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Impact of Corporate Governance on Non-Performing Loans of Nigerian Deposit Money Banks

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Abstract: This study examines the impact of Corporate Governance (CG) variables of Board Size (BS), Board Composition (BC), Composition of Audit Committee (CAC) and Power Separation (PS) on Non-performing Loans of Nigerian Deposit Money Banks; with a view to finding out whether these CG variable can be useful in curtailing the incidence of non-performing loans that have bedeviled Nigerian Money Deposit Banks. Secondary data was used from fourteen (14) quoted banks on Nigerian Stock Exchange from 2005-2011. Using multivariate regression analysis, the study finds that corporate governance variables of BS, BC, CAC and PS have no significant impact on non-performing loans of Nigerian Deposit Money Banks. Hence, the study concludes that BS, BC, CAC and PS cannot be relied upon to check the rising figure of non-performing loans of Nigerian Deposit Money Banks. Therefore, we recommend that the oversight and monitoring functions of Central Bank of Nigeria should be strengthened to ensure adherence to rules and principles guiding the approval and monitoring of loans and advances.

JEL Classifications: G34, E58

Keywords: Corporate Governance, Non-performing loans, Board Size, Board Composition, Power separation

1. Introduction

Banks grant credits in the day-to-day transaction to customers with the expectation of repayment at the end of a specified time. However, sometimes such credits remain uncollectible; these uncollectible credits constitute what is known as non-performing loans (NPLs). Nonperforming loans are loans that are no longer producing income for the bank. Loans become nonperforming when borrowers stop making payments and the loans enter default. Non-performing loan according to the International Monetary Fund (IMF), is any loan in which interest and principal payments are more than 90 days overdue; or more than 90 day's worth of interest has been refinanced, capitalized, or delayed by agreement, or payments are less than 90 days overdue, but are no longer anticipated; that is, there are good reasons to doubt that payments will be made in full. The Central Bank of Nigeria issued prudential guidelines for licensed banks on November 7, 1990 which defines nonperforming loans as when interest or principal of a credit facility is due and unpaid for 90 days or more; and interest payments equal to 90 days interest or more have been capitalized, rescheduled or rolled over into a new loan.

The risks associated with non-performing loans are very serious in banking business. The financial crisis rocking Nigeria Deposit money banks is caused mainly by the monumental figure of non-

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performing loans reported in their financial statement. Oyejide and Soyibo (2001) opined that, one major component of bank's assets is loans and advances, and the effective management of such loan portfolio has remained a herculean task for some Nigerian Deposit money banks.

The Central Bank of Nigeria (CBN) in August 2008, considered eight (8) banks unhealthy due to high figures of non-performing loans recorded in their accounts. On August 13, 2009 the CBN sacked the Managing Directors/Chief Executives and Executive Directors of five banks namely, Afribank Plc, Finbank Plc, Intercontinental Bank Plc, Oceanic Bank Plc and Union Bank Plc. The CBN attributed the removal to high level of non-performing loans in the five banks.

Nworji, Olagunju, and Olanrewaju (2011) opined that the consistent increase in the figure of non-performing loans of Nigerian Deposit Money Banks in recent time has raised questions on the consistency of the corporate governance practices in the banking sector. Hence the objective of this study is to examine the impact of corporate governance on non-performing loans of Nigerian Deposit Money Banks, using corporate governance components of Board Size (BS), Board Composition (BC), Composition of Audit Committee (CAC) and Power Sharing (PS).

Corporate Governance (CG) is the process which facilitates the creation of shareholder's value, protection of the individual and collective interests of all stakeholders in an establishment are achieved through. Corporate governance is generally associated with the existence of agency problem and its roots can be traced back to separation of ownership and control of the firm. Agency problems arise as a result of the relationship between shareholders and managers and are based on conflicts of interests between controlling shareholders and minority shareholders which is at the heart of the corporate governance literature.

In order to forestall or mitigate the weaknesses in Corporate Governance, the Central Bank of Nigeria (CBN) in 2006, pronounced a set of codes of corporate governance that should be mandatorily observed by Nigerian Deposit Money Banks in day to day operations of the banks. They are: Equity ownership, Organizational structure, Executive duality, quality of Board membership, Board performance appraisal, quality of Management, reporting relationship, industry transparency, due process, data integrity and disclosure requirement.

The study comprises of fourteen (14) Nigerian Deposit Money Banks for a period of seven years from 2005 to 2011. The seven year period is because of the period that corporate governance became pronounced in Nigeria. Moreover, Nigerian bank consolidation in 2005 led to many banks having their names changed due to mergers, acquisitions.

This study is organized into five sections. Section two is review of related literature and it carefully synthesized relevant works conducted by others in order to synchronize the views held on the subject matter. Section three is methodology of this study and it covers techniques of sampling, data collection and analysis. Section four presents and analyses the data obtained based on the methodology of the study and section five concludes the study and offers recommendations.

2. Review of the Empirical Studies on Corporate Governance and Nigerian Money Deposit Banks

Oghojafor, Olayemi, Okonji, and Okolie (2010) examine poor corporate governance and its consequences on the Nigerian Banking Sector. The study used structured questionnaires to elicit responses from one hundred and twenty (120) respondents consisting of investment analysts, financial experts, banks' employees, shareholders and customers among others. Using chi-square, the study confirmed that poor governance culture and supervisory laxities were majorly responsible for the current banking crisis. The study concludes that Central Bank of Nigeria (CBN) supervisory officials are judged to lack integrity and boldness in carrying out their oversight functions; the officials are known to have compromised in issuing clean bills of health in their bank examination report.

Enobakhare (2010) examines the relationship between corporate governance and the profitability of banks in Nigeria. The he used secondary data and a multiple regression to analyze the data and the relationship between the variables. The study concludes that corporate governance culture has significant relationship with the operation of Nigerian banks. He also proved that the ownership style of the banks has significant effect on the profitability of Nigerian banks. His study emphasizes that the past bank crisis in Nigeria have been fuelled by poor corporate governance.

Boudriga, Boulila, and Jellouli (2009) empirically analyzed the cross-countries' determinants of non-performing loans and the potential impact of regulatory factors on credit risk exposure. They employ aggregate banking, financial, economic and legal environment for a panel of 59 countries over the period 2002 – 2006. Baseline model was used for the purpose of analysis. Their results indicate that higher capital adequacy ratio and prudent provisioning policy seem to reduce the level of non-performing loans. However, all regulatory devices either exert a counter productive impact on bad loans or do not significantly enhance credit risk exposure for countries with weak institutions, corrupt business environment and little democracy.

Nworji *et al.* (2011), examine issues, challenges and opportunities associated with corporate governance and Banks failure. The study used structured questionnaire and Pearson product coefficient of correlation to analyze the data. Their findings revealed that the new code of corporate governance for Banks is adequate to curtail Bank distress and that improper risk management, corruption of Bank officials and over expansion of Banks are the key issues why Banks failed. The study concludes that corporate governance is necessary to the proper functioning of Banks and that corporate governance can only prevent bank distress only if it is well implemented.

Bebeji (2010) evaluates credit management strategies and non-performing loans of Nigerian Banks. He employs survey design using both primary and secondary data with a sample of thirty (30) employees of Ecobank. He finds that a liberal credit policy, poor management and ineffective monitoring of debts are significantly related to non-performing loans.

Somoye (2010) investigates the variation of risks on non-performing loans of banks in Nigeria. A sample size of fifteen (15) banks was used and data were extracted from the audited financial statements from 1997 – 2007. To estimate the variation, he adopted a multiple regression model of the ordinary least square (OLS) method. The results show that earning risk has a greater significant influence on non-performing loans, followed by interest rate risk and monetary policy rate.

The Central Bank of Nigeria and the Nigerian Deposit Insurance Company (NDIC) commissioned special examinations on all 24 banks in Nigeria in August 2009. Eight (8) banks were found to have major weaknesses in corporate governance and risk management practice and similar factors, while another two were found to have primarily capital deficiencies (Sawa, 2011).

As can be seen from the above review of related empirical studies, several efforts have been made to examine the problem of non-performing loans of Nigerian money deposit banks, but none has looked at it from the angle of Corporate Governance. Studies on Corporate Governance and Nigerian deposit money banks addressed bank failure, corporate performance and other characteristics of banks but did not include non-performing loans. Clearly, this is the first attempt ever to address the problem of non-performing loans from corporate governance angle; to the best of our knowledge, we have not come across any such study. In this regard, this study has made significant contribution to fill up the existing gap literature.

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3. Methodology

This study adopts ex-post factor research (after the fact) design which implies that the events observed have taken place already. Hence, the study utilizes secondary data from the annual reports and accounts of the sampled banks.

The population of the study consists of all Nigerian deposit money banks quoted on Nigerian stock exchange as at December, 2011. However, because of the need for availability, reliability and accuracy of data, only money deposit banks quoted on the Nigerian Stocks Exchange are considered by the study. Strictly adhering to this criterion resulted to (14) banks emerging as the new population of the study. The entire new population of the study constitutes the sample size because it not too large to be studied. It is seen in table 1 below

Table 1. The population of the Study

S/N	Names of the Banks	Date of Listing
1.	Access Bank Plc	1998
2.	Diamond Bank Plc	2005
3.	Ecobank Nigeria Plc	2006
4.	Fidelity Bank Plc	2005
5.	First Bank of Nigeria Plc	1971
6..	First City Monument Bank Plc	2004
7.	Guaranty Trust Bank Plc	1996
8.	Skye Bank Plc	2005
9.	Stanbic IBTC Bank Plc	2005
10.	Sterling Bank Plc	1993
11.	Union Bank of Nigeria Plc	1970
12.	United Bank for Africa Plc	1970
13.	Wema Bank Plc	1991
14.	Zenith Bank Plc	2004

Source: From NSE Fact Book 2010

The dependent variable of the study is non-performing loan while the independent variables are Board Size (BS), Board Composition (BC), Power Separation (PS), and Composition of Audit Committee. They are defined and estimated in table 2 below.

Table 2. Estimation of corporate governance variables and non-performing loans

Variables	Definitions	Measurement
BS	Board Size	Number of people on the board of the firm.
BC	Board Composition	The proportion of non-executive directors on board, and is calculated as the number of non-executive directors divided by total number of directors.
CAC	Composition of Audit Committee	A dichotomous variable, assigned 1 if there are at least three non –executive directors on the audit committee, otherwise 0.
PS	Power separation	Power separation between the chairman and CEO. If the position is occupied by an individual we assigned O and otherwise I.
NPL	Non-performing loans	As reported in the bank's annual report.

Source: Authors' Field Work

The study utilizes multiple regression analysis to establish whether corporate governance variables explain the variation in Non-performing loans. The quality of corporate governance is estimated as a function of the bank's agency characteristics, which have been defined in the study as BS, BC, PS and AC. The model is consistent with Ibrahim (2009), with little modification. The general form of the model is:

NPL = f (CG), Hence

NPL = f (BS, BC, PS, CAC)

Using the ordinary least square structure, the function could be expressed as:

$$NPL = a_0 + a_1 B_{Si} + a_2 B_{Ci} + a_3 P_{si} + a_4 A_{ci} + e \quad (1)$$

Where:

CG = Corporate governance
NPL = Non-performing loans
Bs = Board size
Bc = Board composition
Ps = Power separation
CAC = Composition of Audit Committee
ao = Constant
a_1, a_2, a_3, a_4 = Linear regression co-efficient
e = Error terms assumed to satisfy the standard ordinary least square.

Significance level is set at 95% confidence level. This gives room for an error of 5%, which is known as the alpha (α) of 0.05 which is 5%.

4. Results

The data obtained for analysis are as seen in Appendix I attached. Multiple regressions were analysis was carried out using SPSS version 17. The apriori expectation is that corporate governance should have a negative relationship with the level of non-performing loans of Nigerian Deposit Money Banks. The result is as seen in table 3 below.

Table 3. Regression models of corporate governance variables on non-performing loans of nigerian deposit money banks.

Models	Coefficient	't' Statistic	'p' value
Constant	6.122	11.034	0.000
BS	0.517	1.254	0.213
BC	0.631	1.016	0.312
CAC	-0.250	-1.908	0.060
Ps	-0.138	-1.031	0.305

R-squared (R^2)	0.058
Adjusted R-squared	0.018
F-Statistic	1.443

Source: Author's compilation from SPSS version 17

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Two of the variables, AC and PS show negative relationship with the level of nonperforming loans consistent with the apriori assumption. The remaining two variables; BS and BC have shown positive relationship to the contrary.

From the result in Table 3, the coefficient of BS is 0.517 and this means that BS is positively related to NPL of Nigerian Deposit Money Banks. However, the low "t" value of 1.254 with the probability of 0.213 clearly shows that BS has no significant relationship with NPL. Similarly, from the result, BC coefficient of 0.631 is positively related to NPL. However, the t-statistic of 1.016 with the probability of 0.312 means that BC has no significant relationship with NPL of Nigerian Deposit Money Banks.

Also from Table 3 above, composition of AC which has the coefficient of – 0.250 shows an inverse relationship with NPL of Nigerian Deposit Money Banks. However, the t-statistic value of -1.908 with the probability of 0.060 means that the relationship is not statistically significant. In the same vein, PS which has the coefficient of -0.138 shows that, there is inverse relationship between PS and NPL. However, the t-statistic value of -1.031 with the probability of 0.305 means that the relationship between PS and NPL is not statistically significant.

The overall model as measured by the F-statistic of 1.443 which is statistically not significant indicates that Corporate Governance in Nigeria, taking BS, AC, PS and BC has no significant impact on NPL of Nigerian Deposit Money Banks. The R^2 of 0.058, means that only 5.8% of the total variation in dependent variable (NPL) is explained by all the independent variables. This is a very poor fit as it shows that a large percentage (94.2%) cannot be explained by the Corporate Governance variables of BS, AC, PS and BC. Also, the adjusted R^2 shows 0.018 which is very low.

5. Discussion

It is expected that Non-performing loans should decrease if Corporate Governance is effective. However, from the above analysis, it is discovered that all the explanatory variables are not statistically significant. This simply means, they have no significant impact on Non-performing Loans of Nigerian Deposit Money Banks. A likely explanation of this could be the way things are been done in Nigeria. For instance, the way committees of the banks are been constituted. Members of audit committee in Nigeria are mixed, that is both finance and none finance members constitute the committee. This can affect the way the committee discharges its functions.

The findings of this study suggest that Corporate Governance has not helped in providing solution to the problem of Non-performing loans, a phenomenon that has been the undoing of Money deposit banks in Nigeria for decades. The reason for sacking the Managing Director/Chief Executives and Executive Directors of five banks by The Central Bank of Nigeria (CBN) on August 13, 2009 confirms the findings of this study; that the banks' officials were removed due to high level of non-performing loans in the five banks which was attributable to poor corporate governance practices, lax credit administration processes, and absence or non-adherence to the banks' credit management practices (Omoh & Komolafe, 2009). The finding of the study confirms the position of Nworji *et al.*, (2011) that the consistent increase in the figure of non-performing loans of Nigerian Deposit Money Banks in recent time has raised questions on the consistency of the corporate governance practices in the banking sector.

6. Conclusion and Recommendation

This study finds that Corporate Governance Variables of Board Size, Board Composition, Composition of Audit Committee and Power Separation do not have significant impact on Non-performing loans of Nigerian Deposit Money Banks. Hence, the study concludes that, these

Corporate Governance variables (BS, BC, AC and PS) cannot be relied upon to solve the problem of Non-performing loans of Nigerian banks. Consequently, the study recommends that emphasis should be shifted from these explanatory variables to other Corporate Governance variables, such as; insider abuse, transparency, disclosure and accountability. Also the oversight and monitoring functions of Central Bank of Nigeria should be strengthened to ensure adherence to rules and principles guiding the approval and monitoring of loans and advances.

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Appendix I. Raw Data (Corporate Governance Variables and Nonperforming Loans of NDMBs)

Name of Banks	Year	NPL	Log Npl	BS	BC	CAC	PS
Access	2005	1,752,232	6.24	0.35	0.57	1	1
	2006	6,092,412	6.78	0.6	0.5	0	1
	2007	10,741,448	7.03	0.6	0.5	1	1
	2008	9,588,685	6.98	0.7	0.57	1	0
	2009	8,765,935	6.94	0.7	0.57	0	1
	2010	2,446,257	6.39	0.7	0.57	1	1
	2011	7,503,599	6.88	0.7	0.57	1	1
Diamond	2005	2,534,977	6.4	0.7	0.4286	1	1
	2006	4,005,619	6.6	0.7	0.4286	0	1
	2007	7,244,809	6.86	0.65	0.5385	1	0
	2008	10,280,201	7.01	0.7	0.6429	1	1
	2009	23,378,125	7.37	0.7	0.6429	0	1
	2010	46,605,507	7.67	0.8	0.625	1	0
	2011	36,878,356	7.57	0.8	0.625	1	1
Eco Bank	2005	3,108,114	6.49	0.35	0.7143	1	1
	2006	1,688,989	6.23	0.7	0.5714	1	0
	2007	11,307,655	7.05	0.6	0.5833	0	1
	2008	69,406,287	7.84	0.55	0.7273	1	1
	2009	89,620,000	7.95	0.75	0.6	1	0
	2010	64,539,000	7.81	0.7	0.5714	0	1
	2011	7,359,940	6.87	0.7	0.7143	1	1
FCMB	2005	995,597	6	0.5	0.8	1	1
	2006	1,628,132	6.21	0.55	0.7273	1	0
	2007	2,739,982	6.44	0.6	0.6667	0	1
	2008	5,290,848	6.72	0.6	0.6667	1	1
	2009	22,517,000	7.35	0.65	0.6154	1	0
	2010	19,085,000	7.28	0.75	0.6	0	1
	2011	9,086,000	6.96	0.75	0.6667	1	1
Fidelity	2005	2,008,165	6.3	0.45	0.7778	1	1
	2006	7,756,529	6.89	0.75	0.7333	0	1
	2007	6,264,340	6.8	0.65	0.6923	1	1
	2008	7,207,519	6.86	0.65	0.6154	1	1
	2009	48,084,866	7.68	0.65	0.6154	1	0

	2010	47,116,000	7.67	0.65	0.6154	0	1
	2011	17,355,000	7.24	0.85	0.5882	1	1
First Bank	2005	34,674,000	7.54	0.7	0.53	1	1
	2006	17,339,000	7.24	0.75	0.53	0	1
	2007	6,620,000	6.82	0.75	0.47	1	0
	2008	6,195,000	6.79	0.75	0.53	1	1
	2009	88,506,000	7.95	0.8	0.5	0	1
	2010	89,703,000	7.95	0.75	0.67	1	1
	2011	28,098,000	7.45	0.8	0.6875	1	0
Guaranty Trust Bank	2005	1,359,293	6.13	0.55	0.45	1	1
	2006	2,911,474	6.46	0.55	0.55	1	0
	2007	2,289,784	6.36	0.55	0.55	0	1
	2008	3,573,179	6.55	0.7	0.5	1	1
	2009	70,123,787	7.85	0.7	0.57	1	0
	2010	41,107,607	7.61	0.7	0.57	1	1
	2011	22,397,489	7.35	0.7	0.57	1	1
Skye Bank	2005	1,252,503	6.1	0.85	0.5294	0	1
	2006	4,759,897	6.68	0.85	0.5294	1	1
	2007	5,513,000	6.74	0.85	0.5294	1	0
	2008	8,535,000	6.93	0.85	0.5294	0	1
	2009	69,100,000	7.84	0.85	0.5294	1	1
	2010	49,639,000	7.7	0.8	0.625	1	0
	2011	25,341,000	7.4	0.8	0.625	1	1
Stanbic IBTC	2005	396,543	5.6	0.6	0.6667	1	1
	2006	12,130,171	7.08	0.6	0.6667	0	1
	2007	9,258,018	6.97	0.65	0.9231	1	0
	2008	15,537,000	7.19	0.65	0.9231	1	1
	2009	17,702,000	7.25	0.9	0.7222	0	1
	2010	8,642,776	6.94	0.65	0.6154	1	0
	2011	7,542,256	6.88	0.55	0.5385	1	1
Sterling Bank	2005	10,725,125	7.03	0.7	0.6429	1	1
	2006	11,839,912	7.07	0.7	0.6429	1	0
	2007	10,901,676	7.04	0.7	0.6429	0	1
	2008	7,196,566	6.86	0.6	0.6667	1	0
	2009	22,289,082	7.35	0.5	0.6	0	1
	2010	11,059,183	7.04	0.55	0.6364	1	1
	2011	8,227,240	6.92	0.65	0.6154	1	1
UBA PLC	2005	2,420,000	6.38	0.95	0.5789	1	1

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	2006	12,989,000	7.11	0.7	0.4286	1	0
	2007	14,087,000	7.15	0.85	0.5294	0	1
	2008	15,579,000	7.19	0.85	0.5294	1	1
	2009	39,647,000	7.6	1	0.55	1	0
	2010	40,200,000	7.6	1	0.55	0	1
	2011	9,088,000	6.96	0.95	0.5263	1	1
Union Bank	2005	18,588,000	7.27	0.75	0.5333	1	1
	2006	28,281,000	7.45	0.75	0.5333	0	1
	2007	23,597,000	7.37	0.85	0.5294	1	0
	2008	54,289,000	7.73	0.88	0.5294	1	1
	2009	209,089,000	8.32	0.7	0.6429	0	1
	2010	102,044,000	8.01	0.7	0.6429	1	0
	2011	95,044,000	7.98	0.7	0.6429	1	1
Wema Bank	2006	42,284,405	7.63	0.45	0.5556	0	0
	2007	21,161,431	7.33	0.35	0.8571	1	1
	2008	25,151,243	7.4	0.35	0.8571	0	1
	2009	69,907,288	7.84	0.35	0.5714	1	0
	2010	37,427,763	7.57	0.4	0.625	1	1
	2011	32,123,453	7.51	0.4	0.625	0	1
Zenith Bank	2005	2,084,923	6.32	0.55	0.5455	1	1
	2006	2,309,405	6.36	0.55	0.5455	0	1
	2007	4,022,377	6.6	0.65	0.6154	1	0
	2008	9,406,000	6.97	0.7	0.5	1	1
	2009	46,413,000	7.67	0.75	0.5333	0	1
	2010	41,832,000	7.62	0.65	0.5385	1	0
	2011	31,476,000	7.5	0.6	0.5	1	1

Source: The Annual Reports and Accounts of Nigerian Deposit Money Banks