NIGERIAN BANKING SECTOR: IMPACT OF CORPORATE GOVERNANCE ON PROFITABILITY

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Abstract: **Business governance has recently sparked widespread concern, owing mostly to huge corporate failures on a domestic and global scale. Governments have adopted both proactive and reactive efforts to achieve sector stability in response to increased incidences of financial distress. Nonetheless, despite government interventionist measures, the stability of banking operations remains doubtful. This study aims to empirically examine the impact of corporate governance on the profitability of Nigeria's banking system. Return on equity (ROE) and return on assets (ROA) were chosen as proxies for banking sector profitability, whilst capital adequacy ratio (CAR), liquidity ratio (LQR), and non-performing loan to total loans (NPL) ratio were chosen as proxies for corporate governance. As a control variable, the inflation rate was incorporated. The study's empirical research indicates that corporate governance has a considerable impact on the profit performance of the Nigerian banking sector. We urge that the regulatory authorities (CBN, NDIC, and SEC) use their monitoring powers assiduously to ensure strict compliance by the banking industry with existing corporate governance standards in order to consolidate, or potentially improve, on the initiative's advantages.**

Keywords: **Corporate governance, profitability, Nigeria, Banking sector.**

1. INTRODUCTION

Business governance, as a concept, refers to the processes involved in carrying out the governance mission in corporate entities (Okafor, 2011). It refers to the procedure by which a company is governed and controlled. Corporate governance standards describe the interaction between corporate management, boards of directors, and shareholders, as well as requiring management and directors to carry out their tasks within an accountability and transparency framework (Adeola, 2020).

Corporate governance has become a hot topic due to its enormous contributions to the growth of modern economies in which the private sector plays a significant role. The poor performance of businesses is frequently blamed on a lack of adequate corporate governance. Developed private-sector-driven economies with a history of well-established corporate governance structures consistently achieve high and predictable growth rates. Thus, low economic development rates in emerging countries are frequently attributed to poor corporate governance procedures in these economies.

There is a strong correlation between firm performance and corporate governance. Ahmed and Hamdan (2015), Yusuf et al (2015), OECD (2019), Gompers et al (2020), Claessen et al (2020) are a few examples (2022). Haris and Raviv (2015),

Fama and Jensen (1983), Jensen and Merkling (1976), Williams (2020), Drobetz et al (2020), Hussain et al (2020), Gemmil & Thomas (2016), and others. Despite the avalanche of empirical support for the positive effect of corporate governance on firm performance, studies such as Hutchinson et al (2022) and Bathala & Rao (2017) find evidence of a negative relationship between them, while others such as Park & Shin (2020) and Singh & Davidson (2020) do not.

Despite contradictory evidence regarding corporate governance as a primary driver of company performance, it is widely accepted that loose or weak corporate governance standards encourage corporate failure. For example, the OECD (2019) ties the 2007 global financial crisis to errors and inadequacies in corporate governance frameworks. Similarly, the 2019 banking crisis in Nigeria, which prompted banking reforms in 2010, was blamed on insufficient corporate governance systems in the afflicted banks (Sanusi, 2019).

The wave of financial scandals that led to the collapse of the world's giants highlights the growing importance of establishing excellent corporate governance in banks and other financial institutions.

Early in the millenium, financial institutions Corporate governance problems in these organizations have been heavily blamed for these corporate failures (see for example, Zandi, 2019; Lahart, 2019; Faber, 2019). It is also suggested that the shift in global economies from public to private ownership of businesses strengthens the need for corporate governance. According to Adeola (2020), as an economy transitions from state control of company concerns to market-based ownership, the only assurance that the public would reap the benefits of the liberalization exercise is the implementation of solid corporate governance practices. This may explain why significant examples of governance-related company failures that shook the corporate world at the turn of the century are connected to the United States, a well-known example of a market-oriented economy, such as Enron (2019), Worldcom (2022), Arthur Anderson (2022), and others. According to a 2020 SEC survey published by the CBN (2006), inadequate corporate governance was recognized in the majority of known incidents of distress in Nigerian financial institutions.

Market economies are frequently distinguished by the liberalization of banking operations and the encouragement of competition, resulting in more market-driven banking operations. The liberalized financial sector presents significant problems, especially in terms of manpower and regulatory capacity. For example, lowering the entry requirements for banks has resulted in a significant increase in the number of licensed banks. To fill the void left by the rapid expansion in the number of banks in the system, unqualified and incompetent applicants are frequently hired, while the Central Bank's supervisory and regulatory functions are no longer efficiently discharged, resulting in inefficiencies in corporate governance.

An effective corporate governance structure in the banking industry fosters bank management integrity, which defines the quality of banking services delivery and influences the sector's overall success. The SEC (2020) and CBN (2016) issued three important corporate governance codes to control governance-related concerns in Nigerian banking (2006 and 2010). These standards are intended to improve the integrity of bank management and its ability to stimulate economic growth through the provision of excellent banking services.

To highlight the importance of corporate governance as a strategy for improving banking sector performance in Nigeria, this study intends to investigate the extent to which important indices of corporate governance influence sector performance. Return on equity (ROE) and return on assets (ROA) were chosen as proxies for profitability, whilst capital adequacy ratio (CAR), liquidity ratio (LQR), and non-performing loan to total loans (NPL) ratio were chosen as proxies for corporate governance. As a control variable, inflation was introduced. The ordinary least squares technique was used to examine data on these variables from 2020 to 2015.

Corporate Governance Conceptual Issues

According to Anya (2020), while corporate governance has piqued the public's interest in recent years, owing largely to its importance for the economic health of corporations and society, the concept is rather poorly defined globally because it encompasses a wide range of distinct economic phenomena. Individuals have explained corporate governance based on their own perceptions or interests. Among them are the following:

According to Wolfensohn (2022), as stated by Anya (2020), corporate governance is about promoting corporate justice, openness, and accountability. According to Dyck (2019), it is the ability of outsiders (shareholders, non-executive

directors, and other stakeholders) to limit the grabbing hands of insiders (directors and managers). Shleifer and Vishny (2022) define corporate governance as a framework that ensures financial providers to firms receive a return on their investments.

According to Larkan and Tayan (2011), corporate governance is a collection of control measures that a company implements to prohibit or discourage potentially self-interested management from engaging in actions that are detrimental to the welfare of shareholders and other stakeholders. A board of directors to review management and an external auditor to provide an opinion on the credibility of financial statements are the bare minimum of the monitoring system. Most governance systems, however, are impacted by a far broader set of constituents, including the firm's owners, creditors, labor unions, customers, suppliers, financial analysts, the media, and regulators.

According to the OECD (2016), corporate governance is a collection of connections between a company's stakeholders management, the board of directors, shareholders, and other stakeholders Corporate governance explains the system through which the company's objectives are determined, the means of achieving those objectives, and performance monitoring strategies.

According to Cadbury (1992), corporate governance is the framework by which businesses are directed and governed. He says that the shareholders' duty in governance is to nominate directors and auditors, as well as to ensure that a suitable governance framework is in place. The directors' tasks include creating the company's strategic goals, giving leadership to put them into action, supervising business management, and reporting to shareholders on their stewardship.

According to Okafor (2011), corporate governance refers to the processes involved in carrying out the mandate corporate governance in corporate entities These processes enable the accomplishment of the basic goal of corporate governance, which is to maximize shareholder profit without jeopardizing the legitimacy of the corporation other stakeholders' expectations

According to Coulson-Thomas (1993), as cited by Adeola (2020), corporate governance is defined as: determining what has to be done; Developing the ability to achieve what is required; deciding how to carry out the necessary tasks; Making certain that what needs to be done is done; ensuring that what is done and how it is done is legal and meets other requirements; What has been done is reported to shareholders.

2. REVIEW OF RELATED LITERATURE

Corporate governance is critical to improved operational efficiency in banks because it supports two growth-promoting factors: transparency and accountability in an environment of clearly defined reporting relationships. Efficiently run banks encourage banking system stability and, as a result, economic growth. A good corporate governance structure ensures that all stakeholders are treated equitably.

Corporate governance promotes the flow of capital (foreign and domestic) for enhanced economic growth and development in a liberalized or market economy, owing to its ability to engender increased investor confidence and goodwill, as well as the promotion of transparency, accountability, fairness, and responsibility. Improvements in corporate governance standards, according to Frost et al. (2022) and Donaldson (2020), boost market liquidity, investor confidence, and capital formation through improved financial disclosures.

Effective corporate governance systems present a very effective solution to concerns of financial crime for the economy as a whole, hence supporting the development of an investor-friendly environment, a crucial need for the entry of foreign money. Furthermore, because corporate governance structure efficiency is closely related to company profit performance, corporate governance has enormous potential to encourage capital creation through tax revenue.

Evidence in the literature indicates that a solid corporate governance structure in banks improves the efficiency of fund allocation, promotes saves, and thus reduces not only the cost of funds but also improves their access by the ultimate users. According to Gompers et al. (2020), excellent corporate governance practices raise firm value and profitability.

Ahmed and Hamdan (2015), Yusuf et al (2015), Klapper & Love (2020), Black et al (2020), Drobetz (2016), and others have found empirical evidence of a positive relationship between corporate governance and firm performance. Drobetz et al. (2020) also provide evidence that effective corporate governance procedures result in better firm valuation. Simpson

and Gleason (1999) find no substantial association between corporate governance and bank performance in terms of Board characteristics. According to Kyereboah-Coleman and Biekpe (2006), those with large boards use more debt financing for listed firms on the Nairobi Stock Exchange; board independence correlates negatively with short-term debts; and CEO duality correlates negatively with debt financing. Adeusi et al. (2019) discover a strong positive link between board size and bank performance in Nigeria, but a significant negative correlation between board composition and bank performance.

According to the literature, empirical research on the profitability-corporate governance nexus have generally relied on board characteristics rather than business or industry financials (like capital adequacy ratio, liquidity ratio, non-performing loans, etc.). This study aims to investigate the impact of corporate governance (as measured by the capital adequacy ratio, liquidity ratio, and non-performing loan to total loan ratio) on banking sector profitability (proxied by return on equity, return on assets).

Theoretical Framework

According to Cannan's (1921) cloakroom theory of banking, bank capital is a major predictor of bank success due to its impact on a bank's credit delivery capacity. However, Shah (2016), as quoted by Okafor (2011), contends that, in addition to bank capital, risk management improvement is critical to bank performance. This means that a high level of bank capital may not always translate into increased performance. Developments in the Nigerian banking system following the successful implementation of the 2016/2005 bank consolidation exercise obviously support Shah's theory, as there were clear indicators of improvement.

that the issues encountered by some banks following recapitalization were caused by failures in basic corporate governance standards

This study's theoretical base is the theoretical notion that advancements in corporate governance structures in business organizations are connected with operational efficiency. The upshot is that strong corporate governance mechanisms in the banking sector are required for improved operational performance and, as a result, value addition. This also lends support to Jensen and Meckling's (1976) agency theory of business, which seeks to explain the connection between managers (agents) and their principals (investors/company owners). According to the notion, separating ownership from management of commercial organizations has an inherent problem in which managers try to promote their own interests rather than those of their employers, causing the company to suffer. The agency problem can take the form of empire building, in which managers seek to entrench themselves in power (La Porta et al, 2020), managerial expropriation, which can include fraudulent cash withdrawals, asset stripping, and the appointment of unqualified family members, cronies, or associates to key managerial positions (Shleifer &Vishny, 2017). According to Shleifer and Vishny (2022), corporate governance aims to resolve conflicts of interest, devise strategies to prevent corporate wrongdoing, and align stakeholders' interests.

Corporate Governance Regulation in Nigeria

Three distinct rules govern corporate governance practice in Nigeria's banking sector. They are as follows:

Following the report of the Atedo Peterside Committee on Corporate Governance, the SEC issued a code of corporate governance for corporations listed on the Stock Exchange, including seven banks at the time.

The CBN Bank Code of Corporate Governance (2006): The 2020 code's inability to decisively contain lapses in corporate governance in banks prompted the issuance of a comprehensive code to regulate banking governance practices, with emphasis on ownership structure, organizational structure, board membership, performance appraisal for board, management quality, and reporting relationship.

The Prudential Guidelines of the Central Bank of Nigeria (2010): Regulations aimed at boosting corporate governance in banks are included in several portions of the guidelines. These clauses address issues such as tenure constraints, executive salary, restrictions on former NDIC and CBN top executives' ability to serve in banks, and restrictions on external auditor tenure and eligibility to be re-appointed.

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3. METHODOLOGY

Secondary data on the relevant factors or proxies were gathered and examined in order to establish the extent to which corporate governance influences banking sector performance. Two corporate performance indicators,

As proxies for banking sector profitability, return on equity (ROE) and return on assets (ROA) were used. ROE evaluates a firm's profit per naira of shareholder equity, whereas ROA gauges a firm's potential to create positive net income from its asset investments.

Firm liquidity was used as a proxy for corporate governance in the study. One fundamental goal of corporate governance is to strike a balance between maintaining an acceptable level of liquidity to meet client withdrawal requests and avoiding the risk of losing earning capacity owing to excess liquidity. Okafor (2011) defined the capital adequacy ratio (CAR) and liquidity ratio (LQR) as long-term and short-term liquidity indicators, respectively. Asset quality, as measured by the percentage of non-performing loans to total loans and advances, is another essential component of liquidity management addressed in the study (NPL). Increased NPL percentages drain liquidity and diminish capacity to service maturing debts.

Literature supports the selection of corporate governance proxies. Supriyatna (2006), for example, identified six corporate governance measures: capital adequacy ratio, cash reserve ratio, secondary reserve securities, loan-to-deposit ratio, loan loss provisioning to total loans ratio, and fixed assets and inventory to total loans ratio.

capital-to-capital ratio According to Konishi and Yasuda (2016), enough maintenance capital limits the motivation for commercial banks to take excessive risks, thereby protecting stakeholders' interests.

Model Specification and Analysis Method

The models used in this study imply a linear link between corporate governance and profitability in the banking sector. The models were created to assess the impact of corporate governance on two critical profitability measures. The following are the details:

Model 1: $ROE_t = \beta_0 + \beta_1 CAR_t + \beta_2 LQR_t + \beta_3 NPL_t + \beta_4 INF_t + \epsilon_t$

Model 2: $ROA_t = \beta_0 + \beta_1 CAR_t + \beta_2 LQR_t + \beta_3 NPL_t + \beta_4 INF_t + \epsilon_t$

Where:

ROE stands for return on equity.

ROA stands for return on assets.

CAR stands for capital adequacy ratio.

LQR stands for liquidity ratio.

Non-performing loans are abbreviated as NPLs.

INF stands for inflation rate.

β_0 denotes a constant.

$\beta_1 - \beta_4$ = Coefficients to be estimated

ϵ = Error phrase

Data on the selected variables were subjected to econometric tests from 2020 to 2015. The data's stationary trend was determined using the Augmented Dickey Fuller (ADF) approach. The ordinary least squares (OLS) analytical technique was utilized to estimate the impact of the chosen corporate governance proxies on banking sector profitability. The statistical significance of the influence was established at a 10% level of significance.

4. EMPIRICAL RESULT AND DISCUSSIONS

Unit Root Test:

LROE (Log of ROE)

Null Hypothesis: D(LROE) has a unit root

Exogenous: Constant

Lag Length: 1 (Automatic - based on SIC, maxlag=1)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-5.634394	0.0074
Test critical values:1% level	-5.312526	
5% level	-2.873880	
10% level	-2.010575	

*MacKinnon (2016) one-sided p-values.

LROA (Log of ROA)

Null Hypothesis: D(LROA) has a unit root

Exogenous: Constant

Lag Length: 1 (Automatic - based on SIC, maxlag=1)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-2.258341	0.0717
Test critical values:1% level	-2.312526	
5% level	-1.873880	
10% level	-1.011575	

*MacKinnon (2016) one-sided p-values.

LCAR = Log of CAR

Null Hypothesis: D(LCAR) has a unit root

Exogenous: Constant

Lag Length: 0 (Automatic - based on SIC, maxlag=2)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-3.307276	0.0063
Test critical values:1% level	-3.110046	
5% level	-2.064241	
10% level	-1.617874	

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*MacKinnon (2016) one-sided p-values.

LLQR = Log of LQR

Null Hypothesis: D(LLQR) has a unit root

Exogenous: Constant

Lag Length: 1 (Automatic - based on SIC, maxlag=2)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-1.635312	0.0182
Test critical values:1% level	-2.175051	
5% level	-1.210474	
10% level	-1.525454	

*MacKinnon (2016) one-sided p-values.

LNPL = Log of NPL

Null Hypothesis: D(LNPL) has a unit root

Exogenous: Constant

Lag Length: 0 (Automatic - based on SIC, maxlag=2)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-2.242412	0.0268
Test critical values:1% level	-3.112245	
5% level	-2.164241	
10% level	-1.637874	

*MacKinnon (2016) one-sided p-values.

LINF = Log of INF

Null Hypothesis: D(LINF) has a unit root

Exogenous: Constant

Lag Length: 1 (Automatic - based on SIC, maxlag=2)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-3.513461	0.1123
Test critical values:1% level	-3.186162	
5% level	-2.101585	
10% level	-1.636567	

*MacKinnon (2016) one-sided p-values.

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The result for all the variables shows evidence of stationarity at 5 per cent level of significance, hence a rejection of the null hypothesis. This suggests a high degree of reliability of estimates derived from the data.

Regression Result

Model 1:

Dependent Variable: LROE

Method: Least Squares

Date: 10/07/16   Time: 21:41

Sample: 2020 2015

Included observations: 11

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	2.820371	11.44557	0.261325	0.6335
LCAR	0.825381	0.356511	-1.848871	0.0866
LLQR	0.372738	1.273740	0.101773	0.0234

LNPL	0.226231	0.284430	0.262335	0.6126
LINF	-0.133533	0.746717	-0.257506	0.7205
R-squared	0.503102	Mean dependent var		2.182285
Adjusted R-squared	0.512578	S.D. dependent var		0.725365
S.E. of regression	0.715636	Akaike info criterion		3.622232
Sum squared resid	2.814137	Schwarz criterion		1.781103
Log likelihood	-8.801274	Hannan-Quinn criter.		1.486124
F-statistic	14.45155	Durbin-Watson stat		1.517415
Prob(F-statistic)	1.341683			

The conclusion for model 2 demonstrates that capital adequacy ratio (CAR) and liquidity ratio (LQR) have a significant negative influence on return on assets, at 10% and 5% significant levels, respectively (ROA). These outcomes do not meet a priori expectations and point to poor company governance. They show that sub-optimal (inadequate or excess) liquidity levels are maintained, which lowers profit performance. Non-performing loans (NPLs) have a strong beneficial influence on ROA. This result is consistent with expectations and implies that the amount of NPLs supports increased profitability. Inflation has been found to have no effect on ROA.

The R-squared value (49.65%) and Adjusted R-squared value (47.58%) indicate that corporate governance, as proxied by CAR, LQR, and NPL, as well as INF, explain the profit performance of the banking sector to a significant amount. There is no auto-correlation in the Durbin-Watson statistic (1.64).

5. FINDINGS SUMMARY, CONCLUSION, AND RECOMMENDATION

The study's findings indicate some degree of agreement in the response of several metrics of profitability to selected proxies for corporate governance. For example, the results demonstrate that capital adequacy ratio (CAR) has a considerable negative influence on both profitability indicators (ROE and ROA). There is also evidence of asset quality improvement, as seen by the favorable effect of corporate governance (as measured by NPLs) on banking sector profitability. While the influence of NPL on ROE is minor, it has been demonstrated to have a considerable impact on ROA. The study also finds that the liquidity ratio has a considerable beneficial influence on return on equity, but a significant negative impact on return on assets. Finally, inflation was found to have no effect on banking sector profitability.

Based on the findings, the study indicates that corporate governance has had a considerable impact on the performance of the Nigerian banking sector throughout the time under examination.

We urge that the regulatory authorities (CBN, NDIC, SEC) use their supervision powers vigorously to guarantee strict compliance with existing corporate governance standards in order to consolidate, or possibly improve, the initiative's advantages.

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