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Corporate Governance and Financial Performance: An Empirical Investigation of Money Deposit Banks in Nigeria

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Abstract:

This study examined the impact of corporate governance mechanisms on financial performance of selected Money Deposit Banks in Nigeria. The data used for this study were derived from the audited finance statements of the firms listed on the Nigerian Stock Exchange (NSE) from 2011 – 2017 which comprises of fifteen (15) listed banks as sample size for the study. Panel data methodology was adopted because its combined time series and cross-sectional data. The method of analysis is that of multiple regressions and the method of estimation is Ordinary Least Squares (OLS). The result of the study revealed that corporate governance mechanisms jointly contribute to financial performance of Nigeria banks. Moreover, result also revealed that directors' equity interest and the corporate governance disclosure contributed positively to earnings per share and return to equity, while, board size has negative impact of earnings per share and return on equity respectively. The paper recommended that management should improve efforts on corporate governance by focusing on the value of the stock ownership of Board Members. Also, an effective legal framework that specifies the rights and obligations of a bank, its directors, and shareholders should be developed; such frameworks should specify disclosure requirements and provide for effective enforcement of the law.

Keywords: Corporate governance, roe, EPS, commercial bank

1. Introduction

It is a common statement that where there are no set of rules to govern the activities of an organization or country, no one can be so accused of breaching such rules and regulations. While it is impossible to have a crime free society, the need to spell out the rules of the engagement cannot be over emphasized. Corporate governance therefore has become a global issue over the last decade, leading to countries around the world amending their legal system and stock exchange listing requirements to conform to corporate governance principles as well as developing new codes of best practices. Okoi, Stephen and Sani, (2014) affirmed that corporate governance has attracted a good deal of public interest in recent years, because of its apparent importance on the economic health of corporations and society in general. There has been a wide variety of interests among researchers, scholars, governments and agencies on corporate governance after the financial crisis of 2008 that led to the collapse of many institutions in the world (Babatunde & Akeju, 2016). The term corporate governance covers all the general mechanisms which management are led to act in the best interest of the companies' owners.

In Nigeria, despite the corporate governance laws and regulations such as; Nigeria Deposit Insurance Corporation (NDIC) Act of 1988, the Company and Allied Matters Act (CAMA) of 1990, the Prudential Guidelines, the Statement of Accounting Standard (SAS 10), the Banks and Other Financial Institutions (BOFI) Act of 1991, the Central Bank of Nigeria (CBN) Act of 1991, the CBN Circular and Guidelines, and some government agencies and non-governmental associations; (Securities and Exchange Commission (SEC), the Nigerian Stock Exchange (NSE), Corporate Affairs Commission (CAC), Institute of Chartered Accountants of Nigeria (ICAN), Financial Institution Training Centre (FITC), Institute of Directors (IOD), Chartered Institute of Bankers of Nigeria (CIBN) that are in the vanguard of promoting good corporate governance practices in the; Nigerian banking sector. Nigeria Banks still witnessed several cases of collapses in Nigeria due to financial malpractices, unethical practices, insider abuses, poor quality services and weak supervisory structures, employment of unqualified staff, unhealthy competitions and recklessness amongst managers. These had eroded the confidence the depositors have in Nigerian banking sector. In the recent past, the banking industry in Nigeria witnessed serious reforms arising from the central bank of Nigeria's requirement for banks to increase their capital base (share) to a minimum level of twenty-five billion naira (N25B) (Ogbeche, 2006). This had made some banks to merge while some were acquired. This mergers and acquisitions exercise have reduced the number of banks in Nigeria from eighty-nine (89) to twenty-one (22) as at August 2018. Also, the recent corporate governance failure of formal Sky Bank also prompts the study to further taking interest in the banking sectors in the area of corporate governance and financial performance. These failures raise some fundamental questions such as shareholders activities, board composition, directors' equity

interest, corporate governance disclosure, management style, audit independence, the nefarious practices of board members, ethics, professionalism and conflict of interest.

The impact of corporate governance on the financial performance of banks or corporate entity was an important issue since the last financial distress in USA and Europe which have brought to the fore, once again, the need for the practice of good corporate governance. Thus, the focus here is to examine empirically whether or not the independent variable factor, that is corporate governance, can influence the dependable variable (firm performance). The study was set to determine how corporate governance practices affect banks' performance in Nigeria and to ascertain to what extent corporate governance practices explain the dynamism of the performance of banking sectors in Nigeria. The banking sector in Nigeria remained a subject of concern in term of good corporate governance because of its role in facilitating and stimulating economic development.

This study contributes to the existing literature of banking governance in Nigeria from a perspective of board size, directors' equity and corporate governance disclosure, and also to indicate how these corporate governance aspects are significantly influence the performance of banks in Nigeria. The research would also give empirical insights to banking institutions on how they can improve on their performances. The bank regulators, policy makers and others would defiantly benefit immensely from this study.

1.1. Research Questions

- To what extent does board size affect the financial performance of banks in Nigeria?
- Is there a significant relationship between directors' equity holdings and financial performance of banks in Nigeria?

It is in the light of the above research questions, that this research work tested the following hypotheses;

- Ho₁: There is no significant relationship between board size and financial performance of banks in Nigeria.
- Ho₂: There is no significant relationship between directors' equity holding and the financial performance of banks in Nigeria?

2. Literature Review

2.1. Concept of Corporate Governance

To give an acceptable meaning of corporate governance may be too cumbersome than what we perceived, because there is no acceptable definition of corporate governance in the previous review of literature; Corporate governance is continuously evolving due to the fact that there is no set definition of the term. This is due to the differences in the cultures, language, history, academic backgrounds and financial dealing which vary from one nation to the other (Melih & Suat, 2015). Concept of corporate governance relates to the system by which companies are directed and managed or controlled in such a way that will meet the aspiration of the stakeholders. It is the relationship between a company's management board shareholders and other stakeholders. From the perspective above, good corporate governance entails efficient management of resources and provision of responsible leadership; it requires the provision of timely and quality information and the enforcement of sanction for breaches in ethical standard, regulations and Code of conduct (Ogbeche, 2006). Coleman and Nicholas-Biekpe (2006) defined corporate governance as the relationship of the enterprise to shareholders or in the wider sense as the relationship of the enterprise to society as a whole. The Organization for Economic Corporation and Development (1999) has also defined corporate governance as a system on the basis of which companies are directed and managed. It is upon this system that specifications are given for the division of competencies and responsibilities between the parties included (board of directors, the supervisory board, the management and shareholders) and formulate rules and procedures for adopting decisions on corporate matters. Awan (2012) stressed that corporate governance is about ensuring that the business is run well and investors receive a fair return. Shleifer and Vishny (1997) defined corporate governance by stating that it deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. Corporate governance has been considered as one of the most critical factors influencing firm performance. Corporate governance is concerned with ways all parties (the stakeholders) interested in the well-being of the firm attempt to ensure that managers and other insiders are always taking appropriate measures or adopt mechanisms that safeguard the interests of the stakeholders. Such measures are necessitated by the separation of ownership from management, and increasingly vital feature of the modern corporations (Waseem, Saleh and Fares, 2011). Corporate governance specifies the distribution of rights and responsibilities among different participants in the corporation such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company's objectives are set and the means of attaining those objectives and monitoring performance (Kajola, 2008).

According to Ogbeche, (2006), corporate governance means utilizing resources effectively, showing responsibility in supervising over these resources and aligning individuals' interests with companies' and societies. It assists companies to be more credible, domestically and internationally, and ensure managerial system that promotes creative and progress entrepreneurship.

According to Ayininuola (2009), corporate governance is about ensuring that a mechanism is in place to guarantee that goals pursued by managers do not diverge from those of owners. Macey (2008) states that the purpose of corporate governance is to persuade, induce, compel, and otherwise motivate corporate managers to keep the promise they make to investors. Appah (2017) opined that corporate governance is about reducing deviance by corporation where deviance is

defined as any actions by management or directors that are at odds with the legitimate investment –backed expectations of investors. Good corporate governance then, is simply about keeping promises. Armeanu, Vintila, Gherghina and Petrache, (2017) added that good corporate governance can be an antidote to firm risk. Bad governance (corporate deviance) is defined as promise breaking behavior.

Definitions and concepts of corporate governance is a process of supervision and control to warrant that manager's performance concords with stockholders' interests, structures, processes, cultures and systems that lead to organization's success. Factors such as legal, cultural and religious systems, political and economic conditions (inside and outside company), and ownership structure are effective in formation of corporate governance.

Despite the fact that the existing definitions failed to agree on an acceptable definition, all tends to go toward the same direction which is to ensure the well-being of the owners and other stakeholder of the organizations. However, Ajala, Amuda and Arulogun (2012) stated that a wider or broader 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.

2.2. Firm's Financial Performance and Board Size

For the survival of any organization, its resources should be effectively and efficiently utilized to meet the general objectives of corporate entity. The relationship between firm's performance and Board size was explicitly explained by two schools of thoughts. The first school of thought was of the opinion that a smaller board size contributes more to the success of any firm in terms of financial performance (Lipton and Lorsch, 1992, Jensen, 1993 & Yermack, 1996) cited in Ducvo and Thuy, 2013. On the other hand, Pfeffer, 1972, Liein, 1998, Coles & ctg, 2008 also cited in Duc and Thuy, 2013; in their studies argue that large board size will enhance better performance of firms. The basis of their argument was that in view of diversity of organisation culture and complexity of business environment, a large board size will advise and support firm's management more effectively. Babalola (2013) also argued that the larger a firm is, the more the influence it has on its stakeholders and so large firm has a tendency of performing well.

The size of firms depends on the nature of industry and is vital to its success due to the singularity of economics of scale, hence; Shaheen and Malik (2012) looked at the firm size as the quality and array of production capability and potential a firm possesses or the quality and diversity of service a firm can concurrently make available to its clients. This study which looks at the relationship between firm performance (financial) and firm size in Nigeria supports the first school of thought that the smaller the boards size the better the performance as it indicates that the larger the board size, the higher the cost of co-ordination at the expense of the shareholders.

2.3. Empirical Review

Yermack (2006) in his research using 452 large US Companies find that there exists an inverse association between board size and the firm value measured by Tobin's Q. The result further shows that the major part of loss in firm value happens when the board size grows from relatively small to relatively medium. The author also finds that the companies with smaller boards tend to have greater operating profitability and higher likelihood of CEO dismissal after poor firm performance.

Eisenberg, Sundgren and Wells (2008) find a negative relation between board size and firm's profitability measured by industry-adjusted return on asset using a sample of nearly 900 small-sized Finnish firms. The consistent results of these two studies, which are conducted on different categories of companies in different countries, enhance the explanatory power of board size in firm performance. In another study by Kajola (2008) the study conducted in Nigeria of twenty listed firms concluded that there is a positive and significant relationship between return on equity (ROE) and board effectiveness. This was in line with the study of Balta (2008) which found that there was positive relationship between corporate governance mechanisms and business performance.

Ajala, Amuda and Arulogun (2012) examined the effects of corporate governance on the performance of Nigerian banking sector. The secondary source of data was sought from published annual reports of the quoted banks. The Person Correlation and the regression analysis were used to find out whether there is a relationship between the corporate governance variables and firms' performance. The study revealed that a negative but significant relationship exists between board size and the financial performance of these banks while a positive and significant relationship was also observed between directors' equity interest, level of corporate governance disclosure index and performance of the sampled banks.

Also, Hassan and Bello (2013) investigated firm's characteristics and financial reporting quality of quoted manufacturing companies in Nigeria using correlation analysis with pooled balanced panel data. Their study found that there is a significant positive relationship between firm characteristic and financial reporting quality in Nigeria. They also found that profitability and independent directors are positively related to earnings quality while an inverse relationship exists between liquidity and quality of financial reporting in Nigeria. Okoi, Stephen and Sani, (2014) examined the effects of corporate governance on the performance of commercial banks in Nigeria. The result showed that corporate governance contributes to the economic health of banks in Nigeria. The study concluded in absolute terms that corporate governance does affect banks' performance and value of the firm. That strong governance standard is important for banks and increased governance quality leads to higher levels of investment as well as greater responsiveness of investment to growth opportunities.

In the study carried out by Faisal and Abdul (2015) they considered seven different measures to proxy corporate governance (G-Index, E-Index, Board independence, director dollar value of ownership, director percentage value in

ownership, and CEO-Chairman duality). Their study found that better governance, as measured by the G-Index, E-Index, stock ownership of board members, and CEO-Chairman separation was significantly and positively correlated with present and subsequent operating performance as measured by ROA and Tobin's Q. Also, board independence was negatively correlated with the present and subsequently operating performance.

Osundina, Olayinka, and Chukwuma (2016) conducted study on corporate governance and financial performance of selected thirty manufacturing companies listed in Nigeria Stock Exchange for a time period of 2010 to 2014. Multiple regression analysis and descriptive statistics were used in analyzing the data and the study found that Audit committee index had a positive but insignificant relationship with the performance (ROA) of the sampled manufacturing companies, while Ownership structure index had an insignificant negative relationship with performance (ROA) of the sample manufacturing companies. The study finally concluded that the performance indicator (ROA) related with each component of the corporate governance index in a peculiar manner.

Also, Ebenezer and Appiah (2017) examined the impact of corporate board size on firm performance for a sample of 137 listed firms in Ghana and Nigeria. The evidence of the findings revealed that a statistically significant and positive relationship between board size and firm performance, which implying that in Ghana and Nigeria allowing corporate board size to be dependent of firm size tends to improve firm performance.

Jimoh and Adekunle (2018) investigated the relationship between corporate governance and firm performance of selected financial institution and manufacturing companies listed in Nigeria Stock Exchange. The study used board size, firm size was used to proxy the corporate governance while profit after tax was used to proxy firm performance and the result revealed that board size has statistically significant influenced on firm performance. That is, the larger board size the better the firm's performance. Their study also revealed that the coefficient of firm size has negative influence on the performance of financial institution and manufacturing companies in Nigeria.

2.4. Theoretical Frame Work

This study adopts among others, the stakeholder's theory as appropriate and relevant to the subject of discuss which is corporate governance and firm performance.

2.5. Stakeholders Theory

The origin of stakeholders' theory could be traced to management theory, politics and law; within the confine of literature, it tends to focus on the coordinating role of Governing Board in pursuance of stakeholder's interest (Hung, 1998; Clarke, 1998 & Cooper and Owen, 2007). The theory suggests that the primary focus of Corporate Governance rest with the Governing Board with the assertion that there are numerous groups in the society aside from the stakeholders and employee to whom the corporation is responsible. Hung (1998) further explained that the Governing Board under the umbrella of Corporate Governance holders achieves corporate goals by performing a balancing act with the often conflict of interest of these groups. The concept of stakeholders' theory also suggests that for a manager in a network to serve according to corporate strategies, he should be able to take care of the interest of all the stakeholders. Stakeholders theory is relevant to this study because, in summary, it posits that the stakeholders do have their representatives appointed on the board (whether large or small in size) who look after their interest.

3. Methodology

The population for this study consists of all the 22 listed as Deposit money bank as at September 2018 (9 of the listed as international authorization, 10 were listed as national authorization, 2 as regional authorization and 1 listed as non-interest banking) Central Bank of Nigeria (2018). The time frame considered for this study is 2011 to 2017. This 7-year period allows for a significant lag period for banks to have reviewed and implemented the recommendations by the CBN post consolidation code. The purposive sampling technique was used in selecting the 15 listed banks out of the 22 banks that made the consolidation dead line of 2005.

These banks were considered because they are listed in the Nigerian Stock Exchange market which therefore enabled us to have easy accessibility to their annual reports which is the major source of our secondary data. The data used for this study were secondary data derived from the audited financial statements of the banks listed in the Nigerian Stock Exchange (NSE) between the seven years period of 2011 and 2017.

This study also made use of books and other related materials especially the Central Bank of Nigeria bulletin and the Nigerian Stock Exchange fact book (2017). Some of the annual reports that were not available in the NSE fact book were either collected from the corporate offices of concerned banks or downloaded from the bank's corporate websites. Financial performance was measured by Earnings per share (EPS) and Return on Equity (ROE) of banks selected. Tobin's Q (the market value of equity plus themarket value of debt divided by the replacement cost of all assets) which has been used extensively as a proxyfor measuring firm's performance would not be used in this study because information on the market value of debt issued by Nigerian business organizations are not available, since these are not usually disclosed in their financial reports. Panel data methodology was adopted because its combined time series and cross-sectional data. The method of analysis is that of multiple regressions and the method of estimation is Ordinary Least Squares (OLS).

3.1. Conceptual Framework

This study will utilize the following conceptual framework. That is, the relationship between corporate governance and financial performance of some selected banks in Nigeria.

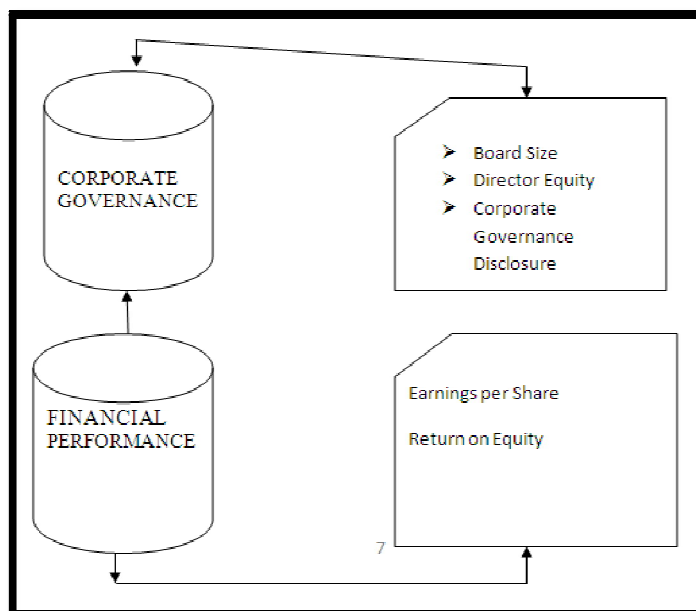


Figure 1: Conceptual Framework

3.2. Model Specification

The economic model used in the study (which was in line with what is mostly found in the literature) is given as: Financial performance = f (Corporate governance). Financial performance is measured by the following: Earning Per Share (EPS) and Return on Equity(ROE), while Corporate governance is measured by Board size (BOSI); Director’ equity (DIRE) and Corporate governance disclosure (COGD). Thus, this led to formulation of two separate models each representing a measure of financial performance. i.e.

Model I: $EPS = \beta_0 + \beta_1 BOSI + \beta_2 DIRE + \beta_3 COGD + \beta_4 + \mu_i$ equ 1

Model II: $ROE = \alpha_0 + \alpha_1 BOSI + \alpha_2 DIRE + \alpha_3 COGD + \alpha_4 + \mu_{ij}$ equ 2

4. Analysis of Data and Discussion of Results

Model 1	BOSI	DIRE	COGD
B	-0.789	2.098	3.170
t- statistics	-2.023	4.142	5.075
p- value	0.043*	0.000**	0.000**
R ²	0.655		
F -value	18.967		
Probability	P<.05		

Table 1: Regression Result of Corporate Governance Mechanisms and Earnings per Share

Table 1 shows that corporate governance mechanisms (board size, directors’ equity interest and corporate governance disclosure) were jointly contribute 65.5% to earnings per share of selected banks. Furthermore, directors’ equity interest ($\beta = 2.098, t = 4.142, P < .01$) and corporate governance disclosure ($\beta = 3.170, t = 5.075, P < .01$) have positive and significant impact on earnings per share. This indicates that individuals who form part of management of banks in which they also have equity ownership have a compelling business interest to run them all. This invariably is expected to improve the earning per share. In addition, banks that disclose more on corporate governance issues are likely to perform better than those that disclose less in terms of earning per share. This result is in line with Okoi et al (2014) and Ajala et al (2012). However, board size has a negative and significant impact on earnings per share of Nigerian banks. This implies that larger board is ineffective as compared to smaller boards. This result conforms to previous studies (Ajala et al, 2012; Awan, 2012 and Naveen and Singh, 2012). That as board size increases it will lead to increase in communication gaps and cost of coordination.

Model 1	BOSI	DIRE	COGD
B	-1.609	3.072	2.009
t- statistics	-2.989	4.782	3.325
p- value	0.000**	0.000**	0.000**
R ²	0.75		
F -value	24.05		
Probability	P<.01		

Table 2: Regression Result of Corporate Governance Mechanisms and Return on Equity

Table 2 also shows that corporate governance mechanisms (board size, directors' equity interest and corporate governance disclosure) were jointly contribute 75% to Return on Equity of Nigerian banks. Furthermore, directors' equity interest ($\beta = 3.072$, $t = 4.782$, $P < .01$) and corporate governance disclosure ($\beta = 2.009$, $t = 3.325$, $P < .01$) were significantly independent predictor of return on equity of Nigeria banks. This implies that director' equity interest and corporate governance disclosure are major corporate governance mechanisms that improve return on equity in Nigeria banks. This result is consistent with Okoi et al (2014) and Ajala et al (2012).

However, board size ($\beta = -1.609$, $t = -2.989$, $P < .01$) also has a negative and significant impact on Return on Equity of Nigeria banks. This implies that larger board has negative effect on Return on Equity. This result is in agreement with other researchers (Ajala et al, 2012; Awan, 2012 and Naveen and Singh, 2012).

5. Conclusion and Recommendations

This study examined the impact of corporate governance mechanisms on financial performance of Nigeria banks. The result of the study revealed that corporate governance mechanisms jointly impacted positively on financial performance of Nigeria banks. Moreover, result also revealed that directors' equity interest and the corporate governance disclosure contributed positively to earnings per share and return to equity, while, board size has negative impact of earnings per share and return on equity respectively. This indicates the larger the board size, the higher the cost of coordination at expense of the shareholders. It is therefore concluded that corporate governance is a managerial tool that can enhance financial performance.

Based on the findings and conclusion, it is therefore recommended that management should improve efforts on corporate governance by focusing on the value of the stock ownership of board members. This is because it has positively related to both future operating performances. Also, small size boards should be encouraged because finding showed that small size boards are positively related to high firm performance. Also, an effective legal framework should be developed that specifies the rights and obligations of a bank, its directors, and shareholders, specifies disclosure requirements and provide for effective enforcement of the law.

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