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Research Paper

Corporate Governance A Panacea For Effective Bank Performance In Nigeria 2006-2010:

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ABSTRACT:- The paper examined corporate governance as a panacea for effective bank performance in Nigeria .The study which used15 banks as case study covers period 2006-2010. Capital adequacy ratio CAR and loan deposit ratio LDR were used as proxies for corporate governance while earning per share EPS, return on capital employed ROCE and return on equity ROE were used as proxies for bank performance. The study adopted ordinary least square estimating techniques as its method of analysis. Findings from the empirical result show that high CAR has the tendency of improving bank performance while high LDR has the tendency of reducing bank performance. The overall test of statistical significance shows that corporate governance does not have significant impact on the bank performance in Nigeria. The policy recommendation is that monetary authorities should improve on monitoring and supervision in relation to corporate governance in the Nigeria banking sector since findings have revealed that corporate performance has not played the expected role in improving bank performance in Nigeria.

Keywords:- *Capital Adequacy ratio, loan deposit ratio, corporate performance, bank performance.*

I. INTRODUCTION

Corporate governance research has been increasingly popular in recent years. Especially from the recent trend of events in the banking sector in Nigeria. This ranges from, recapitalization era to the global financial crisis and now to non performing loan crisis which According to to the Enron (2008) is a reflection of poor corporate governance. Corporate governance is considered as one of the most critical factors influencing firm performance. Corporate governance in the banking sector is particularly important. This is because the banking sector plays a special role in the economic system as it facilitates capital allocations and the risk management of the business. Thus, the corporate governance arrangements of banks are very important for the business of the banks and their business customers.

The banking sector of the Nigerian Economy plays a major role in the countries economic development. but over the years the sector has been bedeviled with different sorts of problems that has transformed to overall colossal set back for other sectors in the economy. Adekanye [1986]. The Nigeria Banking Sector has practically undergone different phases of developmental stages that have significantly affected the performance of the sector. However, most of these phases are characterized by the need to solve one problem or the other currently existing in the banking industry at that particular period. Sanusi [1997].

According to Odoko [2002], The problems confronting the Nigerian banking sector are multi- faceted, he stated some of them as [i] Weak corporate governance, [ii] Indiscipline in ensuring banking soundness by late or non publication of annual accounts and submitting them to the apex regulating authority for scrutiny. [iii]Gross insider abuses.[Iv]Insolvency [v]Weak capital base.[vi] Over dependency on public sector deposit, and [vii] Neglect of small and medium class savers. All these problems have been coming with the Nigerian Banking Sector over the years, it spanned through periods before 1960 when the economy was unregulated but still under the colonial government, to the period between 1960 and 1984 when the economy was regulated, uptill the period the country adopted Structural Adjustment Programme in 1985 [SAP], this year marks the beginning of the regulation in the Nigerian economy. Nnanna [2002]. The adoption of SAP in 1985 brought with it so many challenges for the Nigerian banking sector, some of these challenges are globalization of supervisory and prudential requirements that conform to international standards. All these challenges coupled

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with the regulation of the financial sector have led to so many remarkable changes in the Nigerian banking system over the years. The changes were characterized by number of financial institutions, ownership structure, as well as depth and breadth of operations.

However, for the past five years in the Nigerian banking sector attention of the monetary authorities have shifted more to the issue of corporate governance this was the aftermath of recent stunning revelations in the Nigerian banking industry whch has led to the sacking of MDs and CEO of some major banks. All these happenings have raised questions about the effectiveness of corporate governance in the effective running of the Nigerian banking sector. Soludo (2002) emphasized good corporate governance as a major way of curbing myriads of problem confronting the Nigerian Banking sector Consequently, this paper among others will verify this assertion by exploring corporate governance role in improving bank performance in Nigeria from 2006 till 2010.

II. SOME LITERATURE

The purpose of corporate governance is to coordinate a conflict of interests among all parties' relationship within the company and to develop a system that can reduce or eliminate the agency problems (OECD, 1997). It argues that the agency problems become more critical with weak governance and limited protection of minority shareholders in a company (Dharwadkar, George, & Brandes, 2000). OECD (1997) also outlines that sound corporate governance should be able to help the board of directors and managers to achieve the best interests of the company and shareholders. Moreover, it can be argued that firm performance can be improved with better corporate governance controls in a company.

Famma and Jensen (1983) argued that corporate governance does affect firm performance. They found that the majority of larger firms with stronger governance controls are rewarded over the long-term. Klein, Shapiro, and Young (2004) examined the relationship between corporate governance and firm value by using the Corporate Governance Index (CGI) and Tobin's Q, which measures the firm's value. The results conclude that corporate governance does matter in firm value.

In addition, Carse (2000) argued that a strong corporate governance standard is particularly important for banks. This is because most of funds that banks use for business belong to their creditors and depositors. The failure of a bank will affect not only its own shareholders, but have a systemic affect on other banks. Therefore, it is important to ensure that banks are operating properly. Carse also stated that the corporate governance of banks in Hong Kong is at a good standard due to the fact that the Hong Kong Monetary Authority has set out strict guideline in relation to corporate governance for banks. On the other hand, a large number of studies have investigated the relationship between ownership structure and firm performance. Morck, Shleifer, and Vishny (1998) argued that higher ownership concentration has a positive impact on firm performance, because it increases the ability of shareholders to properly monitoring managers. Shleifer and Vishney (1986) also argued that higher level of block-holder is likely to have a positive effect on firm value. The large shareholders can work effectively for monitoring managers in order to prevent the potential takeover threat. Based on the corporate governance structure, the board of directors will be the supreme policy maker in a company, so the relationship between structure of board composition and firm performance is extremely close. As we know board composition is part of the corporate governance, so our research takes a step forward to evaluate the relationship between board composition and firm performance.

III. METHODOLOGY

This paper evaluates the impact of corporate gorvarnabnce on the bank performance of some selected 15 banks in Nigeria. The research method adopted follows the work of cordeiro and veliyath(2003) and that of Christopher (2009). According to the both corporate gorvanance can be internal or external. They identified Board of size of directors and level of loan to related party as major measurement of corporate performance, while return on asset (ROA), return om equity(ROE) and return on capital employed(ROCE) were identified as measures of bank performance. But Denis (2001) identified capital adequacy ratio (CAR) as the major proxy for corporate governance because it represents the degree of banks obedient function toward rules which serve to protect public interest. Konishi and Yasuda (2004) also supported this view and asserted that implementation of capital adequacy requirement reduces risk taking of banks. However they added that loan deposit ratio (LDR) is another good proxy for corporate governance. Following the work of these people our model expressing bank performance as a function of corporate performance is hereby formulated

IV. MODEL SPECIFICATION

i.e Bank performance=f(Corporate performance)

Bank performance is measured by the following: Earning per share, return om equity(ROE) and return on capital employed(ROCE) while corporate performance is measured by capital adequacy ratio (CAR) and loan deposit ratio (LDR). In our paper interest rate (IR) is used as our control variable. Thus, this led to formulation of three separate models each representing a measure of bank performance. i.e

Model I
$EPS=\beta_0 + \beta_1 CAR + \beta_2 LDR + \beta_3 IR + \beta_4 + U_i$
Model II
$ROCE=\alpha_0 + \alpha_1 CAR + \alpha_2 LDR + \alpha_3 IR + \alpha_4 + U_{ii}$
Model III
$ROE=\partial_0 + \partial_1 CAR + \partial_2 LDR + \partial_3 IR + \partial_4 + U_{iii}$

Where: CAR= Capital adequacy ratio
EPS= Earning per share.
ROCE= Return on Capital Employed
ROE= Return on Equity
LDR= Loan Deposit Ratio
IR= Interest Rate
Ui-iii= Stochastic variables.
B, α and ∂ are regression parameters.
Variable Definition

Dependent Variables (Measures of Bank performance)

Earning per Share (EPS): This is a measure of profitability of the common shareholders investment Pandey(1993). It is calculated by dividing the profit after tax by the total number of commom share outstanding, It is used as a proxy for bank performance in our paper.

That is $EPS = \frac{\text{Profit After Tax}}{\text{Number of common share outstanding}}$

Return on Capital Employed (ROCE): This ratio also relates profit to invest ment. It is computed by dividing the profit before investment and tax by the capital employed (Total long term Fund) which is the fund employed in the net asset plus total debt Anao and Osaze (1993). That is

$ROCE = \frac{\text{Net Profit Before Interest and Taxes}}{\text{Total Long Term Fund}}$

Return on Equity (ROE): this is the summary measure of the overall firm performance Van Horne and Wachowicz (1993) It indicates how well the firm has used the resources of owners as it measures the profitability of the owners investment. It is calculated by dividing the Profit after tax which reperesent share holder's equity or net worth which include common share capital, share premium and reserves and surplus less accumulated losses. That is

$ROE = \frac{\text{Profit After Tax}}{\text{Shareholder's Equity or Net Worth}}$

Independent Variables (Measures of Corporate Governance)

Capital Adequacy Ratio (CAR): This is capital divided by the risk –weighted average assets. Capital included in CAR comprises of both secondary and main capital. Central bank determines that banks should reserve minimum level of CAR at least 8%. The CAR number represents the degree of banks obedient to function toward the rules which serves to protect public interest. Lerger CAR number represents higher bank sensitivity toward public interest Christopher (2009) That is

$CAR = \frac{\text{Total Capital}}{\text{risk –weighted average assets}}$

Loan Deposit Ratio (LDR): Loan is represented by total loan on the balance sheet, while deposit include demand deposit, time deposit, certificate of deposit, savings, issued securities, prime capital, loan capital and borrowing. This ratio shows the proportion of public contribution as source of capital to finance the banks' loans. Smaller LDR number indicates that public provides smaller proportion to support the banks' loans. In addition central bank determines that bank concern the level of LDR to be lower than 85%. Smaller LDR number suggests that banks attempt to maintain obedient function toward the rules which serves to protect public interest. Hence is a good proxy for corporate governance. Christopher (2009). That is

$LDR = \frac{\text{Total Loan}}{\text{Total Deposits}}$

Interest Rate (IR): this is the cost of borrowing or the reward of capital. It is used as control variable.

Estimating Technique

The ordinary least square (O L S) method of multiple regression on is used in the estimation process. This is because the OLS appears appropriate as it yields estimator which are best linear, unbiased and efficient. The average values of the variable as it related to the 15 banks were used in the regression analysis.

V. RESULTS AND DISCUSSION

The estimated regression models are presented as follows:

Model I

EPS=31.14+259.7CAR-47.19LDR-4.07IR
(30.30)* (166.07)* (29.66)* (1.62)*
R^2= 0.88, F(3,!) 2.52 (0.427)
D.W=1.77

Model II

ROCE=-6.93+203.3CAR-62.73LDR-2.98IR
(74.45)* (408.08)* (72.88)* (3.98)*

R^2= 0.81, F(3,!) 1.419 (0.535)
D.W=1.71

Model III

ROE=-20.90+402.93CAR-31.25LDR-5.44IR
(151.49)* (830.24)* (148.28)* (8.10)*

R^2= 0.56, F(3,!) 0.423 (0.7781)
D.W=1.75

The first model expresses the empirical relationship between earning per share as a measure of bank performance and variables of corporate governance. The result showed that there is a direct relationship between capital adequacy ratio (CAR) as a core measure of corporate performance in our model and the earning per share. This is in line with the findings of konishi and Yasuda (2004) that higher CAR will aid bank performance. They emphasized that higher CAR normally promote public confidence in the stability of a bank hence tendency for the bank to enjoy more patronage from the public.. However Model II and Model III also show the same relationship between ROCE,ROE and CAR respectively. Therefore as capital adequacy ratio rises(higher bank sensitivity toward public interest) the earning per share EPS, return on capital employed ROCE and return on equity ROE will also rise. However, another feature from our result that is common to all the models is that none of the parameter estimates of the CAR in the three model is statistically significant. This \means that CAR does not have significant impact on the EPS, ROCE and ROE.

Secondly, in all the three models, LDR demonstrated inverse relationship with the EPS, ROCE and ROE respectively. According to Christopher (2009) Smaller LDR number suggests that banks attempt to maintain obedient function toward the rules which serves to protect public interest. From our result it has shown that banks in Nigeria that attempt to keep high LDR which is against good ethics of corporate governance will have negative effect on bank performance.. This account for the existence of bad loans in the Nigerian banking sector because high LDR means excessive loans at the expense of deposits. But it is also important to note that none of the parameter estimates of LDR is statistically significant in the three model. This follows the previous findings that LDR also does not have significant impact on all the bank performance indicators namely EPS, ROCE and ROE.

Thirdly, The interest rate which is the control variable demonstrate same inverse relationship with all the indicators of bank performance. This means that higher interest rate is a dis-incentive to improved bank performance. Scholars like Nnanna (2002) as emphasized that a constructive and careful lowering of interest rate will have the tendency of improving bank performance. In other words the lower the interest rate the higher the EPS, ROCE and ROE. Again the parameter estimate is not statistically significant.

The R square value of 0.88 in model I is an indication that 88% variation in variation in the EPS is explained by the variables of corporate governance. The R square is also very high in model II, the value is 0.81 showing that about 81% systemic variation in ROCE is explained by the variables of corporate governance. However the value is not as high in the 3rd model. The value is 0.56 which means that about 56% variation in ROE is explained by the model i.e variables of corporate governance.

The test of overall statistical significance i.e the F test shows that all the three models are not statistically significant. This is revealed from the value of F statistics which is not significant at both 5% and 10% levels of significance. It further attests to why individual variable of corporate governance does not have significant impact on each of the indicators of bank performance. This is an indication that corporate governance does not have significant impact on bank performance in Nigeria during the period under review. The durbin Watson values of 1.77, 1.71, and 1.75 in models I, II and III respectively fall within the range of rejection of presence of autocorrelation. This simply means that the three models are not having the problem autocorrelation..

VI. CONCLUSION AND RECOMMENDATIONS

It can be concluded from our empirical research that corporate governance does not have significant impact on the bank performance during the period under review. It can also be deduced from our findings that the two major indicators of corporate governance that is capital adequacy ratio (CAR) and loan deposit ratio (LDR) respectively exhibited a positive and negative relationship with all the three measures of bank performance. This simply means that banks in Nigeria that attempt to keep high LDR which is against the corporate governance ethic run the risk of having lower performance. Again, it appears from our result that both CAR and LDR do not have any significant impact on the three indicators of bank performance. It has also shown that interest rate which is used as the control variable exhibited an inverse relationship with all the three indicators of bank performance. Based on these findings it is recommended that:

(i) Bank operators should pay more attention to corporate governance since our findings have shown that its role in improving bank performance is far below expectation in the Nigerian banking sector

(ii) Banks should be encouraged to maintain the required high capital adequacy ratio since high capital adequacy ratio as a measure of corporate governance is a panacea for improved banking performance.

(iii) Monetary authorities should improve on bank supervision and monitoring in the area of loan deposit ratio LDR. They should be encourage to keep a lower LDR . According to Christopher (2009), LDR as a measure of corporate governance should be kept low if bank performance is to be enhanced.

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