Nigeria. This study recommends the minimum Board Size of 12 members and maximum of 17 members for banks as revealed in the Descriptive statistics of this paper.

Keywords: Corporate Governance, Financial Performance, Audit Committee and Board Size

1. Introduction:

The policy of corporate governance is mostly common to banks and multinational firms. Corporate governance has become a great importance on the policy agenda in developed countries for many years now. "Corporate Governance" was viewed in different ways by various studies. Magdi and Nadereh (2002) stress that corporate governance is about ensuring that the business is run well and investors receive a fair return. The rise in company failures and increased fraudulent activities in recent time have led to significant pursuit in terms of literature and study of governance principles to determine best codes of practices that will improve company performance and going concern. A significant element in the pursuit of an effective corporate governance system is the responsibility bestowed on the board of directors of the company.

The board is in place to supervise and monitor the activities of management and also determine the strategic position of the company. The board appraises and approves management proposals, and they are the first and most significant check for effective governance practices in the firm (Brennan, 2006 and Jonsson, 2005).

In Nigeria, due to the banking sector crisis in 2006, the Central bank of Nigeria issued a code of corporate governance to complement the existing one and the provisions of the new code were said to be indispensable in achieving viable and successful banking practice.

According to the Central Bank of Nigeria (CBN) code of corporate governance for banks and other financial institutions in Nigeria "corporate governance is the process by which the business activities of an institution are directed and managed".

Most of the resent post consolidation studies on corporate governance and bank performance covered five years period with some of them using primary data. Majority of those that used secondary data have either used statistical package for social sciences (SPSS) as analytical software or centered on some banks that have gone distressed.

This study made use of different statistical software Eviews9 and underwent certain Diagnostic test to increase the reliability of findings. Hence, this study is a contribution to the ongoing debate on the examination of the relationship that exists between corporate governance mechanisms and financial performance of banks in Nigeria by also made use of Earning per share as a proxy for financial performance which previous studies rarely considered.

The main objective is to examine the effect of Corporate Governance on Financial Performance of Deposit Money Banks in Nigeria. Specific objective is examine the direction of causality among the indices of corporate governance and financial performance.

2. Literature Review:

Several corporate governance theories have been developed concerning the nature and significance of corporate governance. These include agency theory, stakeholder theory.

Agency Theory: In the study of Ashenafi , Kelifa and Yodit (2013), the agency theory was cited as being widely used as a means of explaining various corporate governance issues. The essence of the theory is based on the existence of separation of ownership and control in large corporations. In such corporations, the managers (agents) are hired to work and make decision on behalf of the owners (principals) in order to maximize return to the shareholders. However, conflict of interest between the agent and the principal inevitably occurs when the agent fails to act in the best interest of the principal, and instead act to maximize their own value.

Stakeholder theory*:* According to Abdullah and Valentine (2009), the stakeholder theory originated from the management discipline and gradually developed to include corporate accountability to a broad range of stakeholders.

According to Imam,(2006), Sound corporate governance practice is fundamentally meant to improve corporate performance by blocking the control of the company by the significant shareholders and encouraging improved decision making in the process. In return to improved governance practices, the value of the firm may react immediately to information showing improved corporate governance practices. It should be noted that material report backing the link or association between the disclosure and compliance to corporate governance and firm performance is scarce.

According to a research conducted by McKinsey and Company (2002) cited in Adams and Mehran (2003), the study showed that most investors in Malaysia showed the desire to pay more for the shares of a good governance company. The research also showed that the investors were ready to pay a mean premium within the limit of 20% to 25%.

Enhanced director independence, according to Young (2003) is intuitively appealing because a director with ties to a firm or its CEO would find it more difficult to turn down an excessive pay packet, challenge the rationale behind a proposed merger or bring to bear the skepticism necessary for effective monitoring.

Mak and Kusnadi (2005) also report that small size boards are positively related to high firm performance. When a board gets too big, it becomes difficult to coordinate and for it to process and solve strategic problems of the organisation. Klein (2002) reports a negative correlation between earnings management and audit committee independence. Anderson, Mansi and Reeb (2004) find that entirely independent audit committees have lower debt financing costs.

Al-Hawary (2011),Investigated the effect of governance on the performance of Jordanian commercial banks. He tested the effect of governance mechanisms such as board size, CEO duality, percentage of non-executive directors, capital adequacy, the ownership percentage of large shareholders, and the ownership percentage of the largest shareholder on the bank performance as measured by Tobin's Q. He found that CEO duality, and percentage of nonexecutive directors had statistically significant positive effect on performance; whereas leverage had statistically significant negative effect on performance.

This study is a contribution to the ongoing debate on the examination of the relationship that exists between corporate governance mechanisms and financial performance of banks in Nigeria by also made use of Earning per share as a proxy for financial performance which previous studies have not considered.

3. Data and Methods of Research.

Data for this study were sourced from the audited annual financial statement of five Deposit Money Banks in Nigeria (namely; First bank, Union bank, UBA, Zenith bank and GT bank) covering the period between 2013 and 2017. Hence, the study employed the use of panel data of deposit money banks for 5 years (25 observations).

The data analysis for this study centred basically on Descriptive Statistics and Panel Least Square Regression. The descriptive statistics was used to analyse the Means, Maximum, Minimum, Standard Deviation and Skewness of the variables. The Panel Least Square regression was conducted to examine the effect of Corporate Governance indices on Financial Performance of Deposit Money Banks in Nigeria.

3.1 Model Specification:

This study used the following econometric model to examine the effect of corporate governance mechanisms on financial performance of deposit money banks in Nigeria.

Financial performance = f(Corporate Governance) ----------------------(1)

Earning Per Share was adopted as a proxy for Financial performance and (1) can be expressed as:

EPS = f(BODCOM, BODSIZE, AUDIC, CEOD) ----------------------(2)

An Econometric model derived from (2) above is:

$$EPS = \beta_0 + \beta_1 BODCOM + \beta_2 BODSIZE + \beta_3 AUDIC + \beta_4 CEOD + U_t \text{ ------(3)}$$

Where:

EPS = Earning Per Share that proxied Financial Performance.

BODCOM = Board composition

BODSIZE = Board Size

CEOD = CEO duality

AUDIC = number of Audit committee members

β_0 = constant

$\beta_1 - \beta_4$ = coefficients of variables

U_t = Error term

3.2 Description of Variables used:

Earning Per Share (EPS): According to Economic Times (2019), EPS is an important financial measure, which indicates the profitability of a company. Hence, this validates the use of EPS as a proxy for financial performance. Hitherto, other studies have been using ROE, ROA to measure financial performance. For this study, EPS is a dependent variable.

Board size (BODSIZE): This is the total number of directors sitting on the board of a particular bank which in line with the code of corporate governance should not be more than 20. This study examines the extent to which bank performance will be affected by the size of the board.

Board composition (BODCOM): This is the number of non-executive directors on the board and it is measured by the percentage of outside directors (non-executive directors) on the total board members.

CEO duality (CEOD): CEO duality exists when a single person holds both the position of chairman and MD/CEO of the company. For banks with CEO as the chairman, a one (1) value is assigned and zero (o) otherwise .

Audit committee (AUDIC): This is taken as the total number of members in the audit committee. It is expected that the higher the number though within the limit set by code of corporate governance, the better the performance

4. Data Analysis of Interpretation of Results

The statistical method of descriptive statistics, regression analysis and granger causality test were used to analyse the data.

4.1 Descriptive Statistics

The descriptive analysis of the variables used are presented in table 1 below. Earning per share (EPS) is the dependent variable that measure financial performance of banks. The other variable (BODSIZE, BODCOM, AUDIC and CEOD) are the independent variables that are indices of corporate Governance.

The EPS has a mean value of 2.042 and median value of 1.63. The maximum value is 6.03 while the minimum value is 0.06. It had a standard deviation of 1.5755 which is close to the mean value. This indicates a low degree of data variance between the time series. Earning Per Shares was positively skewed with a skewness value of 0.715247. BODSIZE had the highest mean value of 16.64

Table 1 :

	EPS	BODSIZE	BODCOM	AUDIC	CEOD
Mean	2.042000	16.64000	0.525600	5.600000	0.040000
Median	1.630000	17.00000	0.500000	6.000000	0.000000
Maximum	6.030000	20.00000	0.630000	7.000000	1.000000
Minimum	0.060000	12.00000	0.420000	3.000000	0.000000
Std. Dev.	1.575529	3.053413	0.067025	1.384437	0.200000
Skewness	0.715247	-0.340848	0.553122	-1.173125	4.694855
Kurtosis	2.794924	1.497954	2.159409	2.931002	23.04167
Jarque-Bera	2.175386	2.834218	2.010804	5.739220	510.2449
Probability	0.336993	0.242414	0.365898	0.056721	0.000000
Sum	51.05000	416.0000	13.14000	140.0000	1.000000

Sum Sq. Dev.	59.57500	223.7600	0.107816	46.00000	0.960000
Observations	25	25	25	25	25

Source : Researcher's Computation 2019

4.2 Regression Analysis

The table 2 below shows the regression result conducted on the impacts of corporate governance on financial performance of Nigerian Deposit Money Banks. From the result, the R^2 value shows that about 79% of systematic variations in the financial performance (EPS) are explained by the indices of corporate governance (BODSIZE, BODCOM, AUDIC, and CEOD). Board Size (BODSIZE) , Board composition (BODCOM) and CEO Duality (CEOD) have positive effect on Earning Per Share (EPS) which proxied Financial Performance. However, members of Audit committee (AUDIC) had a negative effect on Earning Per Share, which implies the smaller the members of audit committee the better the financial performance. Only BODSIZE and AUDIC are individually statistically significant. The durbin Watson statistics of 1.588136 which is close to 2 indicates no sign of serial correlation. The P-value of F-statistics explains the overall significance of the result. The p-value of 0.00002 means the indices of corporate Governance used in this model have overall significant effect on financial performance of deposit money banks in Nigeria.

Table 2: **Regression Result**

Dependent Variable: EPS

Method: Panel Least Squares

Date: 03/18/19 Time: 22:28

Sample: 2013 2017

Periods included: 5

Cross-sections included: 5

Total panel (balanced) observations: 25

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	10.97794	1.518126	7.231246	0.0000

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BODSIZE	0.369153	0.056267	6.560786	0.0000
BODCOM	0.894781	2.659533	0.336443	0.7400
AUDIC	-0.410248	0.120058	3.417082	0.0027
CEOD	0.638838	0.861723	0.741349	0.4671

R-squared	0.787129	Mean dependent var	2.042000
Adjusted R-squared	0.744555	S.D. dependent var	1.575529
S.E. of regression	0.796297	Akaike info criterion	2.559168
Sum squared resid	12.68179	Schwarz criterion	2.802943
Log likelihood	-26.98960	Hannan-Quinn criter.	2.626781
F-statistic	18.48840	Durbin-Watson stat	1.588136
Prob(F-statistic)	0.000002		

Source : Researcher’s Computation 2019

The table 3 below shows the result of Pairwise Granger Causality test conducted on the variables. The rule of thumb is that if P-value is less that 0.05 level of significance, there is causality. Hence, there is no directional causality between Board Size and Earning per share. Also there is no directional causality between BODCOM and EPS. However, there is a bi-directional causality between AUDIC and EPS since then P-value 0.05. hence, both variables granger cause each other.

The fourth segment shows a unidirectional causality from BODCOM to AUDIC with P- value of 0.0000 less than 0.05. It means Board composition(BODCOM) influences the number of members that constitute Audit committee(AUDIC)

Table 3:

Pairwise Granger Causality Tests

Date: 03/18/19 Time: 22:45

Sample: 2013 2017

Null Hypothesis:	Obs	F-Statistic	Prob.
BODSIZE does not Granger Cause EPS	20	2.48104	0.1337

EPS does not Granger Cause BODSIZE		0.24194	0.6291
BODCOM does not Granger Cause EPS	20	1.06132	0.3173
EPS does not Granger Cause BODCOM		1.96048	0.1794
AUDIC does not Granger Cause EPS	20	4.27569	0.0442
EPS does not Granger Cause AUDIC		95.9662	0.0000
AUDIC does not Granger Cause BODCOM	20	0.08427	0.7751
BODCOM does not Granger Cause AUDIC		2072.88	0.0000

Source : Researcher's Computation 2019

In order to test the reliability and liability of empirical result , three diagnostic test were conducted. The tests are Multicollinearity, Heteroskedaticity and Autocorrelation.

To test the presence of multicollinearity in the model, the variance inflation factor (VIF) was conducted. The breush-pagan-Godfrey test was used to test the Heteroskedasticity while the breush-Godfrey LM test was conducted to test the presence of autocorrelation in the mode

Table 4: **Variance Inflation Factors**

Variance Inflation Factors

Date: 03/21/19 Time: 12:12

Sample: 1 25

Included observations: 25

Variable	Coefficient Variance	Uncenterd VIF	Centered VIF
C	2.304707	90.86681	NA
BODSIZE	0.003166	35.67907	1.117205
BODCOM	7.073117	78.24173	1.202662
AUDIC	0.014414	18.86729	1.045657
CEOD	0.742567	1.171077	1.124233

Source : Researcher's Computation 2019

Table 4 shows the variance inflections factor result which was used to check for multicollinearity. The rule of thumbs is that the centered VIF must be below benchmark of 10,it can be concluded that there is no issue of multicollinearity in the model.

Table 5

Heteroskedasticity Test: Breusch-Pagan-Godfrey

F-statistic	1.265589	Prob. F(4,20)	0.3163
Obs*R-squared	5.049761	Prob. Chi-Square(4)	0.2822
Scaled explained SS	3.874570	Prob. Chi-Square(4)	0.4232

Source : Researcher's Computation 2019

Table 5 shows that the result of Brench-pagan-Godfrey test on Heteroskedasticity since the F-statictics and Obs R-squared have the associated p-values of 0.3163 and 0.2822 respectively which are greater than 5% level of significance it is good to conclude that there is no presence of Heteroskedasticity

Table 6: **Auto-correlation Test –**

Breusch-Godfrey Serial Correlation LM Test:

F-statistic	0.751472	Prob. F(2,18)	0.4859
Obs*R-squared	1.926561	Prob. Chi-Square(2)	0.3816

Source: Researcher's computation 2019

From table 6 the f statistics and obs R –square values of 0.751472 and 1.926561 with p-values of 0.4859 and 0.3816 respectively indicates the absence of auto-correlation in the model since the P-values are greater than 0.05 level of significance.

5. Conclusion and Recommendations

This study examined the effects of corporate governance on financial performance of deposit money banks in Nigeria proxied by Earning per share and four corporate governance indices – Board size, Board composition, Audit Committee and CEO duality. The regression result show that Board size, Board composition and CEO duality have positive effect on financial performance. This is consistent with the findings of brown and caylor (2004) who found that firms with larger Board size brings better financial performance. However, the study revealed that AUDIC(members of Audit committee) has a negative effect on financial performance which connotes the smaller the members of audit committee the better the financial performance.. The P- value of F- statistics in the regression result which is 0.000002 < 0.05 significance level revealed that corporate governance indices have overall significant effect on financial performance of deposit money banks in Nigeria.

This paper recommends the minimum Board size of 12 and maximum of 17 as reflected in the mean value of 16.6 in the above Descriptive statistics. Board composition should comprise of both executive and non executive Directors to checkmate executives excesses.

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