CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE IN THE BANKING SECTOR OF NIGERIA AND THE UNITED KINGDOM

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Abstract

Banks are the support system of any economy, hence the significant need for economies to have a healthy system of banking with operative corporate governance system. The study examined the effect of corporate governance and financial performance in the banking sector of Nigeria and United Kingdom. It analysed secondary data collated from the annual report of ten listed banks each from the Nigeria and UK stock exchange markets. Using multiple regression model, the study examined the combined effect of board size, board composition, audit committee and firm size on the performance of the listed banks. The result shows that corporate governance variables have a significant effect on the financial performance of the Nigeria and U.K banking sector.

Keywords: Inflation, monetary policy, economic growth, purchasing power, Nigeria.

Introduction

Corporate governance has become a timely and relevant issue which has drawn significant interest from scholars and practitioners. In the past years, investor’s confidence globally has been shaken by multiple evidence and cases of corporate fraud in the sector. According to (Abdulazeez, Ndibe, & Mercy, 2016) poor corporate governance has also led to major scandals and failures in the finance industry. Scholars such as Owolabi (2010) and Udeh & Ugwu (2018) have observed that fraud is linked to

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most crisis in banks, which at some point, culminated in bank failure.

The increase in the failures of companies and rise in fraudulent activities have necessitated the need to enhance corporate governance and evolve a new code of company performance. (Ogege, 2014). A crucial element in the process is the emergence of stronger corporate governance through more and robust board of directors, expected to provide strategic direction and management oversight for the company. The board is also expected to supervise, appraise operations and approve management proposals, in addition to checking for signs of corporate ineffectiveness and managerial pitfalls. (Ogege, 2014).

Nigeria has had its fair share of financial crises. In recent past, the banking sector of Nigeria has witnessed an unprecedented distress in the finance sector. Several banks thought to be healthy by investors turned out to be distressed. For instance, Diamond bank, now incorporated into Access bank experienced major volatility due to poor financial performance and bad corporate governance. Nelson (2018) opined that the evidence of the menace in choosing to ignore the lines between competency and mediocrity resulted to the poor governance perpetrated at Diamond bank. The Securities and Exchange Commission (SEC) in 2008 reviewed the 2003 Code of Corporate Governance for Public Companies in Nigeria to contend with the impotence of corporate governance and to ameliorate the instrument for enforcing it. SEC board believes that with the new corporate governance code, the highest standard of transparency, good corporate governance and accountability would be established.

Globally, corporate scandals and financial crises at Enron, Tyco, WorldCom and other United States’ banks was the result of weak corporate governance being a determining factor of fraudulent financial reporting, unethical corporate culture and earnings management (Hugh Grove, 2014). In 2002, the U.S. congress enacted The Sarbanes-Oxley Act (SOX) which buttressed corporate accountability to revive and restore the confidence of investors in the financial market as well as being accountable for financial reports. In 2008, Lehman Brothers which was the US's largest investment bank collapsed, which sparked another unexpected crisis in the global financial system.

This global financial crisis also affected the U.K economy deeply to the extent that tax payer’s money had to be used to rescue banks like the Royal Bank of Scotland, Lloyd bank and Halifax bank of Scotland (BBC NEWS, 2013). U.K. federal reporting council revised its corporate governance code “the combined code” formerly known as “the code” to help promote and support the confidence and outcomes in corporate reporting
and governance. It also states that “good corporate governance should contribute to better company performance by helping a board discharge its duties in the best interests of shareholders; if it is ignored, the consequence may well be vulnerability or poor performance” (Financial Reporting Council, 2008).

While the global financial crisis caused a certain level of misfortune in the banking sector, the U.K. banking sector has displayed a remarkable growth by surviving interest rates limitations as well as revenue stream spreading and regulations. The banking sectors gets income from interest on mortgages and loans, fees and commissions. However, developing countries like Nigeria have it different. Challenges such as bad credit growth, declining quality of assets and weak capitalization, bad debts, over reliance of public sector credit. The future expectation from all these does not look bright because their system of governance is linked directly to their performance. A scrutiny compares of what can be applied in U.K and Nigeria would issue a solution to the problems in Nigeria banking sector.

Financial institutions is any economy’s pillar, therefore it is of great importance for economies to have a healthy and float banking system with an effective corporate governance practice. Poor corporate governance may have a great impact on any country’s economy, it can lead to poor financial performance which in turn leads to financial distress or bank failures. Such weaknesses result in erosion of trust and confidence with potentials for diminished assets of the sector. Against this backdrop, this study examines the impact of corporate governance on the financial performance of both Nigeria and U.K. banking sector. The findings are critical for improving the managerial and operational approaches of the sector.

Literature Review

Corporate Governance

Corporate governance relates to the laws, rules and processes by which organizations are regulated, operated and governed (Central Bank of Nigeria, 2014). Naser (2020) explained that corporate governance are guidelines, practices and set of actions that are put in place to ensure that the managers of the company work towards achieving the vision and mission of the organization and make sure the wealth of the shareholders are maximized in an ethical manner. Sani (2019) emphasized that corporate governance is about the directing and controlling of an organization as well as the structures and also to monitor the effectiveness of management. The view was also expressed by (Munir, Khan, Usman, & Khuram, 2019) stating that corporate governance is a process through which
organizations are managed as well as being controlled systematically. The whole idea of corporate governance according to (Rajesh, 2017) is to affirm a trustworthy and transparent relationship between the organization and its stakeholder. (Akinsulire, 2019) explained that the term corporate governance covers all the general mechanisms by which management are led to act in the best interest of the companies owners. A perfect system of corporate governance would give management all the right incentives to make value-maximizing investment and financing decisions that is investments with positive NPVs.

Varied views exist surrounding how scholars incorporate and comprehend the essence, concept and principles of corporate governance. Nevertheless, researchers always come to the conclusion that is ensuring the owners of the organization wellbeing. Due to the sensitive contractual nature of the banking system in both U.K. and Nigeria, a broader instead of constricted view of corporate governance should be followed.

**Review of Related Empirical Studies**

Several studies serve as the empirical underpinning of this study. However a few of them are reviewed to put the study in proper context.

Aminu, Aisha, & Muhammad (2015) studied the effect of board size and composition on the financial performance of banks in Nigeria. Using the Pearson Correlation and Regression to analyze the relationship between the board size and financial performance, the study found that there is a significant but negative relationship between board size and the financial performance of the selected banks. In a similar study, Gadi (2015) analysed the impact of corporate governance on financial performance of microfinance banks and observed that there is a negative relationship between the board size and financial performance. However, the study carried out by (Joshua, 2019) on eleven banks selected in Nigeria using the regression model concluded that there is a positive correlation but no significant relationship between the board size and performance.

There have been a series of mixed results from the empirical study of the effect of board composition and performance. Shamsi (2019) study resulted to the conclusion that there is no significant relationship between the financial performance and the board composition and it does not factor improved performance. This is consistent with the study by Jesse (2019), which established that board composition has no relationship with financial performance. This outcome is also affirmed by studies from (Mamunur & Rima, 2019) and (Wisdom, 2019).

However, findings from other studies contradict those cited above. For example,
Odunayo (2019) and Biruk & Gurdip (2019) showed that there is a significance impact between the board composition and financial performance. In a similar vein, Araoye & Olatunji (2019) established that board of directors are essential in resolving agency problem. From this standing, the firm performance and the fraction of outside directors sitting on the board are expected to have a positive relationship.

Some studies are however ambivalent on the relationship. The findings of Ataur (2018) were inconclusive that is the board composition has both positive and negative influence on bank performance but not significant.

The interest of the shareholders is protected through the audit committee’s activities. Sometimes, the management’s action may not be to the owners of the organizations advantage. Researches in support of larger audit committee opined that the more people monitoring the activities of managers the less wrongdoings will and that would lead to an increase in performance.

A few studies disclosed positive relationship between audit committee size and firm performance, some are; (Melia & Samsul, 2018), (Ajibade & Okunade, 2019). However, studies like (Ahmed & Durga, 2019) (Norziaton & Hafizah, 2019) concluded that there is no positive relationship between the size of the audit committee and the firm performance. From these studies mixed results and reaction exists between the size of the audit committee and the performance of the firm. It is more logical to have a positive relationship because if shareholders interest can be protected by a number of people, manipulation becomes a difficult task.

**Theoretical Review**

**Agency Theory**

Agency theory is interested in the collision between the principals and agents. The theory exhibits the primary clash of interest. (Sanda, Mikailu, & Garba, 2005) Further explained that the information present can make agents take actions that might be unfavorable to the principal’s interest. The alignment of the two interest can start conflict between the interest groups. In contrast to the stakeholder’s theory, agency theory optimizes only the goals of the principals.

Agency theory explains basically corporate governance and financial performance in the banking sector especially where the fundamental principle of corporate governance is the protection of interests of shareholders who also are the managements’ principal. In the

The Stewardship Theory
The steward theory implies that the firm performance is the way the steward protects and maximize the wealth of shareholders. The company managers and executives are the stewards working for the owners of the organization (shareholders) to make profit.

(Akingunola & Adedipe, 2013) cited Donaldson and Davis explaining that good stewards are managers and executives who work diligently to reach a high level shareholders return and profit. Achievements are what motivates the managers and that’s what the assumptions of this theory is based on. The boards Non-executive directors serve the function better.

The Stakeholder’s Theory
The stakeholder theory focuses on the impact of organizations activity on the identifiable stakeholders of the organization. The theory posits that the interest of the owners of the organizations should be taken in consideration by the managers (officers and directors) during the governance process.

Research Methodology
This study seeks to observe the association amid corporate governance and financial performance in the Banking sectors of Nigeria and U.K. The research design employed in this study is the ex-post facto design. Secondary data extracted from the annual financial statements of banks quoted on the United Kingdom stock market and the Nigerian stock market between the ten years’ period of 2009 and 2018. Multiple regression model was adopted for this study to examine the combined effect of board size, board composition, audit committee and firm size on the performance of the listed banks in Nigeria and United States. The model has been specified bellows as;

\[
\text{Performance} = f (\text{BSIZE, BCOM, ACOM, FSIZE})
\]

\[
\text{ROA} = \beta_0 + \beta_1 \text{BSIZE} + \beta_2 \text{BCOM} + \beta_3 \text{ACOM} + \beta_4 \text{FSIZE} + \beta_5 \text{CDUAL} + e_t
\]

Where;

ROA which means Return on Asset represents a firm performance variable

Variable and its measurement

\[
\text{ROA (return on asset)} = \frac{\text{profit after tax}}{\text{total asset}} \times 100\%
\]

BSIZE= Board size
This includes the total number of directors on the board of a bank which is in line with the corporate governance code and must not be over 20.

**BCOM= Board composition**
This includes the number of non-executive directors on the board

**ACOM= Audit committee**
This is the total number of people in the audit committee.

**FSIZE = Bank Size**
The firm size is used as the control variable for this study. This is measured by the log of the value of the total assets.

**$\beta_0 \text{ to } \beta_4=$ Coefficient**

$e_t = \text{Stochastic error term.}$ The error term accounts for other elements that could possibly affect the ROA that were not captured in the model.

The a-priori is such that: $\beta_1, \beta_2, \beta_3, \beta_4 > 0$. This means a positive relation is expected between the explanatory variables ($\beta_1; \beta_2; \beta_3; \beta_4$) and ROA which is the dependent variable. The coefficient size will aid in the explanation of the various relationship levels between the explanatory variables.

**Results and Discussion**

**Correlated Random Effects - Hausman Test (Nigeria)**
Equation: Untitled Test cross-section random effects

<table>
<thead>
<tr>
<th></th>
<th>fe</th>
<th>re</th>
<th>Difference</th>
<th>S.E.</th>
</tr>
</thead>
<tbody>
<tr>
<td>bsize</td>
<td>-0.0759759</td>
<td>0.0618526</td>
<td>-0.1378284</td>
<td>0.1077589</td>
</tr>
<tr>
<td>bcom</td>
<td>-0.3196995</td>
<td>-0.340171</td>
<td>0.0204715</td>
<td>0.1852596</td>
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<tr>
<td>acom</td>
<td>0.2409594</td>
<td>-0.0021842</td>
<td>0.2431435</td>
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<tr>
<td>bfsize</td>
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<td>-0.575804</td>
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<td>0.3093833</td>
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**TEST SUMMARY:** chi2(4 = 8.11 Prob>chi2 = 0.0877

Correlated Random Effects - Hausman Test (UK)

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<tr>
<td>bsize</td>
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<tr>
<td>bcom</td>
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<td>0.0093724</td>
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<tr>
<td>acom</td>
<td>0.0414913</td>
<td>0.043401</td>
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<tr>
<td>bfsize</td>
<td>-1.048015</td>
<td>-1.154541</td>
<td>-0.8934738</td>
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</tr>
</tbody>
</table>
Test Summary; chi2(4)= -29.27   chi2<0 ==> 
The hausman test was used to select the model suited best for the panel regression. The hausman test rule states:

Adopt a fixed effect method if the p-value is statistically significant.

Adopt a random/fixed effect model if the P-value is not statistically significant.

Also, the p-value (0.0877) < 5% significant for Nigeria. Thus, for this regression analysis, a fixed effect model will be used.

Regression analysis output (NIGERIA)

<table>
<thead>
<tr>
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<td>8.20612911</td>
<td>4.0394</td>
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<tr>
<td>Residual</td>
<td>134.127505</td>
<td>45</td>
<td>2.98061121</td>
<td>0.1966</td>
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<tr>
<td>Total</td>
<td>166.952021</td>
<td>49</td>
<td>3.4071841</td>
<td>1.7264</td>
</tr>
</tbody>
</table>

| roa  | Coef. | Std. Err. | t     | P>|t| | [95% Conf. Interval] |
|------|-------|-----------|------|------|---------------------|
| bsize| .0618526 | .1255504 | 0.49 | 0.625 | -.191019 .3147241 |
| bcom | -.340171 | .2432963 | -1.40| 0.169 | -.830195 .1498529 |
| acom | -.0021842 | .5643235 | -0.00| 0.997 | -.113879 1.134422 |
| bfsize| -.575804 | .2280902 | -2.52| 0.015 | -1.035201 .1164068 |
| _cons| 10.98859 | 4.582582 | 2.40 | 0.021 | 1.758799 20.21839 |

Regression analysis output (U.K.)

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<td>7.70643504</td>
<td>0.0000</td>
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<tr>
<td>Residual</td>
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<td>45</td>
<td>1.73475286</td>
<td>0.7979</td>
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<tr>
<td>Total</td>
<td>38.632128</td>
<td>49</td>
<td>.788410776</td>
<td>.4165</td>
</tr>
</tbody>
</table>

| roa  | Coef. | Std. Err. | t     | P>|t| | [95% Conf. Interval] |
|------|-------|-----------|------|------|---------------------|
| bsize| .0199913 | .0476417 | 0.42 | 0.677 | -.075964 .1159466 |
| bcom | -.0059564 | .0516794 | -0.12| 0.909 | -.1100441 .0981313 |
| acom | .0414913 | .056828 | 0.73 | 0.469 | -.0729662 .1559488 |
| bfsize| -1.048015 | .0956978 | -10.95| 0.000 | -1.24076 -.8552696 |
| _cons| 12.34142 | 1.065416 | 11.58 | 0.000 | 10.19557 14.48728 |

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Discussion of Panel Regression Results

This research examines the effect of corporate governance on the financial performance of Nigeria and U.K banking sector. The dependent variable which is the financial performance was measured by Return On Asset (ROA) and the independent variable that is corporate governance was measured by Board Size, Board composition, Audit committee and firm size (BSIZE, BCOM, ACOM & BFSIZE).

I. For Nigeria, the determining coefficient which is represented by r-squared is 0.19(19%), while the adjusted R-squared which justifies all the independent variables are 0.12(12%). This denotes that 19% of the dependent variable has been explained by the independent variables while the remaining 81% is as a result of factors not included in this research. The F-Statistics result shows a positive (2.75) which shows the model fitness. From this analysis, it shows that there is no significant relationship between corporate governance (BSIZE, BCOM, ACOM & BFSIZE) and financial performance of the banking sector in Nigeria.

The autonomous coefficient which is the constant term "C" has a value of 10.98859 percent. The result indicates that an increase of 10.9886 in Nigeria banks financial performance will definitely occur including or excluding the independent variables and the cause of this increase could be by the variable outside this model. The bank financial performance variation on corporate governance is statistically explained in the value of F-statistics which is 0.0394. according to the result, BSIZE, BCOM, ACOM and FSIZE all have with the return on asset (ROA) have a positive significant as the model shows the P-value of 0.625, 0.169, 0.997, 0.015 respectively.

II. The effect of corporate governance and financial performance in the U.K. banking sector was examined and the result shows the r-squared is 0.7979(79%) while the adjusted R-squared is 0.7800 (78%) implying that that 79% of the dependent variable (ROA) has been explained by the independent variables while the remaining 29% is as a result of factors not included in this research. The F-statistics result shows a positive (44.42) which shows the model fitness. From this analysis, it shows that there is a significant relationship between corporate governance (BSIZE, BCOM, ACOM & BFSIZE) and financial performance of the banking sector in U.K.

Also, BSIZE showed a positive result of (0.677) but significant relationship with the ROA. This would mean for each unit of increase in BSIZE, the higher the level of profitability. BCOM had (0.909) which shows that there is a significant relationship with ROA. ACOM result was (0.469) which means there is a significant relationship with ROA. This can be deciphered as the higher the number of auditor on the board the better
the financial performance of the bank. For this study, FSIZE was used as a control variable. FSIZE result showed (0.000) which means there is no relationship or significance with ROA.

This findings are consistent with the works of some researchers (Abdulazeez, Ndibe, & Mercy, 2016) (JOSHUA, 2019) who observed a positive relationship between corporate governance and financial performance. Audit committees, large board size, board compositions promote financial performance positively.

The implication of this result is that corporate governance is a crucial factor of good financial performance for the banking sector of developing countries like Nigeria and developed countries like the U.K. this study shows that governance is flexible. Different countries have different governance effect.

**Conclusion and Recommendation**

The effect of corporate governance and financial performance in the banking sector of both Nigeria and U.K from 2009 to 2018. This was done using collected data from the annual reports of 10 listed banks in the Nigerian and United Kingdom stock exchange and it was observed that bigger board size has more contribution to the financial performance than smaller board size. Also, with a large board size it will be difficult for a person to dominate the board and the decisions made by the board would be made from a sound and constructive perspective. To get the full advantage of bigger board size it is imperative that efforts should be placed on the credentials, expertise and experience range of those brought on board.

The board compositions result summary revealed that the number of the non-executive directors are higher than the directors and this is in compliance with the codes of corporate governance.

The audit committee shows that the higher the auditors in the board, the higher the financial performance that is the finances are monitored properly. In conclusion, corporate governance variables have a significant effect on the financial performance of the Nigeria and U.K banking sector.

**References**


evidence from Nordics. Aalto University School of Business.