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Corporate Governance and Earnings Management in Money Deposit Banks in Nigeria

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Abstract

The study examines corporate governance and earnings management in money deposit banks in Nigeria. The research design is ex-post facto. Multiple regression analysis was used in analyzing the data sourced from published financial statement of the banks under study. A significant outcome of the study is that corporate governance mechanisms impact positively and significantly on Earnings per share. A major implication of the findings is that compliance with code of governance as issued by regulatory authorities will support enhanced and superior financial performance among other things. Conclusively, the study has shown that right application of corporate governance mechanisms in Nigeria will be of great benefit to all corporate stakeholders.

Keywords: Earnings per share, Board size, Board composition, Board meeting, ownership structure.

Introduction.

The level of fury activities in banking industry have led to collapse of many financial institutions in the world. Rapid growths in technology has also altered the nature of activities in the financial arena and open it up to new products and services, regulators everywhere are scrambling to assess the changes and master the turbulence (Sandeep, Patel & Lilicare, 2009).

The government on its own has enacted and enshrined some policies to boost public confidence and ensure efficient and effective functioning of the banking system (Soludo, 2004). Heidi and Marleen (2003) opined that Banking Supervision cannot function well if corporate governance is not in place. An illiberal or a licit Banking Supervision has interest in ensuring that there is effective corporate governance at every banking organization in an increasingly open environment (Kashif, 2008).

Uwigbe (2011) as cited in Ajala, Amuda & Arulogun (2012) opines that corporate governance has been on the priority list of developed economies over the decades and African continent is not left out. Ntim (2009) asserted that corporate governance of banks in developing economies as it relates to financial performance has a lot been ignored. Nwachukwu (2007) as cited in Momoh and Ukpong (2013) opines that good corporate governance has a positive link to national economic growth and development.

Oyejide and Soyibo (2001) describe corporate governance from two perspectives – a narrow one in which it is seen as the structures within which a corporate entity or enterprise receives its basic orientation and direction and a broad perspective in which it is described as being the heart of both a market and democratic society. Corporate governance is about building credibility, ensuring transparency and accountability as well as maintaining an effective channel of information disclosure that will foster good corporate performance (Jenkinson & Mayer, 1992). Lemo (2010) opines that it is a body of rules of the game by which companies are managed and supervised by the board of directors in order to protect the interest and financial stakes of shareholders that are far removed from the management of the firm. Mensah (2003) pended that corporate governance is an institutional arrangement which provides the discipline and checks over excesses of controlling managers (Uwuigbe and Fakile 2012). Corporate governance is the whole lot of process involved in installing rule and ensuring compliance to the rule for effective and efficient functioning of management and organization.

Corporate governance deficiencies have led to the dismissal of directors in some corporations (Grawforal, 2007, Parta, Copez & Slilerifier, 1999, Akpan 2007) in the world and Nigeria is not left out as the banking sector in 2009 witnessed poor corporate governance as Directors of few banks failed in their functions as manifested in lack of vigilant oversight, relinquishing control to corporate managers who pursue their own self interest and the board being remiss in its accountability to stakeholders (Uladiale, 2010). The outcome was adoption of some banks like Oceanic bank, Intercontinental banks, Afribank and spring bank.

Furthermore, poor composition of audit committee has manifested in corporate failure in Nigeria. An audit committee that is composed of more executive directors than non-executive directors has more influence on the decisions of the board and this seriously hinders proper compliance which in turn affects performance negatively.

Again in some banks, directors' equity ownership is low in other to avoid signing blank share transfer forms to transfer share ownership to the bank for debt owned banks (Inan, 2009).

In Nigeria, the few empirical literatures available on the subject of corporate governance and earnings management in the banking sector are for short period, of not more than three years period and were based only on profitability ratios. Therefore, this study seeks to investigate the impact of corporate governance on earnings management of money deposit banks in Nigeria during 2006 – 2015 and this contributed to the literature and body of knowledge. However, the pivotal hypothesis of this study is that corporate governance has no significant effect on earnings management of money deposit banks in Nigeria.

Literature review.

The major objective of effective corporate governance practice is maximization of stakeholders' wealth and growth of the economy in general. Corporate governance also ensures reduction of risk for investors, attraction of investment capital and improving the performance of corporations (Alalada, Onadeko & Okezie, 2014). Therefore, the adoption of corporate governance is a sin-qua-non mainly when considering financial market stability, investment and economic growth. An effective corporate governance system provides a degree of confidence that is necessary for the proper functioning of market economy and economic growth.

Codes of corporate governance

According to Gardi, Emesuawu & Yakubu (2015), code of good governance are sets of best practices and recommendations issued to address deficiencies in a country's governance systems by recommending set of norms aimed at improving transparency and accountability among top managers and directors. However, most good governance codes have no specific legal basis and are not legally bonding (Hamid, 2009). In countries like Nigeria, Germany and Netherlands in Europe, the law attaches explicit legal consequences to the codes. Code of governances touches fundamental and crucial issues such as farmers to all stakeholders, accountability by directors and managers, transparency in financial and non financial reporting, composition and structure of boards, the responsibility of stakeholders' interest and companion with the law (Gregory & Simmelkjaer, 2002). Lorsch and Madver (1989), Demba and Neubar (1992), Charan (1998) and Lawler III and Finegold (2001) recommend for increasing number of non-executive and independent directors, the splitting of chairman and chief executive officers roles, the creation of board audit, as these will assist to reduce governance deficiencies and increase board performance:

Principles of corporate governance:

Bocean (2001), Singhal (2011) and Garg and Garg (2011) opines that principle of good corporate governance should include:

- Protection of shareholders right
- Interest of shareholders
- Fulfillment of responsibilities by board
- Integrity and ethical behavior
- Disclosure and transparency.

Corporate governance and the current crisis in Nigeria banks:

The consolidation process in the Nigerian banking sector as introduced in 2005 by the then Governor of Central bank Prefessor Chukwuma Soludo created mega banks. However, its inability to overcome the fundamental weakness in corporate governance in many of these banks accounted for its failure. The huge surge in capital availability occurred during the time when corporate governance standards at bank were extremely weak and porous. As the root of financial crisis was principally non compliance with corporate governance codes at banks.

Some banks were engaging in ethical and potential fraudulent business practices and the scope and depth of these activities were recorded in CBN Examinations Sanusi (2010).

It was uncovered that intercontinental bank 30% share capital was purchased with customer deposits. 80% of IPO in Afribank was also purchased with depositor's fund, and when its shares were trading at N11 on the floors of Nigerian stock exchange, the bank paid N25 per share and these shares later went down to N3. The Chief executive officer of Oceanic bank controlled over 35% of the bank through SPVS borrowing customers deposits. The collapse of the capital market wiped out these customers deposits amounting to hundreds of billion naira. Hence capital raised by so called "mega banks" was fake capital as it was financed with depositor's funds, therefore the banks never raised the capital they claimed (www.centbank.com).

Corporate governance mechanisms:

Mechanisms of corporate governance imply the tools, technologies and instruments through which accountability is ensured (George & Karibo, 2014). It is the medium through which stakeholders monitor and shape behavior to align with set goals and objectives. Adekoye (2012) opines that it is the processes and system by which a country's company laws and corporate governance codes are enforced. Some of the corporate governance mechanisms considered in this study are:

Board composition: This refers to the executive and non-executive directors' representation on the board. There are mixed opinion on the effect of board membership and structure on firm performance. Weiback, (1998), Rensenstein and Wyalt (1990) Metran (1995) and John and Senbat (1998) opines that firms with board of directors dominated by outsiders perform better, whereas Weir and Laing (2001) Pinteris (2002) find no relationship in terms of accounting profit or firm value.

Board size: This is the total number of head count of directors seated on the company's board. The code of governance stated that the number of no executive directors should be more than that of executive directors subject to a maximum board size of 20 directors (CBN, 2006) but SEC states 15 directors.

Ownership structure: This implies the proportion of the total number of common stock owned by board of directors to the total number of stock outstanding.

According to Barce and Means (1932) separation of ownership from control of Modern Corporation actually reduces management incentives to maximize corporate efficiency. In support of this assertion is Jensen and Meckling (1976) which opines that agency cost would be reduce of those who owned the company also managed the company.

Board meeting: This has to do with the number of times the board of directors officially meets to discuss issues concerning the company. Lipton and Lorsch (1992) Jensen (1993) opined that board meeting is a crucial measure of the monitoring powers and effectives of the board.

Earnings Management: Maximization of investors' economic welfare is the major focus of financial management. But this can be influenced by external and internal factors include market preferences and perceptions, country's rules and regulations, and economy of the country. The market and laws are same for smaller businesses but different across industries while internal factors are fundamental variables which are specific to firms such are Earnings Per Share (EPS), **Theoretical framework:**

Resource Dependency Theory:-

Wanyama and Olweny (2013) as cited in Alalade et al (2014) opines that response dependency theory concentrates on the appointment of representatives of independent organizations as a means for gaining access in resources critical to firm success. The theory focuses on relationship with many groups for individual benefits, that is, it concentrates on the role of board of directors in providing access to resources needed by the firm. Hillman, Camella & Paetzold (2000) asserts that resource dependency theory is mainly concerned with the role directors play in providing or securing essential resources for an organization through their linkages to the external environment (Babalola & Adedipe, 2014).

Agency theory:-

This theory defines the relationship which exists between the agent and his principal. The principal here refers to the shareholders – the providers of fund while the agents are the company executives and managers. Agency theory agrees with delegation and concentration of control in the board of directors and use of compensation

incentives. The board of directors monitors agent through communication and reporting, review and audit and the implementation of codes and policies.

Empirical reviews:

Hamidah (2015) Investigated "Earnings per share as a method of assessment of financial performance and its effect on shareholders wealth: Evidence from banks listed in Indonesian Stock Exchange". The challenge was to find out whether earnings per share impacts on shareholders' wealth. The study covered 30 Banks listed in Indonesian Stock Exchange between the periods 2011-2013. The study utilized secondary data gotten from published financial statement of the Banks. The panel data regression model was employed for analyzing the data, the result showed that earnings per share have a positive and significant impact on shareholders' wealth. The study concluded that earnings per share are a strong variable for measuring shareholders' wealth.

Gardi and Emesuanwu (2015) investigated the "impact of corporate governance on financial performance of microfinance Bank in North Central Nigeria". The challenge was on the non compliance of microfinance banks with the provision of code of corporate governance which led to weak internal control system, absence of or non adherence to limits of authority, disregards to Canons of lending insider abuses and fraudulent practices. The study covered 23 Microfinance Bank for the period 2011-2013. The study utilized secondary data obtained from annual report and accounts of the 23 microfinance banks. The data was later analyzed with Pearson correlation co-efficient, ordinary least square regression. The Pearson correlation shows that significant relationship exists between Earning for share and corporate governance (Board, composition and composition of Board committee), while the regression analysis shows that no significant relationship exists between corporate governance and bank's financial performance. However, there are areas of non compliance which include the appointment of Executive Director and Managing Directors and sometimes Chief Executive officer as Board Committee members. He therefore concluded that Board of directors of microfinance banks should as a matter of urgency adhere strictly to the provisions of code of corporate governance on Board Composition (BC) and composition of Board Committees (CBC).

Okoi and Stephen (2014) carried out a study on Empirical study of the compact of corporate governance on the performance of financial institutions in Nigeria. The challenge was as result of the fact that corporate governance has been relied on statement which does not represent a true situation of the strength of banks. The study employed ordinary least square regression. The findings were that profitability of banks increased within the year under review as assets base of banks increased. As policy shift and investment increases profitability of bank also increases. The study concluded that the prime determinants of corporate governance of commercial banks are capital adequacy, assist base, policy shift, investment and liquidity ratio, as well as inflation rate. Hence, they recommend that the regulatory authority should restrictive their regulatory framework and strengthen their supervisory capacity to ensure a smooth working relationship with banks, prevent distress and failure in the post-consolidation era. There should supervision of heavy sanctions for those that violate banking regulations and other laws that guide bank business.

Qasim (2014) investigate the impact of corporate governance on firm performance: Evidence from united Arab Emendates. The challenge was to find out of strong corporate governance mechanisms are expected to have a positive impact on performance measures. The period of the study was 2007 – 2011. The study employed Tobin's score and find out that corporate governance measurers impact significantly on firm performance except for audit quality. He concluded that attitude of shareholders to some extent affects good corporate governance practices.

Research methods:

The research design for this study is ex-post facto research method. Secondary data used for analysis spanned a 10year period (2006 – 2015). The dependent variable earnings management is measured by Earnings per share (EPS) while the independent variable corporate governance is measure by board composition, board size, board meeting and ownership structure. The data were analyzed with SPSS 22.0 using multiple regression inferential statistics to determine the impact/effect of corporate governance on financial performance.

Model specification

To achieve the objectives of this study, therefore the following functional and explicit model were formulated:

$EPS_{it} = f(BComp_{it}, BSize_{it}, OSE_{it}, BMT_{it})$

$EPS_{it} = \beta_o + \beta_1 BComp + \beta_2 BSize + \beta_3 OSE + \beta_4 BMT + e_t$

Discussion of findings

The effect of corporate governance on earnings per share of money deposit banks in Nigeria is not significant.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.867[a]	.752	.699	.19525

a. Predictors: (Constant), lnose, lnbmt, lnbosize, lnbocomp

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constan)	-1.465	.964		-1.520	.145
	Lnbosize	1.789	.419	.917	4.270	.000
	lnbocomp	1.191	.380	.695	3.138	.005
	Lnbmt	.641	.128	.641	5.012	.000
	Lnose	.132	.077	.227	1.707	.104

a. Dependent Variable: lneps

The coefficient of regression β for Board size (BOSIZE) gave a value of 1.789. This value indicate that there is a positive relationship between Earnings per share (EPS) and Board size with the indication that every unit increase in EPS board size will increase by 1.789 and vice versa. Furthermore, the calculated t-statistic for the coefficient of BOSIZE gave a value of 4.270 which is greater than the critical t-statistic value of 1.960 which imply that BOSIZE is statistically significant and thus can be relied on to explain the EPS of listed banks in Nigeria. In addition, the significant value of 0.000 supported that BOSIZE is significant and relied on to explain the Earnings per share of listed banks in Nigeria. This implies that the bigger the size of the Board, the better performance as relates to Earnings per share.

The coefficient of regression β for Board composition (BOCOMP) gave a value of 1.191. This indicating that there is a positive relationship between Earnings per share (EPS) and Board composition with the indication that every unit increases in BOCOMP will lead to 1.191 units increase in EPS and vice-versa. The calculated t-statistic of 3.138 for the coefficient of BOCOMP is greater than the critical t-statistic of 1.960, this implying that the relationship between BOCOMP and EPS is statistically significant and can used to explain the EPS of listed banks in Nigeria. Moreso, the significant value of 0.005 also supported the t-statistic value of 3.138. Indicating that increase in number of non-executive Directors will help to improve Earnings per share of listed banks in Nigeria.

On the other hand, the coefficient of regression for Board meeting β gave a value of 0.641 which is about 64.1% showing that there is a positive relationship between Board meeting (BMT) and Earnings per share (EPS). Thus a unit increase in number of times the officially sits is predicted to lead to an increase in EPS of listed banks in Nigeria. The result further shows that the effect of BMT on EPS is statistically significant with the implication that BMT significantly affect the outcome of listed banks in Nigeria. This can be seen from the calculated t-statistic of the coefficient of BMT of 5.012 which is greater than the critical t-statistic of 1.960 with probability value of 0.000.

Ownership structure is positively related to EPS with a value of 0.227 with the implication that for every unit increase in OSE, EPS is predicted by 0.227 and vice-versa. However, the relationship is shown not to be statistically significant as the calculated t-statistic of 1.707 is less than the critical t-statistic of 1.960. Thus, OSE cannot be relied on to explain the EPS of listed banks in Nigeria. Also, considering its level of significant of

0.104 which is greater than 0.05 level, we conclude that OSE has a positive and non significant relationship with EPS of listed banks in Nigeria.

Conclusion and recommendations

From the findings of this study, it can be concluded that corporate governance mechanisms impact positively and significantly on financial performance of listed banks in Nigeria. Hence, the study makes the following recommendations:

- That the board of directors of listed banks in Nigeria should as matters of urgency adhere strictly to the provision of corporate governance.
- That regulatory authority should restrict their regulatory framework and strengthen their supervisory capacity to ensure smooth working relationship with banks and prevent distress and failure of banks.
- That Nigerian bank should not be over capitalized or over valued as this will lead to the collapse of these banks in their near future.
- That improve effort on the corporate governance should focus on study of value of stock ownership of board members.

Contribution to knowledge

This study has been the recent and has the longest duration on the subject of corporate governance when compared to previous studies there is only on 2 – 5 years.

Also, the study considered four corporate governance mechanisms like previous studies that considered one or two. This helps the researchers to draw inference in the areas of interest

Suggestions for further studies

The study explored corporate governance and financial performance of listed banks in Nigeria in broader context, hence further research could be carried out in other sectors of Nigerian economy other than the banking sector such as Insurance companies, Manufacturing companies and Non trading organizations.

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