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Impact of Selected Corporate Governance Indicators on Capital Adequacy and Liquidity in Nigerian Deposit Money Banks

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Abstract: Purpose: The recent corporate scandals and events across the world redirected the thinking of regulators around the world towards enacting more robust rules to ensure transparency, adequate disclosure, and accountability in the corporate regulation. The banking sector is critical to the economic development of any nation, therefore, apex regulatory bodies (Central Banks) in various countries regulate the activities of banks to prevent a systemic collapse to assure financial stability. This study investigates the impact of corporate governance indicators on capital adequacy and liquidity of selected Deposit Money Banks in Nigeria. Methodology/Design/Approach: The study adopts a quantitative research approach in which data were collected from publicly available secondary sources between 2009 and 2018 for 12 banks using judgmental sampling techniques out of 21 Deposit Money Banks as of 2018 to represent the Nigeria Banking sector, Pooled OLS, Random effect model were estimated by random-effect GLS regression and fixed effect models were used to analyze the impact of corporate governance indicators selected on capital adequacy and liquidity Nigerian DMBs. Originality/Value: The body of knowledge in the areas of corporate financial management, finance and accounting, as well as bank performance and corporate governance, particularly in Sub-Saharan African nations, will be enriched by this research.

Keywords: Capital Adequacy, Liquidity, Corporate Governance, DMBs

1. Introduction

It became apparent as far back as the 1930s, with the decline and fall of various family business dynasties, that increasing division between ownership (possession of the company) and control (management of the company) produced problems [23]. At the beginning of 1970's, issues pertaining to corporate governance has been a contending subject of substantial debate in the US and around the globe. There are several reforms of corporate governance in developed and developing countries and efforts to reform corporate governance have been driven in part by the needs and desires of shareholders to exercise their rights of corporate ownership and increase the value of their shares and wealth. Over the past three decades corporate directors' duties have expanded their traditional legal responsibility of duty of loyalty to corporate organizations and shareholders, especially in developed countries. In the mid- 1990s the issue of corporate governance in the US and UK received considerable press attention due to the wave of corporate governance failure in some firms which led to a wave of institutional shareholder activism [1, 11].

The recent corporate scandals and events across the world redirected the thinking of regulators around the world towards enacting more robust rules to ensure transparency, adequate disclosure and accountability in the corporate regulation. Bitter lessons were learnt from the Asian Financial Crisis of 1997-98 fueled largely by a distending currency crisis and weak financial system; series of corporate mismanagements and obvious professional abuses, as evidenced with Enron scandal in United States in 2001 and the global financial meltdown of 2008 which began with the crash in United States mortgage industry and later affected all other part of the world [17]. Following the crises witnessed,

an international forum of ministers and central bank governors from the twenty most economically developed countries (G-20) set up the Financial Stability Board in 2009 to ensure global convergence of standards and their consistent application, enhanced risk disclosure, disclosure of complex financial instruments, and financial regulatory reform [17]. The International Forum of Independent Audit Regulators made greater emphasis on mandatory rotation of auditors; enhancement of corporate governance practices; greater transparency in financial and accounting statement and call for convergence of standards and financial regulatory reform.

The banking sector is seen to be crucial to the development of any nation, therefore, apex regulatory bodies (Central Banks) in various countries regulate the activities of banks to prevent a systemic collapse so as to assure financial stability. The surge of the financial crisis and corporate scandals between the late 20th and 21st century resuscitated corporate governance consciousness, leading to several corporate governance reforms in Nigeria. One of the reforms is the consolidation reform of 2005 that led to merger and acquisitions and the eventual shrinkage of banks from 89 to 25 by end of 2005 [25]. The minimum required capital base of N25 billion naira that was prescribed for banks led to consolidation of banks into diversified, reliable and strong capitalized institutions. At the end of 2018, the number of Deposit Money Banks in Nigeria became twenty-two (22) banks with different licenses of operation ranging from Regional, National and International authorization [6]. To this end, what role does corporate governance on play in the increase capital base and the management of facility in terms of quality of assets (asset quality)? Securities Exchange Commission in Nigeria revealed that despite all the laws and provisions there are still existence of corporate failures in the banking and non-banking sector of the country SEC [1]. The corporate failures experiences are what led to the consolidation of banks in Nigeria reducing the number of commercial banks to 25 in the year 2004.

2. Literature Review

2.1. Conceptualization of Major Variables

Corporate governance on its own is a multifaceted topic. With no laid down principles; its model, identification, and solutions lie in multidisciplinary fields i.e., economics, accountancy, finance among others [26]. In every organization, corporate governance is perceived to be one of the key determinants of the sound managerial system and its ability to withstand economic shocks. The healthiness of every organization depends on the interaction between individual corporate governance components. Corporate governance is seen to be the collection of mechanism, techniques and procedure in which corporate entity are governed and controlled.

In the standard CAMELS framework, capital adequacy focuses on the total risk-weighted capital intended to protect the depositors from the potential shocks of losses that a bank might incur. Capital adequacy is assessed according to the volume of risk assets, the volume of marginal and inferior assets, bank growth experience, plans, and prospects; and the strength of management in relation to all the above factors [5]. Core capital adequacy takes into consideration banks solvency and ability to absorb risk, it includes the tier 1 and tier 2 capital generated divided by the sum of risk weighted assets and risk weighted off statement of financial position exposures. In doing this we are investigating the capital adequacy of the bank in relation to the risk profile of the bank. Capital adequacy gives an insight into the financial stability and reliance on debt [15].

Liquidity is assessed according to the volatility of deposits; reliance on interest-sensitive funds; technical competence relative to structure of liabilities; availability of assets readily convertible into cash; and access to inter-bank markets or other sources of cash, including lender-of-last-resort (LOLR) facilities at the central bank [5]. Chaterjee, Harrison and Bergh (2003) regarding the liquidity factors, highlights aspects like adequacy of liquidity sources compared to present and future needs, availability of assets readily convertible to cash without undue loss, access to money markets, level of diversification of funding sources: on- and off-balance sheet, degree of reliance on short-term volatile sources of funds, trend and stability of deposits, ability to securitize and sell certain pools of assets, and management competence to identify, measure, monitor and control liquidity position.

2.2. Stakeholders Theory

The stakeholder's theory was developed by Freeman in 1984 with an emphasis on the need for managers to be corporately accountable to the stakeholders instead of concentrating on shareholders alone. Stakeholders' theory put forward a strong argument against the narrowness of the agency theory for noting shareholders as the only group interested in corporate entities. Broadening the scope of interested parties, the stakeholder theory stipulates that, a corporate entity is invariably seeking to maintain a balance between the interests of its diverse stakeholders in order to ensure that each interest group receives some degree of satisfaction [29].

Freeman (1984) defines stakeholders as "any group or individual who can affect or is affected by the achievement of the organization's objectives". (Freeman as cited in Freeman, 1999) suggested that 'any organization striving to be recognized as an effective entity, they must give cognizance to all the relationship that is capable of affecting the achievement of the organization. To this end, one can conclude that the stakeholder theory is a rational model. Notwithstanding, the organization should endeavor to manage all the parties (stakeholders) in the sense that no party is left behind.

2.3. Empirical Review

The study of bank performance has been implemented across the globe due to the pressure from the global crisis that requires a detailed review and pre-emptive measures to maintain the performance of the banking sector. Besides taking into account the outcome and mitigating measures of the study, researchers investigated the methods and variables that should be used to evaluate bank performance. One of the elements to evaluate bank performance is corporate governance. Corporate governance is among the best indicators to measure bank performance [3].

Some previous studies on corporate governance that have used the financial ratio analysis to measure bank performance [2, 14, 18, 20, 27]. Motlagh et'al., (2011) used different dimensions by grouping the financial ratios into growth, profitability, marketability and efficiency measurements. Furthermore, [10] stressed asset quality, profitability, liquidity, risk management and also the management competency (MC) must be considered to measure the performance. Based on [28] the literature is still seeking the best group variables besides the typical financial analyses. Apart from employing the random financial ratios to evaluate the bank performance, the CAMEL framework is one of the common tools to assess the bank performance by using the specific ratios under its component. It is a useful method to examine the financial health of the bank [4, 21]. Douglas, Lont and Scott (2014) employed a group of financial variables known as CAMEL ratios, which stand for capital adequacy (CA), asset quality, management competence, earnings quality, and liquidity. They mentioned that CAMEL ratios are the most important ratios to predict failure and evaluate the performance of finance companies. The CAMEL ratios have been studied by many researchers including [8, 13, 14, 16, 24, 22].

To this end, past literatures have shown that both CAMELS composites and corporate governance affects bank performance separately. A study bringing together corporate governance indicators, capital adequacy and asset quality individually have nearly not been extensively looked into in Nigeria banks; capital adequacy because its measures solvency and banks' ability to absorb risk; asset quality because it measures the efficiency in the utilization of asset compared with those mechanism and processes available to govern the affairs of corporate entity. Therefore, this study takes initiatives by examining the effect of selected corporate governance indicators on capital adequacy and asset quality using Nigeria Deposit Money Banks.

3. Methodology and Data Description

To see the effect of corporate governance on capital adequacy and asset quality in the deposit money banks in Nigeria, the study made used board independence, board size, audit committee and audit quality as a measurement for corporate governance for twelve selected deposit money banks in Nigeria with a ten-year duration from 2009 to 2018. These data were logged in order to de-trend them and post estimation test using Breusch and Pagan Lagrangian Multiplier Test and Hausman test results were presented to validate the robustness of the models used for this study.

The study adopted random effect, pooled OLS and fixed effect model to examine the effect of dependent variable have on the independent variable. The models specified for this relationship are defined as follows.

$$cad_{it} = con + \sum_{*=1}^{k} m_i \, x_{*it} + e_{it};\ * = 1,\ldots,k \quad (1)$$

$$liq_{it} = con + \sum_{*=1}^{k} m_i \, x_{*it} + e_{it};\ * = 1,\ldots,k \quad (2)$$

x = board size, board independent, audit quality and audit committee independent, dummy.

Where: cadit is capital adequacy, asqit is asset quality, x is the explanatory variables, k is the number of the explanatory variables and dum is the dummy, which is a binary variable and e is the disturbance/error term and it is defined below as.

$$eit = ui + wit \quad (3)$$

ui and wit are the specific error and common error respectively.

4. Descriptive Statistics

The descriptive statistics is presented was computed to examine the nature of each of the variables specified for this research work. The approximated statistical values are reported in table 1 as shown as follows.

Table 1. *Descriptive Statistics of Capital Adequacy and Asset Quality.*

	CAD	LIQ
Mean	0.199110	0.553951
Median	0.187250	0.494370
Maximum	0.440000	2.514492
Minimum	-0.160000	0.060600
Std. Dev.	0.081201	0.335011
Skewness	-0.930341	3.062939
Kurtosis	9.042598	17.09457
Jarque-Bera	199.8757	1180.916
Prob	0.000000	0.000000
Observation	120	120

Source: Researcher's computation (2019) using stata.

It becomes very clear in table 1 that the mean value of capital adequacy (CAD) and liquidity (LIQ) are 0.199110 and 0.553951respectively. The two variables are positive value meaning they have the tendency to increase in the future. Only CAD has a negative skewness value while LIQ is positively skewed. They follow asymmetric pattern of distribution. All the kurtosis values are larger than 3. The probability of Jarque-Bera statistic for all the variables are zeros implying that they all have a normal distribution pattern.

Table 2. *Descriptive Statistics of Corporate Governance Indicators.*

	BOI	BOZ	AUQ	ACI
Mean	0.606225	14.09167	1.000000	0.744009
Median	0.583333	14.00000	1.000000	0.666667
Maximum	0.909091	20.00000	1.000000	1.000000
Minimum	0.400000	7.000000	1.000000	0.272727
Std. Dev.	0.089181	2.995784	0.000000	0.245762
Skewness	1.093289	-0.222462	NA	-0.113606
Kurtosis	5.031931	3.238598	NA	1.414551
Jarque-Bera	44.54931	1.274434	NA	12.82636
Probability	0.000000	0.528762	NA	0.001640
Observations	120	120	120	120

Source: Researcher's computation (2019) using stata.

It is seen in table 2 that the mean value of board size is the largest mean value of all the mean values of the other variables used. All the variables have positive average values. The average value of board size, board independent, audit quality and audit committee independent are approximately 14.09, 0.61, 1.00 and 0.74, respectively. The standard deviation of board size is the highest among the others, while audit committee independent has the lowest value of standard deviation. This infers that board size is the most volatile variable, whose changes are more dynamic than the other variables and audit committee independent is the least volatile variable among the other variables. Board size and audit committee independent are negatively skewed, while board independent has a positive skewness value. Implying, that this variable follows asymmetric distribution pattern and there is tendency that it will increase in the nearest future. Board size is mesokurtic in nature, board independent is leptokurtic and audit committee independent is platykurtic. The probability of Jarque-Bera statistic shows that both board independent and audit committee independent series are normally distributed.

Regression Analysis:

This segment gives the parameters of the models. Fixed effect model, random effect model and OLS model are employed to investigate the effect the independent variables have on the dependent variables employed in this study. The first regression table (table 3) is on corporate governance indicators and capital adequacy. The second table 6 is on corporate governance and asset quality.

Table 3. *Capital Adequacy versus Corporate Governance Indicator based on fixed, Random and Pooled OLS.*

Regressors	Random				Fixed				Pooled OLS			
	Coef.	Std Err.	Z	P	Coef.	Std Err.	Z	P	Coef.	Std Err.	Z	P
Boi	0.1673	0.0915	1.83	0.067	0.1754	0.0987	1.98	0.079	0.1673	0.0915	1.83	0.067
Boz	0.0037	0.0032	1.14	0.254	0.0038	0.0038	1.03	0.307	0.0037	0.0032	1.14	0.254
Aci	0.0317	0.0393	0.81	0.420	0.0235	0.0471	0.50	0.619	0.0317	0.0393	0.81	0.420
Auq	0				0				0			
Cons	0.0227	0.0906	0.25	0.802	0.0211	0.1006	0.21	0.835	0.0227	0.0906	0.25	0.802

Note: The dependent variable is capital adequacy, the number of regressors is four, the critical t-statistics using one tail is 1.667, and the degree of freedom is 95%.

Source: Researcher's computation (2019) using stata.

Table 3 above displays the results obtained from analyzing the dependent variable against the independent variables. Here capital adequacy was regress against all the corporate governance indicators using three different models. The results yielded by the random and pooled OLS are the same. The coefficient value of board independent, board size and audit committee independent are approximately 0.18, 0.004 and 0.023 respectively under the fixed effect. The coefficient of board independent, board size and audit committee independent are approximately 0.17, 0.004 and 0.03 respectively for random and pooled models. It is clearly observed that these three competing models show a positive relationship between capital adequacy and the corporate governance indicators. From the three models it is seen that only board independent has strong relationship with the explained variable. As a one percent increase in board independent will induce about 1.18 units increase in capital adequacy. Both board size and audit committee independent are weakly related to capital adequacy. Also, only board independent that has a significant influence on capital adequacy at 10 percent. Therefore, the post estimation test of these models is conducted to verify which of the model is more appropriated. The results of these tests are reported in table 4 and table 5.

Table 4. *Post Estimation Test using Breusch and Pagan Lagrangian multiplier test for random effects.*

	Var	sd = sqrt (Var)	chibar2 (01)	p-value
cad	0.0066	0.0812	20.02	0.0000
e	0.0052	0.0721		
u	0.0020	0.0451		

Source: Researcher's computation (2019) using stata.

In the above table the random model was tested against the Pooled OLS. The results show that the probability value is zeros; it is less than 5 percent level of significant. This suggests that there is evidence of panel effect that is to say random model is superior to the pooled OLS model. However, the random model is tested against the fixed model and the results of this test are reported in table 5 below.

Table 5. *Post Estimation Test using Hausman to Fixed against Random.*

Statistics	Value	P-Value
Chi-square	0.15	0.9845

Source: Researcher's computation (2019) using stata.

As shown from table 5 the results of the test of fixed model against random model. The chi-square value is 0.15 and the probability value is 0.98. It is observed that the probability value is larger than 5 percent, signifying we do not reject the null hypothesis that is the random effect model is able to explain the variation in the panel.

Table 6. *Liquidity versus Corporate Governance Indicators based of Fixed, Random and Pooled OLS.*

Regressors	Random				Fixed				Pooled OLS			
	Coef.	Std Err.	Z	P	Coef.	Std Err.	Z	P	Coef.	Std Err.	Z	P
boi	0.0397	0.3768	0.11	0.916	0.3913	0.4037	-0.97	0.335	0.0397	0.3768	0.11	0.916
boz	0.0074	0.0125	0.60	0.551	0.0061	0.0153	0.40	0.691	0.0074	0.0125	0.60	0.551
aci	-0.0422	0.1511	-0.28	0.780	-0.4546	0.1926	-2.36	0.020	-0.0422	0.1511	-0.28	0.780
auq	0				0				0			
cons	0.4563	0.3612	1.26	0.206	1.0435	0.4115	2.54	0.001	0.4563	0.3612	1.26	0.206

Note: The dependent variable is capital adequacy, the number of regressors is four, the critical t-statistics using one tail is 1.667, and the degree of freedom is 95%.
Source: Author.

Table 5 above shows the outcome of the test of Liquidity versus Corporate Governance Indicators based on Fixed, Random and Pooled OLS. The random model and fixed model show that the coefficient value of board independent, board size and audit committee independent are approximate 0.04, 0.01 and -0.04 respectively. This suggests that liquidity has an inverse relationship with audit committee independent and a positive relationship with both board independent and board size. Under the fixed model the coefficient figure of board independent, board size and audit committee independent are approximately -0.39, 0.01 and -0.46 respectively. It is clear that board independent and audit committee independent can negatively determine the liquidity of the selected banks. But board size has a weak and positive influence on liquidity. Audit quality is omitted; it cannot be estimated since it is correlating with the other independent variables. Therefore, the post estimation test results are reported below.

Table 7. *Post Estimation Test using Breusch and Pagan Lagrangian multiplier test for random effects.*

	Var	sd = sqrt (Var)	chibar2	p-value
liq	0.1122326	0.3350113	7.72	0.0027
e	0.0868088	0.2946333		
u	0.012872	0.1134549		

Source: Author.

Post Estimation Test using Breusch and Pagan Lagrangian multiplier test for random effects versus pooled model results are presented in the above table. It is evident that the probability value for this statistic approximately 0.003, this value is lesser than 5 percent significant level. By implication we reject the null hypothesis that there is no heterogeneity in the group. Consequently, the Random effect model is better than the pooled model in this study. In the succeeding table the test results of Random effect model against fixed effect model is reported as shown below.

Table. 8. *Post Estimation Test using Hausman to Fixed against Random.*

Statistics	Value	P-Value
Chi-Square	20.63	0.0001

Source: Author.

The previous post estimation test using Breusch and Pagan Lagrangian multiplier test reveals that random model is suitable for this study. This position leads to another post estimation test using Hausman to test fixed model against random model. The chi-square probability value is approximately 0.0001. We therefore reject the null hypothesis that is random effect is more efficient for this research work.

5. Conclusion

The purpose of this paper was to study the effect of corporate governance on capital adequacy and asset quality in the deposit money banks for a period of 10 years in the Nigerian Deposit Money Banks. Thus, the study reveals that capital adequacy and asset quality have a positive relationship with corporate governance indicators. Also, the three models show that only board independent has strong relationship with asset quality. it also concluded that board size and audit committee independent have negative impact on capital adequacy and asset quality using the three models as a basis of judgment. The study recommended the management of these banks should formulate policy that will lead to increase in their capital adequacy and asset quality efficiency use so as to increase their confidence and effective participation in the competitive and hostile market.

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