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BOARD CHARACTERISTICS AND FINANCIAL PERFORMANCE OF LISTED DEPOSIT MONEY BANKS IN NIGERIA

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Abstract

This paper investigates the relationship between specific board attributes and the financial performance of publicly listed deposit banks in Nigeria, focusing on board size and composition, which are examined in relation to the measure of financial performance proxied by the return on assets (ROA). Drawing from agency theories, a panel data approach spanning 2011 to 2020 examines ten deposit banks listed on the Nigerian Stock Exchange (NSE), resulting in 60 firm-year observations. The study obtained data from the annual reports of selected banks and the official websites of the NSE. The model's validity is assessed through a multiple regression analysis. The findings of this study reveal a positive and significant association between board size and financial performance, highlighting the pivotal role of larger boards in enhancing deposit banks' financial outcomes on the NSE. In contrast, the study finds a negative and significant relationship between board composition and financial performance, suggesting that an increased board composition leads to decreased financial performance. Overall, this study underscores the significant impact of board characteristics on the financial performance of listed deposit banks in Nigeria. The implications of these findings are pertinent for policymakers and market regulators, as they offer valuable insights into the role of board characteristics in bolstering the financial performance of banks.

1. Introduction

In the dynamic landscape of contemporary business, the pivotal role of boards in ensuring the effective functioning of organizations cannot be overstated. Boards are entrusted with multifaceted responsibilities, ranging from providing strategic direction (Ghosh & Ansari, 2018; Kemp, 2006; Oyedokun, 2019) to supervising management decisions, hiring and firing executives (Hermalin & Weisbach, 1998), and facilitating access to vital resources (Hendry & Kiel, 2004; Hillman et al., 2000). Additionally, boards play a crucial role in monitoring management activities to mitigate agency costs (Eisenhardt, 1989; Ranasinghe, 2010; Roberts et al., 2005). The significance of board characteristics becomes even more pronounced in the context of Nigerian banks, which have faced a history of financial failures, frauds, and questionable business practices, adversely impacting investor confidence. Hence, there is an urgent need to explore the impact of board characteristics on the financial performance of listed deposit money banks in Nigeria.

While empirical research has extensively explored the association between board characteristics and financial performance, the majority of these studies have been concentrated in advanced economies, with a notable dearth of emphasis on emerging economies, especially within the financial sector (Busta, 2007; Cornett, 2009; De Andres, 2008; Romano et al., 2012). This scarcity is particularly evident in the case of deposit money banks, where evidence on the relationship between board characteristics and financial performance remains sparse in the existing literature (Abubakar, 2015; Al-Hawary et al., 2011; Gwaison&Maimako, 2021; Mokhtar et al., 2009; Oyedokun, 2019; Trabelsi, 2010). This gap in research highlights the need for a dedicated exploration of the board-performance nexus in the unique context of Nigerian deposit money banks.

Furthermore, the global landscape of corporate governance is witnessing a transformation, with regulatory bodies and policymakers introducing fresh standards to attract foreign direct investment and capital formation (Agrawal & Chadha, 2005). The Securities and Exchange Commission (SEC) in Nigeria, for instance, endorsed a revised framework in 2003, incorporating listing provisions recommended by esteemed organizations such as the National Association of Corporate Directors (NASD), the New York Stock Exchange (NYSE), and the Sarbanes-Oxley Act (SOX, 2002). These standards encompass crucial aspects like board composition, size, audit committee responsibilities, and composition, emphasizing the need for optimal corporate governance practices.

The financial institutions in Nigeria have grappled with breakdowns attributed to unethical practices by boards, a lack of accountability, and inadequate corporate governance standards, leading to a loss of trust among shareholders (Nuhu, 2017). In response to these challenges, the SEC introduced a Code of Best Practice, outlining guidance on Nigerian corporate governance standards. This underscores the essential role of a proficient corporate governance system in administering a company's operations for the utmost benefit of shareholders. The board of directors, as a central figure in corporate governance, holds the primary responsibility of overseeing management and ensuring accountability to shareholders and stakeholders. The ongoing debate surrounding the impact of board characteristics on company performance, including indicators like education, gender composition, director compensation, CEO duality, block holders, and professional experience (Akpan & Amran, 2014; Vo & Phan, 2013), underscores the need for a comprehensive investigation.

Numerous studies globally have explored the effects of board composition and size on financial performance, with Nigerian researchers contributing to this body of knowledge (Akpan & Amran, 2014; Gwaison & Maimako, 2021; Oyedokun, 2019; Ujunwa, 2012). However, the goal of this study is to specifically investigate how board characteristics impact the financial performance of listed deposit banks in Nigeria. The rationale behind this focus lies in the pivotal role of boards as instruments for informing and overseeing corporate management, aligning business affairs with the best interests of shareholders, as proposed by Fama and Jensen (1983).

This study contributes to the existing body of knowledge by providing empirical evidence on the link between board characteristics and the financial performance of Nigeria's listed deposit banks. The objective is to discern whether the Nigerian context aligns with global best practices or if distinctive patterns emerge concerning the association between board characteristics and financial performance within the Nigerian business landscape.

Despite the diverse evidence on the impact of board characteristics on financial performance globally, with some studies observing improvements (Andres & Vallelado, 2008; Assenga et al., 2018; Cornett et al., 2009; Kumar & Singh, 2012; Mishra, 2020; Naciti 2019; Progress et al., 2014) and others finding no relationship (Al-Hawary et al., 2011; Ganguli & Deb, 2021; Junaid et al., 2020; Oyedokun, 2019), our findings align with studies supporting the notion that greater board size and composition contribute to improved financial performance (Assenga et al.,

2018; Cornett et al., 2009; Mishra, 2020; Andres and Vallelado, 2008). This analysis is expected to enrich the ongoing discourse regarding this relationship, particularly within the unique context of Nigerian banks.

The remaining section of this paper is structured as follows: In Section two, we present an in-depth review of relevant literature, including insights from prior research. The research approach used in this study is described in section 3. Section 4 shows the findings from our analysis. Lastly, the concluding section offers a discussion of the results and the study's overall conclusions.

2. Literature Review and Hypotheses Development

The review of existing literature has highlighted the absence of a singular overarching theoretical framework capable of providing a complete understanding of the multifaceted factors influencing the connections between board of directors and the financial performance. It has become evident that the relationship between the board of directors and financial performance is considerably more complex and varied than any single governance theory can comprehensively address, as (Nicholson & Kiel, 2007). Nevertheless, this paper leverages the two most prevalent corporate governance theories to review prior relevant literature and establish the study's hypotheses. Firstly, agency theory is employed to investigate the roles played by directors in contributing to the success of the companies they oversee. This entails an examination of the impact of board leadership and board composition on performance. Secondly, the theory of resource dependence is utilized to explore the relationship between organizations and the critical resources required for achieving maximum efficiency, including an analysis of board size's influence on overall performance. The integration of agency theory aligns with previous research conducted by Hillman and Dalziel (2003) and Jackling and Johl (2009), who argue that the boards of directors serve pivotal functions by overseeing management in the interests of shareholders (as per agency theory). The literature review discusses the findings of previous studies regarding their implications for company performance within each of these key dimensions of sound governance. When relevant, it places emphasis on studies pertinent to corporate governance in Nigeria. The growth of the theory outlined in this section of the paper is rooted in a comprehensive examination of prior literature within the context of agency theory.

The size of a board is often seen as indicative of its dual roles in advising and monitoring (Klein, 1998). However, empirical evidence regarding the ideal board size is inconsistent. The argument revolves around the notion that larger board sizes

can lead to internal conflicts and higher costs, while smaller boards may be criticized for not effectively controlling the actions of influential managers (Ujunwa, 2012). Prior research by Sanda, Mikailu, and Garba (2010) has revealed empirical evidence that smaller board size, in contrast to larger board size, presents a positive and significant relationship with firm performance. In a similar vein, Mak and Kusnadi (2005) revealed that a smaller board size is significant and positively associated with high firm performance. On the contrary, Dey and Chauhan (2009) discovered that as board size increases, coordination costs, communication gaps, and group dynamics also rise, resulting in lower performance.

However, research conducted by Andres and Vallelado (2008) revealed that larger board sizes are more efficient in advising management and monitoring functions, generating greater value for the firm. However, several studies conducted by Busta (2007), Al-Hawary et al. (2011), and Oyedokun (2019) in various countries' banking sectors have found no significant relationship between board size and the bank performance. Conversely, Trabelsi (2010) suggested that board size has an insignificant and negative association with bank performance, while Assenga et al. (2018) and Cornett et al. (2009) found that larger board sizes have a positive and significant association with the corporate performance.

According to Romano et al. (2012) argued that the activities and structures of bank holdings can make a larger board size more appropriate and increases in board size due to the addition of directors with subsidiary directorships may enhance value. Paul et al. (2011) and Progress et al. (2014) have provided evidence of the causal association between corporate governance and the bank performance. Given this extensive literature, the resulting hypothesis is formulated as follows:

H₁: There is a significant relationship between board size and financial performance.

From the standpoint of agency theory, it is proposed that a greater percentage of external directors serve independently on boards of directors to monitor circumstances in which conflicts of interest occur between management and shareholders. Agency theory is based on the idea that management and firm shareholders have an inherent conflict of interest (Fama & Jensen, 1983). Global corporate governance codes and regulations typically mandate a composition of boards of directors in publicly listed corporations that includes a mix of both internal and external directors. Nevertheless, one of the most extensively discussed and investigated topics in corporate governance centers on the impact of external

directors on the firm performance, a subject that has garnered substantial attention and research (Jackling & Johl, 2009).

The presence of external and independent directors on the boards is deemed essential due to their role as impartial overseers with the ability to monitor management's opportunistic behavior and improve the firm's performance (Duchin, et al., 2010). Additionally, Rhoades et al. (2000) argue that external directors can effectively reduce conflicts of interest among managers and mitigate agency problems, given their freedom from potential conflicting interests and their perceived financial independence. Thus, they are better equipped to safeguard shareholder interests, perform monitoring and control functions, and optimize firm resources to enhance overall efficiency (Kumar & Singh, 2012).

Evidence from empirical literature on board composition, such as studies by Mishra (2020), Naciti (2019), and Kumar and Singh (2012), shows that company's performance is improved by having independent directors on its board. However, studies conducted by Adams and Ferreira (2009), Ganguli and Deb (2021), Junaid et al. (2020), and Uadiale (2010) found no relationship between the composition of the board and the presence of independent external directors with company performance. This divergence in findings is often attributed to the selection of independent directors not being based on their experience and expertise. In a study conducted by Abdul Rahman et al. (2006), it is suggested that directors may face challenges in effectively carrying out their duties due to a lack of requisite skills and inadequate knowledge about the company's affairs. In a separate study, Kaplan (1995) found a link between appointing an external director and poor corporate performance. In light of this extensive body of research, the resulting hypothesis is formulated as follows:

H₂: There is a significant relationship between board composition and financial performance.

3. Methodology and Model Specification

The research approach used in this study involves the utilization of secondary data sourced from the annual reports of firms listed on the NSE. The purpose of this research is to investigate the association between board characteristics and the financial performance in Nigeria listed deposit banks. The population under consideration comprises all 14 publicly banks listed on the NSE as of December 31, 2020. However, a stringent filtering process was applied to the population. Firstly, any banks that were not continuously listed on the NSE throughout the

entire study period, spanning from 2011 to 2020, were excluded from the analysis. Additionally, banks for which data access presented challenges were also excluded from the study. As a result of these filters, the annual reports of seven banks were unavailable during the time this research was conducted. Therefore, the study was limited to 10 banks, making up the final sample size for this study. The selected study period covers six years, ranging from 2011 to 2020. This time frame was chosen due to the prevalence of numerous financial-related cases that led to corporate collapses within Nigeria during this period. The selection of this particular period enables a thorough examination of the association between board characteristics and the financial performance in a context marked by significant financial events and challenges. This methodological approach ensures that the research focuses on a relevant and consistent sample of Nigerian listed deposit banks over a critical six-year period, thereby enhancing the quality and reliability of the findings. The study employs the following model to investigate the association between board characteristics and the financial performance of firms. The regression equation is presented as follows:

$$ROA_{it} = \alpha^0 + \beta_1 BSZ_{it} + \beta_2 BCM_{it} + \beta_3 FSZ_{it} + \beta_4 LVG_{it} + \varepsilon_{it}$$

Whereas;

ROA represents return on assets proxied using financial performance, α^0 represents Constant, BSZ represents the Board Size, BCM represents Board Composition, FSZ represents Firm Size, LVG represents Leverage, and ε_{it} represents Error term.

Table 1: Summary of variables and measurements

| S/ N | VARIABLES | MEASUREMENTS | PROXIE S | SOURCES |
|-------------------------------|-----------------------|--|-------------|-----------------------|
| Dependent Variable: | | | | |
| 1. | Financial performance | This refers to the proportion of earnings prior to interest and taxes when compared to the total assets. | ROA | (Lin & Jen, 2011) |
| Independent Variables: | | | | |
| Board Characteristics: | | | | |
| 1. | Board Size | Measured as the total number of directors serving on a bank's board. | BSZ | (Kumar & Singh, 2013) |
| 2. | Board Composition | Measured as a percentage of the aggregate number of independent/nonexecutive/out | BCM | (Abidin et al., 2009) |

| | | |
|--|-----------------------------------|--|
| | side directors on a bank's board. | |
|--|-----------------------------------|--|

Control Variables:

| | | | | |
|----|-----------|---|-----|--|
| 1. | Firm Size | Measured as the natural logarithm of the total assets | FSZ | (Kota & Tomar 2010; & Swamy, 2011) |
| 2. | Leverage | measured as the proportion of total liabilities to total assets | LVG | (Ibrahim & Abdul Samad 2011; Karaca & Ekşi 2012) |

Source: Authors Compilations, 2023.

4. Results and Discussion

Descriptive Statistics

The descriptive analysis of the research variables in this study is provided in Table 2 below. These statistics offer valuable insights into the dataset and serve as a foundation for further analysis. Table 2 offers valuable insights into the characteristics of the sampled deposit banks over the designated period. Specifically, it reveals that the financial performance, as measured by ROA, is approximately 1.13% with a standard deviation of 1.402% respectively. The data from this variable ranges from a minimum of -1.362% to a maximum of 4.511%. The higher standard deviation indicates a considerable dispersion of data points from the mean, suggesting variability in financial performance among the sampled banks.

Furthermore, Table 2 reveals that the sampled bank's average board size is 14.02, with a standard deviation of 2.721. Board sizes ranges from 10 to 22 members, with 10 being the least and 22 being the most. This indicates diversity in the sizes of boards among the sample banks. Delving into the composition of the board, the results present that, on average, approximately 19% of the board composition in the sample banks consists of the outside/independent directors (BCM), as indicated by the mean value of 0.188 and a standard deviation of 0.176. The data ranges from a minimum of 0.074 to a maximum of 0.956. These findings imply that, on average, the deposit banks in this study adhere to the provisions of the corporate governance code set forth by the Central Bank of Nigeria (CBN) during the period under examination. This adherence is substantiated by the observation that the outside or independent directors outnumbered executive or inside directors on the boards.

Finally, considering the control variables, the firm size (FSZ) is approximately 4.173, with a data range spanning from a minimum of 3.926 to a maximum of

6.142. This variable is included as a control variable due to its known associations with various firm characteristics. Meanwhile, leverage (LVG) is approximately 0.061, with data ranging from a minimum of 0.023 to a maximum of 0.472, respectively. These detailed statistics offer a comprehensive snapshot of the dataset, providing a solid foundation for the subsequent analytical exploration conducted in this study. These descriptive statistics provide valuable insights into the characteristics of the sample dataset and lay the foundation for further statistical analysis and interpretation of the relationships between these variables.

Table 2: Descriptive statistics

| Variables | Obs | Mean | Std. Dev. | Min | Max |
|------------------|------------|-------------|------------------|------------|------------|
| ROA | 60 | 1.128 | 1.402 | -1.362 | 4.511 |
| BSZ | 60 | 14.02 | 2.721 | 10 | 22 |
| BCM | 60 | 0.188 | 0.176 | 0.074 | 0.956 |
| FSZ | 60 | 4.173 | 0.806 | 3.926 | 6.142 |
| LVG | 60 | 0.061 | 0.087 | 0.023 | 0.472 |

Note: Return on assets represents (ROA) proxied using financial performance, BSZ represents the Board Size, BCM represents Board Composition, FSZ represents Firm Size, LVG represents Leverage

Correlation Matrix

This section of the study presents the Pearson correlation analysis of variables, as showed in Table 3 below. These correlation statistics offer insights into the strength and magnitude of the associations among the study variables, as outlined by Gujarati and Porter (2012). Table 3 presents the following key observations, provides us with critical insights. Notably, the highest coefficient, with a value of 0.532, signifies a significant and positive association between Board Composition (BCM) and the Board Size (BSZ) at the 1% level of significance. This correlation suggests that as the size of the board increases, the composition of the board also tends to include more outside/independent directors.

Additionally, Board Size (BSZ) presents a significant and positive correlation with return on assets (ROA) at the 1% level of significance. This finding implies that larger boards are associated with higher ROA. Furthermore, it's worth noting that Board Composition (BCM) demonstrates a negative and significant correlation with ROA at the 1% level of significance. This suggests that a higher proportion of independent/outside directors on the board are linked to lower ROA.

While Firm Size (FSZ) shows a significant and positive Correlation with ROA at the 1% level of significance. This indicates that larger firms tend to achieve higher

ROA. These correlation coefficients provide valuable insights into the relationships among the study variables, shedding light on both the strength and statistical significance of these associations. This information enhances our understanding of the intricate dynamics explored within the regression model.

Table 3: Correlation Statistics

| | ROA | BSZ | BCM | FSZ | LVG |
|-----|----------|---------|--------|-------|-------|
| ROA | 1.000 | | | | |
| BSZ | 0.508** | 1.000 | | | |
| BCM | -0.158** | 0.532** | 1.000 | | |
| FSZ | 0.164** | 0.026 | -0.023 | 1.000 | |
| LVG | -0.082 | 0.040 | 0.027 | 0.018 | 1.000 |

Note: Return on assets represents (ROA) proxied using financial performance, BSZ represents the Board Size, BCM represents Board Composition, FSZ represents Firm Size, LVG represents Leverage

** . Correlation is significant at the 0.01 level (2-tailed)

Regression Results

This section of the study presents and analyse the findings of the regression model and the diagnostic tests conducted to examine the hypothesized relationships among the dependent variable with the two independent variables, namely board size and the board composition. Additionally, we employ firm size and leverage as control variables to account for their impact on financial performance. The analysis in this study is grounded in data collected from a sample of 10 deposit banks listed on the NSE. The results of our regression analysis are shown in the table below in Table 4. The table below presents the standard errors, regression coefficients, p-values, and other relevant statistics for the relationship between financial performance and the board characteristics.

Table 4: Regression Results

| ROA | Coef. | Std. Err. | t-value | P>[t] | VIF | 1/VIF |
|--------------------|--------|-----------|----------|--------|------|-------|
| BSZ | 0.005 | 0.002 | 3.07*** | 0.000 | 1.30 | 0.747 |
| BCM | -0.063 | 0.015 | -3.46*** | 0.010 | 1.05 | 0.964 |
| FMZ | 0.057 | 0.020 | 1.73 | 0.128 | 1.30 | 0.790 |
| LVG | -0.048 | 0.011 | -4.02** | 0.003 | 1.01 | 0.974 |
| CONS | 0.072 | 0.008 | 5.61*** | 0.000 | | |
| Prob > F | | | | 0.0000 | | |
| R ² | | | | 0.470 | | |
| Adj R ² | | | | 0.418 | | |
| Hetttest (Chi2) | | | | 0.82 | | |
| P.value | | | | 0.383 | | |
| Mean VIF | | | | | 1.16 | |

| Number of Obs | 60 | 60 | 60 | 60 | 60 | 60 |
|--|----|----|----|----|----|----|
| Note: Return on assets represents (ROA) proxied using financial performance, BSZ represents the Board Size, BCM represents Board Composition, FSZ represents Firm Size, LVG represents Leverage | | | | | | |

Table 4 provides a comprehensive overview of the findings pertaining to the relationship between board characteristics and the financial performance, employing an aggregate R-squared R^2 of 0.470. The significance of the F ratio, established at 1% ($P < 0.00$), suggests that the model adequately explains the variation in financial performance (ROA) based on the selected independent variables. This model, as reported in Table 4, underscores that a substantial portion, precisely 47%, of the total variation in ROA is explained by the collective impact of the independent variables, which encompass board size, board composition, as well as the control variables such as firm size and leverage. Notably, this cumulative R^2 value surpasses the R^2 of 0.26 reported by Jackling and Johl (2009) in their study involving India's top companies.

Moreover, an in-depth examination of Table 4 reveals that all three variables within this study exhibit a significant and positive relationship with financial performance, as proxied by ROA. To elaborate further, board size (BSZ) shows a positive and statistically significant association with the financial performance of the sampled deposit banks in Nigeria. This is corroborated by a regression coefficient of 0.005, is accompanied by a t-value of 3.07, which attains statistical significance at all levels (p-value of 0.000). This suggests that the listed deposit banks in Nigeria would perform financially better if the board size is increased. This finding is in line with the results of Akpan and Amran (2014), who also identified a positive and statistically significant association between board size and the financial performance. This alignment is further reinforced by the research of Assenga et al. (2018), who explored the impact of board characteristics and the financial performance of Tanzanian firms and similarly identified a positive and statistically significant association between board size and financial performance. These congruent findings collectively underscore the importance of board size as a determinant of financial performance within the context of deposit banks, emphasizing the potential benefits of a larger board size in fostering improved financial outcomes.

On the other hand, Table 4 finding show a negative and significant relationship between board composition (BCM) and the financial performance of the sampled Nigerian deposit banks. This is shown from a regression coefficient of -0.073 with a t-value of -3.46, with a statistically significant at a level of significance (p-value

of 0.010). Therefore, this result suggests that an increase in board composition is linked to a decrease in the financial performance of the sampled deposit banks in Nigeria. This conclusion corroborates the findings of Uadiale (2010), who studied the impact of board structure on the corporate financial performance in Nigeria and found that board composition is significant and negatively related with the financial performance. This result is further confirmed by the research carried out by Junaid et al. (2020) in which they explored corporate governance mechanisms and their impact on the performance of insurers in Pakistan. Their findings also shows that board composition is significant and negatively related with the financial performance.

Regarding the control variables known to have a connection with the financial performance, as proxied by ROA, firm size (FSZ) presents a regression coefficient of $\beta > 0.057$ with a p-value of 0.128, indicative of a positive and insignificant association with the financial performance. On the other hand, leverage (LVG) reveals a regression coefficient of $\beta > -0.048$ with a p-value of 0.003, signifying a negative and statistically significant association with the financial performance. This implies that higher leverage is associated with lower financial performance. This is in line with the results of Abubakar (2015), who also found a negative and statistically significant association between financial leverage and the financial performance.

5. Conclusions

This study centred on exploring the link between board characteristics and the financial performance, drawing insights from the context of listed deposit banks in Nigeria. Our primary objective was to examine how specific board characteristics, specifically board size and board composition, impact the financial performance of these listed deposit banks. The study was based on a sample comprising 10 listed deposit banks, with data spanning from 2009 to 2014. This research aligns seamlessly with prior studies, and the following sections provide an in-depth exploration of each distinct objective. Firstly, the findings pertaining to the initial objective shed light on a significant and positive association between board size and the financial performance, as proxied by ROA. This result not only supports our hypothesis but also successfully achieves the stated objective, providing a definitive answer to the associated research question. Moreover, it emphasizes the crucial role that board size plays in enhancing the financial performance of listed deposit banks in Nigeria.

The second objective aimed to investigate the association between board composition and the financial performance, also proxied by ROA. The results of the regression analysis present a contrasting picture, revealing a significant and negative impact of board composition on the financial performance, directly contradicting the initial hypothesis. As a result, this finding challenges the initial assumptions. Based on the collective outcomes derived from the analysis, this study concludes that a statistically and significant association exists between board characteristics and the financial performance, as proxied by ROA. More precisely, this study presents a positive and statistically significant relationship between board composition and the financial performance over the study period, while a negative and significant relationship is found between board composition and the financial performance.

These findings carry significant implications, suggesting that without improvements in the characteristics of boards within listed deposit banks in Nigeria, there may be potential threats to the financial performance of these banks. Future research should focus on other corporate governance characteristics that were not included in this study. These could encompass exploring board processes, including the experience of board directors, gender diversity, religious backgrounds, and organizational culture. Furthermore, upcoming studies should consider alternative measures of financial performance, such as Tobin's Q, return on investment (ROI), and return on equity (ROE). The results highlighted the significance of board characteristics in increasing the financial performance of banks, providing significant recommendations for policymakers and regulators.

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