# The Effect of Corporate Governance Attributes on Financial Performance of Listed Deposit Money Banks in Nigeria

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## ABSTRACT

*This study examines the effect of corporate governance attributes on financial performance of listed deposit money banks in Nigeria. Secondary data were obtained from Nigeria Stock Exchange and the bank's annual reports for the period 2012 to 2018. The total number of banks listed in the financial institution sector on the NSE is twenty five (25) fifteen (15) samples were drawn from the total population. Regression analysis was conducted to obtain coefficient of determination (R), Correlation Coefficient (R-Square), P-value and F-tests statistics to measure the possibility of a connection between the variables. The analysis involved a regression of dependent and independent variables (return on asset and board size, board composition, audit committee). The results revealed that board size (BS) is significant and positively correlated to the financial performance of listed deposit money banks, while board composition (BC) and audit committee (AC)have negative and significant effecton corporate governance attributes of financial performance in listed deposit money banks in Nigeria. Board of directors should raise capital through the issue of long term debt that will not attract much interest so as not to jeopardize cash flow to such an extent that prevent cash dividend payment and put in place policies to ensure efficient management. That* *board (membership) should be increased but not exceeding the maximum number specified by the code of corporate governance for banks.Banks Regulatory authorities should not compel banks to increase the number of nonexecutive directors in their board composition as this negatively affects the profitability of banks BC is showing negative relationship with the ROA and finally the banks should have audit committee in their board to enhance a higher financial performance. The members of the audit committee should be given the opportunity to discharge their duties effectively without undue influence.*

***Keywords:*** *Return on asset; corporate governance; Audit committee; Board size; Board composition; financial performance*

## Introduction

Corporate Governance has been the topic of much discussion by policymakers at various levels: international, transnational and national. One reason is that there is a clear link between corporate governance, investments and economic growth, and financial performance (Kajola,2008) Corporate governance has become a popular discussion topic in developed and developing countries.Itis all about running an organization in a way that guarantees that its owners as one of the stakeholders are receiving a fair return on their investment. It is the process of a virtuous circle that links the shareholders to the board, to the management, to the staff, to the customer and to the community at large (Clarkson & Deck, 2007).

However, at varying levels of agency interactions, market institutional conditions that reduce informational imperfections and facilitate effective monitoring of agents impinge on the efficiency of investment. Likewise, corporate governance has assumed the centre stage for enhanced corporate performance (Korir&Cheruiyot, 2014). For instance, Magdi and Nedareh (2002) emphasize the need for organization managers to act in the interest of the bank; this study will further empirically explore this subject matter by finding the relationship between some selected corporate governance attributes and financial performance of listed banks in Nigeria.

## Review of Literature

Corporate governance attributes are a uniquely complex and multi-faceted subject. Devoid of a unified or systematic theory, its paradigm, diagnosis and solutions lie in multidisciplinary fields including: economics, accountancy, finance among others (Cadbury, 2002). The health of the organization depends largely on the underlying soundness of its individual components and the connections between them. Levine, (2009) emphasized the importance of corporate governance of banks in developing economies and observed that:

first, banks have an overwhelmingly dominant position in the financial system of a developing economy and are extremely important engines of economic growth; second, as financial markets are usually underdeveloped, banks in developing economies are typically the most important source of finance for majority of banks; third, as well as providing a generally accepted means of payment, banks in developing countries are usually the main depository for the economy's savings. This view was extended by Demaki,(2011) that, corporate governance attributes are an institutional arrangement that checks the excesses of controlling managers. The whole essence of corporate governance according to Kajola, (2008)is to ensure that the business is run well and investors receive a fair return. Adegbemi, Donald and Ismail, (2012)something is moving is an important concept which relates to the ways and manners in which the resources (human, machine, finance) of an institution are effectively used to achieve the overall corporate objective of an organization.

Okeahalam and Akinboade (2003) it improves the confidence of the investing public and attracting foreign investors to the companies in particular and the economy in general Love,(2011) Good corporate governance attributes is a prerequisite for national economic development. The study therefore analyzed the effect of Corporate Governance attributes on Financial Performance of Listed Deposit money Banks in Nigeria.Furthermore, 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.

### *Return on Asset (ROA)*

Return on asset is an indicator of how profitable a company is relative to its total assets. It gives an idea as to how efficient management is at using its assets to generate earnings, that is, it measures efficiency of the business in using its assets to generate net income (Levine, 2009). ROA is displayed as a percentage. Sometimes this is referred to as "return on investment". Return on assets is the ratio of annual net income to average total assets of a business during a financial year. Average total assets are calculated by dividing the sum of total assets at the beginning and at the end of the financial year by 2. Total assets at the beginning and at the end of the year can be obtained from year ending statement of financial positions of the two consecutive financial years. The formula to calculate return on assets is:

$$ROA = \text{Annual net income} / \text{Average total asset}$$

### *Corporate Governance Attributes*

Corporate governance mechanisms assure investors in corporations that they will receive adequate returns on their investments (Emmon&Schmid, 2002).

If these mechanisms do not exist or function properly, outside investor may not lend to banks or buy their equity securities and economic performance would suffer becausemany good business opportunities would be missed and temporary financial problems at individual firms spread quickly to employee and consumers. This study adopts three corporate governance attributes namely:board size, board composition, and Audit committee size.

### *Board Size*

There is a convergence of agreement on the argument that board size is associated with financial performance. However, conflicting result emerge on whether it is a large, rather than a small board, that is more effective. For instance, Yermack, (1996) in a review of the earlier work of Monks and Minow, (1995), argues that large boardrooms tend to be slow in making decision and hence can be an obstacle to change. A second reason for the support for small board size is that directors rarely criticize the policies of top managers and that this problem tends to increase with the number of directors (Lipton &Lorsch, 1992; Yermack 1996). Empirical studies have shown that small boards were more positively associated with high firm performance (Sanda, Mikailu, and Garba, 2005). However, result of the study of Kyereboah-Colemon, (2007) indicates that large boards enhanced shareholders wealth more positively than smaller ones.

### *Board Composition*

Zahra and Pearce, (1989) pointed out that boards are among the most venerable instruments of corporate governance. A positive relationship is expected between banks financial performance and the proportion of outside director sitting on the board, unlike inside directors, outside director are better able to challenge the CEOs. Empirical studies have grown but the results are conflicting. Studies by Weisbach (1988), and Pinteris, (2002) have produced evidence in support of a positive role of outside directors on financial performance.The code of corporategovernance emphasizes board composition that has qualitative, qualified, experienced members and people of proven integrity

### Audit committee

This is taken as the total number of members in the audit committee. (Klein,2002)

It is expected that the higher the number though within the limit set by code of corporate governance, the better the financial performance.

### Board Size and financial performance

Hermalin and Weisbach, (2003) argued the possibility that larger boards can be less effective than small boards. When boards consist of too many members agency problems may increase, as some directors may tag along as free-riders. They argued that when a board becomes too big, it often moves into a more symbolic role, rather than fulfilling its intended function as part of the management (Padilla, 2000).

Furthermore, larger boards are more likely to be associated with an increase in board diversity in terms of experience, skills, gender and nationality (Dalton and Dalton, 2005)Mak and Yuanto, (2014) reported that listed banks valuations of Singaporean and Malaysian banks are highest when the board consists of five members.

Contrary to the above findings, a positive impact on performance was recorded with larger board size by Makand Li, (2001) and Adams and Mehran (2005); however, in examining 147 Singaporean firms from 1995 data, Mak and Li, (2001) support the argument that board structure is endogenously determined when the results oftheir OLS indicate that board size, leadership structure and firm size have a positive impact on firm performancebut their 2SLS regressions do not support this result.

While, Adeusi, Akeke, Aribaba&Adebisi, (2013) Klein, (2002) and Lin, (2007): found that larger boards are associated with poorer performance, Bhagat& Black, (2002) and Limpaphayom and Connelly, (2006) found no significant association between board size and firm performance.

### Audit committee size and financial performance

Shareholders' interests are protected through the activities of audit committee because management may not always act in the interest of corporation's owners. Studies in favour of larger audit committee posited that when more people are involved in checking the activities of managers, wrongdoings will be reduced and performance will be enhanced. A number of studies which revealed positive relationship between audit committee size and firm performance include (Blao, Wallace & Peter 2003,Kyereboah, 2007)

## Methodology

### *Research design*

This study employs ex-post facto research design using panel data for the periods under study (2012-2018) as it allows for the collection of past and multi-dimensional data which provide basis for the full establishment of the relationship between corporate governance attributes and the financial performance of listed deposit money banks in Nigeria.

***Table 1. Population of the study***

| S/No | Name of Banks |
|---|---|
| 1 | Access Bank |
| 2 | Citibank |

| | |
|---|---|
| 3 | Diamond Bank ( Acquire by Access bank ) |
| 4 | Ecobank Nigeria |
| 5 | Enterprise Bank Limited (Acquired by Heritage bank) |
| 6 | Fidelity bank |
| 7 | First Bank of Nigeria |
| 8 | First City Monument Bank |
| 9 | Mainstreet Bank |
| 10 | Guaranty Trust Bank |
| 11 | Heritage Bank Plc. |
| 12 | Keystone Bank Limited |
| 13 | Skye Bank (now Polaris bank) |
| 14 | Stanbic IBTC Bank Nigeria Limited |
| 15 | Standard Chartered Bank |
| 16 | Sterling Bank |
| 17 | Union Bank of Nigeria |
| 18 | United Bank for Africa(UBA) |
| 19 | Unity Bank Plc |
| 20 | Wema Bank |
| 21 | Zenith Bank |
| 22 | Stanbic IBTC Holdings Plc |
| 23 | FCMB Group Plc |

*Source: Central Bank of Nigeria (CBN) 2019*

From the above listed banks, a working population was drawn base on certain criterion. This is because only listed banks can be termed public banks (Plc.) which are also expected to comply fully with the requirements of CBN code of corporate governance. Also, being listed enabled the researcher to have access to the banks' annual reports.

***Table 2: Sample size of the study***

| S/N | Banks | Year of listing |
|---|---|---|
| 1 | Eco Bank PLC | 2006 |
| 2 | Guarranty Trust Bank (GTB) PLC | 1996 |
| 3 | Fidelity Bank PLC | 2005 |
| 4 | First Bank | 1971 |
| 5 | Stanbic IBTC PLC | 2005 |
| 6 | Sterling Bank PLC | 1993 |
| 7 | Wema Bank PLC | 1991 |
| 8 | United Bank for Africa (UBA) PLC | 1970 |
| 9 | Heritage Bank PLC | 2012 |
| 10 | First City Monument Bank (FCMB) PLC | 2004 |
| 11 | Access Bank PLC | 1998 |
| 12 | Union Bank PLC | 1970 |
| 13 | Unity Bank PLC | 2005 |
| 14 | Zenith PLC | 2004 |

*Source: Generated from table 1*

Sample size of the study will consist of fourteen (14) listed deposit money banks in the Nigeria Stock Exchange as at 31st December, 2018. These banks were so used because they were considered viable and were seen to have the required financial wherewithal to carry on banking business in Nigeria, the CBN code of corporate governance, which regulates the operating activities of the banks.

**Variables and their measurement**

The dependent variable used in this study is the performance of banks which the researcher provied by; Return on asset (ROA) measured by dividing the net profit after tax by the total assets toCorporate governance is the independent variable with the following proxies and measurements.

**Board size (BS):** This is the total number of directors sitting on the board of a particular bank which in line with the code of corporate governance should not be more than 20. This study examines the extent to which bank performance will be affected by the size of the board.

**Board composition (BC):** This is the number of non-executive directors on the board and it is measured by the percentage of outside directors (non-executive directors) on the total board members.

**Audit committee (AC):** This is taken as the total number of members in the audit committee. It is expected that the higher the number though within the limit set by code of corporate governance, the better the performance (Klein, 2002)

**Model specification**

This study adopts and modifies the econometric model used by Adeusi, Akeke, Aribaba & Adebisi, (2013) which is given as follows:

$$ROA = \beta_o + \beta_1 BS_{it+} \beta_2 BC_{it} + \beta_3 AC_{it} + \mu_{it}$$

*Where:*

*ROA represents bank financial performance variable; Return on Assets (ROA) for bank in time t, a0 is the constant term, Board Size (BS), Board Composition (BC),Audit committee (AC), and µit, is the error term.*

**DATA PRESENTATION AND ANALYSIS**

**Descriptive Statistics**

The descriptive statistics is presented in Table 3 where minimum, maximum, mean, standard deviation, Skewness and Kurtosis of the data for the variables used in the study are described.

***Table 3: Descriptive Statistics***

| Var. | Minimum | Maximum | Mean | Std. Dev | Skewness | Kurtosis |
|---|---|---|---|---|---|---|
| **ROA** | 0.001 | 129.00 | 9.3180 | 33.7332 | 4.3147 | 21.9121 |
| **BS** | -102.10 | 93.36 | 4.5494 | 27.8274 | 0.3664 | 9.1825 |
| **BC** | -4.9400 | 62.690 | 5.3172 | 12.921 | 2.7710 | 10.819 |
| **AC** | 1.7200 | 44.020 | 19.627 | 8.3142 | -0.3963 | 3.9204 |

*Source: Stata Output*

Descriptive statistics are used to describe the basic features of the data in a study. They provide simple summaries about the sample and the measures. Table 3 presents the detail account of descriptive statics for the dependent and independent variables. From the table, Return on asset (ROA) has minimum and maximum values of 0.001 and 129.00 respectively and the mean and standard deviation of 9.3180 and 33.7236 respectively. This means that on the average, for every 1% increase in capital structure, the dividend payout of food and beverages companies in Nigeria will increase by 9.32% approximately. The standard deviation of 33.7236 indicates that the data deviate from the mean value from both sides by 33.72% which implies that there is a wide dispersion of the data from the mean because the standard deviation is greater than the mean value.

***Table4: Correlation Matrix***

| VAR | ROABS | BC | AC | |
|---|---|---|---|---|
| ROA | 1.0000 | | | |
| BS | 0.6053*<br>0.0012 | 1.0000 | | |
| BC | 0.3849*<br>0.0002 | 0.4630*<br>0.0003 | 1.0000 | |
| AC | -0.5118*<br>0.0010 | -0.6151*<br>0.0000 | -0.6322*<br>0.0001 | 1.0000 |

*Source:Stata output*significant at 1% **significant at 5%*

Table 4 shows the relationship between corporate governance attributes on financial performance of listed deposit money banks in Nigeria. The table shows a positive and significant relationship between financial performance and Board size equity (BS) from the correlation coefficient of 0.6053 and a p-value of 0.0012. This suggests that as BS ratio increases, return on asset also increases in the same direction. The relationship between Board composition(BC) and return on asset proved to be positiveand significant as indicated by the correlation coefficient and a p-value of 0.3849 and 0.002 respectively. However, Audit committee (AC) has a significant negative relationship with the Return on asset as shown by the coefficient of -0.5118 and a p-value of 0.000. This implies that as the BC ration of the banks increase, return on asset will decrease significantly.

**Regression Results Discussion**

This presents the regression results of the dependent variables (financial performance) and the independent variables of the study. This is followed by the analysis and interpretation of the association between the variables ($ROA=\beta_o+ \beta_1 BS_{it+} \beta_2 BC_{it} + \beta_3 AC_{it} +\mu_{it}$) is presented on the table below.

***Table 5: Regression Results***

| Variables | Coefficients | T-Statistics | P-Sig | VIF/Tolerance |
|---|---|---|---|---|
| Constant | -34.9432 | -1.53 | 0.130 | |
| BS | 0.3424 | 2.03 | 0.047 | 2.59/0.3859 |
| BC | -0.8290 | -1.99 | 0.051 | 1.57/0.5975 |
| AC | -1.5555 | -2.18 | 0.033 | 3.46/0.2889 |
| $R^2$ | | | | 0.2644 |
| F-Stat | | | | 7.81 |

*Source: Stata Output*

Table 5 present summary of the regression result obtained from the study model ($ROA=\beta_o+ \beta_1 BS_{it+} \beta_2 BC_{it} + \beta_3 AC_{it} +\mu_{it}$)**.** The regression result revealed that the cumulative $R^2$ (0.2644) which is the multiple coefficient of determination gives the proportion or percentage of the total variation in the dependent variable explained by the independent variables jointly. Hence it signifies that about 26% of the total variation of return on asset of listed Deposit money banks in Nigeria is caused by board size, board composition and audit committee. Similarly, the result of the F- statistic (7.81) shows that the model is well fitted and the corporate governance proxies in this study are well selected and utilizedas confirmed by the P-value (0.0000) which is significant at 1%.From the result, the coefficient of BS is 0.3424; t-stat is 2.03 while the P- value is 0.047. This indicates a positive and significant relationship between ROA and BS. The positive relationship between board size and return on asset indicates that as the BS ratio increases, return on asset also increases in the same direction. This provides an evidence of board size has no significant effect on the financial performance of listed deposit money banks in Nigeria.

The coefficient of value of BCis -0.8290 and t-stat of -1.99 with P- value 0.051; this indicates a negative and significant relationship between BC and ROA at 10% level of significance.

Furthermore, the coefficient of audit committee (AC) is -1.5555; t-stat is -2.18 while the p-value is 0.033 which is significant at 5% level of significance. This indicates a negative and significant relationship between ROA and AC which implies that as the AC ratio increases, ROA decreases.

## Conclusion and Recommendations

### *Conclusion*

The study specifically found that board size (BS)has a positive significant relation with the financial performance (ROA).Based on this finding, the study concludes that financial performance is affected by corporate governance attributes of banks positively such that an increase in corporate governance attributes, increases the bank's return on asset and vice versa. The study also found that board composition (BC) and audit committee (AC) have negative and significant influence on financial performance (return on asset). The study therefore, concludesthat BC and AC have negative effect means they will reduce the return on asset of listed deposit money banks in Nigeria.

### Recommendations

The following recommendations were given:

i. The size of the board (membership) should be increased but not exceeding the maximum number specified by the code of corporate governance for banks
ii. Banks Regulatory authorities should not compel banks to increase the number of nonexecutivedirectors in their board composition as this negatively affects the profitability of banks.
iii. The banks should have audit committee in their board to enhance a higher financialperformance.

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