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Corporate Governance and Financial Performance of Listed Deposit Money Banks in Nigeria

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Abstract: *Good corporate governance practice is required for effective management of organizational resources particularly in banking industry where there is management/shareholders separation. Since the introduction of corporate governance code after the CBN consolidation exercise in 2005, corporate governance has attracted an unprecedented attention of researchers. However, efforts aimed at improving corporate governance practice in Nigerian banking industry are yet to yield the desired result. It is against this basis that the study examines the impact of corporate governance on the financial performance of all listed deposit money banks in Nigeria for a period of seven (7) years (after consolidation). Data for the study were quantitatively retrieved from the annual reports and accounts of the studied banks. Regression analysis was used to analyze the data and it was found that larger board size contributes positively and significantly to the financial performance of deposit money banks in Nigeria. The study however, recommends among others that banks should increase their board size but within the maximum limit set by the code of corporate governance.*

Keywords: *Corporate Governance, Audit Committee, CEO Duality, Board Size, Board Composition, Firm Size and Return on Asset.*

I. Introduction

In recent times corporate governance has become a topical issue which has attracted the attention of academic scholars and practitioners. Revelations of corporate fraud all over the world in the past years have clearly shaken investors' confidence and historical antecedents in financial practices have indicated that financial crisis is the direct consequence of poor corporate governance (Akingunola, Olosegun & Adedipe, 2013). For instance, the Enron saga and the crash of sub-prime mortgage institutions which led to the last global financial crisis. 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 (telecommunication and transportation)

Africa particularly Nigeria had its own share of the contagious financial crises. In the recent past, financial institutions in Nigeria witnessed untold financial distress in which banks that were considered healthy by investors happened to be the most distressed. This made the Securities and Exchange Commission (SEC) in 2003 to posit that, the financial sector attracted poor corporate governance because only 40% of companies including banks quoted in the exchange had recognized code of corporate governance. Subsequently, in 2003, the Nigerian Securities and Exchange Commission rolled out a code of best practices on corporate governance for all public quoted companies.

The banking sector crisis remained a subject of concern because of its role in facilitating and stimulating economic development. This however made the apex bank (Central Bank of Nigeria) to take a bold step in revitalizing the banking sector through the stipulation of N25 billion naira capital base for all banks in Nigeria. This led to the emergence of 25 commercial banks in Nigeria as at 31st December, 2005. 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 (Demaki, 2011).

Since the issuance of the code of corporate governance by the CBN, efforts have been made to evaluate its impact on the performance of banks. From empirical perspective, efforts aimed at studying the impact of corporate governance among scholars have yielded varying outcome where a consensus is yet to be reached. This led to continuous study in the area of corporate governance and the performance of banks in the post consolidation era. While a number of performance measures were used by previous authors such as Net Interest Margin (NIM), financial reporting quality and earnings management, financial performance has not been given the desired attention in the literature particularly in Nigerian studies. It is based on this vacuum created by previous studies that this study intends to fill by examining the impact of corporate governance on the performance of listed deposit money banks in Nigeria.

II. Literature Review

2.1 The Concept Of Corporate Governance

According to the Central Bank of Nigeria (CBN) code of corporate governance for banks and other financial institutions in Nigeria (2006), corporate governance is the process by which the business activities of an institution are directed and managed. Adeusi, Akeke, Aribaba and Adebisi (2013), explained that corporate governance is a set of rules and incentives through which the management of an organization is being directed and controlled. However, Lemo (2010) emphasized that corporate governance consists of body of rules of the game by which companies are managed. This view was extended by Demaki (2011) that corporate governance is an institutional arrangement that checks the excesses of controlling managers. The whole essence of corporate governance according to Kajola (2008) 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, (Pandy, 2005). Akinsulire (2006) explained that, corporate governance is a term which covers the general mechanisms by which management is led to act in the best interest of the company owners. Corporate performance according to Adegbemi, et al. (2012) is an important concept which relates to the ways and manners in which the resources (human, machine, finance) of an institution are effectively used to achieve the overall corporate objective of an organization. What keeps an organization in business is simply its ability of judiciously use its available resources and make sure that the providers of economic resources and its managers mutually benefit from the use of the resources.

Though there exist different views with respect to how scholars integrate the concept of governance but, however, at the end, they tend to point toward the same direction which is to ensure the well-being of the owners of organizations. A wider rather than a narrow view of corporate governance should be adopted in the banking sector because of the peculiar contractual nature of banking which requires the extension of corporate governance benefit to depositors (Macey & O'Hara, 2001) cited in Ajola, et al. (2012). This broader view makes a lot of sense because apart from using owners' found in business transactions, money deposited by depositors are also used for business investment purposes, hence the need for broader view.

2.2 Review of Related Empirical Studies

The empirical relationship among the variables for the study are examined under the following headings.

2.3 Board Size And Financial Performance

Ajola, et al. (2012) studied the effect of corporate governance on the performance of Nigerian banking sector using the Pearson Correlation and Regression to analyze the relationship between corporate governance variables and banks' performance and found that a negative but significant relationship exist between board size and the financial performance of the selected banks covering a period of five years. Bawa and Lubabah (2012) examined corporate governance and financial performance of banks on twelve banks in Nigeria covering a period of five years (2006-2010) and found negative relationship between board size and profitability of banks.

However, the study carried out by Akpan and Rima (2012) on eleven (11) selected banks in Nigeria using linear regression analysis arrived at a conclusion which also tallies with the finding of Asiyagwu (2013), that smaller board size positively and significantly enhance performance and Yoshikawa and Phan (2003) added that larger board size increases agency cost.

Mansi and Reeb (2004) argued that larger board is better than smaller board size in that larger board size have the ability to push the managers to track lower cost of debt because creditors believe that such firms are more effective monitors of accounting process. This position is in consonance with the findings of Adeusi, et al (2013) who also examined the effect of board size on the performance of ten selected banks for a period of six years (2005-2010) using econometric model of linear regression and found that increasing number of board size increases the performance of banks. The findings of Prakash and Martin (ND) on a study of corporate governance and efficiency in Nepalese commercial banks revealed that bigger board size lead to efficiency in commercial banks.

2.4 Board Composition and Financial Performance

Weisbach, (1988), Hermalin and Weisbach (1991), (Choe and Lee as cited in Sanda, et al, 2005), posited that the proposition of board composition is to help reduce agency problem. From this position, a positive relationship is expected between firm performance and the proportion of outside directors sitting on the board. Conflicting empirical evidence has evolved with respect to board composition in the recent past.

There exist mixed results from empirical studies on the effects of board composition and performance. Kajola (2008) examined corporate governance and firm performance on some Nigerian listed banks between 2000 and 2006 and found no significant relationship between board composition and firm performance. This outcome has

also, the support of (Sanda et al, 2005; Bawa and Lubabah, 2013; Bhagat and Black, 2002; and Adeusi et al, 2013) who further added that the performance of banks tends to be worse when there are more external board members.

However, the findings of Prakash and Martin (n.d.) on twenty-nine (29) Nepalese banks for a period of six (6) years (2005-2011) via the use of regression analysis, shows that outside directors have positive and significant effect on the bank performance. This is also the position taken by Bawa and Lubabah (2013) and Ezzamel and Watson (1993). The code of corporate governance emphasizes board composition that has qualitative, qualified, experienced members and people of proven integrity (Bawa & Lubabah, 2013). Klein (2002) and Benerd, Chrauroue & Courteau (2004) argued that the board of directors' ability to monitor and advise a firm depends on their influence, competence and experience. This will reduce fraud and increase performance.

2.5 Audit Committee Size And Financial Performance

Shareholders' interests are protected through the activities of audit committee because management may not always act in the interest of corporation's owners (Prakash & Martin, n.d.). Studies in favour of larger audit committee posited that when more people are involved in checking the activities of managers, wrongdoings will be reduced and performance will be enhanced. A number of studies which revealed positive relationship between audit committee size and firm performance include, (Biao, Wallace & Peter, n.d; Klein, 2002; and Coleman-Kyereboah, 2007). However, other researchers like (Kajola, 2008; and Hardwick, 2003) reported that there is no positive relationship between audit committee size and the performance of firms. From the foregoing, there exist a mixed reaction with respect to the relationship between audit committee size and firm performance. The position of Prakash and Martins make logical sense as the interest of shareholders can be protected by a number of individuals who will be difficult to manipulate especially when they are large in number.

2.6 Chief Executive Officer (CEO) Duality And Financial Performance

When an organization is structured in a way that the Chief Executive Officer (CEO) also serves as the Chairman of the board of directors of the same firm, then there is duality in the function of the CEO (Callapham, 2005). Orwall and Gentile (2004) cited in Mansur and Bawa (2013) posited that CEO duality does not encourage effective communication between the CEO and the board. In order to enhance performance therefore, CEO duality should be discouraged in its totality.

Though there is evidence that having independent Chairman still does not prevent misconduct and malpractices (Damato, 2004). Studies which examined the relationship between CEO duality and performance include Daily and Dalton (2003), cited in Mansur and Bawa (2013) and Calligham (2005) and they found significant relationship between CEO duality and firm performance while Rhoades, Rechner and SundaraMurthy (2001) found no significant relationship in firms having executive duality and performance. Also, in the work of Yermeela (1996), cited in Kajola (2008), evidence from 452 sampled USA public firms revealed that agency problems are higher when the same person occupies the position of CEO as well as that of the Chairman of the board.

From the reviewed empirical studies on the effect of corporate governance on the performance of banks in Nigeria, scholars appear to have varying conclusions. The position of scholars that posited that larger board size influences performance makes logical sense. This is because when more individuals are brought into the board, it increases the managerial ability of the bank as divergent views that will lead to proper positioning of bank are brought to bear thereby contributing meaningfully to the organization. This study also takes side with scholars' position on increased non-executive members on the board but the level of competence and experience of these non-executives is also of utmost important.

The significant positive relationship between audit committee and performance is also logical as that will protect the interest of the owner since manipulations will be difficult without collusion. Also CEO duality appears the best way for managing the activities of an organization because decision taken by one person can be challenged by another person thereby propelling the organization towards better performance.

2.7 Theoretical Framework

Smith (1976) was the earliest known economist that addressed the theoretical issues of the role of board of directors in the governance of firms (Asuagwu, 2013). Smith further observed that as a result of the fact that managers control resources other than theirs, it should not be expected that they will watch over the business with anxious vigilance as possibility of negligence abound. Negligence is the direct consequence of the separation of ownership from control which is very common in modern corporation (Sanda, et al 2005). The need to explain the theoretical framework within which the owners' and managers' relationship exist becomes

indispensable. Theories which are used to explain corporate governance and firm performance include and not limited to the following:

2.7.1 The Stewardship Theory

Donaldson and Davis, cited in Akingunola, et al (2013), explained that managers are good stewards who diligently work to attain high level of profit and shareholders' returns. This theory is based on the assumption that managers are motivated by achievement. Non-executive directors on the board serve this purpose better.

2.7.2 The Stakeholders Theory

This theory states that the firm is a system of stakeholders operating within a larger system of the society which provides the required legal and market infrastructure for the firm to thrive. The purpose of the firm in this case is to serve the general public who may have direct or indirect relationship with the firm. The management and the provision of information should be directed at satisfying the interest of the general public rather than shareholders.

2.7.3 Agency Theory

This theory sees shareholders as the principals and management as their agents. Sanda et al (2005) explained further that the presence of information asymmetry can make agents to pursue interest that may be detrimental to the interest of the principal. The process of aligning these two interests can ignite conflict between the interest groups. In agency theory unlike stakeholder theory managers only optimize principal's objective rather optimizing multiple objectives.

From the foregoing, agency theory practically explains corporate governance and firm performance especially in the banking sector where the basic tenet of corporate governance is to protect the interests of absentee owners (shareholders) who are also the principal of the management (agents). On the basis, this study adopts agency theory alongside (Akinloye, 2010; Sanda, et al, 2005; Asuagwu, 2013; and Akingunola et al, 2013) as the theoretical basis for explaining corporate governance and bank performance.

III. Methodology

3.1 Research Design

This study employed ex-post facto research design using panel data for the periods under study (2006-2012) as it allowed for the collection of past and multi-dimensional data. This provided the basis for the full establishment of the relationship between corporate governance and the financial performance of banks in Nigeria.

3.2 Population And Sample Size

The study used all the fifteen (15) banks that are currently listed on the Nigeria Stock Exchange (NSE) as the study population. The table below shows the list of listed deposit money banks in Nigeria as at December, 2013.

Table 3.1: listed banks in Nigeria

S/N	BANKS	YEAR OF LISTING
1	ECOBANK PLC	2006
2	GUARRANTY TRUST BANK (GTB) PLC	1996
3	FIDELITY BANK PLC	2005
4	STANBIC IBTC PLC	2005
5	STERLING BANK PLC	1993
6	WEMA BANK PLC	1991
7	FIRST BANK PLC	1971
8	UNITED BANK FOR AFRICA (UBA) PLC	1970
9	DIAMOND BANK PLC	2005
10	FIRST CITY MONUMENT BANK (FCMB) PLC	2004
11	SKYE BANK PLC	2005
12	UNION BANK PLC	1970
13	UNITY BANK PLC	2005
14	ZENITH PLC	2004
15	ACCESS BANK PLC	1998

Source: Generated from NSE fact book 2012/2013

The study adopted all the fifteen (15) listed banks as the sample size since they are all listed on or before 2006 which is the base period for the period of coverage of this study, and remain listed up till December, 2013.

3.3 Variables specification and measurements

There are two basic variables used in this study. They are financial performance (dependent) and corporate governance (independent) variables respectively.

3.4 Dependent Variable And Measurement

The dependent variable used in this study is the performance of banks which the study proxied by: Return on asset (ROA) measured by dividing the net profit after tax by the total assets to examine how productive the banks' assets have been used to generate wealth. This method of measurement is in line with the work of (Akpan & Riman, 2012).

3.4 Independent Variables And Measurements

Corporate governance is the independent variable with the following proxies and measurements.

Board size (BS)

This is the total number of directors sitting on the board of a particular bank which should not be more than 20 members specified by the 2006 code of corporate governance. The measurement of board size used in this study is in line with the measurement used by (Ahmad, 2013).

Board Composition (BC)

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 (Ahmad, 2013).

Ceo Duality (Cd)

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 (Sanda, et al 2005).

Audit Committee (Ac)

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, (Klein, 2002).

3.5 Control Variable

Firm Size (FS)

FS is used as the control variable and it is measured by the total value of each bank. Values for total assets were too large for the regression analysis, hence, the nlog of the assets was used to reduce the values. This control variable was introduced because of the notion that financial performance may also be affected by other factors not captured in the independent variables in which firm size is one (Adeusi et al., 2013).

3.6 Method Of Data Collection And Data Analysis

The data used in this research were generated from the audited annual financial statements of the 15 banks under study covering a period of 7 years (2006-2012). Secondary method of data collection was adopted because Saunders and Lewis and Thornhill (2012) posited that the use of secondary data gives better quality for a cross-sectional analysis than primary data. Saunders et al (2012) further argued that the reliability of secondary data depends on reputation of the source. The nature of the research design also required past and documented facts to be used as basis for performance evaluation. Regression analysis was used analyze the data in order to examine the relationship between the identified variables and to confirm the viability of previous findings.

3.7 Model Specification

This study adopts and modifies the econometric model used by Adeusi, et al (2013) which is given as follows:

$Y_{it} = a_0 + B_1 CG_{it} + B2\ C_{it} + e_{it}$

Where: Y_{it} represents bank performance variable; Return on Assets (ROA) for bank in time t, a_0 is the constant term, CG_{it} is a vector of corporate governance variables; Board Size (BS), Board Composition (BC), CEO duality (CD), Audit committee (AC), C_{it} is a vector of control variable 'Size of the firm' (FS) and e_{it}, is the error term. The model is modified thus;

$ROA_{it} = a_0 + \beta_1 BS_{it} + \beta_2 BC_{it} + \beta_3 CD_{it} + \beta_4 AC_{it} + \beta_5 FS_{it} + e_{it}$

IV. Data Analysis And Discussion

The data sets are summarized in Table 1 below, which provides the summary statistics. The correlation matrix between the variables is also provided in Table 2 and table 3.

Table 4.1 descriptive statistics result of the variables

Variable	Obs	Mean	Std. Dev.	Min	Max
roa	105	.2955683	2.569893	-.22713	26.3155
bs	105	14.13333	2.47319	7	20
bc	105	.6143722	.0899756	.285714	.857143
cd	105	0	0	0	0
ac	105	5.990476	.325081	4	8
fs	105	20.00392	1.152296	14.23428	21.73438

Source: Generated from the financial statements of the studied banks (2013)

Of the 15 banks studied, the mean board size is about fourteen (14) which suggests that banks in Nigeria have relatively moderate board sizes as the mean value 14 is greater than the average of the maximum number of board size of 20. Also, with a maximum board size of twenty (20) and standard deviation of 2.47319, it implies that banks in Nigeria have relatively similar board sizes. The mean description for board composition is high compared to the maximum board composition which suggests that the ratio of outside directors to the total number of directors in Nigerian banks is very high. Generally, the summary for the standard deviation reveals that factors that influence performance are evenly distributed across all the banks. However CEO duality will be omitted from subsequent analyses because of lack of collinearity.

Table 4.2: Correlation matrix result for the variables

	roa	bs	bc	ac	fs
roa	1.0000				
bs	0.2338	1.0000			
bc	-0.0706	0.0068	1.0000		
ac	0.0029	-0.0223	0.0088	1.0000	
fs	-0.0218	0.0269	-0.0231	-0.0149	1.0000

Source: Generated from the financial statements of the studied banks (2013)

There is no high correlation among the determinant variables used in measuring return on asset which shows that the predictive ability of each of the combined independent variables are high and different.

Table 4.3: Test of Multi-collinearity

Variable	VIF	1/VIF
bc	1.01	0.987146
fs	1.01	0.987308
ac	1.00	0.998302
bs	1.00	0.998796
Mean VIF	1.01	

Source: generated from the financial statements of the studied banks (2013)

Multi-collinearity exists when the predictor variables are highly correlated among themselves. If the variables have VIF of above 10 and TV less than 0.10, then there is a strong indication of the existence of excess correlation (Gujarati, 2004). With the above values of VIF that are less than 10 and the values of TV which are also more than 0.10, there is therefore an absence of multi-collinearity.

Table 4.4 Regression Result

Table 4.4 Regression Result

roa	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
bs	.2444517	.1007644	2.43	0.017	.044538	.4443653
bc	-2.082735	2.76892	-0.75	0.454	-7.576192	3.410723
ac	.0663171	.7664216	0.09	0.931	-1.454242	1.586876
fs	-.0662644	.2162941	-0.31	0.760	-.4953858	.362857
_cons	-.9514985	6.743251	-0.14	0.888	-14.32992	12.42692

$R^2 = 0.0608$

Source: Generated from the financial statements of the studied banks (2013)

The regression results presented in Table 3 above show that both board composition and firm size are negatively and insignificantly related to the performance of banks. However, audit committee has positive but insignificant relationship with performance.

Board size is positive and significant at 5% (level of significance) on bank performance. The result indicates that increase in board size would increase the performance of the banks. The R^2 of 0.0608 suggests that the independent variables used only accounted for about 6% of the banks' performance while other factors and variables not included in this study account for the remaining percentage.

From the above regression result, it shows that increase in board size would increase the performance of the banks. This result therefore is in consonance with studies that support the view that larger board size is better for corporate performance than smaller board size because in larger board, members have a wide range of expertise to help make better decisions and are also difficult for a powerful CEO to dominate.

The finding of this study is consistent with the findings of (Adeusi, 2013; Prakash and Martin, n.d; and Anderson, et al, 2004) who found bigger board size better than smaller board size in terms of contribution to performance of banks. This study therefore, does not support the views of (Ajala, et al, 2012; Bawa and Lubabah, 2012; Akpan and Rima, 2012; and Asiyagwu, 2013) who all concluded that smaller board size contributes more to financial performance than larger board size.

V. Conclusion And Recommendations

The relationship between corporate governance and the financial performance of listed deposit money banks in Nigeria from 2006 to 2012 has been explored. Data for the study were retrieved from the financial statements of all the fifteen listed (15) deposit money banks in the Nigerian stock exchange. It was discovered that bigger board size contributes more to performance than smaller board size. Also, when a board size is large, it will be difficult for a person (may be CEO) to dominate the board and decisions reached by the board are seen to have emanated from sound and constructive arguments. The result of the summary statistics revealed that the proportion of non-executive directors serving in the boards of banks is high and this is in compliance with the specification of corporate governance code.

Sequel to the findings of this study, it is recommended that the size of the board (membership) should be increased but not exceeding the maximum number specified by the code of corporate governance for banks.

Also, continue to enjoy the advantage of larger board size, efforts should be directed at bringing on board those with relevant credentials, competence and wide range of experience.

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