CORPORATE GOVERNANCE AND DEPOSIT MONEY BANKS' PERFORMANCE IN NIGERIA

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Abstract

This research work observed the relationship between corporate governance and bank performance in Nigeria. Over the years, emphasis has been placed on the use of effective governance to ensure corporate discipline in maximizing the interests of all relevant stakeholders of an organization. Using auditors, board of directors and performance information of five quoted banks in the Stock Exchange of Nigeria with a total of 40 observations during the 2007-2014 sample years, this study sheds some light on the association and effect of internal corporate governance (board size, board composition, board independence, and bank liquidity) on bank performance. The method of analysis adopted is the panel regression involving fixed effect estimation techniques. The correlation coefficient was used to measure the degree of association between our governance variables and profitability indices; while a robust estimator involving panel corrected standard error was applied. The estimated result for board size and board independence reveals a significant lag effect on bank performance. Board composition appears to have a significant inverse relationship with bank performance which further suggests a low acceptance and adherence to cooperate governance by most banks with its resultant adverse effect on the bank performance. Also, a statistical inverse relationship between the board size of a bank and its performance was observed which suggests that increasing the size of the board of directors of a bank does not guarantee its performance. The study therefore suggests that regulatory agencies should encourage firms to maintain a reasonable board size since overly large boards may be detrimental to the firms' performance. Also, the study recommends there is need for the regulatory authorities to reassess the procedures for the appointment of directors to the board in order to ensure uniform standards; transparency, accountability and stability exist in these financial markets.

Keywords: Corporate Governance, Board Size, Bank Performance

1. INTRODUCTION

The new banking standard was revealed by the Central Bank of Nigeria (CBN) in July 2004 which was devised to reorganize and consolidate the banking industry via mergers and acquisition. The main aim of this was to make banks in the Nigerian financial system more viable thereby commanding presence in the global

market. Nevertheless, success of procedures globally entails transparency, accountability, and regard for the set down rules. In the section (1) of the Corporate Governance Code for Nigerian banks following the consolidation process of 2006, it was affirmed that the consolidation of industry creates more disputes regarding corporate governance given rise from the process of integration, culture and information technology. An indication from the code reveals that about 70 percent of mergers globally are not successful because of lack of ability to integrate systems and personnel as well as due to the contradictory variances in management and corporate culture, which gives rise to in Board of Management arguments. All these measures notwithstanding, the corporate governance challenge still lingers unsolved amid banks in Nigeria and resulting into an increase in fraud by so doing (Schjoedt, 2000).

The banking crises of 2009 in Nigeria has been related to unprofessional conduct of governance among the consolidated banks, this has incessantly become a norm majorly in the banking sector. In several banks, corporate governance failed due to misconduct of boards to these practices on the basis of issues including misleading attitudes by executive management, participation in acquiring loans that are not secured to the detriment of depositors and also their incompetence in enforcing excellent governance in managing the bank. Poor corporate governance has resulted in decline in shareholders' wealth and corporate failure. The sequence of cases that are extensively publicized regarding misconduct of accounting procedures witnessed in the banking industry in Nigeria relate to the absence of cautious supervisory functions by the boards of directors, the board delegating management to corporate managers who follow their own selfish motives and these persists without check due to the negligence of the board and their persistent inability to be accountable to stakeholders. Due to this fact, several reforms of corporate governance have been distinctively highlighted regarding the required changes needed to be made to the board of directors relating to the structure, composition and size.

In view of the highlighted challenges, this study focused the impact of corporate governance systems on the financial performance of deposit money banks in Nigeria and aimed to answer questions such as: to what extent (if any) does board size affect the financial performance of banks in Nigeria? What effect do the proportions of non-executive directors have on the financial performance of deposit money banks in Nigeria? And what is the nature of the relationship between corporate governance practices and financial performance of firms in the deposit money banks in Nigeria? This paper is divided into five sections. Following this introductory section is the review of literature. Section three shows the methodology adopted and section four reports the analysis of data done while the paper concludes in section five.

2. REVIEW OF EMPIRICAL LITERATURE

In a bid to give firm support to corporate governance Herring and Safar (2004) promoted that market forces be used to assist in achieving management goals as a reasonable mode of advancement in supporting corporate governance and personal discipline by ensuring full communication with the board, for more enhanced support towards financial stability. Research works on bank governance regarding their performance have considered subjects from diverse viewpoints varying from inert to vibrant governance. Begger, et al (1987), utilized data from the United States; it established minimal economies of scale or diseconomies concerning static disparities in efficiency among indigenous banks and their expatriate and government owned equivalents. Deniser and Strahan (1997) determined likely rewards of revenue for big banks than for banks that are small in 1990's. Deyoung, et al (2004), discovered that big banks and banks that are small provide services for diverse collections of clients, they also, utilize varying types of technologies which have varying impact on competition.

The study of Profit efficiency determined that mergers and acquisition enhance profitability, due to shifts in portfolio (Akhavein, et al 1997). Regarding the subject of efficiency, the topical issue is usually on availability of credit and distribution of portfolio in addition to performance. This is due to the fact that the aim of government owned banks particularly depends on enhancing the performance of certain industries or region, enlargement of the export platform and consistently connected to focus lending. Yung (2003), utilized panel regression analysis, it affirms that size of board has a tangible effect on performance of bank. While Love and Rachinsky (2009), made use of 107 banks in Russia and 50 banks in Ukraine it determined that tangible, but efficiently insignificant association within governance and contemporary operating efficiency with a relationship that is insignificant with succeeding efficiency.

Okoye, Erin, Ahmed, and Isibor (2017) examined the nexus between corporate governance and financial sustainability of microfinance institutions in Nigeria using the generalized least square method. The study shows significant positive impact of board size on financial sustainability. Return on assets and operating self-sufficiency were adopted as proxies for financial sustainability while board independence, gender diversity and board size were adopted as proxies for corporate governance.

Ojeka, Iyoha, Ikpefan,and Osakwe (2017) explored the relationship between corporate governance mechanisms and stock market performance in Nigeria. Audit committee independence, audit committee financial expertise, board independence, and ownership structure (corporate governance mechanisms) were adopted as independent variables while share price, volume of trade, market capitalization, and earning per share were adopted as indicators of market performance. The study showed significant positive impact of audit committee independence, audit committee financial expertise, and board independence on share price, volume of trade, market capitalization, and earnings per share.

Charkam (2004) affirms that common experience in banking are causes of failure such as unawareness, fraud, wrong judgment, societal and political demands, and if these causes are addressed, governance will be in a better position for enhanced effect. Nonetheless, failure of banks, persuaded government of the need to institute a minimum capital requisite for banks' that are insured. Oluyemi (2007), affirm that a solid capital base builds realistic assertion of customers' and creditors' protection.

The regulatory and capital cushion theory in Nigeria permits banks to sustain a soft landing that would avert the proportion of stochastic capital from attaining rates less than the allowed minimum so as to prevent penalties. This update the clause of the CBN that banks need to obtain fifty billion-naira (₦50 billion) minimum of capital base for relevance and universal competition. Despite the level of policies on consolidation essentially via mergers and acquisitions that has occurred, howbeit, resulting into the reduction of the banks in number from eighty-nine to twenty-five (89 to 25) in Nigeria in the year 2006, the banking industry has not yet attained expectation of its set goals of ascertaining excellent and appropriate corporate governance (Kama, 2006). In April 2006, the transformation schedule initiated a new set of laws of corporate governance for banks in Nigeria. The code provides transparency, equity ownership, and requirements of disclosure, structure of the organization in addition to some of the responsibilities of the auditors.

3. METHODOLOGY

3.1 Definition of the Key Variables

a) *Existence of code of corporate governance* (CODCGOV): codes of corporate governance are a best practice recommended sets, regarding the attitude and organization of the management team of a firm (Aquila et al, 2008). Nevertheless, obvious proof of the precise level to which firms in Nigeria have implemented these codes or enhanced their individual definite-organisational governance practices is widely known due to lack of data that is easily accessible (Duke & Kankpang, 2011). This study will also make use of board independence (BI) as a proxy for corporate governance codes in the banks.

b) *Return on asset* (ROA): This variable shows how effective an organization is in relation to its total assets. The ROA suggests the resourcefulness of management in effectively utilizing its assets to create returns.

The data used in this study were obtained from the audited financial statements of the banks listed in the Nigerian Stock Exchange (NSE) for the year 2014. This study used books and other related materials especially the Nigerian Stock Exchange Fact Book (2014).

3.2 Model Specification

Basically, this study adopted the models used by Duke & Kankpang (2011); the models seek to link corporate governance and financial report reliability with firm performance. Thus, the models are specified as follow:

$$ROA = f (BI, BCOM, BSZ, LQR) \dots\dots\dots\dots\dots\dots\dots\dots (1)$$

This is expressed in its explicit form as:

$$ROA = \beta_0 + \beta_1 BI + \beta_2 BCOM + \beta_3 BSZ + \beta_4 LQR + \mu_t \dots\dots\dots (2)$$

Where

ROA = Return on Assets

BI = Board Independence.

BCOM = Board Composition

BSZ = Board Size

LQR = Bank Liquidity

μ$_t$ is the error term

β$_1$, β$_2$ β$_3$ β$_4$ > 0

3.3 Estimation technique and procedures

In analyzing the relationship between corporate governance and financial performance in Nigeria, the study made use of cross-sectional data derived from a total of five banks over the duration of 8 years from 2007-2014. Thus, the method of analysis adopted is the panel regression involving ordinary least square estimation techniques. The correlation coefficient is used to measure the degree of association between the governance variables and profitability indices; while a robust estimator panel corrected standard error (PCSE) for the regression analysis is used to investigate the impact of corporate governance indices on banks' financial performance.

4. DATA ANALYSIS AND INTERPRETATION

4.1 Preliminary Data Analysis

Table 1: Panel Unit root test

Variable	At levels	First Difference
ROA	-0.660431(0.2532)	-5.86790 (0.0000)
BSZ	-9.77496 (0.0000)	-13.0601 (0.0000)
BI	-0.70844 (0.2393)	-3.18647 (0.0007)
BCOM	-3.35633 (0.0004)	-9.92533 (0.0000)
LQR	-2.64964 (0.0040)	-5.28205 (0.0000)

Source: Authors' Computations

Note: Levin, Lin & Chun p-values are in parentheses.

The analysis of the unit root result indicates that all the variables in the model except board size (BS) were not stationary at levels. This indicates the presence of unit root among the series considered. Hence the null hypothesis of no trend stationary process cannot be rejected for the data series at their levels and there is tendency of the series to exhibit a high stochastic trend and drift in the movement. It therefore becomes necessary for the series to be subjected to further test by differencing them at first difference. The result in table 1 shows that the Levin, Lin & Chun test result indicates that the entire series attained stationary at their first differences which therefore neglects the null hypothesis of unit root present in the data while suggesting the observations were integrated to order 1.

The Engle-Granger (1987) co integration test is premised on a test of the residuals of a spurious regression done by utilizing I (1) variables. The residuals would be I (0), if the variables are co integrated. Conversely, if they are not co integrated then the residuals will remain I (1). Pedroni (1999, 2004) and Kao (1999) expanded the framework of Engle-Granger for tests involving panel data. Quite a number of tests were proposed by Pedroni for co integration that allow for heterogeneous intercepts and trend coefficients across cross-sections. Evidence from the above co integration test n table 4.2 reveals evidence of co integration with the panel (t-statistic1.9786; p-value= 0.0339) and group (t-statistic-2.3347; p-value (0.0098) Phillip Perron (PP) statistic at 5 percent and 1 percent significance level.

Table 2: Panel Co-integration Test

Pedroni Residual Cointegration Test					
Series: LROA LBS LBI LBCOM LLQR					
Alternative hypothesis: common AR coefs. (within-dimension)					
				Weighted	
		Statistic	Prob.	Statistic	Prob.
Panel v-Statistic		-37.45434	1.0000	-0.345902	0.6353
Panel rho-Statistic		0.494734	0.6896	0.494734	0.6896

Panel PP-Statistic	-1.978556	0.0239	-1.978556	0.0239
Panel ADF-Statistic	-1.167685	0.1215	-1.167685	0.1215
Alternative hypothesis: individual AR coefs. (between-dimension)				
		Statistic	Prob.	
Group rho-Statistic		1.027357	0.8479	
Group PP-Statistic		-2.334765	0.0098	
Group ADF-Statistic		-1.242931	0.1069	

Source: Authors' Computation

Table 3: Correlation Matrix

	BSZ	BI	BCOM	LQR
BSZ	1.000000			
BI	-0.233875	1.000000		
BCOM	0.414224	-0.072265	1.000000	
LQR	-0.219135	-0.226056	-0.093400	1.000000

Source: Authors' Computations

Correlation measures the potency of association among two or more variables. The scale of measurement utilized must have minimal interval scales, though; other coefficients of correlation are accessible to take care of other types of data. The coefficients of correlation could vary from -1.00 to + 1.00. The value -1.00 signifies a perfect negative correlation whereas the value + 1.00 signify a perfect positive correlation. The value 0.00 signifies no correlation. It is shown that there is little or no negative correlation relationship among the independent variables. The board size and the board composition indicate weak positive correlation. Also, there is no evidence of a strong correlation relationship between the independent variables used in the study which suggests absence of multi-collinearity in the estimated model.

4.2 Empirical Analysis

Table 4: Hausman Test

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section			
random	10.138504	4	0.0382

Source: Computed by the Authors using Eviews 7

The Hausman test compares two estimators, the fixed effects model and the random effects model. Under the null hypothesis given by the test, both are consistent, but the random effects model is a more efficient estimator. Under the alternative, the fixed effects model is consistent, but the random effects model becomes inconsistent. If the P-value of the Chi-square results in the Hausman test is not significant, it will then be safe to utilize random effects. However, if P-value is significant, the fixed effect is utilized. From the results shown above, it is determined that the coefficients are significant at the 5 percent level of significance and thereby we conclude that the coefficients approximated by the random effects are different from estimations by the fixed effects. Therefore, the null hypothesis that says random effects model is better should be rejected and, the alternative hypothesis accepted. This implies that for the model underlying this study, the fixed effects model would be a more efficient estimator.

Table 5: Panel Fixed Effect Regression Result

Dependent Variable: LROA				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.728518	1.043331	1.656731	0.1101
LBSZ(-1)	-0.988867	0.393899	-2.510455	0.0189
LBI(-1)	-1.145146	0.537416	-2.130839	0.0431
LBCOM	-0.856028	0.123454	-6.933958	0.0000
LLQR	1.111132	0.115399	9.628578	0.0000
	Effects Specification			
Cross-section fixed (dummy variables)				
	Weighted Statistics			
R-squared	0.920828	Mean dependent var		-8.251175
Adjusted R-squared	0.895493	S.D. dependent var		4.793238
S.E. of regression	0.685170	Sum squared resid		11.73644
F-statistic	36.34616	Durbin-Watson stat		2.199612
Prob(F-statistic)	0.000000			
	Unweighted Statistics			
R-squared	0.551594	Mean dependent var		-3.745355
Sum squared resid	k13.53669	Durbin-Watson stat		1.397475

Source: Authors' Computations

The R-squared is 92.1%, and this implies that the independent variables explain about 92.1% of the changes or variations in the dependent variable in the model. It shows that internal corporate governance accounts for about 92.1 percent of the changes in bank performance in Nigeria. The adjusted R-squared which falls to 89.54percent as it accounts for the loss of degree of freedom signifies that the model internal corporate governance accounts for 89.54 percent of the changes in the performance of Nigerian banks. The R-squared and adjusted R-squared can be used to measure the "goodness of fit" in the model. The values obtained, signifies a strong relationship between corporate governance and bank performance in Nigeria. The variation in deposit money bank performance is significantly explained by the changes in the independent variables. This further shows that the model is of good fit. It shows that the level of corporate governance of Nigerian banks is strong and has high effect on the performance of the banks. The Durbin Watson which can be used to test for the presence of auto-correlation is about 2.19, shows absence serial autocorrelation between the variables estimates and error term. The F statistics has a value of 36.34 and is statistically significant at the 1 % level of significance and this shows the overall joint significance of the independent variables in the model as they explain changes in the dependent variable. The evidence from the F-statistics (36.34) shows that the independent variables jointly and significantly explain changes in financial performance of banks. Statistically it indicates that model correctly explain the data at 1 percent level of significance and hence statistically

different from zero. The above result shows that the estimated results of the model are free from bias and could be useful for policy recommendations.

Giving the double log function for financial development model all the coefficient are interpreted in absolute term expressed in percentages.

4.3 Discussion of Result

Table 5 above shows the result estimation utilizing the fixed effects model for a panel least square estimation technique. In the regression analysis, board size, board independence, board composition and bank liquidity are converted into a log-linear form this is done through obtaining the natural logarithm of these variables. The modification is related to the conduct given by Sridharan and Marsinko (1997), Kyereboah-Coleman and Biekpe (2005) and Chen, Elder and Hsieh (2005) in their researches on corporate governance and firm value. It can be observed that board size, board independence and board composition have an inverse relationship with bank performance (ROA), and they both vary statistically and significantly from zero at 1 % level of significance respectively while bank liquidity revealed a significant direct relationship with bank performance.

The inverse relationship between the board size and ROA implies that increasing the board size reduces firm performance. This supports the agency theory that postulates that, restricting the size of board to a certain point is usually considered to enhance firm efficiency due to bigger experience of boards resulting into higher monitoring costs, and poorer communication between members in decision making. Studies on size of board done empirically appear to present conclusions that are similar: a rather apparent indirect association seems to subsist within the size of board and the value of the firm. Yermack (1996), utilized data from Finland and Liang and Li (1999), with data from China, also found an indirect relationship within the size of board and efficiency. Eisenberg, Sundgren and Wells (1998) and Mak and Kusnadi (2005) furthermore take a position that boards that have small size are directly associated to greater organisational performance. Sanda et al (2003) in a study conducted in Nigeria, affirms that performance of the firm is directly related to board size that is small, as disparate to board size which is large.

The estimated result for board independence lag 1 indicates a significant relationship with bank performance and could be regarded as a significant determinant of bank performance in the model. This further implies that changes in structure and composition of the board executives have significant effect on bank profitability. The empirical evidence from the estimated co efficient for board independence shows that a percentage change in board independence will bring about a more proportionate change in bank performance. Hence economically the degree of the responsiveness of bank performance to the variations in bank independence is elastic.

The inverse association within independence of board and the performance of firm indicates that it is possibly vital to assign individuals that have the technological proficiency and those who have had contact with a firm and are conversant with the environment to ascertain that value is created. This further implies that for the board of directors to be effective monitors, it is not enough just to be independent thus; they must be active as this furthermore ascertains the situation of the firm in addressing transparency and striving to enhance value of shareholder.

From the results presented above, it can also be inferred that an inverse relationship exists between board composition and bank performance (ROA), and it is statistically significantly different from zero at the 1% level of significance. Hence, this governance variable has an effect on the performance of banks. It is argued that directors that are not executives could perform as professional referees to make sure that action is stimulated by competition amongst insiders which is reliable for shareholder value maximization. Cotter et al. (1997) holds up this perception highlighting the significant function of external directors in preserving the interest of shareholders by efficient control of decision. The inverse relationship between board composition and performance shows that at certain limits within the banks, increasing the non-executive composition of the board also has associated cost which could affect the profitability of the banks. Hence, the decision about the composition of the board should be done with due consideration of the cost implications on the banks performance.

This regression result mirrors the fact that there is a significant relationship between internal governance indicators and the performance of banks. This is reinforced by the statistical significance of the variables board size of banks, independence of the board of directors, board composition and bank liquidity. A board size which is kept to a minimum and an audit committee that has a low proportion of shareholders who have adequate skills will promote performance. Also, the F statistic is statistically significantly different from zero at the 1 % level of significance, and it shows the joint significance of the independent variables used in the

model. The implication of this finding is that the null hypothesis earlier formulated which stated that corporate governance indicators has no statistically significant effect on bank performance is rejected and the study concludes that corporate governance influences the performance of banks.

4.4 Policy Implications of Findings

Overall, the result of this study has indicated that good governance structures put in place will foster the improved performance of banks. Effective governance in firms will serve to ensure corporate discipline and protect the interests of all players and stakeholders of the institution. The directors that are independent, those directors on the board and independent auditors can enhance firm value by efficient execution of their duties as this can serve to decrease agency costs in an organization. From the results the indirect association within board size, board independence and board composition show that in a developing nation such as Nigeria, the feeble condition of the judiciary and institution that regulates in the economy gives room for the directors to engage in prejudiced making of decision that protects the interests of the main shareholders however, resulting into a shortcoming for the firm. Also, the independent shareholders on the committee lack adequate accounting skills and are often selected through biased political means. They influence the firm's financial reports and work for the benefit of the major shareholders furthermore creating shortcomings for the minority shareholders.

The frail corporate law and varying standards of accounting also has effect on the efficiency of the auditors and result into volatility in the financial system in Nigeria. However, the inverse relationship between the independence of the board, and the bank performance indicates, that boards largely composed of greater number of independent directors does not guaranty the profitability of the banks. However, a reasonable number of independent director who can help to monitor activities and protect the interests of relevant stakeholders, as they will enhance decision making without being biased since they are not directly linked to the bank activities. In order to ensure effective corporate governance, and improve the financial system of an economy, the government and regulatory agencies can ensure that the board size is limited to a sizeable amount, the directors appointed are of reputable character and possess the right skills and also, the shareholders appointed are persons that are familiar with the banking terrain. The estimated coefficient of bank liquidity reveals a significant direct effect on bank performance. The liquidity of the bank appears to play a significant role in the determination of banks' performance. This further shows that there is a need to consistently maintain a high liquidity level among banks and ensure appropriate measures are put in place to guide against bank distress since this will help in enhancing bank performance and maximizing profit for the banks.

5. CONCLUSION

This study has discussed corporate governance and the performance of banks and it establishes that there is a relationship between corporate governance and the performance of banks in Nigeria. The board of directors and its characteristics hold many implications for the value of a firm. The degrees of qualifications or skills possessed by persons appointed to these boards and various committees can influence their performance in a dynamic business environment. The research work infers that econometric tests be implemented on a set of data that is greater and covers more firms for a longer range of time for an external corporate governance model. This may lead to a new viewpoint on the association amid the efficiency of a firm and corporate governance, alongside new policy implications. For a least developed nation like Nigeria to attain growth and development in the economy that is rapid, there is need for a solid, secure financial system, and to retain the stability of this system and maintain high competitiveness, it calls for firms that are governed well to achieve maximal resource utilization and peak performance. The study therefore recommends that regulatory authorities must persuade firms to sustain a realistic size of board because an excessively outsized board could be unfavorable to the performance of the firm. Also, the regulatory agencies should reconsider the processes for the selection of directors to the board so as to ensure uniform standards; transparency, accountability and stability exist in these financial markets. More so, it is important that structures and agencies are set up to ensure that corporate laws and standards set in place are strictly complied with to achieve effective governance of financial firms.

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