CORPORATE GOVERNANCE AND BANK PERFORMANCE: A POOLED STUDY OF SELECTED BANKS IN NIGERIA

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Abstract

This paper examines the impact of corporate governance on bank performance in Nigeria during the period 2005 to 2009 based on a sample of six selected banks listed on Nigerian Stock Exchange market making use of pooled time series data. Form the findings, we observe that corporate governance have been on the low side and have impacted negatively on bank performance. The study therefore contends that strategic training for board members and senior bank managers should be embarked or improved upon, especially on courses that promote corporate governance and banking ethics.

Keywords: Corporate governance, Bank performance, Nigeria, Pooled data, JEL codes, G3, G21

Introduction

The importance of a vibrant, transparent and healthy banking system in the mobilization and intermediation of fund, for the growth and development of the economy need not be over-emphasised. Worthy of is the fact that the level of functioning of the financial sector depend on the perception and patronage of the citizens towards its services (Al- Faki, 2006). The situation where the public losses confidence in the financial institutions, can result in panic and consequential financial and economic woes. The absence of confidence in any organisation is attributable to opaque management practices with deleterious effect on its performance. The measure of performance in this case is not limited

to the financials (turnover and profit) but also customer satisfaction, employee welfare, social corporate responsibility, indeed, the whole gamut of balanced score card.

There are many ways of defining corporate governance, ranging from narrow definitions that focus on companies and their shareholders, to broader definitions that incorporate the accountability of companies to many other groups of people, or 'stakeholders'. The Cadbury Report (1992) was set up by the Committee on the Financial Aspects of Corporate Governance, known as the Cadbury Committee in May 1991 by the Financial Reporting Council, the London Stock Exchange, and the accountancy profession. The report made far reaching recommendations on corporate governance concerning the way in which companies are directed and controlled. The central components of the voluntary code of corporate practice are: that there be a clear division of responsibilities at the top, primarily that the position of Chairman of the Board be separated from that of Chief Executive, or that there be a strong independent element on the board; that the majority of the Board be comprised of outside directors; that remuneration committees for Board members be made up in the majority of non-executive directors; and that the Board should appoint an Audit Committee including at least three non-executive directors.

Corporate performance is an important concept that relates to the way and manner in which financial, material and human resources available to an organization are judiciously used to achieve the overall corporate objective of an organization. It keeps the organization in business and creates a greater prospect for future opportunities. The overall effect of good corporate governance should be the strengthening of investor's confidence in the economy of our country. Corporate governance is therefore about building credibility, ensuring transparency and accountability as well maintaining an effective channel of information disclosure that would foster good corporate performance. It is therefore crucial that banking sector observe a strong corporate governance ethos.

Massive corporate collapses resulting from weak systems of corporate governance have highlighted the need to improve and reform corporate governance at an international level. The Enron in the USA, Cadbury in Nigeria and other similar cases around the world have led to enactment of the Sarbanes–Oxley Act in July 2002 in the USA, the Higgs Report and the Smith Reports in 2003 in the UK and the st-code for corporate governance for banks in Nigeria which became operational in 2006 amongst others.Corporate governance is the system of checks and balances, both internal and external to companies, which ensures that companies discharge their accountability to all their stakeholders and act in a socially responsible way in all areas of their business activity (Solomon and Solomon, 2004).

The Nigerian banking system has undergone remarkable changes over the years in terms of the number of institution, ownership structure and the depth and breadth of the operations. These changes have been influenced largely by the opportunities presented by the deregulation of the financial sector, globalization of operations, technological advancements, impact of global economic downturn and the adoption of regulatory guidelines that conform to international standards. The developments in the Nigerian banking industry show that absence of good corporate governance was mainly responsible for the dismal performance of the industry as a catalyst for economic growth. In 1992, Bank of Credit and Commerce International (including its Nigerian affiliate) went bust and lost billions of dollars for its depositors, shareholders and employees. Another company, Polly Peck, reported healthy profits in 1992 while declaring bankruptcy the next year.

Given the nature of banking business and the antecedents of the operators such as unrecoverable loans, unethical bank practices, illiquidity, etc of Nigeria banks, corporate governance is fundamental to the nation's financial stability Afrinvest, (2010). Shleifer and Vishny (1997) opined that effective corporate governance reduces control rights, shareholders and creditors confer on managers, increasing the probability that managers invest in positive net present value projects. Thus, the relationship of the board and management, according to Al-faki (2006), should be characterized by transparency to shareholders, and fairness to other stakeholders.

This study will add to the general body of knowledge, on the impact of corporate governance and performance of banks in Nigeria; which is a very sensitive and vital sector. It also expands the body of literature in terms of its scope in integrating both bank internal factor, regulatory factor and the economic factor that may mitigate bank performance. Narrowing to sectorial macro analysis, picking Six Banks; 2 first generation, 2 new generation and 2 middle generation banks; In order to make a generalization on corporate governance level in the banking industry of Nigeria, as such seem limited in corporate governance literature in Nigeria.

Considering the sensitivity of the subject area of corporate governance, and the limitation of gaining access to relevant materials, this study will cover and review corporate governance and performance of six major banks in Nigeria {First Bank of Nigeria Plc, United Bank of Africa (UBA), EcoBank, Fidelity Bank, First City Monument Bank (FCMB), and Guarantee Trust Bank (GTB)} in the post consolidation era- 2005 to 2009.

The data used for this study, were retrieved majorly from Annual reports of the six banks, the Central Bank of Nigeria Annual statistical Bulletins, financial summary of listed banks on the Nigerian Stock Exchange, and other published articles.

Review Of Literature

The word governance is synonymous with the exercise of authority, direction and control. Zingales (1998) defined corporate governance as a group of mechanism that stakeholders use to guarantee that directors effectively manage corporate resources, a task that include the way in which quassi rents are developed and distributed. Metrick and Ishil (2002) see corporate governance from the investors' perspective as "both the promise to repay a fair return on capital invested and the commitment to operate a firm, efficiently given investments." Grevning and Bratonovic (1999) stress the partnership approach to corporate governance in which each player has a defined accountability for specific dimension of every responsibility area. This extends to identification and allocation of task as part of corporate governance process. They identify six key players in the corporate governance to include the market regulations/supervisors, shareholders, board of directors, executive managements, audit committee, external auditors and the public/ consumers.

Yermack (1996), in a review of the earlier work of Monks and Mino (1995), argues that large boardrooms tend to be slow in making decisions, 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 this problem tends to increase with the number of directors (Yermack, 1996; Lipton and Lorsch, 1992). Yermack (1996) examines the relation between board size and firm performance, concluding that the smaller the board size the better the performance, and proposing an optimal board size of ten or fewer. John and Senbet (1998) maintain that the findings of Yermack have important implications, not least because they may call for the need to depend on forces outside the market system in order to determine the size of the board.

Oyejide and Soyibo (200l) review the corporate governance legislation In Nigeria focusing on the financial performance. Adams and Mehram (2002) study on a sample of bank holding, they examine the effect of "boardsize and "board composition" as measure of corporate governance on value. Their results explain the absence of robust relationship between board composition and value and a positive relationship between board size and value in contract with the abundant existing literature for non- financial firms. The result of

Adams and Mehram (2002) indicates the inherent complexity of monitoring and advising financial entities.

Two recent studies by Beltratti and Stulz (2010) and Fahlenbrach and Stulz (2011) analyze the influence of corporate governance on bank performance during the credit crisis. However, both studies rely on variables that have been used in the literature to analyze the relation between corporate governance and firm value of non-financial institutions. Specifically, Fahlenbrach and Stulz (2011) analyze the influence of CEO incentives and share ownership on bank performance and find no evidence for a better performance of banks in which the incentives provided by the CEO"s pay package are stronger (i.e., the fraction of equity-based compensation is higher). In fact, their evidence rather points to banks providing stronger incentives to CEOs performing worse in the crisis. A possible explanation for this finding is that CEOs may have focused on the interests of shareholders in the build-up to the crisis and took actions that they believed the market would welcome. Ex-post, however, these actions were costly to their banks and their shareholders when the results turned out to be poor. Moreover, their results indicate that option-based compensation had no negative influence on bank performance, that bank CEOs did not reduce their stock holdings in anticipation of the crisis, and that CEOs did not hedge their holdings. Hence, their results suggest that bank CEOs did not anticipate the crisis and the resulting poor performance of the banks as they suffered huge losses themselves.

Erkens, Hung, and Matos (2010) use an international sample of 296 financial firms from 30 countries. Consistent with Beltratti and Stulz (2010), they find that firms with more independent boards and higher institutional ownership experienced worse stock returns during the crisis. They argue that firms with higher institutional ownership took more risk prior to the crisis which resulted in larger shareholder losses during the crisis period. Moreover, firms with more independent boards raised more equity capital during the crisis, which led to a wealth transfer from existing shareholders to debt holders.

Methodology

The broad objective of this study is to examine the impact of corporate governance and performance of bank in Nigeria. The analysis is conducted on a sample of six banks (First Bank, United Bank of Africa (UBA), EcoBank, Fidelity Bank, First City Monument Bank (FCMB) and Guarantee Trust Bank (GTB)) available on the Nigerian Stock Exchange Fact Book (2009). The sample period is 2005-2009. The data was extracted from Nigerian Stock Exchange Fact Book (2009) and it comprises the earnings for the year 2005-2009as measured by profit after tax. The interest rate policy reform is captured by a dummy variable

(0- regulated interest rate and 1-deregulated interest rate policy), while the inflation rate, Real Gross Domestic Product (RGDP), Broad Money Supply (M2), and Inflation rate are collected from the Annual Statistical Bulletin of the Central Bank of Nigeria. The model is then specified as:

$$\mathbf{BankPef_{it} = \beta_0 + \beta_1 CorpGov_{it} + \beta_2 IntrRf_t + \beta_3 M2_t + \beta_4 GDP_t + \beta_5 Inflt_t + u \ldots\ldots\ldots. (1)}$$

Expressing the model in logarithm form; thus, taking accounts of the variable in ratios, or their growth rates.

$$\mathbf{Log(BankPef_{it}) = \beta_0 + \beta_1 log(CorpGov_{it}) + \beta_2 Intrdum_{i*t} + \beta_3 log(M2_{i*t}) + \beta_4 log(GDP_{i*t}) + \beta_5 Inflt_{i*t} + u.}$$

Where:

logcorpgov = corporate governance

inflt = Inflation

intrdum = interest rate policy reform

RGDP = Real Gross Domestic Product

β_1-β_6= parameter coefficients of the model and

i*t = time script of common variables across the cross section

U = random term.

From our cross-sectional or pooled time series model specification above, we have a pooled time series regression model, to estimate the parameters of the model, we apply the Pooled-Time Series Ordinary Least Square (OLS). After which a Panel data fixed estimate is applied to compare the estimated parameter values. The choice of these estimates measures is predicated on the structure of the research work and the building up of available data, and the given limited number of estimation technique that can be employed on such pooled-cross sectional data as employed in this study.

Discussion Of Findings

From the estimated model as shown in Table 1, using the Pooled OLS, it is observed that three of the five independent variables are significant at 5%. Theoretically and practically, it is expected that corporate governance "if Good", would increase the performance of banks as indicated by their profitability and "if Bad", the reverse should be the case. The background of this study, reports that corporate governance in the banking sector given the period of 2005 to 2009, has been catastrophic resulting to the emergency intervention of the Central Bank of Nigeria (CBN) and the Nigerian Deposit Insurance Corporation (NDIC) in forming the AMCON (Asset Management Corporation of Nigeria) in June 2010. From our empirical findings, we concur that, corporate governance in Nigeria has

been poor and have had a negative effect on the performance of the banks. This is indicated by the negative relationship coefficient of -2.38652, implying that as poor corporate governance increases, the performance of the banks falls. This conclusion is significant at 5% and reliable. Bad corporate governance reduces the confidence of the public in the financial-banking sector of the economy and thus a fall in savings, bank productivity, profit, fewer investable fund, investment and invariably aggregate production and output in the economy. Increasing rate of inflation affected bank performance negatively as expected, also significant at 5%, it effect stood at -0.1888, inferring that a one percent increase in inflation rate, results, to approximately 1.89% fall in the performance of the selected banks. The magnitude and sign of interest rate policy control of the CBN, suggest that the policy has not been too favourable on the banks performance. It indicates a negative relationship between the interest rate policy and the performance of banks. The other variable of the model (GDP and M2) were reported to be insignificant by the study. The variables of the model account for 50% variations in the dependent variable as indicated by the R-squared, implying a fair goodness of fit. The Durbin-Watson (DW) value seems okay at approximately two. The remaining 50 percent variation in the dependent variable can be accounted to other factors like gains from advances, loans and the ability of the banks to expand their gains from transactions.

Table 1**: Pooled OLS**

Dependent variable: Log(bankpef)

	Coefficient	*t-ratio*	*p-value*
Const	26.5832	0.2613	0.7960
Log(corpgov)	-2.38652	-2.3725	0.0260**
Log(gdp)	-2.63212	-0.2751	0.7855
Log(m2)	2.27616	1.2730	0.2152
Inflt	-0.188892	-2.7660	0.0107**
Intrdum	-2.15494	-2.1290	0.0437**

*Note: *, **, and ***, indicates significant at 10%, 5% and 1% respectively.*

R-squared	0.5005	Durbin-Watson (DW)	2.004	Adjusted R-squared	0.3965

Source: Author's Computation

Log(bankpef) = 26.6 -2.39*log(corpgov) -2.63*log(gdp) + 2.28*log(m2) - 0.189*inflt - 2.15*intrdum

(102) (1.01) (9.57) (1.79) (0.06) (1.01)

n = 30, R-squared = 0.501. (standard errors in parentheses).

Table 2**:Fixed-effects**

Dependent variable: Log(bankpef)

	Coefficient	*t-ratio*	*p-value*
Const	27.5783	0.2477	0.8070
Log(corpgov)	-2.5481	-2.2558	0.0360**
Log(gdp)	-2.7184	-0.2596	0.7979
Log(m2)	2.3159	1.1831	0.2513
Inflt	-0.1905	-2.5488	0.0196**
Intrdum	-2.1768	-1.9645	0.0642*

*Note: *, **, and ***, indicates significant at 10%, 5% and 1% respectively.*

R-squared	0.5265	Adjusted R-squared	0.2774	Durbin-Watson	2.007

Source: Author's Computation

The panel fixed effect estimation, reports a very similar result as the Pooled OLS. It also reports the same three variables of corporate governance (logcorpgov), Inflation (inflt) and interest rate policy reform (intrdum) has been significant, this time at 5%, 5% and 10% respectively. Same also, it reports that corporate governance in the selected banks have been poor and have a negative relationship with the performance of the banks as measured by the profit after tax. The poor corporate governance is evident by the negative sign of the coefficient (-2.5481), slightly different from that reported by the pooled OLS by approximately 0.2. Further the same is the negative relationship between inflation and the performance of the banks (-0.1888), which when compared to the earlier report approximately, we find no difference. Lastly, the interest rate policy was not left out in this chain of conformity. It also suggest a negative relationship to the dependent variable (-2.1549), almost showing no divergence from the coefficient of the variable when estimated using the Pooled Ordinary Least Square. The goodness of fit, R-squared measured fairly this time at 52% and the Durbin-Watson approximately two.

Conclusion

Form the findings, we observe that corporate governance have been on the low side and have impacted negatively on bank performance. Considering the grievous consequence of poor corporate governance on the confidence of the public, and the economy at large, this study therefore recommends that strategic training for board members and senior bank managers should be embarked or improved upon, especially on courses that promote corporate governance and banking ethics. Also, the regulatory and supervisory authorities should be more cautious in the scrutinizing the account books of banks and also make more frequent examination of the bank's asset base and liquidity stance.

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