Evaluating the Effects of Corporate Governance on the Performance Of Nigerian Banking Sector

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Abstract
This paper 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. In examining the level of corporate governance disclosure of the sampled banks, a disclosure index was developed and guided by the Central Bank of Nigeria code of governance. 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. The study recommends that efforts to improve corporate governance should focus on the value of the stock ownership of board members and that steps should be taken for mandatory compliance with the code of corporate governance.

Keywords: Corporate Governance, Board Size, Directors' Equity Interest, Corporate Governance Disclosure Index, Return on Equity, Return on Assets, Financial Performance, Nigerian banks

Introduction
Given the fury of activities that have affected the effects of banks to comply the various consolidation policies and the antecedents of some operators in the system, there are concerns on the need to strength corporate governance in banks. This will boost public confidence and ensure efficient and effective functioning of the banking system (Soludo, 2004).

Banking supervision cannot function well if sound corporate governance is not in place (Heidi and Marleen, 2003). As a result, banking supervisors have strong interest in ensuring that there is effective corporate governance at every banking organization in an increasingly open environment (Kashif, 2008). Several events are therefore responsible for the heightened interest in corporate governance especially in both developed and developing countries. This concept of corporate governance of banks and every large firm have been a priority on the policy agenda in developed market economics for over a decade.

Further to that, the concept is gradually warming itself as a priority in the African continent (Uwuigbe, 2011). Indeed in developing economics, the banking sector among other sectors has also witnessed several cases of collapses, some of which include Savannah Bank Plc and Society Generale Bank Ltd among others (Akpan, 2007).

Although corporate governance in developing economies has recently received a lot of attention, yet corporate governance of banks in developing economies as it relates to financial performance has a almost been ignored by researchers (Ntim,2009). Even in developed economies the corporate governance of banks and their financial performances has only been discussed recently in literature (Macey and O' Hara, 2011).

In Nigeria, the issue of corporate governance has been given the front burner status by all sectors of the economy. This is in recognition of the failure of the critical role of corporate governance in the success or failure of companies (Ogbechie, 2006). Corporate governance is about building credibility, ensuring transparency and accountability as well as maintaining an effective channel of information disclosure that will foster good corporate performance. Corporate governance therefore refers to the processes and structures by which the business and affairs of institutions are directed and managed in order to improve long term shareholders' value by enhancing corporate performance and accountability while taking into account the interest of other stakeholders.

Statement of the Problem

The few studies on bank corporate governance normally focused on a single aspect of governance, such as the role of directors or that of shareholders while omitting other factors and interactions that may be important within the governance framework. Feasible among these few studies is the one by Adams and Mehran (2000) for a sample of US companies, where they examined the effects of board size and composition on value. Another weakness is that such research is often limited to the largest, actively traded organizations, many of which show little variation in their ownership, management and board structure and also measure performance as market value.

In Nigeria, among the few empirically feasible studies on corporate governance are the studies by Sanda et al (2005) and Ogbechie (2006) that studied the corporate governance mechanisms and firms' performance. In order to address these deficiencies, this study is not restricted to the framework of the organization for Economic Co-operation and Development principle, which is based primarily on shareholder sovereignty. It analyzed the level of compliance of code of corporate governance in Nigerian banks with the Central Bank of Nigeria code of corporate governance.

Finally, while other studies on corporate governance neglected the operating performance variable as proxies for performance, this study employed the accounting operating performance variables to investigate the existence if any relationship between corporate governance and performance of banks in Nigeria.

Generally this study seeks to explore the relationship between internal corporate governance and financial performance of banking sector in Nigeria as its main objective. However the specific objectives are:

i. To examine the relationship between board size and banks performance in Nigeria.

ii. To investigate if there is any significant relationship between directors' equity interest and the financial performance of banks in Nigeria.
iii. To determine empirically if there is any significant relationship between the level of corporate governance disclosure and the financial performance of banks in Nigeria.

As a result of these the following research questions were raised:

i To what extent does board size affect the financial performance of banks in Nigeria?
ii Is there a significant relationship between directors' equity holdings and financial performance of banks in Nigeria?
iii To what extent does the level of corporate governance disclosure affect the performance of banks in Nigeria?

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

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

Ho: There is no significant relationship between directors' equity holding and the financial performance of banks in Nigeria.

Ho: There is no significant relationship between the corporate governance disclosure and banks performance in Nigeria.

Literature Review

Corporate governance is a uniquely complex and multi-faceted subject. Devoid of a unified or systematic theory, its paradigm, diagnosis and solutions lie in multidisciplinary fields i.e. economics, accountancy, finance among others (Cadbury, 2002). As such it is essential that a comprehensive framework be codified in the accounting framework of any organization. In any organization, corporate governance is one of the key factors that determine the health of the system and its ability to survive economics shocks. The health of organization depends on the underlying soundness of its individual components and the economics between them.

Corporate governance has been looked at and defined variedly by different scholars and practitioners. However, they all have pointed to the same end, hence giving more of a consensus in the definition. 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.

In another perspective, Arun and Turner (2002) contend that there exist narrow approach to corporate governance, which views the subject as the mechanism through which shareholders are assured that managers will act in their interest. There is a consensus, however that the broader view of corporate governance should be adopted in the case of banking institutions because of the peculiar contractual form of banking which demands that corporate governance mechanisms for banks should encapsulate depositors as well as shareholders (Macey and O'Hara,2001). Arun and Turner (2002) supported the consensus by arguing that the special nature of banking requires not only a broader view of corporate governance, but also government intervention is order to restrain behavior of bank management.

They further argued that, the unique nature of the banking firm, weather in the developed or developing world requires that a broad view of corporate governance, which encapsulates both shareholders and depositors, be adopted for banks. They posit that, in particular, the nature of banking firm is such that regulation is necessary to protect depositors as well as the over all financial system.

This study therefore adopts the broader view and defines corporate governance in the context of baking as the manner is which systems, procedures, process and practice of a bank are managed so as to allow positive relationships and the excise of power in the management of assets and resources with the aim of advancing shareholder' value and shareholders' satisfaction together with improved accountability, resource use and transparent administration.

Better corporate governance is supposed tom lead to better corporate performance by preventing the expropriation of controlling shareholders and ensuring better-making. In expectation of such an improvement, the firm's value may respond instantaneously to news indicating better corporate governance. However, quantitative evidence supporting the existence of a link between the quality of corporate governance and firm performance is relatively scanty (Imam, 2006). Good governance means little expropriation of resources by managers or controlling shareholders, which contributes to better allocation of resources and better performance. As investors and lenders will be more willing to put their money in firms with good governance, they will face lower costs of capital, which is another source of better firm performance. Other stakeholders, including employees and suppliers, will also want to be associated with and enter into business relationship with such firm, as the relationships are likely to be more prosperous, fairer, and long lasting than those with firms less effective governance.

Implications for the economy as whole are also obvious. Economic growth will be more sustainable, because the economy is less vulnerable to a systemic risk. With better protection of investors at firm level, the capital market will also be boosted and become more developed, which is essential for sustained economic growth, at the same time, good corporate governance is critical for building a just and corruption-free society. Poor corporate governance in big Businesses is fertile soil for corruption and corruptive symbiosis between business and political circles. Less expropriation of minority shareholders and fewer corruptive links between big business and political power may result in a more favorable business environment for smaller enterprises and more equitable income distribution (Iskander and Chamlou, 2000).

Methodology

The population for this study consists of all the 24 commercial banks in Nigeria as at 2010. The time frame considered for this study is 2006 to 2010. This 5-year period allows for a significant lag period for banks to have reviewed and implemented the recommendations by the CBN post consolidation code. The judgemental sampling technique was used in selecting the 15 listed banks out of the 24 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 five years period of 2006 and 2010. 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 (2010). 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 banks corporate websites.

However, the proxies that were used for corporate governance are: board size, the directors' equity interest and corporate governance disclosure index. Proxies for the financial performance of the banks also include the accounting measure of performance; return on equity (ROE) and return on assets (ROA). To examine the level of corporate governance disclosures of the sampled banks the corporate annual reports of the banks were examined and a dichotomous procedure was followed to score each of the disclosure issue of '1' if it appeared to have disclosed the concerned issue and '0' otherwise. The score of each bank was totalled to find out the net score of the bank. A corporate governance disclosure index (CEDI) was then computed by using the following formula:

$$CGDI = \frac{\text{Total score of the individual company}}{\text{Maximum possible score obtainable by company}} \times \frac{100}{1}$$

In analyzing the relationship that exists between corporate governance and the financial performance of the studied banks, a panel data regression analysis method was adopted. The person correlation was used to measure the degree of association between variables under consideration. Based on the fact that we employed different corporate governance and performance proxies, the below models were used to determine the relationship between corporate governance and bank performance in Nigeria. These models are as follows;

Model 1:

$Y1 = a + b_{1x1} + b_{2x2} + b_{3x3} \ldots \mu$

Model 2:

$Y2 = a + b_{1x1} + b_{2x2} + b_{3x3} \ldots \mu$

Where:

Y1 = Return on Equity (ROE)
{Performance/ dependent variables}
Y2= Return on Assets (ROA)

b_i-b_3 = Partial regression coefficient attached to variable x_1, x_2 and x_3
x_1-x_3 = Independent variables that significantly contributed to the variance of financial performance.
X_1 = Board Size
X_2 = Directors' Equity Interest
X_3 =Corporate Governance Disclosure Index

μ =error term (Unexplained variance)

Result and Discussion

From the correlation result for model 1 in table 1, board size has a strong negative correlation of - .893 with return on equity which is significant at 1% and 5%.

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. This also implies than an increase in the board size will lead to a decrease in return on equity. Similar trend was observed from correlation result for model 2. From the correlation result it was observed that board size also have a negative correlation of - .821 with return on asset. The outcome from the two models for board size is consistent with earlier studies by Harris and Raviv (2005): Bennedsen et al (2006) and Uwuigbe (2011). They all agreed that larger board is ineffective as compared to smaller boards.

The result further showed that at 1% level and 5% level of significance, directors' equity interest has a positive correlation of 0.657 and 0.622 with return on equity and return on asset respectively. 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 performance. This is also seen in Mallin (2004).

In addition, the corporate governance disclosure index is positively correlated at 0.775 and 0.823 for models 1 and 2 respectively. This is also seen to be significant at both 1% and 5%. This further indicates that banks that disclose more on corporate governance issues are likely to perform better than those that disclose less. This correlation result is in consonance with Makhija and Patton (2000) and Cheng (2008).

Among the corporate governance variables, board size has a negative correlation with both directors' equity interest and corporate governance disclosure index. This is further explained to mean that bigger boards disclose lesser corporate governance information than smaller ones, likewise in smaller boards the directors are more interested in the organization equity

More so, a positive correlation was observed between the directors' equity interest and corporate governance disclosure index. This connotes that the more the equity owned by directors of the banks under review, the more they disclose on corporate governance issues and comply with the code of practice. This agrees with the work of Uwuigbe (2011).

The results from the regression equation are shown in tables 4 to 9. The equation employs return on equity and return on assets as its dependent variables while board size, directors' equity interest and corporate governance disclosure index are the independent variables. For the two models, the F-values which are significant at both 1% and 5% levels indicate that our models do not suffer from specification bias. However, from model 1, the coefficient of determination (R2) indicates that about 88% of change in return on equity is accounted for by the explanatory variables while the adjusted R-squared of 87.3% further justifies this effect. Also for the second model, 84% of change in return on asset is accounted for by the independent variables supported by adjusted R-square of 83.5% to that effect.

Based on the fact that more significant relationships are noticed between the corporate governance variables and return on equity than in return on asset, this implies that return on equity is a better performance proxy than return on asset. This study therefore based its decisions on return on equity.

Therefore, in our first hypothesis, we assumed that there is no significant relationship between board size and financial performance of banks in Nigeria. From the analysis, the correlation between board size and return on equity has a coefficient(r) of -.893, indicating an inverse correlation between the two variables. Also, the regression coefficient of the model is negative (-8.125), with a p-value of .000 significant at only 1%. This indicates a significant negative effect of board size on the financial performance of the quoted banks.

On the premise of these results, since the negative effect is significant, we therefore reject the null hypothesis and accept the alternative hypothesis which states that there is a significant relationship between board size and financial performance of banks in Nigeria.

The significant negative relationship found between bigger board size and return on equity is consistent with the conclusion drawn by Loderer and Peyer (2000). They have reported a significant negative relationship between board size and the performance of a firm. We therefore argue that a large board size leads to the free rider problem where most of the board members play a passive role in monitoring the firm.

The correlation result of the hypothesis two shows a strong significant positive correlation of 0.657 between the directors' equity holding and the performance of quoted banks in Nigeria. The regression result also shows that the positive correlation noticed between the studied variable is significant at 1% and 5%. Hence, we therefore reject the null hypothesis and accept the alternative hypothesis. The implication of this is that there is significant relationship between directors' equity holding and financial performance of banks in Nigeria. This means 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. These findings are in line with McConnell et al (2008) that agree that within a certain range, a positive relation is predicted between directors' equity interest and firm performance.

For the third hypothesis, a positive correlation of .775 is observed between the level of corporate governance items disclosed by the banks and return on equity which is the proxy for performance. The regression result further reveals that a positive significant relationship with a p-value of 0.000 (significant at 1%) occurs between the dependent and the independent variables. Based on these findings, we therefore reject the null hypothesis and accept the alternative hypothesis. This result implies that banks who disclose more on corporate governance issues are more likely to do better than those that disclose less. This result is consistent with Ogidefa (2008).

Conclusion and Recommendations

The result of the study revealed that a negative relationship exists between the board size and bank performance while a percentage increase in return on equity can be explained by directors' equity interest and the corporate governance disclosure level. However, the study therefore concludes that there is no uniformity in the disclosure of corporate governance practices made by banks in Nigeria. Though, they all disclose their corporate governance practices but what is disclosed does not conform to any particular standard. Despite the requirement of Stock Exchange and governance regulations, certain bank managers still disclose selectively, especially when the monitoring and enforcement of disclosure requirements are not strict in Nigeria.

In the light of these, we therefore present the following recommendations which will be useful to stakeholders. There must be improved efforts on corporate governance to focus on the value of the stock ownership of board members. Steps should also be taken for mandatory compliance with code of corporate governance. 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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Appendices

Table 1 List of Quoted Banks in Nigerian Stock Exchange

S/N	Banks
1	Access Bank Plc
2	Diamond Bank Plc
3	Ecobank Transnational Incorporation
4	Fidelity Bank Plc
5	First Bank of Nig Plc
6	First City Monument Bank Plc
7	Guaranty Trust Bank Plc
8	Skye Bank Plc
9	Stanbic IBTC Bank Plc
10	Sterling Bank Plc
11	UBA Plc
12	Union bank Plc
13	Unity Bank Plc
14	Wema Bank Plc
15	Zenith Bank Plc

Source: Nigerian Stock Exchange, 2012.

Table 2 Pearson Correlation Coefficients for Model 1

		ROE	BS	DEI	CGDI
ROE	Pearson Correlation	1.000	-.893	.657	.775
	Sig(2-tailed)		.000	.000	.000
	N	75	75	75	75
BS	Pearson Correlation	-.893	1.000	-.616	-.672
	Sig (2-tailed)	.000		.000	.000
	N	75	75	75	75
DEI	Pearson Correlation	.657	-.616	1.000	.359
	Sig (2-tailed)	.000	.000		.001
	N	75	75	75	75
CGDI	Pearson Correlation	.775	-.672	.359	1.000
	Sig (2-tailed)	.000	.000	.001	
	N	75	75	75	75

Source: Data Analysis, 2013

Table 3: Pearson correlation Coefficients for Model 2

		ROA	BS	DEI	CGDI
ROA	Pearson Correlation	1.000	-.821	.622	.823
	Sig (2-tailed)		.000	.000	.000
	N	75	75	75	75
BS	Pearson Correlation	-.821	1.000	-.616	-.672
	Sig (2-tailed)	.000		.000	.000
	N	75	75	75	75
DEI	Pearson Correlation	.622	-.616	1.000	.359
	Sig (2-tailed)	.000	.000		.001
	N	75	75	75	75
CGDI	Pearson Correlation	.823	-.672	.359	1.000
	Sig (2-tailed)	.000	.000	.001	
	N	75	75	75	75

Source: Data Analysis, 2013

Table 4 : Model Summary

Model	R	R Square	Adjusted R Square	Std Error of the Estimate
1.	.937	.879	.873	.00562

a. Predictors: (Constant), Corporate Governance Disclosure Index, Directors' Equity Interest, Board Size.

b. Dependent Variable: Return on Equity

Source: Data Analysis 2013

Table 5: ANOVA

Model		Sum of Squares	df	Mean Square	F	sig
1	Regression	.016	3	.005	171.217	.000
	Residual	.002	71	.000		
	Total	.018	74			

a. Predictors: (Constant), Corporate Governance Disclosure index, Directors' Equity Interest, Board Size.

b. Dependent Variable: Return on Equity

Source: Data Analysis, 2013

Table 6: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std error	Beta	t	sig
1.	(Constant)	.035	.012		3.016	.004
	Board size	-.012	.001	-.540	-8.125	.000
	Directors' Equity Int	.111	.029	.202	3.838	.000
	Corp. Gov. Disclo	.220	.036	.339	6.048	.000

a. Dependent Variable: Return on Equity

Source: Data Analysis, 2013.

Table 7: Model Summary

Model	R	R Square	Adjusted R Square	Std Error of the Est
2.	.917	.842	.835	.04202

a. Predictors: (Constant), Corporate Governance Disclosure Index, Directors' Equity Interest, Board Size.

b. Dependent Variable: Return on Asset

Source: Data Analysis, 2013

Table 8: ANOVA

Model		Sum of Squares	df	Mean Square	F	sig
2.	Regression	.666	3	.222	125.741	.000
	Residual	.125	71	.002		
	Total	.791	74			

a. Predictors: (Constant), Corporate Governance Disclosure Index, Directors' Equity Interest, Board Size.

b. Dependent Variable: Return on Asset.

Source: Data Analysis, 2013

Table 9: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	std error	Beta	t	sig
2.	(Constant)	.061	.088		.691	.492
	Board size	-.048	.011	-.327	-4311	.000
	Director Equity Interest	.837	.216	.234	3.879	.000
	Corporate Gov Disc Index	2.207	.272	.519	8.104	.000

a. Dependent Variable: Return on Asset

Source: Data Analysis, 2013