EFFECT OF CORPORATE GOVERNANCE ON FINANCIAL PERFORMANCE OF SOME SELECTED BANKS IN NIGERIA

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Abstract

This paper considered the effect of corporate governance on financial performance of some selected banks in Nigeria. This study employed ex-post facto research design and the study has been both cross-sectional and longitudinal. A standard multiple regression model also contains control variables, which are part of the models for this research. Arisen from the analysis of the study, the study reveals that board size have significant effect on the performance of the banks; board committee structure has significant effect on the financial performance of bank in Nigeria; board composition has significant effect on the financial performance of banks; and non-executive directors on the audit committee have significant effect on the financial performance of banks. Arisen from the findings of the study, the researcher recommends that Deposit Money Banks (DMBs) should give adequate attention to the board size because it has significant effect on the financial performance of the banks; board committee structure should be of optimal concern to the banks because it also has significant effect on the financial performance of bank in Nigeria; Central Bank of Nigeria should ensure that board composition of banks is adequately monitored because it has significant effect on the financial performance of banks; and Central Bank of Nigeria should ensure that Non-executive directors on the audit committee are not compromised by the banks because it has significant effect on the financial performance of banks.

Keywords: Corporate Governance, Financial Performance, Deposit Money Banks, Executive

Introduction

Corporate failure has been recently witnessed in both developed and developing countries with the reported cases of the East Asia crisis of 1997/98, the Collapse of Enron in 2001 and world come in 2992, (Agrawal & Chadha, 2010) and just ended global financial crisis of 2007/8. The crises emanated from the poor governance practices form the financial sector (the mortgage market). Since mortgage market was the mother of the crisis, this has triggered the world leaders to enact some laws which increase bank governance World Bank is currently helping many economies in undertaking banking sector reformation and restructuring. The exercise will ease, reduce or eliminate some fatal global macroeconomic troubles which have emanated from poor governance of large financial and nonfinancial institution (Uzun, Szewcyzyk & Varma, 2004).

In developing economies, the banking sector among other sectors has witnessed several cases of the collapse or failure of which some Nigerian examples include; savannah bank PLC, Societe Generale bank Ltd and recently Oceanic Bank, bank of the North African, Mainstream bank with the failure in Nigerian banks and the activates of some of the bank of operators, there are concerns on the need to strengthen corporate governance in banks. This will boost public confidence and ensure efficient and affective functioning of the banking system (Sanusi, 2011).

In Nigeria, the issue of corporate governance has been given the front burner status by all sectors of the economy. This is in recognition of the failure of the critical role of corporate governance in the successes or failure of companies (Bell, Szykowny & Willingham, 2017). Corporate governance is about building credibility, ensuring transparency and accountability as well as maintaining an effective channel of information disclosure that will roster great corporate performance corporate governance and therefore be said to refer to the processes and structure by which the business and affairs of institutions are directed and managed in order

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improve long term shareholders value by enhancing corporate performance and accountability while taking into account the interest of other stakeholders (Bell, Szykowny & Willingham, 2017).

Poor corporate governance was identified as one of the major factors in virtually all known instances of bank distress in the country. Weak corporate governance was seen manifesting in form of weak internal control systems, excessive risk taking, override of internal control measures, absence of risk management processes, insider abuses and fraudulent practices remain a worrisome feature of the banking system (Sanusi, 2011).

CBN code of corporate governance, which shows that corporate governance was a rudimentary stage, as only about 40% of quoted companies including banks had recognized codes of corporate governance in place. This, as suggested by the study may hinder the public trust particularly in the Nigerian banks if proper measures are not in place by regulatory bodies. The code of corporate Governance for banks in Nigerian post consolidation (2006) stated that the industry consolidation poses additional corporate governance challenges arising from integration processes, Information Technology and culture. This is in view of the fact that despite all these measures, the problem of corporate governance remains unresolved among consolidated Nigerian banks, thereby increasing the level of fraud. Data from the National Deposit Insurance Commission report (2006) shows 741 cases of attempted fraud and forgery involving ₦5.4 billion. Soludo (2004) also opined that a good corporate governance practice in the banking industry is imperative, if the industry is to effectively play a key role in the overall development of Nigeria.

The series of widely publicized cased of accounting improprieties recorded in the Nigerian banking industry in 2010 some banks were related to the lack of vigilant oversight functions by the boards of directors, the board relinquishing control to corporate managers who pursue

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their own self – interests and the board being remiss in its accountability to stakeholders. This research will examine the effect of corporate governance on financial performance of some selected banks in Nigeria.

The general objective of the study is to provide empirical evidence on the effect of corporate governance on the financial performance of banks. The specific objectives are;

1. To examines the extent to which board size affects the performance of the banks.
2. To determine the effect of board committee structure on financial performance of bank in Nigeria.
3. To ascertain the effect of board composition on the financial performance of the banks.
4. To examines the extent to which non-executive directors on the audit committee affects the financial performance of the banks.

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Review of Related Literatures

Concept of Bank Performance

By bank performance, generally it simply implies how a bank has fared within a trading period to realize its set objectives. The only document that explains this is presumably the published financial statements. A fair evaluation of any bank's performance usually starts by evaluating whether it has been able to achieve the objectives set by management and stockholders.

Bank performance or rather solvency or insolvency has been given much attention both at the local and international level. It is a term used as a general measure of the bank's overall accomplishment over a given period of time. It is also a subjective measure of how well the bank is utilising assets from the primary source to revenue generation efforts. Financial ratios are often used to measure the overall financial soundness of a bank and the quality of its management. Banks' regulators, for example, use financial ratios to help evaluate a bank's performance as part of the CAMEL system (Eboreime, 2010). Regularly, a number of criteria such as profits, liquidity, asset quality, attitude towards risk, and management strategies are considered when measuring bank performance.

Certainly, many banks have their own unique objectives. Some wish to grow faster and achieve some long-range growth objective, others seem to prefer quiet life, minimizing risk and conveying the image of a sound bank, but with modest rewards to their shareholders. Ordinarily, stock prices and their behaviour are deemed to reflect the performance of a firm. This is a market indicator and may not be reliable always.

Concept of Corporate Governance

Corporate governance has become a contemporary issue that has attracted unprecedented attention of students, academic scholars and practitioners. Disclosures of corporate fraud all over the world in the past years have clearly stunned investors' confidence and historical antecedents in financial practices have clearly indicated that financial crisis is a direct consequence of poor corporate governance (Bewick, Cheek, & Ball, 2010). An instance which led to the last global financial crisis is the Enron saga and the crash of sub-prime mortgage institutions. These problems transferred to other parts of the world through globalization which makes countries of the world to be interconnected as a result of trade liberalization and advancement in technology.

The whole essence of corporate governance is to ensure that the business is run well and investors receive a fair return. A firm is said to have observed corporate governance rule if the firm is managed with diligence, transparency, responsibility and accountability aimed at maximizing shareholders' wealth, because the term covers the general mechanisms by which management is led to act in the best interest of the company owners (Uzun Szewcyzyk, & Varma, 2004)

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Corporate governance is a crucial issue for the management of banks, which can be viewed from two dimensions. One is the transparency in the corporate function, thus protecting the investors' interest (a reference to agency problem), while the other is concerned with having a sound risk management system in place with special reference to banks (Robson, 2000). The Basel Committee on Banking Supervision (1999) states that from a banking industry perspective, corporate governance involves the manner in which the business and affairs of individual institutions are governed by their boards of directors and senior management, affecting how banks: set corporate objectives (including generating economic returns to owners); run the day-to-day operations of the business; consider the interest of recognized stakeholders; align corporate activities and behaviours with the expectation that banks will operate in a safe and sound manner, and in compliance with applicable laws and regulations; and protect the interests of depositors. On a theoretical perspective, corporate governance has been seen as an economic discipline, which examines how to achieve an increase in the effectiveness of certain corporation with the help of organisational arrangements, contracts, regulations and business legislation. It is not a disputed fact that banks are crucial elements to any economy; this, therefore, demands that they have strong and good corporate governance if their positive effects were to be achieved (Basel Committee on Banking Supervision, 1999).

The theoretical reviews of this study are on the review of theories relevant to explain the concepts of Corporate Governance and Bank Performance. The study puts up an in-depth exploration into some details of the aforementioned theoretical concepts namely; Agency Theory, Ethical Theory, Resource Dependence Theory, Stewardship Theory, these theories provide a detailed account of firm performance in spite of the limitations in their applications (Easterby-Smith, Thorpe, Jackson, & Lowe, 2008).

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The Stewardship Theory

Easterby-Smith, Thorpe, Jackson and Lowe (2008), explained that Managers are good stewards who diligently work to attain high level of profit and shareholder's returns. This theory is based on the assumption that Managers are motivated by achievement. Non – executive directors on board serve this purpose better.

Stewardship theory is a contrast or a direct opposite to the Agency Theory and this theory adopts a more idealistic view of humans. This theory is based on a model and believes of the agent not being a self-opportunist but a steward that perceives greater utility in the interest of the principal and the organization as a whole. The theory assumes that a significant correlation exists between the firm's success and the manager's satisfaction. This trade-off is achieved by the steward admitting that working towards achieving company's and collective goals will lead to self-actualization.

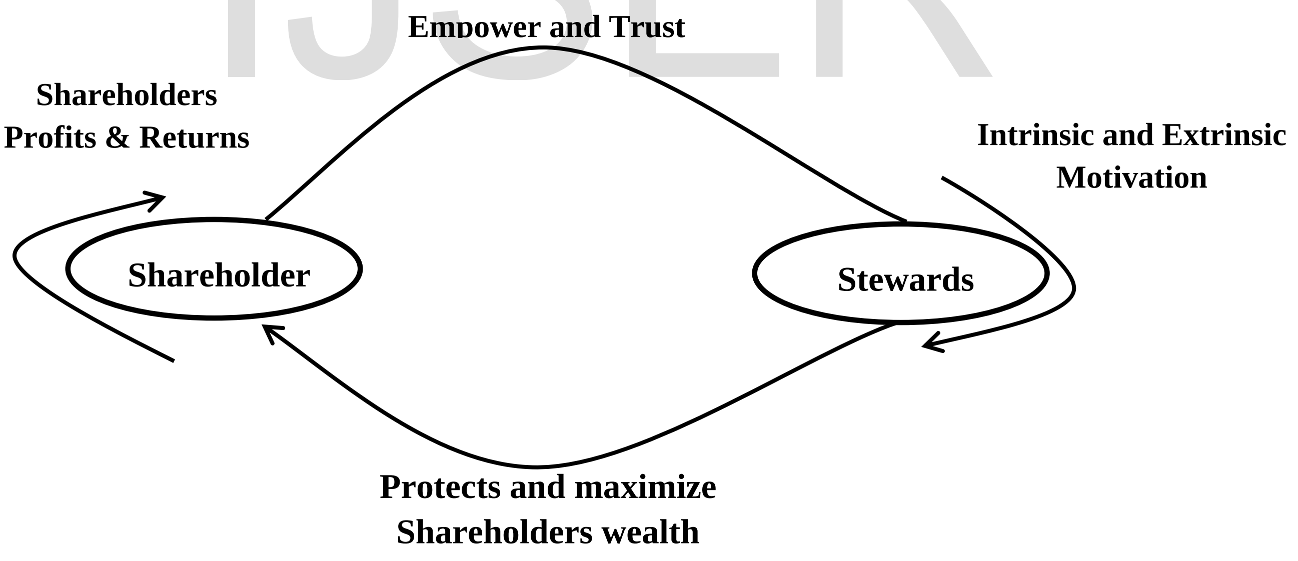

Figure 1: The Stewardship Model

Source: Middle Eastern Finance and Economics. Issue 4 (2010)

Agency Theory

The agency theory can be traced way back to Adam Smith in 1776 and his explanation of main issues that arises as a result of separation of ownership and control of a business. He was of the opinion that Managers of a fund cannot be expected to have a very watchful eye like the owners or providers of funds. Also, the extravagant behaviour will always persist in the management of the activities of a firm. Loebbecke, Eining, and Willingham (1989) established this relationship as an agreement involving at least two parties. The two parties usually involved are the principal and the agent. The principal usually the provider of the fund employs the agent (usually the Managers), to perform and run the company on their behalf. Included in the contractual agreement, the principal will bestow upon the agent decision – making authority.

The effect of this agency theory is that one can only try to mitigate against this agency problem when the board is composed largely by non – executive directors (independent and dependent) who will be able to control the activities of Managers and thereby maximize shareholders' wealth. The theory having its roots in economic theory was exposited Madala, (1991) and further developed by Madala, (1991). Agency theory is defined as "the relationship between the principal such as shareholders and agents such as the company executive and Managers".

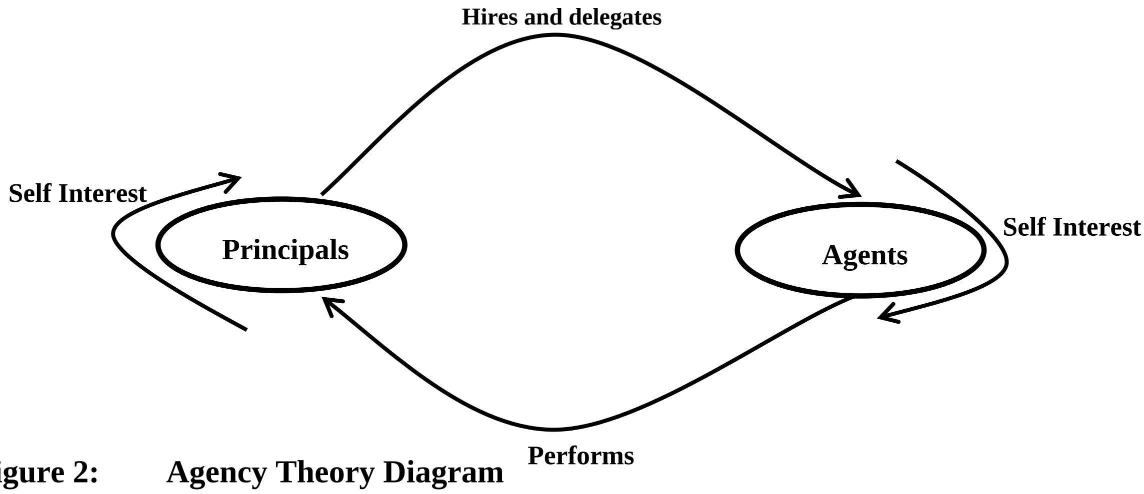

Figure 2: Agency Theory Diagram

Source: Madala, (1991).

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Methodology

The explanatory, non-experimental design has been adopted in this research, since the purpose is to not only explain the relationship between the main internal mechanisms of corporate governance affects the financial performance of banks. This study employed ex-post facto research design and the study has been both cross-sectional and longitudinal, as the data have been collected on a year-by-year basis, spread over a period of ten (10) years, from 2010-2019, and analysed in two phases. The research relies wholly on secondary data. The secondary data are published information, contained in the Annual Reports and Accounts of the organizations selected for the study, as well as related information that is available in, or obtainable from the Annual Accounts, Publications, Circulars and other relevant communications of or by the Regulatory/Supervisory Agencies, including the CBN, NDIC, SEC and NSE.

Both descriptive and inferential statistical techniques and procedures have been used. The descriptive statistics vary depending on the objective to be achieved. Largely, the objective has been to investigate and establish the effects of corporate governance on the financial performance of listed Deposit Money Banks. In line with these, specific tests have been employed, including the t-test and panel data regression methods.

Model Specification

The panel data regression model analysis technique in its multi-variate form has been adopted for this study, reflecting each of the variables contained in the hypotheses of the study, encompassing the dependent and the independent variables as depicted in the research models. A standard multiple regression model also contains control variables, which are part of the models for this research.

Table 1. Logistic Regression Models

Dependent Variable	Independent variable
1. $Fin\text{-}Perf_i$	$\beta_0+\beta_1 BSZ + \varepsilon_i$
2. $Fin\text{-}Perf_i$	$\beta_0+\beta_1$ BSTRUCTi + ε_i
3. $Fin\text{-}Perf_i$	$\beta_0+\beta_1$ BCOMi + ε_i
4. $Fin\text{-}Perf_i$	$\beta_0+\beta_1$ NEDAC i + ε_i

Source: Created by Researcher, 2020, guided by Previous Studies including Beasley (1996), Uzun et al (2004), D'Onza and Lamboglia (2011).

Where β_0 = Intercepts

β_1 = Coefficients of independent and control variables

Fin-Perf = Financial Performance

BSZ =Board Size

BSTRCT = Board Structure

BCOM = Board Composition (Made up of Non-executive director and Independent Director)

NEDAC = non-executive directors on the audit committee (Non-Executive Directors and Independent Directors)

Data Presentations and Analysis

Correlation Analysis

Though the study is aimed at ascertaining the effect of corporate governance on the financial performance of Deposit Money Banks. Tables 2 present the correlation matrices of the variables for the periods respectively.

Table 2: Correlation Matrix of Board Attributes and Financial Performance

	FIN-PERF	BSZ	NED	BOD COM	Board STRCT
FIN-PERF	1.0000				
BSZ	0.3347	1.0000			
NED	0.3547	0.4044	1.0000		
BOD COM	0.3464	0.3215	-0.5047	1.0000	
Board STRCT	0.3214	-	-	0.4082	1.0000

Source: STATA-Generated Output from Data, 2020

From Table 2, the independent aspect of board composition, the presence of nomination committee and its non-executive director composition, both aspects of the audit committee composition and the activeness of the committees, on the other hand are positively correlated with Financial Performance. While the correlation is reasonable with most of these variables, that with the activeness of the audit and nomination committees is very low (-0.0361 or 3.61%),

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even though all are in line with expectations – associated with tendency to reduce Financial Performance.

The positive influence of the Board Committee Structure is reflected in their association with the control variables, as it is with the NED aspect of board composition. Similarly, this influence is reflected in the low negative association of the activeness of the critical committees, reflected in the frequency of their meetings, with Financial Performance. This might be indicative of the near dysfunctional nature (of the meetings) of the committees- mere number without quality.

Tests of Hypotheses

Table 3: Logit Regression Results for Hypotheses, Financial Performance

Variable	Predicted Relation	Estimated Coefficient	Standard Error	Wald/Z Statistic	P-value
Independent:					
BSZ	-	0.135	0 .198	0.007	0.004
%BSTRUCT	–	0.012	0.084	0.019	0.001
%BCOM	–	2.759	787.78	0.000	0.007
NEDAC	–	18.973	5429.0	0.000	0.007

Cox & Snell R^2: Various, Nagelkerke R^2: Various

Log likelihood: Various.

*Omitted because predicts failure perfectly (no data).

Hypothesis 1 is concerned with the test of effect of board size on Financial Performance.

Table 3 shows the value of the coefficient is 0.135. This means that board size in the period has a positive effect on Financial Performance –increased the likelihood of Financial Performance occurring by 13.5%. The p-value of 0.007 indicates that the relationship is significant statistically since it is lesser than the critical value of 0.05. Based on this, complemented by the overwhelming significance of the univariate tests, the null hypothesis that the size of the boards of directors of banks has no significant effect on Financial Performance in banks is rejected.

Board composition, made up of %NED and %ID, is the focus of hypotheses 2. The results show that %NED has a coefficient of -0.012, indicating a positive effect on Financial Performance to the effect that for every unit increase in the attribute, 0.012 (or 1.2%) tendency for increase in Financial Performance occurs. However, this value, though has the desired effect of increase in Financial Performance occurrence, it is also found significant, with a p-value of 0.001 relative to the standard of 0.05, thereby leading to the null hypothesis that there is significant effect of board composition, in terms of non-executive directors, on Financial Performance.

Hypothesis 3 tests the composition of the Audit Committee, made up of the proportion of Non-Executive Directors and Independent Directors. As the logit regression result in Table 3 shows, Non-Executive Directors and Independent Directors has a high coefficient of 0.616 and the attendant p-value of 0.009. The coefficient shows that the presence of independent directors on the audit committee has the desired effect of increasing Financial Performance occurrence by 0.616 or 61.6%. Impressive as it is, this also translate to significant effect, with the p-value being far lower than the critical level of 0.05. In line with our decision criteria, the null version should be rejected, the banks had independent directors on their audit committees.

The coefficient of board structure shows a positive effect on Financial Performance by -0.129 or 12.9%, with a p-value of 0.011. However, is a significant outcome, being below the assumed significance threshold, hence the null hypothesis bordering on board structure not upheld but rejected in favour of the alternate that there is significant effect of the board structure on financial performance.

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Discussion of findings

Both the univariate and multivariate analyses show that banks' board size, BSZ, has significant effect on Financial Performance in the banks. This is not surprising since the descriptive statistics, the means, medians and variances – show significant differences between the Financial Performance. This is the result of the test of hypothesis 1, and is consistent with quite a number of previous research findings, including Uzun et al (2004), while to the contrary, Matoussi and Gharbi (2012) found effectiveness up to a point, Peng, Lee and Ingersoll, (2002) found negative effect on earnings management, implying effectiveness of size on that aspect of Financial Performance.

Board composition, the focus of hypothesis 2 also proved to have had a significant effect on Financial Performance in accordance with the logit regression result, which ordinarily would entail the rejection of both aspects of its null hypotheses. As in the case of board size, this result is not surprising, especially in terms of the proportion of non-executive directors, %NED, which is greater for the Financial Performance. Quite a number of previous studies (for instance, Beasley, 1996; Uzun etal., 2004), have however, established that Financial Performance organisations most often have a lower percentage of Non-executive directors on the board than their no-Financial Performance counterparts, with the resulting less effectiveness in oversight functions with the greater tendency for Financial Performance. Consistent with this empirical trend, the higher number would have entailed more effective oversight over executive management with the usual expectation of reduced tendency for Financial Performance, evidenced in the often-predictive negative sign in typical studies (Carcello & Neal, 2003). On the contrary, the logit regression shows mixed result, with slight tendency for reduced Financial Performance - 0.012 (1.2%) and increased Financial Performance occurrence by 0.0276 or 2.76% in the periods respectively.

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This finding is consistent with those of several previous studies, including Beasley (1996). A few others, including Matoussi and Gharibi (2012) however, find board independence as not being of significant effect on Financial Performance.

Further justification for this phenomenon (tendency of higher %NEDs to increase the tendency of occurrence of Financial Performance) is apparent in the influence of the Board Committee Structure, manifest in among others, the selection of members of the board, more so that only one bank had a full nominations committee in the entire Financial Performance. Even those, including the, which had a committee with other human resource management responsibilities aside board appointment in either the pre- or period, had their Board Committee Structures/Deputies or other EDs either as members or non-members but in attendance at all meetings of the committee, logically to ensure members selected to the board are those they can influence or manipulate to do their bidding, consistent with the findings of Matoussi and Gharibi (2012).

The regression result of the test of the influence of the Board Committee Structure on Financial Performance, the focus of hypothesis 3, turned out to be significant. This result implies that the towering influence of some of the Board Committee Structures in the Financial Performance, particularly, did not translate into the deep, widespread and devastating Financial Performances that characterised their banks' operations. This is contrary to the findings of several previous researchers that Board Committee Structure influence is the key factor in perpetration of most Financial Performances (Omoh, & Komolafe, 2010), as in other aspects of board performance. This influence manifests in several aspects of results in this study, evidenced in the discussions on the findings with respect to board composition, and nominations and audit committees' compositions. This pervasive influence is reflected in the univariate tests all indicating statistically significant differences between the sample categories, hence the appropriateness of the decision taken to reject the null hypothesis, which is in accord with the dominant

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empirical evidence highlighted earlier in this paragraph, notably Beasley et al (1999) findings of Board Committee Structure's involvement in Financial Performance 72% to 83% of the time.

Perhaps, to properly lend credence to these have been the several convictions of Board Committee Structures and their EDs for their roles and direct involvement in Financial Performances in the industry over the decades, from the Failed Banks' Tribunals of the 1990s (Bewick, Cheek, & Ball, 2010) to the most recent, including Anaba, 2011. These are in tandem with virtually all Financial Performances globally, as for instance, were the monumental cases of Enron, WorldCom and Cendant, among others, in the US where the topmost Accounting/Finance executives were all convicted upon disclosure of having been either encouraged or directed to manipulate financial statements or the underlying Accounting processes, by the topmost executive teams or Board Committee Structures which/who approved same knowingly.

The effect of the composition of the audit committees of banks on their Financial Performance status. From the logit regression results, the indices of the independence aspect of the committee composition prove statistically significant, even with the coefficient living up to expectation of considerably having the tendency to increase the Financial Performance, hence the rejecting of the null hypothesis. This is in tandem with empirical evidence of no significant impact as reported by among others, Beasley etal. (1996), inconsistent, however, with most empirical evidence on different aspects of Financial Performance unearthed in the course of this study, including Beasley et al (1996). This inconsistency arises in our case from the nature of the raw data, which indicate that only three banks out of the entire sample, had independent directors on their audit committees, and even then, in only three out of the five years of the period, hence the appropriateness of not rejecting the null hypothesis, as there is no sufficient statistical evidence.

For the non-executive director component, the regression results show clear significance, both in the periods of analysis, supported by both the univariate tests and correlation analysis, hence the decision to out rightly reject the null hypothesis. This is in accord with not only the prescriptions of regulatory regimes in line with corporate best practices, but particularly empirical evidence. Some others, including Beasley (1996); Uzun et al (2004), however, reported findings differently, hence contrary to the results of this research.

The statistical significance of the %NEDAC is surprising as it was in the test of board composition generally, with the category of directors being higher on the boards of the Financial Performance. The justification of this anomaly in the discussion on that variable is applicable here – largely due to the lack of independence of the non-executive directors, enhanced by the pervasive influence of the Board Committee Structure. For this, it becomes worsened by the fact that while they were almost fully (96%) represented on the audit committee by non-executive directors, the reverse was the case in the Financial Performance banks, some of which had as low as 33.33% especially in the first three years.

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Conclusion

This study concluded that board size has significant effect on the performance of the banks; Board committee structure have significant effect on the financial performance of bank in Nigeria; Board composition have significant effect on the financial performance of banks; and Non-executive directors on the audit committee have significant effect on the financial performance of banks.

Recommendations

Arisen from the findings of the study, the researcher recommends that:

1. Deposit Money Banks (DMBs) should give adequate attention to the board size because it has significant effect on the financial performance of the banks.

2. In the same vein, board committee structure should be of optimal concern to the banks because it also has significant effect on the financial performance of bank in Nigeria.
3. Central Bank of Nigeria should ensure that board composition of banks is adequately monitored because it has significant effect on the financial performance of banks.
4. In the same vein, Central Bank of Nigeria should ensure that Non-executive directors on the audit committee are not compromised by the banks because it has significant effect on the financial performance of banks.

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