FINANCIAL PERFORMANCE OF QUOTED BANKS IN NIGERIA AND CORPORATE GOVERNANCE STRUCTURE.

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Abstract: This study empirically examines the relationship between corporate governance structure and financial performance of banks in Nigeria, with particular emphasis on quoted banks. This study examines the impact of large board size on the financial performance of quoted bank in Nigeria. The research adopted a cross sectional analysis of the financial report of quoted banks on first tier security market of Nigeria stock exchange. Data used in the study was basically secondary data generated from the published annual report of the studied bank. One hypothesis was tested with the use of regression correlation. Result showed that large board size impacted negatively on firm's financial performance as a result of increase in agency cost. The study concludes that the result of this study implies that large board size impacted negatively on firm’s financial performance, as a result of increase in agency cost and recommended that quoted banks should endeavor to comply with CBN and other financial, monetary and regulatory guide line to enable them achieve the objective ofimproving the Return on Asset.

Keywords: Corporate Governance Structure And Financial Performance Of Quoted Banks In Nigeria

INTRODUCTION

The importance of financial performance for any organization, especially banks which plays intermediary role in the economy cannot be overemphasized. Financial performance is a measure of how well a firm has used the assets and other resources entrusted to its care to generate adequate revenue for the owners of the firm (Investopedia, 2018). Corporate governance has become a topical issue because of its immense contribution to the growth and development of organization and nations around the world. The absence of good corporate governance is a major cause of failure of many well performing companies. Existing literature generally supports the position that good corporate governance has a positive impact on organizational performance (Organization for Economic Co-operation and Development) OECD (2014), Gampers et al (2003), Claessen et al (2002).

Nigeria is not left out of the phenomenon of financial and accounting scandal. It has affected the banking sector with 26 banks liquidated in 1997 and the falsification of company and financial statement in Cadbury Nigeria Plc in 2006 and more recent events in 2009 post consolidated banking crises when ten banks were declared insolvent and 8 executive management teams of the banks removed by the Central Bank of Nigeria (CBN 2010). Also the economic meltdown especially that of 2008 has forced the Nigerian firms to realize the need for the practice of good corporate governance. Problems that spurred researching on this topic are specifically the loss of confidence by the investors on the capital market, the persistent agency problem and the insolvency of large banks as a result of financial improprieties (Claessen, 2003).The main aim of this study is to examine the extent to which board size affects Return On Assets (ROA) of quoted banks in Nigeria.

Hypotheses

The following null hypotheses have been tested in this study:-

Ho_1: Board size does not significantly affect Return on Assets (ROA) of quoted banks in Nigeria.

Literature Review

Conceptual Framework

Corporate governance is the relationship among shareholders, board of directors and the top management in determining the directors and performance of the corporation. It includes the relationship among the many players involved (the stakeholders) and the goods for which the corporation is governed (Kim &Rasiah, 2010).According to Imam and Malik (2007) the corporate governance theoretical framework is the widest control mechanism of corporate factors to support efficient use of corporate resources. The challenge of corporate governance could be to help align the interests of individuals, corporations and society through a fundamental ethical basis and it fulfills the long term strategic goal of the owners. It will certainly not be the same for all organizations of all the key stakeholders (Imam and Malik, 2007). Therefore, excellent corporate governance systems help a corporation maintain adequate compliance with all the legal and regulatory standards under which it does its business.There are a number of theoretical perspectives which are used in explaining the impact of corporate governance mechanisms on firms financial performance. The most important theories are the agency theory, stakeholder's theory and resource dependency theory (Maher & Anderson 1999).

Corporate Governance

Corporate governance is a system by which the activities of companies are directed and controlled in a lawful and responsible manner by those charged with responsibility in order to meet the needs and expectations of the stakeholders (Sharafa, 2014).Corporate governance has no single accepted definition; this is often attributed to the huge differences in countries corporate governance codes (Solomon, 2010). The definition varies based on the framework and cultural situation of the country under consideration (Armstrong & Sweeney, 2002). Also, the differences in definition can be as a result of the different viewpoint from different perspective of the policy-maker, researcher, practitioner, or theorist (Solomon, 2010). When used generally, "the fundamental principles by which enterprises and management of organisations were managed and controlled" is what is referred to as "corporate governance" today. 2011 (Dor et al) By guiding and supervising management actions with sound business judgement, impartiality, and honesty, O'Donovan (2003) defines corporate governance as "an internal structure including policies, procedures, and people that meets the demands of shareholders and other stakeholders".

Board Size

The board is an important internal mechanism for resolving the agency problems, since it is primarily responsible for recruiting and monitoring the executive management to protect the interest of the shareholders (Haque, Arun, & Colin, 2008). MakandKusnadi (2005); Randoy, Thomsen, and Oxelheim, (2006); Mashayekhi and Bazaz (2008) concludes that a negative relationship exists. Frick and Andreas (2010); results report a non-consistent relationship between board size and firm performance. Ning, Davidson and Wang (2010) assert that when board size increases, agency problems in the boardroom increases simultaneously, therefore leading to more director free-riding problems and internal conflicts among directors. Drawing from this pattern of thought, agency theory encourages smaller boards because of the ease of decision-making and reduced tendency of conflict of interest.
In the United States it has been observed that the board size in publicly traded companies range from 8 to 11 directors and overtime, small board with 7 or fewer directors tend to increase their size but large boards with 12 or more directors tend to shrink their size (Ning, Davidson & Wang 2010). Kajola (2010) in his study on the Nigerian environment advocates that board size be limited to a sizeable level. Smaller boards preferably reduce agency cost and increase performance.

Audit Committee Independence

The audit committee is a critical link between company's financial reporting function and its external shareholders (Balton, 2010). They act as representatives of the shareholders by monitoring internal control, overseeing the external auditing process. Accounting scandals and concerns about the quality of financial statements have led to many calls for improved audit committee effectiveness (Bronson, Carcellor, Hollingsworth & Neal, 2009). Audit committee effectiveness can be achieved by growing independence of the committee in terms of more independent outside directors on the committee. The audit committee serves as the eyes of the shareholders because their duty is to ensure transparency and accountability in the financial reporting process. It is anticipated that a strong audit committee will address weak governance systems (such as agency issues), which seem to be prevalent in emerging markets (Choi, Hain, & Lee, 2011). This depicts that an independence audit committee can reduce the opportunistic tendencies of managers.

The Role of the Board of Directors, Chairman, and Chief Executive Officer

The board of directors comprises the executive and non executive board members. The SEC code of best practice recommends a maximum board size of 15 persons and a minimum of 5 persons. The general responsibility of the board of directors is to exercise oversight in the organizations in which they function and ensure good congruence. Their roles therefore include:

a. Strategic planning with organizational resources in order to achieve organizational objectives.
b. Selection, performance appraisal and compensation of senior executives.
c. Ensuring that a good succession plan is in place so as to ensure that the organization remains a going concern.
d. Communication with shareholders.
e. Ensuring the integrity of financial controls and reports.
f. Ensuring that ethical standards are maintained and the company complies with the laws.

The Role of the Audit Committee

The audit committee structure which was inaugurated in CAMA 1990 as amended till date recommends that there be an equal number of directors and shareholders subject to a maximum of six members. The following duties are outlined in Section 359 (6) for the audit committee:

a. Determine whether the company's accounting and reporting standards are in line with legal requirements and accepted ethical norms. Review, the scope and planning of audit requirements.
b. Review the findings on management matters in conjunction with the external auditor and departmental responses thereon.
c. Keep under review the effectiveness of the company's system of accounting and internal control.
d. Provide the board with suggestions about the hiring, firing, and compensation of the company's external auditors..
e. Authorize the internal auditor to carry out investigations into any activities of the company which may be of interest or concern to the committee.

The SEC code of best practices stipulates that the function of the audit committee shall include:

i. Assisting the Board: Fulfilling its oversight responsibilities.
ii. Reviewing the financial reporting process, the system of internal control and management of financial risks, the audit process, and the company's process for monitoring compliance with laws and regulations.
iii. Maintain effective relations with the board of directors, management and both internal and external auditors.
iv. Understanding the detailed responsibilities of committee membership company's business, operations and industry specific task.

Firm Performance

Financial performance which assesses the fulfillment of a firm's economic goals has long being an issue of interest in managerial research. Firm financial performance relates to the various subjective measures of how well a firm can use its given assets from primary mode of operation to generate profit. Kothari (2001) defined the value of a firm as the present value of the expected future cash flows after adjusting for risk at an appropriate rate of return.According to Eyenubo (2013), it is the accomplishment of previously established objectives, targets, and goals within a given time frame. Qureshi (2007) proposed four alternative methods for identifying a firm's worth in the corporate finance literature. The capital structure approach examines the impact of capital structure changes on the value of the firm and how various factors impact the debt and equity component of the firm capital structure either directly or indirectly. These include the financial management approach, which focuses on the evaluation of cash flows and investment levels before identifying and assessing the impact of financing sources on firm value, the resource based approach which explains the value of firm as an outcome of firm's resources and finally, the sustainable growth approach which is a summary of the above three approaches to a firm values, taking into account the firm's operating performance, its investment and financing needs, the financing sources, and its financing and dividend policies for sustainable development of firm's resources and maximization of firm value. This study examines three key accounting measures of firm's financial performance which are Return on Assets, Return on Equity and Earnings Per Share.

Returns on Assets (ROA)

One of the widely used accounting based measures of corporate governance in literature is the Return on Assets (ROA) (Finkelstein, D'Aveni 1994, Weir & Laing 1999). It assesses the effectiveness of capital employed and provides a basis in which investors can measure its investment in capital assets (EPPS &Cereola 2008). The Return on Assets (ROA) is a metric that reveals how much profit was made from capital that was invested. It is a measure of how many Kobo were earned for every naira's worth of assets. It allows users, stakeholders and monitoring agencies to assess how well a firm's corporate governance mechanism is securing and motivating efficient management of the firm (Chagbadari, 2011). The ROA is the ratio of annual net income to average total assets of a business during a financial year. It measures thus:

$$\text{ROA} = \frac{\text{Annual Net Income}}{\text{Average Total Assets}}$$

Theoretical Framework

Agency Theory

This study is based on agency theory which requires the board members and managers to play the roles of agents to the owners of the banks who are known as shareholders.

Politics, economics, sociology, marketing, accounting, management, and administration are just a few of the areas where agency theory has been used. The agency theory is a neoclassical economic theory (Ping & Wing, 2011) and is usually the starting point for any debate on the corporate governance. The theory is based on the idea of separation of ownership (principal) and management (agent). It states that "in the presence of information asymmetry, the agent is likely to pursue interest that may hurt the principal (Sanda, Mikailu&Garbe, 2005). It is earmarked on the assumptions that parties who enter into a contract will act to maximize their own self-interest and that all actors have the freedom to enter into a contract or to contract elsewhere. Furthermore, it is concerned with ensuring that agents act in the best interest of the principals.Unfortunately, poor corporate governance has led to a high rate of fraud, conflicts of interest, and self-interest in Nigeria, which has caused many businesses and enterprises to fail.From the foregoing, agency theory practically explains corporate governance and firm performance especially in the banking sector where the tenet of corporate governance is to protect the interest of absence owners (shareholders) who are also the principal of the management (agenda). On this basis, this study adopts agency theory as the theoretical basis for explaining corporate governance and bank performance.

Stakeholders' Theory

The agency theory, which defines shareholders as the only interest group of a corporate body, left a void that was later filled by the stakeholders theory.Within the framework of the stakeholders' theory the problem of agency has been widened to include multiple principals (Sanda, Garbe&Mikailu 2011). The stakeholders' theory attempts to address the questions of which group of stakeholders deserve the attention of management. The stakeholders' theory proposes that companies have a social responsibility that requires them to consider the interest of all parties affected by their actions.

Empirical Studies

Based on the type of data gathered, several approaches may be used to assess the link between corporate governance and business performance. The business environment which the study observes and the intended goal of the researcher also informs the nature of the methodology applied. Some researchers are inter-country based while some are intra-country specific. However, the most predominant methodology is the econometric methods including the panel data methodology and ordinary least square regression. This leads to a discourse on the methodology applied in this study.

Khatab, Masood, Zaman, Saleem, &Saeed (2011) utilized multiple regression model to test the significance of corporate governance and company profitability.Mashayekhi and Bazaz (2008) use multiple regression analysis and the correlation analysis to assess whether multicollinearity does not exist among independence variables. Kajola (2008) studying the Nigerian environment, uses panel methodology and ordinary least squares as a method of estimation. Sanda, Mikailu and Garbe (2005) study also uses the pooled ordinary least squares regression analysis. Kyereboah – Coleman (2007) in a study of Africa, makes use of the dynamic panel methodology. The state of corporate governance in an economy plays a dominant role in attracting and holding foreign investors, for building a robust capital market and for maintaining and restoring the confidence of both domestic and foreign investors (Ahmed, Alam&Zaman 2008).In a study conducted by Mckinsey and Company and cited in Adams and Mchan (2003), 78% of the professional investors in Malaysia expressed that they are willing to pay a premium for a well governed company. The corporate governance of countries specifies that there should be a proportion of outside directors on the board of every listed firm, for the UK a minimum of 3 independent board of directors is required while in the US it is stipulated that they constitute at least two-third (2/3) of the board (Bhagat& Black 2002).A study on board size by Eyenuba (2013) for Nigeria using regression analysis for 50 firms quoted on the Nigerian Stock Exchange during the period 2001 – 2010 showed that the bigger board size had a significant negative relationship with the indicator of firm financial performance. Finally, Uwuigbe (2013) studied fifteen (15) listed firms in manufacturing and banking sector in the Nigerian Stock Exchange showed that corporate governance mechanism ownership structure has negative and insignificant relationship with share price, on the other hand corporate governance mechanisms and audit committee independence was found to have positive and significant correlation with share price. This suggest thus, the higher the number of shareholders compared to directors on the audit committee, the better the share price value of the company.

Identification of Research Gap

An appraisal of the literature reviewed shows that Return on Assets (ROA), Return on Equity (ROE) and other financial ratios were tested by previous studies. This is the latest study on corporate governance and financial performance to test empirically after the pandemic in Nigeria.

METHODOLOGY

This study employs the technique of panel data analysis. It involves an empirical analysis of the annual financial reports and accounts of selected banks on the Nigerian Stock Exchange. It requires the use of descriptive and inferential statistics for data analysis as a result of the need to test hypothesis. The reason for the use of panel study is that it allows for measuring of the pattern of change and gathering of factual information on a regular basis.

Data collected and utilized in this study was secondary data. Textbooks, journals, theses, the annual reports of the banks under examination, and the Nigerian Stock Exchange were the primary sources for the secondary data. This study makes use of numerical data. The instrument used to gather the quantitative data is the annual reports and accounts of the selected banks.

Model Specification

Model 1: Functions

$$ROA = \int(BS, ACI) \ldots\ldots\ldots\ldots\ldots \text{(i)}$$

Mathematics Form

ROA = $\propto_0 + \propto_1\ BS + \propto_2\ ACI$ ………… (iv)

Econometric Form

ROA = $\propto_0 + \propto_1\ BS + \propto_2\ ACI + e$

Where:

ROA	=	Return on Assets
BS	=	Board Size
ACI	=	Audit Committee Independence
$\propto_0$	=	Constant
$\propto_1$	=	The Coefficient of the Explanatory Variable (Corporate Governance)
e	=	Error term

Decision Rule

If significant 2-tailed value/Probability Value (PV) = 0.000< 0.005 Reject Ho.
If significant 2-tailed value/Probability Value (PV) = 0.000 > 0.005 Accept H_1.

Methods of Data Analysis:

Statistical approaches are used to examine the secondary data that was gathered for the research and represents the corporate governance framework and performance metrics.Tablesare used to display data collected. The data is further analyzed using descriptive statistics which describe the mode, median and standard deviation. The hypotheses are tested using multiple regressions. The multiple regression tests were conducted with the dependent variables are (ROA) Return on Assets, while the independent variables is Board Size (BS).

RESULT AND DISCUSSION

Data collected and analyzed is presented in this section using panel methodology. It comprises of descriptive statistics correlation analysis and econometric analysis. E-views 6 and STATA SE 10 are the instruments used for the data analysis. The model specification is tested to find out the extent of the relationship between corporate governance and performance of quoted banks in Nigeria for a period of five years.

The link between corporate governance and business performance is examined using the ordinary least square regression and the generalised least square regression. The hypothesis is tested using the regression analysis in achieving the objectives of the study.

Data Analysis

RANDOM EFFECT

Table 2: ROA ON BOS

Dependent Variable: ROA

Method: Panel EGLS (Cross-section random effects)

Date: 08/03/22 Time: 23:56

Sample: 2012 2016

Periods included: 5

Cross-sections included: 10

Total panel (balanced) observations: 50

Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	4.858918	2.162401	2.247001	0.0293
BOS	-0.195963	0.177011	-1.107069	0.2738

	Effects Specification			
			S.D.	Rho
Cross-section random			2.881545	0.6030
Idiosyncratic random			2.337959	0.3970

	Weighted Statistics		
R-squared	0.025240	Mean dependent var	0.927423
Adjusted R-squared	0.004932	S.D. dependent var	2.327396
S.E. of regression	2.321649	Sum squared resid	258.7226
F-statistic	1.242882	Durbin-Watson stat	0.917089
Prob(F-statistic)	0.270467		

	Unweighted Statistics		
R-squared	-0.003913	Mean dependent var	2.719000
Sum squared resid	603.9634	Durbin-Watson stat	0.392858

HAUSMAN TEST

Correlated Random Effects - Hausman Test
Equation: Untitled
Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	0.332623	1	0.5641

Cross-section random effects test comparisons:

Variable	Fixed	Random	Var(Diff.)	Prob.
BOS	-0.219565	-0.195963	0.001675	0.5641

Cross-section random effects test equation:
Dependent Variable: ROA
Method: Panel Least Squares
Date: 08/03/22 Time: 23:54
Sample: 2012 2016
Periods included: 5
Cross-sections included: 10
Total panel (balanced) observations: 50

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	5.116652	2.011307	2.543944	0.0150
BOS	-0.219565	0.181680	-1.208528	0.2341

Effects Specification

Cross-section fixed (dummy variables)

R-squared	0.645657	Mean dependent var	2.719000
Adjusted R-squared	0.554800	S.D. dependent var	3.503961
S.E. of regression	2.337959	Akaike info criterion	4.727972
Sum squared resid	213.1760	Schwarz criterion	5.148617
Log likelihood	-107.1993	Hannan-Quinn criter.	4.888156
F-statistic	7.106287	Durbin-Watson stat	1.117977
Prob(F-statistic)	0.000003		

Hypothesis: Board Size does not significantly affect Return on Assets (ROA) of quoted banks in Nigeria

Panel data analysis has two models, Fixed Effect (FE) and random effect (RE) models. To apply the rightmodel at any given time a Hausman test has to be carried out. Prior to doing a Hausman test we have totake note of the hypothesis associated with it and it is stated below.

Ho: Random effect model is more appropriate than fixed effect model.

A Hausman Test was carried out and the result is aspresented in table 3 above.The assumption that random effect model is better than fixed effect model in exploring the data collected in this study is accepted because the Hausman test result indicate a Hausman probability value of 5.64% which is greater than the 5% conventional significance level.The notion that some distinctive elements are typically present in each business is one presumption that typically favours the fixed effect model (for example, corporate culture, corporate climate, etc.), these peculiar factors may affect a firm's performance or operations generally, and they are not as a result of random variation, that is, they are always present. This means that fixed effect model takes into account all the other variables that do not change over time that might affect the criterion variable in each firm that were not included in the model. Because we were mainly interested in examining how board size and audit committee independence affected return on assets and return on equity over time, we decided to utilise the FE model.Another key assumption that favours FE model is that those factors do not vary over time are peculiar to each firm and should not be correlated with other firms' unchanging factors. Each firm is different from the other, hence, the firm's error term and the constant (which depictseach firm's peculiarity) must not be correlated with the others. If the error term of each firm correlates with those of others, then FE is not suitable because results may be spurious and so we should model that relationship that exist between the different error terms (perhaps by using random-effects), this is the main reason for the Hausman test (presented above). The Hausman test results indicate that the error term correlate with the predictor variable, hence, random effect model is the appropriate model for our data and the basis for decision on the study's first hypothesis. Therefore, the random effect model is used to test the hypothesis that, board size does not significantly affect Return on Asset (ROA). From the random effect estimation result in table 2 the regression of ROA on BOS showed an intercept of 4.858918, which means that the average level of return on asset is more than zero when BOS is zero. Because board size will never be zero, we shall ignore the intercept.There is a negative relationship between BOS and ROA in terms of its slope which has a coefficient of -0.195963, and p-value of 0.2738, which is far greater than 0.05 level of significance, thus, we will not reject the hypothesis that states that board size does not significantly affect return on asset.

The negative coefficient means that for every single increase in board size the average level of return on assets is estimated to decrease by 0.195963. It is also important to point out that the coefficient of determination is 2.5 percent which reveals an extremely weak relationship between board size and return on assets.

Discussion of Findings

1. The results of the data analysis on the link between the size of the board of directors and the financial performance of Nigerian banks on Ho:1 show a negative association between the two metrics in terms of their slope, with a coefficient of -0.195963 and a p-value of 0.2739, which is far greater than 0.05 level of significance, thus, we will not reject the hypotheses that states that board size does not significantly affect return on asset.

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

Background information on the study's focus on the value of financial performance and how corporate governance may affect how well organisations perform.The result of this study implies that large board size and large number of executive members of the audit committee impacted negatively on firm's financial performance, as a result of increase in agency cost. This result may discourage investors and prospective ones from investing in such firms, because excessive board size and audit committee could be sources of financial leakage. Since quoted banks financial performance does not necessary depend on how large the board size is, the banks should ensure that they use the size board that is most appropriate to each bank in order to avoid unnecessary high cost of board members and audit committees' members.

Recommendations:

1. Quoted banks should endeavor to comply with CBN monetary, financial and regulatory guide line to enable them achieve the objectives improving the Return on Asset, Return on Equity and Earnings Per Share.
2. It is recommended that Board Size should remain at the statutory required number and should not exceeded as any increase would lead to increase in the operational cost which will impact Return on Asset. Equally, corporate entities should have more of non-executive board members with the required financial skill and expertise to ensure effective oversight on financial reports.

Contribution to Knowledge

This study has been able to design a reliable model for determining the effect of board size and ROA. The models will also be used to evaluate the effect of audit committee independence on ROA.This study has also provided empirical literature for researchers on corporate governance and financial performance.

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