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Corporate Governance and the Performance of Nigerian Banks

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Abstract

Although the consolidation and regulatory reforms were initiated in the Nigerian banking industry in 2004, the expected improvement in the operational performance and efficiency in the banking system has not been reflected in the overall health of the economy. It is in the light of the above, that this research examined the relationships between governance mechanisms and performance of banks in Nigeria. This study used secondary data derived from publications of Central Bank of Nigeria (CBN), Nigeria Deposit Insurance Corporation (NDIC) and Security and Exchange Commission (SEC) from 2006 to 2014. The Pearson Correlation was used to assess the relationships between the corporate governance variables and banks' performance. Statistical Package for Social Sciences (SPSS) was used for the analysis. The study observed that a significant negative relationship exists between board size, board composition and the financial performance of banks, while a positive and significant relationship was observed between directors' equity holding and banks' performance. The study concludes that, the directors' equity holding is paramount in boosting the performance of banks in Nigeria. Thus, this study recommends that the regulatory authorities should make sure that all directors own a reasonable amount of equity in the banks they oversee as this will move them to do their best to enhance the performance of these banks.

Keywords: *Corporate Governance, Bank Performance, Nigeria.*

Background to the Study

Corporate governance has been an issue of serious concern around the world. Several events are responsible for the heightened interest in corporate governance in both developed and developing countries. The subject of corporate governance came out to global limelight from relative obscurity after a string of collapse of high profile companies; Enron, the energy giant, WorldCom, the telecom giant and Xerox, the world producer of office equipment, shocked the business world with both scale and age of their fraudulent practices. These organizations seem to indicate only a tip of a dangerous iceberg (Iwuigbe, 2011).

The banking sector in Nigeria had about 89 active players before the consolidation exercise whose overall performance led to the sagging of customers' confidence. There was lingering distress in the industry, the supervisory structures were inadequate and there were cases of official recklessness amongst the managers and directors, while the industry was notorious for ethical abuses (Akpan, 2007). Poor corporate governance was identified as one of the major factors in virtually all known instances of bank distress in the country.

More importantly, Caprio, Laeven and Levine (2008) opined that there should be a revision of bank supervision and corporate governance reforms to ensure that deliberate transparency reductions and risk mispricing are acted upon. According to Sanusi (2010), the current banking crisis in Nigeria, has been linked with governance malpractices within the consolidated banks which has therefore become a way of life in large parts of the sector. He further said that corporate governance in many banks failed because boards ignored these practices for reasons including being misled by executive management, participating themselves in obtaining unsecured loans at the expense of the depositors and not having the qualifications to enforce good governance on bank management. The boards of directors were further blamed for the decline in shareholders' wealth and corporate failure. They were said to have been in the spotlight for the fraud cases that resulted in the failure of major corporations such as Enron, WorldCom, Global crossing and Xerox.

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) were related to the lack of vigilant oversight functions by the board 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 (Uadiale, 2010). Moreover, the non-executive directors may be compromised, since, they are being paid by the banks they are expected to oversee.

As a result, various corporate governance reforms have been specifically aimed at appropriate changes to be made to the board of directors in terms of its composition, size and structure (Abidin, Kamal and Jusoff, 2009).

Objectives of the Study

This study examines the relationship between internal corporate governance structures and banks' performance in Nigeria. The study will examine among others:

i. The relationship (if any) between board size and financial performance of banks in Nigeria.
ii. The relationship between directors' equity holding and the financial performance of banks in Nigeria.
iii. The relationship between the proportion of non-executive directors and the financial performance of banks in Nigeria.

Research Hypotheses

The study will be guided by the following hypotheses:

1. There is no significant positive relationship between board size and financial performance of banks in Nigeria.
2. There is no significant positive relationship between directors' equity holding and the financial performance of banks in Nigeria.
3. There is no significant positive relationship between the proportion of non-executive directors and the financial performance of Nigerian banks.

Literature Review

Corporate governance as defined by Mayer (1999) is the sum of the processes, structures and information used for directing and overseeing the management of an organization. According to Coleman and Nicholas-Biekpe (2006), corporate governance is the relationship of enterprise to shareholders or in the wider sense, the relationship of the enterprise to society as a whole. The Organization for Economic Corporation and Development (1999) 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 responsibilities between the parties (board of directors, supervisory board, the management and shareholders) and formulate rules and procedures for adopting decisions on corporate matters.

Theoretical Review

There is the need to backup this study with certain theories. These theories include: Agency theory, Ethical theory, Stakeholder theory, Stewardship theory. An agency relationship arises whenever one or more individuals, called principals, hire one or more individuals called agents, to perform some service and then delegate decision-making authority to agents (Bamberg and Klaus, 1987). The scholars both opined that, the primary agency relationships in business are those: (1) between stockholders and managers and (2) between debt holders and stockholders. These relationships are not necessarily harmonious; indeed agency theory is concerned with so called agency conflict or conflict of interest among other things, corporate governance and business ethics.

From the ethicists' point of view, “it is pointed out that the classical version of agency theory assumes that agent (that is, managers) should always act in principals' (owners') interests. In view of the above vis-à-vis the practice of corporate governance, it clearly shows that huge responsibility is placed on the neck of the agents by the principals. To fulfill the ultimate goal of the agency theory by the so-called agents, the need to apply corporate governance is such that it is inevitable to the whole process and operations of the corporate organizations. The

recent Nigerian experience of failed banks is a reflection of poor understanding and application of agency theory which led to bad practice of corporate governance.

Ethical theory as it were, is a build-up on the concept of ethics in general. The term ethics comes from the Greek ethos meaning something like morals. It is defined as the systematic reflection on what is moral. By this simple submission, morality is the whole of opinions, decisions and actions with which people express what they think is good or right. Hence, one of the major cardinal thrusts of ethical theory is utilitarianism. It implies, that ethical theory sometimes focuses not on actions but majorly on consequences (Jeremy Bentham, 1748-1832) cited by (Uwuigbe 2011). The name utilitarianism is derived from the Latin "Utilis" meaning "useful". Therefore, in utilitarianism, the consequences of actions are measured against values. These values can be happiness, welfare, high productivity, expansion etc. By way of emphasis, the cardinal point in this theory is that, it is essential to give the greatest happiness to the greatest number of people. So, for a successful practice of corporate governance in Nigeria and beyond, practical application of utilitarianism is a core requirement.

The utility of the shareholders and other stakeholders should be paramount in the minds of the corporate managers. The agents should make all efforts to ensure that principals have satisfactory values with regards to their investment. Stakeholder theory is a further development on the concept of stakeholder and its relationship to any business corporation. Freeman (1984) offers a traditional definition of a stakeholder thus, "any group of individual who can affect or is affected by the achievement of the organization's objective". The theory states that the organization itself should be thought of as grouping of stakeholders and the purpose of the organization should be to manage their interests, needs and viewpoints. This stakeholder management is thought to be fulfilled by the managers of a firm.

The main groups of stakeholders are: customers, employees, local communities, suppliers and distributors, shareholders, the media, general public, business partners, future generations, past founders, academics, competitors, competitors, regulators and governments.

In other to achieve the overall corporate objectives (with the practice of good corporate governance) managers of business corporations need to understand, appreciate and conscientiously apply the propositions of stakeholders' theory. For every individual or group that have stake in the organization, effort must be made by the so-called agents to preserve and protect their interests for the survival of the corporations. In the stewardship model, managers are good stewards of the corporations and diligently work to attain high level of corporate profit and shareholders' returns (Donaldson and Davis, 1994). Donaldson and Davis noted that managers are principally motivated by achievement and responsibility needs and given the need of managers for responsible, self-directed work; organizations may be better served to free managers.

Empirical Review

Findings of reputable studies on corporate governance and how it affects performance of banks were critically reviewed in this section of our research work. Their views, location, methodology used, results of findings and their recommendations were discussed. Ayorinde

et al (2012) studied the effect of corporate governance on the performance of the Nigerian banking sector. The judgmental sampling technique was used in selecting the 15 listed banks out of 24 banks that met the consolidation date line of 2005. These banks were considered because they were listed in the Nigerian Stock Exchange. A positive correlation was observed between the level of corporate governance items disclosed by the banks and return on equity which is the proxy for performance. This means that banks who disclose more on corporate governance issues are more likely to do better than those that disclose less. More so, a positive correlation was observed between the directors' equity interest and corporate governance disclosure index. 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 well. This invariably is expected to improve the performance. But board size has strong negative correlation with return on equity. This implies that how large the size of a board is does not have a positive effect on the level of financial performance of commercial banks in Nigeria but a negative effect.

Uwuigbe (2011), researches on corporate governance and financial performance of banks in Nigeria. This study made use of secondary data in establishing the relationship between corporate governance and financial performance of the 21 banks listed in the Nigerian Stock Exchange. A panel data regression analysis method was adopted in analyzing the relationship that exists between corporate governance and the financial performance of the studied banks. The Pearson correlation was used to measure the degree of association between variables under consolidation. From the analysis: 1. An inverse relationship between board size and ROE was observed. This indicates a significant negative effect of board size on the financial performance of the listed banks. 2. Outside directors do have significant but negative impact on bank performance as measured in terms of ROE. 3. A significant positive correlation was observed between directors' equity interest and banks' performance. 4. Banks who disclose more on corporate governance issues are more likely to do better than those that disclose less (a positive correlation).

They recommended that: 1. Effort to improve corporate governance should focus on the value of stock ownership of board members, since it is positively related to both future operating performance and to the profitability. 2. Steps should also be taken for mandatory compliance with the code of corporate governance. Also an effective legal framework should be developed that specifies the rights and obligations of a bank, its directors, shareholders, specific disclosure requirements and effective enforcement by the law.

Ahmad et al (2012) examined corporate governance and financial performance of banks in the post-consolidation era in Nigeria. Data were sought from sixty annual reports of 12 banks for the period of 2006 – 2010. The independent samples t-test was employed to analyze data gathered for the study. Multiple regressions (Analysis of Variance) were used to further analyze hypotheses two and three. Findings revealed that Dispersed equity holding does have an impact on the earnings and dividend of banks. Also, board size does not have an impact on profitability of banks. The existence of a chief compliance does not significantly enhance profitability of healthy banks in Nigeria. The study recommends the practice of restrictive equity holding in banks, be upheld. Secondly, the need to strengthen managerial policies so that financial performance can be improved is important as the stress test

conducted by CBN and NDIC revealed only a positive operational performance. Also, the compliance status needs to be identified in banks that are yet to comply with this provision, so that efficiency and effectiveness in management is complimented with other internal controls.

Methodology

Descriptive, quantitative and correlational research designs were used in this study. The population for this study consists of all the 21 commercial banks in Nigeria. The time frame considered for this study is 2006 to 2014. The sample size is equal to the population.

This study used secondary data derived from the Central Bank of Nigeria Statistical Bulletins, Nigeria Stock Exchange Fact Book and publications of Nigeria Deposit Insurance Corporation from 2006 to 2014. The proxies that were used for corporate governance are: Board Size, Board Composition and Directors' Equity Holding. Proxy for the financial performance of the banks is Return on Equity (ROE).

The Pearson correlation was used to measure the relationship between the variables under consideration. The analysis was done with the use of Statistical Package for Social Sciences (SPSS).

The model below is used for the analysis of this work:

ROE = f (BOS, BOC, DEH) - (1)

ROE = a0 + a1BOS + a2BOC + a3DEH + e - - - - - - - - - - - - - - - (2)

Where:

ROE = Return on Equity

BOS = Board Size

BOC = Board Composition

DEH = Directors' Equity Holding

a1 – a3 = Coefficients attached to the independent variables

e = Error Term.

Apriori Expectation

Board Size is expected to have a significant positive relationship with Return on Equity. This is due to the fact that an increase in the number of directors should add more expertise and experience to the board's decision-making.

Similarly, a significant positive relationship is expected between Board Composition (proportion of non-executive directors) and Return on Equity.It is expected that the non-executive directors would take the right decisions without fear or favour. As such, a board dominated by non-executive directors should do better.

Directors' Equity Holding is expected to have a significant positive relationship with Return on Equity. This is because, having a stake in the banks they run will motivate the directors to do their best to increase the profitability of these banks.

Banks and Average Measurement Variables

Banks	Return on Equity	Board Size	Board Composition	DEHD
Access Bank	0.034341	13.0	0.69	0.14
Citibank Nigeria Limited	0.029618	12.62	0.59	0.11
Diamond Bank	0.044870	12.67	0.72	0.07
Eco Bank	0.097752	12.0	0.56	0.19
Enterprise Bank (formerly Spring Bank)	0.029159	12.42	0.54	0.17
Fidelity Bank	0.031143	13.33	0.58	0.06
First Bank	0.039760	12.69	0.69	0.05
First City Monument Bank	0.058481	13.67	0.60	0.17
Guarantee Trust Bank	0.041824	12.68	0.55	0.04
Heritage Banking Industry	0.030124	13.46	0.61	0.14
Keystone Bank (formerly Bank PHB)	0.027356	15.89	0.67	0.13
Mainstreet Bank (formerly Afribank)	0.029473	15.24	0.69	0.03
Skye Bank	0.027735	15.0	0.67	0.11
Stanbic IBTC Bank	0.039452	13.56	0.81	0.15
Standard Chartered Bank	0.040645	14.60	0.79	0.26
Sterling Bank	0.142780	11.40	0.57	0.22
Union Bank	0.022250	15.0	0.69	0.01
United Bank for Africa	0.016461	12.0	0.71	0.09
Unity Bank	0.1525	9.67	0.51	0.25
Wema Bank	0.167941	6.70	0.54	0.28
Zenith Bank	0.024380	15.0	0.59	0.11

Source: Computed by Researcher using CBN Statistical Bulletins and Banks' Annual Report (2006 - 2014)

Result and Discussion

Correlations

		ROE	BOS	BOC	DEH
ROE	Pearson Correlation	1	-.806**	-.519*	.712**
	Sig. (2-tailed)		.000	.016	.000
	N	21	21	21	21
BOS	Pearson Correlation	-.806**	1	.513*	-.554**
	Sig. (2-tailed)	.000		.017	.009
	N	21	21	21	21
BOC	Pearson Correlation	-.519*	.513*	1	-.253
	Sig. (2-tailed)	.016	.017		.268
	N	21	21	21	21
DEH	Pearson Correlation	.712**	-.554**	-.253	1
	Sig. (2-tailed)	.000	.009	.268	
	N	21	21	21	21

**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed).

The correlation result shows that board size has strong negative correlation of -.806 with return on equity which is significant at 1%.This implies that an increase in board size will lead to a decrease in profitability (ROE). This means that a large board size does not have a positive effect but a negative effect on the level of profitability in the Nigerian Banks. Thus, the result contradicts the apriori expectation of a significant positive relationship between the variables. This result is consistent with earlier studies by Harris and Raviv (2005); Lipton and Lorsch (1992); Jensen (1993); Iwuigbe (2011). They all agreed that largerboard is ineffective as compared to smaller boards. However, the result of this study differs from that of Kyereboah-Coleman and Biekpe (2006) who argued that there is a positive relationship between board size and firms' value. Also, the result of the hypothesis differs from Zahra and Peace (1989) who concluded that a large board size brings more management skills and makes it difficult for the CEO to manipulate the board.

Board composition (proportion of outside directors) is another variable that recorded a negative correlation coefficient (r) of -.519 which is significant at 5%. This means that the more the number of outside directors, the lower the performance of the bank in terms of ROE. However, the result is contrary to the apriori expectation of a significant positive relationship between board composition and ROE. This is consistent with the studies of Bhagat and Black (1999), Staikouras et al (2007) and Uwuigbe (2011). They discovered a negative correlation between the proportion of outside directors and corporate performance. However, our findings are different from Bebchuk et al (2009) and Pathan et al (2007). They noticed a positive relationship between the variables.

The result shows a strong significant positive correlation of .712 between the directors' equity holding (equity interest) and the performance of the banks under consideration. This result is significant at 1%. The result shows that the more banks' equity owned by the directors, the better the banks' financial performance. This implies that individuals who have equity holdings in the banks they manage have compelling business interest to run them well. This result agrees with the apriori expectation of a significant positive relationship between directors' equity holding and return on equity. This is in-line withLoderer and Peyer (2002). They observed a positive relationship between directors' equity interest and firms' performance.In contrary, Lin (2007) found that there is no significant positive relationship between the quantities of stock held by directors and firms' performance.

Hypotheses Testing

Hypothesis 1:

H0: There is no significant positive relationship between board size and financial performance of banks in Nigeria.

H1: There is significant positive relationship between board size and financial performance of banks in Nigeria.

From the analysis, the correlation between board size and Return on Equity (ROE) has a coefficient (r) of -.806, depicting an inverse correlation between the two variables. This indicates a significant negative effect of board size on the financial performance of the sampled banks. On the premise of this result, since the significant effect is negative, we therefore accept the null hypothesis which states that there is no significant positive relationship between board size and ROE, and reject the alternative hypothesis.

Hypothesis 2:

H0: There is no significant positive relationship between the proportion of non-executive directors and the financial performance of Nigerian banks.

H1: There is a significant positive relationship between the proportion of non-executive directors and the financial performance of Nigerian banks.

From the result of the analysis, the correlation between the variables gives -.519 which is significant at 5%. This means that an increase in the number of outside will result in a decrease in the performance of banks in Nigeria. Based on this result, we accept the null hypothesis which states that there is no significant positive relationship between the proportion of non-executive directors and the financial performance of banks in Nigeria.

Hypothesis 3:

H0: There is no significant positive relationship between directors' equity holdingand the financial performance of banks in Nigeria.

H1: There is significant positive relationship between directors' equity holding and the financial performance of banks in Nigeria.

The result shows a strong significant positive correlation of .712 between the directors' equity holding (equity interest) and the performance of the banks under consideration.Based on the result, we therefore reject the null hypothesis and accept the alternative hypothesis which states that there is significant positive relationship between directors' equity holding and financial performance of banks in Nigeria.

Conclusion

A smaller board size enhances banks' performance while a bigger board size results in poor performance of banks in Nigeria. This means that an increase in board size results in poor performance of the banks. Also the directors' equity holding is paramount in boosting performance of banks in Nigeria. Finally an increase in the number of outside (independent) directors will result in a decrease in banks' performance as measured with Return on Equity (ROE).

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Recommendations

Based on the result of this study, the following recommendations will be useful to stakeholders:

I. Banks should operate with small board size as large board size may negatively affects performance. Therefore, banks should have small board size where the board members are active on their duties to enhance higher performance.

ii. The new code of corporate governance for Nigerian banks should not emphasize increase in the number of non-executive directors in banks to avoid poor performance. Alternatively, executive directors should be considered in reasonable number.

iii. The regulatory authorities should make sure that all directors own a reasonable amount of equity in the banks they oversee as this will push them to do their best to enhance the performance of these banks.

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