BOARD CHARACTERISTICS AND FINANCIAL PERFORMANCE OF MONEY DEPOSIT BANKS IN NIGERIA

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Abstract

The study examined board characteristics and financial performance of money deposit banks in Nigeria using board size and board composition as proxies of board characteristics and return on assets as proxy of financial performance of money deposit banks.

The study used a sample of 13 quoted banks among the 15 banks quoted on the floor of the Nigerian Stock Exchange as at December 31st, 2019 for the period of 5 years (2015-2019) due to the availability of data. The study employed multiple regression technique for the data analysis with the help of EViews 11.0 econometric software.

The study revealed that board size and board composition are positively significant to financial performance of money deposit banks in Nigeria. This connotes that increase in board size and increase in the number of non-executive directors sitting on the board will go a long way in increasing the financial performance of money deposit banks in Nigeria. The study recommends that regulatory authorities should ensure the increase in the number of persons sitting on the board and they should also ensure the increase in the number of non-executive directors sitting on the board since they are likely to bring their knowledge, expertise and integrity to bear in enhancing the financial performance of money deposit banks in Nigeria.

Keywords: Board Size, Board Composition, Money Deposit Banks and Financial Performance.

Introduction

The growth and development of every economy depends on the country's financial system. In Nigeria, the banking industry practically commands the financial sector. The industry has undergone series of restructuring all geared towards protecting deposit funds, maintaining and ensuring soundness of banking and improving the welfare of employees and stakeholders. The banking sector has been bedeviled with internal (workers and investors) and external (public and depositors) dissatisfaction culminating to image problem. As a result, most banks have sort for improved techniques like information and communication technology (ICT), total quality management strategies, corporate governance strategies, repackaging and rebranding, to compete more effectively to solve these problems and as well to enhance their financial and corporate performance (Akintoye, 2010; Adekunle, 2013).

Money deposit banks play crucial roles in propelling the entire economy of any nation by channeling surplus funds to the deficit units, of which there is dire need for repositioning to achieve efficient financial performance through a reform process geared towards forestalling bank collapse. In Nigeria, the reform process of the banking sector is part and parcel of government strategic agenda aimed at restructuring and integrating the Nigerian banking sector into continental and global financial system. To make the banking sector sound according to Akpan and Rima (2012), the sector has undergone remarkable changes over the years in terms of number of institutions, structure of ownership, as well as breadth and depth of operations. These changes have been influenced mostly by the constraints posed by deregulation of the financial system, globalization of operations, technology advancement and implementation of supervisory and prudential requirements that conform to international regulations and standards, which corporate governance is inclusive.

Effective boards are essential ingredients in achieving and maintaining public trust and confidence in the financial system. They are critical to proper functioning as they determine the performance of the banking sector of the economy in any country of the world. Poor corporate governance may lead to ineffective boards, which eventually may contribute to bank failures. Also, poor boards could in turn lead to a run on the bank unemployment, fraudulent activities, questionable dealings that may result to negative impact on the economy (Ogbechie & Koufopoulos, 2010). The scenario concerning board leadership as a corporate governance mechanism has generated debatable issues and continued to receive considerable attention in recent times from academics, market participants, professionals, and regulators (Abu, Okpeh & Okpe, 2016).

Abuse of corporate governance practices have been identified as one of the factors responsible for the failure of many banks in Nigeria (Abu, Okpeh & Okpe, 2016). The financial health and performance of banks are important for the economic growth of Nigeria. According to Ogbechie and Koufopoulos (2010), banks play three crucial roles to the development of any nation. Firstly, banks have an overwhelmingly dominant position in the financial systems of developing economies, and are extremely important engines of economic growth. Secondly, banks in these developing economies are typically one of the most important sources of finance for the majority of firms. Also, banks in developing countries are the main depository for the economy's savings and provide the means for payment. Therefore, the banking industry in Nigeria has a significant role to play in the development of the country's economy. Banks have been the main sources of financing in the Nigerian financial market and bank loans were the predominant sources of debt financing in the economy (Central Bank of Nigeria Annual Report 2006).

Banks and other financial intermediaries are the heart of the world's recent financial crises. The deterioration of their asset portfolios, coupled with fraudulent acts of presenting fictitious financial statements and lack of adherence to corporate governance principles largely due to distorted credit management, were some of the main structural sources of the crises (Sanusi, 2010). This draws the attention of the public and investors to see the board of directors as the major actor responsible for the failure of corporations, both in developed and developing nations. In fact, board of directors are criticized for being responsible for the dwindling in shareholders' wealth , both in developed and developing economies with Nigeria inclusive (Abu, Okpeh & Okpe, 2016).

The board of directors are seen as the fore-runner or prime factor for the fraud cases that had resulted in the failure of major corporations, such as Enron Corporation, Tyco International, WorldCom, Global Crossing, Arthur Anderson, Marconi, Parmalat , Oceanic bank plc, Wema bank plc, NAMPAK, Fin bank, Spring bank, Afribank, Intercontinental bank, Bank PHB and Cadbury PLC in Nigeria etc. (Adeyemi & Fagbemi, 2011; Ogbonna & Ebimobowei, 2011). Board characteristics are particularly important in the Nigerian banking industry because a number of financial failures, frauds and questionable business practices had adversely affected investors' confidence. Consequently, there is the need to examine the impact of board characteristics and financial performance of deposit money banks in Nigeria. It is in the light of the above, that this study examines the effect of board characteristics on the financial performance of deposit money banks in Nigeria.

The remainder of this paper examines the review of literature and hypothesis development, methodology, data presentation, analysis of results and discussion of findings as well as the conclusion and recommendations.

Literature Review and Hypotheses Development

The concept of the board is derived from the attributes or incentives variable that plays a significant role in monitoring and controlling managers and can be described as a bridge between company management and shareholders (McIntyre, 2007; Bonn, 2004; Kiel & Nicholson, 2003). To understand the role of the board, it should be recognized that boards consist of a team of individuals, who combine their competencies and capabilities that collectively represent the pool of social capital for their firm that is contributed towards executing the governance function (Westphal, 2001). The board is the supreme decision-making unit in the company, as the board of directors has the responsibility to safeguard and maximize shareholder's wealth, oversee firm performance, and assess managerial efficiency.

Daltoni, Catherine, Alan and Jonathan (1998) pointed out four actions of initiation, ratification, implementation, and monitory, undertaken by the board in the decision making processes. Therefore, the main role of the board is seen as the ratification and monitoring of decisions, overseeing the actions of managers/ executives. From the above concept, the role of the board is quite daunting as it seeks to discharge diverse and challenging responsibilities. The board should not only prevent negative management practices that may lead to corporate failures or scandals but ensure that firms act on opportunities that enhance the value to all stakeholders

Financial performance is a measure of an organization's earnings, profits and appreciation in its value which are reflected by the rise in share price and the degree to which financial objectives are being met or has been accomplished. Return on assets is one of the several indicators that is used in measuring financial performance of firms. The return on assets (ROA) ratio is calculated as net profit after tax divided by the total assets. This ratio measures the operating efficiency of the company based on the firm's generated profits from its total assets (Abu, Okpeh & Okpe, 2016). Return on Asset (ROA) is an indicator of the value of a firm's relative to its total assets. ROA gives an idea as to how efficient management is at using its assets to generate earnings. It is calculated by dividing a company's annual earnings by its total assets.

Board Size and Financial Performance

Oyerogba, Memba and Riro (2016) studied the impact of board size on the profitability of listed firms; the study empirically examined the listed companies in Nigeria for a period of ten years ranging from 2004 to 2013. Specifically, the study investigated the impact of board size, firm size and firm age on return on capital employed of the selected companies. The study relied on the secondary data extracted from the audited financial statement of a sample of 70 companies purposefully selected from the 198 listed companies in Nigeria. Both descriptive and inferential statistics were carried out. The results revealed that a significant positive relationship exists between the board size and return on capital employed. It was therefore recommended that listed companies should adopt the use of a large board (12 members) to improve profitability.

Enilolobo, Adesanmi and Aigbe (2019) examined corporate governance and financial performance of listed firms in Nigeria; comparing the food and petroleum products industries**.** The study used secondary data for ten (10) listed food and petroleum firms over a period of seven (7) years (2011-2017). Board size was used as a proxy for corporate governance while financial performance was represented with return on asset (ROA). Panel regression analysis was used to analyze the data. Hausman test was carried out for the appropriateness of the panel method to use. The Hausman test revealed that the Fixed effect was more appropriate as such, fixed effect panel regression was applied. The results of the analysis show that board size has a significant positive effect on the financial performance of food and petroleum companies in Nigeria.

Ongore, K'obonyo, Ogutu and Bosire (2015) investigated the effects of board composition on financial performance. Using multivariate regression analysis on panel data, with Return on Assets, Return on Equity, and Dividend Yield as performance indicators, the study found out that board size had an inverse relationship with financial performance. These results are largely consistent with the conceptual and empirical literature on corporate governance with respect to small board size (5 to 7). Oyedokun (2019) examined board characteristics and financial performance of commercial banks in for the period 2013-2017. Data were extracted from the annual reports of the quoted commercial banks. Multiple panel regression analysis was used to analyse the data. The result shows that board size has an insignificant negative effect on financial performance.

There is no consensus in literature as to the number of size of the board that can enhance financial performance and financial reporting quality of firms since smaller boards can increase decision taking processes. On the other hand, companies with large boards tend to become less effective and easier for CEO to control. A high number of decision makers in any committee may reduce their effort and give rise to some degree of free riding. When a board gets too big, it becomes difficult to coordinate and becomes problematic, especially in terms of the process involved in decision making.

Against this backdrop, the postulation of the hypothesis is as follows: Ho1: Board size has no significant impact on the financial performance of money deposit banks in Nigeria.

Board Composition and Financial Performance

Ongore, K'obonyo, Ogutu and Bosire (2015) investigated the effects of board composition on financial performance. Using multivariate regression analysis on panel data, with Return on Assets, Return on Equity, and Dividend Yield as performance indicators, the study found out that independent board members had an insignificant effect on financial performance. Muller (2014) investigated the impact of board composition on the financial performance of FTSE100 constituents using econometric regression models the impact of 9 corporate governance characteristics regarding board composition on the contemporaneous and next year's performance (measured as ROA) using a sample comprised of the constituents of FTSE100 between 2010 and 2011. The study revealed that board independence and the proportion of foreign directors in the total number of directors (as characteristics of corporate board composition) have a significant strong positive impact on firm performance (both contemporaneous and subsequent).

Fuzi, Abdulhalim and Julizaerma (2016) examined board independence and firm performance. The board requires the combination of executive and non-executive directors to pursue the shareholders' interest. The non-executive directors on the board will not be able to exercise their duties effectively unless they are independence from management and ensure they provide unbiased business judgment. Independent directors are the person entrusted by shareholders to represent them and will help to reduce agency problems. Wu, Lin, Lin and Lai (2014) investigated the impact of the corporate governance mechanism on firm performance. The study used correlation analysis and descriptive statistic to analyze the effect of corporate governance on firm performance. The study found that firm performance has a positive and significant relationship to Board independence and insider ownership. The study recommended that the larger gap between the voting rights and cash flow rights, the more incentives controlling shareholders could have; thus they may embezzle firm asset, causing damage to small shareholders' interest and deteriorating firm performance

Abu, Okpeh and Okpe (2016) carried out research on board characteristics and financial performance of deposit money banks in Nigeria. The study examines the influence of board characteristics on the performance of listed deposit money banks in Nigeria. Executive director, Independent non-executive director, Grey director, Woman director and Foreign director constitutes the board characteristics of the selected banks, while the ratio of profit after tax to total asset and profit after tax to shareholder total fund represents the Performance which stands as the dependent variable of the study. The study found that the executive director has no significant influence on the performance of listed banks in Nigeria.

No clear conclusion has been reached on the issue of whether directors should be employees of or affiliated with the firm or outsiders. Inside directors are more familiar with the firm's activities and they can monitors to top management if they perceive the opportunity to advance into positions held by incompetent executives.

Against this backdrop, the postulation of the hypothesis is as follows:

Ho2: Board composition has no significant impact on the financial performance of money deposit banks in Nigeria.

Theoretical Framework

The theoretical framework on which this study is based is the stakeholder theory.

Stakeholder Theory

The stakeholder theory developed and championed by Edward Freeman in the year 1984. The stakeholder theory takes a broader view of the firm. According to the traditional stakeholder theory, the corporation is responsible to a wider constituency of stakeholders other than shareholders. Other stakeholders may include contractual partners such as employees, suppliers, customers, creditors, and social constituents such as members of the community in which the firm is located, environmental interests, local and national governments and society at large (Blair, 1995). This view holds that corporations should be "socially responsible" institutions, managed in the public interest. According to this model performance is judged by a wider constituency interested in employment, market share, and growth in trading relations with suppliers and purchasers, as well as financial performance.

Stakeholder theory has been perceived to be advancement on the agency theory and corroborates the concept of corporate governance in organisations in a more robust manner than the agency theory. This theory recognizes not only the shareholders or owners of the organisation but also the stakeholders. Stakeholders are a combination of those individual or group that influences an organisation and those that are being influenced by the organisation. Stakeholders therefore comprise of the shareholders, creditors, employees, customers, competitors, suppliers and the community. Stakeholder theory asserts that companies have a social responsibility that requires them to consider the interests of all parties affected by their actions (Branco and Lucia, 2007). This confers more responsibility on the managers in terms of ensuring that no stakeholder is dissatisfied either in the short run or long run. Put simply by Sternberg (1997), stakeholder theory is the doctrine that businesses should be run not for the financial benefit of their owners, but for the benefit of all stakeholders.

Rusconi (2009) posits that the fundamental basis of the stakeholder theory is normative and involves the acceptance of ideas that stakeholders are persons or groups with legitimate interests in procedural and/or substantive aspects of corporate activity and that the interest of all stakeholders are of intrinsic value. Kostyuk, Braendle, & Apreda (2007) suggest that stakeholder theory focuses on the relative differences of a stake-holder oriented corporate governance system compared to a shareholder oriented one. Consequently, it can be inferred that stakeholder theory broadens the horizon of interests attached to corporate governance with respect to firm performance.

Methodology and Model Specification

This study adopted the ex-post facto design method. This is because the study seeks to investigate the impact of board characteristics on money deposit banks in Nigeria. The data for this study were obtained mainly from secondary sources which were collected from the audited annual reports and accounts of the listed deposit money banks in Nigeria. 15 banks are quoted on the floor of the Nigerian Stock Exchange as at December 31st, 2019. However, due to the availability of data, 13 banks formed the sample size. The study covered a 5 year period ranging from 2015-2019. The data was analysed using multiple regression (Ordinary Least Square Technique) and EViews 11.0 was used to run the regression.

In order to examine the influence of board characteristics on the financial performance of money deposit banks in Nigeria, a linear model was built. The model captures the impact of board size and board composition on financial performance of money deposit banks in Nigeria.

$PERF_{it} = \alpha + \beta 1BS_{it} + \beta 2BC_{it} + \varepsilon_{it}$

Where PERF is performance (dependent variable) measured as a ratio of profit after tax to total asset (Abu, Okpeh & Okpe, 2016; Enilolobo, Adesanmi, & Aigbe, 2019).

BS is board size (independent variable) measured as total number of persons sitting on the board (Oyerogba, Memba, & Riro, 2016; Oyedokun, 2019).

BC is board composition (independent variable) measured as total number of outside directors divide by total number of directors sitting on the board (Ongore, K' Obonyo, Ogutu, & Bosire, 2015; Akpan & Riman, 2012).

α is constant

$\beta 1 - \beta 2$ are the coefficient of the parameter estimate

ε is the error term

Data Presentation, Analysis of Results and Discussion of Findings

The presentation of data begins with descriptive statistics which shows the level of average and risk variation of the quoted sampled firm for the period of 2015 to 2019. The result was represented in the table below.

Table 4.1: Descriptive Statistics.

Variables	Mean	Std. Deviation	Jarque-Bera
PERF	1.57	1.37	4.01 (0.13)
BS	14.23	3.04	2.56 (0.27)
BC	0.59	0.11	8.56 (0.01)

Source: Author's Computation (2020)

Table4.1 shows the mean (average) for each of the variable, their standard deviation (degree of dispersion) and Jarque-Bera (JB) statistics (normality test). The results in table 4.1 provided some insight into the nature of the selected quoted banks that were used in this study. On the average, financial performance measured by return on asset was N1.57 with a corresponding standard deviation value of 1.37, board size on the average was 14.23 with a corresponding standard deviation value of 3.04. This implies that the number of directors sitting on the board of quoted banks in Nigeria was fourteen (14) on the average. Board composition measured by the ratio of non-executive directors to total board size on the average was 0.59 with a corresponding standard deviation value of 0.11. To find out the level of distribution of the variables, the Jarque-Bera (JB) statistics shows that the independent variables were normally distributed.

To examine the relationship between board characteristics and firm performance of money deposit banks in Nigeria, Pearson correlation matrix was conducted and the result was presented in Table 4. 2 below

Table 4.2: Pearson Correlation Matrix

	PERF	BS	BC
PERF	1		
BS	-0.1776	1	
BC	-0.1643	0.4661	1

Source: Author's Computation (2020)

Correlation matrix measures the degree of linear association between the dependent variable and explanatory variables. The result of the Pearson correlation matrix showed that board size (BS) was negatively correlated with financial performance measured by return on asset (ROA= -0.1776). This means that large board size will lead to a decrease in financial performance of money deposit banks in Nigeria. Board composition (BC) was also negatively correlated with financial performance measured by return on asset (ROA=-0.1643). A close look at the correlation matrix also revealed that no two explanatory variables were perfectly correlated. This means that there is the absence of multicollinearity problem in our model.

Multicollinearity between explanatory variables may result to wrong signs or implausible magnitudes, in the estimated model coefficients and bias of the standard errors of the coefficients. The mean aggregate value of the Variance Inflation Factor (VIF) of 1.27 confirms the absence of multicollinearity problem in our model (see appendix below).

To examine the significant impact of board characteristics on financial performance of money deposit banks in Nigeria, the study employed a multiple regression technique to test the formulated hypotheses. The results obtained were presented in table 4.3 below;

Table 4. 3: Multiple Regression Results

Variable	**Coefficient**	**t-test**	**p-value**
C	5.92	3.74	0.0004
BS	0.14	2.39	0.0195
BC	3.80	2.33	0.0230

R-Square = 0.109632

Adjusted R-Square = 0.080910

F-Statistic = 3.81

Prob(F-Statistic) = 0.02

Source: Author's Computation (2020)

From the multiple regressions results, the study revealed that board size (BS) had a significant positive impact on financial performance of money deposit banks in Nigeria. This means that an increase in board size will lead to increase in the financial performance of money deposit banks in Nigeria. The significant of board size was because the p-value is less than 0.05. The result is consistent with the findings of Oyerogba, Memba and Riro (2016) and Enilolobo, Adesanmi and Aigbe (2019) which revealed that board size had a positive significant impact on financial performance of firms. However, the result is inconsistent with the studies of Ongore, K'obonyo, Ogutu and Bosire (2015) and Oyedokun (2019) which revealed that board size had a negative insignificant impact on financial performance of firms.

The result also revealed that board composition (BC) had a positive significant impact on financial performance of money deposit banks in Nigeria. This means that an increase in the number of non-executive directors sitting on the board would lead to increase in the financial performance of money deposit banks in Nigeria. The significant of board composition was because the p-value less than or equal to 0.05. The result is in tandem with the studies of Fuzi, AbdulHalim and Julizaerma (2016), Muller (2014) and Wu, Lin, Lin and Lai (2014) which revealed that board composition had positive significant impact on financial performance of firms. The result is however not consistent with the studies of Abu, Okpeh and Okpe (2016) and K'obonyo, Ogutu and Bosire (2015) which revealed that board composition had insignificant impact on financial performance of firms.

Given table 4.3 above, the systematic variation between board characteristics and financial performance of money deposit banks in Nigeria is 8% as deduced from the coefficient of determination (adjusted R^2). The F-statistic value of 3.81 showed a significant linear relationship between corporate board characteristics and financial performance of money deposit banks in Nigeria. To test for the presence of heteroskedasticity in the result, the Harvey heteroskedasticity test conducted indicates that the insignificance of the F-statistic (0.749126) and observed R-squared (1.533687) showed that there is absence of heteroskedasticity in the regression results. This was reported in table 4.4 below;

Table 4.4: Breusch-Pagan Godfrey White heteroskedasticity Result

F-Statistics	0.749126	prob. F (2, 62)	0.4770
Obs*R-Square	1.533687	prob. Chi-Square (2)	0.4645
Scaled explained SS	0.989994	prob. Chi-Square (2)	0.6096

Source: Author's Computation (2020)

Conclusion and Recommendations

The study examined board characteristics and financial performance of money deposit banks in Nigeria. The objective of the study was to specifically examine the impact of board size and board composition on financial performance of money deposit banks. The study used board size and board composition to proxy board characteristics which were the independent variables while return on assets was used to proxy financial performance which was the dependent variable.

The study revealed that board size and board composition are positively significant to financial performance of money deposit banks in Nigeria. This connotes that increase in board size and increase in the number of non-executive directors sitting on the board will go a long way in increasing the financial performance of money deposit banks in Nigeria.

The study recommends that regulatory authorities should ensure the increase in the number of persons sitting on the board and they should also ensure the increase in the number of non-executive directors sitting on the board since they are likely to bring their knowledge, expertise and integrity to bear in enhancing the financial performance of money deposit banks in Nigeria.

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APPENDIX: RESULTS

Descriptive Statistics

	PERF	BS	BC
Mean	1.578889	14.23077	0.590308
Median	1.587000	15.00000	0.560000
Maximum	4.996700	19.00000	0.880000
Minimum	-0.800400	6.000000	0.370000
Std. Dev.	1.379590	3.040195	0.114482
Skewness	0.594269	-0.470341	0.884036
Kurtosis	2.738167	2.747093	3.194821
Jarque-Bera	4.011527	2.569784	8.569266
Probability	0.134558	0.276680	0.013779
Sum	102.6278	925.0000	38.37000
Sum Sq. Dev.	121.8091	591.5385	0.838794
Observations	65	65	65

Pearson Correlation Matrix

	PERF	BS	BC
PERF	1.000000	-0.177683	-0.164338
BS	-0.177683	1.000000	-0.466199
BC	-0.164338	-0.466199	1.000000

OLS Regressions

Dependent Variable: PERF
Method: Least Squares
Date: 06/06/20 Time: 02:06
Sample: 1 65
Included observations: 65

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	5.923657	1.583196	3.741582	0.0004
BS	0.147441	0.061468	2.398646	0.0195
BC	3.805766	1.632357	2.331454	0.0230

R-squared	0.109632	Mean dependent var	1.578889
Adjusted R-squared	0.080910	S.D. dependent var	1.379590
S.E. of regression	1.322601	Akaike info criterion	3.442133
Sum squared resid	108.4550	Schwarz criterion	3.542489
Log likelihood	-108.8693	Hannan-Quinn criter.	3.481730
F-statistic	3.817055	Durbin-Watson stat	0.590925
Prob(F-statistic)	0.027331		

Heteroskedasticity Test: Harvey

F-statistic	0.749126	Prob. F(2,62)	0.4770
Obs*R-squared	1.533687	Prob. Chi-Square(2)	0.4645
Scaled explained SS	0.989994	Prob. Chi-Square(2)	0.6096

Test Equation:
Dependent Variable: LRESID2
Method: Least Squares
Date: 06/06/20 Time: 02:07
Sample: 1 65
Included observations: 65

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.811276	2.161545	0.837954	0.4053
BS	0.049480	0.083923	0.589590	0.5576

BC	2.727535	2.228665	1.223842	0.2256

R-squared	0.023595	Mean dependent var	-0.502949
Adjusted R-squared	-0.007902	S.D. dependent var	1.798662
S.E. of regression	1.805754	Akaike info criterion	4.064889
Sum squared resid	202.1664	Schwarz criterion	4.165245
Log likelihood	-129.1089	Hannan-Quinn criter.	4.104486
F-statistic	0.749126	Durbin-Watson stat	1.191320
Prob(F-statistic)	0.477010		

Variance Inflation Factors
Date: 06/06/20 Time: 02:07
Sample: 1 65
Included observations: 65

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
C	2.506509	93.13753	NA
BS	0.003778	29.71018	1.277696
BC	2.664589	35.77957	1.277696