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AN EVALUATION OF THE IMPACT OF CORPROATE ADMINISTRATIVE MECHANISM ON BANK PERFORMANCE INDICES IN EMERGING ECONOMIES: NIGERIA EXPERIENCE

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ABSTRACT

This paper evaluates the impact of corporate administrative mechanisms on the performance indices of Nigeria deposit Money Banks. The study examines three corporate governance indices namely: board size, board composition and audit committee and bank performance indices on a sample of ten (10) deposit money banks between 2005 and 2014. Data was analyzed using panel data method with the aid of E-view soft-ware package. The results revealed that, board size and composition have significant influence on the performance of banks in Nigeria, while the independence of the audit committee has negative effect. On the basis of the findings, we made the following recommendations amongst others: banks should assign more number of seats on the board to independent members in conformity with the Central Bank of Nigeria's code of corporate administration; banks are encouraged to adopt good corporate governance practices to improve performance and to protect the interest of shareholders.

KEYWORDS: Administrative, Bank, Corporate Governance, Indices, Performance

INTRODUCTION

The issue of corporate administrative mechanism widely referred to corporate governance has become as popular as topic of discussion. Many deposit money banks in Nigeria failed due to absence of good corporate governance. After the failure of banks in the 1990s, customers' confidence was eroded. This necessitated the institutional investors, board of directors and regulators to focus more on corporate governance. Recently there have been an explosion of research on corporate governance among which include: Albanise et al (1997), Cornet et al (2008), Yermarek, (1996), Klapper et al (2004), Adams and Mehran (2005), Larcker et al (2007).

This issue, according to Chow (1999), is a group of people getting together as one united body with task and responsibility to direct, control, and rule with authority. With collective efforts, this body is empowered to regulate, determine, restrain, curb and exercise the authority given to it. The principal players include are shareholders, management board of directors, regulators, employees etc. Worthy of note is that the global financial crisis is actually an important event that has provided many distractions to its collapse and consequently, international regulators are working hard to influence appropriate regulatory controls (Al-Manaseer et al, 2012).

Another important factor that has drawn increased attention to the issue in recent years is scandals and unexpected crises in many corporate organizations, which in some cases had abruptly terminated the existence of large corporate entities. The scandals and consequent failures of corporations such as Enron Incorporation, Polly Peck, WorldCom,

Johnson Matheys Bank, Bank of Credit and Commerce International, Barings Banks, and many others are all traced to several lapses associated with it and including conflicts of interest (Cadbury (1992); Adam and Mehran(2008). Effective corporate administration is of public importance for the society as a whole not only for the fact that it encourages the efficient use of scarce resources within the organization and the economy and also it promotes flow of resources to the most efficient sectors or entities. Al-Manaseer et al (2012) add that it helps managers to remain focused on improving performance and also provides a tool of choosing the best executive to control the scare resources.

The Basel Committee on Banking Supervision pronouncements which "Nigeria has also adopted in its Code of Corporate Administration for banks have drawn attention to the need to study and improve on the issue in the banking industry. The committee especially advocates a governance structure composed of a board of directors and senior management and believes that corporate administration is necessary to guarantee a sound monetary system, and, therefore, a country's economic development. Some empirical studies (Adams and Mehran, 2008; Lacker et al, 2007; Caprio et al; 2007) have concentrated on bank corporate administration because of its complex framework which encompasses a bank's shareholders, its managers and other employees and the board of directors. Banks also operate under a unique system of public oversight in the form of bank supervisors and a comprehensive body of banking laws and regulation. All these elements interact amongst themselves and these determine how well the performance of a bank will satisfy the desires of its shareholders, while also complying with public objectives and regulatory operations policies (Al-Manaseer et al, 2012).

The concern of this study, which defines its scopes, is that of corporate administration and the performance of Nigerian banks. As widely acknowledged in the literature, banks play a vital role in promoting economic growth and development of modern nation-states making Schumpeter (1934) to note it as a key agent in the process of development. Dyck (2000) summarizes that as financial intermediaries, and pivotal agents in the payment mechanism and conduit for transmission of monetary and fiscal policies to the real sector, banks act as a catalyst for economic growth and development. He added that their failure could spell doom for the national economy, supporting the position of Kanda (2000) that bank failures are widely perceived to have greater adverse effects on the economy and are thus considered more important than the failure of other businesses.

Development in the Nigerian financial sector in the last few years, have reinforced the need for greater concern for corporate administration in financial institutions in the country. The upsurge in the number of banks following deregulation and re-capitalization policies of the regulatory authorities; the failure of a significant number of banks with attendant agony suffered by many depositors/customers and the systematic threat to the economy; the dismissal and re-organization of management of many banks during the period really underscore the imperative for greater concern for corporate administrative mechanisms in banks.

CBN/NDIC (1995) posits that banks were severely distressed which was attributed to their poor condition largely to undue interference from board members in management and bad credit policy. These are clear attestation to the presence of serious corporate administrative problems in the country's banking sector. But in recent time, the Central Bank of Nigeria (CBN) and other regulatory authorities have deployed much sanitization efforts to contain the problems of distress in the banking sector in particular, but the manifestation of the corporate administrative problems in the nation's banking sector is the motivation of this study.

This study is intended to contribute to the ongoing debate on the subject matter of corporate administrative

mechanisms and bank performance. Although studies conducted in the developed nations are full of mixed findings. However, this study intends to reduce the knowledge gap between what is known in literature on corporate administrative mechanisms in the developed nations and the developing nations using Nigeria as a case study. The study focuses on testing whether there is significant impact of corporate governance mechanisms on performance of deposit money banks in Nigeria. In this respect, the study is streamlined thus: section two is on the review of empirical literature, section three is the research method and model specification, results presentation is the section four while section five is the discussion of findings, recommendations and conclusion.

REVIEW OF EMPIRICAL LITERATURE

Corporate administration encompasses the legal and regulatory framework governing the actions of firms/organizations, their internal policies and controls established by the institutions themselves. It is concerned with the decision-making at the heart of, and the highest level of an organization (Kajola, 2008). The issue of corporate administrative mechanism has attracted much attention that many studies have been carried out mainly to investigate how it affects the performance of corporate organizations. However, empirical evidence on the relationship between corporate administration and bank performance is mixed.

Yermack (1996) tested the effect of board size on the performance and management efficiency of firms using such dependent variables as Return on Assets and Return on sales as performance measures. The result was that there is an inverse relationship between board size and firm performance. Companies with large boards appear to use asset less efficiently and earn less profit. Arun and Turner (2004) studied the corporate administration of banks in developing economies and found that banking reforms can only be fully implemented and better performance achieved once prudential regulatory systems is in place. They pointed out that in developing economies, bank performance can be enhanced by privatization.

Cadbury (1992) and Chow (1999) asserted that large board size could be less effective than small boards. They added that increase in board's size occurs with increase in agency problems (such as director free-riding) within the board and the board becomes less effective. Their result differs from Kyereboah-Coleman and Biekpe (2005) and Al-Hawary (2011) who argued that large board size and its composition bring management skills and make it difficult for Chief Executive Officer to manipulate the board. There is empirical evidence on the existence of outside directors' influence on board. Kajola (2008) asserts that it plays positive role in boards monitoring and control function. The proponents of agency theory say that corporate administration should lead to higher stock price or better long-term performance, because managers are better supervised and agency costs are decreased. However, Kisenberg et al (1997) submit that the evidence of a positive association between corporate administration and firm performance may have little to do with the agency explanation.

Studies on board membership and structure on firm's value or performance generally show results either mixed or opposite to what would be expected from the agency cost argument. Weisback (1988), Resenstein and Dyck (2000), and John and Senbet (1998) found that there are better performances for firms with boards of directors dominated by outsiders. On the hand, Damb and Neubauer (1992) argue that there is no such relationship in terms of accounting profit or firm value. Also, Kanda (2000) find no relationship between the proportion of outside directors and various performance measures.

David (2010) has argued that although a larger board of directors is beneficial and increases the collection of expertise and resources accessible to a firm, however, it has several problems. Empirical studies on board size seem to provide the same conclusion that a fairly clear negative relationship appears to exist between board size and bank performance. Boards with too many members lead to problems of coordination, control, and flexibility in decision making. Eisenberg et at (1997) supporting Cadbury (1992) agree that large boards are less effective and also give excessive control to the Chief Executive Officer (CEO) and thereby harming efficiency. Jensen et al (2010) argue that as board size increases, boards' ability to monitor management decreases due to a greater ability to avoid an increase in decision-making time. In their studies, Yermack (1996) and Al-Hawary (2011) found negative correlation between board size and profitability. In Nigeria, Kajola (2008) reports that firm performance is positively correlated with small, as opposed to large boards. Similarly, Adams and Mehran (2008) also report that small size boards are positively related to high firm performance. The conclusion and summary of the findings are consistent with the notion that a large board is characteristic of weak corporate administrative posture which seems to affect banks' performance negatively.

David (2010) argues that enhancing directors' independence is intuitively appealing as a director with ties to a firm or its CEO would find it more difficult to turn down an excessive pay packet; challenge the rationale behind a proposed merger or bring to bear the skepticism necessary for effective monitoring. Moreover, the proponents of agency theory say that corporate administration should lead to higher stock prices or better long-term performance, since managers are better supervised and agency costs are decreased. However, Albanise et al (1997) submit that the evidence of a positive association between corporate administration and firm performance may have little to do with the agency explanation.

Empirical evidence suggests that more active and independent directors make better monitors. A number of studies find better stock returns and operating performance when outside directors hold a significant number of board seats (Cornet et al., 2008; and Tense et al 2010). Furthermore, Kajola (2008) found that companies perform better if boards include more outsiders and Klein (2002) found a lower presence of abnormal accruals when the board had more than a majority of outside directors. The above arguments and the findings of several empirical studies (e.g., Klein (2002) Adams and Mehran, (2008) John and Senbet(1998), Cornett et al. (2008); and Al-Manaseer et al, (2012) presupposes a positive relationship between banks performance and the number of independent board members.

A closer look at the results of various empirical studies on this subject indicates mixed findings. This means that, there is no consensus among authors. This study therefore intends to contribute to the ongoing debate by focusing on two widely accepted variables of performance that is return on asset and return on equity and to determine their relationships with two widely accepted corporate administrative mechanisms : Board size and board composition with Nigeria as reference point.

RESEARCH METHODS AND MODEL SPECIFICATION

Sources of Data

This study makes use of secondary data. The objective of this study is to evaluate the effects of corporate governance mechanisms on performance of deposit money banks in Nigeria. The corporate governance indices adopted in this study include board size, board composition and audit committee.

Hypothesis was formulated to test whether there is significant impact of corporate governance indices on bank

performance indices in Nigeria.

Population and Sampling Design

The population of the study is the twenty four (24) deposit money banks that emerge after the consolidation and recapitalization exercise in 2005 and subsequent merger and acquisition in 2007. The data for this study were derived from the audited account (financial statement) of ten (10) banks between 2005 and 2014. The sample of ten (10) banks was selected using the combination of non-probability sampling technique. Panel data methodology was adopted because it combined time series and cross sectional data.

Method of Data Analysis

The study adopted descriptive statistics, correlation coefficient, and panel (pooled) multiple regression analysis. The model is specified as follows

$Yr = A + \beta F\ if + eif$

Where

Yr = is the dependent variable

∂ = Constant

β = The coefficient of the explanatory variables

Fif = The independent variable

Eif = Error term

By adopting the model, we have ROA = $\partial + \beta_1 BS + \beta_2 BC + \beta_3 AC + eif$

Where

ROA = Return on Asset

BS = Board size

BC = Board composition

AC = Audit Committee (independent members)

In this study, the board size (BS) is taken to mean the number of directors on board, board composition (BC) is the proportion of outside directors on the board, while ROA is the net earning divided by total assets.

DATA ANALYSIS AND INTERPRETATION OF RESULTS

Table: 1

	ROA	BS	BC	AC
Mean	0.297420	0.850600	0.764050	0.57000
Median	0.158000	0.70000	0.71240	0.50000
Max	3.020000	1.00000	0.90045	1.50040
Min	0.031000	0.50000	0.500411	0.0000
Std. dev.	0.405176	0.124002	0.12046	0.212100

Table: 1 Cond.,

Skewness	3.40403	0.353290	0.254112	1.490467
Kurtosis	23.40244	2.06400	2.35402	7.61140
Jarg-Bera	940.621	5.44304	2.80241	135.724
Prob.	0.064000	0.055045	0.24110	0.0000
Sum	29.56100	84.0600	72.40012	57.00101
Sum sq. dev	16.11040	1.801100	1.08114	4.051400
Obs	100	100	100	100

Source: E-View, version 7.0

Correlation Coefficients among Variables

Table B: Test of Correlation of Variable

	ROA	BS	BC	AC
ROA	1.0000	-0.12411	-0.0514	-0.00510
BS	0.14211	1.0000	0.21340	-0.14204
BC	0.05224	0.21221	1.0000	0.09144
AC	-0.00411	-0.14500	0.9040	1.0000

Source: E-View, version 7.0

Table C: Test of Hypothesis

Variables	Coeff.	Std. Error	T-Stat	Prob.
C	0.611240	0.542110	1.204200	0.9400
BS	0.125410	0.034210	3.142004	0.0426
BC	0.03454	0.005112	6.231140	0.0102
AC	-0.13410	0.115401	-1.21400	0.0161

Effects Specification

	Sd	Rho
Cross-section random	0.17504	0.2001
Period fixed (during variable)		
Idiosyncratic random	0.36495	0.71104

Weighted Statistics

R –square	0.54247	Mean dep. Var.	0.27540
Adj R^2	0.48267	S.D dep. Var.	0.36740
S.E	0.36784	Sum sq. resid	11.5524
F – stat	570.0616	Durbin Watson stat	2.305110
Prob. (f-stat)	0.034542		

Un-weighted Statistics

R –square	0.214110	Mean dep. Var.	0.28400
Sum sqresid	14.7640	DW stat	1.804557

Source: E-view

DISCUSSION OF FINDINGS

Table A results indicates that average bank performances in relation to return on asset is 29.7 per cent, average board size is 85.1 percent, average board composition in the form of outside independent directors is 76.4 percent. This indicates that a higher percentage of board members are independent. The average value of audit committee is 57 per cent.

This result also indicate that majority of the banks' audit committee are outsiders (independent).

Table B results reveal the relationship between dependent and independent variables. ROA is positively correlated with the banks' board size and has low significance of 0.0426. The board composition also shows positive correlation with performance index ROA. However, ROA has a negative significant relationship with audit committee.

Table C represents all the three corporate governance indices, namely BS, BC and AC. All are statistically significant to ROA.

To examine to accuracy of the model the coefficient of determination is 04.2 percent degree of accuracy. The adjusted R^2 is 0.48267 indicating that ROA is capable of being explained by the independent variables. The F-value statistics confirmed the significant impact of corporate governance on bank performance.

RECOMMENDATIONS

From the findings, we recommend as follows:

- Every deposit money bank operating in Nigeria should properly define corporate governance and adhere strictly to its code and implement them effectively for improved performance.
- The Central Bank of Nigeria should come with measures that will ensure compliance of the corporate governance code of conducts.
- Banks should assign more members of board to outside or independent members. This will generate investment flows, instill confidence of stakeholders and increase return on assets.

CONCLUSIONS

The board size shows positive effect on bank performance which is consistent with the finding of (Cornet et al 2008, Coprio et al 2007, Kin and Rasiah 2010, Klein 2002). The board composition has direct effect on performance. This result is consistent with the findings of (Yermack 1996, Eisenberg et al 1998 and Albanise 1997). This implies that the relationship of board size/outside board member vis a vis corporate governance in developing economy is not completely different.

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