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Impact of Corporate Governance on Financial Performance of Financial Holding Companies in Nigeria

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ABSTRACT

The paper impact of corporate governance on financial performance of financial Holding Companies in Nigeria. The paper used corporate governance mechanism proxied by board size, board independence, board composition, board meetings and board number of committees on Return on Assets. Data were obtained from three financial holding companies in Nigeria Annual Reports for the period 2012 to 2019. A strongly balanced longitudinal time series data was employed for the analysis, while the Hausman test was conducted for selection of fixed or random effects. The random effect was chosen, and the results indicates that variables of corporate governance such as board size and board Independence have negative relationship with financial performance of Financial Holding Companies (Holdcos) in Nigeria. Board composition and Board Committees had positive nexus with financial performance of financial Holdcos . While board meeting had a negative effect on financial performance of financial Holdcos in Nigeria. Consequent upon the results obtained, the study recommends that the board size should be moderate, board members (executive, non-executive and independence) should be well experience and qualified as well as available to attend to its oversight functions. High frequency of meeting of the board should be restrained from as it may not necessarily engenders increase in financial performance. Also, Holdcos should have more Board Committees to ensure effective oversight as it leads to better financial performance.

Keywords: Financial Holding Company, Corporate Governance, Financial Performance, Random effect.

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1. INTRODUCTION

Sequel to the repeal of the erstwhile Universal banking model, the Central Bank of Nigeria introduced a New Banking Model in 2010. This model permitted bank to either operating a monoline banking structure and then spin –off its non-banking subsidiaries, alternatively banks could seek to operate as a financial holding company, with a parent company that is non-operating but owns at least one bank. A financial holding company could be defined as "any corporation that owns controlling shares in another company (subsidiary) or companies (subsidiaries) to influence decision making process" (CBN, 2011). The New Banking Model of 2010 categorized banks into commercial banks, merchant banks and specialized banks. And banks that were hitherto universal banks were requested to divest from non-core banking business. However, where they intend to carry on with such businesses, this would necessitate the bank to seek for a financial holding company licence from the CBN.

In view of the above three universal banks out of the existing 24 banks as at 2010, pioneered the introduction financial holding company in the Nigeria financial industry, they are: FBN Holding PLC, Stanbic IBTC Holding PLC, and FCMB Group PLC. The three Holding companies existed for over 7 years before the entrance of FSDH Holding Company and others. The financial holding structure is expected to facilitate better risk management and supervision; ring-fence the risks associated with other riskier non-banking activities in the relevant entities rather than under the bank; ensure better specialization in the different financial services; and support clearer responsibility and reporting lines (Proshare, 2013).

The operation of these new institutions as it pertains to issues of corporate governance needs to be examined. This studied intends to investigate the effect of corporate governance and performance of the Holding companies. Corporate Governance can be seen as the process, mechanism or medium in which a company's affairs is governed, encapsulates the means in which the Board, and Management manage the affairs of a company. The cardinal objective of corporate governance is to safeguard the shareholders and relevant stakeholders' interest and the overall public interest in a sustainable manner. As noted by many international standard setting organizations the importance of corporate governance is essential to maintaining public trust and confidence in the financial industry. It could be seen as an essential ingredient for the health existence and performance of a company and industry (Maher &Andersson, 1999)

As noted by BCBS (2015), good corporate governance will enable better financial performance and provide fair return and treatment to all stakeholders and incentives for management to pursue objectives that are in the best interests of the institution and its shareholders. Corporate governance also aims at ensuring transparency, accountability, adequate disclosure and a reporting system that is effective (Chow, 1999).

Brennan (2013) observed that poor corporate governance exists in the Nigerian banking sector. More so, Onakoya, et al (2012) observed that weak corporate governance practice was a major contributing factor to high profile corporation failures in Nigeria. Sanusi (2010) also said that one of the cardinal reasons for bank failures in Nigeria has been attributed to weak corporate governance systems.

Previous studies like Ogege & Boloupremo, 2014; Akinyomi & Olutoye, 2015; Kakanda et al., 2016; Ibrahim et al 2018; Aris et al., 2019; Mustapha et al., 2020 have sought to establish the relationship between corporate governance and organizational performance. We have just few studies on corporate governance and performance of financial holding company. They include Cornett, McNutt and Tehranian (2009) who examined the effect of corporate governance on earnings of bank holding companies in the United States; Huang, Shen, Shieh and Tzeng (2019) examine effect of corporate governance on earnings of bank holding companies in theTaiwan. But none of these studies to the best of the researcher's knowledge was conducted on relationship between corporate governance and performance of financial holding company in Nigeria. Therefore, this paper seeks examine the impact of corporate governance on performance of financial holding companies in Nigeria.

1.2 Objectives of the Study

The cardinal objective of the study is to examine the impact of corporate governance on financial performance of financial holding Companies in Nigeria.

2 .0 THEORETICAL AND EMPIRICAL REVIEW

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There are various theories that have been developed relating to the nature and significance of Corporate Governance, however for the purpose of this research, we would consider only two namely: Agency theory and Stakeholders theory. The theories are briefly described in the ensuing paragraphs.

2.1 The Agency theory

This theory has its bedrock in economic theory and leads in corporate governance literature. The agency theory regards shareholders (owners) as the principals and management as their agents As noted by Jensen & Meckling (1976) who pioneered the theory, an agency relationship is the engagement of management by the owners of the business to perform or act on their behalf, it involves delegation of decision-making to the agent to act. From the classical view; agency theory opines that agents (that is, managers) should continuously act in the best interest of their principals (owners). Thus, huge obligation or responsibility is placed on the agent by the principal (Isaac and Nkemdilim, 2016) The theory further maintains that agents (managers) are custodians of the organizational business while managing the business in the best interest of the shareholders. As Sanda et al (2005) noted, there is a problem of information asymmetry which can make agents to pursue interest that may be detrimental to the interest of the shareholders (principal). The process of aligning these two interests can ignite conflict between the interest groups. The theory supports delegations and the concentration of control in the board of directors as well as use of compensation incentives. It could be said that from the standpoint of the agency theory, other stakeholders are irrelevant. This translates that they are not to be carter for or be entitled to any benefits from the business as by doing this, will hamper the best interest of the owners. However, this viewpoint of ignoring the interest of the stakeholders has been a contentious issue as the organization does not operate in a vacuum.

2.2 Stakeholder Theory

The theory considers the firm as a system of stakeholders operating within a bigger system of the society which provides the required legal and market infrastructure for the firm to thrive. The main objective of the firm is to serve the interest of the general public who may have a direct or indirect relationship with the firm. One of the early advocates of stakeholder theory, (Freeman, 1984), recognized the emergence of stakeholder groups as vital elements to the organization requiring consideration. According to Abdulazeez et al (2016) the theory hypothesizes that the firm is make up of a system of stakeholders and the purpose of the firm is to serve all the stakeholder and not only the shareholders (owners). Thus, the firm's activities including the provision of information should be channeled towards satisfying the interest of all stakeholders rather than only the shareholders. Stakeholders can be classified into two main groups: internal and external. The internal group includes the board of directors, management, and employees while the external group is comprised of customers, creditors, suppliers, trade unions and regulators/government, etc. These stakeholders are important as they are involved in managing the process of the firm's performance in diverse ways with various purposes (Dao & Hoang, 2012).

2.3 Empirical Literature Review

Adegboye et al (2020) using panel data analysis employed static and dynamic estimators in studying corporate governance and Non-Performing Loan (NPL) sensitivity. They utilized data from 12 banks, between 2009 to 2017. It was observed that the corporate governance structure of Nigerian banks has significant and a negative impact on banks NPL in Nigeria. The result further reveals that sound corporate governance structure improves the quality of loans that banks in Nigeria books and this leads to bank stability.

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Kyere and Ausloos (2020) in a recent investigation of the effect of corporate governance on financial performance on 252 non-financial listed firms on London Stock Exchange, used five corporate governance mechanisms of insider shareholding, board size, independent directors, CEO duality, and audit committee meetings while for financial performance, ROA and Tobin's Q were used . The study just like other previous one had mixed results as some of the explanatory variables were positive while others were negative. This obviously supports some of the existing theoretical framework. They concluded that if firms in the United Kingdom applies good corporate governance mechanism it would enhance financial performance.

Mustapha et al (2020) in their empirical analysis of the nexus between corporate governance and bank performance of fifteen (15) listed Nigeria banks from 2013 to 2015 used Board Independence (BIND), Board Meeting (BME), Board Gender (BGR) and Board Size (BSZ)as proxies for the independent variables while Return on Assets (ROA) was used as proxy for performance which is the dependent variable. The results of the panel data analysis used random effects which showed that the relationship between BIND and ROA is insignificant and negative. For BME and ROA it was observed that a negative but significant relationship exist, while in the case of BGR and BSZ, the result showed that BGR and BSZ were negative as well as insignificant determinants of ROA.

Aris et al (2019) in their research on Corporate Governance and bank Performance in the Malaysian Banking Industry, noted that strong board composition and bank leverage engenders better bank performance in Malaysian banks The work adopted the following methodologies, Pooled Ordinary Least Square (OLS), descriptive analysis, correlation analysis and some Diagnostic test.

Olayiwola (2018) examined the influence of corporate governance (CG) on the performance of companies using board size, board composition and audit committee size as proxies for corporate governance while net profit margin (NPM) was used as proxy for performance, data from 2010 to 2016 were employed. A panel data regression was used to analyse the data and the conclusion was that Performance would increase with a smaller board size, also it recommended that the composition of board should comprise of more of the non-executive directors while it was noted that the audit committee should be reviewed and strengthen from time to time

Babatunde et al (2017) investigated the relationship between corporate governance, bank performance and banking crisis in Nigeria from 2005 to 2015.The study employed board size and board composition as proxy for corporate governance while Profit after Tax was used as the proxy for performance. The paper used primary and secondary data in its analysis, Chi-square and regression analysis were the techniques used. The finding revealed that corporate governance variables such as board size have a positive relationship on the performance of banks. While there is a negative relationship between profit after tax and board composition. The paper is in tandem with the hypothesis that corporate governance positively impacts banks performance and recommended the implementation of good corporate governance mechanism by banks in Nigeria.

Abdulazeez et al (2016) using Pearson correlation and regression analysis examined the impact of corporate governance on the financial performance of all listed Deposit Money Banks (DMBs). The paper noted that for effective management of organizational resources, good corporate governance practice is required particularly in banking industry. The finding indicated that bigger board size contributes positively and significantly to the financial performance of banks in Nigeria. The paper therefore recommended among others that DMBs should increase their board size but this should be within the maximum limit of 20 as contained in the CBN code of corporate governance.

3.0 METHODOLOGY

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This study is quantitative and employs ex-post facto research design using panel data analysis. The data were sourced from Annual Reports of the first three Financial Holding Companies in Nigeria (FBN Holding, FCMB Group and Stanbic IBTC Holding) licensed by the Central bank of Nigeria. The period for the study is from 2012-2019, this ensures that data is collected from past years and allows for a multi-dimensional data collection, which offers a basis for a complete establishment of the relationship between corporate governance and the financial performance of financial Holding Companies in Nigeria. The work used panel data regression analysis in examining the collected data via statistical software “Stata version 15”

3.1 Model Specification

The study adopted a modified version of Ibitamuno et al (2018) model which in their study of Corporate Governance and Banking Sector Performance in Nigeria adopted the following model:

$ROA_{it} = \beta_0 + \beta_1 BOS_{it} + \beta_2 BED_{it} + \beta_3 BND_{it} + \beta_4 INTR_{it} + \beta_5 PROFT_{it} + U_{it}$

Where; ROA_{it} = Return on Asset; BOS_{it} = Board size; BED_{it} = Executive Board Composition; BND_{it} = Non executive Board Composition; $INTR_{it}$ = Bank charges proxy by interest rate margin $PROFT_{it}$= Profit of the banks and U_{it} = Error term.

The above model was modified in line with the variables examined in the study as follows:

ROA = f (BSZ, BINZ, BCOM, BNOM, BNOC)……………………………………… Equation 1

Transformed to econometric terms as

$ROA_{it} = \beta_0 + \beta_1 BSZ_{it} + \beta_2 BINZ_{it} + \beta_3 BCOM_{it} + \beta_4 BNOM_{it} + \beta_5 BNOC_{it} + U_{it}$ ………… Equation2

Where: ROA= Return on Asset (a proxy for performance); BSZ = Board Size; BINZ= Board number of Independent Non-Executive Directors; BCOM = Board Composition; BNOM = Board Number of Meeting; BNOC=Board Number of Committees; U= Error term

β_0 represents a constant parameter

β_1, $\beta 2$, $\beta 3$, β_4, and β_5 represents parameters to be estimated

4.0 DATA ANALYSIS AND INTERPRETATION

Stylized facts

Below, is **Table1** showing the 3 Holdcos’ numbers of subsidiaries, bank subsidiaries and number of branches as at December 31, 2019.

SN	Name of Holdcos	Number of subsidiaries	Number of bank subsidiaries	Number of bank branches
1.	FBN Holding	10	8	615
2.	FCMB Group	8	2	206
3.	Stanbic IBTC Holding	9	2	176

*Sources 2019 Annual Reports of the 3 Financial Holding Companies

A Bar chart presentation showing the 3 FHCs showing total assets and shareholders fund as at December 31, 2019

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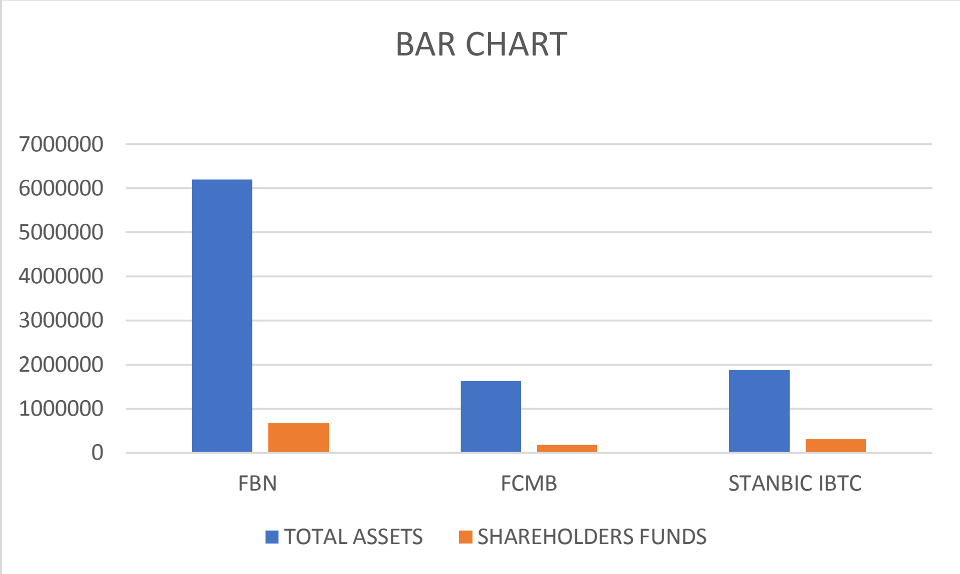

Figure 1 Financial Holding Companies

*Sources 2019 Annual Reports of the 3 Financial Holding Companies

4.1 DESCRIPTIVE STATISTICS

Below is a presentation of the descriptive statistics table and analysis which considered the cardinal indicators of central tendency- mean; measure of dispersion from the mean-standard deviation, as well as the results of minimum and maximum values.

TABLE 2: DESCRIPTIVE STATISTICS FOR HOLDCOs

Variable	Observation	Mean	Standard Deviation	Minimum	Maximum
ROA	24	0.024	0.031	0.003	0.159
BSZ	24	9.875	1.801	6	15
BCOM	24	0 .860	0.077	0.6	0.917
BINZ	24	0.175	0.074	0	3
BNOM	24	5.833	1.834	2	9
BNOC	24	3.541	1.503	2	6

From table 2 above, it was observed that for the three (3) Holding Companies, the mean ROA was about 2.4% percent, the Standard deviation from the mean was 3.1% . This suggests that ROA can fluctuate from its mean by about 3.1%.The maximum and minimum values of ROA generated over the study period are 0.3% and 15.9% respectively. For Board Size (BSZ) 9.9 was observed as mean, while the minimum and maximum size was 6 and 15 respectively, this is in line with theSection 2.2.1. of the Central Bank of Nigeria "Guidelines for Licensing and Regulation of Financial Holding Companies in Nigeria" that requires Holdcos to have a board size of between 7 and 12.

Board Composition had a mean of 86% signifying that on the average 86% of directors for the three Holdcos were non-executive board members, this is in line with principles of Corporate Governance as state in Basel Committee on Banking Supervision guidelines (Basel, 2015). The minimum and maximum values for BCOM were 60% and 92% respectively.

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The number of Independent non-executive directors on the Board had an average of 17.5% indicating that 82.5% of directors on the boards of Holdcos were not independent. The minimum and maximum numbers of independent director is zero (0) and three (3) respectively. This may be due to the fact that it was not until 2014 that the CBN release a regulation requiring banks and financial institutions to have at least two independent directors on their Board (CBN, 2014)

Board Meeting was held for an average of six times a year, this confirms with aprior expectations as the CBN Code of Corporate Governance requires Boards to meet at least quarterly. It was observed that the minimum and maximum number of meetings was 2 and 9 respectively. The number of Board Committee had a mean of 4 committees, this is in tandem with aprior expectation as the CBN Code of Corporate Governance requires a minimum of 2. While 2 and 6 Board committees were the minimum and maximum committees in the period under review.

4.2 Correlation Matrix

Table 3. Correlation Matrix

Variable	ROA	BSZ	BINZ	BCOM	BNOM	BNOC
ROA	1.0000					
BSZ	-0.0738	1.0000				
BINZ	0.0907	-0.1874	1.0000			
BCOM	0.1314	-0.2690	0.3018	1.0000		
BNOM	-0.4038	-0.1645	0.3650	0.0463	1.0000	
BNOC	-0.0001	0.1064	0.0965	-0.3758	0.1288	1.0000

The pairwise correlation result in Table 3 indicates that the correlation between ROA and Board Size, Board Number of Meeting and Board number of Committee is weak and negative. This suggest that some components of corporate governance (BSZ, BNOM and BNOC) have weak relationship with the financial performance (ROA) of Holdcos in Nigeria. Conversely, Board number of Independent directors, and Board Composition have positive but weak correlation with financial performance (ROA) of Holdco in Nigeria.

4.3 The Hausman Tests

The study used the Hausman specification test to ascertain whether to use the panel fixed effects or random effects. The rule is when the probability chi-squares of the model is less than 0.05 that is at 5% level of significance, the null hypothesis is not accepted meaning the difference in coefficients of the model is systematic otherwise the random effect panel regression will be adopted.

Table 4 Result of Hausman test of random effects of the Model

Model	Test Statistics (chi2)	d.f	Prob.
ROA	0.42	**5**	0.994

Source: Extract from result on regression of data using Stata version 15

The results of the Hausman specification test indicate that the probability chi square of the model is more than 0.05 hence the null hypothesis is accepted and concluded to use the random effects panel model for analysis of this study.

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4.5 Regression Results

TABLE 5: Random Effect T Result

ROA	Coefficient	Std. Err.	Z- Statistics	Prob
BSZ	-1.9689	2.025	-0.97	0.331
BINZ	-0.1407	1.1423	-0.12	0.902
BCOM	3.2581	1.9326	1.69	0.092
BNOM	-2.1872	0.5718	-3.82	0.000
BNOC	0.9997	0.4421	2.26	0.024
CONS	3.5578	4.4767	0.79	0.427

The estimated regression model as shown in the table above can be summarized as follows:
ROA = 3.5578 -1.9689BSZ -0.1407BINZ+ 3.2581BCOM -2.1872BNOM + 0.9997BNOC. The panel result captured in Table 5 above, shows that there is a negative and insignificant relationship between board size of Financial Holdcos in Nigeria and ROA. This indicates that an increase in board size would lead to a slight reduction in the performance of Holdcos. This may be due to the fact that increase in board size may lead to conflict of interest and boardroom squabbles which can be counter-productive. The result is not strange as it agrees with the findings of some previous research that noticed that a bigger board size does not lead to increase in performance. It is as observed by Fallatah and Dickens (2007), Uwuigbe (2011), Kutubi (2011), Ibitamuno et al (2018) Orozco and Vargas (2018) and Bezawada (2020).

The random effect result above, also shows that the relationship between the number of independent non-executive directors on the board of Holdcos and their performance is negative and insignificant. Thus, an increase in the number of INED on the board would not corresponding lead to improvement in the performance of Holdco according to the result. This result is in consonance with some finding of the following: Weir and Laing (2001); Coles et al. (2004), Shukeri et al. (2012) Ibrahim et al (2018) and Mustapha et al (2020).

The result reveals that Board Composition of Holdcos have a positive but insignificant relationship with the performance of Holdcos. Hence an increase in the ratio of non-executive members of board to the executive board members will lead to increase in the performance of Holdco but in a small dimension. This resulted corroborates the results of Pathan et al (2007), Bebchuk et al (2009), Ogege & Bolouppremo (2014); Akinyomi & Olutoye, (2015); Ibrahim et al (2018) and Aris et al (2019).

The number of Board meeting held in a year, has a negative but significant association with the Return on Assets. This establishes that increases in Board meeting have a negative effect on the Holdco performance in Nigeria as the meetings may not lead to growth of the business. Thus, the regulatory approved quarterly meeting for Holdco as contained in the CBN Code of Corporate of Governance may be good for their performance rather than increasing the number of meetings this result is in tandem with the results of other researchers' findings: Garcia-Sanchez (2010); Kakanda et al (2016) and Mustapha et al (2020).

For the results of the board number of committees, it was observed that board committee has a positive and significant impact on the performance of Holdcos, it therefore follows that an increase in board committees would likely lead to increase in the return on assets. Thus, more Board Committees would propel better oversight which would lead to higher performance. Also, Extant regulations of the CBN requires a minimum of two committees, one for risk and audit functions which may be separated for big institutions and a committee in charge of Governance and Nomination It indicates that the more the committee the better the

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performance of Holdco in Nigeria. On the average Holdco have 4 committee which include audit and risk management committee; finance and investment committee; nomination & governance committee andr board remuneration committee.

5.0 CONCLUSION AND RECOMMENDATIONS

5.1 Conclusion

The main objective of this study is to investigate the impact of corporate governance mechanisms on the performance of Financial Holding Companies Nigeria, it specially sought to examine how board size, board number of independent directors, board composition, board number of meeting and board number of committees effect the financial performance of financial holding companies in Nigeria. The study concludes that board size and board number of independent non-executive directors have a negative and insignificant effect on the financial performance of financial Holdcos in Nigeria. While board composite has a positive but insignificant effect on the financial performance of financial Holdcos in Nigeria. The empirical findings also led to the conclusion that the number of board meeting in a year has significant negative effect on financial performance of financial Holdcos in Nigeria. Furthermore, based on the results obtained, the study concludes that the number of board committees has a positive and significant effect on financial performance of financial Holdcos in Nigeria

5.2 Recommendations

In the light of the findings obtained from the study, the following recommendations are suggested:

1. Financial Holding Companies in Nigeria should not have large board size as it may hamper their performance. Since the CBN regulations require them to have a minimum of 7 and maximum 12 directors. Holdcos should strive to keep the board size moderate. They should ensure that only well qualified and experienced persons that are knowledgeable with issues of oversight function and have the time to serve are brought on board.
2. The study recommends that since the number of independent non-executive directors has an insignificant negative effect on Holdco financial performance, they should ensure that increase in INED on the board should not be pursued vigorously, care should be taken in increasing the number of INED as the results shows that it may lead to slight decrease in performance. It is thus recommended that the minimum of two INEDs as contained in extant regulations of the CBN should be maintained.
3. Financial Holding companies in Nigeria should increase the number of non-executive directors to the total number of directors on the board. We recommend that NED they are not only willing, ready and capable but are also very knowledgeable on their functions should be brought on board.
4. Financial Holding Companies should strive not to have very frequent meetings as it may not produce higher performance.
5. It is strongly recommended that Financial Holding companies should have more board committees, also recommended is that Board Audit Committee should be distinct from Board Risk Management Committee.

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