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CORPORATE GOVERNANCE AND BANKING SECTOR PERFORMANCE IN NIGERIA

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Abstract

This study investigates the effect of corporate governance on the performance of banks in Nigeria over the period 2012-2016. To achieve the purpose of the study data on corporate governance proxy by board size, executive and non-executive board members, interest rate margin, profit level and Return on Asset (ROA) of 15 deposit banks in Nigeria were sourced from the CBN and the records of the banks and analysed using panel technique. The results indicated that none of the variables that represents corporate governance was significant in explaining changes in the performance of banks. This implies that corporate governance has less implication on the performance of banks in Nigeria. The result also shows that board size and non-executive board members have negative effect on ROA while executive board members have positive effect on the performance of banks over the period of this study. The implication of this result is that increase in executive members of a bank's board could improve the performance of the bank in Nigeria. Other variables like interest rate margin and profit level were also insignificant in explaining changes in the performance (ROA) of banks. The result further revealed that the effect of corporate governance on banks 'performance differs across the banks in Nigeria. Based on this result, the study recommends: an upward review of executive members of the board of banks and a periodic review of guidelines on the management of banks in order to enhance efficiency in management of banks and their performance.

Key words: *Return on Asset; Corporate governance; Board size; Interest rate margin and profit.*

INTRODUCTION

Financial scandals around the world and collapse of major corporate institutions in the USA, Europe such as Lehman Brothers, Merrill Lynch, American International Group (AIG), have brought to the forefront, the need for the practice of good corporate governance. Nigeria being a part of the global economy in the last two decades, has followed this development in the financial sector by reinforcing the need for greater concern for corporate governance in financial institutions in the country. According to

Shleifer and Vishny (1997), corporate governance means the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. Chow (1999) explained that the objectives of corporate governance are to ensure transparency, accountability, adequate disclosure and effectiveness of reporting systems. He asserted that the need for good corporate governance originated from what he termed expectation gap problem which arises when the behavior of companies falls short of shareholders and other stakeholders' expectations.

Nigeria has vibrant but challenging financial environment characterized by endemic systemic governance problems, capacity complains and defaulting in compliance and implementation of laws which has inhibited financial and economic growth. The global economic crisis and the decline in the value of investment of Deposit Money Banks (DMBs) banks particularly in Nigeria are due to distorted credit management and this problem is associated with poor corporate governance. Given the fury of activities that have affected the efforts of banks to comply with the various consolidation policies and the antecedents of some operators in the system, there are concerns on the need to strengthen corporate governance in banks.

Before the consolidation exercise in 2006, the banking industry had about 89 active players whose overall performance led to sagging of customers' confidence. The guiding laws and regulations which contain provisions that address the issue of corporate governance include the Company and Allied Matters Act (CAMA) of 1990, the Prudential Guidelines, the Statement of Accounting Standards (SAS 10), the Banks and Other Financial Institutions (BOFI) Act of 1991, Central Bank of Nigeria (CBN) Act of 1991, CBN Circulars, the Nigeria Deposit Insurance Corporation (NDIC) Act of 1988, and the Investment and Securities Act (ISA) of 1999. According to Sanusi (2010), the current banking crises in Nigeria, has been linked with governance malpractice within the consolidated banks which has therefore become a way of life in large parts of the sector. He further opined that corporate governance in many banks failed because boards ignored these practices for reasons including being misled by executive management, participating themselves in obtaining un-secured loans at the expense of depositors and not having the qualifications to enforce good governance on bank management. The boards of directors were further criticized for the decline in shareholders' wealth and corporate failure. They were said to have been in the spotlight for the fraud cases that had resulted in the failure of major corporations, such as Enron, WorldCom and Global Crossing.

The series of widely publicized cases of accounting improprieties recorded in the Nigerian banking industry in 2009 (for example, Oceanic Bank, Intercontinental Bank, Union Bank, Afri Bank, Fin Bank and Spring Bank) and even the recent sack of the

Chairman and Managing director of Skye Bank in July, 2016 for improper management of funds were related to the lack of vigilant oversight functions by the boards of directors, the board relinquishing control to corporate managers who pursue their own self-interests and the board being remiss in its accountability to stakeholders (Unadiale, 2010). Inan (2009) also confirmed that in some cases, these bank directors' equity ownership is low in other to avoid signing blank share transfer forms to transfer share ownership to the bank for debts owed banks. He further opined that the relevance of non- executive directors may be watered down if they are bought over, since, in any case, they are paid by the banks they are expected to oversee. From literature it can be deduced that corporate governance is influenced by board size, board composition, profitability, capital adequacy, asset base, policy shift, investment, liquidity ratio as well as inflation rate.

In Nigeria, few empirically feasible studies on corporate governance are available in literature, some of the available ones are: Sanda et al., (2005) Ogbechie (2006), Okike (2007), and Adegbite (2015) which all studied the corporate governance mechanisms and firms' performance. In order to address these paucity of facts on the effect of corporate governance on the performance of DMBs, this study examined the role of corporate governance in enhancing the financial performance of banks in Nigeria.

LITERATURE REVIEW

According to the Agency Theory, the need for corporate governance arises because of the separation of management and ownership in the modern corporation. This separation of ownership from control implies a loss of effective control by shareholders over managerial decisions. Partly as a result of this separation between the two parties, a system of corporate governance is implemented to assist in aligning the incentives of managers with those of shareholders. With the significant increase in equity holdings of investors, there has been an opportunity for a reversal of the separation of ownership and control problems because ownership is not so diffused. One consequence of the separation of ownership from management is that the day to today decision-making power that is, the power to make decision over the use of the capital supplied by the shareholders' rests with persons other than the shareholders themselves. The separation of ownership and control has given rise to an agency problem whereby there is the tendency for management to operate the firm in their own interests, rather than those of shareholders' (Jensen & Meckling, 1976; Fama & Jensen, 1983). This creates opportunities for managers to build illegitimate empires and, in the extreme, outright expropriation. These presumptuous agency theories are however predominantly invalid in developing

countries such as Nigeria. For instance, the aftermath of Nigeria independence from Britain in 1960 led to an indigenization programme with resulted in majority ownership by government, individuals and families in corporate Nigeria (Nmehielle & Nwauche, 2004) hence there is no single best institutional arrangement for organizing economic systems and corporate governance.

Agency theory supports the delegation and the concentration of control in the board of directors and use of compensation incentives. The board of directors' monitor agents through communication and reporting, review and audit and the implementation of codes and policies.

The Stakeholder theory by Sundaram and Inkpen (2004a) also suggest that "stakeholder theory attempts to address the question of which groups of stakeholder deserve and require management's attention". Shareholders play a key role in the provision of corporate governance. Small or diffuse shareholders exert corporate governance by directly voting on critical issues, such as mergers, liquidation, and fundamental changes in business strategy and indirectly by electing the boards of directors to represent their interests and oversee the myriad of managerial decisions in the banking sector, (CBN, 2015). Incentive contracts are a common mechanism for aligning the interests of managers with those of shareholders. The Board of directors may negotiate managerial compensation with a view to achieving particular results. Thus small shareholders may exert corporate governance directly through their voting rights and indirectly through the board of directors elected by them.

However, a variety of factors could prevent small shareholders from effectively exerting corporate control. There are large information asymmetries between managers and small shareholders as managers have enormous discretion over the flow of information. Also, small shareholders often lack the expertise to monitor managers accompanied by each investor's small stake, which could induce a free-rider problem. Stakeholder theory offers a framework for determining the structure and operation of the firm that is cognizant of the myriad participants who seek multiple and sometimes diverging goals.

Due to the vital role banks play in promoting economic growth and development, the conduct of their financial intermediation functions and the environment in which they operate remain particularly important. In recognition of this strategic importance of banks, knowing full well that the governance of any banking institution in Nigeria is statutorily placed in hands of board of directors, appointment and activities of bank directors in Nigeria are governed by laws and regulations, which presumably, the implementing bodies rigorously enforce. The financial crisis of 2008 has shown that the corporate governance of financial institutions has been an under highlighted area, as there were massive failures at major institutions in advanced countries. Corporate

governance in financial institutions has been identified to differ from that of corporations, but in which ways is not yet clear besides the important role of prudential regulations, given the special nature of banks. In this area, more work is needed for emerging markets as well, in part related to the role of banks in business groups. While there is some research on state ownership, corporate governance of banks in emerging markets is little analyzed. (Claessens &Yurtoglu, 2013).

According to Claessens and Yurtoglu (2013), the identified channels in which corporate governance affects corporations and countries include:

- The increased access to external financing by firms. This in turn can lead to greater investment, higher growth, and greater employment creation;
- Lowering of the cost of capital and associated higher firm valuation. This makes firms more attractive to investors, leading to growth and more employment;
- Better operational performance through better allocation of resources and better management. This creates wealth more generally;
- Good corporate governance can be associated with less financial crises, important, as highlighted recently again, given the large economic and social costs of crises; and
- Good corporate governance can mean generally better relationships with all stakeholders. This helps improve social and labor relationships and aspects such as environmental protection, and can help further reduce poverty and inequality.

All these channels matter for growth, employment, poverty, and well-being more generally. Empirical evidence using various techniques has documented these relationships at the level of the country, the sector, and the individual firm and from the investor perspectives. Klein et al., (2004: 32) examined the relationship between corporate governance and firm value by using the corporate governance index (CGI) and Tobin's Q, which measures the firm's value, the results concluded that corporate governance does matter in a firm value

According to Sanusi (2010) it was well known in the industry that since consolidation, some banks were engaging in unethical and potentially fraudulent business practices and the scope and depth of these activities were documented in recent CBN examinations. Governance malpractice within the consolidated banks has therefore become a way of life in large parts of the sector, enriching a few at the expense of many depositors and investors. Sanusi further opined that corporate governance in many banks failed because boards ignored these practices for reasons including being misled by executive management, participating themselves in obtaining un-secured loans at the expense of

depositors and not having the qualifications to enforce good governance on bank management. In addition, the audit process at all banks appeared not to have taken fully into account the rapid deterioration of the economy and hence of the need for aggressive provisioning against risk assets. As banks grew in size and complexity, bank board's often did not fulfill their functions and were lulled into a sense of well-being by the apparent year-over year growth in assets and profits. In hindsight, boards and executive management in some major banks were not equipped to run their institutions.

Eisenberg et al., (1998) studied 879 Finnish firms and found that companies with smaller boards had higher ROA, positing that the effect of board size may in part depends on the size and wellbeing of the firm. Spencer Stuart Board Index (2008) also indicated that globally, board size has been reducing over the years and that there is a continued quest towards smaller board size. However, other studies by (Druckeriv, 2002; Dalton et al., 1999; Kiel & Nicholson, 2003; Adams & Mehran, 2003; Anderson et al., 2004; Coles et al., 2008; Belkhir, 2009; Arslan et al., 2010; Chang & Duta, 2012), found that board size have a positive impact on the stock market performance of company. This implies that found that, large board size improves corporate performance through enhancing the ability of the company to establish external connection with the environment, providing on that way rare resources for company operations.

According to Caprio et al., (2007), and Andres and Vallelado, (2008) Size of board plays a critical role in the company's performance because it supervises the management and takes more human capital to advise management. Javid and Iqbal (2008) and Yasser et al., (2011) studies reported positive relationship between board size and firm performance. However, the findings of Yermack (1996); Eisenberg et al., (1998); Mak and Kusnadi (2004); and Andres et al., (2005) found is negative relationship between board size and firm efficiency.

In a related study by Tariq et al., (2014) found that Non-executive director participation in the board increases the performance of the decision and it also monitors the affair of corporation in a better way. According to the authors, the purpose of involvement in the board is to protect and increase the value of shareholder. Their participation in board brings new windows of universe (Tricker, 1984). They safeguard the interest of shareholder from the management. Empirical studies by (Weisbach, 1988; Prevost et al., 2002; Anderson & Reeb, 2004; Rebeiz & Salameh, 2006) reported a positive and significant relationship between outsider directors and firm performance. Notwithstanding, others studies by Baysinger and Butler (1985), Hermalin and Weisbach (1991), Agrawal and Knoeber (1996), and Yasser (2011) found a negative relationship between the outside directors and firm performance.

Kanwal and Nadeem (2013) studied the impact of macroeconomic factors on deposit money banks' performance in Pakistan over the period 2001 to 2011 using the Pooled Ordinary Least Square (POLS) method. The study used inflation rate, real gross domestic product (GDP) and real interest rate as explanatory variables while return on assets (ROA), return on equity (ROE) and equity multiplier (EM) were used as dependent variables. Their result indicated that real interest rate was significant and positively related to all the measures of profitability. GDP has negative nexus with ROE and EM only, while it is insignificant with ROA. The result also indicated that inflation rate was negatively related to the three measures of profitability. The study therefore concludes that macroeconomic variables have very strong impact on banks' performance in Pakistan.

Adeusi et al., (2014) examined factors that affect the profitability of 14 banks in Nigeria over the period 2000 to 2013. The study used ROA as a proxy for profitability and selected bank-specific, industry-specific and macroeconomic indicators. The findings of the study revealed that total loans to total assets, interest income to interest expenses, and GDP growth have the most significant effect on banks' profitability. The finding also revealed that capital adequacy, liquidity risk and inflation have no significant effect on banks 'performance in Nigeria.

Prowse (1997) argued that research on corporate governance applied to financial intermediaries especially banks, is indeed scarce. This shortage is confirmed in Oman (2001); Goswami (2001); Lin (2001); Malherbe and Segal (2001), and Arun and Turner (2002). They held a consensus that although the subject of corporate governance in developing economies has recently received a lot of attention in the literature, however, the corporate governance of banks in developing economies has been almost ignored by researchers. The idea was also shared by Caprio and Levine (2001). To the best of the researchers' knowledge, apart from the few studies by Caprio and Levine (2002), Peek and Rosengren (2000), Okoi and Ocheni (2000), Okike (2007), and Adegbite (2015) on corporate governance and bank performance, not much empirical studies have been carried out specifically on this subject especially in developing economies like Nigeria. A similar study carried out in Nigeria was by Sanda et al., (2005) where they looked at corporate governance and the financial performance of non-financial firms. It is on this premise that this study seeks to examine the impact of corporate governance on the performance on banks in Nigeria.

METHODOLOGY

To achieve the objectives of the study, data on Return on Asset (ROA), board composition, board size and interest rate margin and profit of 15 Deposit Money Banks selected for this study were sourced from the records of the banks and the Central bank of Nigeria from 2012-2016. The data was analyzed using the panel technique. The purposes of our analysis are: to examine the relationship between corporate governance and performance of the banking sector (ROA) and to find out if the impact of corporate governance on performance (ROA) varies across the banks in Nigeria or not.

This study employs a modified version of the econometric model adopted by Eisenberg et al., (1998) and Adeusi et al., (2014) in examining the effect of corporate governance on the performance of banks. It also used the CBN best practice rules and the specific governance index as provided by the Institutional Shareholder Services. The CBN prudential guideline specifies the number of directors (executive and non-executive) that constitute a board. Deposit money banks are expected to comply with such guideline in order to enhance efficient management and performance of the banks. In this study, performance is measured by return on Asset (ROA). The rationale for the use of this variable as a measure of performance is that banks in Nigeria are privately owned firms financed by individual/group of individuals whose interest is to maximize profit. Return of Asset captures how valuable the assets of banks are over time. The higher the quality of asset of a bank, the higher, its potentials to attract investors and growth

Corporate governance is critical for performance of a firm and the banking sector in particular. This is because the governance and management of a bank is key in decision making and growth of the business. Corporate governance also has serious implication on credit administration of the bank which directly affect performance. Based on this illustration, the study specifies a bank performance function thus:

$$ROA_{it} = f\left(BOS_{it},\ BED_{it},\ BND_{it},\ INTR_{it} + PROFT_{it}\right) \quad \text{(I)}$$

In order to estimate the functional relationship between corporate governance and banks' performance (ROA) using econometric technique, equation 1 is expressed in mathematical form as follows:

$$ROA_{it} = \beta_0 + \beta_1 BOS_{it} + \beta_2 BED_{it} + \beta_3 BND_{it} + \beta_4 INTR + \beta_5 PROFT_{it} + U_{it} \quad \text{(II)}$$

Where; ROA_{it}= Return on Asset; BOS_{it} = Board size; BED_{it}= Executive Board Composition; BND_{it}= Non executive Board Composition; $INTR_{it}$= Bank charges proxy by interest rate margin $PROFT_{it}$= Profit of the banks and U_{it}= Error term.

RESULTS AND FINDINGS

We started our analysis by examining the trend in board size in the selected 15 banks investigated. The trend in figure 1 shows that UBA, Union bank, first bank and Skye bank has the highest number of board size while Guaranty Trust bank, FCMB and Fidelity banks have the least number of board members. In nutshell, there appeared to be a common trend in board size among the banks operating in Nigeria. This may be the result of the guideline by CBN to all the banks on the maximum number of board.

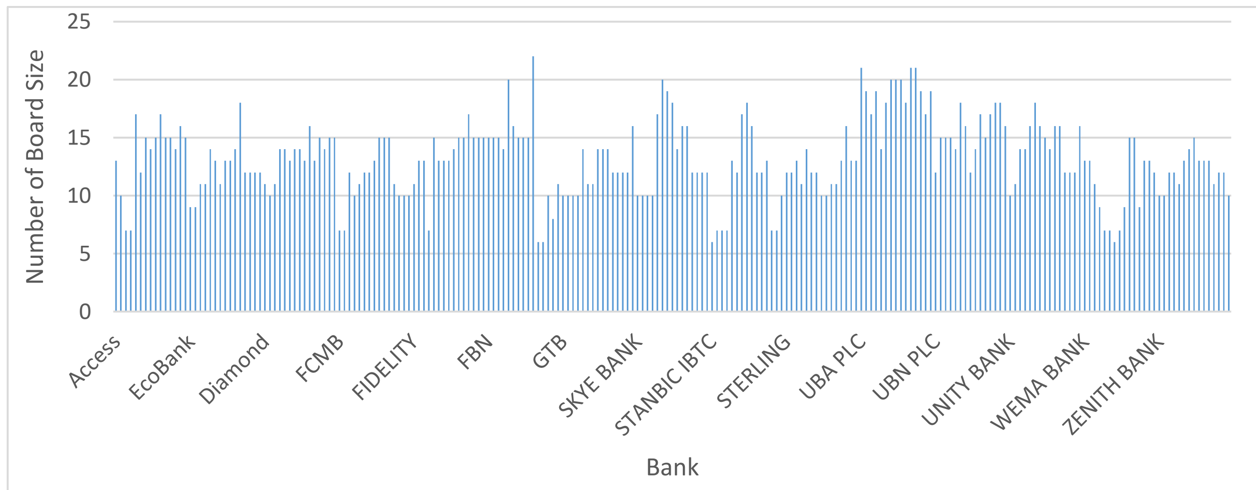

FIGURE 1. TREND IN BOARD SIZE IN THE 15 SELECTED BANKS IN NIGERIA 2002-2016

Figure 2 shows that Return on Asset (ROA) appeared to evenly distribute among the selected 15 banks. However, it was very high in Skye, UBA and Wema banks. This shows that ROA differ across the banks unlike the evidence/trend in board size.

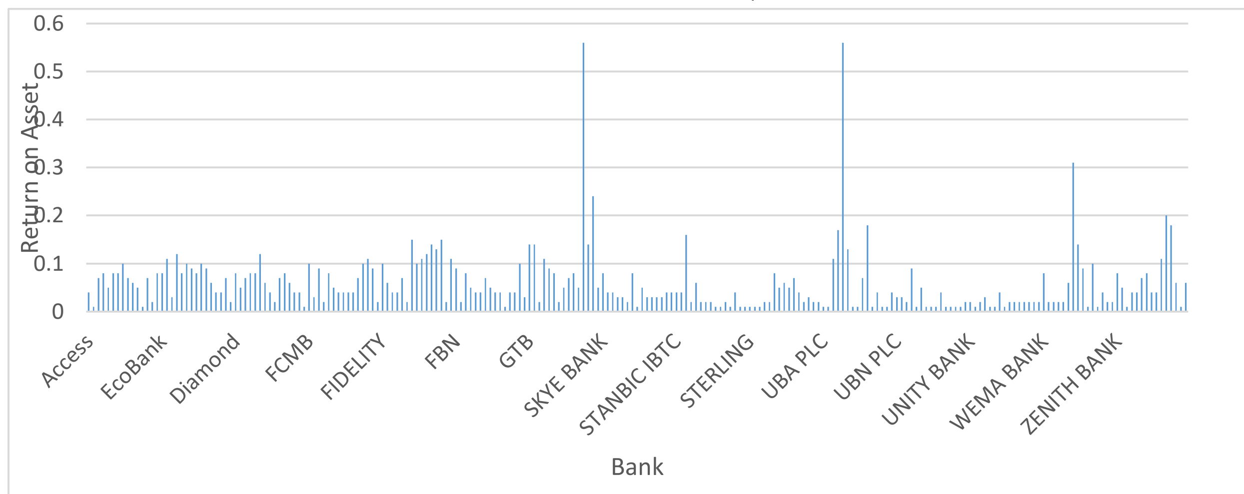

FIGURE 2. TREND IN RETURN ON ASSET IN THE 15 SELECTED BANKS IN NIGERIA 2002-2016

TABLE 1. DESCRIPTIVE STATISTICS

Variable	Mean	Standard Deviation	Minimum	Maximum
ROA	0.594	0.066	0.01	0.56
Bos	13.20	3.282	6	22
Bed	4.57	1.981	1	11
Bnd	8.79	2.209	4	16
Intr	19.88	3.388	14.82	26.04
Proft	4335.09	27859.49	-286169.1	126836.8

The descriptive statistics reported in Table 1 revealed a high deviation in the mean of the variables investigated in this study. The high deviation from the mean in ROA, board size, executive board composition, non-executive board size, interest rate margin and profit level show that the variables experienced very high level of fluctuation during the period under study. This wide fluctuation in the variables could be attributed to the instability in the banking sector in Nigeria.

TABLE 2. PAIRWISE CORRELATION RESULT: ROE BOS BED BNDINTR,PROFTSTAR(6)

Variable	Roe	Bos	Bed	Bnd	Intr	Proft
ROA	1.000					
Bos	-0.112	1.000				
Bed	-0.003	0.6995*	1.000			
Bnd	-0.159*	0.7752*	0.2080*	1.000		
Intr	-0.050	-0.0231	-0.0567	0.0214	1.000	
Proft	0.182*	0.0421	0.0987	-0.0615	0.1136	1.000

The pairwise correlation result in Table 2 revealed a negative and weak correlation between board size, executive board composition, non-executive board composition, interest rate margin and ROA. This implies that components of corporate governance and interest rate margin have very weak relationship with bank performance (ROA). On the other hand, profit level has positive but weak correlation with return on asset. The correlation result also revealed that only board non-executive members and profit level are significant.

TABLE 3: PANEL RESULT OF CORPORATE GOVERNANCE AND RETURN ON ASSET (ROA)

Random Effect (RE) Model				Fixed Effect (FE) Model		
Variable	Coefficient	Z-statistic	Prob	Coefficient	T-statistic	Prob
Bos	-0.0027	-0.65	0.517	-0.0036	-0.81	0.416
Bed	0.0011	0.24	0.811	0.0008	0.18	0.857
Bnd	-0.0019	-0.42	0.675	-0.0015	-0.28	0.778
Intr	-0.0011	-0.80	0.426	-0.0015	-0.97	0.335
Proft	2.76e-07	1.76	0.079	2.14e-07	1.24	0.215
Cons	0.127	3.69	0.000	0.1449	4.25	0.000
$R^2 = 0.053$				FE test $F(14,190) = 1.92$; F-Prob = 0.03; $R^2 = 0.043$		

The panel result reported in Table 3 indicated that board size was negatively and insignificantly related to ROA in the random and fixed effects models. This implies that increases in board size retarded return on asset/performance in Nigerian banks. This result is in tandem with some earlier studies which found higher board size to be unfriendly with performance. Some of the earlier studies that found negative relationship between board size and performance are of Yermack (1996), Eisenberg et al., (1998), Mak and Kusnadi (2004), and Andres et al., (2005). Large Board size may lead to additional cost and reduce return on asset/ performance.

The result of the panel analysis also revealed that executive member of the board of the banks in Nigeria has positive but insignificant relationship with ROA both in the random and fixed effect models. This implies that increases in the executive members of the board of banks stimulated the performance of banks in Nigeria and vice versa. This result is in consonance with the studies of Druckeriv (2002), Dalton et al., (1999), Kiel & Nicholson, (2003), Adams & Mehran (2003), Anderson et al., (2004), Coles et al, (2008), Belkhir (2009), Arslan et al., (2010), Chang & Duta (2012), which found that large board size improves corporate performance through enhancing the ability of the company to establish external connection with the environment, providing on that way rare resources for company operations.

Non-executive board size appeared with a negative coefficient both in the random and fixed effect models. This implies that increases in non-executive members of a board have a negative implication on the performance of banks in Nigeria. This result agreed with the findings of: others studies by Baysinger and Butler (1985), Hermalin and Weisbach (1991), Agrawal and Knoeber (1996), and Yasser (2011), which reported a negative relationship between the outside directors and firm performance. It should be noted that non-executive board members are not directly involved in the day-to-day running and management of the banks. Hence increasing the numbers may offer higher cost burden on the banks.

Interest rate margin appeared with negative sign both in the random and fixed effect models. The implication of this result is that increase in charges impose on credit by banks have adverse effect on the performance (ROA) of banks in Nigeria. Increases in charges may drive away customers to other alternative sources of borrowing and funding for their businesses. This may affect the bottom line of banks and their performance. This result is not in tandem with earlier study by Kanwal & Nadeem (2013) which found a positive and significant relationship between interest rate and performance of banks.

Profit margin has a positive coefficient with return on asset (ROA) both in the random and fixed effect models. This implies that increase in profit level of banks increased ROA while a decrease in profit level diminished ROA. This result agrees with theoretical expectation. Firms/Banks ROA tend to improve as it profits margin rises.

The test for fixed effect indicates that the null hypothesis is rejected given the probability of the F-statistic. This implies that the effect of corporate governance on the performance of banks differ across the banks investigated in Nigeria. This return tends to agree with the trend analysis reported in Figure 2.

CONCLUSION AND RECOMMENDATIONS

The result of our investigation on the effect of corporate governance on the performance of banks indicated that none of the variables that represents corporate governance was significant in explaining changes in the performance of banks. This implies that corporate governance has less implication on the performance of banks in Nigeria. The result also shows that board size and non-executive board members have negative effect on ROA while executive board members have positive effect on the performance of banks over the period of this study. The implication of this result is that increase in executive members of a bank's board could improve the performance of the bank in Nigeria. Other variables like interest rate margin and profit level were also insignificant in explaining changes in the performance (ROA) of banks. The result further revealed that the effect of corporate governance on banks 'performance differs across the banks in Nigeria Based on this result, the study recommends: an upward review of executive members of the board of banks and a periodic review of guidelines on the management of banks in order to enhance efficiency in management of banks and their performance.

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