

## **THE EFFECT OF BOARD CHARACTERISTICS ON THE FINANCIAL PERFORMANCE OF LISTED BANKS IN NIGERIA**

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### **ABSTRACT**

The issue of corporate governance and financial performance has always been an essential and critical element for banking sector in Nigeria. Good supervision by the board of directors and monitoring the executives are regarded as important in boosting investors' confidence and improving performance. This study investigates the effect of board characteristics on the financial performance of listed banks in Nigeria. Furthermore, the research used secondary data obtained from the annual report of fourteen (14) banks listed in the Nigerian stock exchange for the year 2014-2016 with 42 firm-year observations and based on panel data approach. Furthermore, the regression estimates are based on random effect. The result indicates that board financial knowledge and board independence, exhibit a significant negative relationship with ROA. Meanwhile, board size has a negative insignificant relationship with ROA. Besides providing suggestion for future research work, this study provides several recommendations for regulators and the Nigerian banking industry.

**KEYWORDS** - board size, independence, financial knowledge, firm performance

## **1. INTRODUCTION**

Banks are important for economic development because they offer various services. Their intermediation function is said to be an incentive for economic development. The financial strength in any country is solely depended on the efficient and effective performance of the banking industry over time. Stable banking systems are important element of good financial systems, as clearly shown by current growths around the world (Barth, Caprio Jr, & Levine, 2001).

Banks are been affected by many factors in trying to comply with several consolidation policies. Enforcing corporate governance in banks is essential, as it will makes the banking system perform efficiently and boost public confidence. (Soludo, 2004). Heidi and Marleen (2003), explain that when good corporate governance is not established banking supervision cannot function well.

Corporate governance is involved with procedures through which the affairs of business and institutions are control, the goal is to enhance shareholder's value through improving corporate accountability and performance, while protecting the shareholders interest (Jenkinson & Mayer, 1992).

Financial scandals and the recent corporate failure across the globe have reinforced the need for corporate governance mostly in developing and developed countries (Waweru, 2014). The issue of many breakdown of high-profile institutions such as Enron and Anderson have stunned the business world with scale of their illegal and unethical dealings, corporate governance bounced to global business attention.

In Nigeria, corporate governance is been given attention by all the sectors of the economy. In 2003 a committee was set up for public companies regarding corporate governance known as peterside committee by the Security and exchange committee (SEC). Also, in August 2003, in response to the serious roles played by corporate governance in the collapse or success of Banks in Nigeria a subcommittee was established for banks (Ogbechie, 2006).

Aarma, Vainu and Vensel (2004) they stated that performance analysis of banks is an important issue in the states of transition economies because of the strategic role played during the successful transition of the financial sector. Altman and Hotchkiss (2010) stated that ratio analysis is a depiction of the true picture of performance of a

business at a point. Nimalathasan, (2008) the common purpose of supporting financial performance discussions and research is because, growing financial performance analysis will provide improvement in processes and responsibility of the organization.

## **1.2 Problem statement**

The issue of corporate governance is key in the banking sector and has turned into a topic of global concern, it is a fundamental element used in other to improved services and strengthening of financial intermediation with respect to banks and enables appropriate banking operations. Boards of directors are the focus of attention for most fraud cases that result to collapse of many companies, also blamed for corporate failure and the decrease in shareholders' wealth.

In 2009, the banking sector in Nigeria widely reported many accounting irregularities (Uadiale, 2010). Such as, spring Bank, Fin Bank, Afri Bank, Union Bank, Oceanic Bank and Intercontinental Bank was because of lack of good supervision roles by the board, the board give control to executive management who were after their own self-interests (Uadiale, 2010).

Sanusi (2010) explain that governance misconduct among the merge banks has been related to banking distress in Nigeria, which has turn to routine practice in the sector. Additionally, corporate governance has failed in many banks because boards are being misinformed by the executive in acquiring loans that are not secured and they lack experience to impose good corporate governance practice on the management.

As a result of the foregoing statements, this study examines the effect of board characteristics on the financial performance of listed banks in Nigeria. The paper is divided into five sections. Section one provides the introduction and problem statement, section two reviews various literatures and hypothesis, section three explains the methodology and measurement of variables, followed by results and discussions in section four, conclusion and recommendations in section five.

## **2. LITERATURE REVIEW**

### **2.1 Evolution of Corporate Governance in Nigeria**

Corporate governance developed after the study of corporate control and ownership separation, they recognise components of corporate governance importance. The divergence increases, and performance diminishes when the degree of separation between ownership and control increases (El-Chaarani, 2014).

Nigeria has a change of power in the year 1999 which resulted to a new administration into power with the aim of adopting a strategy to pull in new and feasible foreign investment which is needed for reform in all sectors of the economy. In Nigeria a commission was set up to study the adequacy, and importance of corporate governance in relation to the global best practices (Oyebode, 2009).

The Securities and Exchange Commission (SEC) is in-charge with the responsibility for issuing and revealing any weaknesses with regards to corporate governance code 2003 and 2008 and arrive at revised codes of corporate governance 2011 which is assumed will guarantee uppermost ethics of good governance mechanism and which will increase transparency and accountability in operations of corporations in Nigeria. The code was developed particularly to be applied by the public limited companies; however, the board of the commission security and exchange commission (SEC) has included all other business venture such as private corporations, small and medium industries to implement the new set standards and ethics.

### **2.2 Corporate Governance Structure**

#### **2.2.1 Board Size**

Board size has a role in influencing the firm's value. Board of directors should contain both executive and non-executive directors. The chairman should be giving command to executive and non-executive directors. It is the responsibility of the board to control the management and the CEO of organisation to enhance the value of the firm (Daily & Dalton, 2005).

Prior research on board size show the association between bank performance and board size because they have the capability to support make good decisions, which

is difficult for CEO to control. Mak and Li (2001) explain there is positive association concerning board size and bank financial performance based on their ordinary least squares (OLS) outcome but their two-stage least squares (2SLS) regressions do not accept this outcome in investigating 147 Singaporean banks using data of 1995. Adams and Mehran (2003), discover a positive association between the board size and performance of United States banking sector. However, Dalton and Dalton (2005) explain that larger boards and bank performance were related.

Those boards with a larger size are recognized as having different backgrounds, skills and expertise, which can give a greater abundance of ideas that can provide high levels of performance (Brown *et al*, 2011). Pearce and Zahra (1992), explain that bigger boards offer advice and guidance concerning strategic options to firm.

Many recent studies on the other hand supported boards that are smaller. Yermack (1996) discover a negative association between board size and financial performance of banks. Also an inverse relationship was found by Eisenberg, Sundgren and Wells (1998) between size of the board and profitability. Vafeas (2000) also explain that banks with smaller boards are knowledgeable about profitability.

**H1:** there is a negative relationship between board size and financial performance of listed banks in Nigeria.

### **2.2.2 Board Independence**

Board Director independence is one of the important aspects of good corporate governance because, this enables the board in properly meeting its obligation to supervise management and to safeguard the shareholders' interests and other parties. The board of directors is normally composed of executive directors and non-executive directors.

Independent directors need to be independent from a controlling shareholder and from management. Importantly, directors with a lack of management-centered independence will have problems in exercising independent judgment, which eventually puts shareholders interest at risk (Hermalin & Weisbach, 1988).

Several empirical studies have indicated a strong positive link between board independence and firm performance. Zainal Abidin *et al*. (2009) recognize that a

larger number of independent non-executive directors on the board have a positive effect in terms of the performance of the firm. Amran and Che-Ahmad (2009; 2010) find that board independence has a strong association with firm value. . Uadiale (2010) also recognise that strong positive link exist between board independence and firm performance.

However, other studies indicate an insignificant and negative link with firm performance, such as the study conducted by Abdullah (2004), who established that the independence of board members has an insignificant link with any of the measures of performance. Yermack (1996) identified a negative link between the percentage of independent directors on the board and Tobin's Q. Nevertheless, their findings are not necessarily the same as the case of performance measures.

**H2:** there is a positive relationship between board independence and financial performance of listed banks in Nigeria.

### **2.2.3 Board Financial Knowledge**

Better educational levels are recognized as assisting in the better management of firms and also with greater receptiveness to innovation, as highlighted by Kimberly and Evanisko (1981). It is believed that individual education has relationship with conflict over money, and strategic vision and management control, where those who have achieved a greater level of education are recognized as having a good grasp of fiscal issues more so than those who have not sought educational attainment.

Kesner (1988) recognised that most directors' occupations are business executives, with consultants, lawyers and school professors following. The directors' expertise, such as accounting, financing, consulting, and law, all support management in decision making. Wiersema and Bantel (1992) suggested that a greater level of education can be related with higher data-processing capability and the capacity to discriminate amongst alternate stimuli.

Arifina, and Tazilahb (2016) Directors with accounting, finance, economics and business education background are also an important person to be appointed as part of board members. Their presence will help the companies to ensure financial matter being managed effectively and efficiently.

**H3:** there is a positive relationship between board financial knowledge and financial performance of banks in Nigeria.

### **3 METHODOLOGY**

This study collects and utilize secondary source of data acquired from the annual reports and accounts of listed banks in Nigeria for the period under study. From population of the study, there are fifteen (15) banks listed on the Nigerian Stock Exchange from 2014-2016 which are sampled out for the study, but only 14 banks have complete data. In this study, due to the potential benefits provided by this approach panel data structure rather than cross sectional or time series is utilized, it can improve the quantity and quality of data that could not be provided with either a cross sectional or a time series alone (Greene, 2003). Multiple regression method is used to study the relationship between the financial performance of listed banks in Nigeria and board size, board independence, board financial knowledge.

The result from the regression analysis is the prediction of a dependent variable from many independent variables. This method is employing when the independent variables are related with one another and with the dependent variable this method is used.

The regression equation is estimated as follow:

$$\mathbf{FP = \alpha_0 + \beta_1 \text{ BOARDSIZE} + \beta_2 \text{ BOARDINDE} + \beta_3 \text{ BOARDFINKNOW} + \beta_4 \text{ FIRMSIZE} + \beta_5 \text{ BANKAGE} + \beta_6 \text{ LEVG} + \varepsilon \text{ it}}$$

Where:

FP	= Financial Performance
BOARDSIZE	= Board size
BOARDINDE	= Board independence
BOARDFINKNOW	= Board financial knowledge
FIRMSIZE	= Firm size
BANKAGE	= Bank age
LEVG	= Leverage
$\varepsilon \text{ it}$	= Error term

### 3.1 Measurement of Variables

Table 1 below shows the variables and their measurement as used in this study.

Table 3.1

*Summary of the Operationalization of Research Variables*

No	Variables	Acronym	Operationalization	Source
<b>Dependent</b>				
1.	<b>variable:</b> Return on Assets Ratio	ROA	Net profit divided by total assets (NP/TA)	Garba & Abubakar (2014); Makki & Lodhi (2014)
<b>Independent</b>				
1.	<b>Variable:</b> Board size	BOARDSIZE	Total number of directors sitting on the board of directors.	Shukeri (2012); Eklund et al. (2009); Garba and Abubakar (2014)
2.	Board independence	BOARDINDE	Proportion of non-executive directors divided by total directors	Sanda et al. (2010); Davidson & Rowe (2004)
3.	Board financial knowledge	BOADFINKNOW	Proportion of directors with educational background in accounting, finance, economics, and business administration	Dionne & Triki (2005)



<b>Control</b>			divided by total directors	
<b>1. variable:</b> Firm Size	FIRMSIZE	Natural log of total assets	Alhaji (2012); Kurawa & Kabara (2014)	
<b>2.</b> Bank Age	BANKAGE	Number of years since the company start incorporation	Alhaji, (2014); Faruq (2011).	
<b>3.</b> Leverage	LEVG	Total debts divided by total asset	Huda & Abdullah (2013)	

## 4 RESULT AND DISCUSSIONS

### 4.1 Descriptive Statistics

Table 4.1: *Summary of Descriptive Statistics*

<b>Variable</b>	<b>Mean</b>	<b>Std. dev.</b>	<b>Min</b>	<b>Max</b>
ROA	2.120	1.219	0.360	4.660
BOARDSIZE	13.500	2.540	9.000	17.000
BOARDFINKNW	0.403	0.101	0.235	0.600
BOARDINDE	0.678	0.137	0.533	0.900
BANKAGE	42.190	33.100	3.000	120
LEVERAGE	14.277	3.891	9.01	22.070
FIRMSIZE	9.202	0.356	8.556	9.794

ROA = return on asset; BOARDSIZE = Board size; BOARDFINKNW = Board financial knowledge; BOARDINDE = Board independence

From the descriptive analysis the overall average mean for return on asset (ROA) is 2.120 with maximum 4.660 and minimum of 0.360. With regards to the CG variables, the result from the descriptive statistics of board size (BOARDSIZE), shows that the mean value for board size is 13.500 with a minimum of 9 members and the maximum of 17 members, this implies that the listed banks in Nigeria have comply with CBN code of corporate governance (2014) which require banks to have a minimum of 5 and maximum of 20 members in their board.

Also the result reveal that the mean for board financial knowledge (BOARDFINKNW) is 0.403 with the minimum number of 0.235 members and the maximum of 0.600 members in the Nigerian banks. The statistical outcome relating to the board independence (BOARDINDE) ranges indicate the mean of 0.678 with a minimum of 0.533 members and maximum of 0.900 members.

#### **4.2 Correlation Analysis**

Table 4.2: Correlation Analysis

	<b>RO A</b>	<b>BDSI ZE</b>	<b>BDFN KW</b>	<b>BDIN DE</b>	<b>BANK AGE</b>	<b>LEVER AGE</b>	<b>FIRMS IZE</b>
<b>ROA</b>	1						
<b>BOARDSIZ E</b>	0.15 1	1					
<b>BOARDFIN KNW</b>	- 0.35 3*	-0.137	1				
<b>BOARDIN DE</b>	- 0.24	- ***	0.064	1			
<b>BANKAGE</b>	- 0.31 7*	0.114	-0.152	6	- 0.022 1		

<b>LEVERAG</b>			-				
<b>E</b>	0.03		0.504*				
	0	-0.016	**	0.168	-0.15		1
<b>FIRMSIZE</b>	0.16	-0.104	0.308*	0.16	0.043	-0.337*	1

ROA = return on asset; BOARDSIZE = Board size; BOARDFINKNW = Board financial knowledge; BOARDINDE = Board independence; BANKAGE = Bank age; LEVERAGE = Leverage; FIRMSIZE = Firm size.8, \*\* p<0.05\* p<0.01\*\*\*p<0.001

Table 4.2 above shows significant correlation, positively weak, and negative significant correlation concerning dependent variable (ROA) and independent variables. The correlation between firm size, and board size with ROA is 0.160, and 0.151 respectively, which shows they are positively correlated. However, the ROA is positively correlated with leverage with a weak value of 0.030. A weak and negative correlation was found between board financial knowledge, bank age, and board independence with ROA of -0.353, -0.317, -0.24 respectively.

Furthermore, board size is positively correlated with bank age with a weak value of 0.114. Also board financial knowledge, leverage and firm size has a weak negative correlation with board size with a value of -0.137, -0.016, -0.104 respectively. Lastly, board size have a negative significant correlation with board independence with a value of -0.757 at 1% level of significant.

A weak and positive correlation was found between board independence, and firm size, with board financial knowledge of 0.064, and 0.308 respectively. Board financial knowledge have a negative significant correlation with leverage with a value of -0.504 at 1% level of significant. Board independence have a weak positive correlation with leverage and firm size with a value of 0.168, and 0.160 respectively. Bank age have a negative correlation with board independence with a value of -0.023.

Moreover, bank age have a weak positive correlation with firm size with a value of 0.0425. Also leverage have a weak negative correlation with bank age with a value of -0.150. Leverage have a weak negative correlation with firm size with a value of -0.337 at 10% level of significance.

### 4.3 Linear Regression Analysis

Table 4.3: *Result of the Estimated Regression*

VARIABLES	RANDOM				RANDOM ROBURST			
	Coef	Std. Err.	Z	P> z	Coef	Std.Err	z	P> z
BOARDSIZE	-0.10	0.10	-0.9	0.35	-0.10	0.098	-1.04	0.298
BOARDFINKN	-1.83	1.83	-1.0	0.09	-1.731	1.731	-1.0	0.0
W	3.07	3.07	1.6	0.10	3.07	3.07	1.78	0.076
BOARDINDE	-2.05	2.05	-1.0	0.05	-1.880	1.880	-1.0	0.0
BANKAGE	-0.01	0.01	-1.7	0.07	-0.01	0.007	-1.91	0.056
LEVERAGE	-0.03	0.03	-1.2	0.22	-0.031	0.031	-1.47	0.142
FIRMSIZE	0.84	0.70	1.2	0.23	0.84	0.670	1.26	0.208
Cons	0.87	6.57	0.1	0.89	0.87	7.100	0.12	0.902
Wald chi2				11.2				13.44
Prob > chi2				0.08				0.031
R-Sqr				0.35				0.351
Number of groups				14				14
Obs.				42				42

ROA = return on asset; BOARDSIZE = Board size; BOARDFINKNW = Board financial knowledge; BOARDINDE = Board independence; BANKAGE = Bank age; LEVERAGE = Leverage; FIRMSIZE = Firm size.8, \*\*  $p < 0.05$ \*  $p < 0.01$ \*\*\* $p < 0.001$

Table 4.3 Table 4.3 shows the result of board characteristics and banks performance as measured by return on asset (ROA). H1 states that there is a negative relationship between board size and financial performance of listed banks in Nigeria. The study found a negative and insignificant relationship. Hence the hypothesis is rejected. This finding is similar with Shakir (2008) that also discovered a negative relationship between board size and firm performance.

Hypothesis 2 states that there is a positive relationship between board independence and financial performance of listed banks in Nigeria. The study found a negative and significant relationship between board independence and financial performance of listed banks in Nigeria. This negative value indicates that when there is a decrease in board independence, financial performance (ROA) will increase and reverse is the case. Abdullah (2004) also found similar outcome that independence of board members is negatively link with firm performance (ROA).

Hypothesis 3 states that there is a positive relationship between board financial knowledge and financial performance of listed banks in Nigeria. The study found a negative and significant relationship between board financial performance and financial performance of listed banks in Nigeria. The negative value show that when there is decrease in board financial knowledge, financial performance will increase and vice versa. A similar result was found by Darmadi (2013) that educational backgrounds do not matter to firm profitability. There may be other factors apart from educational background such as experiences, training, and managerial skills that lead to better firm profitability.

## **5 CONCLUSION AND RECOMMENDATIONS**

The objective of the research which is to investigate the effect of board characteristics on financial performance of listed banks in Nigeria. The study examines the relationship between the three independent variables board size, board independence, board financial knowledge. Based on the outcome of the panel data analysis, only

one variable namely board size was found to be negative and insignificant relationship with banks financial performance which was measured using return on asset (ROA). This implies that board size have no effect on the performance of Banks in Nigeria. The study further reveals that board independence and board financial knowledge were found to be negative and significant relationship with financial performance of listed banks in Nigeria. The negative value indicates that when there is decrease in board independence and board financial knowledge, financial performance which is measured using return on asset (ROA) will increase.

The study recommend that future research should incorporate other corporate governance variables like risk management expertise, ownership concentration, director remuneration, management ownership and board meetings.

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