Globalizing the Board and Financial Performance : Evidence from Nigerian Banks

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Abstract

The board of directors is crucial and very important in a business control structure. The value of boards in decision making and increasing the wealth of shareholders depends on how well directors perform their functions. However, the role of foreign independent directors (FIDs) in a firm can never be over emphasized. It is expected that they can improve the advisory role of boards because of direct information about international markets. This study, therefore, investigated if there is a significant difference between the performance of firms with and those without FIDs. The paper observed that a non- significant relationship existed between the tested parameters. This non-substantial difference is likely to be due to the fact that international directors have a tendency to adjust to the socio-organizational values of the location in which they function from. The study, therefore, recommends that FIDs should be encouraged because of their different backgrounds. This will enable them to add to the firm's values and various skills which some domestic board members do not possess. In order to encourage both minority and majority foreign investors, foreign board members should be allowed on boards for assurance that the corporation is being managed by professionals in their best interests.

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Lately, business components, personnel and top management are diverse in terms of gender, age and ethnicity composition. These are part of other diversities relating to experience and skills, acquired tenure, educational background and socio-economic situations (Jackson & Alvarez, 1992). Board mix has enticed the interest of researchers (Johnson, Daily, & Ellstrand, 1996 ; Uwuigbe, 2013) from many disciplines. The board of directors is crucial and very important in the corporate governance structure of a firm and it has two significant functions. The first one is associated with hiring, firing, and compensating managers. These are the monitoring role on one hand and the other is to advisory role on key strategic decisions. The value of boards in the decision

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making and increasing shareholder's wealth depends on how effective these two functions are performed by the directors.

Therefore, directors serving on a boards are expected to play an important role in corporate governance through their advisory function and monitoring. Generally, researchers and policymakers see board mix as one of the most important pointers of board enhancement (Karpagam & Murugesan, 2014; Adams, Hermalin, & Weisbach, 2008; Uwuigbe, Uwuigbe & Daramola, 2014). The term "board mix" can have numerous meanings, related to differences in board composition in relation to ethnicity, educational background, age, gender and nationality. This study focuses on board diversity relating to the nationality of directors. We particularly analyzed whether the presence of foreign directors on boards makes them do better than firm without foreign directors.

The geographical location of foreign directors is a double-edged sword. This is because foreign directors can offer transnational proficiency and guidance to firms, particularly those with expansion plans in overseas countries. Additionally, foreign directors are assumed to be ineffective in supervising than Nigerian independent directors and consequently, they could make a board's monitoring and disciplining role weak. This is because substantial oversight cost is generated when a director's geographical location is far from corporate headquarters. Therefore, being present during board meetings at the headquarters becomes more challenging. This weakens the ability of the director and motivations to get information and monitor management closely. In line with the proposition of Lerner (1995), venture capitalists are always unwilling to sit on boards that are distant corporations. In the same vein, Knyazeva, Knyazeva and Masulis (2011) observed that difficulties created by distance are very serious for foreign independent directors, as the differences in time zone, time and energy expended on international travel, are likely to impose heavier burdens on foreign directors than on domestic directors. This in turn, erodes their ability and motivation to check motivation and ability.

Also, directors that are not domiciled in the locality of a company's head office are not attached to local networks that provide valuable and essential information (Coval & Moskowitz, 1999). All these arguments suggest that foreign independent directors can wane a board's monitoring efficiency, which in the long run brings about more agency challenges between managers and shareholders which later lead to poorer firm performance.

Regardless of the poor monitoring on the part of foreign independent directors, they can improve the advisory role of boards because, operating from overseas countries enables them to have direct knowledge of foreign markets and allows them to get foreign contacts. With the pace of globalization around the world, a lot of Nigerian firms are searching outside their national boundaries for prospects that will increase shareholder's value. For most of firms, the knowledge and expertise of foreign independent directors and their connections can be beneficial.

In light of arguments that Foreign Independent Directors (FIDs) bring both benefits and costs to Nigerian firms, we therefore carried out a comparative study between firms with FIDs and those without FIDs in relation to their operating performance.

Literature Review and Hypothesis Development

In the past decade, many authors have studied the relationship between board composition and firm performance (Rogers, 2005; Zahra & Pearce, 2007), but very few studies have focused on the role of foreign directors on boards.

Nevertheless, the few empirical proofs of the association between board diversity in relation to nationality mix and firm performance are still ambiguous. For instance, some researchers observed that the relationship between the proportion of foreign directors serving on a company's board and firm performance is not significant (Kilduff et al., 2000; Rose, 2007), while others observed that the existence of foreign directors is positively related to the performance of firms' (Oxelheim & Randøy, 2003; Ruigrok & Kaczmarek, 2008). Furthermore, in a related study, Sanda et al. (2008) observed that the relationship between the presence of foreign directors on the board and firms' financial performance was significant and positively related.

Other prior studies, however, confirmed that no empirical proof of such association exists. Representing performance measure with market share and net marketing contribution of the European companies, Kilduff et al. (2000) did not find a significant association between the performance variables and foreign directors. Also in another study, Rose (2007) opined that no significant relationship exited between the firms ratio of foreign nationals and the market performance using Tobin's *q*. This view was also supported by Schwizer et al.(2012) who observed a similar relationship between a firms' ratio of foreign nationals and the market performance. Based on the arguments above, we therefore formulate our hypotheses stated in its null form as follows:

Hypothesis 1

H_0: No significant difference exist in the financial performance of banks with foreign directors and banks without foreign directors in Nigeria.

Research Method

This research used secondary records (data) extracted from annual reports of the 15 randomly selected listed banks in Nigerian between 2009 and 2013. In examining the association that exists between foreign independent directors and banks' financial performance, this study made use of a simple regression analysis. However, in analyzing the differences in the performance of banks with international directors (foreign directors) and those without foreign directors, the study made use of the t- test. A code of 1 was assigned to banks with international directors and 0 to those without. Also, the performance measure used was the Return on Equity.

Model Specification

$$Tobin's\ Q_{1-t} = f(FID_t\ ,ROA_t)\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \quad (1)$$
$$Tobin's\ Q_{1-t} = \beta_o + \beta_1 PFID_t + \beta_2 ROA_t + \ + e_t \quad \ldots\ldots\ldots\ldots\ldots\ldots.. \quad (2)$$

Where, $\text{Tobin's Q} = \dfrac{\text{Market value of equity (MVE) + Book value of debt (BVD)}}{\text{Book Value of Assets (BVA)}}$

PFID = Proportion of foreign independent directors on the board,

TOA = total assets; fixed assets + current assets,

β = Coefficient of parameters,

e_t = Error term that captures other explanatory variables not explicitly included in the model stated above,

t = time coefficient.

Analysis and Results

From the Table 1 above, a weak positive correlation exists between Tobin's *q* and the independent variable. This implies that as the Tobin's q increases, the independent variable (PFID) and the control variable will also rise. The regression result shows that the proportion of Foreign Independent Directors and Total Asset are positively related to the dependent variable (tobin's *q*). However, the relationship is only significant with TOA. The R-Squared result signifies that the independent variables are able to account for only 8.76% .

From Table 3, banks with foreign independent directors have a mean of 0.04541 whereas those without overseas directors recorded a mean of 0.06155. Additionally, the variances of 0.0010 and 0.0025 were recorded

Table 1. Correlation Analysis

	Tobin's *q*	PFID	TOA
Tobin's *q*	1.0000		
PFID	0.0541	1.0000	
TOA	0.2003(*)	0.0750	1.0000

Table 2. Ordinary Least Square

Variables	Coefficients	*P* Values
PFID	0 .7027408	0.561
TOA	9.06E-08	0.082
Constant	0.285478	0.523
R-squared	0.0783	
Adjusted *r*-squared	0.0672	
F-statistic	6.59	
Prob (*F*-statistic)	0.00143	

Table 3. *t* - Test Result

	WITH FIDs	WITHOUT FID
Mean	0.045416232	0.061551083
Variance	0.00101748	0.002532089
Observations	6	9
Hypothesized Mean Difference	0	
Df	14	
t Stat	-0.292281459	
P(*T*<=*t*) one-tail	0.395703063	
t Critical one-tail	1.743063592	
P(*T*<=*t*) two-tail	0.763405127	
t Critical two-tail	2.100822036	

for banks with overseas directors and those without foreign directors respectively. At two- tailed, the *t*- calculated of -0.2922 is seen to be less than the *t*-tabulated of 2.1008. The result of the *t*- test shows that the calculated value of *t* (-0.2922) is not significant. The tabulated *t* value of 2.1008 is also depicted. Equally, the mean of banks with foreign directors is 0.0463 while for banks without foreign independent directors is 0.0516.

Since the tabulated value of *t* (2.1008) is more than the t-calculated of -0.2922, hence we accept the null hypothesis which implies that the profitability of the banks with international directors is not significantly different from the profitability of banks without foreign directors. The insignificant difference is likely to be based on the fact that foreign directors are likely to adjust to the corporate socio - organizational culture of the environment in which they operate. Another is that the real effects of board diversity are difficult to establish because so many other factors also influence company performance. This is in line with Fich (2005) however not in line with the propositions of Djankov and Hoekman (2000) that companies with foreign directors maintains higher than those without foreign directors.

Conclusion and Implications of the Study

This study concludes that having foreign independent director on the board of companies is not a pre-requisite to performance. It was further established that no significant relationship exists between the performance of firms with foreign directors and firms without foreign directors. As observed in this study, banks with foreign nationals have no influence on either the accounting or market performance. The result further implies that foreign directors appear to be less effective monitors of management for several reasons. These reasons include; non-attachment to local networks that provide valuable and essential information, substantial oversight costs that are associated with the long travel distances and they are likely to lack adequate knowledge and understanding of Nigerian accounting standards and regulations. The implication of this is that firms with excessive intervention by foreign ownership in management via foreign outside directors are likely to mitigate firm performance.

Recommendations

The study therefore recommends that although the presence of Foreign Independent Directors (FIDs) does not increase the performance of banks in Nigeria significantly, however, FIDs should be encouraged because of their different backgrounds. This will enable them to add values and different expertise that domestic board members do not have. In other to encourage both minority and majority foreign investors, foreign board members should be allowed on board for assurance that the firm is managed professionally in their best interests.

Limitations of the Study and Scope for Further Studies

This study is limited to the effects of foreign directors on financial performance of banks in Nigeria. The observations were limited to 15 listed banks in Nigeria and also Tobin's *q* was used as a measure of performance. However further studies can look at other performance measures and also increase the number of observations. A comparative study can also be made between financial and non-financial sectors in Nigeria.

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