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Effect of Corporate Governance on the Financial Performance of Listed Deposit Money Banks (DMBS) in Nigeria

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Abstract: *The study examined how corporate governance influence financial performance of listed deposit money banks in Nigeria from 2011 to 2020. Archived secondary data explored and collated via purposive sampling were tested for robustness, skewness and kurtosis and found fit for purpose. The Multiple Regression Analysis results of General Least Square-random effect (as selected by Hausman specification test) shows that, Corporate governance as set and dictated by the Nigerian Code of Corporate Governance under the auspices of the Financial Reporting Council of Nigeria as amended in 2018 by the Federal Executive Council of Nigeria determines to some extent the position of the returns on assets of the listed DMBs in Nigeria. Thus, the fluctuations of the NCCG practice in Nigerian Bank does result in high or low returns accruing to the DMBs in Nigeria. Therefore, the Financial Reporting Council of Nigeria's committee on corporate governance is advised to set a more inclusive, effective, thoughtful and more flexible code of corporate governance in other to improve the financial performance of DMBs in the short-run and the Nigerian economy in the long run.*

Keywords: *Corporate Governance, Financial Performance, Deposit Money Banks.*

1.1 Introduction

The COVID-19 fueled economic contraction in 2020 and the ones witnessed in the last few decades led to a large number of corporate scandals and corporate failures in financial and service institutions across the world. Corporate governance is a central issue to these financial scandal and corporate failures as it portrays an inefficient corporate governance mechanism, and hence, taken in to consideration for further investigation by scholars as well as investors (Nodeh, Anuar, Ramakrishnan & Raftnia, 2016). Investigations into the causes and conditions of the scandals have yielded mixed results due to the multifaceted and endemic nature of weak corporate governance structure.

Entrusting unlimited authority to executives also provide desirable ground for abuse of trust in tune with the maxim, absolute power corrupts absolutely; all these conditions among others are some of the factors that contribute to scandals in big companies around the world. To mitigate such situations, efficient corporate governance mechanisms should be put in place by stakeholders through regular monitoring and auditing of the executive management for their stewardship intermittently; this process of holding corporate managers to account for their stewardship by stakeholders in other to checkmate corporate excesses is known as corporate governance. KPMG (2017) recognizes that good corporate governance is a key driver in the establishment of sustainable enterprise; hence, alignment with leading corporate governance practices will guide companies in establishing a framework of processes and attitudes that increases their value, builds their reputation and ensures their long term prosperity.

Corporate governance is a system by which corporations are governed and controlled with a view to increasing shareholders value and meeting the expectations of the stakeholders (Garko, 2014). However, it was explained as the process and structure used to direct and control the affairs of companies for promoting business prosperity and corporate accountability. In Nigeria, the first attempt to provide a code of corporate governance for public companies was in 2003 when the Code of Corporate Governance for Public Companies was issued by Securities and Exchange Commission (SEC), to supplement the existing legal framework of corporate governance principles, particularly the Companies and Allied Matters Act (CAMA), 2004, and other statutory provisions; however, the inadequacies that became apparent in the implementation of the SEC 2003 Code of NCCG 2018, led to the new code which was brought into force in 2011 and 2018. The 2011 Code applies to all public companies that are listed on the Nigerian Stock Exchange (NSE), as well as those companies seeking to raise funds from the Nigerian capital market. The main objective of the Code of Corporate Governance for Public Companies 2011 is to promote good corporate governance practices in public companies in Nigeria and align the Code with international best practices. The ultimate objective of CG (Corporate Governance) is the realization of long-term shareholder value while taking into account the interest of other stakeholders (Nigerian Code of Corporate Governance, 2018). The NCCG endorses that corporate governing bodies for businesses should be comprised of an appropriate balance of knowledge, diversity, and independence for discharging their duties objectively and more efficiently.

Jensen and Meckling (1976) defined such problem (Corporate governance and Performance) as a principal-agent problem which could affect firm performance and value, where the principal is the shareholder and the agent is the manager. Taking these conflicts into consideration, rules and guidelines are needed to make sure that firms are well governed and directed to achieve success and stability, as without such guidelines and regulations these conflicts will affect firm performance. Understanding different aspects of performance measurement and choosing relevant measures are important for pursuing research objectives. Performance measurements offer insights into appropriate measures for answering research questions. However, it is not always agreed as to what performance measures should be employed and used (Haniffa & Hudaib, 2006). There are various measures which have been used regularly in past researches as a measure for firm performance (value ratio, labour productivity, net present value, market-to-book value, and earnings per share); however, the measures of performance for the purpose of this thesis is divided into two major groups: market measures and accounting measures, specifically Tobin's Q and ROA (Farhat, 2014). The outcomes obtained in the collected works are neither conclusive nor definitive and, accordingly, the contribution of new evidence will improve the state of knowledge vis-à-vis the questions raised in this thesis, in essence, whether the composition of the corporate governance structure gives priority to the functions of supervision and, furthermore, determining if that composition affects the performance of the firm.

The concept of firm performance is of vital importance to accounting research because explaining variation in performance is the core focus in this study. Firm performance is conceived as a multidimensional concept that comprises different aspect and metrics such as financial performance, operational effectiveness, corporate reputation and organizational survival (Richard, Devinney, Yip, & Johnson, 2009). According to Gentry and Shen (2010), firm performance has also been classified into two dimensions, financial (which is the focus of this study is viewed as the fulfilment of economic goals of the firm) and non-financial performance (customer satisfaction, quality of output, attitudes of employees, innovation, among others). Historically, researchers in the early 1980s used accounting based profitability ratios such as ROA, ROCE and ROE as measures of financial performance until the mid-1980s, finance theories (clean surplus, stock valuation among others) and market based performance measures (most common stock market-based measures of performance are: share price, stock return, market to book ratio, price to earnings ratio and Tobin's Q) were introduced into management research (see Bromiley, 1990 as cited in Gentry and Shen, 2010) many companies began adopting shareholder value maximization as the stated objective following the rise of shareholder activism in the 1990 (Useem, 1993). This development gave rise to the adoption of market based performance measures in management research and its subsequent use since then (Hoskinsson, Hitt, Wan, & Yiu, 1999; Gentry & Shen, 2010). These authors (Hoskisson *et al*., 1999; Gentry and Shen, 2010) noted that organizational researchers generally use either some of the most popular and most common accounting-based measures of profitability (such as revenues, operating income, earnings before interest and tax, net income, comprehensive income, earnings per share, or ratios such as return on assets (ROA), return on investment (ROI), return on equity (ROE), return on sales (ROS) among others) or market based performance measures (such as share price, stock return, market to book ratio, price to earnings ratio, Tobin's Q among others). Ratios are designed to improve the usefulness of performance indicators since absolute line item amounts from the income statement line may not be sufficient for meaningful comparison; however, there is no consensus about the relationship between past/short-term performance and future/long term performance.

It is against these background and considering the huge amount of resources in form of agency costs that shareholders commit to good corporate governance structure for the sake of sustainability and posterity vis-à-vis performance that this study examine the effect of corporate governance on the financial performance of listed Deposit Money Banks (DMBs) in Nigeria.

2.0 Review of related literature

Most of the empirical literature on the Corporate governance practices and performance are focused on developed countries and developed capital markets such as the works of Lima, Dob, and Vu, (2020); Rajkovic, (2020); Lu and Zhu, (2020); Li, Li, and Xie, (2020); Nodeh, et al., (2016); and Farhat (2014). The findings of these studies may not be applicable to African countries including Nigeria which have different regulatory and cultural environments. By contrast, a limited number of research studies have examined disclosure practices of companies in developing economies such as Amedu, (2016); Garko, (2014) among others. The findings of these studies are mixed. Some scholars like, Gul and Leung (2004) and Wallace and Naser (1995) argue that socio-economic and political environments between countries, organizational structures and construction of corporate disclosure indices may also lead to different results between corporate governance mechanisms and corporate performance. As a result, an investigation, in other settings of corporate governance that correlate with the extent of performance disclosure seems justified. A further motivation for this study was to examine whether the variables that researchers have found to be significant in explaining performance of companies in developed countries also apply in a developing country like Nigeria.

Although, in Nigeria, Amedu (2016) examines the impact of CEO Power on Company Performance in Nigeria Nigerian quoted firm for the year 2016, with corporate governance element utilized as proxies foe CEO power and Tobin's Q and ROA as proxies for performance, in a cross-sectional study that used hierarchical regression analysis and survey research strategy. However, this study differs from Amedu (2016) in terms of the variables examined, scope covered and in the aspect of the unit of the study, domain, and methodology. Again, this study covered the period 2010 to 2019 as against the period 2016 covered by the study of Amedu (2016). Moreover, the findings in Amedu's study is generalized on Nigerian quoted firms, hence making it difficult to ascertain the effect of corporate governance element (CEO power) on performance due to industry basis. This study in addition to the explanatory variables used by Nigerian and other developed economies corporate governance disclosure studies also uses institutional share ownership, audit committee composition and audit committee meetings as explanatory variables which are not covered by most of the Nigerian corporate governance studies. The volatile nature of Nigeria's economy and how some corporate governance decision affects the profitability of DMBs and given the huge role the DMBs play in balancing between both the aisle of the Nigerian economy (lenders and depositors) and considering the fact that CBN has now taken over most of that responsibility by providing interest free loan and other similar frequent interventions due to COVID 19 among others are some of the problems that this study intends to investigate on how all these affects profitability of listed DMBs as a service to basic research and a quest to extend the barrier of knowledge in accounting and finance discipline.

Developing countries are often faced with a myriad of problems, such as underdeveloped and illiquid stock markets, economic uncertainties, weak legal controls and investor protection, frequent government intervention, weak financial markets, ineffective legal system, weak corporate governance, predominance of concentrated shareholding, low information disclosure level and desire to maintain control over firms by the majority shareholder in connivance with firm managers; however, in Nigeria, it is not the lack of corporate governance structures that is the issue, but their appropriateness, as well as the effectiveness of monitoring the compliance mechanisms (Garko, 2014). These structural characteristics, demand effective corporate governance in these countries (Gonenc & Aybar, 2006). It is suggested by Okike (2007), that corruption fueled by unreliable audit firm is a major obstacle to the enforcement of standards in Nigeria. Nigerian stakeholders see that some auditors are unreliable because they connive with management to defraud their companies (Okike 1986, 2007). The recent events that follows the aftermath of the 2009 world financial crisis involving the much publicized corporate governance failure in Nigeria's banking sector (that led to collapse, merger, acquisition and eventual recapitalization order of a minimum of ₦25 billion by the CBN) reveal common trends in the affected institutions; this makes investors and other stakeholders to lose faith in most organizations, resulting in a negative effect on total assets, turnover and the profitability potentials of organizations (Garko, 2014). The reasons being the pervading culture of corruption and lack of institutional capacity to implement a credible code of corporate governance, that has also earned Nigeria a bad reputation and made private and institutional investors (local and foreign) hesitant to invest in the Nigerian economy due to the lack of transparency, accountability and disclosure and set an obstacle to the international capital flow toward the Nigerian economy (Garko, 2014). These postulations made provides the need for more investigations into the corporate governance culture in Nigeria's DMBs and how it impacts profitability of the firms. Hence, using different variables, methods, scope, and domain, among others; the need to reinvestigate corporate governance structure elements and how it affects profitability in Nigeria (a developing country) are some of the problems identified in line with the philosophy of positivism and critical realism. It is against these background and considering the huge economic importance of the corporate governance structure on the profitability of all the firms in various domains in the economy and the raising insecurity bedeviling Nigeria as a result of variants of socio-economic problems that this study examines the impact of corporate governance decisions on the performance of listed DMBs in Nigeria.

Therefore, this study distinguishes itself from prior studies in many aspects, among which are: First the study contributes to two streams of literature, the performance literature and corporate governance literature, by providing up to date empirical evidence on the association between Corporate governance and performance in emerging markets - Nigeria where corporate governance studies are relatively limited compared to developed countries. Therefore, based on the above statement of problem, the following hypotheses are raised:

H_{01} Board characteristics (board size) does not significantly affects the performance of listed deposit money banks in Nigeria.

H_{02} Board characteristics (board composition) does not significantly influence the performance of listed deposit money banks in Nigeria.

Considering the fact that this study is longitudinal in nature, the scope in time for this study is ten years, from 2011 to 2020; this is because it's during this stated period in scope that Nigeria witnessed the effects of the 2008 recession that affects the world economy till 2012 together with the recent COVID 19 fueled recession of 2019 and considering the fact that, ten years is enough to capture the full cyclical changes in the Nigerian economy.

3.0 Methodology

The research study utilized a secondary source of data obtained from the Audited Annual Reports and Accounts of the listed Deposit Money Banks for the period of ten (10) years. An archival-longitudinal strategy was utilized in the study bearing in mind the nature of the data and the study. A judgmental/purposive sampling technique was used to arrive at a working sample of the DMBs from the total population due to the fact that, not all the banks are listed during the course of the study scope. Multiple regression analysis was employed to predict whether the predictor variables namely Board size, and Board composition (proxies for corporate governance) have significant impact or not on the outcome (dependent) variable return on assets (proxy for firm performance). The hypotheses were tested using multiple regression with the aid of the latest version of STATA 16. The research paradigm for this work is epistemology, it is supported by positivism and critical realism philosophies.

4.0 Results and Discussion

The normal p-plot of the regression standardized residual (see Appendix B) indicates a good fit and does not suggest the presence of many outliers among the regression standardized residuals. In other words, the points on the plot do not appear to deviate significantly from the line of best fit indicating that the normality assumption is valid and fulfilled. The VIF in excess of 10 should be taken as an indication of harmful Multicollinearity (Neter, Wasserman, & Kutner, 1989 and Gujarati, 2003). Therefore, Multi-collinearity test carried out to check whether there is a sequential correlation between independent variables which will mislead the result of the study shows that the maximum VIF is 1.36, average is 1.26 and the minimum VIF is 1.15 and this is less than 10 which indicate absence of Multi-collinearity (See Appendix B). Skewness and Kurtosis test carried out on all the variables indicates that, none of the variables were highly skewed with a value of 0.32, 0.73 and 0.06 respectively (Appendix B). The results of the tests therefore affirm that the dependent variable data of the research did not differ significantly from a normal distribution, as evidenced by the normal Skewness and Kurtosis test. Hence, there is no need to normalize the variable data found to be highly skewed using Winsorization by limiting extreme values in the statistical data to reduce the effect of possibly spurious outliers.

The result of Breusch-pagan/Cook-Weisberg test for heteroscedasticity reveals that errors have non-constant variance (it is heteroskedastic and not homoscedastic), which indicates that the OLS estimators will have the maximum variance of all unbiased estimators, and also the P-values will not be reliable. This is evidenced by the significant probability (p-value) of the chi square of 0.000 (See Appendix B). This signifies presence of heteroscedasticity and absence of homoscedasticity in the model (Garko, 2014). OLS is no longer an unbiased estimator when heteroscedasticity is present (Gujarati, 2003). As a result, we can no longer rely on the conventionally computed confidence intervals, hence, the presence of Heteroscedasticity in the model suggests the need to add weight to the variables, hence, we adopt the GLS. The fact that there is a trade-off between the efficiency of the random effect (RE) approach and the consistency of the fixed effect (FE) approach, the Hausmann specification test is performed to decide between fixed or random effect models. The result of the test reveals that the two model (Fixed and random effect) are not correlated with chi-square probability (p-value) of 0.035 at 5% and 10% significance level and that the difference in coefficient is asymptotic, hence, the random effect model cannot be rejected as shown in Appendix B. From the results of the robustness tests performed to determine the accuracy and reliability of research data used in testing the study hypotheses, it shows that the data is free of regression errors capable of invalidating the research's regression assumptions. In other words, the data is suitable and the regression estimates obtained are reliable.

The GLS random effect regression results reveal the cumulative R^2 (0.37) which is the multiple coefficient of determination that gives the proportion or percentage of the total variation in the dependent variable (firm performance) explained by the corporate governance (Garko, 2014). Hence, it signifies that 37% of the total variation in profitability of listed deposit money banks on the Nigerian Stock Exchange are caused by board size, and board composition, while the remaining 63% of the total variation in the firm performance (proxied by return on assets) are caused by factors not explained by the model. This indicates that the model is fit and the variable are properly selected, combined and used. This can be confirmed by the p-value statistics of 0.002 at 5% level of significance, confirming the rejection of the null hypotheses and acceptance of the alternate hypotheses, that, corporate governance (as proxied by board size and board composition) have significant impact on the performance of listed deposit money banks in Nigeria.

5.0 Conclusion and Recommendation

Corporate governance as set and dictated by the Nigerian Code of Corporate Governance under the auspices of the Financial Reporting Council of Nigeria as amended in 2018 by the Federal Executive Council of Nigeria determines to some extent the position of the returns on assets of the listed DMBs in Nigeria. Thus, the fluctuations of the NCCG practice in Nigerian Bank does result in high or low returns accruing to the DMBs in Nigeria. Therefore, the Financial Reporting Council of Nigeria's committee on corporate governance is advised to set a more inclusive, effective, thoughtful and more flexible code of corporate governance in other to improve the performance of DMBs in the short-run and the Nigerian economy in the long run.

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