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CORPORATE GOVERNANCE AND THE NIGERIAN BAILED-OUT BANKS PERFORMANCE: A PROPOSED MODEL ON THE INFLUENCING ROLE OFBOARDS' EQUITY OWNERSHIP

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ABSTRACT

This paper proposes a model on the moderating role of board equity ownership on the relationship between corporate governance and performance of banks during apost banking crisis era that necessitated a bailout reform. The corporate governance characteristicsin this study were appropriately selected specifically based on the Nigerian banking sector's corporate governance problems. This paperalso addresses the board's functions of resources provision as established by resource dependence theory.

Keywords: Corporate Governance, Board Equity Ownership, Banks Performance, Resource dependence theory, Resource provision roles of BODs

INTRODUCTION

Corporate Governance (hereafter called CG) had been regarded as one of the basic fundamental determinants of the performance of a corporate organisation. Poor CG had been severally cited as the major cause of the Asian financial crisis in 1997, the CG scandals in USA, and Europe that turns out to be a global phenomenon (de Villiers, Naiker, & van Staden, 2011; Kao, Hodgkinson, & Jafar, 2008).CG was not as an important issue in many countries until the advent of a series of corporate scandals such as Enron and WorldCom in the US and Parmalat in Europe.Nigeria as a developing nation was greatly hit by sporadic collapse of various financial institutions especially the banking sector. Banking sector becomes the most regulated sector in the economy in order to sustain the confidence of depositors, enhance efficiency, ensure the continued soundness of the system itself and thereby minimizing the risk of bank failures (Oluranti, 1991). In the Nigerian financial sector, poor managerial performance and poor CG had been identified as the major factors causing almost all known cases of a financial institution's distress in the country. These two also necessitated the introduction of consolidation reform in 2004 (Soludo, 2004)and yet re-emerged afterwards, and led to another reform that brought a rescue program termed "bail-out" reform in late 2009. The reform necessitated the bail-out by injecting N620 billion naira into ten (10) banks which nearly collapsed due to high non-performing loans, poor CG, bad liquidity and risk management (CBN, 2010; NDIC, 2011; Sanusi, 2010). Consequently, the bail-out reform generated a lot of panic and doubt concerning the status of the investments of these banks' depositors, shareholders and

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other Nigerians consequently, led to a sparked interest in examining the potential outcome of this reform through researches.

The relationship between CG and firm performance is important in ensuring efficient corporate control through the monitoring or advisory, counselling roles of Board of Directors (hereafter called BODs) who are regarded as the instrument of corporate control (Clifford & Evans, 1997). Majority of prior literature mostly focuses on the CG practices in the developed western countries like US, UK, Germany, Australia and others etc. (e.g., Albring, Robinson, & Robinson, 2013; Bhagat & Bolton, 2008; de Villiers et al., 2011; Guest, 2008; Zahra & Pearce, 1989; Zahra, 1996 etc.). While few studies are conducted in developing nations like Nigeria with a particular emphasis on examining the resultant effect of CG on firm performance in a post reform era.Therefore, this paperaims at proposing a framework in Nigerian context that could examine the potential relevance of board equity ownership (BEO) in influencing the relationship between CG and the performance of these bail-out banks. This study is therefore proposing a framework that focuses on the board resources provision variables (board size, andfemale membership in a board) that best address the banks' CG problems peculiar to Nigeria, and introducing a moderating variable (BEO) that will strengthen the inconsistent conflicting results on the relationship between CG and banks performance indirectly, as opined byHillman and Dalziel (2003), Zahra and Pearce(1989). This framework, unique as it is, aims at covering only the bailed-out banks with a total of 2,811 branches in Nigeria using a primary source of data (i.e. questionnaire).

There is paucity of studies that use BEO as moderating variable that captures board'sresource provision role which addresses the Nigerian bail-out banks, hence the need to be introduced into these inconclusive mixed results.The outcome of this paper shall be of immense importance tothe academia by addition to literature, regulators, shareholders, and other Nigerians as it will reveal the contribution of BEO in strengthening BODs' functions in ensuring good banks' performance. The paper is subdivided into 5 sections from 1.introduction, 2.literature review, 3. BEO (moderator), 4. Bank performance, framework, conclusion, 5. Reference.

LITERATURE REVIEW

Overview of the Nigerian Banking Sector Crisis and Reforms

Historically, the banking system in Nigeria has experienced so many major challenges since after commencement in 1892. Banking crisis is dated back to the late 1940s and early 1950s, 1962 which were mostly attributable to lack of proper regulations, followed by Structural Adjustment Programme (SAP) in 1986, financial liberalisation in 1987-1988 and prudential guidelines in 1991 (Beck, Cull, & Jerome, 2005; Oluranti, 1991). Additionally, between 1990 and 2004, Central Bank of Nigeria (hereafter called CBN) as bank regulators, mandated all banks to increase their required minimum share capital about five (5) times, in 1991, 1997, 2000, 2001 and 2005. Yet, all these measures had failed to curtail the series of bank distress and failures within the 1990s and beyond(Aburime, 2008). Lastly came the consolidation reform in 2005 and then the recent bail-out reform in 2009.Apparently, consolidation reform occurred when CG standards were ineffective. Factually, CG failure was among the key factors that contributed to the financial institutions' crisis (CBN, 2006; SEC, 2003). Consolidation brought stronger banks but failed to address the necessary faults in CG of most of these banks.

Recently, due to a major hit by the global financial crisis, another set of banking sector rescue program "Bail-out" was inevitably being introduced to ensure stability and prevent distress. After a joint special examination of all the 24 banks in Nigeria by CBN and the Nigeria Deposit Insurance Corporation (hereafter called NDIC) in July 2009, significant poor CG practices, poorliquidity andcapital adequacy, poor risk management practices were found to give birth to excessively high level of non-performing loans in the banks. The Governor of CBN Mal. Sanusi Lamido Sanusi, declared ten (10) banks as being distressed and a bail-out of about N620 billion was injected to rescue them, and then the Chief Executive Officers (CEOs/MDs) and the board of directors of eight (8) banks were immediately removed and then replaced with new ones. These CEOs were then detained, prosecuted by the Economic and Financial Crimes Commission (EFCC) and also tried before the high court for outright stealing, corruption and mismanagement of their banks (CBN, 2010; NDIC, 2011; Sanusi, 2010). The CBN has also appointed advisory companies like Deutsche Bank, Chapel Hill Denham, KPMG Professional Services and Akintola Williams Deloitte etc. to work with the new boards and management of these banks by exploring all options for securing their stability and long-term future growth. Even though some of these banks had been acquired by other banks, up till now their performance is still probationary under watch.

Corporate Governance

Since after the global financial crisis that touchedmany nations, the mid 2000s saw a renewed academic interest in the field of CG and firm performance.CG has been viewed from different perspectives by different authors and practitioners based on certain reasons. In simple terms, CG is the system by which organizations are directed and controlledin order to enhance the strategic values, corporate performance and accountability, for the interest of shareholders and other stakeholders.However, most researches conducted globally and Nigeria in particular, are observed to have some kind of limitationsthatusually results in mixed or conflicting resultssuch as, inconsistent operationalization of board variables, limited scope, and convenience samples, and usual focus mainly on the direct relationships between board variables and firm's performance, thus ignoring the indirect path through roles and strategic initiatives (Hillman & Dalziel, 2003; Zahra & Pearce, 1989). Studies in the Nigerian context which adopts a moderating variable that captures board resource provision role are very rare, hence the need to be introduced into these inconclusive relations/findings. Also, most of the studies on CG in Nigerian context are either conducted before the banks' bail-out, or not in the area of bail-out reform or not covering the banking sector such as Adekoya (2011), Okereke, Abu, and Anyanwu (2011), Onakoya, Ofoegbu, and Fasanya (2012), Uwuigbe and Fakile (2012). Only few studies were found on bail-out such as Kuye, Ogundele, and Otike-Obaro(2013), Nworji (2011), Oghojafor, Olayemi, Okonjia, and Okolie(2010), which all have certain kind of shortcomings, small sample, addressing policy issue not the banks' performance etc. Studies on CG covering both financial and non-financial performance are very rare in Nigeria except Ogbechie, Koufopoulos, and Argyropoulou (2009). Finally, in terms of theory, there had been mix-up or misapplication of theories that should underpin the diverse CG variables leading to vague findings (Hillman & Dalziel, 2003).

In this paper, board size and female membership in a board are classified under the resource dependence theory perspective where "board size is the total number of board members in a board while number of females in a board is the other". Again, independent directors and directors who own shares will be more likely to guide and advice rigorously

(Bhagat & Bolton, 2008; de Villiers et al., 2011; Hillman & Dalziel, 2003).This study therefore, propose two board variables and develop hypotheses in this paper which reflect directors' resource provision role (driven by resource dependence theory).Additionally, these variables were actually selected based on their prominent importance in solving the practical problem of CG in Nigerian banks as mentioned in Sanusi (2010).

BODs' Resource Provision Role (Resource Dependence theory based)

This study adopts resource dependence perspective as in the framework as in Bhagat and Bolton (2008) de Villiers et al., (2011), Hillman, Cannella, and Paetzold (2000), Hillman and Dalziel (2003), Pfeffer and Salancik (1978) which opined that boards have the functions of facilitating access to vital resources because accessibility to resources is a serious problem for firms. A resource rich directors could be actively involved and certainly influence business strategy and programs. Resource provision role emanatesfrom the resource dependence theory, through a seminal work of Pfeffer and Salancik (1978). They explained the various resources which a director can provide to aid a firm were identified, comprising advice, guide and/or counsel, legitimacy, creating information networks between the firm and externals members, in addition to privileged linkage to various external resources. All this constitute the vital resources that brings a sound performance to a company if directors effectively utilize these in delivering this role.

Also, Hillman et al., (2000), categorized outside BODs according to resource dependence theory by suggesting their classification as “business experts,” “support specialists,” and “community influentials,” signifying the diverse kinds of resources BODS could bring to its board. Extant studies had offered results that confirms these roles such as de Villiers et al., (2011), Hillman and Dalziel (2003), and Zahra and Pearce (1989). In support of this, Kor and Misangyi(2008)contend that BODs having special professional experience may perhaps complement the inexperience of CEOs of new enterprises in making strategic investments/production. This kind of expertise expedites contact to essential information as well as business resources linkages and collaborations (Hillman & Dalziel, 2003). Zahra and Pearce(1989) opined that, under this role, BODs could review strategic opportunities through recommending new business innovative ideas. Therefore, this study identify board size and female membership in a board, as CG characteristics that are linked to the diverse important resources obtainable from the BODs of the bailed-out banks.

However, to the best of our knowledge, no study has been conducted using these selected variables together in a single framework on the Nigerian bail-out banks. Therefore, these board characteristics are proposed to examine their indirect effect on banks' performance with the influence of a moderator (board equity ownership) due to the inconclusive, conflicting findings on the relationship of these variables to firm performance as suggested by Baron and Kenny (1986) on mixed inconclusive results. Also, since boards' ownership is found to be related to firm performance, then it can moderate CG to performance.

Banks Performance

Organisational performance is an important concept that relates to the way and manner in which financial, material and human resources available to an organization are judiciously used to achieve the overall corporate objective of an organisation. Various measurement models were previously developed to take care of either managerial or organisational or both performance. However, among them all this study adopts the Balance Scorecard (BSC) performance model which was developed by Kaplan and Norton (1996). Balance Scorecard model provides an excellent system for performance measurement in the commercial banking industry Bremser and Chung (2005). The BSC is the major element of a strategic management system that enables organizations to translate strategic goals into measures of performance. The measures consist both financial and non-financial measures which serves as indicators used in monitoring strategy implementation throughout the organization and whether strategic goals are being achieved or not (Bremser & Chung, 2005).The framework comprises of four (1 financial, and 3 non-financial aspects (customer perspective, internal process, learning & growth).

HYPOTHESES DEVELOPMENT

Direct Relationship

Board Size (BS) and Banks' Performance

As explained by the resource dependence theorist, the total number of directors within a firm's boardroom significantly influences its effectiveness. Despite uniform regulation on CG, up to date, there are contradictory notions about the proper or optimal size of BOD in a firm. The CBN Code of CG for Nigerian Post-consolidated banks (2006), No.5.3.5 however provided that "the number of non-executive directors should be more than that of executive directors subject to a maximum board size of 20 directors" (CBN, 2006, p.10). Here, it could be deduced that no specific figure is legally stated as the optimal size, and such allowing the shareholders/board to determine it. However, if a board size (BS) is too large, directors may be individually constrained in actively participating in board decisions, create an ideological conflict hence, lead to trivial contribution. Also, if a board size is too small, the directors may not be able bit the time and effectively deliver their functions. Due to the Sanusi(2010)report that BODs fail to make meaningful contribution in their boardrooms, this study will therefore seek to examine the relative effect of the diverse sizes of the banks' boards on their banks performance. In an attempt to determine the effect of BS on the performance of a firm, several conflicting results were reported.

The theoretical link amongst these different activities is their common focus on BODs as resources provider instead of monitor of firm's management (Hillman & Dalziel, 2003; Zahra & Pearce, 1989). Regarding board size, several conflicting mixed results were given since the past decades. On one hand, studies of Eisenberg, Sundgren, and Wells(1998), Hermalin and Weisbach (2001), Jensen (1993), Lipton and Lorsch(1992), Uwuigbe and Fakile (2012), Yermack (1996)etc. contends that smaller BS contributes better to the firm performance as bigger BS are usually ineffective and cumbersome to manage. On the other hand, majority of other prior and extant researches such as Chen and Al-Najjar (2012), Dalton, Daily, Johnson, & Ellstrand (1999), de Villiers et al., (2011), Guest (2008), Hillman and Dalziel (2003), Sanda, Mikailu, and Garba(2005), Uadiale (2010) among others asserted that larger board size relates positively to firm performance. This is because, bigger BS were predicted to consist many directors with different expertise, qualifications and business experience, external connections, reputations and other qualities that lead to qualitative decision making. As BS increases, the domination of BODs by a CEO becomes more challenging and BODs would have a good chance to utilize their authority in leading the firm (Zahra & Pearce, 1989). Consistent with these prior studies, this study argues that, in a larger board, it is more likely that one or more BODs may have acquired skills regarding banking crisis and on how to revive the bank especially after a bail-out. As such, any director having such skills/exposure can guide the remaining BODs regarding the related strength, weakness, challenges and opportunities that must be managed to succeed in their function. Thus, we form the following hypothesis:

H.1: Board size is significantly related to bail-out banks performance.

Female Membership in a Board (FMB) and Banks' Performance

To strengthen the resources provision abilities, more recent researches on CG has begun to refocus on proposing of gender diversity (female board membership) in top management positions and corporate boardrooms (Carter, Simkins, & Simpson, 2003; Dalton et al., 1999; Farrell & Hersch, 2005). Female membership as corporate BODs is very minimal globally. Female corporate board membership is less than "15% in countries like UK, USA, Canada, Australia and many European countries, but some Asian countries have as low as 0.2%"(Terjesen & Singh, 2008). However, in Nigeria, no empirically data is reported as female representation is also less than 0.2% of Asia. Several researches have reported conflicting findings about the influence of female membership on board on the performance of firms (Carter et al., 2003; Vo & Phan, 2013). In Nigeria's context, nothing is known in the case of bail-out banks hence, there is need to investigate whether the female members might be more ethically responsible and might be more vigorous in monitoring management to ensure better banks performance after the bail-out rescue. Therefore, the study will introduced it to the model, testing it alongside a moderator. Vo and Phan(2013)'s work reveals that female membership on boards signifies that board's membership is actually diversified which in turn improves the firm's performance. Several other views were found regarding the effect of female membership in a board. Both Carter *et al*., (2003) and Adams and Ferreira (2003) found a strong relationship between the number of female membership on board and value of the firm using Tobin's q. Also, the Norwegian study of Nielsen and Huse (2010) additionally confirmed the positive correlation between women directorship and firm performance using a survey questionnaire data administered among 120 firms in Norway. They added that women directors positively influence strategic decision making and monitoring. Theirresult is also supported by another study in Australian context by Kang, Cheng, and Gray(2007).

Also in support, Agrawal and Knoeber (2001), revealed a significant correlation between Board size and the female membership on board. Since the presence of an experienced, competent female director could provide more credible, unbiased advice, counsel, connections, and also monitoring the management's strategy implementation to protect their reputation, the firm performance tend to be better (Farrell & Hersch, 2005). The study of Farrell and Hersch (2005) reported that females naturally tend to only serve in better performing firms, hence this study argues that presence of female in boards could probably lead to better firm performance due to her ability to deliver her advisory and guidance duties diligently, effectively and vigorously. Thus we form the following hypothesis:

H2: Female Membership in a Boardis significantly related to bail-out banks performance.

Indirect Relationship

Board Equity Ownership (Moderator)

Practically, the implementation of CBN code of corporate governance in Nigeria, posed some challenges, prominent among which were: ambiguities regarding the appointment of independent directors and the share ownership status of these independent directors (CBN, 2008). Thus, it has been an unresolved debate concerning the potential importance/ effect of board members' equity ownership on both the board functional performance and firm performance. Albring et al., (2013), opined that in the USA, the Blue Ribbon Committee (1999), among others, suggests that director stock ownership should reduce agency problems and therefore the need for external monitoring. Thus, in an attempt to make a proper alignment of the interest of director and shareholders, many boards have implemented stock ownership guidelines and holding requirements for directors, leading to a substantial rise in the ownership of managers and directors but in Nigeria, there exist ambiguities and challenges regarding the directors share ownership status (CBN, 2008).

There exist conflicting researchers' views regarding this which until now, no clear position is given by the CBN. This show the real extent of the misconception on whether or not equity ownership by the board of Directors would influence their mandated functions. Also, the percentage of the shareholding is still not clearly determined. However, Bhagat and Bolton (2008), Bhagat, Carey, and Elson (1999), de Villiers et al.,(2011), Hillman and Dalziel (2003), and Zahra(1996)all agreed and suggested that Stock ownership aligns the interests of the directors with those of shareholders. Bhagat & Bolton, (2008)'s study further revealed that particularly in a poor firm performance, the likelihood of disciplinary management turnover (replacement) is positively correlated with stock ownership of board members. As such, directors with more equity ownership are likely to objectively evaluate firm performance and control firm choices (Patton & Baker, 1987). Similarly, Weisbach(1988) also reported that CEO replacement in poorly performing firms was greater as the representation of independent outside directors increases. Board members (both executive and non-executive) share ownership reduces manager/shareholder conflicts. To the extent that executive board members own part of the firm, they develop shareholder-like interests and are less likely to engage in behaviour that is detrimental to firms' / shareholders interest. In support, Kren and Kerr, (1997) shows that boards with significant holdings are more likely to link CEO pay to firm performance and replace CEOs of poorly performing firms Bhagat, Carey, and Elson(1999).

On the contrary view, Demsetz and Lehn(1985)) reported that BEO is not associated with the performance of firms and a trivial support for the discrepancy in managers and shareholders' interests. Fama and Jensen (1983) argued that contribution of board's ownership is considered as a "two-edged knife" in which there is an optimal level of board ownership which contributes positively to a firm's performance. However, the study of Morck, Shleifer, and Vishny (1988) revealed that performance of companies improves firstly BEO increases up to 5%, and then decreases as BEO rises up to level of 25% and then lastly increases again slightly at a higher BEO. McConnell and Servaes (1990) in their study confirmed that there exist a significant curvilinear interrelationship between BEO distribution and the value of a firm. Uadiale, (2010) in a Nigerian study with a sample of 30 listed firms reported a negative relationship between BEO and the financial performance of firms.

Corporate Governance, Board Equity Ownership, and Banks Performance

By and large, boards' equity ownership, was viewed as an encouragement that will help board members advice, guide and supervise management in a more efficient way. Consistent with the positive view, Chung and Pruitt (1996), Jensen and Murphy(1990), Mehran (1995)supported that, board's ownership will improve firm's performance and are positively correlated. More related to this study, (Albring et al., 2013; Bhagat & Bolton, 2008; Bhagat et al., 1999; de Villiers et al., 2011; Hillman et al., 2000; Hillman & Dalziel, 2003; Westphal, 1999; Zahra, 1996)show that director ownership influence or improves boards' advisory, external connections, and guidance of strategic decision making. Similarly, Hillman and Dalziel (2003) argue that ownership incentives motivate directors to forgo short- term returns for long-term projects and strategies.

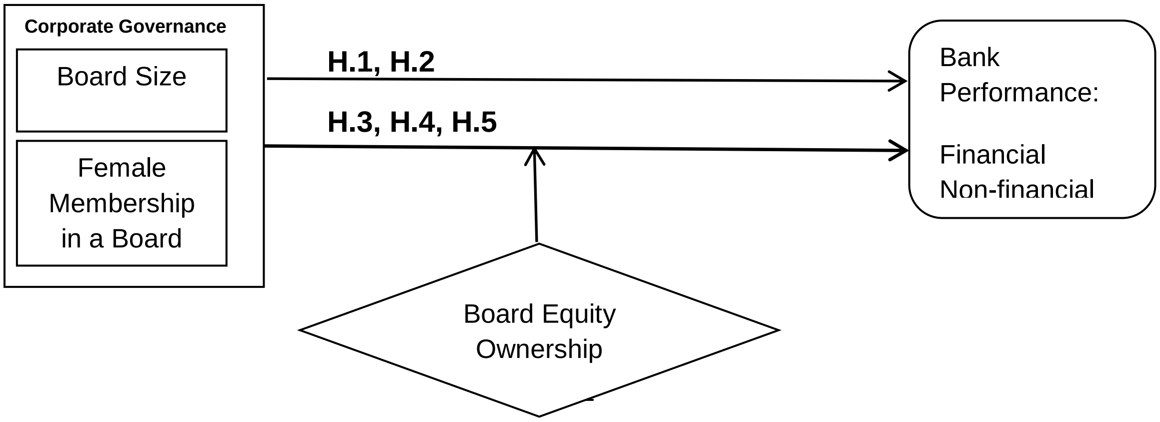
The study further argues consistent with many studies like Albring et al., (2013), Bhagat and Bolton, (2008); de Villiers et al., (2011); Guest, (2008) that, if these banks' board of directors were having a substantial equity ownership in the banks or compensated with equity as incentives for a targeted performance, they would definitely have advised, monitored and counselled those sacked incompetent/fraudulent banks' managements. In the current aftermath of banking crisis, it is plausible that higher ownership could motivate directors to provide resources (advices, counsel connections etc.) to management which will in-turn lead to higher firm performance in the long run. Boards' equity ownership could motivate large or small sizeof a board and motivate a female board member in her fiduciary duty. Thus, we form the following hypotheses:

> **H.3:** Board equity ownership has a relationship with the bail-out banks' performance.
>
> **H.4:** Board equity ownership moderates the relationship between board size and bail-out banks' performance.
>
> **H5:** Board equity ownership moderates the relationship between female membership in a board and bail-out banks performance.

PROPOSED FRAMEWORK:

Figure 1 is the proposed study framework based on the perspective of resource provision roles of BODs which is covered by the resource dependence theory.

Figure 1: Framework



CONCLUSION

This paper proposes a framework based on an ongoing research, to examine the influence of equity ownership in motivating BODs of banks and improving their functional effectiveness in providing advisory, guidance, and other resources to the managements' overall strategic control system. This will results in a better banks performance after the reform. The findings of this research will provide significant contribution to the literature, managers and banks regulators like CBN, NDIC etc.

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