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DOES BOARD NATIONALITY INFLUENCE THE RETURN ON EQUITY OF MONEY DEPOSIT BANKS? EMPIRICAL EVIDENCE FROM NIGERIA

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ABSTRACT

This study examines the influence of board nationality on the return on equity of money deposits banks in Nigeria. This study makes use of econometric procedure and data was collected through a secondary source of information. The population of interest for the study comprised the twenty-two deposit money banks listed on the Nigerian Stock Exchange (NSE) and the sample size consists of nine selected money deposit banks which were purposively chosen based on the consistency in their publication of their financial account up to 2016; and as well based on their equity. The finding shows that the board nationality brings diverse experience and expertise to bear on the operations of banks and it has a significant positive effect on the ROE of the selected banks. It is therefore recommended that the money banks in Nigeria should infuse more independent non-executive directors in the board to acts as checks on the excesses of the executive directors and to counter-balance the influence of the executive directors on the management. Further, the study also advised that more foreign directors should be elected on the board of deposit money banks in Nigeria as more foreigners on the board provide a large stock of qualified candidates with broader experience and diverse expertise which the domestic members may not possess.

Key words: Board Nationality, Corporate Governance, Return on Equity, Money Deposit Banks.

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1. INTRODUCTION

Bank boards have been placed with many prospects, reflecting the significant role banks have in our financial system. Some of these requirements derive from federal law or regulations. Others are included in guidance provided to boards by the bank regulatory agencies. It is important to note, however, that directors sitting on the bank of boards owe a fiduciary duty only to the shareholders of the firm (Jacob, 2011). These bank directors are held responsible for exercising the same duties that are assigned to all corporate boards by state corporate law. The precise role and supremacy of boards in any crisis or normal circumstances remain unidentified; it is obvious that directors are not likely to take into account the interests of other stakeholders, for instance, creditors, and taxpayers when making decisions. Unless the corporation is in distress, it may be against the law for them to do so (Macey & O'Hara 2003).

Regulators also expect boards to keenly supervise progress in addressing and contorting the weaknesses cited by the regulators or other groups such as inner and external auditors. In light of the failures, legislative action was taken to fortify board committees and hold them more responsible for bank performance. Remarkably, this was the case during the industrial turbulent towards the end of the 1980s. In view of that, the function of the board has become even more demanding more than ever before, directors of large financial institutions are expected to recognize the complexity of risks in the financial sector and the speed with which severe losses can merge. (Rashid & Lodh, 2008). In law, the board of directors may moderate the principal-agent problem; individual directors may face incentives that make them inconsistent monitors of management. Legally directors may be found liable for failing to fulfill their fiduciary duty but, practically speaking, proving this negligence is incredibly difficult. Banks needs an adequate number and appropriate composition of directors who are capable of exercising judgment independent of the views of management, political interests or inappropriate outside interests. In addition, the board of directors has a responsibility to protect the bank from illegal or inappropriate actions or influences of dominant or controlling shareholders that are favorable or unfavorable in the best interest of the bank and its shareholders. Independence and objectivity can be enhanced by including qualified non-executive directors on the board or by having a supervisory board or board of auditors separate from a supervisory board (Ahern & Dittmar 2010).

The Nigerian deposit banks have been through a lot of challenges in the last three decades. The middle 1990s witnessed the failed bank phenomenon where most banks collapsed largely due to mismanagement, insider-abuse and huge incidence of bad debts. In the early 2000, the 89 banks operating at the time were adjudged to be largely undercapitalized, fragile and unable to provide the required capital to boost huge long-time investment. No Nigerian bank was ranked among the first 100 banks in Africa. This scenario led to the increase in the required fully paid up capital requirement from 2 billion naira to 25 billion naira in 2004 with 18-month period for compliance. The result was a reduction in the number of banks from 89 to 25. All these shook the confidence of the banking and investing public. Anecdotal evidence suggests that most of the failed banks was attributable to the management of the banks and more specifically the ownership structure, the probable nature of the extant policies and oversight activities of the board of directors (BoD) to ensure compliance. it is against this background that the study evaluate the influence of board nationality on the return on equity of money deposits banks in Nigeria.

2. REVIEW OF LITERATURE

2.1. The Concept of Board Nationality

Hillman, Nicholson, Abdullah, Shropshire, and Singh (2008), have provided the characteristics of firm with ethnic nationalities on board in the context of the U.S. and the U.K. respectively, this study addresses that research gap in the context of Malaysia as one of the developing country using a different dimension of board diversity, for examples, gender and nationality diversity. The characteristics of firms with women and foreign directors are examined and compared with firms without women and foreign directors.

Board nationality and gender diversity on boards, therefore, will likely provide managers with unique information and skill sets, allowing for better decision making at the corporate level. Furthermore, board gender and national diversity increase access to talent, as it sends positive signals to both product and labor markets. As countries like the United States experience increased growth in ethnic nationality groups, the ability for a national diverse board to provide legitimacy for a corporation also grows in importance (Ibid). The findings revealed from prior literature, for examples, with Brammer et al. (2007), who illustrated the relationship linking board size and diversity. Hence, board diversity could be used as an effective way to improve on corporate governance among the listed companies in the event of economic instability. It could also serve as a means for achieving better financial returns to firm. Hence, we hypothesized that:

HA; Board nationality has significant effect on return on equity of money deposit banks.

Maina, (2005), outlines that heterogeneity in boards of directors would as well improve the value of corporate result as the members of the boards are directly involved in issuing, restructuring, takeover exercises, introducing measures to enhance regulatory, transparency, accountability and independence. Hence, board with diverse nationalities will improve firm performance by increasing board independence (Carter et al., 2003). Carter, D´Souza, Simkins, and Simpson (2010), studied not only the impact of increasing the proportion of women but also the effect of nationalities on boards ethnics diversity of US for the business years 2007, 2010 and 2011. The authors conducted a comprehensive study based on 2.563 companies covering a five-year period of the S&P-index firms.

2.2. Return on Equity

Return on equity represents profitability of shareholders of the firms after meeting all expenses and taxes. ROE is net earnings per dollar equity capital. (Alchian & Demsetz, 2016). Higher ROE means better managerial performance, but higher ROE can be due to financial leverage. Higher leveraged firms have higher ROE which increases risk too (Baske, Istanbul & Velnampy 2013). Usually ROE is higher for high growth companies. ROE=Net Profit/Shareholders' Equity.

Return on equity (ROE) and return on assets (ROA) are two of the most important measures for evaluating how effectively a company's management team is managing the capital that shareholders entrust to it. Below is an overview of the main differences between ROE and ROA and how they are related. ROE and ROA are important components in banking for measuring corporate performance. Return on equity (ROE) helps investors gauge how their investments are generating income, while return on assets (ROA) helps investors measure how management is using its assets or resources to generate more income.

ROE is a very effective metric for evaluating and comparing similar companies, providing a solid indication of earning performance. Average returns on equity vary significantly between industries, so it is not appropriate to use ROE for cross-industry company comparisons. However, as a general evaluation, most analysts consider an ROE in the range of 15% to 20% to be favorable for purposes of investment. A higher return on equity indicates a company is effectively using the contributions of equity investors to generate additional profits and return the profits to investors at an attractive level. There is one inherent flaw with the ROE ratio, however. Companies with disproportionate amounts of debt in their capital structures show smaller bases of equity. In such a case, a relatively smaller amount of net income can still create a high ROE percentage from a more modest base of equity.

3. METHODOLOGY

This study adopted the ex-post facto design given that it is targeted at analyzing the impact of some independent variables on a specified dependent variable. This study makes use of econometric procedure in estimating the effect of board nationality on the return on equity of selected money deposit banks in Nigeria. The study utilized the secondary source of data. The population of interest for this study comprised the twenty-two deposit money banks listed on the Nigerian Stock Exchange (NSE). For the purpose of this study, the sample size was chosen based on the following criteria: banks that are consistent in the publication of their financial account up to 2016 were included in the sample; banks with negative equity or is subject of government take-over within the period were excluded. For the empirical part of this study, the data is limited to the bank that is in existence throughout the period of the study. After applying the above criteria, nine deposit money banks were selected. They are First Bank of Nigeria Plc, Diamond Bank Plc, Fidelity Bank, Union Bank, United Bank for Africa, Zenith Bank, Access Bank, Eco Bank and Sterling Bank Plc. The study adopted the systematic and purposive sampling technique to select the nine banks into the sample. The data for the study were collected from annual reports and account of deposit money banks quoted on the Nigerian stock exchange (NSE).

4. RESULTS

Linear regression with the application of ordinary least squares (OLS) technique was adopted. The primary justification for adopting the linear regression is based on the fact that it possesses the optimal properties of linearity, un-biasness and minimum variance.

To ascertain the effect of board nationality on return on equity of money deposit banks, the model specification was given below:

$$ROE = \beta_o + \beta_{BONA} + \mu \ldots\ldots\ldots\ldots\ldots\ldots \quad (1)$$

By Definition:

BONA = Board Nationality,

ROE = Return on Equity,

β = parameters to be estimated and

μ = the stochastic error term.

Board nationality is represented by the number of foreigners in the board as a ratio of the total number of board members.

Board nationality = No. of Foreigners/Total No. of Board members

Table 1 Board Nationality versus Return on Equity (ROE)

Dependent Variable: ROE
Method: Least Squares
Date: 01/18/18 Time: 05:49
Sample: 2000 2016
Included observations: 17

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	210.8518	285.1600	0.739416	0.4711
BONA	0.490105	0.104226	4.702345	0.0003

R-squared	0.595819	Mean dependent var	417.0588
Adjusted R-squared	0.568873	S.D. dependent var	1582.193
S.E. of regression	1038.872	Akaike info criterion	16.83979
Sum squared resid	16188823	Schwarz criterion	16.93781
Log likelihood	-141.1382	Hannan-Quinn criter.	16.84953
F-statistic	22.11204	Durbin-Watson stat	1.784713
Prob(F-statistic)	0.000283		

Source: E-views Output

Model Line: ROE = bo + b_1CEOINT

Regression Line: ROE = 210.8518 + 0.104226 **BONA**

Interpretation

A regression analysis was carried out having Return on Equity (ROE) as the dependent variable and Board Nationality (BONA) as the independent variable. Table 1 which displays the regression output shows that the numerical coefficient of BONA yielded a positive value at the magnitude of 0.490105. This entails that a 1% change in BONA leads to a positive change in ROE by 0.490105. This reveals a positive relationship between the two variables. The coefficient of determination which measures the control power of the independent variable over the dependent variable was calculated with the instrument of adjusted R-Squared and it yielded 0.568873. This entails that the variations in ROE of the selected deposit money banks is significantly influenced by BONA. This is in the magnitude of approximately 56.8873%. This is significant given that it is beyond average.

The hypotheses stated earlier in this research were tested using t-statistics anchored on the regression method. Three steps were used to test the hypotheses. In step one; the hypotheses were restated in null and alternate forms. In step two, the results were analyzed while in step three, decisions were made. The decision rule involved the rejection or acceptance of the null or alternate hypotheses based on criterion of the techniques of analysis.

Ho: Board nationality has no significant positive effect on the ROE of selected money deposit banks in Nigeria.

Ha: Board nationality has significant positive effect on the ROE of selected money deposit banks in Nigeria.

Having computed the regression, the regression table 1 above shows that the computed t-statistics yielded 4.702345 and a check at the tabulated t-statistics at 5% level of significance yielded 2.131. This shows that the computed value of the t-statistics is greater than its tabulated value.

The decision rule is to accept the alternate hypothesis (Hi) if the computed t-statistics (t*) is greater than the tabulated t-statistics ($t_{0.025}$) otherwise accept the null hypothesis

From the above analysis, it is clearly seen that the computed t-statistics value = 4.702345 is greater than its tabulated value of 2.131. This compels the rejection of the null hypothesis (Ho) and the acceptance of the alternative (H_1). Hence; Board nationality has significant positive effect on the ROE of selected money deposit banks in Nigeria.

Hypothesis was tested using linear regression with the application of ordinary least squares (OLS) technique. The result showed that board nationality has significant positive effect on the ROE of selected money deposit banks in Nigeria ($t^*_{calculated} = 4.702345 > t^*_{critical} = 2.131$). The Board nationality brings diverse experience and expertise to bear on the operations of banks which has significant positive effect on the ROE of selected money deposit banks in Nigeria for the period under analysis. This is in line with the findings of Adams, Hermalin, and Weisbach (2010) that carried out a study to examine the effect of corporate governance on banking performance in Pakistan. The study used bank efficiency as the dependent variable. Efficiency was measured in the study by Cobb-Douglas cost function. One of the measurements of corporate governance was Board nationality and it was discovered that this variable has significant positive effect on the efficiency of selected money deposit banks in Nigeria. the findings is in consonant with the study done by Awino (2011), though it negates the submission of the outcome of the results of Fidelia and Tabachnick (2011) who counter the submission that board governance activities determine the financial success of financial institutions.

5. CONCLUSION AND IMPLICATIONS

This study investigated the analysis of the effect of board nationality on ROE of selected money deposit banks in Nigeria covering the period 2000-2016. Based on the findings, the study concluded that on the average, board nationality has significant effect on financial performance of selected money deposit banks in Nigeria. Based on the findings of the study, the following recommendations are proffered. First, deposit money banks should ensure that ownership of shares is well spread and diffused. A situation where a bank is quoted as a public liability company (PLC) but still being controlled by a family interest is not healthy from corporate governance standpoint. In this case, the Nigeria stock exchange, securities and exchanges commission (SEC) and corporate affairs commission (CAC) has to do a more thorough job. Secondly, deposit money banks in Nigeria should infuse more independent non-executive directors in the board to acts as checks on the excesses of the executive directors and to counter-balance the influence of the executive directors on the management. Further, more foreign directors should be elected on the board of deposit money banks in Nigeria as more foreigners on the board provide a large stock of qualified candidates with broader experience and diverse expertise which the domestic members may not possess.

The findings of the study provide support to previous studies, with up to-date and more diverse data, of an existence of relationship between board nationality and performance of deposit money banks in general and particularly highlights unique relationship between board composition and deposit money banks performance. Further, as against earlier studies on this subject which made largely use of primary data, this study made use of secondary data which is less prone to individual perception and bias.

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