Journal of Economics and Sustainable Development www.iiste.org
ISSN 2222-1700 (Paper) ISSN 2222-2855 (Online)
Vol.6, No.20, 2015

Factors Affecting Financial Decisions and Corporate Governance Structure of Commercial Banks in Nigeria

O. I. Olaifa

Department of Management and Accounting, Ladoke Akintola University of Technology, P. M.B. 4000, Ogbomoso, Nigeria.

F. A. Ajagbe,
Federal University of Agriculture, Abeokuta, P.M.B.2240,Ogun state, Nigeria

ABSTRACT
The main purpose of this study is to ascertain factors affecting financial decisions and corporate governance structure of commercial banks in Nigeria. Both primary and secondary data were used. 20 commercial banks that operated during 2000-2013 period constitute the sampling frame. In analyzing the data, descriptive statistics such as mean, standard deviation, minimum and maximum and correlation analysis were employed. The results show that linear and positive association exists between debt ratio and board size (r = 0.46). This implies that finance decisions of banks were correlated with their corporate governance structure. However, the correlation between debt to equity ratio and board size is negative (r = -0.33), implying that inverse association exist between the two variables. Board composition is found to be positive and significantly related (r = 0.419) to earning per share of banks implying a high and direct relationship between governance structure and investment decision of banks. It is against this background that these recommendations were made that banks should pay more attention to other financing decisions such as dividend and liquidity in order to keep the banks at high level of performance which is crucial to their sustainability. Besides, commercial banks should reduce the number of individuals in their board if they desire to maintain or sustain a good level of performance as well as maintaining a good investment decisions for the overall performance of commercial banking institutions in Nigeria.

Keywords: Financial decision, Corporate governance structure, Commercial banks, Nigeria.

1. INTRODUCTION

Commercial banks are very crucial to economic growth of the nation for the services they provide such as financial mediation between savers and investors, credit creation and encouragement of capital accumulation. The health of the economy is closely related to the soundness of its banking system. Banking as an activity involves acceptance of deposits and lending or investment of money. It facilitates business activities by providing money and certain services that help in exchange of goods and services.

The traditional role of banks has been that of intermediary, that is, the bringing together of borrowers and lenders (savers or depositors). This role can only be done successfully and for a sustained period with the careful management of credit and liquidity, prudent financial decisions, efficient governance structure, and interest rate risk. Corporate performance is an important concept that relates to the way and manner in which financial resources available to an organization are judiciously used to achieve the overall corporate objective of an organization, it keeps the organization in business and creates a greater prospect for future opportunities (Sunday, 2008). Thus, corporate governance is ensuring good business behavior. It is about the way in which a board oversees the running of a bank by its managers, and board members are in turn accountable to shareholders and the company.

The corporate governance structure therefore specifies the distribution of rights and responsibilities among different participants in the banks and spells out the rules and procedures for making decisions on corporate affairs. This specification of rights and responsibility is made possible through various structures of corporate governance such as board size, board composition, audit committee, chief executive officers status among others. While corporate governance structure has become a center of attraction in performance estimates of banks, the role of financial decision merits scrutiny. In view of efficient corporate governance structure to be sustained with the careful management of credit, liquidity, prudent financial decisions, and interest rate risk, it is therefore pertinent to analysis factors affecting financial decisions and corporate governance structure of commercial banks Nigeria.

2. LITERATURE REVIEW

The importance of financial decisions in bank performance is evident, since many of the factors that contribute to failure can be managed properly with strategies and financial decisions that drive growth and the bank's objectives. According to a number of studies (Ibarra, 1995; Van-Auken and Howard, 1993) the main causes of business failure are the lack of financial planning, limited access to funding, lack of capital, unplanned growth, low strategic and financial projection, excessive fixed-asset investment and capital mismanagement. Many of these causes of failure are challenges that can be successfully managed with financial strategies developed and implemented by the commercial banks. However, the study of financial decisions has been, for a long time, limited to large corporations, about which extensive research has been published.

Given the series of activities that have affected the efforts of banks to comply with the various consolidation policies and the antecedents of some bank operators in the Nigerian banking sector, it is therefore, pertinent to examine the need to strengthen corporate governance and ensure good financial decisions in banks. This will raise public confidence and ensure efficient and effective functioning of the banking system (Soludo, 2004).

The governance mechanism of banks establishes a set of relationships between stakeholders and the bank. Ciancanelli and Gonzales (2000) stated that in the banking sector, the regulation and regulator represent external corporate governance mechanisms. In the conventional literature on corpora te governance, the market is the only external governance force with the power to discipline the agent. The existence of regulation means there is an additional external force with the power to discipline the agent. This force is quite different than the market. This implies that the power of regulation has different effects to those produced by markets. Whilst the issues become a major concern in banking practices, the conceptual issues are literarily debated.

Shleifer and Vishny (1997), define corporate governance as the way in which suppliers of finance to corporation ensure themselves of getting a return on their investments. Corporate governance concerns the inter-relationships between principals, agents, and other stakeholders who may have different interests in the firm. Conflict of interests between different stakeholders is potentially high in banking sector. The unusual agency problem in banking sector could not be resolved satisfactorily using conventional agency theory.

The challenges facing the banking sector following corporate financial scandals have been traced to poor corporate governance and ineffective financial decisions. A major role for ensuring the banks stability is played by the corporative governance and proper financial decisions of banks. Weak corporate governance was seen manifesting in form of weak internal control systems, excessive risk taking, override of internal control measures, absence of or non-adherence to limits of authority, disregard for cannons of prudent lending, absence of risk management processes, insider abuses and fraudulent practices remain a worrisome feature of the banking system (Soludo, 2004).

The financing decision is concerned with the raising of funds that finance assets. Funds should be adequate to procure the assets necessary for operation; at the same time, if the funds are more than required, the excess would remain unutilised making no contribution to output but adding to the financing cost, thereby considerably eroding profitability. In other words, the financing decision should ensure optimum capitalisation. The major sources of long-term capital are shares and debentures. Funds can also be obtained in the form of term loans and leases, as the latter serves as an alternative to borrowing. If sufficient funds are not raised domestically, they are obtained from sources abroad. Financial strategy consists of three interrelated kinds of decisions: investment, funding and working capital decisions (Adeusi et al., 2013).

Shleifer and Vishny (1997) they postulated that corporate governance ensured investors in corporation received adequate return on their investment otherwise; outside investors would not lend to the firm or purchase their equity securities. Consequently, firm would be forced to rely on internally generated funds. They added that legal and political environment are critical influence on the nature of corporate governance and there by improve corporate performance in every country. Hence investor protection and stronger rule of law are related to corporate governance and organization performance.

Saeed et al. (2013) examined the impact of capital structure on performance of Pakistani banks. The study extends empirical work on capital structure determinants of banks within country over the period of five years from 2007 to 2011 by utilizing data of banks listed at Karachi stock exchange. Multiple regression models are applied to estimate the relationship between capital structure and banking performance. Performance is measured by return on assets, return on equity and earnings per share. Determinants of capital structure includes long term debt to capital ratio, short term debt to capital ratio and total debt to capital ratio. Findings of the study validated a positive relationship between determinants of capital structure and performance of banking industry.

3. MATERIALS AND METHODS

The study was carried out in Lagos and Abuja, Nigeria. The study areas were chosen because of its precedence, geographical location and most of the banks have their headquarters situated in the study areas. Both primary and secondary data were used. The primary data involves a structured questionnaire, which was distributed among the top officials of the sampled banks. This is due to the framework of corporate governance and financial decisions which rested on the administrative structure of the banks. The instrument was validated using cronbach–alpha test. While the secondary data covering 2000 – 2013 was collected from the various issues of the Statement of Accounts and Annual Reports of selected banks, the Central Bank of Nigeria's Statistical Bulletin, and Nigeria Deposit Insurance Corporation's Annual Account. 20 commercial banks that operated during 2000-2013 period constitute the sampling frame. In analyzing the data descriptive statistics such as mean, standard deviation, minimum and maximum and correlation analysis were employed.

4. RESULTS AND DISCUSSION

Table 1 highlights summary statistics for some of the dependent and independent variables of the study. The table shows that performance measures of the sampled banks were on the average, relatively high, with return on capital employed (ROCE) the highest. The value of ROCE stood at 16.7 compared to the value of return on asset (ROA) which stood at 2.2. Standard deviation estimates of the values of the two variables show that ROCE and ROA can deviate from mean to both sides by 8.86 and 6.10 respectively. The results from the standard deviation further show that ROCE is the least stable of the two performance measures. This is premised on its higher standard deviation value.

Debt ratio has a mean value of 1.53 and a standard deviation of 1.05. The minimum debt ratio observed for the banks is 0.95. This shows that the bank with the least debt ratio had ratio index of 0.95 with the possible deviation up to 1.05. Bank with the maximum debt ratio had a value of 4.65, indicating that the highest debt ratio of any bank for the study period is about 4.65. Capital labour ratio was also computed and an average of 6.95 was obtained for the study period with a standard deviation of 2.89. The minimum for the least bank is 1.67 while the highest is 11.95. Average debt to equity ratio was found to be 0.58 with a standard deviation of 0.06. Banks with the least debt to equity ratio had a value of 0.47 while the banks with most had a value of 0.70. Average dividend yield for the bank is 7.34. The dividend yield for least bank is 0.01 while the maximum is 31.13. Dividend yield can deviate from the mean by 9.03.

The average board composition of the sampled banks for the sampled period is 16.2 and total average of its composition is 11. The result indicates that average board size for the sampled period is greater than board composition. From the descriptive of financial decisions variables, average debt ratio of the sampled banks is 1.53 with a maximum of 4.65. Dividend yield had an average of 7.34 with a maximum of 31.13.

Descriptive statistics of governance variables was also presented. The average board size of the banks is 16 while the highest is 20. The minimum is 15 with a possible deviation from the mean being approximately 2. This result shows that the average board size of all the banks is similar since the minimum for the banks is 15.

The most volatile / least stable of the variables as indicated by the value of the standard deviation (SD) is return on equity (ROE) with a SD of 10.3. This is followed by ROCE with a deviation value of 8.86. The most stable of the performance indicators is the profit margin with a deviation value of 4.29. However, the performance indicator with the maximum value is ROI (18.5) followed by profit (31.8).

Table 4. 1: Descriptive statistics of the study variables

Variables	Mean	S.D	Minimum	Maximum
Debt ratio	1.53	1.05	0.95	4.65
Capital labor ratio	6.95	2.89	1.67	11.95
Debt to equity ratio	0.58	0.06	0.47	0.70
Dividend Yield	7.34	9.03	0.01	31.13
Earnings per share	0.79	0.08	0.05	3.32
Size	12.08	4.18	6.99	14.51
CEO duality	0.006	0.02	0	1
Profit margins	9.63	4.29	3.43	31.79
ROA	8.2195	6.10	0.97	3.48
ROE	18.12	10.25	9.82	35.75
ROI	13.22	5.10	6.52	18.48
ROCE	16.75	8.86	11.43	30.57
Board size	16.2	1.98	15	20
Board composition	10.50	0.09	0.4	17
Number of Executive Director	8	1.71	5	10
number of non executive director	8.2	1.989	6	11

Source: Data analysis, 2014

4.2 Results of Correlation Analysis between Financial Decisions and Corporate Governance

In order to understand the underlying relationship between the study variables and the level of significance between them, pairwise correlation coefficient was used. The results of the pairwise correlation between financial decisions and corporate governance (Table 2) show that linear and positive association exists between debt ratio and board size (r = 0.46). Similarly, correlation between debt ratio and board composition is positive and significant (r = 0.35). The result implies that finance decisions of banks were correlated with their corporate governance structure. Results further show a positive but insignificant relationship between debt ratio and chief executive officer status. However, the correlation between debt to equity ratio and board size is negative (r = -0.33), implying that inverse relationship or association exist between the two variables. The findings further indicate that governance structure had a possibility of inversely related to finance decisions. Board size is also negatively associated with dividend decisions of banks (r = -0.271). Earnings per share, another indicator of financial decisions is also related positively and significantly to corporate governance variable, board size. Further, Liquidity has a positive and significant association with board size (r =0.379).

Board composition, an important measure of corporate governance is found to be positive and significantly related (r = 0.419) to earning per share of banks. The correlation between board composition and

Journal of Economics and Sustainable Development www.iiste.org
ISSN 2222-1700 (Paper) ISSN 2222-2855 (Online)
Vol.6, No.20, 2015

liquidity is high and significant (r = 0.62), implying a high and direct relationship between governance structure and investment decision of banks.

Table 2: Pairwise correlation between the financial decisions and corporate governance variables

	Debt	Debt/equity	Dividend	Earnings	Liquidity	Board size	Board comp.	CEO duality
Debt ratio	1							
Debt to equity	0.4136**	1						
Dividend	0.4641**	0.4425**	1					
Earnings	0.5531**	0.5062**	0.2986*	1				
Liquidity	0.6062**	-0.0818	0.0236	0.4324**	1			
Board size	0.4591**	-0.3379	-0.2714*	0.6459**	0.3796**	1		
Board composition	0.3529**	0.1075	0.1143	0.4195**	0.6217**	0.2070	1	
CEO duality	0.067	0.4758**	0.1491	0.0256	0.4144**	0.1535	0.2167	1

Source: Data analysis, 2014

*** significant at 10%**

**** significant at 5%**

4.3 Regression result for Influence of corporate governance structures on the performance of commercial banks

The result from the estimated equation is shown in Table 3. The Hausman test (Table 4) suggests the 2SLS estimates is appropriate for inference. From the results, the coefficient of determination (R^2) indicates that about 61% of change in performance of the banks is accounted for by the explanatory variables while the adjusted R-squared further justifies this effect. From the diagnostics, the fit of the model is good suggesting its appropriateness in evaluating the effects of corporate governance on performance of banks.

The findings of the study suggested that high board size do have negative effect on the performance of the banks. This implies that increase in the board size lead to reduction in performance indices of the banks. The results provide evidence that larger board size tends to ensure that the management control of the banks is weak. Consequently, such weakness in control generates negative influence on the managers to effectively manage the conflict of interest and personal interest and thus, unable to ensure that the managers and bank administrators strive to work for the overall improvement of the banks. The improvement is then expected to translate into reduced performance. This finding is consistent with several literature which argued that large boards are less effective. When a board gets too big, it becomes difficult to coordinate and for it to process and tackle strategic problems of the organization, resulting in poor performance.

However, board composition has no significant effect on performance of banks, although the coefficient is positive. CEO duality is found to be positive and significantly related to performance of banks. Duality refers to situations in which the Chief Executive Officer (CEO) position is combined with the board chair position. The CEO duality is found to be positive and significantly related to performance of banks. The result implies that the sampled banks, in the period under study, had separate persons occupying the posts of chief executive and the board chair. This has influence on the financial performance of the sampled firms and in line with the tenet of the code of corporate governance best practices of Nigeria (Kajola, 2008).

Table 4: Influence of corporate governance structures on the performance of commercial banks in Nigeroa.

	OLS		2SLS	
Variables	Coefficient	t-value	Coefficient	t-value
Board size	-0.493	-2.09**	-0.384**	-3.54
Board composition	0.695	1.58	0.843	1.64
CEO duality	0.164	1.99**	0.597**	2.33
R squared	0.61		0.65	
Adj. R squared	0.59		0.64	
F-statistics	22.05		35.76	
Second stage SSR	-	-	13.034	

Source: Data analysis, 2014

Table 5: Hausman (1978) Specification Test

	h-statistics	p-value
OLS vs 2SLS	76.99	0.000

Source: Data analysis, 2014

5. CONCLUSION

The results showed in this study revealed that the main financial decision that is of paramount importance to the commercial banks in Nigeria is investment decision. Also, finance decision of the banks has potential to reduce the profit of the banks if not addressed. Moreso, it was also reached from the analysis of the influence of corporate governance structure in financial decisions of commercial banks in Nigeria that high board size would significantly reduce finance decision of the banks which could affect the overall profit in the long run. However, board composition has no significant effect on performance of banks, although the coefficient is positive. CEO duality is found to be positive and significantly related to performance of banks.

It is against this background that these recommendations were made that banks should pay more attention to other financing decisions such as dividend and liquidity in order to keep the banks at high level of performance which is crucial to their sustainability. Besides, commercial banks should reduce the number of individuals in their board if they desire to maintain or sustain a good level of performance as well as maintaining a good investment decisions for the overall performance of commercial banking institutions in Nigeria.

REFERENCES

Adeusi, S. O., Akeke, N. I., Aribaba, F. O., and Simeon, A. O., (2013): Corporate Governance and Firm Financial Performance: Do Ownership and Board Size Matter?

Ciancanelli, P. and Gonzalez, J. A. R.., (2000): Corporate Governance in Banking: A Conceptual Framework, Social Science Research Network, Electronic Paper Collection: http://www.papers.ssrn.com/paper.taf

Ibarra, V. (1995): Los primerospasos al mundoempresarial: unaguía para emprendedores. México: Ed. Limusa.

Saeed, M. M., Gull, A. A., and Raheed, M. Y., (2013): Impact of Capital Structure on Banking Performance (A Case Study of Pakistan), Interdisciplinary journal of contemporary research in business 4 (1): 393-403

Shleifer, A. and Vishny, R., (1997): A Survey of Corporate Governance. Journal of Finance 52, 737-7 83.

Soludo, C. C. (2004): Consolidating the Nigerian Banking Industry to Meet the Development Challenges of the 21st Century. Being an Address to the special Meeting of Bankers Committee, Held on July 6.

Sunday, K. O., (2008): Corporate Governance and Firm Performance: The Case of NigerianListed Firms. European Journal of Economics, Finance and Administrative Sciences. ISSN 1450 - 2275.

Van Auken, P. & Howard, E. (1993): "A factor analytic study of the perceived causes of small business failure", Journal of Small Business Management, vol. 31(4), p. 23-31.