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The Impact of Corporate Governance Mechanism on the Performance of Banks in Nigeria

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BSTRACT

The objective of this paper is to critically assess the impact corporate governance mechanism on bank performance in Nigeria using content analysis was used in on corporate governance mechanism such as board composition, board size, ceo chairman duality on the other hand empirical studies were also reviewed on bank performance, the study recommend the need for more to be done to strengthen the effectiveness of the corporate governance mechanism further studies should focus on the tenure of chief executive.

Keyword : Corporate governance Mechanism, Bank Performance , Corporate Governance

INTRODUCTION

Corporate governance plays a vital role towards the development of both public and private organizations. This is because of the fact that it attracts foreign Direct Investment, resulting from globalization. It also allows for the transfer of modern information and communication technologies (ICTs) and capital inflow from private investors across the globe. Despite the significance of corporate governance, it is not held in Nigeria with the esteem that is in consonance to its significance in the area of economic development. Hence, it has been identified as one of the major problems facing developing countries, Nigeria inclusive.

In the Nigerian context, ineffective corporate governance has become a subject matter of public discourse both at national and international levels. The lack of the desired corporate governance mechanism has been identified as the major problem that causes economic backwardness and stagnation in the country. This has been attributed to decades of military dictatorship the country experienced over the years. However the return of democracy in 1999 marks a significant landmark achievement towards the implementation of the code of good corporate governance in the public and the private sectors of the economy.

Given the need for the development of the Nigerian economy, there have been calls for good corporate governance as it plays a vital role in the development of the financial sector and the economy as a whole. However, little is known about corporate governance in the banking industry. Most of the researches carried out in Nigeria on corporate governance focused on companies listed in the Nigerian stock exchange. Base on this premise, the study examines the impact of corporate governance mechanism on the performance of first generation banks in Nigeria.

In 2005 after the consolidation of the banking sector, poor corporate governance coupled with weak institutional capacity was identified as a major challenge in the Nigerian banking sector. Consequently, in an attempt to remedy the situation and strengthen the sector and the wider economic environment for Nigeria, the central bank of Nigeria issued code of corporate governance effective from April, 2006 aimed at ensuring sound corporate governance in the banking sector.

Over the years, the Nigerian financial sector has witnessed changes as a result of distress of banks due to poor corporate governance and reforms in the financial sector which aimed to ensure good corporate governance.

CONCEPTUAL FRAMEWORK

The major concepts which serve as the building blocks of this topic of discussion are corporate governance mechanism and banks. Therefore, under this section of the paper, attempt was made to clarify the said concepts.

CORPORATE GOVERNANCE

To begin with, corporation is a big company, or a group of companies acting together as a single organization. It can also be referred to as a group of people elected to govern a town or city. The first definition is the one relevant to this paper. Governance on the other hand, refers to having the power to control an organization or country. Therefore, corporate governance has to do with the power to control a company or a group of companies acting together as a single organization. The paper is interested in discussing corporate governance because it is very important in the survival of both private and public organizations.

This is because when it is effective, the organization stands the chance of being run with certain degree of trust and understanding between management and owners of the corporations. It is so because in an organization where corporate governance is effective, those at the helm of affairs are said to put the interest of the organization ahead of their personal interest. Consequent to this, there is every likely hood that there will be the existence of trust in the organization because the stakeholders of the organization will have the feeling that the management can do to them what they can do to themselves. This therefore means that corporate governance is the key to the survival and success of any organization. Hence, if it is ineffective, there is every tendency for the collapse of the organization.

CORPORATE GOVERNANCE MECHANISM

By corporate governance mechanism refers to those variables through which the power to control a company or group of companies can be measured. Some of these variables are discussed below:

BOARD COMPOSITION

The composition of board of directors refers to the ratio of non – executive directors to the executive directors. There are however divergent opinions among scholars on how best for a firm to constitute their board of directors. Some are of the opinion that when there are more non – executive directors the board is more independent, the reason being that they are considered more effective monitors of managers and predicts board effectiveness. Hence, as the proportion of non-executive directors on the board increases, firm performance should also increase (Adams and Mehran, 2005), (Marte Uadiale, 2010), (Bhagat and Black, 2000)

BOARD SIZE

(Adams and Mehran, 2005) found that board size are significantly higher in banking firm than in manufacturing firms which they argued is as a result of consolidation through merger and acquisition and nature of their operation which is different from the manufacturing firm, and claim that significant board size characterized their sample size.

CEO – CHAIRMAN DUALITY

The chief executive officer may be the same person holding the position of chairman. With chairman responsible to board of directors, while CEO responsible to the management of the company. There are divergent views as regards to which one is the best. (Dykes, 2003) in his view said CEO and chairman of board should be two different people, because it will prevent concentration of power in one hand and ensure accountability free flow of information for decision making of the board which agency cost tends to achieve. The UK code also stressed the need for the separation of CEO and chairman as well as clear identification of their responsibilities to avoid encroachment into functions of the other. As clearly stated in the Nigerian code of corporate governance, the position of chairman should be clearly separate from the CEO to prevent giving too much power to one individual

AUDIT COMMITTEES

The audit committee has been referred to as one of the important mechanism for achieving corporate governance and it is saddled with the responsibility of overseeing the financial reporting of the company through regular meeting with statutory auditors and financial manager, in the review of company's accounting policies, internal control systems and risk management. As such, the responsibility of ensuring high quality corporate governance lies not only on the board of directors but, also audit committee (Gramling and Hummason, 2006). It also serves as direct link through which board of directors and independent auditor communicated for ensuring effective corporate governance through provision of timely information for the decision in achieving corporate objectives (Puri, Tehran and Kakkar, 2010

CEO TENURE

The CEO tenure has become a subject of argument as such questions are raised on how long the CEO should stay in office. Some argued that when CEO stays long in office he/she will feel secure in his job and put his/her best in promoting shareholder's interest which will ultimately affect firm performance. On the contrary, some argued that, the longer his/her tenure in office the more he/she will concentrate on building empire in the firm, rather than enhancing the performance of the firm.

THEORETICAL FRAMEWORK

For the purpose of finding theoretical bearing for the study, agency theory was found more relevant for the study. Meaning that, the study was found to fit more neatly into agency theory, for the purpose of gaining sound theoretical bearing.

AGENCY THEORY

This theory seeks to explain the relationship between managers and owners (shareholders). This is with a view to ameliorate the incessant clash of interest between the two (agent and principal or owners and managers). Agency is a consensual relationship existing between two parties by which one, the agent, is expressly or impliedly authorized to act on behalf of another, the principal, in any dealings with third parties. An agent, therefore, is a person who is employed with, or for, the purpose of putting his/her employer (the principal) into legal relationship with third parties (Adesanya and Oloyede, 1972). According to this theory, a cordial relationship the two parties (agent and principal) would significantly improve the financial position of the organization. While on the other hand, if the agent pursue his/her personal interest at the expense of his/her principal, the relationship between them will be characterized by conflict of interest and mistrust. Consequently, the principal may institute some defiance mechanisms geared towards protecting him/her/their selves from any decision made by the agent (Jensen and Mackling, 1976).

At this point, it is worth nothing that agency theory is solely interested in revealing the idea of agency problem. By agency problem is a situation where the agent will carry out actions that are more beneficial to him/her than the principal, actions that are not desirable to the principal or actions that the habit of the principal cannot cope with. This kind of scenario is presumed by what is called information asymmetry. By information asymmetry means that the agent has a knowledge which the principal do not have and which necessitated his/ her appointment by the principal to act as his/her/their representative. Hence, the agent took the advantage of the ignorance of the principal and carry out actions detrimental to his/her interest. It is so because the agent is never willing to divorce what he/she knows to the principal. Agency theory views man as rational being that is selfish and not to be trusted (Yakasai, 2001). Rationality as attributed to man here, means that man is sensible and able to make decisions based on intelligent thinking rather than on emotion. Many scholars have suggested various sound corporate governance mechanisms that can help in reducing agency problems. The aim is to align the interest of managers and owners in order to achieve and maintain corporate governance.

EMPIRICAL REVIEW OF RELATED LITERATURE ON CORPORATE GOVERNANCE MECHANISM AND BANK PERFORMANCE

The review of related literature suggested that there is a positive association between firm performance and the proportion of non – executive directors. The studies concluded that it is as a result of their ability to challenge the chief executive. In recognition of their importance towards ensuring effective corporate governance, United Kingdom requires companies to have a minimum of three non – executive directors while in the USA non – executive directors should constitute at least a two third majority of board members. Some other views argued that there is no one best optional way of choosing board composition in the banking firm, that any attempt in choosing the board without considering the nature of operational features such as the bank ownership structure and environment could have a negative effect on the corporate governance. In the same vein, (Marte Uadiale, 2010), maintained that the non – executive directors have a positive impact on the firm performance.

On the other hand (Haniffa and Hudaib, 2006) in their study of 347 companies listed in Kuala Lumpur Stock Exchange reported that having a higher number of non executive directors does not affect the firm performance, irrespective of the performance variables used and the attributed it to the nature of developing countries where appointment of non executive directors is politically motivated. Not on merit as such, they lack the knowledge of their responsibility which will increase agency cost. This necessitated the suggestion for continued training of the non executive directors on their responsibility in order to discharge such effectively. In their study, Santiago and Baek, of 71 Latin American Firms Based in USA, board composition has no effect on firm performance using ROA as a measure of Firm Performance (Santiago, Castro and Baek, 2004).

(Cowman, 2004) claimed that, board that is relatively small in size, composed of people conversant and highly experienced in business and industry where company is operating as well as having balance in the ratio of executive and non executive directors tend to be more effective in its strategic process. While in a board with large number of people, there is tendency for the chairman and CEO to create power group that will dominate the decision making process.

(Weibach, 1988), (Rosentein and Wyatt, 1990), (Mehran, 1995), (John and Senbet, 1998), (Fosberg, 1989), (Ehikioya, 2009), (Ranti and Stephen, 2011) in their findings revealed no relationship between outside director and firm performance. Several researches conducted using data on the financial statements revealed no relationship firm performance and board independence, but research using return on share revealed relationship between board independence and company performance (Sunday, 2008). On the other hand (Uadiale, 2010) in his research revealed significant relationship between board size and firm financial performance more especially where there is higher composition of non executive directors. Bino and Tomar, in their study shows that board composition have a strong impact on banks performances using the data of 14 firms as sample listed on Amman Stock Exchange market over the period of 1997 – 2006 (Marte, Uadiale, 2010). There is also evidence that a higher proportion of outside directors on the board have a positive impact on firm financial performance (De Anders and Valledo, 2008). An optimum mix of executive and non executive directors is adequate to create value for the banks than excessively independent boards. New results show that, for the board to be independent, the proportion of outside directors also has a limit. Thus, a board with a balance between executive and non executive directors could carry out an efficient advising without overlooking the monitoring function. (Belkhir, 2009) in his research revealed that banks with higher insider ownership rely less on outside directors' representation on their boards, are less likely to have a CEO who is also the chairman of the board, and have larger boards. (Adams and Mehran, 2005), (Adams and Mehran, 2008) in their studies discovered that there is a positive relationship between board size and bank performance using Tobin Q as measure of performance. (Dehaene et al, 2001b) in their studies discovered relationship between board composition and corporate performance

(Mark and Li, 2001) in their studies argued that the number of outside directors is negatively related to managerial ownership, board size and government ownership. (Choi and Hassan, 2005) in their studies revealed that the proportion of outside directors does not have any significant effect on firm performance. (To and Thi, 2011) in their empirical findings, shows that independent directors enhance firm performance. The number of independent directors on the board has significant impact on firm value. (Paul et al, 2011) in their study saw no relationship between outside directors and firm performance using return on equity as major of performance. (Dehaene et al, 2001a) in their studies found that there is a significant positive relationship between ROE of a company and the number of external directors: the more external directors the better the performance. (Adams and Mehran, 2005 and 2008) found significant relationship between board composition and Tobin Q as measure of performance.

. (Dehaene et al, 2001a) maintained that there is a significant relationship between board size and firm performance. (Haniffa and Hudaib, 2006) found mixed results using Q ratio and ROA , the result using Q ratio revealed no significant relationship between firm performance and large board size which they argued was due to inability to monitor and cost to maintain, which will negatively impact firm performance. Similarly, the result of performance using ROA revealed that board has significant impact on firm performance because of its ability to provide firm with diversity, expertise and experience that can enhance the firm performance. (Marte, Uadiale, 2010) was of the view that, large board size, significantly affect firm performance and suggested for large board size. Also, (Kyeyereboah, Coleman and Biekpe, 2005a) examined the impact of corporate governance and firm performance in Africa using both Tobin and Accounting Ratio as variables for measuring performance, examine the data of 103 firms from Ghana, Nigeria, South Africa and Kenya covering 1997 – 2001. The result revealed that large board size has positive impact on firm performance. (Bino and Tomar) argued that board size has no effect on banks' performance. (Mang'unyi, 2011a) argued that if the board size is large, it will affect the decision making process. On the overall, this will have an impact on the financial performance of the firm. (Coles et al, 2001) said the relationship between board composition and firm performance using Economic Value Added (EVA) and Market Value Added (MVA) as a measure of performance, impact the relationship more significantly using (MVA). (Sakawa and Watanabel, 2011) found that a significant negative relationship exists between the board size and Tobin Q, this study is consistent with that of the US banking industry (Adams and Mehran, 2008). (De Anders and Vallelado, 2008b) saw positive relationship between board size and firm performance and caution against having oversized board because of the problem associated with decision making and coordination.

(Kyeyereboah, Coleman and Biekpe, 2005a) in their studies revealed that there is a positive relationship between board size and ROA regardless of listed or non listed bank. (Sanda et al, 2011) also found significant relationship between board size and firm performance and suggested ten individuals as the board size. (Kama and Chuku,) are also of the view that increasing new members on board has positive effect on bank performance while continuous increasing has negative impact on bank performance. (Tanko and Oladele), posited that there is a significant relationship between the board's size and firm performances. (Uadiale,

2010) maintained that there is a significant relationship between board size and firm financial performance more especially where there is composition of non executive directors. In order to formulate the hypothesis the assumption is that board size has positive effect on bank performance. In order to measure the size of the board, the study will use the number of members serving on the board.

. (Ehikioya, 2009) opined that companies where there is no duality tend to have minimal risk of bankruptcy, which in turn increase company's chance in raising additional capital. He went further to state that, separation of CEO and chairman will not only ensure check and balance in banks, but also reduces agency problem. (Levine, 2004) in her studies found mixed results, negative relationship between CEO duality and firm performance using ROE as measure of performance and significant relationship using ROCE as a measure of performance. (Dehaene et al, 2001b) in their studies revealed that, company where the CEO is not the chairman shows a higher performance in ROA.

(Kyereboah – coleman and Biekpe, 2006a) revealed that firm where CEO and chairman is the same person tend to have lower performance. (Cristina et al,) in their studies revealed that, banks where there is no separation between chairman and CEO shows low cost efficiency and lower return on asset (ROA). (Abor and Biekpe, 2007) in their study of SMRs in Ghana, reported statistically significant positive relationship between CEO duality and firm performance. (Sanda et al, 2005) suggested the separation of CEO from chairman because it promotes firm performance. (Adams and Mehran, 2008) reported that company where there is separation between chairman and CEO shows higher performance using ROA as measure of performance).

(Anderson, Mansi and Reeb, 2004) found that, lower cost of debt is highly correlated with independent audit committee. On the other hand, (Sunday, 2008) revealed that there is low correlation between ROE and audit committee using 20 non financial firms listed in the Nigerian Stock Exchange using 2000 – 2006 financial data. (Turlea, Mocanu and Carmen, 2010) identifies audit committee, internal audit and external audit as significant corporate governance mechanisms in promoting sound banking system. They are all independent of each other playing complementary role toward ensuring sound corporate governance. Internal audit functions to ensure compliance with its policies and procedures. While external auditor, provides important feedback on internal control efficacy by internal auditor. In turn, audit committee supervises the activities of both internal and external auditor. (Kyereboah – Coleman, Biekpe, 2006a and Daehaene et al, 2001a) asserted that, the size of audit committees and the frequency of their meetings have positive influence.

CONCLUSION

The rationale behind this study is to examine the impact of corporate governance mechanism on the performance of banks in Nigeria. Four characteristics of boards were studies Board size, board composition, CEO duality, CEO tenure, audit committee, return on asset and return on equity as measure of performance.

One of the major challenges facing Nigerian banking industry is the regulatory laxity and poor corporate governance. The audit conducted by CBN and NDIC in 2009 revealed how 2008 global economic recession is connected to Nigerian economy despite the pronouncement by the CBN governor that Nigeria is not exposed to global economy as well as poor corporate governance that have eaten deep into the fabric of Nigerian banking sector. The audit affected ten banks among which are top four big banks. One of the major actions taken was the sack of some top executives and their prosecution as a result of insider dealings due to poor corporate governance. Most of these CEOs spent more than ten years in office to such extent they become very powerful, they can do and undo. As a result, the CBN came up with a number of reforms among which are restrictions of the tenure of CEO to only ten years. Hence, there is a need for further research on the effect of CEO tenure on the bank performance.

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