CORPORATE GOVERNANCE AND DEPOSIT MONEY BANKS' PROFITABILITY: EVIDENCE FROM A NIGERIAN DEPOSIT MONEY BANK

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ABSTRACT

This study examines how corporate governance influences the profitability of deposit money banks in Nigeria with a view to understanding how profitability in the Nigerian banking sector is affected by corporate governance. To achieve the foregoing objective, the study employs the expo facto research design. The Secondary data which were extracted from the annual reports of a Nigerian deposit money bank between 2009 and 2018 were used for the analysis. The study revealed that board composition and audit committee activities have no significant relationships with the profitability of deposit money banks in Nigeria. The research recommended that the board composition and audit committee activities should not be the only focal points, for profitability. It was further recommended, amongst others, that more emphasis be placed on other factors which may affect profitability. Corporate managers in the banking and related industries will now be encouraged to use board sizes and audit committees that impact positively on profitability.

Keywords: Corporate governance, Board composition, Audit committee activities, Deposit money banks and Profitability.

1.1 Background of The Study

Corporate governance has gradually become an essential element in shaping the operations of most firms. It is the assemblage of rules and processes which an entity uses for governing and controlling its activities. Adams and Mehran (2003) described corporate governance as the process by which companies' stakeholders are controlled by management and insiders to protect their interests. In the banking sector, corporate governance involves how the operations of banking institutions are handled by boards of directors. It dictates the way and manner banks execute their strategies, goals and policies including the provision of equal business opportunities for stakeholders. Corporate governance roles have shifted focus recently, due to lack of control initiatives and corporate frauds.

The fundamental objective for issuing the CBN Circular (2014) is to create a transparent and rewarding system of banking that establishes the rule of law and supports dependable and sustainable segregation of duties. Codes have been established for corporate governance and given to the Nigerian banking sector as a barometer for financial institutions to function effectively. They are as follows: BOFIA: The Bank and Other Financial Institutions Act 1991, FRCA: The Nigerian Financial Reporting Council Act 2011, BRMA: The Business and Related Matters Act 2018 (as revised), NDIC: The Nigerian Deposit Insurance Corporation Act 1988, SEC: The Securities and Exchange Commission, NSE: The Nigerian Stock Exchange and CAC: The Corporate Affairs Commission Act 1988 and others not mentioned here.

Corporate governance is a strong pillar that plays an important role in the success and profitability of a bank. Ilaboya and Uwubamwem (2005) commented as follows: "Profitability in alternative courses of action or decision is the relative pattern of profit-making". Profit according to Isukul and Chizea (2017), is a performance measurement index which is used to test the viability of a business. Many corporate institutions categorize the factors that determine a bank's financial success into internal and external. Internal success factors which can narrowly be segmented into two are usually under management control, for example, financial statement variables and non-financial statement variables (Linyiru, 2006). Financial statement factors refer to the operations which directly influence the balance sheet and income statement items while non-financial statement factors do not affect financial statement items. The number of branches, the status of a branch, bank location, and bank size are examples of non-financial statement factors (Sudin, 2004). Factors which are beyond the control of bank management are regarded as external variables. Sudin however, argued that lousy governance makes banks and other businesses to become less efficient or competitive. Previous researches have done a lot of work to study how corporate governance influences profitability in the developed, developing and underdeveloped countries of the world, but we observed that not many pieces of research in this area have been carried out in the Nigerian banking sector especially the one that has to do with pitching board composition and audit committee activities against profitability. Therefore, this study is carried out to fill this gap.

1.2 Statement of the problem

The banking industry is one of the most important criteria for good corporate governance, as banks are profoundly affected by their numerous stakeholders. Acceptable governance practices will include well-diversified boards, the optimal board size, well-committed board members, equal ownership structure, and well-designed policies to be adhered to, respectively, by management and staff. Usually, with these variables in place, it would be predicted that a bank's output would be on the positive side. In terms of the high profitability and satisfaction of its different stakeholders, good governance will be expected to produce great results.

Unfortunately, this is not the case as banks still have a long way to achieve excellent governance. At the 2017 edition of the CBN Financial Institutions Training Centre Continuous Education Program for Directors of Banks and Other Financial Institutions, Godwin Emefiele, Governor of the Central Bank of Nigeria (CBN), noted that "the financial industry still has a deficiency in governance. The foregoing comment is exemplified by instances of ambiguous returns distribution, and corporate governance violations. The Central Bank of Nigeria (CBN) Governor blames these problems on the inability of the boards and committees of banks to play their supervisory functions. The volatility of banks' overall performance and their volatile characteristics indicate that, while a bank may decide to put up a credible front, there may still be some board and committee related problems that threaten its corporate governance and profitability.

1.3 Objectives of the study

The main objective of this study is to understand how corporate governance influences the profitability of deposit money banks in Nigeria. The specific objectives of this research are as follows:

1. To examine how the composition of the board of directors affects the profitability of deposit money banks in Nigeria.
2. To examine how the activities of audit committees affect the profitability of deposit money banks in Nigeria.

1.4 Research questions

The following questions have been formulated to guide this research.

1. To what extent has the composition of the board of directors influenced the profitability of deposit money banks in Nigeria?
2. To what extent have audit committee activities influenced the profitability of deposit money banks in Nigeria?

1.5 Research hypothesis

The research hypotheses formulated for the study are as follows:

Ho_1: There is no significant relationship between the board composition and deposit money banks' profitability in Nigeria.

Ho_2: There is no significant relationship between audit committee activities and deposit money banks' profitability in Nigeria.

1.6 Scope of the research area

The study's scope covers the effect of corporate governance mechanisms on the profitability of deposit money banks concerning the Nigerian banking industry. The study used time-series data obtained from a Nigerian deposit money bank's annual reports, covering ten years (2009-2018) for all the relevant variables.

1.7 Significance of the study

The study's findings will be of great importance to the shareholders and management of deposit money banks and the central bank of Nigeria (CBN). CBN is the body charged with regulating the activities of deposit money banks and ensuring strict compliance with its corporate governance guidelines and codes issued, amongst its other functions. This study will also be necessary for stakeholders of other deposit money banks, as the findings will keep them updated with the benefits of acceptable corporate governance practices. This study will also benefit researchers who wish to carry out a similar study, as this would serve as a guide. Lastly, the research will be necessary for students, lecturers, and the general public who desire to seek knowledge in such areas.

1.8 Operational definition of terms

- **Profitability:** This is defined as the profit-after-tax of deposit money banks in Nigeria.
- **Corporate Governance:** This is described in this study as board composition and audit committee activities.
- **Board Composition:** This is the number of independent directors that sit on the board to monitor and contribute to the effective and efficient management of deposit money banks.
- **Audit Committee Activities:** This is measured in the study by the number of meetings held by the audit committee annually.

2.1 CONCEPTUAL FRAMEWORK

Corporate governance can be described as a framework that seeks to give guidelines and principles to the board of directors to effectively fulfil their obligations and shareholders' expectations by minimizing corporate scandals and frauds (Muriithi, Mwikamba, & Rosana, 2016). Corporate businesses are the key areas where the application of corporate governance principles lie. Dyck (2001) sees it as external stakeholders' rights to prevent the seizure of internal stakeholders' hands. A company is healthy if it possesses reliable and interactive components. According to Morck, Shleifer and Vishny (1989), effective corporate governance, a reliable marketing system, effective prudential guidelines and oversight functions, clear and correct financial reporting mechanism, good disclosure rules, and effective framework for protecting savings/deposits are some of the main factors that maintain the sustainability of a nations' financial system. The board structure and the audit committee operations are two of the tools applied in promoting and fulfilling corporate governance ideals. The board structure and the audit committee operations are the main points of this research.

A corporation's board of directors is a mechanism for guiding and improving managers' actions. To track managers effectively and reduce agency cost, board structure and audit committee operations become critical (Choe & Lee, 2003). Internally managing the business efficiently and effectively and paying attention to costs and budget reports are areas of corporate governance that should also be considered seriously. These two significant mechanisms will have an impact on corporate profitability, which is the fundamental objective of all activities of the organization. Profitability is one of the essential functions of a business organization such as a deposit money bank. Profitability is a contentious issue that all companies still face today. The higher the effectiveness of the members who make up both the board of directors and the audit committee, the greater the company's level of profitability.

2.2 THEORETICAL FRAMEWORK

2.2.1 Theory of Agency

This theory was propounded by Berle and Means in 1932 and further reviewed by Stephen Ross and Barry Mitnick in 1973. To describe and give understanding to the relationship between the principal and his agent, the agency's theory is used. The agent is employed in a given situation on behalf of the principal and is required to represent the best interests of the principal, irrespective of his own interests. The problem occurs only in the case of an agent's conflict of interest, where the agent conducts his duties, not in the interests of the principal, but the agent's interests. As main-agent issues can occur due to miscommunication and disagreement between management and shareholders, this is not always the case. Modern firms suffer from the separation of possession and control and are run by professional managers and directors who cannot be held liable by shareholders. Agency theory suggests that there are several ways to reduce the agency problem in the firm. Some incentives to help bridge the gap between the interests of the shareholders and management include managerial incentive mechanism which compensates managerial efforts to serve the owners' interests. The attempts of other shareholders to minimize the cost of equity of the agency, generated by moral hazard managers, include the aim of shareholders to desire a trustworthy board of directors; direct shareholder participation, the threat of dismissal, and the threat of acquisition (Sanda, Mikailu, & Garba, 2005).

2.2.2 Theory of Stakeholders

Unlike the agency theory, stakeholder theory looks at the internal and external environment and relates management's accountability function not just to the shareholders but to all other forms of stakeholders which include employees, customers, suppliers, government, etc. This theory looks at how the activities of a business are influenced by all its stakeholders and are strong opposition to the agency theory. The main idea of the stakeholder theory is that organizations that make it one of their priorities to manage their stakeholder relationships effectively will survive longer and perform better than organizations that do not. Freeman suggests that organizations should increase certain stakeholder competencies. Some of these include monitoring stakeholder interests, developing methods to effectively deal with stakeholders' concerns, categorizing interests into manageable segments and ensuring that organizational functions deal with the needs of shareholders.

2.3 EMPIRICAL REVIEW

The relationship between corporate governance and efficiency is not yet well understood and there is still a relatively little financial effect of corporate governance on corporate performance in emerging economies. The links between corporate governance and corporate profitability have shown conflicting outcomes in previous studies. Ahmed's (2015) research found that particular systems of corporate governance affect the quality of market value. The consistency of book value is affected by distinct structures of corporate governance. There was no meaningful relationship between the duality of the Chief Executive Officer and the Return on Assets and Return on Equity of the sampled banks in the regions of the Middle East and North Africa (Boussaada & Karmani, 2015).

Low corporate governance quality would limit management's ability to function effectively (Georgantopoulos & Filos, 2017). The contribution of corporate governance to bank success has been opposed (Pratiwi & Nugraha, 2016; Umanto, Wijaya, & Atmoko 2016). Contrary to the report of Umanto, Wijaya and Atmoko, (2016), Sutopo, Trinugroho, and Damayanti (2017) discovered that it is beneficial if regional banks are politically related, while the study of Iramani, Muazaroh, and Mongid (2018) also revealed a positive relationship between corporate governance and bank efficiency. Mayur and Saravanas (2017) used the Indian banking sector to research the impact of corporate governance on performance. Their research concluded that performance was positively associated with the size, composition, and frequency of board meetings. Orazalin, Mahmood, and Jung Lee (2016) were also favourably aligned with bank success and corporate governance. In comparison, ownership regulation by Berger, Imbierowicz, and Rauch (2016) was found to be quite important. Corporate governance and risk management have had a positive impact on Indonesia's bank financial results (Bastomi, Salim, & Aisjah, 2017) and Chou and Buchdadi (2016) have found that success on pay and pay for performance effects is true in assessing the executive compensation and corporate efficiency of Indonesia.

The positive effect of corporate governance implementation on the profit of listed banks has been reported by Haryati and Kristijadii (2014). In Malaysia, this was accompanied by promising results from Haniffa and Hudaib (2006). Audit policies, the composition of the board, corporate social responsibility have significantly increased leverage of corporate effectiveness (Pillai & Al-Markawi, 2018). A survey conducted by De Haan and Vlahu (2016) revealed regularities in corporate governance literature, such as a positive effect on the number and performance of members of the independent board. However, the corporate governance process relies on the external circumstances under which the company works. Improving good corporate governance, better credit risk management and the right business approach are the best ways to improve bank profitability (Saladin, 2018). Studies by Rafiul and Zakea (2017) have found that the successful results of a company are paramount to corporate governance.

Salma and Cesario (2016) found that the board's size correlates favourably with performance. Their findings showed that corporate governance variables have real effects on bank efficiency. The positive contribution of good corporate governance to banking success was endorsed by Okike and Turton (2009). Erkens, Hanged, and Matos (2012) discovered that lower stock returns are generated by greater board independence and institutional ownership. Ferretti, Romano, and Rigolini (2012) found that women's presence on boards of directors has a positive effect on Return on equity and return on assets. Their presence in the board of directors increases financial performance and can contribute to a wide pool of expertise, information, and relationships that are useful for enhancing the success of the bank.

Otieno (2012) concluded that appropriate corporate governance practices improve banks' productivity and value. Between 2005 and 2008, in Nigeria, the relationship between corporate governance and bank results was examined by Akpan and Riman (2012). The study found that increasing the size of the bank's board of directors and the size of shareholders would improve the return on assets and return on equity. The study's outcome was that rather than larger board sizes, smaller board sizes of qualified practitioners contributed to greater profitability or better financial results.

3.1 RESEARCH METHODOLOGY

An expo facto research design was used to carry out this quantitative study. The target population for this study was annual reports of the deposit money bank for 28 years since the bank was established 28 years ago. This analysis could not cover the entire population of annual reports for 28 years, taking into account time and other variables as constraints on the researchers. To represent the population, a survey of 10 years was selected as the population sample. The judgmental sampling method was used in selecting the sample and sample size. This approach was used because it allowed the investigators to apply a sense of justice to the study. The data was collected from a deposit money bank's annual reports using the extraction method. The data was, therefore, collected from the secondary source. The multiple regression techniques through the statistical package for social sciences (SPSS) was the tool used by the study to analyze the data collected. The variables were transformed into logs to conform to normal distribution.

3.2 Model specification

The relationship between the variables is shown by the mathematical model below:

PAT $= \alpha + B_1BC + B_2ACA + e$

Where,

PAT = profit after tax
α = intercept
B_1-B_2 = regression coefficients
BC = Board Composition
ACA = Audit Committee Activities
e = Standard Sample Error

3.3 Limitations of the study

The research took into account an internationally recognized deposit money bank, which, as a representative of Nigeria's banking industry, has over 500 branches. Nevertheless, to test the same theory, other banks may be adopted into the model, as results could vary to a degree. The data time frame only considers data limited to 2009 to 2018 from the annual reports due to the time factor and data availability. It was not possible to collect data for 2019. The analysis did not recognize other corporate governance factors and other deposit money banks.

4.1 Data presentation

This section contains the analysis, and description of the data used for this research work. It incorporates both mathematical and statistical techniques adopted to investigate the effect of corporate governance on profitability in testing the study hypotheses of this report. Data for this analysis were collected from the audited annual reports published by the Nigerian Deposit Money Bank covering the period between 2009 and 2018. Table 1 shows the extracted data used to help the creation of the analysis.

Table 1: Summary of Profit after Tax, Board Size and Audit Committee Meetings For 2009-2018

Period	Profit after tax (in millions)	Board size	No of Audit committee (meetings)	Logpat	logbs	logme
2009	20603	15	5	4.31	1.180	0.70
2010	37414	18	4	4.57	1.260	0.60
2011	48704	12	4	4.69	1.080	0.60
2012	100681	14	4	5.00	1.150	0.60
2013	95318	15	4	4.98	1.180	0.60
2014	99455	13	4	5.00	1.110	0.60
2015	105663	10	4	5.02	1.000	0.60
2016	129652	13	5	5.11	1.110	0.70
2017	173791	14	4	5.24	1.150	0.60
2018	193424	13	4	5.29	1.110	0.60

Source: A deposit money bank's annual reports for 10 years with over 500 branches within and outside the shores of Nigeria.

4.2 Regression Analysis

The multiple regression output (tables 3 and 4 see appendix page) indicated that the joint contribution of the independent variables was very low while the linear relationship among the variables was not significant (R^2 = .263, F (2,7) = 1.247, p>.05. The expected value (the constant or intercept) of the criterion variable (PAT) when the predictor variables equal to zero was positive but was not significant (B_0 =8.314, n.s, p>.05)

4.3 Test of Hypotheses

Two null hypotheses as stated previously were tested as follows:

Hypothesis one: There is no significant relationship between the board composition and the profitability of deposit money banks in Nigeria. This was supported by a non-significant and weak negative correlation coefficient (B_1 -1.674, n.s, p>.05 see table 5 on the appendix page). The null hypothesis was, therefore, accepted and the alternative rejected.

Hypothesis two: There is no significant relationship between audit committee activities and deposit money banks' profitability in Nigeria. This was supported by a non-significant and weak negative correlation coefficient (B_2 -2.409, n.s see table 5 on the appendix page). The null hypothesis was, therefore, accepted and the alternative rejected.

4.4 Discussion of Findings

This analysis illustrates a negative relationship between the board's composition and the profit after tax of the deposit money banks in Nigeria. The composition of the board has no major link with the profit-after-tax of deposit money banks in Nigeria. It means that, regardless of the size of the board, it will not have a huge effect on the profit-after-tax of the deposit money banks in Nigeria. The regression results showed that the audit committee's operations have a negative relationship with Nigeria's deposit money banks' profit-after-tax. The roles of the Audit Committee had no significant connection with the profit-after-tax of the deposit money banks in Nigeria. It means that the volume or frequency of meetings of the Audit Committee does not contribute to the profit received after tax by the bank.

5.1 Summary of Findings and Conclusion

The influence of corporate governance on the profitability of Nigeria's deposit money banks was explored in this research. The study's scope was limited to ten years. They also revealed the following:

The composition of the board has a negative relationship with Nigeria's deposit money banks' profitability, and the relationship was not significant. The activities of the audit committee were negatively related to the profitability of Nigeria's deposit money banks, and the relationship was not significant.

This research established factors that may affect the profitability of Nigeria's deposit money banks. Based on the results of this report, the study concludes that the composition of the board and audit committee operations do not have significant relationships with the profitability of deposit money banks in Nigeria. It, therefore, indicates that the makeup of the board and the efforts of the audit committee are not contributing effectively to the profitability of Nigeria's deposit money banks. This study found that the composition of the board and the activities of the audit committee as variables for corporate governance have no major profitability effects.

5.2 Recommendations

Based on the findings of this study, the following are recommended:

i. Deposit money banks should adopt a small board as this may be better for their profitability, in terms of faster decision-making processes where there are fewer members on the board.
ii. Deposit money banks should invest in other areas such as securing and maintaining their customers.

iii. The management of deposit money banks should focus on other corporate governance mechanisms as they may have a significant effect on profitability, such as its Risk Committee.
iv. Deposit money banks should focus efforts more on other factors which may affect their profitability, such as human resource asset.

5.3 Suggestion for further study

More deposit money banks should be included in the study while a similar study be carried out on non-bank financial institutions.

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APPENDIX

TABLE 2

Variables Entered/Removed[a]

Model	Variables Entered	Variables Removed	Method
1	LGME, LGBS[b]	.	Enter

a. Dependent Variable: LGPAT

b. All requested variables entered.

TABLE 3

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.513[a]	.263	.052	.29795	.263	1.247	2	7	.344

a. Predictors: (Constant), LGME, LGBS

b. Dependent Variable: LGPAT

TABLE 4

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.221	2	.111	1.247	.344[b]
	Residual	.621	7	.089		
	Total	.843	9			

a. Dependent Variable: LGPAT

b. Predictors: (Constant), LGME, LGBS

TABLE 5

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	8.314	2.150		3.867	.006
	LGBS	-1.674	1.485	-.368	-1.127	.297
	LGME	-2.409	2.443	-.322	-.986	.357

a. Dependent Variable: LGPAT