

## **CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE OF QUOTED DEPOSIT MONEY BANKS IN NIGERIA**

<sup>1</sup>Sanyaolu, O. A.; <sup>2</sup>Adesanmi, A.D.; <sup>3</sup>Imeokparia, L.; <sup>4</sup>Sanyaolu, A. O.; and <sup>5</sup>Alimi, A.

<sup>1,2,3,4,5</sup>Department of Economics, Accounting and Finance, College of management sciences,  
Bells University of Technology, Ota, Ogun State, Nigeria

### **ABSTRACT**

This study examined the effect of corporate governance on the financial performance of listed deposit money banks in Nigeria from 2007-2016. The study used board size, audit committee, board independence, board gender diversity and Firm size as proxy for corporate governance while financial performance was proxy with return on asset (ROA). The study randomly examined eight (8) deposit money banks listed on the Nigerian stock exchange and obtained data from the annual reports of the banks from 2007-2016. The data extracted were analyzed using pooled least square method of regression. The study found a negative significant relationship between board size, Audit committee, Firm size and return on asset. However, the study found a positive and insignificant relationship between Board Independence and return on asset of the studied banks. The study therefore recommends that board size of companies in Nigeria should not be too many in order not to overwrite its benefits; this implies that the size of the board should be kept at a manageable size for effective and efficient running of the business, as larger board size may lead to ineffective decisions and thereby affect performance negatively. Also, companies should embrace and strengthen their audit committee to ensure efficient financial reporting.

**Keywords:** Board Gender Diversity, Board Size, Firm Size, Audit Committee, Performance

### **1.0 INTRODUCTION**

Over the years, the issue of corporate governance has facilitated various responses from different organizations and countries all over the world because of its paramount importance to the survival of most business organizations. Also the need for corporate governance has become more relevant in recent times. This is because the global financial crisis that lead to the collapse of prestigious companies such as Cadbury, Parmalat, Enron, World com, Xerox and other

prominent companies around the world, which have increased the need for good corporate governance practice that will limit the incidence of global financial crisis affecting various organizations all over the world (Wilson, 2006 & Emeni, 2014).

In order to improve the corporate governance practice of organizations around the world, coupled with the need to reduce corporate failures, abuse of corporate power and dubious accounting practices witnessed in various organizations all over the world, regulators and professional bodies in different countries proposed a system of codes of best governance practices. This is important considering the rate of global financial crisis that have occurred over the last few years. Thus, corporate governance is committed to providing codes of best practices within the banking industry which are necessary in protecting the interest of shareholders as well as other stakeholders within the banking industries (Mohammed, 2014). The banking sector represents an important sector in the growth and development of every nation. It is however necessary for shareholders and other investors to retain confidence in the banking industry. Thus, due to the importance of the banking sector to the development of other sectors of the economy, there is an increased demand for high quality codes of conduct to regulate the activities of organizations such that the issue of good corporate governance practices cannot be overemphasized (Sanusi, 2013 & Odozi, 2007).

Over the last two decades, there have been concerns among shareholders, regulators and other stakeholders as to the quality of corporate governance mechanisms provided by banks and other financial institutions all over the globe. It is in this regards that stakeholder, investors, firms and other stakeholders have embraced the principle of good corporate governance mechanism. Furthermore, the concept of corporate governance has reduced the issues of bank failure, conflict of interest, concentration of power, separation of ownership from control and other corporate governance issues. It is however necessary to understand the impact of codes of corporate governance on the financial performance of listed banks in Nigeria. The main aim of investigating corporate governance practice in Nigeria is to take advantage of the code of best practice to assist organizations in reducing financial crisis in the banking sector and the world at large (Ahmed, 2006; Odozi, 2007 & Mohammed, 2014).

It is argued that the principle of good corporate governance practices will improve the way in which organizations are directed as well as improve the economy of nations adopting such practices. It is therefore necessary to investigate the potential impact of corporate governance on the financial performance of listed banks in Nigeria, as it is of importance to the shareholders, interest groups and other stakeholders connected with good corporate governance practices (Kajola, 2008). Furthermore, as a result of the global financial crisis affecting organization around the world, there have been effort by regulatory authorities and government to produce

codes of conduct that will improve organizational practices worldwide (Anya, 2003). Due to the numerous advantages associated with good corporate governance practices all over the world, most organizations in various countries have adopted the principle of best corporate governance practices. Also, good corporate governance practices has benefitted shareholders and other stakeholders in areas such as improved governance structure, improved performance and better accountability through check and balance system and other benefits (Heneetigala, 2011; Uwuigbe, 2011; Hassan and Ahmed, 2012 & Adekunle and Aghedo, 2014).

Although there have been numerous number of studies on corporate governance in many countries all over the world. Majority of these studies have been conducted in developed nations (Aggarwal, 2013; Coskun & Sayilir, 2012; Orazalin, Makarov and Ospanora, 2014; Marashdeh, 2014; Qasim, 2014 & Rahman, Ibrahim and Ahmed, 2015). However, only a few number of empirical studies on corporate governance and financial performance of firms have been conducted in developing nations (Uwuigbe 2011; Tornyeva and Wereko, 2012; Momoh and Ukpong, 2013; Adekunle and Aghedo, 2014 and Mohan and Marimuthu, 2015). Furthermore, the extent of literature review indicate that none of the study has investigated the effect of corporate governance in Nigeria using current data and other combinations of corporate governance mechanisms used in this study. This constitute an important gap in literature taking into account the different between developed and developing nations (Ojeka and Mukoro, 2011; Uwuigbe, 2011 & Iyoha and Fagboyede, 2011).

Also, despite the general idea that good corporate governance improves organizational performance some studies such as (Agarrwal, 2013; Adekunle and Aghedo, 2014; Wu, Lin, Lin and Lai, 2014; Hamed and Hamdan, 2015 & Amba, 2015) have found a positive relationship between corporate government and firm performance while others such as (Coleman, 2007; Uwuigbe, 2011; Hassan and Ahmed 2012; Mohammed, 2012 & Marashdeh, 2014) have found a negative relationships between corporate governance and firm performance. The mixed results found in these studies have made the subject matter of corporate governance and firm performance inconclusive, especially in relation to emerging nations, were such studies are limited or Non- Existence.

Hence, the aim of the study is to examine the impact of the Corporate Governance and Financial Performance of Listed Deposit Money Banks in Nigeria. The remaining part of this study is structured as follows: Section 2, provides existing literature review on Corporate Governance and Financial Performance, and also the theoretical framework that underpin the study. The section 3, dealt with the hypothesis formulation, model specification and data collection method. The section 4, outlined the findings of the study, while the Section 5, focused on the conclusions and recommendations of the study.

### **Hypothesis Testing**

H0: Corporate Governance has no significant effect on the Financial Performance of Listed Deposit Money Banks in Nigeria.

H1: Corporate Governance has a significant effect on the Financial Performance of Listed Deposit Money Banks in Nigeria.

## **2.0 LITERATURE REVIEW AND THEORETICAL FRAMEWORK**

This section discusses Corporate Governance and Financial Performance of Listed Deposit Money Banks in Nigeria. It also presents the theoretical as well as the empirical framework for the study.

### **Concept of Corporate Governance**

The concept of corporate governance refers to a system of rules, practices, and processes by which a company is directed and controlled. Corporate governance refers to a system of creating an appropriate balance between the interest of a company's management, shareholders, customers, suppliers, the government and other stakeholders. According to the Central Bank of Nigeria (CBN), corporate governance refers to the processes by which activities of an institution are directed and managed. Mayer, (1999) explained that corporate governance is the sum of the processes, information and structures used in directing and overseeing the management of an organization.

### **Corporate Governance Variables**

The study covers some key corporate governance variables which include, audit committee, board independence, firm size, board gender diversity and board size.

### **Board Independence and Financial Performance**

Boards comprising a reasonable proportion of internal and external directors are more likely to be independent of management decisions, unlike a board dominated by internal directors only, and therefore are more likely to protect the interests of other stakeholders. The importance of external directors has been recognized even at the policy levels, with codes of corporate governance giving a special attention to the need to have a reasonable proportion of external director on the board of listed firms. Empirical evidence suggest that properly constituted boards with the right mix of non-executive directors tend to contribute more to performance than boards with a predominance of internal directors only (Rahman, Ibrahim and Ahmad, 2015; Wu, Lin,

Lin and Lai, 2014 & VO and Nguyen, 2014). A closely related issue is the participation of non-executive directors on the main committees of the board. John and Senbet (1998) argued in favor of a committee structure that gives the non-executive directors a key role especially in the audit, remuneration and appointment committees. This recommendation appears to suit the policy makers. In Nigeria, recent code of corporate governance practice provides that the non-executive directors should be in the majority, and that a non-executive director should chair the remuneration committee, the membership of which should comprise wholly or mainly of external directors. Hayes et al. (2004) found no relationship between a fraction of external directors serving on a committee and the performance of the firm, while this is in contrast with the finding of VO and Nguyen, (2014) which are in support of a greater participation of external directors on the major committees of the board.

### **Board Gender Diversity and Financial Performance**

Board gender diversity is the presence of female directors in corporate boards of directors. The participation of women in the labor market has grown since 1980 although this has not been matched with the improvement in quality of employment (Ilo, 2007). In many European countries the participation of women in the labor market is lower as compared to men (Curdova, 2005). This is a common phenomenon in majority of countries including Spain (Campbell & Mínguez-Vera, 2008). The effect of gender diversity on firm performance is inconclusive given the findings of various studies that have been undertaken worldwide. Although the effect is not clear, many theories have been put forward explaining why gender diversity may have effect on firms' value. Robinson and Dechant (1997) argue that firms that are diverse in the board rooms tend to outperform those that are less diverse. They argued that diversity promotes better understanding of the marketplace by matching the diversity of directors to that of customers and employees hence increasing market penetrability. It is also argued that gender diversity leads to creativity and innovation as these features are not randomly distributed in the population. Erhardt et al. (2003) established that a board that is diverse in terms of gender is likely to have positive impact on its performance and that a company that has got women and minority groups as part of its directors tend to have positive impact on performance while Kochan et al. (2003) found no relationship between gender diversity and firm performance.

### **Board Size and Financial Performance**

Board size refers to the total number of directors sitting on the board of a particular organization, which should be in line with the code of corporate governance. This study examines the extent to which financial performance are affected by the size of the board. Ajola, Amuda and Arulogun, (2012) studied the effect of corporate governance on the performance of the Nigerian banking

sector, using the Pearson correlation and regression to analyze the relationship between corporate governance variables and banks' performance. The study found that a negative but significant relationship exists between board size and the financial performance of the selected banks covering a period of five years (2006-2010). However, Asuagwa, (2013) using liner regression analysis, found that a smaller board size positively and significantly improve performance while Anderson, Mansi and Reed (2004) argued that larger board size are better than smaller board size in that larger board size have the ability to push the managers to track lower cost of debt because creditors believe that such firms are more effective monitors of accounting process. This position is in line with the findings of Adeusi, Akeke, Aribaba and Adebisi, (2013) who examined the effect of board size on the performance of ten selected banks for a period of six years (2005-2010) using econometric model of linear regression, the study further found that an increased board size increases the performance of banks.

### **Firm Size and Financial Performance**

Firm size refers to the size of an organization in relation to its assets. The size of a firm plays an important role in determining the kind of relationship that exists within and outside the firms' operating environment. Babalola, (2013) explained that the larger a firm is, the greater the influence it has on its stakeholders. Also, the growing influences of conglomerates and multinational corporations in today's global economy (and in local economies where they operate) are indicative of what role size plays within the corporate environment.

Some authors have argued that larger firms have some advantages such as a greater possibility of taking advantage of scale of economies which can enable more efficient production, a greater bargaining power over both suppliers and distributors or clients, exploiting experience curve effects and setting prices above the competitive level (Fiegenbaum & Karnani, 1991). It is also argued that larger firms are more stable, matured and can generate greater sales because of the greater production capacity that will enhance capacity cost savings with the economies of scale. On the contrary, some authors claims that size may have no or negative impacts on profitability, especially if growth in size causes diseconomies of scale (Goddard et al., 2005).

### **Audit Committee Size and Financial Performance**

Audit committee size refers to the total number of members in the audit committee. It is expected that the higher the number audit committee set by the code of corporate governance, the better the firm's performance. Shareholders' interests are protected through the activities of the audit committee members because management may not always act in the interest of shareholders. Studies in favour of larger audit committee posit that when more people are involved in checking the activities of managers, financial crisis are minimized and performances are better enhanced.

A number of studies have found a positive relationship between audit committee size and firms' performance (Kyereboah, 2007 & Blao, Wallace and Peter, 2003). However, other researchers such as (Kajola, 2008 & Hardwick, Adams and Zou, 2003) have reported that there is no relationship between audit committee size and firms' performance.

### **Measurement of Performance**

Return on assets: Return on asset represents how profitable a business is in relation to its total asset to generate earnings. It is displayed as a percentage and calculated by dividing a company's annual earnings by its total assets. This study made use of ROA as proxy to measure performance. Mousavi et al. (2010) studied the effect of some of the regulatory mechanisms of corporate governance such as ownership concentration on the rate of return on assets, return on equity and the ratio of market value to book value. The results showed that there is a significant relationship between the concentration of ownership and return on assets. But there is no relationship between concentration of ownership and return on equity and the ratio of market value to book values.

### **Theoretical Framework**

A number of researchers have identify various theories such as the Agency theory, Stewardship theory, Stakeholders theory and the Market theory as the prominent theories in the determination of corporate governance and financial performance of firms (Joel and Dondjio, 2012, Ahmad, Tariq, Hamad and Samad, 2014; Mohan and Marimuthu, 2015; Asuagwu, 2013, Amba, 2015 & Abdulazeez et.al, 2016). However the agency theory is adopted for the purpose of this study.

### **Agency Theory**

The agency theory identifies shareholders as the principals and managers as their agent. Adekunle et al (2013) explained that as employees and directors of a company tend to maximize their monetary compensation, job stability and other self-interests which may not be in the interest of shareholders. This theory therefore underlines the basis for which corporate governance codes were established. Sanda et al, (2005) suggest that the presence of information asymmetry can make agent to pursue interest that may be detrimental to the interest of the principal. On this premise, the study adopts the agency theory as the theoretical basis for explaining the relationship that exists between the various interest groups while assessing the effect of corporate governance and performance of firms.

Agency theory is used to understand the relationship between agents and principals. The agent represents the principal in a particular business transaction and is expected to represent the best

interests of the principal without regard for self-interest. The different interest of principals and agents may become a source of conflict, as some agents may not perfectly act in the principal's best interest. The resulting miscommunication and disagreement may result in various problems within the companies. Incompatible desires may drive a wedge between the stakeholder and cause inefficiencies and financial losses which lead to a principal-agent problem. The principal-agent problem occurs when the interests of a principal and agent are in conflict. Companies should seek to minimize these situations through solid corporate policy. Where such conflicts exist, incentives may be used to redirect the behavior of the agent to realign with the principal's interest. Corporate governance therefore refers to a system of creating an appropriate balance between the interest of a company's management, shareholders, customers, suppliers, the government and other stakeholders.

### **Empirical Review on Corporate Governance and Financial Performance**

Ahmad, Tariq, Hamad and Samad (2014) studied the link between corporate governance and firm's financial performance with the use of descriptive statistics. The correlation and regression analyses method were used to establish the link between the variables. The study found that board size and board composition have positive impact on financial performance. The study recommended that with effective board size and board composition, the firms are able to improve their performances.

Ahmed and Hamdan, (2015) explored the impact of corporate governance characteristics on firm performance in Bahrain stock exchange. The study made use of descriptive statistics such as regression and correlation analyses. The study found a positive effect of corporate governance mechanisms on performance for the entire firms in Bahrain stock exchange. The study recommended that further research be undertaken from different aspects.

Wu, Lin, Lin and Lai (2014) examined the impact of the corporate governance mechanism on firm performance. The study used correlation analysis and descriptive statistic to analyze the effect of corporate governance on firm performance. The study found that firm performance has a positive and significant relationship to Board independence and insider ownership. The study recommended that the larger gap between the voting rights and cash flow rights, the more incentives controlling shareholders could have; thus they may embezzle firm asset, causing damage to small shareholders' interest and deteriorating firm performance.

Otieno, Mugo, Njeje and Kimathi (2015) investigated the effect of corporate governance on the financial performance of savings and credit cooperatives. The study used the Spearman's rank correlation analyses. The study used descriptive statistics such as percentages, frequency distributions, graphs and pie charts. The study found a significant relationship between corporate



governance and financial performance of savings and credit cooperatives. The study recommended that studies on corporate governance be carried out in other areas such as microfinance institutions, commercial banks and the financial sector as a whole.

Amba, (2015) evaluated the impact of corporate governance variables on firms' financial performance. Multiple regression analysis was employed to test the relationship between firm's financial performance measured by Return on Assets and corporate governance variables. The study found that corporate governance variables do influence firms' performance. CEO duality, proportion of non-executive directors and leverage has negative influence and board member as chair of audit committee, proportion of institutional ownership has positive influence on firms' financial performance. The study recommended the need for controlling concentrated ownership in the equity ownership of the firm.

VO and Nguyen (2014) studied the relationship between corporate governance and firm performance listed companies in Vietnam. The study made use of the Feasible Generalized Least Squares (FGLS) method on the dataset of 177 listed companies in Vietnam for a period of 5 years, from 2008 to 2012. The study found that duality role of the CEO is positively correlated with firm performance. The study also found that there is a structural change in relation between managerial ownership and firm performance while board independence has negative impacts on firm performance. However, the study failed to provide empirical evidence supporting the statistically significant relationship between board size and firm performance. The study recommended that solutions for listed companies should enhance firm performance through improved corporate governance practice.

Haider, Khan and Iqbal (2015) explored the relationship between corporate governance practices and firm financial performance in Islamic banking sector. The study used the Pearson correlation coefficient and regression analysis. The study found a positive relationship between corporate governance and financial performance of Islamic banking sectors. The study recommended that banks must pursue best corporate governance practices in achieving higher performance.

Mohan and Marimuthu (2015) investigated the relationship between financial performance of firms and corporate governance of 30 Indian companies, listed on the BSE. The study made used correlation, regression and Mean values. The study found that the two Corporate Governance variables of Board Ownership and CEO Duality had a significant impact on ROA. The study recommended that companies should assign the posts of Chairman and Managing Director to two different persons and have maximum promoters in their board to enhance their financial performance.

**3.0 METHODOLOGY**

The study used the survey research design while the cross sectional research technique was adopted for the purpose of the study. The choice of the cross sectional research technique is premise on the fact that the data used in this study was gotten at a specific point in time and the objective is to examine the effect of Corporate Governance on the Financial Performance of Listed Deposit Money Banks in Nigeria.

The population of the study consist of the 21 deposit money banks in Nigeria, out of which 15 deposit money banks are quoted on the Nigerian stock exchange. However, 8 out of the 15 banks quoted on the Nigeria Stock Exchange formed the sample size of the study as a result of data availability as at the time the study was conducted. In analyzing the relationship between corporate governance and financial performance of listed deposit money banks in Nigeria, the panel data regression analysis was used for the purpose of the study.

Hence, the corporate governance variables include; board size, board gender diversity, board independence, firm size and audit committee while return on asset (ROA) was used to measure the financial performance of the listed deposit money banks. The data used for this study were obtained from the secondary source derived from the annual reports of the sampled banks listed on the Nigerian stock exchange (NSE) for a period of ten (10) years from 2007-2016. In order to achieve the objective of the study, the mathematical equation has been developed to investigate the effect of Corporate Governance on the Financial Performance of Listed Deposit Money Banks in Nigeria.

**Model specification**

The following model was used to examine the relationship between the corporate governance variables on the financial performance of the firm;

PERF= ROA..... (1)

PERF= (BSIZE, ACOM, BIND, FSIZE, BGD).....(2)

ROA=  $\beta_0 + \beta_1 BSIZE_{it} + \beta_2 ACOM_{it} + \beta_3 BIND_{it} + \beta_4 FSIZE_{it} + \beta_5 BGD_{it} + \mu_{it}$ ..... (3)

Where:

PERF= Performance

BSIZE= Board Size

ACOM= Audit Committee

BGD= Board Gender Diversity

FSIZE= Firm Size

BIND= Board Independence.

$\mu$ = Stochastic error term/ random error term.

$i$ = Cross section dimension and ranges from 1 to  $n$  number of period.

$t$ = Time series dimension and ranges from 1 to  $t$  number of banks.

$\beta_1, \beta_2, \beta_3, \beta_4$  and  $\beta_5$  are the parameters to be estimated.

$\beta_0$ = Intercept.

### **A priori expectation**

All explanatory variables are expected to have a positive impact on corporate governance. This can further be written as follows:  $\beta_1, \beta_2, \beta_3, \beta_4, \beta_5 > 0$ .

### **Measurement of variables**

#### **Dependent variable: Performance**

Performance is measured using return on asset (ROA).

**Return on assets (ROA):** It is the measured by dividing profit after tax by total assets i.e.

$$\frac{\text{Profit after tax}}{\text{Total asset}}$$

**Independent variables:** The corporate governance variables include:

**Board size:** It is measured by the number of directors on the board. It is calculated by counting the number of directors on the board for each bank.

**Audit Committee:** Audit committee size refers to the total number of members in the audit committee of each bank.

**Board Independence:** It is measured as the percentage of independent outside directors to the total number of directors on the board.

**Firm Size:** It is measured as natural logarithm of total assets.

**Board Gender Diversity:** It is measured as the percentage of female directors to the total number of directors on the board.

#### 4. RESULT

##### Panel Regression Analysis Result

Dependent Variable: ROA				
Method: Panel EGLS (Cross-section weights)				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
BS	-0.001580	0.000855	-1.848837	0.0589
AC	-0.033586	0.021772	-1.542670	0.0276
FS	-0.020100	0.003524	-5.703504	0.0000
BIND	0.024689	0.019903	1.240442	0.2191
BGD	0.126551	0.027096	4.670433	0.0000
C	0.760085	0.143648	5.291296	0.0000

  

Effects Specification				
Cross-section fixed (dummy variables)				
Weighted Statistics				
R-squared	0.574265			
Adj R-squared	0.508014			
F-statistic	7.531234	Durbin-Watson stat	2.080477	
Prob(F-stat)	0.000000			

**Source: Authors computation 2017**

##### Hypothesis Re-statement

*H1: Corporate governance has a significant effect on the financial performance of listed deposit money banks in Nigeria.*

The result in the table above shows the estimation of the effect of corporate governance on the

financial performance (Return on Assets) of the sampled banks. The data for the 8 listed banks were estimated over 10 year period using panel ordinary least square method of regression. The result shows that the probability of f-statistic is 0.000000 which indicate that the totality of the model is significant and the model has high goodness fit. The result shows that the R2 is 0.57 (57%) and adjusted R2 is 0.50 (50%) this shows that 57% of the total variation in the dependent variable (ROA) is explained by the independent variables (Board Size, Board Independence, Audit committee, Firm size and Board gender diversity). The probability F statistics is 0.00000 while the Durbin-Watson of 2.080477 indicates that the result is free from serial auto correlation problem.

The result further shows that there is a negative and significant relationship between board size, audit committee, firm size and return on asset, which implies that a unit increase in board size, audit committee and firm size will lead to a decrease in the return on asset of the sampled banks. The result also shows that there is a positive and insignificant relationship between board independence and return on asset of the sampled firms. This indicates that a unit increase in board independence will lead to an insignificant difference in the financial performance of the sampled firms. Also, Board gender diversity has a significant and positive relationship on the financial performance of the sampled banks. This indicates that a unit increase in Board gender diversity will lead to an increase in the return on asset of the sampled firms

## **5. CONCLUSIONS AND RECOMMENDATIONS**

### **Conclusion**

The importance of corporate governance cannot be over-emphasized because it constitutes the climate for internal activities of the firm. Therefore, the study concludes that corporate governance variable such as board size, firm size and audit committee negatively affect the financial performance of the firms while board independence positively and insignificantly affect the financial performance of the sampled banks. The board of directors is responsible for ensuring compliance with the code of corporate governance. In practice, there is a difference between the management and the board, as generally the chairman and the chief executive officer is not the same person. Furthermore, stakeholders have no clear duties since rules and regulations are determined by specific standards related to functions that the board should fulfill.

### **Recommendations**

Based on the findings and conclusions of the study, the following recommendations are therefore put forward;

- 1) The number of board of directors should not be too many in order not to override its benefits; this implies that the size of the board should be kept in a manageable size for effective and efficient running of the business, as larger size may lead to ineffective decisions and thereby affect performance negatively.
- 2) The bank should also devise its own programs to expose board and top management requisite skill and technical know-how based on the dynamism of financial market.
- 3) Banks should setup more committees that will improve or facilitate good corporate governance in order to checkmate corruptions in the banking sector in Nigeria. Also, banks should embrace and strengthen the audit committee to ensure efficient financial reporting.

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