IMPACT OF CORPORATE GOVERNANCE ON BANKING SECTOR PERFORMANCE IN NIGERIA

Fatimoh Mohammed
Department of Economics and Financial Studies
College of Management Sciences
Fountain University, Osogbo, Osun State, Nigeria

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 debate on transparency and disclosure of financial information to the various users, as a means of appraising good governance in banks. This study made use of both primary and secondary data in ensuring that data obtained are sufficient for a reasonable conclusion. The secondary data obtained from the annual financial statement of the banks for a period of five accounting year was used in analyzing the financial ratios for the study. 158 questionnaires were retrieved from respondents out of the 200 questionnaires distributed. The primary data was analyzed through the chi-square analysis method. The study concludes that corporate governance significantly contributes to positive performance in the banking sector. It therefore recommends that corporate governance codes should be adapted to meet the need of Nigerian business environment.
Keywords: corporate performance, governance and business failure

INTRODUCTION

Corporate financial reporting is fundamental to all stakeholders - shareholders, management, government, creditors and society at large. It requires vital attention in practice considering the effect on institutional failures and abuse of power. The dynamic business environment, therefore, calls for improved recognition, measurement and transparent disclosure on firm's operation.

The rate of business failure is sporadic as evidenced by Enron, Worldcom, Sunbeam, Cadbury Nigeria Plc and other high-profile scandals. The causes of such failure, according to Krehmeyer (2006), are excessive short-term strategies which undermine market credibility and discourage long term value creation and investment. The consequences of institutional failure on economic growth and sustainable development are unbearable to a developing country like Nigeria. This affect the level of confidence the public has in various corporate establishments. The consequences of ineffective corporate governance 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 sound management practice 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). Corporate governance is therefore important to ensure transparency, accountability and fairness in corporate reporting. In this regard, corporate governance is not only concerned with corporate efficiency, it relates to company strategy and life cycle development (Mayer, 2007). It is also concerned with the ways parties interested in the wellbeing of firms (stake holders) 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 valid objective functions to resolve these conflicts, management often focus on short term result and lose sight of ethical issues such as effective corporate management. Inadequate consideration for ethical values and good governance hinders company's performance as experienced in the recent corporate failures. The impact of good governance on firms' reputation cannot be over emphasized. Good corporate governance promotes goodwill and confidence in the financial system. Numerous recent studies emanating from academic research shows that good corporate governance lead to increase valuation, higher profit, higher sales growth and lower capital expenditure (Wolfgang, 2003). Sound corporate governance, therefore, enhances corporate performance and provides meaningful and reliable financial report on firms operations.

Given this background, this study examines the efficacy of corporate governance with a view to determine it impact on firms' performance and providing measures to enhance corporate financial performance and sound business practices. The experience of business failure and financial scandals around the world brought about the need for good governance practices. The United States of America, Brazil, Canada, Germany, France, England, Nigeria and so on, all witnessed financial failures. Bell and Pain (2000) supported this view that the last 20 years have witnessed several bank failures throughout the world. Financial distress in most of these countries were attributed to high incidence of non-performing loans, capital deficiencies, weak management, poor credit policy and governance system. In the view of Bollard (2003), the weaknesses in some of the ailing banks reflected poor management of conflicts of interest, inadequate understanding of banking risks and poor oversight by boards of the risk management system and internal audit arrangements. These problems were further compounded by poor quality of financial disclosure and ineffective external audit.

The banking institution occupies 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 resulting from weak governance practices. In this regard, Oluyemi (2005) considers corporate governance to be of special importance in ensuring stability of the economy and successful achievement of banks' strategy. Corporate governance is an important framework for effective development of equity market, research and development, entrepreneurship and economic growth. (Maher and Anderson, 1999). Agusto (2007) views that effective corporate governance improves economic efficiency, access to domestic and foreign capital, human resources productivity and development of market economy. Hence, creating an effective corporate governance framework is desirable in order to enhance efficiency and transparency in the Nigerian financial system.

The different national system of corporate governance reflected major differences in ownership structure of firms in different countries and particularly, differences in ownership concentration (Shleifer and Vishney. 1997). This resulted from the variation in country's legal, regulatory, institutional, historical and cultural factors that separate ownership from control of firms (agency function). Corporate governance was therefore practised throughout the world depending upon the relative power of owners, managers and providers of capital (Craig, 2005). Rwegasira (2000) posits that corporate governance is a structure within which corporate entity or enterprise receive it basic orientation and direction.

The commitment to the rights and equitable treatment of shareholders depict good quality of governance practices in the banking sector. Chide (2007) opines that shareholders (especially, the minority shareholders) should position themselves as a major organ by which corporate governance principles can be implemented and monitored for the overall interest of the organization. Banks should respect the right of shareholders (especially, the minority interest and foreign shareholders) and they should be assisted in exercising these rights through a court system that will strengthen their expertise and capacity to adjudicate corporate governance dispute efficiently and impartially (Oluyemi, 2005).

The quality of information provided by banks is fundamental in promoting sound governance practices. Adequate disclosure and transparency safeguard the integrity of bank's financial reports. CBN (2006) in the code of corporate governance for banks identified industrial transparency, due process, data integrity and disclosure requirement as the core attribute of good governance practices in banks. Hence, timely and detail disclosure of material financial information is desirable in assessing the viability and financial performance of banks

METHODOLOGY

The studied population consists of the 25 commercial banks in Nigeria. The selected sample consists of Union Bank Plc, First Bank Plc, Zenith Bank Plc and Access Bank plc. The non-probability sampling technique was used for this study. Specifically, the study adopted judgmental sampling technique in order to achieve the objective of the study based on the researcher's knowledge of the population.

The sample size of the study consists of two hundred respondents from four banks in Lagos State of Nigeria.

Data was derived from both primary and secondary sources. The data collected were subjected to inferential and descriptive statistical analysis. The primary data were analyzed through inferential statistical method like the chi-square test. 200 questionnaires were administered to the staff of the selected banks, while 158 copies were retrieved. The secondary data collected from the audited annual reports of the banks were subjected to descriptive statistical analysis through data tabulation. The trend and cross sectional analyses of the banks' performance were carried out using financial ratios for a period of five years (2003 - 2007). The ratios used in this study are:

i **_Return on capital employed:_** measures banks performance in terms of their return and the efficiency by which resources are utilized. Return on capital employed = (net profit/capital employed) (100)

ii **_Current ratio:_** The ratio determines the extent by which assets converted into cash within a year could cover the claims of short-term creditors. An average of 2: 1 is generally considered ideal.
Current ratio = (current asset/current liabilities) (x: 1)

iii **_Debt ratio:_** This ratio shows the extent of cover for liabilities by the total assets. Debt ratio = (total liability/total asset) (100)

iv **_Dividend cover:_** It shows the number of times ordinary dividend can be covered from the available earnings.
Dividend cover = (earning per share/dividend per share) (x times)

v **_Retention ratio:_** It shows the percentage of earnings retained in the business for future growth. Retention ratio =
(earning per share - dividend per share)/earnings per share (x times)

RESULTS AND DISCUSSION

Table 1: Trend and Cross Sectional Analysis of Return on Capital Employed Ratio for the Selected Banks.

Years	2003	2004	2005	2006	2007
First bank Plc	41.2%	28.7%	27.3%	23.1%	21.2%
Union bank Plc	20.2%	21.5%	24%	10.5%	12.6%
Access bank Plc	22.3%	21.2%	3.6%	2.6%	21.4%
Zenith bank Plc	31.7%	29.6%	16.9%	11.4%	15.1%

Source: Research computation (2010)

Table 2: Trend and Cross Sectional Analysis of Current Ratio

Years	2003	2004	2005	2006	2007
First bank Plc	1.05:1	1.10:1	1.10:1	1.09:1	1.12:1
Union bank Plc	1.07:1	1.07:1	1.07:1	1.18:1	1.14:1
Access bank Plc	1.03:1	1.00:1	1.21:1	1.08:1	1.05:1
Zenith bank Plc	1.06:1	1.01:1	1.06:1	1.15:1	1.07:1

Source: Research computation (2010)

Table 3: Trend and Cross Sectional Analysis of Debt Ratio

Years	2003	2004	2005	2006	2007
First bank Plc	92%	87%	88%	88%	87%
Union bank Plc	97%	98%	97%	85%	81%
Access bank Plc	89%	90%	79%	83%	91%
Zenith bank Plc	87%	91%	87%	83%	88%

Source: Research computation (2010)

Table 4: Trend and Cross Sectional Analysis of Dividend Cover

Years	2003	2004	2005	2006	2007
First bank Plc	0.66	0.68	0.73	1.34	-
Union bank Plc	0.45	0.57	0.69	1.04	-
Access bank Plc	2.8	1.6	-	-	-
Zenith bank Plc	1.34	0.83	1.1	1.78	1.98

Source: Research computation (2010)

Table 5: Trend and Cross Sectional Analysis of Retention Ratio

Years	2003	2004	2005	2006	2007
First bank Plc	-0.52	-0.32	-0.38	0.25	-
Union bank Plc	-1.21	-0.75	-0.44	0.04	-
Access bank Plc	0.64	0.6	-	-	-
Zenith bank Plc	0.26	0.17	0.09	0.44	0.49

Source: Research computation (2010)

Table 1 to 5 of this study shows the computed ratios for a period of five financial years of the selected banks. Table 1 shows the value of the return on capital employed ratio computed for the banks. This value decreases continuously from 2003 to 2007 for the three banks except Union Bank Plc which value increases till 2005 before a sharp fall in 2006. All the banks except First Bank Plc improved on the utilization of their financial resources in 2007 which resulted to an increase in the ratio from 2006 to 2007. However, the percentage of the ratio for 2007 is low (below 22%), which may indicate the inability of the banks to withstand negative variation that may arise in the business environment.

Table 2 presented the analysis of the current ratio. None of the banks' computed current ratio met the ideal or universally accepted ratio of 2:1. This indicated that the assets of the banks cannot be readily converted into cash within a year to cover the claims of their short-term creditors. Table 3 shows the extent by which the liabilities of the banks could be covered from their assets. On the average, 88.4% of the results obtained from the computed ratio shows that the banks liabilities can readily be covered from their total assets.

Table 4 shows the number of period the ordinary shareholders dividend could be paid from the earnings of the banks. The analysis on the table shows that Access Bank Plc and Zenith Bank Plc has good financial performance during the period in which earnings and dividend was reported. Their performance shows that both banks were able to pay their dividend from the available earnings except for 2004, which depicted Zenith Bank Plc's inability to pay dividend from its earnings. However, both First Bank Plc and Union Bank Plc could not cover their dividends from their earnings for the periods 2003 to 2007 except in 2006. This ratio provided signal to investors on the dividend policy of the banks. In the final analysis, table 5 shows the percentage of earnings retained by the banks for future growth. Both Access Bank Plc and Zenith Bank Plc had some percentage of their earnings retained for the period reported. While First Bank Plc and Union Bank Plc had negative retention value except in 2006 when Union Bank Plc had a very low percentage of their earnings retained. This ratio also provides a very useful guide to investors and other users of financial statement on their investment policy

Analysis of data indicates that there is positive relationship between corporate governance and financial performance. Stewardship functions of management cannot be effective and efficient without sound governance practices which can objectively be measured through financial performance. This reflected the view of the respondents as they support the assertion that corporate governance is positively related to financial performance.

The test of hypothesis two accepts the null hypothesis. The analysis refutes the assertion that business success has impact on the nation's economy. Business successes in Nigeria had not signified better economy. This could be attributed to repatriation of the surplus profit abroad, low investment in the real sector of the economy, increased inflation rate and poor leadership environment. Hence, business success does not have positive impact on the nation's economy in all situations.

Ownership structure of banks in the pre- consolidation period deters management's independent due to political pressure. This led to poor management. The analysis of hypothesis three shows that management independence is positively related to effective corporate performance. Clarity in the roles and responsibilities of stakeholders will strengthen managements' independence. Hence, the null hypothesis was rejected. In the analysis of hypothesis four, the null hypothesis was accepted. Accordingly, majority of the respondents supported the view that continuous education of audit committee has no positive relationship with good management. Rather, what makes management effective could be attributed to the level of their freedom (independence) and self satisfaction.

CONCLUSION AND RECOMMENDATIONS

This research study considered the impact of corporate governance on the performance of banks in Nigeria. It was observed that both advanced and developing economies are not immune against banking sector failure. Though banking failure could be attributed to low economic development in the developing economies. The research study also shows that weak governance practices and agency problems contributed to the failure of banks. Compliance with governance requirements reduces the rate of failure. However, it was observed that compliance to the codes of governance was made mandatory in Nigeria but sanctions for non compliance were not implemented. This renders the principles and codes of governance less attractive and effective. In spite of the increment in the Nigerian banks capital base to N25 billion, the selected ratios examined does not guarantee confidence to the users of the financial statement. The analysis of the selected ratios does not show favourable result on the average and in some instances, does not agree with the industrial standards. 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.

The following recommendations were made to strengthen the importance of sound governance practices in the banking sector.

i Adequate measures should be taken to enhance efficiency and effectiveness of governance frameworks in the banking sector. Stakeholders should be adequately knowledgeable on the relevant laws, rights, responsibilities and ethical requirements.

ii Risk management should be transparent and ethical in order to promote the image of the banking sector. Non-compliance with the standard of reporting and disclosure requirement should be sanctioned.

iii Executive compensation should be regularly reviewed to discourage misappropriation of firms' resources. The level of the remuneration should be sufficient and reasonable to motivate employees for higher performance.

iv The scope of the external audit functions should be adequately defined to safeguard the integrity of the financial reports.

v The study recommended further research in the area of public sector governance and governance of other industries in the private sector.

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