Journal of Emerging Trends in Economics and Management Sciences (JETEMS) 3(3): 257-260
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jetems.scholarlinkresearch.org

Impact of Corporate Governance on Banks Performance in Nigeria

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Abstract
The research study considered the impact of corporate governance on the performance of banks in Nigeria. The increased incidence of bank failure in the recent period generated the current literature on quality of bank assets and also emphasized good governance as means of achieving banks objectives. This study made use of secondary data obtained from the financial reports of nine (9) banks for a period of ten (10) years (2001- 2010). Data were analyzed using multiple regression analysis. The study supported the hypothesis that corporate governance positively affects performance of banks. In conclusion, the study shows that poor asset quality (defined as the ratio of non-performing loan to credit) and loan deposit ratios negatively affect financial performance and vice visa.

Keywords: corporate governance, bank performance, and asset quality

INTRODUCTION

Corporate financial reporting provides fundamental information to a wide range of policy makers in both the corporate and non-corporate sectors of the economy – shareholders, management, government, creditors and society at large. This information is a vital input to effective and efficient management, and requires attention in practices. More specifically, a dynamic and competing financial institution environment calls for improved observations, measurement and transparent disclosure of operations. The consequences of institutional failure (considering the multiplier effect of financial institutional failure on the real sector of the economy) are unacceptably costly to a developing country like Nigeria. This affects the level of confidence the public has in various corporate establishments. The consequences of ineffective governance systems leading to corporate failure will not only affect the shareholders but also, the employees, suppliers, consumers and the nation as a whole. Thus, a governance system that will promote ethical value, professionalism and transparent application of best practices is desirable.

Corporate governance involves a system by which governing institutions and all other organizations relate to their communities and stakeholders to improve their quality of life. (Ato, 2002). It is therefore important that good corporate governance ensures transparency, accountability and fairness in reporting. In this regard, corporate governance is not only concerned with corporate efficiency, it relates to a much wider range of company strategies and life cycle development. (Mayer, 2007). It is also concerned with the ways parties (stake holders) interested in the wellbeing of firms ensure that managers and other insiders adopt mechanism to safeguard the interest of the shareholders. (Ahmadu and Tukur, 2005). Corporate governance is based on the level of corporate responsibility a company exhibits with regard to accountability, transparency and ethical values.

The management has multiple objective functions to optimize which might conflict with those of the shareholders. In the search for a set of socially legitimate objective functions that would resolve these conflicts, management may focus on short term outcomes and loses sight of ethical issues such as efficient corporate management, professionalism, transparency, accountability, compliance with regulatory requirements and adequate supervision. Inadequate consideration for ethical values and good governance hinders banks' performance as experienced in the failures of All States Trust Bank Plc, Lead Bank Plc, Assurance Bank Nigeria Limited, Trade Bank Plc, Metropolitan Bank Limited, City Express Bank Limited, Hallmark Bank Plc., Societe Generale Bank of Nigeria Plc., African Express Bank Plc., Gulf Bank of Nigeria Plc etc. Whose licenses were revoked by the Central Bank of Nigeria (CBN) in 2006 and the recent failures of Intercontinental Bank Plc, Oceanic Bank Ltd, Bank PHB in 2011.

The impact of good governance on a firms' reputation cannot be over emphasized. Good corporate governance promotes goodwill and confidence in the financial system. Recent studies from academic researches shows that good corporate governance lead to increased valuation, higher profit, higher sales growth and lower capital expenditure. (Wolfgang, 2003). This view was supported by Gompers et al (2003), Klapper and Love (2004).

Sound corporate governance, therefore, enhances corporate performance, value as well as providing meaningful and reliable financial report on firms operations.

Given this background, this study examines the efficacy of corporate governance with a view to determine its impact on firms' performance and provides measures to enhance corporate financial performance and sound business practices. The following is a layout of the study: review of literature in section two. Outline of the method of analysis in section three. Section four analyses data obtained and discuss the results. Section five concludes and makes recommendations for further studies.

LITERATURE REVIEW

The experience of business failure and financial scandals around the world brought about the need for good governance practices. The United States of American, Brazil, Canada, Germany, France, England, Nigeria all witnessed financial failures in the 90s and in recent periods. This view was supported by Bell et al (2000), that the last 20 years witnessed several bank failures throughout the world. Financial distresses in most of these countries were attributed to a high incidence of non - performing loans, weak management and poor credit policy. In the view of Omankhanlen (2011), the development was said to have reflected the deterioration in the quality of credit facilities, coupled with the ongoing reclassification of bank assets.

The banking institution occupies a vital position in the stability of the nation's economy. It plays essential roles on fund mobilization, credit allocation, payment and settlement system as well as monetary policy implementation. Management is expected to exhibit good governance practices to ensure achievement of it objectives and avoid the consequences of failure leading to loss of confidence. This view was supported by Wilson (2006) that poor corporate governance can lead market to lose confidence in the inability of a bank to properly manage it assets and liability, including deposits which could in turn trigger a bank liquidity crisis. Oluyemi (2005) considered corporate governance to be of special importance in ensuring stability of the economy and successful realization of bank strategies. In achieving this, strict compliance to standards of lending high risky loan should be adequately secured.

Deposits as major sources of income need to be well managed in a culture that depicts good banking practices and high transparency level to safeguard the integrity of the banks. Alan Greenspan (2001) noted that most bad loans were made through aggressive lending without considering credit worthiness of the borrowers and the significance of collateral. An unfortunate situation is the return of collateral of high risky loans to borrowers while loan is yet to be repaid

METHODOLOGY OF THE STUDY

The target population for this study consists of 25 commercial banks in Nigeria representing both old and new generation banks. The sample study consisted of 9 banks selected based on accessibility to data. These banks include Access Bank Nig. Plc, First Bank of Nig Plc, Guarantee Trust Bank plc, Zenith Bank Plc, WEMA Bank Plc, United Bank for Africa, Eco Bank Plc, Diamond Bank Plc and Access Bank. The study made use of data obtained from the audited financial reports of those banks for a period of ten years (2001- 2010). Data were analyzed using multiple regression analysis.

HYPOTHESIS

- Ho: corporate governance does not positively affects performance of Nigerian banks.
- H_1: corporate governance positively affect performance of Nigerian banks

MODEL SPECIFICATION

The effect of corporate governance on financial performance of the Nigerian banks was estimated using panel data analytical method. Since the banks are heterogeneous, there are certain (unobserved) specific factors/characteristics that may explain financial performance other than the explanatory variables explicitly modeled. In this light, this analysis would employ random effect panel method which assumes heterogeneity in cross-sectional units under analysis. Furthermore, the method assumes that the unobserved characteristics are not correlated with the error term.

The random model is specified as follows:

$$FP_{it} = \alpha_i + \beta AQ_{it} + \delta LDR_{it} + \varepsilon_{it} \quad (1)$$

where:

FP_{it} = performance of bank *i* at time *t,* measured by return on asset (ROA)

βAQ_{it} = asset quality of bank *i* at time *t,* measured by non- performing loan to total credit.

ε_{it} = error term

α = constant

β, δ are coefficients

RESULTS OF ANALYSIS

The panel data regression, using STATA, shows that poor asset quality (defined as the ratio of non-performing loan to credit) and loan deposit ratios have negative effect on the financial performance. A unit increase in each of the asset quality and loan to deposit ratio reduces financial performance by 0.19 and 0.0001 respectively. Though, the effect of loan

deposit ratio is not significant, that of the asset quality is.

Moreover, the model of analysis, as specified above, explains financial performance in the light of the explanatory variables. The p-value of 0.002 of the chi-square test shows that the model (and explanatory variables used) explains the dependent variables.

The result of the analysis appears meaningful in the light of the literature. The higher the value of non-performing loan to credit advanced to their customer, the greater the loan provision required, and the less the return (profit after tax). Hence, the more financial performance (captured by return on asset) dips. The quality of corporate governance in the banking industry bears on the portion of its loan going bad. Thus, non-performing loan as a ratio of credit is an indicator of corporate governance quality. Continuous rise in non-performing loans depicts poor quality of governance. That is, the higher the non-performing loan ratio, the lower the corporate governance quality, and the poorer the financial performance. The regression output, showing the details, is presented in Appendix I.

CONCLUSION AND RECOMMENDATIONS

The survival and stability of any financial sector depends on the quality of its governance. In spite several reforms put to strengthen this sector, banks were still prone to failure. The loss associated with this failure is enormous on their reputation and industrial growth. Strong governance framework that enhances compliance and sanction non- compliance to corporate governance codes becomes imperative. Review of relevant literatures however, showed that court procedures, audit committee and board of directors' efficiency determine the effectiveness of compliance to the governance laws. Hence, more effort is desirable to ensure adequate compliance to corporate governance code, as well as it attractiveness and effectiveness in improving performance.

Both developed and developing economies were not immune against banking failure. The study depicted that poor loan policy and management of assets were to a large extent, contributory to bank failures. Thus, control processes that will safeguard the quality of their services and products should be secured in the interest of shareholders and market efficiency.

Conclusively, continuous review of the governance codes became imperative due to the complexity and constant changing environment of the banking sector in Nigeria. The international codes of corporate governance should be properly adopted to meet the need of Nigerian governance environment.

APPENDIX I

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Random-effects GLS regression                   Number of obs      =       100
Group variable: id                              Number of groups   =        10

R-sq:  within  = 0.1528                         Obs per group: min =        10
       between = 0.1475                                        avg =      10.0
       overall = 0.1425                                        max =        10

Random effects u_i ~ Gaussian                   Wald chi2(2)       =     16.69
corr(u_i, X)       = 0 (assumed)                Prob > chi2        =    0.0002
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roa	Coef.	Std. Err.	z	P>|z|	[95% Conf.	Interval]
asqcr	-.1936673	.04795	-4.04	0.000	-.2876476	-.0996871
ldr	-.0005564	.0462713	-0.01	0.990	-.0912466	.0901337
_cons	4.970895	2.453806	2.03	0.043	.1615233	9.780266
sigma_u	3.4220278					
sigma_e	9.2139075					
rho	.12121639	(fraction of variance due to u_i)				

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