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DIRECTORS' SHAREHOLDING AND NIGERIAN BAILED-OUT BANKS' PERFORMANCE

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Abstract

This paper extends an earlier proposed framework and thus empirically examining the effect of board of directors' share ownership on the non-financial performance of banks in an era of post banking crisis that called for a bailout reform in Nigeria. This board characteristic is adopted to address a peculiar ownership structure problem in the banking sector, and consistent with the board monitoring functions as underpinned in agency theory. Based on a survey data, the result of this analysis revealed a significant relationship between board of directors' share ownership and banks performance (financial and non-financial). This research therefore, suggests more regulation and enforcement of this as it motivates and compels boards to be more vigorous at monitoring CEOs/top managements.

Keywords: Corporate governance, Directors shareholding, Banks performance, Agency theory

1.1 Introduction

Performance measurement of business organizations has captured a serious attention of both managers, BODs, shareholders, researchers and the government of various nations (Epstein & Roy, 2005; Kaplan & Norton, 2000). The intensive and sensitive financial operations makes it inevitable to fully secure the transactional processes in order to stabilize the system from economic shocks, failure, and also protect depositors, investors etc. In the Nigerian financial sector, poor managerial performance and poor corporate governance (CG) had been identified as the major factors in virtually all known cases of a financial institution's distress in the country which even led to consolidation reform in

2004, and yet re-emerged afterwards, and led to another reform in late 2009 that necessitated the bail-out of ten (10) banks which nearly collapsed due to high non-performing loans, poor CG, bad liquidity and risk management (CBN, 2010). The bail-out reform became the only rescue program which could ensure the continuous survival of the banking industry by injecting N620 billion. This bail-out reform generated a lot of panic and doubt concerning the status of the investments of these banks' depositors, shareholders and other Nigerians consequently, sparked a large interest in examining the potential outcome of this reform through researches.

Apparently, this paper is motivated by the so many practical issues affecting the banking sector which is discussed as follows: Firstly, the implementation of CBN code of corporate governance in Nigeria is always hindered by "ambiguities regarding the appointment of independent directors and the share ownership status of these independent directors" (CBN, 2008). Nos study is found to address this problem as regards to bail-out banks. Secondly, this paper will test empirically, a part of an earlier proposed framework of (Aliyu, Jamil, & Mohamed, 2016). Thus, this paper has examine the potential relevance of directors' shareholding (DSH) in enhancing the performance of these bail-out banks. This framework, unique as it is, aims at covering only the bailed-out banks with a total of 2,811 branches in Nigeria using a primary source of data (questionnaire). There is lack of studies in Nigerian context that conceptualised DSH as a performance booster and then evaluating based on financial and non-financial performance. Thirdly, another major problem is that most of the researches on this variable conducted globally and Nigeria in particular, are reported with conflicting findings as a result of factors like; inconsistent operationalization of board variables, limited scope, and convenience samples (Hillman & Dalziel, 2003; Zahra & Pearce, 1989). Studies in the Nigerian context which adopts this variable that captures board control or monitoring role are very rare, hence the need to re-examine this inconclusive findings.

Fourthly, very few studies were done on specifically bailed-out banks in Nigeria. Most of the studies on CG were either out of the scope of bail-out reform, or before the reform, or on non-banking sector e.g Adekoya (2011), Okereke, Abu, and Anyanwu (2011), nakoya, Ofoegbu, and Fasanya (2012), Uwuigbe and Fakile (2012). Only few studies were found on bail-out such as "Kuye, Ogundele, and Otike-Obaro (2013), Nworji (2011), Oghojafor, Olayemi, Okonjia, and Okolie (2010)", which all have different kinds of limitations hence, the need to conduct this study. Lastly, the literature on CG showed large focus and over-reliance on financial performance by use of secondary data thus ignoring the non-financial

performance. CG studies covering both financial and non-financial performance are very rare in Nigeria, the need to do this study.

The result of our analysis revealed that DSH had a significant positive relationship with performance. This paper recommends that DSH must be enforced in order to improve corporate governance practices in firms. This outcome is of immense importance to academics, regulators, shareholders, and other Nigerians as it will reveal the contribution of DSH in strengthening board of directors' functions in ensuring good banks' performance. The paper is subdivided into 5 sections from introduction, literature review, DSH, bank performance, methodology, discussion and conclusion, limitation, then reference.

2.0 Literature Review

2.1 The Nigerian Banking Sector Reforms

Historically, the banking system in Nigeria after commencement in 1892 has experienced so many major challenges and several episodes of the banking crisis. Several major reforms were introduced by the Federal Government of Nigeria (FGN) through the Central Bank of Nigeria (CBN), to sought permanent measures that would enhance the stability and efficiency of the banking sector. For example, reforms like Structural Adjustment Program (SAP) in 1986, financial liberalization in 1987/88, then 1991, prudential guidelines was brought to classify loaned asset quality and prevent bank distress and lastly consolidation reform in 2004 was implemented. All these had an objective of reducing banks' distress. Also to reinforce banks' liquidity position, the CBN raised the required minimum capital base for commercial banks four times between year 1990 and 2004, for instance, in 1992 (from N20 million to N50 million), 1998 (from N50 million to N500 million), 2002 (from N500 million to N2 billion) and 2004 (from N2 billion to N25 billion) respectively (Iganiga, 2010). However, these measures were unsuccessful in curtailing the spate of bank distress and failures in the 1990s and beyond (Aburime, 2008; Beck, Cull, & Jerome, 2005; Iganiga, 2010; Oluranti, 1991).

Recently, due to a major hit by the global financial crisis, another set of banking sector rescue program "Bail-out" was inevitably being introduced to ensure stability and prevent distress. The Central Bank of Nigeria (CBN) and the Nigeria Deposit Insurance Corporation (NDIC) in July 2009, conducted a joint special examination of all 24 deposit banks in Nigeria, with the purpose of evaluating their health, with especial focus on Liquidity, Capital adequacy, Risk management and Corporate Governance practices (CG). The governor of CBN Mal. Sanusi Lamido Sanusi, declared ten (10) banks of the Nigerian banking sector as being distressed due to "excessively high level of non-performing loans

in the banks, which was attributable to poor corporate governance practices, bad liquidity position and risk management”. Consequently, a bail-out of about N620 billion was injected to rescue them, and then the Managing Directors (MD/CEOs) and the board of directors of 8 banks were immediately removed and then replaced with new ones. These CEOs were then detained, prosecuted by the economic and financial crimes commission (EFCC) and also tried before the high court for corruption and mismanagement of their banks (NDIC, 2011; CBN, 2010; Sanusi, 2010).

2.2 Directors’ Shareholding

This research framework is underpinned by agency theory consistent with that of de Villiers, Naiker, and van Staden, (2011), Hillman and Dalziel, (2003) which opined that boards have the functions of monitoring management’s activities. Agency theorist asserts that management initiates and implements business plans, strategies, and systems whereas directors monitor it (de Villiers *et al.*, 2011; Zahra & Pearce, 1989). Under this view, independent directors and directors who own shares will be more likely to monitor rigorously (Bhagat & Bolton, 2008; de Villiers *et al.*, 2011; Hillman & Dalziel, 2003).

Practically, the implementation of CBN code of corporate governance in Nigeria, posed some challenges, prominent among which were: ambiguities regarding the appointment of independent directors and the share ownership status of these independent directors (CBN, 2008). Thus, it has been an unresolved debate concerning the potential importance/ effect of board members’ equity ownership on both the board functional performance and firm performance. Albring *et al.* (2013), opined that in the USA, the Blue Ribbon Committee (1999), among others, suggests that director stock ownership should reduce agency problems and therefore the need for external monitoring. Thus, in an attempt to make a proper alignment of the interest of director and shareholders, many boards have implemented stock ownership guidelines and holding requirements for directors, leading to a substantial rise in the ownership of managers and directors but in Nigeria, there exist ambiguities and challenges regarding the directors share ownership status (CBN, 2008).

There exist conflicting researchers views regarding this which upto now, no clear position is given by the CBN. This show the real extent of the misconception on whether or not equity ownership by the board of Directors would influence their mandated functions. Also, the percentage of the shareholding is still not clearly determined. However, Bhagat & Bolton, (2008); de Villiers *et al.*, (2011); Hillman & Dalziel, (2003) opined that Stock ownership aligns the interests of the directors with those of shareholders. Bhagat & Bolton, (2008)’s study further revealed that particularly in poor firm performance, the likelihood of disciplinary

management turnover (replacement) is positively correlated with stock ownership of board members. As such, directors with more equity ownership are likely to objectively evaluate firm performance and control firm choices. Similarly, Weisbach (1988) also reported that CEO replacement in poorly performing firms was greater as the representation of independent outside directors increases. Board members (both executive and non-executive) share ownership reduces manager/shareholder conflicts. To the extent that executive board members own part of the firm, they develop shareholder-like interests and are less likely to engage in behaviour that is detrimental to firms' / shareholders interest. In support, Kren and Kerr, (1997) shows that boards with significant holdings are more likely to link CEO pay to firm performance and replace CEOs of poorly performing firms (Bhagat & Black, 2000).

By and large, board ownership, was viewed as an encouragement that will help board members supervise management in a more efficient way. Consistent with the positive view, (Chung & Pruitt, 1996; Jensen & Murphy, 1990; Mehran, 1995) supported that, board's ownership will improve firm's performance and are positively correlated. More related to this study, (Bhagat & Bolton, 2008; de Villiers *et al.*, 2011; Hillman & Dalziel, 2003; Westphal, 1999), show that director ownership influence or improves boards' monitoring of strategic decision making. (Hillman & Dalziel, 2003) argue that ownership incentives motivate directors to forgo short- term returns for long-term projects and strategies.

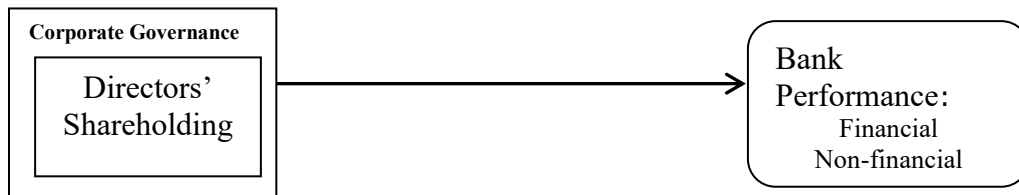
The study further argues consistent with many studies like Albring *et al.*, (2013), Bhagat and Bolton, (2008); de Villiers *et al.*, (2011); Guest, (2008) that, if these banks' board of directors were having a substantial equity ownership in the banks or compensated with equity as incentives for a targeted performance, they would definitely have monitored and counselled those sacked incompetent/fraudulent banks' managements. In the current aftermath of banking crisis, it is plausible that higher ownership could motivate directors to monitor and provide resources (advices, counsel connections etc.) to management which will in-turn lead to higher firm performance in the long run. Thus, we form the following proposition:

H.1 Shareholding of board of directors is positively related with the bail-out banks' performance.

2.3 Banks Performance

Organisational performance is an important concept that relates to the way and manner in which financial, material and human resources available to an organization are judiciously used to achieve the overall corporate objective of an organisation. Various measurement models were previously developed to take care of either managerial or organisational or both performance. However, among them all this study adopts the Balance scorecard (BSC) performance model which was developed

by Kaplan and Norton, Kaplan and Norton (1996). Balance scorecard model provides an excellent system for performance measurement in the commercial banking industry Bremser and Chung(2005). The BSC is the major element of a strategic management system that enables organizations to translate strategic goals into measures of performance. The measures consist both financial and non-financial measures which serves as indicators used in monitoring strategy implementation throughout the organization and whether strategic goals are being achieved or not (Bremser & Chung, 2005).The framework comprises of four (1 financial, and 3 non-financial aspects (customer perspective, internal process, learning & growth).



3.1 Methodology

This paper adopted a survey research method, and collected data by use of questionnaires which were administered to branch, middle & top managers of bailed-out banks. This paper had a population of 2,811 branches from the ten (10) bailed-out banks in Nigeria. The sample size is 338 determined through sample size formula/table of Dillman (2000) and Weaver (2006), Krejcie and Morgan (1970). Although a 50% was added to the sample size making it to be 507 in order to cater for low or non-response bias (Salkind, 1997). Using a stratified sampling technique, the number of branches for each bank was drawn proportionately to the total number of branches in their respective strata (banks). The collected data was screened at the preliminary stage and few missing data treated, outliers deleted and then normality and multicollinearity tests conducted revealing a good data that is normally distributed.

This paper adopts Partial Least Square (Smart-PLS) to run this multivariate test in order to analyse or test the hypothesized relationships in the study. PLS approach is commonly used in most recent researches due to its capability of analysing the relationship between the latent constructs and their measures, modelled in a reflective or formative ways as well as hybrid formative and reflective constructs (Hair *et al.*, 2014). Smart-PLS 2.0 (Ringle *et al.*, 2005) is used for assessing the path model and estimated the parameters based on path weighting scheme (Henseler, Ringle, & Sarstedt, 2012). In this paper, we firstly assessed the measurement model and then followed by the structural model from which our results are presented sequentially. In this study, the model is a reflective measurement model and therefore the quality criteria used comprises the composite reliability (CR) which examines the internal consistency, average variance extracted (AVE) which examines the convergence

validity and then Fornell-Larcker criterion, & Loadings-cross loadings which examines discriminant validity.

3.2 Measurement Model

The result of the measurement model basically interprets the goodness of the measures through the reliability and validity as shown in the subsequent tables. Apparently, there are three quality evaluation criteria namely; (1) the significance level of factor loadings of all items, then (2) the Composite Reliability (CR) of the items should be at least 0.7 and above, and (3) the Average Variance Extracted (AVE) should be at least 0.5 and above (Henseler *et al.*, 2012). The Goodness of measures are determined through the measurement model by revealing the relationships between the items that measures each construct and other constructs in the model. The Reliability test evaluates how consistently measuring instruments measures the what it is meant to measure, while validity tests evaluates how well an instrument measures an exact concept it is designed to measure (Hair *et al.*, 2014). In this study, the convergent validity, and reliability as well as the discriminant validity are presented and discussed accordingly.

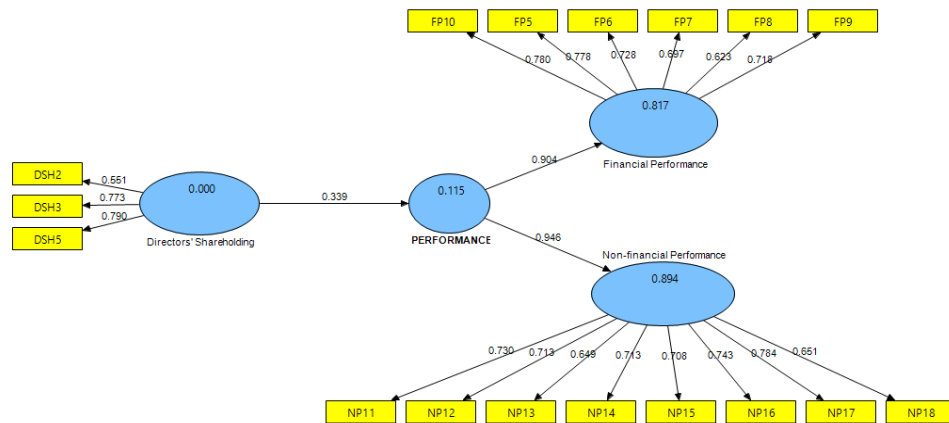


Figure 2:

Measurement Model

In this study, the measurement model was examined through the outer model by evaluating the relationship that exist between constructs and their indicators (Hair, Hult, Ringle, & Sarstedt, 2014). As displayed in Table 1 below, the convergent validity was achieved because the internal consistency reliability represented by composite reliability is actually within the range of .75 to .92 hence, exceeding the required minimum of .70. As for the average variance extracted (AVE), the minimum requirement of .50 is also exceeded for all the constructs in the model (Hair *et al.*, 2012). Performance was subjected to second order based on (FP and NP) and also have achieved all. The discriminant validity is assessed in two ways. Firstly, using Fornell and Larcker (1981) criterion in Table 2, the square roots of AVEs were

exhibited diagonally while the off the diagonal figures signifies the squared inter-construct correlations and it could be seen that all the AVEs exceeds the squared inter-construct correlations, signifying the achievement of the requirement for discriminant validity. Discriminant validity was further confirmed through ensuring that all indicators' loadings were actually more than their respective cross loadings in the model. After these were examined, we thus testifies that the reliability and validity of our constructs was satisfactorily achieved (Hair *et al.*, 2014).

Convergence Validity and Reliability Analysis (Item loadings, Average variance extracted and Internal consistencies)

Constructs	Items	Loadings	AVE	Composite Reliability
Directors' Ownership	DSH3	.551	.509	.752
	DSH4	.773		
	DSH5	.790		
Financial Performance	FP10	.780	.522	.867
	FP5	.778		
	FP6	.728		
	FP7	.697		
	FP8	.623		
Non-financial Performance	NP11	.730	.508	.892
	NP12	.713		
	NP13	.649		
	NP14	.713		
	NP15	.708		
	NP16	.743		
	NP17	.784		
	NP18	.651		
Second Order				
Construct	Item	Loadings	AVE	Composite Reliability
Performance	FP	.904	.855	.922
	NP	.946		

Table 2:

Discriminant Validity (Square root of AVE and Latent Variable Correlations)

Constructs	DSH	FP	NP
Directors' Shareholding (DSH)	.713		
Financial Performance (FP)	.291	.723	
Non-financial Performance (NP)	.331	.716	.713

Note: The bolded diagonal figures are the square root of the variance (AVE)

Constructs	DSH	FP	NP
DSH2	.551	.168	.149
DSH3	.773	.247	.248
DSH5	.790	.203	.291
FP10	.167	.780	.530
FP5	.149	.778	.499
FP6	.170	.728	.451
FP7	.236	.697	.580
FP8	.283	.623	.520
FP9	.259	.718	.516
NP11	.189	.440	.730
NP12	.329	.500	.713
NP13	.264	.436	.649
NP14	.243	.576	.713
NP15	.181	.525	.708
NP16	.274	.633	.743
NP17	.191	.456	.784
NP18	.218	.495	.651

shared between the constructs and their measures while the off-diagonal figures were the correlations among constructs

Table 3:
Loadings and Cross-loadings

Note: The **bold blocked** figures denote the discriminant loadings of each construct which is higher than its cross-loadings.

Basically before the structural model, multicollinearity was further assessed and as known, there is no need for that because only one variable is involved in the analysis hence, this confirms that no multicollinearity exists among constructs of this study. Normally the VIFs values should be less than the 5.00 threshold (Hair *et al.*, 2014).

After this, then the structural model is evaluated to test the significance of the paths and thus reveal the supportive or otherwise of the developed hypotheses. The next figure 3 is the structural model showing the t- value of the path.



Figure 3
Structural Model

In examining the structural model's relationships the path coefficients significance, and R² value were measured (Hair *et al.*, 2014). This paper used the

mart-PLS standard bootstrapping method with 5000 bootstrap samples to evaluate the significance of the path coefficients (Hair *et al.*, 2014; Hair, Sarstedt, Pieper, & Ringle, 2012; Henseler, Ringle, & Sinkovics, 2009). The results of the hypotheses testing, their coefficients, t values and the p values were all presented in Table 5. From the above figure 3, and table 4, it can be seen that all the hypothesized relationship were supported.

Table 4. Result of Hypotheses Test 1

Hypotheses	Relationship	Beta Value	Std. Error	T Value	P Value	Decision
H1	DSH -> PERFM	.339	.046	7.316	.000	Supported

4.1 Discussion and Conclusion

This study has tested the existing agency theory presumption in respect to the possible effect of board equity shareholding by taking managers' perception regarding its influence on performance. This study had magnificently conceptualised performance as a second order hierarchical construct, signifying that all two dimensions (financial and non-financial) expressively reflect performance. The theory's assumption is found to be supported by our result.

From the result in table 4 above, it is found that Shareholding of BODs (DSH) has a significant effect on banks performance revealing ($\beta=.339$, $t=7.316$) confirming a strong relationship exist between them. The strength of the path is so extremely good that the hypothesis is accepted at even 1% level of significance. Hence, this hypothesis is supported.

The implication of this is that equity shares ownership by board of directors of a bank definitely influences them to effectively monitors, advice, counsels, and guide their executive managements during strategic decision making. Our results is consistent with the previous studies like Albring *et al.*, (2013), Bhagat and Bolton (2008), Bhagat *et al.*, (1999) who contend that directors shareholding motivates directors to vigorously evaluates CEO/management's performance, firm performance, be involve in strategic decision making and also deliberate on issues before approving them. The rationale is that their share ownership aligns their interest with that of other shareholders, therefore, they will be effective at monitoring, and resource provision because they want to protect their investments (de Villiers *et al.*, 2011; Fama & Jensen, 1983; Hillman & Dalziel, 2003).

This study contributes immensely to the growing literature by confirming that DSH influences, motivates directors by improving their functional effectiveness in providing advisory, guidance, and other resources to the managements' overall strategic control system. Secondly, the findings of this research will provide

significant contribution to the managers and banks regulators like CBN, NDIC etc. This results thus, implies that with a substantial BEO, banks stand a chance of having a better performance after the bail-out reform.

Thirdly, shareholding of board of directors must be specifically regulated and enforced by CBN because the a CBN annual supervision report of 2008 stated that “there exist an ambiguity regarding equity ownership of directors” (CBN, 2008) and therefore, it is not surprising that lack of substantial equity ownership in their banks made the BODs refused to dismiss and replace the poor performing CEOs in their respective banks. However, the likelihood of replacing CEO/top management for disciplinary reasons when circumstances warrants is part of the monitoring process which is only motivated and ensured if the directors are having a substantial equity shares ownership in the company (Albring *et al.*, 2013; Bhagat & Bolton, 2008; Bhagat *et al.*, 1999; Zahra, 1996).

5.1 Limitations and Suggestion for future studies

Our study is limited to examining only the overall performance (comprising both financial and non-financial) as a single second-order reflective construct. Therefore, the result is only indicating the effect of DSH on overall performance without knowing the relative effect on each of the two dimensions. Also, our sample is restricted to only the bailed-out banks in Nigeria.

Future research should therefore examine the effect of DSH on both financial and non-financial performance together as two different endogenous variables so as to determine their response to DSH. In respect sample size, future studies should look into the whole banks in the industry.

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