EFFECT OF BOARD SIZE ON BANK PERFORMANCE: A STUDY OF SELECTED BANKS IN NIGERIA

JOHN AYODELE AJAYI

Department of Banking and Finance, Federal University of Agriculture, Abeokuta, Nigeria
Email: ayodelejohayo@yahoo.com

Abstract - This study examines the effect of board size on bank performance in Nigeria. Corporate governance has been known to be an essential ingredient for a sound and efficient financial system. The study covers the period 2005 -2014 based on a sample of five banks listed on the Nigerian stockmarket. Data for the study was obtained from the audited financial statements of the five banks. Panel data was adopted and analysis was done with the use of multiple regression and pooled ordinary least square.Findings from the study show that there is a positive relationship between board size and bank performance implying that the higher the number of directors on bank board, the higher will be the profit.The paper concludes that having more people on bank board will enhance effective supervisory, monitoring, and discipline of managers which in turn lead to increase performance.

Keywords - Corporate Governance, Bank Performance, Board Size, Pooled Ordinary Least Square

I. INTRODUCTION

The banking system plays fundamental roles in the growth and development of an economy. These roles vary from one country to another, depending on the economic, political, and the legal system within which the bank operates. Banks, as financial institutions, perform intermediation roles generally through the mobilization of resources from the surplus units and channeling of same to the deficit units for productive activities within an economy designed to ensure a more efficient resource allocation and utilization (CBN Briefs, 2004).

Also, as clearing and settlement institution, banks constitute a useful channel in the payment system and the medium through which the effects of monetary policy are transmitted to the rest of the economy. The capacity of banks to perform these roles efficiently and effectively is dependent on the health and sophistication of the banking system hence it is imperative for banks to embrace corporate governance for a sound and efficient financial system so as to bring about growth to the economy.

Good corporate governance in the banking sector is vital because many banks are now global in terms of size of shareholders' funds, foreign investment inflow and lending activities. It is also in line with global best practices (Philips, 2007). Banks are highly regulated because of the important roles they play in an economy such as the nature of the services they provide, their intermediation functions among others so as to forestall economic disruptions in the system. As a result of the environment in which banks operate, it is therefore important for banks' boards to ensure smooth operations and value-added services to the banks. The complexity of banks business environment also requires that banks' boards not only monitor the managers' efficiency but also gives managers access to independent and valuable advice to operate the banks (Samad et. al., 2010).There has been renewed interest in the corporate governance activities globally due to the collapse of a number of large firms in the United States of America in 2001 such as ENRON Corporation, MCI Incorporated (formerly WorldCom) Global Crossing and ADELPHIA among others.

A study conducted by the Nigeria Deposit Insurance Corporation (NDIC) in 2007 showed that Nigeria lost 75 banks due to poor corporate governance. The Corporation listed the factors that caused severe distress in these banks as follows; economic depression (25%), political crisis (17.9%), bad credit policy (25%), interference of board members (32.1%),
The above relates to corporate governance issues in terms of how the banks were managed and governed, namely bad credit policy and interference by board members were responsible for 51.1% of the severe distress of the banks. In line with the bad scenario painted above, this study seeks to examine the relationship between board size and bank performance.

Hypothesis of the Study

H_o: There is no significant relationship between board size and bank performance.

The remainder of this paper is as follows: The next section discusses the literature review followed by theoretical framework which is in section three. The fourth section discusses the methodology and data for the study. The paper ends with conclusion.

II. LITERATURE REVIEW

Corporate governance is a multi-faceted concept. In a narrow way, it is mainly concerned with the

structures within which a corporate entity or enterprise receives its basic orientation and direction. In a broader sense, it is regarded as being the heart of both a market economy and a democratic society (Oyejide and Soyibo, 2001). However, corporate governance is a set of rules that define the relationship between shareholders, managers, creditors, government, employees and other internal and external shareholders in respect of their rights and responsibilities.

There has not been consensus on studies carried out on the appropriate size of board of directors in financial and non-financial firms in both developed and developing countries. Jensen (1983) opined that a small board can improve performance. He therefore suggested a board size of seven and eight for effective monitoring. Vafeas (1999), Xie et. al. (2003) suggested a board size of 12 and 12.48 respectively in their studies.

In a study carried out by Yermack (1996) he found an inverse relationship between board size and firm performance concluding that the smaller the board size. the better the performance. He proposed a board size of ten or lesser. Using different performance measures, Eisenberg et. al. (1998) found the same correlation like that of Yermack but his research was based on Finish firms. However, Dalton et. al. (1999) found a positive relationship between board size and firm performance. Other studies such as that of Smith and Watts (1992) found out that large sized board has a positive influence on firm performance. This finding was corroborated by Adams and Mehran (2005), Andres and Vallelado (2008) that a large board is needed in the banking industry for regional expansion of business activities. but inconsistent with Samad et. al (2010) that found a negative relationship between board size and bank performance.

III. METHODOLOGY AND DATA

Population of the study

The population of this study consists of21 banks that are quoted on the Nigerian Stock Exchange.

Sample size and Sampling Techniques

From the 21 banks listed on the Nigerian Stock Exchange, 5 banks were selected for the purpose of this study. A simple random sampling technique was used in selecting the banks based on the availability of their audited financial reports.

Sources of Data

Data for this study are from secondary sources as it was obtained from the audited financial statements of the sampled banks for the period of 2005 and 2014. Central Bank of Nigeria Statistical Bulletin and the Nigerian Stock Exchange Fact Book were also consulted.

Model Specification

$ROE = \beta_0 + \beta_1 BSIZE + e$ ---------- (4.1)

Where:

ROE = Return on Equity (proxy for performance)

$\beta_0, \beta_1 =$ Regression coefficients

BSIZ=Board Size

e = Error term

Table 1: Descriptive Statistics

	N	Minimum	Maximum	Mean	St. Deviation
ROE	50	.00	.30	.1439	.08265
BSZ	50	7.00	22.00	15.1600	3.43666
Valid N (listwise	50				

Source: Authors Computation

The table above represents the descriptive statistics of the study variables, namely Return on Equity (ROE) and Board size (BSZ) for 50 observations. As shown in Table 1 above, Return on Equitydoes not disperse too much away from the average return on equity (ROE) of 0.144, as indicated by the standard deviation 0.083.

The table also shows that that the mean of return on equity (ROE) is 14.4% which means that for every ₦100 invested in equity, there is ₦14.4 profit and it deviates by 8.3%. It means the value of profitability can deviate from the mean to both sides by 8.3%.
The minimum number of board size (BSZ) is 7 and a maximum of 22 members, the mean score is 15 members, with a standard deviation of 3 members

Table 2: Correlation Analysis

		ROE	BSZ
Pearson Correlation		1	.025
ROE	Sig.(2-tailed)		.866
	N	50	50
Pearson Correlation		.025	1
BSZ	Sig.(2-tailed)	.866	
	N	50	50

Source: Authors Computation

The Pearson correlation between board size and bank profitability represented by return on equity (ROE) is presented in Table 2 below.

Table 2 above shows the result of the correlation analysis between return on equity (ROE) and outside directors on bank board. The relationship between return on equity (ROE) and board size (BSZ), ($r = 0.025$, $p \leq 0.866$) is weak, positiveand statistically insignificant at 10% level of significance. The positive relationship between return on equity and board size means that the higher the number of directors on bank board, the higher will be the profit. This may be due to the fact that having more directors

on bank board may result to making profitable economic decisions as a result of the qualifications and experiences of each director. In other words, the higher the board size, the more profitable the organization is likelyto be.

CONCLUSION

This study examines the relationship between board size monitoring mechanism and bank performance of five listed banks in the Nigerian stock market covering the period of 2005 to 2014.

Findings from the study show that there is a positive relationship between board size and bank performance implying that the higher the number of directors on board, the higher will be the profit. This may be due to the fact that having more directors on board may result to making profitable economic decisions as a result of the qualifications and experiences of each director. The number of directors on the board is important in the performance of the oversight functions on executive management. The complexity of the banks' business determines to a large extent the size that is appropriate for its operations. Therefore, the larger the board size, the greater the number of directors available to make up membership of sub-committees, particularly audit and compensation. This facilitates good corporate governance and impacts positively on overall bank performance.

Findings from this study is consistent with the result of Adams and Mehran (2005) and Andres and Vallelado (2008) who found a positive relationship between board size and bank performance implying that a large board is beneficial to the banking industry as it will help to facilitate supervision and better monitoring. However, the result of the study is inconsistent with the result of Samad et. al, (2010) which found a negative relationship.

This study is also in tandem with the theoretical explanation of agency theory which is used to explain the governance structure of banking firms.

Conclusively, the paper opines that having more people on the board will add more human capital for advisory purposes which will enhance effective supervisory, monitoring, and discipline of managers which in turn will lead to increase performance.

REFERENCES

[1] Adams, R. and Mehran, H. (2005) Corporate performance, board structure and its determinants in the Banking Industry, Working Paper Series Available at SSRN: http://ssrn.com

[2] Andres, P. and Vallelado, E. (2008). Corporate governance in banking: the role of the board of directors,Journal of Banking and Finance, 32(12), 2570–2580.

[3] Ajayi, A. (2009). Consolidation and recent trends in the Nigerian Banking Industry, Ibadan: Immaculate Press.

[4] Ayoola, I. E. & Ajayi. J. A. (2018). Effect of corporate governance on banks profitability, Uniosun International Journal of Business Administration, 2(1), 175-189.

[5] CBN Briefs (2004). Central Bank of Nigeria, Abuja.

[6] Dabiri, W. B. (2012). Corporate governance and accountability, Adnews monthly, 26-28

[7] Dalton, D.R., Johnson, J.L. and Ellstrand, A.E. (1999). Number of directors and financialperformance: A meta analysis, Academy of Management Journal, 42(6).674–686.

[8] Eisenberg, T.S. and Sundgren, M.W. (1998) Larger board size and decreasing firm value in smallfirms, Journallof Financial Economics, 48, 35–54.

[9] Freeman, R. E. (1984). Strategic management: A stakeholder approach. Boston: Pitman.

[10] Freidman, A. L. & Miles, S. (2006). Stakeholders theory and practice, London: Oxford University Press.

[11] Jensen, M.C. (1983). The modern industrial revolution, exit, and the failure of internal controlsystems, Journal of Financee, 48(3), 831–880.

[12] Jensen, M. C.&Meckling. W. H. (1976). Theory of the firm: Managerial behaviour, agencycosts and ownership structure, Journal of Financial Economics, 3, 305-360.

[13] Oyejide, T. A &Soyibo, A. (2001). Corporate governance in Nigeria. Paper presented atthe conference of corporate governance, Accra, Ghana.

[14] Phillips, T. (2007). Issues in corporate governance in the banking sector, Chartered Institute of Bankers July-September, 31(3), 7-16.

[15] Samad, et. al. (2010). Board structure and firm value: A study on listed Banking firms in the Asian emerging markets, Int. J. Business Governance and Ethics, 5(3), 157-177.

[16] Vafeas, N. (1999). Board meeting frequency and firm performance, Journal of Financial Economics, 53,113–142.

[17] Vanguard (2007, November, 19). Nigeria: How country lost 75 banks to poor corporate governance, Vanguard, Lagos.

[18] Xie, B., Davidson III, W.N. and Dadalt, P.J. (2003). Earnings management and corporate governance: the role of the board and the audit committee, Journal of Corporate Finance, 9,295–316.

[19] Yermack, D. (1996). Higher market valuation of companies with a small board of directors, Journal of Financial Economics, 40(2), 185–212.

★★★