

# Effect of Corporate Governance on the Performance of Financial Institutions in Nigeria

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**Abstract:** This study investigated the relationship between corporate governance and the performance of some selected commercial banks in Nigeria. The purpose of the study is to ascertain the causal relationship between these two variables – corporate governance and financial performance. The study employed cross sectional survey research design, capturing 12 commercial banks studied over the period of 5 years (2015-2020). The matrixes of corporate governance that was used are size of the board, accountability of the board, diversity of the Board. Financial performance indicator is return on investment. Data was collected for the both independent and dependent variables. The independent variables which are board accountability, board size and board diversity were investigated against the financial performance of the selected banks. This is to underscore the causal relationship between these variables and Return on Investment (ROI). Return on Investment (ROI) is our indicator of financial performance. The sample size of the study is 15 financial institutions (commercial banks) using purposive sampling techniques. The study utilized secondary source of data, which include the financial reports of these banks and the corporate governance internal documents of these banks. The data collected was analyzed using multi linear regression data analysis techniques. The population for the study was derived from the Nigerian stock exchange which are 22 in number. The study therefore used census sampling to select all the 22 banks. However, data was only collected for 12 due to incomplete data for the remaining 10. The finding revealed that there is no significant relationship between board size and ROI, there is no significant relationship between board diversity and ROI, and finally, there is also no significant relationship between board accountability and ROI. The study provides an in-depth relationship between the board size, board diversity, board accountability and ROI of commercial banks.

**Keywords:** Corporate Governance, Board Size, Board Diversity, Board Accountability, Return on Investment, Financial Performance

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## 1. Introduction

The success of financial institutions, irrespective of their scope is predicated on a number of factors, in which a core of these factors is corporate governance. Just as good governance is an imperative for nation-building, corporate governance is also an engine room in a corporate/economic milieu [7].

Corporate governance, being the conduit through which the affairs of organizations are piloted must reflect the right values, structures, and processes necessary to give the organization an edge and help it achieve its stated objectives. This involves the relationship between the control system and the company, executive positions, stakeholders and

shareholders as well [14].

Corporate governance is a term used to capture the set of rules, values, practices, and processes by which companies are managed. In this regard, the model of corporate governance adopted by an organization goes a long way in shaping the duties and responsibilities of all participants in the organization. Corporate governance defines the function, structure, and role of a board of directors recognizing the ways in which companies are organized. The board of directors, which is the main vehicle for corporate governance, is responsible for protecting the appropriate interests of stakeholders of a firm through directing its operation and by supporting its decision-making [5].

It is important to accentuate that the effect of openness,

transparency and effectiveness of the financial institutions to the development of economies cannot be downplayed as financial institutions are important engine rooms of economies as they not only help foster the mobilization of funds, but also help in the redistribution of resources, which is a necessity for the economy to thrive. Hence, the level of functionality of these financial institutions is directly proportionate to the level of patronage by the citizens and this is carefully ensured through quality services delivery, and all of these interplay is rooted in corporate governance. However, any iota of corporate devastation or scandals will lead to a loss of public trust in the financial institutions, and will have a rippled effect on the economy in general [1].

Mohammed and Sori (2018) explained that as a result of the globally competitive nature of markets, nations have become increasingly reliant on the private sector as a catalyst for economic growth hence, good corporate governance needs to be leveraged by entities to enable them attract investments, employ assets efficiently, manage capital and achieve stated goals and objectives. Drawing from the aforementioned, for commercial banks to be profitable, it is important they operate within standard corporate governance framework as they are heavily reliant on customer deposits which are greatly shaped by public confidence. Since customer retention and continuous patronage is dependent on the confidence the public holds regarding the safety of their resources in commercial banks, the need for good corporate governance processes in these commercial banks in Nigeria, is of great necessity [3].

The poor asset portfolio of commercial banks happens to be a cogent system cause of corporate governance issues arising from distorted risk portfolio. It is due to the weak corporate governance in the commercial banks in the country. Weak corporate governance reduces investor's confidence; Liu et al. believes corporate governance improve firm performance, while Chong and Cheng were of the view that good corporate governance results to a positive effect on firm productivity [14].

Owing to numerous corporate scandal that bedeviled commercial banks post consolidation, the banker's bank (Central Bank of Nigeria) in 2014 gave an updated governance policy arising from post consolidation corporate scandals in the banking sector. A lot of research work has been done to study the effect of corporate governance and performance of commercial banks in Nigeria as it relates to profitability [14].

The research explored the significance on financial productivity of corporate governance practice in commercial banks by examining the effects of size of the board, accountability of the board and diversity of the board of commercial banks. However, Return on Investment (ROI) as a performance variable has not been exhaustively studied. The research therefore hopes to elucidate the result of corporate governance variables such as diversity of the board, size of the board, and accountability of the board on the ROI of commercial banks in Nigeria.

### **1.1. Statement of Problem**

The practice of corporate governance and its result will always be a prominent discourse in Nigeria and the world over. The advent of fraud and executive recklessness that rocked Enron and WorldCom in the USA has redefined the quest for effective corporate governance management globally. The shareholders and governments became excessively concerned with the happenings in the corporate world [1]. The depository financial institutions in Nigeria had experienced its own portion of corporate impropriety post amalgamation. Reacting from the development, the banker's bank (Central Bank of Nigeria) gave an updated governance policy in May, 2014 [14]. As a way of mitigating the gamut of fraud and recklessness, corporate governance became an indispensable lexicon in the corporate world.

The banking sector in Nigeria remains one of the most viable sector that stirs up public interest. This is due largely to its role of financial intermediation, provision of effective payment system, and facilitation of monetary policies in the country. It plays the role of an intermediary because it takes funds from the surplus units and disburses them to the units that are deficit in order to expand the economic space of the society at large.

Based on the role commercial banks play in Nigeria, studies have been conducted by scholars with the aim of establishing factors responsible for financial performance of commercial banks; one big factor is the nature of corporate governance in the banking sector. Also, a lot of studies were conducted to examine the relationship between corporate governance practice and productivity of commercial banks. However the outcome have differed and most aspect studied align towards profitability [14]. However, Return on Investment (ROI) as a performance variable has not been exhaustively studied. The research therefore hopes to elucidate the result of corporate governance variables such as diversity of the board, size of the board, and accountability of the board on the ROI of commercial banks in Nigeria.

### **1.2. Aim and Objectives**

The aim of this study is to investigate the effect of corporate governance on the financial performance of commercial banks in Nigeria. To fulfil this aim, this study has the following objectives:

- 1) Examine whether the size of the board has effect on the performance of commercial banks in Nigeria; if the board size affects the ROI.
- 2) Ascertain whether board accountability impacts on the performance of these commercial banks.
- 3) Examine the effect of board diversity on the ROI of these commercial banks.

### **1.3. Research Questions**

The study attempts to answer the following research questions:

- 1) What effect does the board size have on the ROI of commercial banks in Nigeria?

- 2) What is the impact of board accountability on the ROI of commercial banks in Nigeria?
- 3) Does the board diversity affect the ROI of commercial banks in Nigeria?

#### 1.4. Research Hypothesis

The hypotheses of the study are set in a null form below:

- 1)  $H_{01}$ : There is no significant effect of the board size on the ROI of commercial banks in Nigeria.
- 2)  $H_{02}$ : There is no significant impact of board accountability on commercial bank's ROI in Nigeria.
- 3)  $H_{03}$ : Board diversity does not affect the ROI of commercial banks in Nigeria.

## 2. Literature Review

### 2.1. Conceptual Framework

The study is focused on investigating the effect of corporate governance in commercial banks in Nigeria. The study adopted Paniagua et al.'s (2018) that conceptualized corporate governance based on agency theory. It was opined

that multiple ownership poses a challenge to the firm because it lacks the tools to control asset management. Corporate governance through a board of director's on one hand, partially solves this problem, it brings about new issues such as information asymmetries that is responsible for the problem between owners and managers. The study identified two variables of corporate governance that affect financial performance: board members and ownership (Independent variable proxies). The two proxies will enable the bank have a better corporate governance practice [10]. This study however used board size, board diversity, and board accountability as proxies for corporate governance.

Board size is one of the proxy variables of corporate governance and it is the composition of the members of the board of directors in an organization and it has two major functions which are directing and controlling. The number of the board members ranges from 6 to 15. The second proxy variable of corporate governance is board diversity which is the gender composition and different age groups. The third proxy variable is the board accountability which is the prudent management of the resources of the organization both assets and liability.

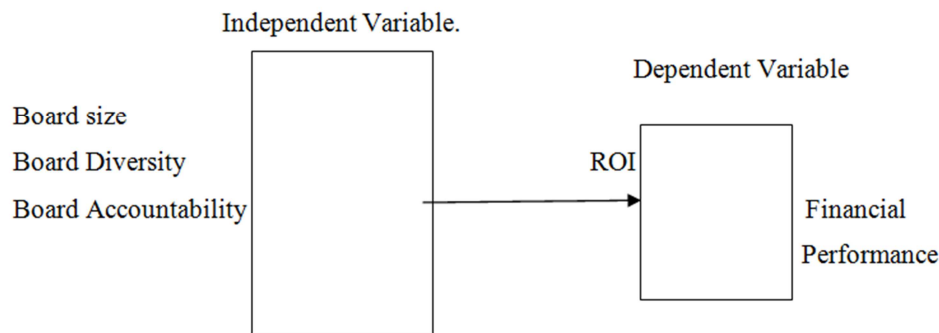


Figure 1. Conceptual framework.

The figure above shows the relationship between independent and dependent variables and their proxy variables.

### 2.2. Financial Performance

The study adopted Zabri et al.'s (2016) conceptualization of financial performance. ROA (Return on Asset) and ROE (Return on Equity) were used as the measurement of financial performance. ROA is the amount of earning that have been made from a firm's invested capital assets and it incorporates firm's profitability and efficiency. ROE is the income before interest expense for the fiscal period divided by total shareholders' equity for that same period. ROE has proven its mettle as a performance measure for corporate stakeholders and it is recommended for both short-term and long-term investments. ROE is a measure that shows the profit generated by a firm's investment, using the funds invested from its shareholders. These proxies will enable the bank improve on its profitability and efficiency for all stakeholders [15]. This study however made use of ROI as proxy for financial performance.

### 2.3. Theoretical Framework

#### Agency Theory

The agency theory espouses the link between the principal and an agent, who acts on behalf of the principal, while the principal is obligated to reward the agent. This theory was developed by Jensen and Meckling (1976) to be a management theory focused on emphasizing relationships and self interest in business settings. This theory clearly elucidates the existing connection between principals who are the owners, and agents who are the managers hence, delegation of control is one key area of their relationship. This theory emanates from the need to segregate householders from managers because owners, in a bid to protect their interest might end up messing things up [2].

The work of Jensen and Meckling (1976) shows that such relationship may be contractual, which implies that the owners (principals) introduces an agent (managers) to perform some corporate imperatives on behalf of the owners. Here, there is delegation of powers to the agent as they are given decision making powers to carry out organizational

activities, but subject to the approval of the board [7].

The agency theory focuses on the governance of a company, which is premised on the inevitable conflict of interest that emanate between the owners (principals), agent (managers) and other stakeholders. It is imperative to state that since each groups have divergent demands and interests, it becomes seemingly impossible to arrive at a perfect contract hence, at the core of creating a balance in this relationship and varying interest, is corporate governance.

Agency theory was postulated in 1932 by American economists Berle and Means who analysed ownership structure to large firms in the U.S.A and revealed that agents appointed by the owners control large firms and execute the business operations. They were of the view that agents might use the firm's property for their own selfish interest, thereby creating a conflict between the principals and the agents [9]. Agency theory attempts to elucidate the relationships and self interest in business organisations. It describes the connection between principals/agents and delegation of control [7].

Agency theory makes four key assumptions: 1) Both principal and agent are motivated by self-interest, 2) Both principal and agent have no equal tendency towards risk, 3) Both principal and agent have different objectives, 4) Both principal and agent have different approach to the information (The principal cannot follow the activities of the agent and know the information that the latter has) [11].

Critics of the Agency theory posited that concentration was done only on the agent side of the principal and agent problem. Perrow (1986) was of the view that the problem may also happen from the principal side. He observed that principals deceive and exploit agents. Principals according to him, are opportunistic and agents are unknowingly dragged into work with perilous working environment. Again, while Agency theory assumes that agents are logical and reward seekers, the agents are rational and behave rationally. Agency theory focused on the principal's objective and agency cost, it was opined that there is a linear relationship between the agent's performance and motivation [9].

#### 2.4. Empirical Review

Paniagua et al. (2018) investigated the effect of corporate governance on financial performance in 1207 companies, across 19 sectors in 59 countries. Corporate governance was conceptualized using two dimensions namely: *Board membership and ownership*. The board member variable was measured by counting the number of members on the board while ownership was measured using a composite index (0.1) where 0 indicated concentration of ownership and 1 indicated maximum dispersion. Financial Performance was conceptualized using the *Return on Equity (ROE)* and Return on Equity was also used to measure financial performance. This study used panel data for random sample for 1207 companies for the period of 2013-2015. Secondary data was obtained from the orbit database (Bureau van Djik). Data analysis was done using multiple regression. The findings revealed that a higher number of board members implies a lower Return on Equity (*ROE*) which is significant, and a

higher payout implies a lower Return on Equity, a high dividend negatively affect financial performance [10].

Mohammed et al. (2012) did a research on nine banks in Nigeria to examine the effects of corporate governance. A sample span of ten years (2001-2010) was used. It was discovered that corporate governance is germane to the achievements of commercial banks in Nigeria. Also, it showed that poor quality assets and loan deposit ratios have a negative footprint on financial institution's productivity. [4]

Onakoya et al. (2014) explored the connection of corporate governance attributes on bank productivity in Nigeria. The specimen consisted of nine banks from time span of 2006-2010. The findings revealed that size of the board and ownership structure unequivocally affects return on equity. However, it was revealed that the assumptions of corporate governance have bleak association with business. [8]

Richard et al. (2017) opined in their research that organizational size depletion is supposed to promote company's capability as the interest of improved control by immense board size are exceeded by the lower planning and resolution making of sizeable circle. It implies therefore that immense board is most likely to be unsuccessful and suffer parasitic problem among members of board directors in the discharge of their duties [13].

Pooja and Aarti (2014) did a research on the consequence of corporate governance variables on company's profitability in South Korea and Indian organizations. The findings from the study show that while corporate governance has minimal impact on company's financials and share worth; its variables significantly impact company's productivity. The numerical composition of board and audit team exerts positively on productivity of company's operations. Incessant board meetings however are inversely related to company's performance [12].

Nguyen, T. (2015) carried out a factual study of firm's listed on the Singapore stock exchange. He opined that the correlation between the size of a firm and its productivity is relative to the methods of measurement. The study concluded that board attributes are inherent and if not taken into cognizance might create a relevant connection which is non-existent [6].

One conclusion that can be drawn from the avalanche of empirical studies previously done is that corporate Governance is a system or process by which corporations, irrespective of its scope, are coordinated and managed for the purpose of goal attainment.

Financial institutions can be: Central banks, Retail banks, Commercial banks, Investment banks.

Central banks are those that set policy direction for other financial institutions. They regulate and manage the banking processes as well as the fiscal activities of the country. They oversee and manage all the banks in their respective countries. They also set the monetary policy of the country and are involved in ensuring adherence to regulatory compliance and standard operational procedures.

Retail banks are financial institutions that provide products and services to individual consumers. These products and

The case of this study, our focus is on commercial banks for the purpose of this investigating if there is a significant relationship between corporate governance and financial performances of these banks.

The sample size of the study is 15 financial institutions (commercial banks) using purposive sampling techniques. The study utilized secondary source of data, which include the financial reports of these banks and the corporate

From the above figure, the P-value is 0.185404 which is far higher than 0.05 significance level. The null hypothesis is therefore accepted and thus conclude that board diversity does not affect the ROI of commercial banks in Nigeria. The R-square is also 0.168235 which is low as this indicate that 16% change is not significantly predicted by the board diversity.

SUMMARY OUTPUT								
Regression Statistics								
Multiple R	0.410165							
R Square	0.168235							
Adjusted R Square	0.085059							
Standard Error	3.523117							
Observations	12							
ANOVA								
	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>			
Regression	1	25.10562	25.10562	2.022632	0.1854036			
Residual	10	124.1235	12.41235					
Total	11	149.2292						
	Coefficients	Standard Error	t Stat	P-value	Lower 95%	Upper 95%	Lower 95.0%	Upper 95.0%
Intercept	1.367806	2.984531	0.458298	0.656536	-5.2821443	8.01775584	-5.28214433	8.01775584
X Variable 1	0.520504	0.365987	1.422193	0.185404	-0.2949656	1.3359728	-0.2949656	1.3359728

SUMMARY OUTPUT	
<i>Regression Statistics</i>	
Multiple R	0.026218
R Square	0.000687
Adjusted R Square	-0.09924
Standard Error	3.861691
Observations	12

ANOVA								
	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>			
Regression	1	0.102575	0.102575	0.006878414	0.935538939			
Residual	10	149.1266	14.91266					
Total	11	149.2292						
	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>	<i>Upper 95%</i>	<i>Lower 95.0%</i>	<i>Upper 95.0%</i>
Intercept	5.904243	6.676019	0.884396	0.397248066	-8.970854817	20.7793414	-8.970854817	20.77934138
X Variable 1	-0.04173	0.503105	-0.08294	0.935538939	-1.162712954	1.07926175	-1.162712954	1.079261752

From the above figure, the P-value is 0.935538939 which is far higher than 0.05 significance level. The null hypothesis is therefore accepted and thus conclude that there is no significant effect of the board size on the ROI of commercial banks in Nigeria. The R square is 0.000687 which is low

indicates that the board size did not predict any change in the financial performance of the commercial banks.

H<sub>03</sub>: There is no significant impact of board accountability on commercial bank's ROI in Nigeria.

*Table 3. Regression Result.*

SUMMARY OUTPUT								
<i>Regression Statistics</i>								
Multiple R	0.265927							
R Square	0.070717							
Adjusted R Square	-0.02221							
Standard Error	7.285198							
Observations	12							
ANOVA								
	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>			
Regression	1	40.38884	40.38884	0.760989	0.403478421			
Residual	10	530.7412	53.07412					
Total	11	571.13						
	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>	<i>Upper 95%</i>	<i>Lower 95.0%</i>	<i>Upper 95.0%</i>
Intercept	7.16238	3.825483	1.872281	0.090667	-1.36132685	15.6860869	-1.361326851	15.68608687
X Variable 1	0.52024	0.596368	0.872347	0.403478	-0.80855118	1.84903143	-0.808551185	1.84903143

From the above figure, the P-value is 0.403478 which is far higher than 0.05 significance level. The null hypothesis is therefore accepted and thus conclude that there is no significant impact of board accountability on the ROI of commercial banks in Nigeria. The R square is 0.07071 which is low indicates that the board accountability did not predict any change in the financial performance of the commercial banks.

## 5. Conclusion and Recommendation

The objective of this research is to investigate if there is a significant causal relationship between corporate governance and financial performance of some selected banks in Nigeria. Return on Investment is used as the indicator of financial performance. The matrixes of corporate governance employed are: Board Accountability, Board size and Board diversity. Panel research design will be used with secondary data collected across the period of 2015-2020 of 10 banks in Nigeria chosen through purposive sampling technique. It is therefore, concluded that board size has no significant impact on the financial performance of commercial banks which means that an increase in board size will not significantly increase financial performance of commercial banks while board diversity has a positive impact on the financial performance of commercial banks which suggests that

mixture of genders on the board with different age grades will increase financial performance.

### Recommendation

Based on the conclusion reached, the study recommends as follows:

With the positive impact of board diversity on the performance, more emphasis should be given to the mixture of genders at different age grades.

The board size should be reduced in order to have positive impact on performance, since the board size has negative impact on performance.

Measures on corporate governance code of compliance should vigorously pursued by financial institutions under the supervision of the Central Bank of Nigeria to ensure compliance.

## 6. Area for Further Research

Most of the previous studies dwelled on board size, board composition, board diversity and board accountability as indicators of the independent variables impacting on performance of the financial institutions. Based on the forgoing, an area of further study is board ethics and its effect or impact on performance. This is with a view to examining the ethics of the board and how will that affect performance of the financial institutions.

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