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Corporate Governance and Profitability of Nigerian Banks

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Abstract

This study examined the impact of corporate governance on profitability of Nigerian banks for the period 2005 to 2015. The *ex-post facto* research design was adopted and data were obtained from the annual financial statements and accounts of five selected banks in Nigeria. Profitability was measured by profit after tax while the number of members in the board was used as a measure of corporate governance. The number of employee was introduced as a control variable. Correction and Regression test statistic was used to test the hypotheses stated. The correlation result revealed that there is a positive relationship between profitability of Nigerian banks and corporate governance measured by number of members in the board of Nigerian banks and also there was a positive relationship between profitability of Nigerian banks and the number of employees and, corporate governance measured by number of members on the board had a positive and significant impact on profitability of Nigerian banks. Again, the number of employees had positive and significant impact on profitability of Nigerian banks. The study therefore concluded that corporate governance had an impact on profitability of Nigerian banks. We therefore recommends that proper attention should be paid to on corporate governance in this part of the world as it has the potential to increase profitability of Nigerian banks.

Keywords: Corporate Governance, Profitability, Banks
Jel Code: L00

1.0 Introduction

In today's business world, most organizations maintain a corporate code of conduct, it's a statement of an organization's values, and includes standards for employees' behaviours that align with the values. Developing a code of conduct helps an organization define how it operates, how it integrates it core values into everyday business operations and how it relates to key stakeholders (George and Lerman, 2011).

The proper governance of firms will become as crucial to the world economy is the proper governing of countries. Nigeria as an emerging economy looks to the private sector for the required quantum leap, towards rapid development. There is a renewed emphasis of effective governance

particularly for Nigerian banks. This is necessitated by the recognition of the fact that effective and efficient corporate governance tend to improve how organisations discharge their corporate and statutory responsibilities and substantially affect their overall performance. Corporate scandals have put banks in the spotlight. It is against these scandals that legislations such as code of conduct and guidelines have been developed to improve corporate governance (Leblanc, 2007).

McGee (2009) was of the view that good corporate governance helps to increase share capital or price and make it easier to obtain capital. Again, international investors tend to be reluctant to lend money or buy shares in a corporation that does not subscribe to good corporate governance principles. It is therefore, note-worthy to mention that the issues of corporate governance in today's corporate world are due to the separation of management and ownership in the modern corporation (Mersah, 2000).

The problem of corporate governance in Nigeria could be attributed to the culture of corruption and lack of institutional capacity to implement the codes of conduct governing corporate governance such as the Peterside code of corporate governance. Company executives enjoyed an atmosphere of lack of check and balances in the system to engage in gross misconducts since investors are in not often recognised in the governing structure. The cases of Intercontinental Bank, Oceanic Bank, Bank PHB in Nigeria are still recent.

Given the poor profile of these organisations, it has become pertinent for management to render stewardship account to shareholders on how the resources put at their disposal were utilized. It is therefore against the forgoing that this study examined the effect of corporate governance indicators on firm's value in Nigeria. The specific objectives are to examine the relationship between board size and the profitability of firms in Nigeria and determine the relationship between ownership structure and profitability of firms in Nigeria.

The subsequent sections of this study are divided into four sections. In section two, this seminar paper review related literature. In section three the methodology adopted was explained. In section four data are presented and result analysed while in section five, the paper concluded and recommended.

2.0 Review of Literature

Several definitions have been put forward to define corporate governance. The organization of Economic corporation and development OECD (2004) defines corporate governance as involving a set of relationships between a company's' management, its shareholders and other stakeholders. From the forgoing therefore, corporate governance provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.

Wise and Mahboob (2009) opined that corporate governance indicate the policies and procedures applied by firms to attain certain sets of objectives, corporate missions and visions with regards to shareholders, employees, customers, suppliers and different regulatory agencies and the community at large. An effective corporate governance practice is thus essential to achieving and maintaining public trust and confidence in the firms' value in Nigeria, which are critical to the functioning of the firms and economy at large.

Again, effective corporate governance practices are necessary to achieving and maintaining public trust and confidence in firms in Nigeria, which are critical to proper functioning of the economy of a country as a whole. Poor corporate governance may contribute to firm's failures, which could in turn lead to a run on the firm, unemployment and negative impact on the economy (Basel committee, 2009). In addition, problems or failures of firms are likely to rapidly expand and have a disproportional adverse impact on the smooth operation of the firms (see, Allen and Herring 2001; Sbracia and Zaghini, 2003).

One of the core stakeholders of the firm's corporate governance structure are board of directors. The board of directors has a significant role in ensuring good corporate governance in the firm and at the heart of the corporate governance debate is the view that the board of directors is the guardian of shareholders' interest (Dalton *et.al.* 1998). Boards are been criticized for failing to meet their

governance responsibilities. Major institutions investors put pressure on directors and have long advocated changes in the board structure (Monks and Minow, 2001). Their call has been strengthened by many corporate governance reforms resulting from major corporate failures. These reforms put great emphasis on formal issues such as board independence, board leadership structure, board size and committees (Van den Berghe and De Ridder, 1999; Weil, Gotshal and Manges, 2002).

These structural measures are assumed to be important means to enhance the power of the board, protect shareholders' interest and hence increase shareholder wealth (Westphal, (1998); Becht et.al., 2002). Structural measures (board characteristics) are not sufficient to understand the workings of boards and Zahra and Pearce (1989) argued that there is a growing awareness of the need to understand better how boards can improve their effectiveness as instruments of corporate governance.

Corporate governance is now widely accepted as being concerned with improved stakeholder performance. Viewed from these perspectives, corporate governance is all about accountability, boards, disclosure, investor involvement and related issues. Research has shown that ''firms with stronger shareholder rights had higher firm value, higher profits, higher sales growth, lower capital expenditure and less corporate acquisition (McRitchie, 2001).

From the foregoing, it is apparent that no matter the angle from which corporate governance is viewed, there is always a common consensus that corporate governance is concerned with improving stakeholder value, and that governance and management should be mutually reinforcing in working towards the realization of that objective. Sheifer and Vishny (1997) corporate governance deals with ways in which suppliers of finance, to corporations, assure themselves of getting a return on their investment, thus OECD (1999) opines that corporate governance is the system by which business corporations are directed and controlled. That the corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provide the structures through which the company objectives are set, and the means of attaining those objectives and monitoring performance.

Mathieson (2002) describes corporate governance as a field in economics that investigate how to secure or motivate efficient management of corporations by the use of incentive mechanism, such as contracts, organizational design and legislation. This is often limited to the question of improving financial performance i.e. profitability, for example, how the corporate owners can secure or motivate so that corporate manager will deliver a competitive rate of return.

Pandey (2006) asserts that corporate governance implies that the company would manage its affairs with diligence, transparency and accountability and would maximize shareholders wealth. Hence, it is required to design systems, process, procedures and structures and take decisions to augment its finance performance and shareholders' value in the long run. Akinsulire (2006) sees corporate governance a term covers all the general mechanism by which management are led to act in the best interest of the company owners. A perfect system of corporate governance would give management all the right incentives to make value maximizing investment and financing decision and would assure that cash is paid out to investors when the company runs out of viable projects i.e. investment with positive NPV

Corporate governance attracts a good deal of public interest, because of its importance to the economic health of corporations, groups, countries, and society at large. But because it covers a large number of economic phenomena, it has become a subject with many definitions, with each definition reflecting an understanding of, and in the domain of an economic phenomenon being considered. In general terms, however, corporate governance deals with the way corporate bodies utilize their funds to generate financial wealth for shareholders, and social wealth for the community in which they are located. This latter consideration is what has now become known as corporate social responsibility (CRS) of organizations.

So, essentially, corporate governance deals with issues of accountability, and fiduciary duty, in the main advocating the implementation of policies and mechanisms to ensure good behavior and

protect shareholders. There is also the perspective of economic efficiency, through which corporate governance should aim to optimize economic results with strong emphasis on shareholders welfare. Yet a third consideration accommodates the interest of all stakeholders, which call for more attention and accountability to players other than the shareholders; like the employees and the environment/ community, for examples. So, in short, corporate governance is about how an entity is managed or run.

A number of studies investigate the efficacy of firm governance structures in promoting performance. As pointed out by core, Holthnusen and Lacker (1999), collective evidence from these studies is mixed, failing to provide a coherent pictures of what constitution an optimal governance arrangement, nevertheless, this study investigates the effects and extend of corporate governance practice in some selected Nigerian quoted companies on overall firm values and performance also intends to uncover new results while confirming the keys finding and prediction of prior research.

The challenges and failures of corporate governance in Nigeria stems from the culture of corruption and lack of institutional capacity to implement the codes of conduct governing corporate governance. Company executives enjoy an atmosphere of lack of check and balances in the system to engage in gross misconduct since investors are not included in the governing structure. Policy and procedures required to ensure efficient internal controls are disregarded, a total lack of thorough selection process (of CEO and board members-round pegs in square holes) remain a challenge in Nigeria. The business cum shareholders interest is secondary to the self-interest of board members and management. Limited opportunities for institutional investors, and near zero interest in corporate social investments to demonstrate companies' sense of belongingness as evidenced in environmental pollution, are clear indicators of failures of corporate governance. Lack of managerial training and to shoulder several avoidable agency cost since the board of directors usually failed as a monitory device to minimize agency problems capacity development among Nigeria executives to manage business risk has resulted in huge agency costs, and shareholders have had to shoulder several avoidable agency cost since the board of directors usually failed as a monitory device to minimize agency problems.

Kojola (2009) examined corporate governance and firm value in Nigeria. The result reveals that there is significant relationship between Returns on Equity (ROE) and board size as well as chief executive status. Likewise, it further reveals a positive significant relationship between profit Margin (PM) and chief executive. Weisbach (1988), Heranlin and Weisbach (1991) examine agency theory and corporate governance. They observed that there is appositive relationship between firm value and the proportion of outside directors sitting on the board. But forberg (1989), Weisbach (1991), Bhaget and Black (2002) and Sanda et al (2005) argued that the relationship between board composition and the performance (Board Size and Outside director) measure is not statistically significant. The implication of this is the for sample firms, there is no relationship between the firms' financial performance and the outside directors sitting on the board.

Aragwal and knoeber (1996) in agency theory and corporate governance examine a range of governance variables within a simultaneous regressions framework and find that the proportion of outside directors on company's board is the only governance mechanism which consistently affects corporate value. However, the relationship is negative, suggesting the US firms have destroyed shareholder wealth by employing these directors. Weisbach (1988) and Warner et al, (1988) in agency theory and corporate governance, was of the view that, the most consistent empirical results in the corporate governance literature is that directors are mostly to lose their jobs if they are poor performers and find that it is only the very poorest performing management who lose their jobs and that is generally takes a prolonged period of poor performance to result in forced up executive turnover.

Ahmad (2002) examined the relationship between corporate governance and performance of banks in Pakistan, result revealed that from all variables stated in the model analyzed, market share variable has an impact on the performance of firms negatively, suggesting that firms in a less competitive environment might feel less pressure to control their costs. Burki and Niazi (2004) and Patti and Hardy (2005) further examined corporate governance and performance of commercial banks in Pakistan but analysis reveal that firms with larger assets size (i.e. state owned banks) give lower efficiency than the other peer groups of banks, i.e. private firms and foreign firms as the division of

banking sector stated. Their study revealed further that better liquidity management implies a better performance of the firms.

Bebehuk and cohaen (2004) also finds out that, board size, board composition, and whether the CEO is also the board chairman have shown that well governed firms have higher firm performance. Though there is a view that large board are better for corporate performance because they have a range of expertise to help make better decisions, and are harder for a powerful CEO to dominate. In a Nigerian study, sanda et al (2003) found that firm performance is positively related with small, as opposed to large boards.

Kyereboad-coleman (2007) examined the effort of corporate governance on the performance of firms Africa by using both market and accounting based performance measure. The study used unique data from 103 listed firms drawn from Ghana, South Africa, Nigeria, and Kenya covering the five year period 1997-2001. The analysis was carried out within the dynamic panel data framework. Their results indicate that the direction and the extent of impact of governance is dependent on the performance measure being examined. Specifically, the findings show that large and independent boards enhance firm value and that combining the positions of CEO and board chair has a negative impact on corporate performance. The study also finds that CEO's tenure in office enhances a firm's profitability while board activities intensify affects profitability negatively. The size of audit committees and the frequency of their meetings have positive influence on market based performance measures and that institutional shareholding enhances market valuation of firms. Finally, the results pointed out that sector characteristics influence the impact of governance on corporate performance. For enhance performance of corporate entities, the study recommended a clear separation of the positions of CEO and board chair and relatively independent audit committees should be maintained.

3.0 Methodology

This study adopted the *ex-post facto* research design to ascertain the impact of corporate governance on profitability of Nigerian banks. The data for this study was obtained from official sources. The annual financial statements of Access bank, First Bank, GT Bank, UBA and Zenith Bank Nigeria, Plcs were utilised for this study. Such published data is believed to be most authoritative and accessible documents for assessing the performance of the affected banks.

The population of this study comprises of 21 banks currently in operation in Nigeria. These are Access Bank Plc, Citibank Nigeria Limited, Diamond Bank Plc, Ecobank Nigeria Plc, Enterprise Bank, Fidelity Bank Plc, First City Monument Bank Plc, Guaranty Trust Bank Plc, Herirage Banking Company Ltd, Keystone Bank, Mainstreet Bank, Skye Bank Plc, Stanbic IBTC Bank Ltd, Standard Chartered Bank Nigeria Ltd, Sterling Bank Plc, Sun Trust Bank Nigeria Limited, Union Bank Nigeria Plc, United Bank for Africa Plc, Unity Bank Plc, Wema Bank and Zenith Bank Plc (from https://www.cbn.gov.ng/Supervision/Inst-DM.asp on 03/09/16). However, for this study, the sample size is made up five banks (Access Bank Nigeria Plc, First Bank Nigeria Plc, Guaranty Trust Bank Plc, United Bank Nigeria Plc and Zenith Bank Nigeria Plc). The sample size was purposively selected based on Forbes 2013 classified of the most branded banks in Nigeria (from www.forbes.org/banknigeria 2013 on 25/07/16).

Thus, the model is specified as shown below in equation 1.

$$y = a + bx + \mu \quad (1)$$

where:

Y	=	Dependent variable
X	=	Independent variable
a	=	Constant of the equation
b	=	Slope of the curve
μ	=	Error Term

Transforming the above model, we have;

PAT = f (BOD) (2)

Where:

PAT = Profit After tax

BOD = Board of Directors

Transforming equation (ii) into an econometric form, and including the control variable, we have:

$$LogPAT = a + b_1(LogBOD) + b_2(LogEMP) + \mu \quad (3)$$

Explanatory Model Variables

Dependent Variable - Profit after Tax (PAT)

The net amount earned by a business after taxation related expenses have been deducted. The profit after tax is often seen as a better measure of business earnings Hence it can be used in its operations than the total revenue since all deductions have been made. For this study, the profit after tax is in absolute value thus, we adopted the natural logarithm of profit after tax of the banks was adopted as a measure of performance.

Independent Variable

Board of Directors (BOD)

Codes of Corporate Governance for Banks in Nigeria Post Consolidation were issued by the Central Bank of Nigeria, the Securities and Exchange Commission's Code of Best Practice and the principles provide the basis for promoting sound corporate governance in Nigerian Bank. The number of members on the board is used to measure corporate governance. For this study we used the log of members on the board of directors.

Control Variable

Total Number of Bank Employees (EMP)

Employees are livewires of any organisation. The structure of any organisation determines the total number of staff employed. The total number of bank staff employed by the selected banks was used as a measure of structure in this study.

To test the hypotheses stated in this study, we employed the regression test statistic for the panel data. Panel data set is a set of observations that span both time and individuals in a cross-section, more information is available, giving estimates that are more efficient. With panel data, it was important for us to control for unobserved or unmeasurable sources of individual heterogeneity that vary across individuals but do not vary over time omitted variable bias. For the decision rule on the regression, the p-value will be employed. Whenever p-value (use is greater than here) < 0.05, the relationship under investigation is statistically significant otherwise insignificant. We also employed the correlation test statistic to explain the data set results. A correlation expresses the strength of linkage or co-occurrence between to variables in a single value between -1 and +1. A positive *r*-value expresses a positive relationship between the two variables (the larger A, the larger B) while a negative *r*-value indicates a negative relationship (the larger A, the smaller B). A correlation coefficient of zero indicates no relationship between the variables at all. However, correlations are limited to linear relationships between variables. Even if the correlation coefficient is zero, a non-linear relationship might exist.

4.0 Presentation and Analysis of Data

This section presents and analysis the data collated from the annual statements and accounts of the selected five banks in Nigeria. This comprises of the profit after tax, the number of members on the board as a measure of corporate governance and the number of employees as a control variable.

Table 4.1: Summary of Profit after Tax, Number of Board of Directors and Total number of Employees 2005-2015

Bank/Year	Profit after Tax (PAT) (N,000)	Number of Board of Directors (BOD)	Total number of employees (EMP)
Access Bank 2005	505,515.00	12	351
2006	737,149.00	12	484
2007	6,083,439.00	12	729
2008	16,056,464.00	14	1,067
2009	22,885,794.00	14	1,434
2010	12,931,441.00	14	1,317
2011	13,660,448.00	15	1,257
2012	36,353,643.00	15	2,896
2013	26,211,844.00	17	2,461
2014	42,520,929.00	16	2,721
2015	61,321,089.00	16	2,797
First Bank 2005	12,184,000.00	15	6,698
2006	19,831,000.00	20	7,053
2007	18,355,000.00	16	7,399
2008	30,473,000.00	16	8,495
2009	1,275,000.00	17	8,221
2010	26,936,000.00	16	7,598
2011	47,462,000.00	16	7,796
2012	71,144,000.00	19	7,915
2013	59,365,000.00	21	7,897
2014	79,351,000.00	21	8,176
2015	2,180,000.00	12	8,235
GTB 2005	5,330,796.00	10	990
2006	7,906,000.00	14	1,256
2007	13,013,000.00	11	1,617
2008	27,608,558	14	2,355
2009	23,848,061.00	11	2,566
2010	39,320,255.00	14	2,672
2011	51,741,620.00	14	2,714
2012	85,264,000.00	14	2,813
2013	85,545,510.00	14	3,149
2014	89,170,777.00	14	3,234
2015	94,308,123.00	16	3,343
UBA 2005	4,921,000.00	19	3,787
2006	11,550,000.00	14	4,659
2007	19,831,000.00	14	4,639
2008	40,002,000.00	20	5,615
2009	12,889,000.00	20	11791
2010	12,889,000.00	19	12,891
2011	(7,966,000.00)	21	9,844
2012	47,375,000.00	18	9,035
2013	46,483,000.00	18	10,295
2014	40,083,000.00	18	9,930
2015	47,642,000.00	18	9,795
Zenith Bank 2005	7,155,926.00	12	2,627
2006	11,488,800.00	12	3,911
2007	17,509,145.00	14	4,966
2008	46,524,991.00	14	7,150
2009	18,365,000.00	14	7,393
2010	32,305,000.00	13	7,190
2011	41,301,000.00	13	7,783
2012	95,803,000.00	13	7,158
2013	83,414,000.00	15	6,615
2014	92,479,000.00	12	6,342
2015	98,784,000.00	12	6,286

Source: Annual Statement and Accounts of Selected Banks 2005-2015

Table 4.2 presents the correlation results of the model.

Table 4.2: Correlation Results

	LOGPAT	LOGBOD	LOGEMP
LOGPAT	1		
LOGBOD	0.284	1	
LOGEMP	0.473	0.551	1

Source: Researcher's E-view 9 Results

As indicated from table 4.2, there is a positive relationship between profitability of Nigerian banks and corporate governance measured by number of members in the board of Nigerian banks (r = 0.284) and also there was a positive relationship between profitability of Nigerian banks and the number of employees (r= 0.473). Again, there was a positive relationship between corporate governance measured by number of members in the board and number of employees (r= 0.551).

Table 4.3 presents the regression results of the model.

Table 4.3: Regression Result

Dependent Variable: LOGPAT Method: Least Squares Sample: 1 55 Included observations: 54				
Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
LOGBOD	3.883100	0.772435	5.027088	0.0000
LOGEMP	0.773953	0.250847	3.085362	0.0033
R-squared	0.731942	Mean dependent var		16.92828
Adjusted R-squared	0.723710	S.D. dependent var		1.208623
S.E. of regression	1.298193	Akaike info criterion		3.396157
Sum squared resid	87.63583	Schwarz criterion		3.469823
Log likelihood	89.69624	Hannan-Quinn criter.		3.424567
Durbin-Watson stat	0.890535			

Source: Researcher' E-view 9 Result

As revealed from table 4.3, corporate governance measured by number of members on the board had a positive and significant impact on profitability of Nigerian banks (LogBOD coefficient = 3.88, p-value – 0.00 <0.05, t-value = 5.02). Again, the number of employees had positive and significant impact on profitability of Nigerian banks (LogEMP coefficient = 0.77, p-value = 0.00 <0.05, t-value = 3.08). The R-squared which showed the goodness of fit of the model shows that 73.2% of variation observed in the dependent variable (profitability was explained by variation in the independent variable measured by corporate governance. This was properly adjusted to 72.3%.

5.0 Conclusion and Recommendations

The study reveals that corporate governance indicator (board of director) have appreciable positive effect on profitability of Nigerian banks within the period of this study. Better corporate governance leads to higher return on equity and greater efficiency. Because most of the banks are now been publicly quoted and so obliged to make their financial performance public. It means that accountability and transparency will be of interest to the management of these firms.

Some of the Nigeria banks already have foreign investors and as the Nigerian banks opens up to international investors, the firms that try to improve their corporate governance rating will have much to gain. The banks that adopt best practices will get the most interest from international investors, the more Nigerian banks reach out to global investors, and the greater the pressure will be to adopt corporate governance best practices

Based on the result of this study we thus recommend that proper attention should be paid for mass enlightenment on corporate governance, in this part of the world corporate governance is relatively a new concept and even some company directors are not fully aware of the enormous responsibility of a director.

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