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DIRECTORS HETEROGENEITY AND FINANCIAL PERFORMANCE OF LISTED DEPOSIT MONEY BANKS IN NIGERIA

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Abstract

The study investigated directors' heterogeneity and its impact on banks financial performance over a period of seven years (2008-2014). Secondary data were collected from the annual financial statements of banks and were analyzed with the ordinary least square regression technique. The result showed that board nationals have a negative significance on return on equity, board gender composition have a positive significance on return on equity, board ethnicity have a positive impact on return on equity, and board size have no significance on return on equity while bank size have negative significant impact on return on equity. The study concluded that directors' heterogeneity has significant impact on banks performance.

KEYWORDS: Heterogeneity, Financial Performance, Deposit Money Banks, Nigeria

1. Introduction

Diversity in the top management composition ranging from gender, cognitive backgrounds, behaviours, orientations, beliefs and multi-ethnic groups have become very important components in understanding characteristics of the board of directors. Gender diversity has received attention from different researchers, practitioners and government agencies all over the world. Thus, relating the characteristics of the board of directors to a firm's performance is important (Marimuthu & Kolandaisamy, 2009). Diversity in characteristics tends to increase board independence by allowing members to voice their opinions more freely; diverse groups are less likely to succumb to management pressures. The benefits of board heterogeneity can be seen from different viewpoints such as diverse talents, different backgrounds, experiences and skills brought to the boardroom which strengthens the managerial advisory role. In addition, it potentially brings diversity of human capital, cognitive behaviour and increases mutual monitoring amongst board members. This could result in fewer directors free-riding, thereby improving managerial monitoring in the board room (Anderson, Reeb, Upadhyay and Zhao, 2009; Kong-Hee & Abdul, 2013).

Heterogeneity of directors allows the board to overcome difficult, complex and ambiguous situations as directors possess different expertise, skills, education, cognitive ability, and attitude to risk. Directors of firms from various ethnic, racial, gender, and diverse age groups have caused positive changes in the value of most firms (Wahid, 2010; Golden & Zajac, 2001). Michel and Hambrick (1992) noted that heterogeneity is positively linked to better problem solving and offers creative solutions. The question of how board heterogeneity will influence directors' choices and performance is very important. This is due to the fact that managements' choices are believed not to

be completely rational but rather influenced by the psychological make-up and background characteristics of managers (Hambrick & Mason, 1984).

On the other hand, arguments against heterogeneity of director are also many in the literature. For instance, diversity may be disadvantageous to organizational performance in the sense that homogeneous top management may produce better results and higher performance when compared with heterogeneous top management (Hambrick, Cho and Chen, 1996). Similarly, Knight, Pearce, Smith, Olian, Sims, Smith and Flood (1999) also argued that team performance tends to deteriorate as diversity level increases.

Recently, special focus is being placed on boards' top executives as regards to their gender. The proportion of women in top management level is still very low in most countries, especially in developing countries. According to Smith, Smith and Verner (2005), the proportion of women in the top management level is increasing in the United States of America and in some European countries. Meanwhile the Swedish and Norwegian governments introduced regulations on gender composition of the boards of directors of private firms in order to improve equal opportunities. In 2005, Norway government decided that for large Norwegian firms; at least 40% of the members of the boards of directors must be women. Board nationality is another form of heterogeneity. The potential merits of foreign board membership have received serious attention in corporate governance studies globally (Marimuthu & Kolandaisamy, 2009).

Nigeria is made of about 250 ethnic groups and 500 languages (travel.nationalgeographic.com). These ethnic groups are broadly classified into major and minor tribes. The major tribes are Igbo, Hausa and Yoruba. In the past, prominent political positions revolved around the three major tribes.

Ujunwa, Okoyeuzu and Nwakoby (2012) argued that a board that is ethnically diffused may have a strong board capital. Several studies on gender and racial diversity gave conflicting results.

Moreover, researches on Nigerian firms rarely examined the ethnic diversity of board members. The main objective of this study is to determine the impact of board's heterogeneity on Nigeria's deposit money banks financial performance. The specific objectives are to determine the impact of board's nationality; gender; and ethnicity; on the banks financial performance.

The rest of the paper is set out as follows: section 2, contains a brief review of literature; section 3 describes the methodology adopted; section 4 presents the empirical results; while the final section contains the conclusions and policy implications.

2. Literature Review

This section examines the conceptual, theoretical and empirical evidence on the research undertaken on directors' heterogeneity and financial performance of listed deposit money banks in Nigeria. Emphasis is placed on board nationality, board gender and board ethnicity as they relate to financial performance of listed deposit money banks in Nigeria. Resource dependent theory (RDT) is the study of how organisational's external resources such as raw materials affect the organization's behaviour. It explains behaviour, structure, stability and changes in organizations.

The theory was propounded by Jeffrey Pfeffer and Gerald R. Salancik in the 1970s (https//www.hrzone.com). According to Hillman, Withers and Collins (2009), RDT sees external

factors influence on the behaviour of organizations, even though constrained by their context, managers try to reduce environmental uncertainty and dependence. An organization's board's ability to utilize internal and external resources is critical to greater success against the competitors.

Study conducted by Sveiby (2000) used the resource-dependence theory to point out that all facets of human resources needs to be fully utilized because diversity in human resources do enable firms to best increase their performance and wealth-creation potentials.

However, this study is based upon the Upper Echelon theory by Hambrick & Mason (1984). The theory states that the outcome of an organization, its strategic choices and performance level are not completely predicted by managerial background characteristic. This theory deals with diversity within top management and its impact on firm performance. In view of this, top management members could with greater demographic diversity influence decision making process in the top management and positively contribute to firm's performance. The theory states that in stable environment, team homogeneity will be positively associated with profitability and that in turbulent environment, especially discontinuous environment; team heterogeneity will be positively associated with profitability. Hambrick (2014) noted that the theory's central premise is top executives' views on opportunities, threats, alternatives, and possibilities of diverse outcomes through their own lenses emanating from personal experiences, personalities, views, values, among other human factors.

The demographic characteristics of top management team include age, functional background, education and tenure. Hambrick & Mason (1984) paved way to deal with diversity within top management and its impact on firm performance. They argued that top management's characteristics (e.g. demographic) influence the decisions that they make and therefore the actions adopted by the organizations that they lead. It occurs because demographic characteristics are associated with cognitive bases, values and perceptions which influence top management decision making ability (Marimuthu & Kolandaisamy, 2009).

Empirical Evidence

Heterogeneity signifies diversity. Marimuthu (2008) stated that demographic diversity contributes positively towards organizational performance as well as firms' financial performance. There are many studies carried out on demographic diversity (mainly on gender, age) and its implications on performance, but very few studies conducted with a special focus on ethnicity involving top management in general and boards of directors in particular. Winston (2001) using the contingency theory observed that the highly rated firms in terms of diversity are also rated highly in respect of other measures of organizational success. This implies that an organization with more diverse board of directors could be highly and better rated in terms of their organization performance.

Kochan, Bezrukova, Ely, Jackson, Joshi, Jehn, Leonard, Levine and Thomas (2003) based on their study concluded that scanty evidence abounds to support diversity as being inevitably good or bad for business and that at every point in time, organizations should pay attention to the conditions that can leverage benefits from diversity or barely reduce its negative effects. Ethnic heterogeneity or diversity refers to a mix of people with different backgrounds, culture or values. The term "board diversity" can have several meanings, linked to differences in board composition in terms of ethnicity, age, education, nationality and gender (Schwizer, Cucinelli and Soana, 2012).

Ethnic diversity of board members would benefit board performance due to a more diverse pool of skills and knowledge that leads to complementary and mutual learning which ultimately improves knowledge. Hoogendoorn & Van Praag (2010) discovered that business performance is lower for board of directors with lower and moderate ethnic diversity relative to those of high ethnic diversity. Alesina and La Ferrara (2003) explained that ethnicity brings diverse abilities, experiences, and cultures which may lead to creativity and innovation. They added that the racially mixed and troubled Los Angeles and New York City are constant producers of innovation in art and in business. Mitton (2002) carried out a cross firm analysis to determine impact of corporate governance on the East Asian financial crisis. He concluded that ethnic diversity could be used as an effective way to improve on corporate governance among the listed companies in the event of economic instability. Knyazeva, Knyazeva and Raheja (2009) concluded that after controlling for firm and industry characteristics, heterogeneity in directors have a significant effect on firm value and key firm decisions that cannot be explained by board composition, size, and expertise levels.

Some studies concluded that ethnic diversity has positive relationship with firm performance (Ujunwa *et al.,* 2012, Marimuthu 2008, Smith *et al.,* 1994). Some studies however found positive relationship between ethnic diversity and performance, while some others concluded that organizations with heterogeneous board often have conflicts that can cause harm to the firms' performance due to inability to reach conclusions on time and exhibition of lack of cohesiveness (Pelled, Kin and Eisenhardt, 1999; Simons & Peterson, 2000; Van den Steen, 2010).

Masulis, Wang and Xie (2010) after using board meeting attendance as a proxy to examine the possibility that the actions of foreign independent directors may influence other board members argued that poor board meeting attendance by foreign independent directors may have broader implications if their actions reduce the incentives of other board members to attend meetings and lessen the stigma on missing meetings. They added that firms with foreign independent directors are prone to paying their Chief Executive Officers excessively high compensations that can lead them to committing financial misreporting. They concluded that firms with foreign independent directors are associated with very poor performance.

Carter, Simkins and Simpson (2010) argued that the empirical relationship between the gender of corporate directors and financial performance has received much more attention in the literature than other aspects of the demographic diversity of corporate directors, possibly because of the availability of data. However, they believe that gender diversity and ethnic diversity are not the same phenomenon and will not affect the firm in identical ways.

The question now is whether or not gender diversity has any impact on board and firm performance as a whole. Credit Suisse Research Institute after examining 2,360 companies and over 14,000 data points in 2012 concluded that organizations that with a woman on the board performs better in terms of stock price than those with no women on their board. The Institute added further that even when markets are dropping, they have higher average ROEs, lower gearing ratios, lower volatility in earnings, and they perform better due to gender diversity.

Furthermore in 2014, the Institute discovered that a greater representation of women in management positions results in excess stock market returns and superior, higher corporate profitability. They added that appreciable female representation is still a mark of differentiation rather than the norm. Eklund, Palmberg and Wiberg (2008) noted that companies with large board size have high propensity to appoint female directors. They also added that incorporating both gender and age diversity in the same model can cause age to become negatively significant. Furthermore, the

presence of foreign directors is a sign of board heterogeneity and their presence is mostly as a result of foreign ownership as in the case of larger firms.

Adams and Ferreira (2009) discovered that gender diversity do have significant impact on board inputs in such areas as corporate governance, meetings attendance, monitoring related committees, among others. Ferreira (2010) highlighted some costs and benefits of diversity adding that the benefit of diversity fosters creativity and produces a wider range of perspectives for solutions to problems, access to resources and connections, career incentives through signaling and monitoring while he pinpoints that conflict, lack of cooperation and insufficient communication are potential costs of diversity.

From the foregoing, it is evident that there are mixed results over the impact of directors nationality, ethnicity, and gender on firms performance. It is also observed that there is paucity of literature on firms' performance as affected by some control variables (firm size and board size). Hence, this study contributes to the body of knowledge by examining the impact of directors' heterogeneity (controlling for firm size and board size) on listed banks performance in Nigeria.

3. Methodology

The data is based on a sample of four deposit money banks which constitutes the first generation banks in Nigeria. The banks were purposively selected as they have been relatively stable overtime in terms of change of name that might have resulted due to major acquisition or merger. Hence, the key variables needed may be readily ascertained. Data from 2008-2014 were obtained from Annual Reports and Statements of Accounts from the Nigerian Stock Exchange, Securities and Exchange Commission.

The study applied the ordinary least square (OLS) regression technique to test the hypotheses. Dependent variable was financial performance while independent variables were board nationality, board gender and board ethnicity. The control variables were board size and bank size. Therefore, in other to examine the relationship between directors' heterogeneity and bank performance, the model developed by Ujunwa *et al.*, (2012) was modified and adopted for this study. The multiple regressions are represented as:

$$Y_{it} = \alpha + \beta_1 X_{it} + \beta_2 X_{it} + \beta_3 X_{it} + \beta_4 X_{it} + \varepsilon_{it} \quad \ldots\ldots (1)$$

$$\textit{Firm Performance} = \alpha_0 + \beta_{1nationality} + \beta_{2gender} + \beta_{3ethnicity} + \sum\beta_{4control\ variables} \quad \ldots\ldots (2)$$

For the dependent variable firm performance; return on equity (natural log of profit after tax divided by total equity) was a measure of performance. The independent variable board nationality is measured as the percentage of foreign nationals on the board (total number of foreign board members divided by total board size). Board gender is measured as the percentage of female board members (total number of female board members divided by total board size).

Board ethnicity: since the three major tribes in Nigeria are the Hausa-Fulani, Igbo and Yoruba: other tribes for the purpose of this study have been grouped under these three major tribes. This makes the total number of groups to be 3, meaning each director can fall only in one group at a time. Therefore, for any group to be present on the board it assumes a weight of 1, which means,

where all three groups are present on the board, they assume a weight of three, giving each group a chance of equal measurement and fair representation. The control variables are bank size (natural log of total asset) and board size (the actual number of the board size).
Therefore, equation (2) is modified as follows;

$$ROE = \alpha_0 + \beta_1 BN_{it} + \beta_2 BG_{it} + \beta_3 BE_{it} + \beta_4 BS_{it} + \beta_5 nlogTA_{it} + \varepsilon_{it} \quad \ldots\ldots(3)$$

Where:
ROE = financial performance
BN = board nationality
BG = board gender
BE = board ethnicity
BS = board size
TA = total asset.
ε_{it} = composite error term

Some researchers have found that board size does not have any impact on performance and therefore excluded it from their model (Ujunwa *et al.*, 2012), stating that the impact is not immediate but lagged over a period while others such as Marimuthu (2008); Marimuthu & Kolandaisamy (2009) have incorporated board size into their models.

The following hypotheses were formulated in null (Ho) form:

Ho_1: Board nationality has no significant impact on Nigeria's deposit money banks financial performance
Ho_2: Board's gender composition has no significant impact on Nigeria's deposit money banks financial performance
Ho_3: Board ethnicity has no significant impact on Nigeria's deposit money banks financial performance

4. Results and Discussion

From table 1, the maximum board national is 31.58% and minimum is zero, while the mean is 4.5%, this means that majority of these banks either have very low number of foreign nationals and at a particular period becomes high but only on a short run. The board ethnicity has a kurtosis of less than 3, meaning that they are normally distributed and the mean score showed 2.50 out of maximum of 3 showing an ethnically diffused board, the remaining .50 of the boards are homogenous in terms of ethnic diversity. The average number of women on board is 9.7% scaled by average board size, while the skewness in above 0 and kurtosis is less than 3, signifying that the variable is normally distributed.

Table 1: Descriptive Statistics

Variables	Min Stat	Max Stat	Mean	Std Dev	Skewness	Kurtosis
ROE	-4.24	4.52	1.7054	2.2756	-1.416	1.205
BN	0.00	31.58	4.4696	8.0222	1.884	3.521
BG	0.00	25.00	9.7036	8.4058	0.311	-1.297
BE	1.00	3.00	2.5000	0.8819	-1.221	-.554
BS	7.00	22.00	14.8571	4.5192	-0.530	-.877
TA	4.99	6.45	5.8464	0.4090	-0.572	-.748

Source: Authors' computation, 2014

The estimated relationship of the model is:

$$ROE = -0.420BN_{it} + 0.598BG_{it} + 1.340BE_{it} - 0.598BS_{it} - 1.159TS_{it}$$

Table 2 shows the regression result of the model. The result shows that all the explanatory variables jointly correlated with the dependent variable by 72%, which indicates that a strong relationship exist between ROE and board nationality, board gender, board ethnicity, board size and firm size. The adjusted R^2 of the model is 0.41, which indicates that 41% of the variation in ROE is explained by the independent variables. The F-value is 4.68 and it is statistically significant at 1% level. Hence the model is of good fit. Furthermore, the Durbin-Watson shows a value of 2.164 indicating the absence of serial auto correlation amongst the residuals. VIF shows the absence of multicolinearity among the explanatory variables because the value corresponding to each variable is less than 10.

The co-efficient for board nationality gives a value of -0.420 with a probability value of 0.094. This signifies that the board nationality is negatively but strongly correlated with ROE. This could be as a result of the fact that foreign directors are more likely to be absent from board meetings yet could still contribute positively in terms of skills and expertise. Another reason may be that foreign nationals could lack the requisite experience in local business transactions but might be vast in international transactions. This result is in line with the study carried out by Masulis *et al.*, (2010) which is contrary to the work of Ujunwa *et al.*, (2012). Based on this result, we do not accept the first hypothesis which states that board nationality has no significant impact on ROE.

The co-efficient for board gender is 0.598 with a probability value of 0.083. This implies that the board gender variable is significant at 10% and board gender composition is positively and strongly correlated with ROE of the firms. This result implies that for every percentage increase in women representation on the board directors, ROE is expected to increase by 0.60 percent. This could be explained in line with the fact that women often serve as role models and cultural change agents that help empower their female counterparts at all levels. This could serve as a motivating factor to other women in the organization to perform better than their male counterparts.

The presence of women in corporate boards seems to increase board effectiveness by reducing the level of conflicts and ensuring high quality performance. This result is in line with the a priori expectation of upper echelon theory adopted in this study. This finding is also consistent with the result of Eklund *et al.*, (2008) but contrary to the work of Ujunwa *et al.*, 2012; Marimuthu & Kolandaisamy 2009; Wahid, 2010. Therefore, the second hypothesis which states that board gender has no significant impact on ROE is unacceptable.

The co-efficient of board ethnicity is 1.340 at a probability value of 0.002 (significant at 1%). This implies that board ethnic composition is positive and strongly correlated with ROE. This indicates that as board diversity increases, ROE will increase by 1.3 percent. This could be as a result of ethnic diversity which may be more efficient in providing solutions to ill-defined and novel problems in case diverse opinions, skills, exposures, cultures knowledge and backgrounds. Also by electing directors with different ethnic backgrounds, firms can gain access to diverse resources needed for the growth and development of their businesses. This result is in line with the a priori expectation of upper echelon theory that ethnic diversity of directors have positive impact on performance. This result is consistent with the works of Marithumu, (2008); Marimuthu & Kolandaisamy, (2009); Schwzer *et al.*, (2012) and Ujunwa *et al.*, (2012).

The co-efficient of board size and firm size are -0.598 and -1.159 respectively and only firm size is significant at 0.002. This implies that firm size is negatively and strongly correlated to ROE. This result is in line with the work of Marimuthu & Kolandaisamy (2009) and Marimuthu (2008) and contrary to the work of Ujunwa *et al.*, (2012).

Table 2: Summary of Regression Result

Variables	Co-efficient	t-values	Sig
C	-	3.741	0.001
BN	-0.420	-1.750	0.094
BG	0.598	1.817	0.083
BE	1.340	3.427	0.002
BS	-0.598	-1.714	0.101
TA	-1.159	-3.587	0.002
R		0.718	
R2		0.515	
Adj. R2		0.405	
F-Stats		4.679	
F Sig		0.005	
DW		2.164	

Source: Authors' computation, 2014

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.718[a]	.515	.405	1.75501	.515	4.679	5	22	.005	2.164

a. Predictors: (Constant), TA, BN, BS, BG, BE

b. Dependent Variable: ROE

5. Conclusion

Based on the findings of this research, the study concludes that foreign directors' composition has a negative but significant impact on banks performance. Also foreign directors bring international exposure and experience to firms' business. Female directors and diverse ethnicity of the board of directors have positive and significant impact on banks' performance. Hence, directors' heterogeneity greatly improves performance of listed Nigerian banks. The study recommends that foreign directors should be present at all times during decision making process in board meetings so as to share their experiences and skills to the firms. It is advised that competent and highly skilled females should be appointed as board members with diverse experience to enhance financial performance. It is strongly recommended that board of directors should be more ethnically diverse so as to capture as much as possible better hands that would bring with them rare expertise that would help in solving complex managerial problems.

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Appendix

Correlations

		ROE	BN	BG	BE	BS	TA
Pearson Correlation	ROE	1.000	-.092	.102	.219	-.011	-.100
	BN	-.092	1.000	.526	.223	.348	.066
	BG	.102	.526	1.000	.679	.567	.728
	BE	.219	.223	.679	1.000	.874	.785
	BS	-.011	.348	.567	.874	1.000	.670
	TA	-.100	.066	.728	.785	.670	1.000
Sig. (1-tailed)	ROE	.	.321	.302	.132	.477	.306
	BN	.321	.	.002	.127	.035	.369
	BG	.302	.002	.	.000	.001	.000
	BE	.132	.127	.000	.	.000	.000
	BS	.477	.035	.001	.000	.	.000
	TA	.306	.369	.000	.000	.000	.
N	ROE	28	28	28	28	28	28
	BN	28	28	28	28	28	28
	BG	28	28	28	28	28	28
	BE	28	28	28	28	28	28
	BS	28	28	28	28	28	28
	TA	28	28	28	28	28	28

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	34.201	9.142		3.741	.001		
	BN	-.119	.068	-.420	-1.750	.094	.383	2.611
	BG	.162	.089	.598	1.817	.083	.203	4.917
	BE	3.456	1.009	1.340	3.427	.002	.144	6.937
	BS	-.301	.176	-.598	-1.714	.101	.181	5.530
	TA	-6.448	1.798	-1.159	-3.587	.002	.211	4.740

a. Dependent Variable: ROE