Board Composition, Executive duality and Performance of Banks in the Post-Consolidation Era in Nigeria

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Abstract

The Nigerian banking system, as the nerve of financial activities in the country had undergone series of reforms from the decade of the 1980s to date. These reforms came at the hill of crises in the system; the crises were attributed to among other things, poor corporate governance. Codes were issued by the security and exchange commission in 2003 for all companies, including banks. The banking consolidation came afterwards. In 2006, the central bank of Nigeria issued another code after the consolidation exercise. Recently, evaluation of these codes in the banking sector revealed some banks were classified unhealthy. This study has, as a major objective to study the impact of board composition on the performance of banks considered healthy by the central bank of Nigeria. Furthermore, the study had also as an objective to establish whether such an impact was attributable to the existence of a corporate governance compliance officer. The 12 banks that emerged as healthy banks, made the sample of the study. Data covering the period 2006-2010 were extracted from their financial statements. The study employed two techniques to test for the two hypotheses formulated from the mathematical model outlined for the study; the multiple regressions (ANOVA), was employed to establish the relationship between the variables. The independent samples t-test was used to further determine the impact revealed. Findings revealed the absence of a significant relationship and impact that was not attributable to the mechanisms of corporate governance. However adherence to these codes promoted the overall effectiveness in functions of these banks i.e operational performance. Sustaining the use of the corporate governance code issued by the Central bank of Nigeria, security and exchange commission as well as the standards issued by the Financial Reporting Council of Nigeria should be further enhanced by complementary managerial policies that would promote the relationship and impact of governance mechanism on financial performance of banks.

Keywords: Board composition, Executive duality, Compliance statue, and financial performance

1 Introduction

Much of the extant literature from all over the world have made it clear about, the need to effectively and efficiently enhance corporate governance in corporations, in order to avoid...
failure. This was also observed in Nigeria. In this wise, the security and exchange commission (SEC) in 2003, posit that, the financial sector attracted poor corporate governance due to the fact that, only about 40% of quoted companies, including banks, had recognized codes of corporate governance in place. Consequently, in 2003, the Nigerian Securities and Exchange Commission (SEC) released a Code of Best Practices on Corporate Governance for public quoted companies. However, in 2006, the consolidation of the banking industry necessitated a review of the existing code for the Nigerian Banks. The new code therefore was developed to compliment the earlier ones and enhance their effectiveness for the Nigerian banking industry. Compliance with the provisions of the Code was mandatory. Some of the provisions the code made imperative to comply with includes, that of executive duality. This provision requires that, the responsibilities of the head of the Board, that is the Chairman, should be clearly separated from that of the head of Management, i.e. MD/CEO, such that no one individual/related party has unfettered powers of decision making by occupying the two positions at the same time. The provision further stated that, no one person should combine the post of Chairman/Chief executive officer of any bank and for the avoidance of doubt, also no executive vice-chairman is recognized in the structure. No two members of the same extended family are allowed to occupy the position of Chairman and that of Chief Executive Officer or Executive Director of a bank at the same time.

However, in furtherance of the on-going banking reforms, the CBN in May 2010, issued guidelines to address some corporate governance issues not specifically addressed in the initial code of corporate governance. Like the tenure of the chief executive officers (CEO). The CEO of a bank is required to serve a maximum tenure of 10years. Furthermore, all CEOs who would have served for 10 years by July 31, 2010 shall cease to function in that capacity and shall hand over to their successors. Where a bank is a product of merger, acquisition, take-over or any other form of combination, the ten years period shall include the pre and post combination service years of a CEO provided that the bank in which he previously served as CEO was part of the new bank that emerged after the combination. Any person who has served as CEO for the maximum tenure in a bank shall not qualify for appointment in his former bank or subsidiaries in any capacity until after a period of 3 years after the expiration of his tenure as CEO. Also, in order to ensure both continuity and injection of fresh ideas, nonexecutive directors are not remain on the board of a bank continuously for more than 3 terms of 4 years each, i.e. 12 years.

Another provision was on quality of board membership. Banks are required to be headed by an effective Board composed of qualified individuals that are conversant with its oversight functions. Also, it is expected that existing (CBN) guidelines on appointment to the board of financial institutions be continued and observed. Only people of proven integrity and who are knowledgeable in business and financial matters are required to be on the Board. Regular training and education of board members on issues pertaining to their oversight functions are to be institutionalized and budgeted for annually by banks. The number of non-executive directors should be more than that of executive directors subject to a maximum board size of 20 directors.
Furthermore, in order to ensure actual adherence to the code, a provision on the need to have a compliance statue in the capacity of the banks’ Chief Compliance Officer (CCO) was also created. The officer is expected, in addition to monitoring compliance with money laundering requirements; monitor the implementation of the corporate governance code. The CCO shall make monthly returns to the CBN on all whistle blowing reports and corporate governance related breaches. The CCO together with the CEO of each bank should certify each year to the CBN that they are (not apart from) aware of any other violation of the Corporate Governance Code. The corporate governance compliance status report should be included in the audited financial statements.

What is made clear from these provisions is to bring about optimised corporate governance practices in the industry, if banks do actually comply with these codes in their entirety. However, in 2009 the central bank of Nigeria (CBN) and the Nigerian deposit insurance corporation jointly carried out a special examination to determine whether banks perform their functions effectively. The examination revealed some banks had no basic necessities to function effectively as a result of non compliance with code good practice. Consequently, these banks were in financial mess. This made the CBN classify them as unhealthy. From this view, the following can be deduced: banks functioning effectively is exogenous; secondly, when banks do actually work with these directives, especially in the areas of executive duality, quality of the board, and the number of non-executive directors to be more than executive directors, as well as the existence of a compliance statue (CCO), there is the possibility of banks to optimize their potentials through best corporate governance practices. It is in this context that the study seeks to address the following questions; to what extent has executive duality, quality of the board, and the number of non-executive directors being more than the number of executive directors significantly relates and impacted on financial performance (FP) of the 12 banks that were considered healthy by the CBN, and whether the impact is attributable to the compliance statue (CCO)?

Besides seeking to address these questions, there is an attempt by the study to contribute to bridging the existing gap on the impact of corporate governance and financial performance in financial institutions. This is influenced by the fact that, most studies conducted in Nigeria focused on relationship between corporate governance and firm performance in mostly non financial institutions. (Sanda, Mikailu & Garba, 2005; Kajola, 2008; & Oghojafor, 2011). This study is a mono-sector, and a typical financial institution sample of the 12 banks considered healthy in Nigeria by the Central Bank of Nigeria. The remaining part of this paper is structured into five sections, section one is the introduction including this paragraph. Section two, presents the literature in concepts, prior studies and theoretical review. Immediately after that is the methodology, presenting the model and how the study defined and measured it variables. Afterwards, is the discussion of findings and based on the findings the paper concludes and highlights the study’s implication in the last section of the paper.
2. Literature Review (Conceptual and Theoretical Framework)

According to Mead, (1928), the term corporate governance derives from an analogy between the government of cities, nations or states and the governance of corporations. The early corporate finance textbooks saw representative government as an important advantage of the corporation over partnerships but there has been and still is little agreement on how representative corporate governance really is, or whom it should represent. Corporate governance is about making certain that, the company is directed appropriately for reasonable return on investments (Magdi & Nadereh, 2002). It is the system by which corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company’s objectives are set and the means of attaining those objectives and monitoring performance. Wolfensohn and OECD (1999); Uche (2004) and Akinsulire (2006).

Corporate governance is concerned with the processes, systems, practices and procedures that govern institutions. (Mensah, et al, 2003). It is also concerned with the resolution of collective action problems among dispersed investors and the reconciliation of conflicts of interest between various corporate claimholders; corporate governance rules can be seen as the outcome of the contracting process between the various principals or constituencies and the CEO (Becht et al, 2005). There are other perspectives on corporate governance – the corporation’s perspective and the public policy perspectives. The corporation’s perspective is about maximizing value subject to meeting the corporation’s financial, legal, contractual, and other obligations. This perspective stresses the need for boards of directors to balance the interests of shareholders with those of other stakeholders – employees, customers, suppliers, investors, etc – in order to achieve long term sustained value for the corporation. From a public policy perspective, corporate governance is about nurturing enterprises while ensuring accountability in the exercise of power and patronage by firms. The role of public policy is to provide firms with the incentives and discipline to minimize the divergence between private and social returns and to protect the interests of stakeholders. These two perspectives provide a framework for corporate governance that reflects the interplay between internal incentives (which define the relationship among the key players in the corporation) and external forces (notably policy, legal, regulatory and market) that govern the behavior and performance of the firm (Iskander & Chamlou, 2000). It is important to note here that, there is no broad unanimity on the definition of corporate governance. However, there is such a degree of consensus of the literature on the mechanisms of corporate governance, which include some of the following:

2.1 Executive duality

According to Callaghan (2005), executive duality refers to the organizational structure where in the chief executive officer (CEO) also serves as the chairman of the same firm’s board of directors. However this position has been contested to be unhealthy as far as governance of
corporation is concerned. For example some studies posit among several other reasons that, it promotes poor communication between the CEO and the board (Orwall & Gentile, 2004).

It is important to note that, developments in governance mechanisms saw the need to bifurcate the Chief Executive Officer duality as a possible solution to poor corporate governance. According to Postelnicu and Chaffin, 2003 the New York stock exchange agreed to split the roles of chairman and chief executive officer per the request of the Securities and Exchange Commission (SEC). The separation is believed to help avoid concentrating too much executive authority in one individual. This position holds same for the code issued in Nigeria, as earlier mentioned the code requires that, the responsibilities of the head of the Board, that is the Chairman, should be clearly separated from that of the head of Management, i.e. MD/CEO, such that no one individual/related party has unfettered powers of decision making by occupying the two positions at the same time. There are studies like that of Damato, (2004) who provided evidence that having an independent chair does not prevent misconduct. On the other hand, there are studies who provide inconclusive evidence on the relationship between executive duality and financial performance. For example the following studies (Daily & Dalton, 1993; Sridharan & Marsinko, 1997; and McWilliams, & Sen, 2001; and Callaghan, 2005) find a significant relationship for firms with executive duality but studies like those of (Baliga, Moyer, & Rao, 1996; Rhoades, Rechner, & Sundaramurthy, 2001) did not find a significant relationship with firms having executive duality, rather in firms with bifurcated duality.

2.2 Board quality and Composition

2.2.1 Board quality

This is the general standard or grade of what makes a director’s eligibility to sit on the board. As earlier mentioned, the code emphasizes quality of board membership; to mean, banks are required to be headed by an effective Board composed of qualified individuals that are conversant with its oversight functions. Also, only people of proven integrity and who are knowledgeable in business and financial matters are required to be on the Board. Regular training and education of board members on issues pertaining to their oversight functions are to be institutionalized and budgeted for annually by banks. There are studies that have provided evidence regarding this position. Studies like, Beasley et al, (2000); Klein, (2002); Bedard et al, (2004) posit that, the board of director’s ability to monitor and advise a firm is affected by its influence, competence, incentives, and involvement. This positively affects performance by reducing high earnings management, restatements, and fraud.

2.2.2 Board composition

Board composition is the manner in which the board is arranged in terms of filters or criteria identified as a basis to form the board. As mentioned earlier, the provision stipulates that, the number of non-executive directors to be more than that of executive directors subject to a maximum board size of 20 directors. This implies more of outside directors are required on board, for governance to be effective as this promotes independence of the board. A lot of studies had looked at the independence, or lack thereof, of corporate boards of directors,
which is often measured by the percent of outsider board members relative to the percentage of insider members with the assumption that the company will be better governed with more outside members (Callaghan, 2005). Furthermore, Dehaene, De-Vuyst, and Ooghe (2001) find that the percentage of outside directors is positively related to the performance of Belgian firms. Rosenstein and Wyatt (1990) find a positive stock price reaction at the announcement of the appointment of an additional outside director, implying that the proportion of outside directors affects shareholders’ wealth. In the same vein, Bhojraj and Sengupta (2003); and Ashbaugh-Skaife; Collins and Kinney (2006) also find that firms with greater proportion of independent outside directors on the board are assigned higher bond and credit ratings respectively. However, this assertion has been evidenced to be inconclusive in other studies (Wagner, Stimpert, & Fubura, 1998; Luoma & Goodstein, 1999; Bhagat & Black, 2002; Klein, 2002; Ellstrand, Tihanyi, & Johnson, 2002).

According to Becht et al, (2005) in practice the structure, composition and exact role of boards varies greatly between individual corporations (charters) and governance systems. The same is true for the rules governing the appointment and removal of a board member and their duties. In formal terms, boards can have one or two tiers. One-tier boards are usually composed of executive directors and nonexecutive directors. In theory the executives manage and the non-executives monitor, but in practice one-tier boards are often close to management. In a two-tier board system there is a separate management board that is overseen by a supervisory board. Supervisory board members are barred from performing management functions. Informally, both types of board can be more or less captured by management or dominated by block holders. To avoid the problem of capture by such interests, corporate governance recommendations emphasize the role of independent directors, non-executive directors who have no links with the company other than their directorship and no links with management or block holders. The role of the board in approving corporate decisions also varies. In one system a decision that can be ratified by the board requires shareholder approval in another. Major decisions, like mergers and acquisitions, almost always require shareholder approval. In most systems the shareholders appoint and remove the board, but the rules vary substantially. The board appoints the managers. In some countries boards have a formal duty vis-à-vis the employees of the company or, as in Germany, employees have the right to appoint directors. In the USA statutes that require boards to take into account the interests of non-shareholder constituencies are commonly portrayed as anti-takeover rules (Romano, 1993).

More so, working, as well as the composition of boards matters for performance. According to Hermalin and Weisbach (1998), board composition is endogenous, which is an indication that, a significant relationship between board structure and general performance is not based on external influences or structures. In the same vein Ekoja, (2007) posit that, board composition has a significant one-directional and endogenous relationship with firm performance. From a different perspective, Vafeas and Theodorou, (1998); Weir, Laing and mcknight, (2002); Hermalin and Weisbach, (2003); Haniffa and Hudaib, (2006); board composition and corporate performance are not related. The position of Romano (1996) is that, there is a relationship but, it is ambiguous.
2.3 Ensuring Compliance

The central bank of Nigeria, in the code it issued in 2006, made it imperative for the existence of a compliance statue in the bank, in other words, the appointment of a Chief Compliance Officer (CCO). This was done to ensure adherence to the code. The officer is expected, in addition to monitoring compliance with money laundering requirements; monitor the implementation of the corporate governance code. The CCO shall make monthly returns to the CBN on all whistle blowing reports and corporate governance related breaches. The CCO together with the CEO of each bank is to certify, each year to the CBN that they are (not apart from) aware of any other violation of the Corporate Governance Code. The corporate governance compliance status report is to be included in the audited financial statements.

2.4 Theoretical Perspective

In this sub-section, an attempt is made to review theory that support achieving corporate governance objectives in banks in a post-consolidation era:

2.4.1 Concentration Theory.

This refers to the degree of control of economic activities by large firms (Sathye, 2002). The theory of concentration proposes economies of scale drive mergers and acquisitions which go hand in hand with efficiency improvements (Demigue-kunt & Levine, 2001). This surmise concentration by virtue of consolidation is beneficial. According to Boyd and Runkle (1993), voluntary consolidation brings about inverse relationship between size and the volatility of asset returns. Contrarily, Allen and Gale (2000) posit less concentrated banking sector with many small banks is more prone to financial crisis than a concentrated banking sector with a few large banks. Concentrated banking sector may also enhance profit and therefore lower bank’s fragility. High profits provide a buffer against adverse shock and increase the franchise value of the bank, reducing incentives for the banks to take excessive risk (Demigue-kunt & Levine, 2004).

What can be deduced from this theory is that, banks in Nigeria are characterized mostly by SEC and CBN directives that specify the mode of conduct expected of banks as entities. Secondly the banking sector is concentrated as a result of the consolidation that resulted in mergers and acquisition. Hence, with consolidation comes integration of processes and culture. This integration, through a well defined code of corporate governance practice yields possible positive results which in turn attracts positive financial performance (FP).

3. Methodology

The objective of this study is to assess the relationship and impact of corporate governance (CG) {board composition, and executive duality} on corporate financial performance (FP){Return on capital employed} of the 12 banks that were considered healthy by the CBN, and to establish whether the relationship and impact is attributable to the compliance statue (CCO).
To achieve this objective, content analysis was used to collect CG and FP data from the annual financial reports and accounts of 12 banks (Access, Fidelity, Guarantee trust, First, First city monument, Stanbic ibtc, Skye, Zenith, Sterling, Eco, Diamond, and UBA) for the period 2006-2010. The choice of this period is influenced by the fact that, it is in the era of post consolidation. The study developed a mathematical model as the basis for testing the hypotheses formulated for this study. The study specified two accounting ratios (Return on capital employed {Gross} [ROCEG] and Return on capital employed {Net} [ROCEN]) as proxies for the dependent variable, corporate financial performance (FP). The choice of these proxies is based on the assertions that, they indicate whether or not management is efficient in the utilization of the assets of the business. For the independent variable, corporate governance (CG) {board composition [BC], executive duality [ED] and compliance officer [CCO]} were used to represent it. The choice of these proxies is based on the objective of this study, which is to know whether board composition, and executive duality relates and impact on FP. Secondly, to establish whether such a relationship and impact is attributable to the existence of a compliance statue (CCO). SPSS version 17 was used to aid the analysis of data collected.

3.1 Population and Sample of the Study

The population of the study is the 12 banks out of the 23 banks quoted on the Nigerian stock exchange, which were considered healthy by the Central Bank of Nigeria. These banks are also the sample of this study. This implies \( n = N = 12 \). Where: \( n \) = Sample size \( N \) = Population size. Arising from the above, considering the period under review (2006-2010), a total of 60 annual reports and account of the following banks; First bank, Union bank, Guarantee trust bank, Sterling bank, Wema bank, FCM bank, Skye bank, Diamond bank, Eco bank, and Zenith bank made the sample.

3.2 Variable Specification

Based on the objectives of this study, a hypothesis was formulated. The study specified two accounting ratios (Return on capital employed {Gross}[ROCEG], Return on capital employed {Net}[ROCEN], ) as proxies for the dependent variable financial performance (FP). The formula for the proxy, Return on capital employed {Gross}[ROCEG] is:

\[
\frac{\text{Profit before tax}}{\text{Capital employed}} \times 100
\]

The formula for the proxy, Return on capital employed {Gross}[ROCEN] is:

\[
\frac{\text{Profit after tax}}{\text{Capital employed}} \times 100
\]

The independent variable proxies (board size, executive duality and compliance statue) were treated as a dichotomous variable, i.e binary number 1 was assigned to the years within the period under review, were the directives in the code for a board composition with more of non
executive directors than executive directors; executive duality bifurcated; and the existence of a compliance statue i.e the chief compliance officer, if otherwise 0 was assigned.

Based on the variables specified for this study, the following mathematical model:

\[ \text{FP (Return on capital employed \{ROCE\}) = F (Board composition \{BC\}; executive duality \{ED\}; and compliance statue \{CCO\})} \]

was developed to test the following null hypotheses:

**\( H_0_1 \)** Board composition and executive duality do not significantly relate and impact on the return on capital employed of banks in Nigeria.

**\( H_0_2 \)** The existence of a chief compliance officer does not significantly enhance return on capital employed of banks in Nigeria.

### 3.3 Techniques of Data analysis

The independent sample t-test was employed to analyse data gathered for hypothesis one. To achieve the independent samples for the study, the proxies for the dependent variable were grouped into 2 samples. ROCEG was categorized as group one and it was assigned binary number 1. For group 2, ROCEN was assigned with binary number 2. Multiple Regressions (Analysis of variance [ANOVA]) was used to analyse hypothesis two.

### 4. Discussion of Findings

Hypotheses were formulated to achieve one of the objectives of this study, which is to determine whether board composition and executive duality significantly relates and impacts on the return of capital employed of banks in Nigeria.

#### Table 4.1a Group Statistics

<table>
<thead>
<tr>
<th>Corporate Governance (BC) and (ED)</th>
<th>N</th>
<th>Mean</th>
<th>Std. Deviation</th>
<th>Std. Error Mean</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROCEG</td>
<td>5</td>
<td>2.0920</td>
<td>.88251</td>
<td>.39467</td>
</tr>
<tr>
<td>ROCEN</td>
<td>5</td>
<td>1.6720</td>
<td>.71775</td>
<td>.32099</td>
</tr>
</tbody>
</table>

**Source: SPSS output listing 2012**

In the table 4.1a above, the mean for group one (ROCEG) is 2.0920 and that of group two (ROCEN) is 1.6720. The standard deviation for group one is 0.88251 with an error mean of 0.39467. For group two, the deviation is 0.71775 with an error of 0.32099. The result reveals that, the difference between the means of the two groups is not wide. This implies it is not
In the table 4.1b above, the F value is at 0.28, this means the levene’s test is not significant. This translates into the t value calculated with the pooled variance estimate (equal variance) to be appropriate. With a 2-Tail significant value (i.e. p-value) of 0.43, the difference between the mean is not significant. This implies, board composition, executive duality does not have an impact on the return on capital employed of banks in Nigeria. Based on these results the hypotheses which states:

**H₀₁** Board composition and executive duality do not significantly relate and impact on the return on capital employed of banks in Nigeria is not rejected.
For the second hypothesis, table 4.2a below was used to test the hypothesis. In the ANOVA table below, the F value is 0.233 with a significant level of 0.0873. This implies the absence of a significant relationship between board composition, executive duality, compliance statue and the return on capital employed. This implies the hypothesis:

\( H_0^2 \) The existence of a chief compliance officer does not significantly enhance return on capital employed of banks in Nigeria is also not rejected.

### 5 Conclusion

The special examination carried out in Nigeria recently by the central bank of Nigeria (CBN) and the Nigerian deposit insurance corporation (NDIC) revealed that, the banks that were considered healthy, had the basic necessities to operate effectively. These necessities include; they are headed by an effective Board, composed of qualified individuals that are conversant with its oversight functions; most of the people on the board are of proven integrity and are knowledgeable in business and financial matters. Furthermore, the numbers of non-executive directors of banks are more than that of executive directors; also the statue of executive duality has been bifurcated alongside providing for a compliance officer.

However, findings of this study revealed that; Board composition do not significantly relate and impact on the return on capital employed of banks in Nigeria. This finding is in line with (Vafeas & Theodorou, 1998; Weir, Laing & mcKnight, 2002; Hermalin & Weisbach, 2003; Hanifia & Hudaib, 2006)). Secondly executive duality does not significantly relate and impact on the return on capital employed of banks in Nigeria. This finding is in line with the findings of (Daily & Dalton, 1993; Sridharan & Marsinko, 1997; and McWilliams, & Sen, 2001; and Callaghan, 2005). Lastly, compliance statue is still not in existence in most of the banks considered healthy by the CBN. This is a pointer to the fact that, monthly returns to the CBN on all whistle blowing reports and corporate governance related breaches as well as the CCO together with the CEO of each bank certifying, each year to the CBN that they are (not apart from) aware of any other violation of the Corporate Governance Code is relegated to the background. Also relegated is
the corporate governance compliance status report, which is supposed to be included in the audited financial statements.

The implication of these findings is that adherence to these codes only promoted the overall effectiveness in functions of these banks i.e operational performance not financial performance, as efficiency in the utilization of asset was not significant because the overall operational performance was based on external influence. This further confirms the findings of (Hermalin & Weisbach, 1998; and Ekoja, 2007) that, board composition is endogenous, which is an indication that, a significant relationship between board structure and general performance is not based on external influences or structures. Based on this conclusion, it is imperative to recommend that, sustaining the use of the corporate governance code issued by the Central bank of Nigeria, security and exchange commission as well as the standards issued by the financial reporting council of Nigeria should be further enhanced by complementary managerial policies that would promote the relationship and impact of governance mechanism on financial performance of banks.

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