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Impact of corporate governance on commercial bank performance in Nigeria

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ABSTRACT

Corporate Governance is the key to the global integrity of corporate institutions especially financial institutions and other sectors. In Nigeria, especially in the financial institutions, there is quest for good relevance of corporate governance and this is strengthened by the desire to draw investments and support economic growth, which constitute a good reward to both local and international investors. Incidentally, Nigerian financial institutions have suffered a lot of deterioration in their asset portfolios, largely due to distorted credit management and this has led to crisis in the institution and ultimately to the merging of Banks. This study sought to: (i) examine the impact of corporate governance on return on assets of some selected commercial banks in Nigeria. (ii) determine the impact of corporate governance on return on equity of some selected commercial banks in Nigeria. The study made use of cross sectional data for 10-years which were collated from Central Bank of Nigeria – Statistical bulletin for the period, 2003-2012. Two major objectives were formed and tested and results revealed that in the first objective the adjusted R-squared estimate is 86% and statistically significant at 5% significant level, which implies that the estimated model has high goodness of fit. For the second objective, the adjusted R-squared estimate is 58% and statistically significant at 5% significant level, which implies that the estimated model has high goodness of fit. The study recommends, among others that central Bank should issue efficient monetary policies that would intensify transparency, integrity and curtail insider abuses on customers account in the Banking institutions. Above all, this study has contributed to knowledge by providing vital information on corporate governance on five of the commercial Banks in Nigeria.

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Introduction

Corporate Governance is the key to the global integrity of corporate institutions especially financial institutions and other sectors. It cannot occur in the absence of accountability and transparency. These two brings development, growth and lasting corporate performance in monetary and operational terms. For this reason, the quality of corporate governance principles in place affects the performance of individual institution and that of the economy as a whole in terms of growth and development. In Nigeria, especially in the financial institutions, there is quest for good relevance of corporate governance and this is strengthened by the desire to draw investments and support economic growth, which constitute a good reward to both local and international investors. Most business failures in recent times in the financial institutions is attributed to failure of corporate governance which has led to the initial collapse of banks in Nigeria in the early 1990's. The recent collapse in the banking industry is as a result of credit-related abuses, poor risks management technique and failure of internal control system which ultimately led to mergers and acquisitions in the sector.

In Nigeria, the reform process of the banking sector is part and parcel of the government strategic agenda aimed at repositioning and integrating the Nigerian banking sector into the African regional and global financial system. Akpan (2007) in his study submits that the sector has undergone remarkable changes over the years in terms of the number of institutions, structure of ownership, as well as depth and breadth of operations. These changes have been influenced mostly by the challenges posed by deregulation of the financial sector, technological innovations, and implementation of supervisory

and prudential requirements that confirm to international regulations and standards, which includes corporate governance.

The Central Bank of Nigeria (CBN) has been the major regulator of banks in Nigeria, yet, banks and other financial intermediaries have been having problems of deterioration of their asset portfolios, largely due to distorted credit management, this problem was as a result of poor corporate governance in the country's banking institutions. In Nigeria, before the consolidation exercise, the banking industry had about 89 active players whose overall performance led to sagging of customer's confidence. During that period, the supervisory structures were inadequate, the institution was notorious for ethical abuses, and there were cases of executive recklessness amongst the managers and directors. Poor corporate governance was identified as one of the major factors in virtually all known instances of bank distress in the country. Soludo (2004) in one of his presentations, submits that weak corporate governance was seen as a result of weak internal control systems, excessive risk taking, override of internal control measures, absence of or non-adherence to limits of authority, disregard for cannons of prudent lending, absence of risk management processes, insider abuses and fraudulent practices. Also, Sanusi (2010), linked the current banking crises in Nigeria, to lack of corporate governance within the consolidated banks. It is in the light of the above problems that this study sought to study the impact of corporate governance on performance of banks in Nigeria. This was with a view to:

(i) examine the impact of corporate governance on return on assets of some selected commercial banks in Nigeria.

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(ii) determine the impact of corporate governance on return on equity of some selected commercial banks in Nigeria.

The rest of the paper is organised as follows: Section One introduces the paper. Section Two discusses the theoretical frameworks, Methodology is in Section Three. While Section Four, presented analysis / discussion of results, Section Five concludes the paper.

Theoretical frameworks

The theories under laying the revolution of corporate governance are: Agency, Stewardship, Stakeholder, Resource Dependency, Transaction Cost and Political Theories. Agency theory has its root in economic theory. However, it was further developed by Jensen and Meckling(1976).The stewardship theory takes its origin from psychology and sociology, The stakeholder theory focuses on relationships with many groups for individual benefits. One of the original advocates of stakeholder theory, Freeman (1984), identified the emergence of stakeholder groups as important elements to the organization requiring consideration. Resource dependency theory concentrates on the role played by board of directors in providing access to resources needed by the firm. Cyert and March (1963) initiated the transaction cost theory, but it was later theoretically described and exposed by Williamson (1970).Political theory brings the approach of developing voting support from shareholders, rather by parching voting power. This study is anchored on Stewardship and Resource Dependency theories.

Stewardship Theories

Donaldson and Davis (1991) suggests an alternative “model of man” where “organisational role-holders are conceived as being motivated by a need to achieve and gain intrinsic satisfaction through successfully performing inherently challenging work, to exercise responsibility and authority, and thereby to gain recognition from peers and bosses. They observed that where managers have served a corporation for a number of years, there is a “merging of individual ego and the corporation. This would suggest that extrinsic incentive contracts are less important where managers gain intrinsic satisfaction from performing their duties. This theory also links the success of firms with that of the managers. It tends to argue against the agency theory which posits that managerial opportunism is not relevant.

Resource Dependency Theories

This theory addresses the availability of resources of the firm to the general public. However, this is in addition to the separation of ownership and control within the firm. Availability of resources of the firm ensures that the organisation is protected from uncertainty of external influences.

Both theories are relevant for this study in the sense that for the steward theory, the theory stipulates that a manager’s objective is first to maximise the firm’s performance because a manager’s need of achievement and success are met when the firm is doing well Coleman, (2006). This theory addresses the issue of trust which the agency theory refers with respect for authority and inclination to ethical behaviour. But for the Resources dependency theory, the theory postulates the presence of firms’ board of directors in other organisations. This helps in building relationships between organisations in order to have access to resources in the form of information which can then be utilised to the advantage of the firm.

Empirical Review

Empirical evidence on the relationship between corporate governance and performance is mixed. For example, La Porta,Lopez-de-Silances, Shleifer, and Vishny (2002) in their

study, finds evidence of higher firm performance in countries with better protection of minority shareholders. But Klapper and Love (2003)report that better corporate governance is highly correlated with better operating performance. They also document that firm level corporate governance provision matter happens more in countries with weak legal environment. Black,et al (2003) provide empirical evidence that there is a positive correlation between corporate governance and performance, but they have no explanation about the causal relationship. At the same time, Drobetz (2004) also finds that higher corporate governance rating is related to high performance. However, the above empirical studies are more concerned about examining the difference and correlations than about causal relationships. On the other hand, Drobetz, et al (2003) explores the relationship between firm level corporate governance and firm performance. They suggests that good corporate governance leads to higher firm valuation (performance), hence, investors are willing to pay a premium, and bad corporate governance is punished in terms of valuation discounts.

In the work of Mester (1989) and Mester (1993), it was documented that public owned banks and mutual banks have slight cost and profit advantages over their private banks. While O’hara (1981), suggesting that management of mutual banks is less efficient than management of private owned banks. On the other hand, La porta, Lopez-de- silances, and Shleifer (2000) in their study, provides contradictory empirical evidence .stating that state owned banks are inconsistent with the optimistic “development” theories of government ownership of banks common in the 1960s. The results are consistent with the political view of government ownership of firms, including banks, according to which such government ownership politicises the resource allocation process and reduces the efficiency. Lang and So (2002) examined the composition of ownership structures of banks in emerging markets and observed that foreign banks have higher holdings than do domestic banks if state stakes are excluded in terms of bank performance, ownership structure and bank performance.

Goldberg, Dages, and Kinney (2000) in their study of comparing the bank performance of domestic- and foreign-owned banks in Argentina and Mexico finds, that foreign banks generally have higher loan growth rates than do domestic private owned banks which have lower volatility of lending that contributes to lower overall volatility of credit. Also, Claessen and joseph (2003) study on corporate governance in Asia finds that agency problems arise from certain ownership structures and that conventional corporate governance mechanisms (through takeovers and boards of directors) are not strong enough to relieve the agency problems in Asia.

Methodology

Population and Sample of the Study

The study made use of cross sectional data of five banks out of twenty one banks in the country and they are : Access bank, Diamond bank, Wema bank, fidelity bank, Zenith bank which were quoted on the Nigerian Stock Exchange. These banks were considered healthy by the Central Bank of Nigeria.

Types and Sources of Data

The data used for this study is secondary data derived from the audited financial statements of the banks listed in the Nigerian Stock Exchange (NSE) between the Ten years period of 2003 and 2012.This study also made use of the Central Bank of Nigeria StatisticalBulletin and the Nigerian Stock Exchange Fact Book (2012).

Techniques for Analysis

The panel ordinary least square (POLS) method of multiple regressions is used in the estimation process. It is important to state that this study employs two financial ratios (ROE and ROA) which represent the dependent variables to measure bank's performance. The corporate governance performance is measured by Board size (BS), Audit committee (AC) and Board composition (BC) and they represent the independent variables. However, added is the loan deposit ratio (LDR) which is another good proxy for corporate governance. Return on assets was selected because of its relative use in past research work in determining how profitable a bank or firm is. A good example in the case of banks is the research on bank performance and corporate governance by Barako and Tower (2007). Also, in more recent research work by Coleman and Nicholas (2008), where a study of corporate governance and firm performance was carried out with emphasis on African firms.

Model Specification

The economic model used in the study is given as:

$$Y = \beta_0 + \beta F_{it} + e_{it} \dots \dots \dots (i)$$

Where, Y is the dependent variable. β_0 is constant, β is the coefficient of the explanatory

Variable (corporate governance mechanisms), F_{it} the explanatory variable and e_{it} is the error term (assumed to have zero mean and independent across time period).

By adopting the economic model as in equation (1) above specifically to this study, equation

(2) Below evolves.

$$PERF = \beta_0 + \beta_1AUDCOM + \beta_2BCOMP + \beta_3BSIZE + \beta_4LDR + e_{it} \dots \dots \dots (ii)$$

Variables Definition:

Dependent Variables (Measures of Bank performance)

Return on Asset (ROA): This exhibits the actual effectiveness associated with administration in order to make use of the overall asset for getting the return from them.

Net Profit after tax

Total Asset

Return on Equity (ROE): This is the summary measure of the overall firm performance. It indicates how well the firm has used the resources of owners as it measures the profitability of the owner's investment. It is calculated by dividing the Profit after tax which represents shareholder's equity or net worth which include common share capital, share premium and reserves and surplus less accumulated losses.

That is: $ROE = \frac{\text{Profit after tax}}{\text{Shareholders equity or net worth}}$

Shareholders equity or net worth

Independent Variables (Measures of Corporate Governance) includes:

Audit committee: The composition of the audit committee, that is, outside as a proportion of the total member for firm I in time t.

Board composition: Proportion of outside directors sitting on the board

Board Size: Number of directors on the board

Loan Deposit Ratio (LDR): Loan is represented by total loan on the balance sheet, while deposit include demand deposit, time deposit, certificate of deposit, savings, issued securities, prime capital, loan capital and borrowing. This ratio shows the proportion of public contribution as source of capital to finance the banks' loans. Smaller LDR number indicates that public provides smaller proportion to support the banks' loans. In addition central bank determines that bank concern the level of LDR to be lower than 85%. Smaller LDR number suggests that

banks attempt to maintain obedient function toward the rules which serves to protect public interest.

That is: $LDR = \frac{\text{Total loan}}{\text{Total deposit}}$

Total deposit

Analysis / discussion of results

For the first objective, the model is ; $ROA_{it} = b_1 + b_2AC_{it} + b_3BC_{it} + b_4BS_{it} + b_5LDR_{it} + e_{it}$

Table 1

Dependent Variable: ROA				
Method: Panel Least Squares				
Date: 05/06/14 Time: 17:25				
Sample: 2003 2012				
Periods included: 10				
Cross-sections included: 5				
Total panel (balanced) observations: 50				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.002489	0.008912	-0.279269	0.7813
AC	0.004702	0.001626	2.891664	0.0059
BC	-0.004330	0.000309	-14.02225	0.0000
BS	0.002840	0.000446	6.368290	0.0000
LDR	-0.017157	0.005922	-2.897181	0.0058
R-squared	0.872212	Mean dependent var		0.017775
Adjusted R-squared	0.860854	S.D. dependent var		0.008014
S.E. of regression	0.002990	Akaike info criterion		-8.692780
Sum squared resid	0.000402	Schwarz criterion		-8.501578
Log likelihood	222.3195	Hannan-Quinn criter.		-8.619969
F-statistic	76.78675	Durbin-Watson stat		1.995375
Prob(F-statistic)	0.000000			

The table above shows panel least squared estimated. The estimated was observed as follows; the adjusted R-squared estimate is 86% and statistically significant at 5% significant level, which implies that the estimated model has high goodness of fit i.e. the independent variables (AC,BCBS, and LDR) in question, was able to explain total variation of 86% in the dependent variable (Return on asset). The F-statistic 76.78675 is statistically significant at (0.000000); which implies that the model is fit. Also, the Durbin-Watson statistic is approximately 2 which implies absence of serial-autocorrelation.

The parameters estimated from the model are presented as follows; the parameter of the audit committee estimated (0.004702) is positively signed and statistically significant at 1% significant level (0.0059), this implies that a unit change in audit committee would lead to 0.4% increase in return on asset, The parameter estimated board committee (-0.004330) is negatively signed and statistically significant at less than 1% significant level (0.0000), this implies that a unit change in board committee would lead to 0.4% decrease in return on asset. The parameter of the estimated board size (0.002840) is positively signed and statistically significant at 1% significant level (0.0000), this implies that a unit change in board size would lead to 0.2% increase in return on asset. The parameter estimated loan deposit ratio (-0.017157) is negatively signed and statistically significant at less than 1% significant level (0.0058), this implies that a unit change in loan deposit ratio would lead to 0.1% decrease in return on asset.

For the second objective, the model is ; $ROE_{it} = b_1 + b_2AC_{it} + b_3BC_{it} + b_4BS_{it} + b_5LDR_{it} + e_{it}$

The table below shows panel least squared estimated. The estimated was observed as follows; the adjusted R-squared estimate is 58% and statistically significant at 5% significant level, which implies that the estimated model has high goodness of fit i.e. the independent variables (AC,BCBS, LDR) in

question, was able to explain total variation of 58% in the dependent variable (Return on equity). The F-statistic 18.37853 is statistically significant at (0.000000); which implies that the model is fit. Also, the Durbin-Watson statistic is approximately 2 which implies absence of serial-autocorrelation.

Table 2

Dependent Variable: ROE				
Method: Panel Least Squares				
Date: 05/06/14 Time: 17:27				
Sample: 2003 2012				
Periods included: 10				
Cross-sections included: 5				
Total panel (balanced) observations: 50				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.407121	0.146911	-2.771217	0.0081
AC	0.142075	0.026803	5.300696	0.0000
BC	-0.037247	0.005090	-7.317222	0.0000
BS	0.034667	0.007353	4.714977	0.0000
LDR	-0.600721	0.097619	-6.153748	0.0000
R-squared	0.620298	Mean dependent var		0.125901
Adjusted R-squared	0.586547	S.D. dependent var		0.076640
S.E. of regression	0.049280	Akaike info criterion		-3.087961
Sum squared resid	0.109283	Schwarz criterion		-2.896759
Log likelihood	82.19902	Hannan-Quinn criter.		-3.015150
F-statistic	18.37853	Durbin-Watson stat		1.967303
Prob(F-statistic)	0.000000			

The parameters estimated from the model are presented as follows; the parameter of the audit committee estimated (0.142075) is positively signed and statistically significant at 1% significant level (0.0000), this implies that a unit change in audit committee would lead to 14% increase in Return on equity, The parameter estimated board committee (-0.037247) is negatively signed and statistically significant at less than 1% significant level (0.0000), this implies that a unit change in board committee would lead to 0.3% decrease in return on asset. The parameter of the estimated board size (0.034667) is positively signed and statistically significant at 1% significant level (0.0000), this implies that a unit change in board size would lead to 0.3% increase in return on asset. The parameter estimated loan deposit ratio (-0.600721) is negatively signed and statistically significant at less than 1% significant level (0.0000), this implies that a unit change in loan deposit ratio would lead to 60% decrease in return on asset.

Conclusion and recommendations

In the study, attempts have been made to assess the resultant impact of corporate governance on return on asset and on return on equity. From the analysis carried out, the study concludes that evidence of corporate governance in an industry like our commercial banks has a great impact on return on asset and on return on equity of the five banks examined. However, it must be noted that parameters estimated from the objectives in question are not all statistically significant. The study recommends, among others that central Bank should issue efficient monetary policies that would intensify transparency, integrity and curtail insider abuses on customers account in the Banking institutions. Above all, this research has contributed to knowledge by providing vital information on corporate governance on five of our commercial Banks in Nigeria.

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