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TOPIC:

Nonperforming Loans, Corporate governance and Financial Performance of Banks in Ghana

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INTRODUCTION

Financial institutions including banks are deemed to perform some functions and roles that promote economic activities, growth and development in most economies.

Banks contributed to the adverse effects of the 2007-2008 global financial crises. This is evidenced in the fact that banks reported huge non-performing loans leading to reduced capitalization, instability and liquidity problems in the financial market.

From empirical literature, corporate governance structures seem to have received much attention as a tool for promoting bank performance (Ntim, 2013) and for mitigating bank risk-taking behaviour (Kusi, Dzeha, Ofori-Sasu and Ansah-Addo, 2018; Laeven and Levine, 2009).

INTRODUCTION

in recent times a series of bank forced takeovers, mergers and acquisitions in Ghana resulting from failed banks and reduced performance have caused some scare among financial market participants between 2017 and 2018.

It is believed that poor corporate governance structures and huge credit risk and losses have contributed immensely to the reduced banking performance and failed status of banks in Ghana between 2017 and 2018.

PROBLEM STATEMENT

It is advanced that the 2007-2008 global financial crises transmitted from advanced economies had a brief and limited impact on African economies (Bandara, 2014) while having a severe impact on European economies (Goddard, Molyneux and Wilson, 2009).

The limited impact of the global financial crises on the African continent and Ghana as a country is attributed to the low nature of financial and economic integration as well as international linkages of African economies into the world financial framework or network (Sugimoto, Matsuki and Yoshida, 2014; Bandara, 2014).

This insulated African economies from the full exposure of the global financial crises at the time.

In recent times a series of bank forced takeovers, mergers and acquisitions in Ghana resulting from failed banks and reduced performance have caused some scare among financial market participants between 2017 and 2018.

It is believed that poor corporate governance structures and huge credit risk and losses have contributed immensely to the reduced banking performance and failed status of banks in Ghana between 2017 and 2018.

PROBLEM STATEMENT

Empirical studies have either studied corporate governance (Darko, Aribi and Uzonwanne, 2016; Fiador, 2013) or nonperforming loans (Laryea, Ntow-Gyamfi and Alu, 2016) on bank financial performance,

Empirical studies that consider how corporate governance structures can modulate the relationship between non-performing loans and financial performance are limited and scanty especially in the context of Ghana.

Evidence on how corporate governance may tame the adverse effect of non-performing loans on the financial performance of banks in Ghana is yet to be empirically established.

It is against this background that this study attempts to investigate the interrelationship between corporate governance and nonperforming loans on bank performance in Ghana.

RATIONALE OF THE STUDY

With the recent happenings in the Ghanaian banking sector, it has become imperative to revisit how nonperforming loans and corporate governance interplay to affect bank financial performance in the context of Ghana.

Empirical studies that consider how corporate governance structures can modulate the relationship between non-performing loans and financial performance are limited and scanty especially in the context of Ghana.

STUDY OBJECTIVES

The purpose of this study is to contribute to literature in the area of the effect of non-performing loans and corporate governance on bank performance in Ghana.

LITERATURE REVIEW

The theoretical perspectives = information asymmetry theory + bad management hypothesis.

Information Asymmetry Theory argues that asymmetric information occurs when one party in a transactional relationship has better knowledge about the transaction than the other party.

Asymmetric information literature considers the impact of decisions based on the difference in the information available to both parties (Mishkin, 1992).

Creditors offering loan facilities to debtors face uncertainty of repayment, as they cannot observe the characteristics and actions of the borrower, thus making it difficult to assess the creditworthiness of the borrower.

Adverse selection, leads to the displacement of high-quality borrowers by low-quality borrowers, which in the long run cause deterioration in the quality of loan portfolios of the bank leading to accumulation of non-performing loans, decrease in profitability and capital erosion

LITERATURE REVIEW

Bad management hypothesis = in responding to the non-performing loans increment resulting from adverse selection, management of banks tends to inject more capital into managing bad loans.

Managers in these banks fail to practice adequate loan underwriting, monitoring, and control.

As ‘bad’ managers, they may a) have poor skills in credit scoring and therefore choose a relatively high proportion of loans with low or negative net present values, b) be less than fully competent in appraising the value of collateral pledged against the loans, and c) have difficulty monitoring and controlling the borrowers after loans are issued to assure that covenants are obeyed

LITERATURE REVIEW

Several researchers such as **Poudel (2012) and Kithinji (2010)** have examined the impact of credit risk on the financial performance of banks and had mixed results.

Poudel (2012) studied the impact of default rates and cost per loan on banks' performance in **Nepal**. Results indicate that default rates are crucial for bank performance, as it significantly contributes to bank profitability.

Roman and Tomuleasa (2013) studied the impact of internal and external factors on profitability of banks in EU countries. They concluded that an increase in non-performing loans had a negative impact on banks' profitability.

Osei-Assibey and Asenso investigated the regulatory capital and its effect on credit growth, non-performing loans and bank efficiency in Ghana using samples from 2002 to 2012. Findings indicate high excess capital increases risk-taking activities of the banks, as excess capital is found to be associated with high NPL ratios, thereby reducing profitability.

LITERATURE REVIEW

Akhigbe and Martin (2008) find that improvements in certain governance characteristics as a result of legal enforcement are associated with greater assessment of financial companies and reduced risk measures.

Most of the studies that investigated the determinants of NPLs employed the macroeconomic or bank-specific determinants as explanatory variables (**Athanasoglou, Brissimis and & Delis, 2008; Fofack, 2005; Makri, Tsagkanos and Bellas, 2014).**

RESEARCH METHODOLOGY

The paper examines ten Ghanaian banks for the period from 2006 to 2017 based on data availability.

Data were obtained from the global financial development indicator in the World Bank database, the financial statement of the banks in Ghana and bankscope database using purposive sampling techniques.

Panel data approach is used to examine the results.

DV = ROA, which is the ratio of net income to total assets

RESEARCH METHODOLOGY

IV = non-performing loan ratio (NPLR),

Total advance to total asset (TATAR) measures the relation of a bank's loan portfolio to the total assets.

Board size (BS) represents the number of directors serving on the board of the bank. Board composition (BC) measures as the number of non-executive members on the board. Audit Committee size (ACS) represents the number of board members serving on the audit committee. CEO duality (CEOD) represents whether the board chairman is the same person acting as the Chief Executive Officer. This is a binary variable 1 = CEO duality, 0 = otherwise.

CV = Age, Leverage, Firm size, GDP growth and Inflation

RESEARCH METHODOLOGY

$ROAit = \alpha it + \beta 1NPLRit + \beta 2CGit + \beta 3CV + Ui + \varepsilon it$

The detailed model is as follows:

Effect of Non-Performing Loans on Performance

$ROAit = \alpha + \beta 1NPLRit + \beta 2ATARit + \beta 3SIZEit + \beta 4AGEit + \beta 5LEVit + \beta 6GDPGit + \beta 7INFL + \varepsilon it$ ……….(2)

Effect of Non-Performing Loans and Corporate Governance on Bank Performance

$ROAit = \alpha + \beta 1NPLRit + \beta 2ATARit + \beta 3BSit + \beta 4ACSit + \beta 5CEODit + \beta 6BCit + \beta 7SIZEit + \beta 8AGEit + \beta 9LEVit + \beta 10GDPGit + \beta 11INFLit + \varepsilon it$ …….. (3)

ANALYSIS OF RESULTS

Multicollinearity

VIF and Tolerance tests. VIF has a maximum value of 2.79 and the lowest value of tolerance is 1.08 which indicate that there are no multicollinearity problems among independent variables.

Heteroskedascity-Breusch–Pagan Lagrange multiplier test p =0.4247

Hausman specification test (p = 0.2607)-- Random effect is preferred for both models

ANALYSIS OF RESULTS

ROA	OLS	Fixed Effect	Random Effect
NPLR	-0.0955872 (0.001)***	-0.0947107 (0.000)***	-0.0953757 (0.000)***
ATAR	-0.0277131 (0.003)***	-0.0102573 (0.310)	-0.0166955 (0.078)*
SIZE	0.0052478 (0.002)***	0.0053133 (0.016)**	0.0052145 (0.002)***
AGE	0.0001376 (0.003)***	0.0001082 (0.833)	0.0001465 (0.045)**
LEV	-0.0005594 (0.001)***	-0.0003919 (0.016)**	-0.0004429 (0.005)***
GDPG	0.3390958 (0.012)**	0.2296899 (0.072)*	0.269629 (0.031)**
INFL	0.0980119 (0.092)*	0.0479894 (0.379)	0.0657973 (0.221)
Constant	-0.063469 (0.041)**	-0.0604021 (0.057)*	-0.0613207 (0.043)**
BP Largrangian			
X2	0.1561		
P-value	0.000		
Hausman			
X2		13.81	
P-value		0.0546	

ANALYSIS OF RESULTS

ROA	OLS	Fixed Effect	Random Effect
NPLR	-0.088007 (0.002)***	-0.0964615 (0.000)***	-0.088007 (0.002)***
ATAR	-0.02666 (0.006)***	-0.0135447 (0.180)	-0.02666 (0.005)***
SIZE	0.0046253 (0.008)***	0.0042689 (0.057)*	0.0046253 (0.007)***
AGE	0.0001217 (0.012)	0.0005289 (0.334)	0.0001217 (0.011)**
LEV	-0.0004454 (0.011)	-0.0003921 (0.018)**	-0.0004454 (0.009)***
GDPG	0.3306164 (0.013)	0.2176317 (0.084)*	0.3306164 (0.011)**
INFL	0.0909329 (0.112)	0.0365835 (0.499)**	0.0909329 (0.109)
BS	-0.0004132 (0.711)	-0.0009142 (0.520)	-0.004132 (0.710)
ACS	0.0018072 (0.032)**	-0.000364 (0.745)	0.0018072 (0.030)**
CEOD	-0.0166245 (0.141)	-0.0032311 (0.789)	-0.0166245 (0.138)
BC	0.0000549 (0.965)	0.0036533 (0.021)**	0.0000549 (0.965)
Constant	-0.561207 (0.071)*	-0.0677612 (0.047)**	-0.0561207 (0.068)*
BP Largrangian			
$\chi 2$	0.00		
P-value	1.00		
Hausman test			
$\chi 2$		15.52	
P-value		0.1598	

MAJOR OUTCOMES

Regression results without corporate governance
NPLR, ATAR, LEV = sig inverse relationship with ROA
SIZE, AGE, GDP = sig direct relationship with ROA

Regression results with corporate governance
NPLR, ATAR, LEV = sig inverse relationship with ROA
SIZE, AGE, GDP, ACS = sig direct relationship with ROA

CONCLUSION AND POLICY IMPLICATIONS

The study aims to investigate the effect of non-performing loans and corporate governance on firm performance relationship for Ghanaian banking industry.

Results = the relationship between corporate governance and performance is not very strong in Ghana but non-performing loans affect performance.

BS, CEOD and BC are not found to be related to ROA.

CONCLUSION AND POLICY IMPLICATIONS

Proper loan underwriting, background checks and monitoring systems should be established by banks before and after issuance of loans to assess borrower's ability to repay their debt.

Banks should be encouraged to enhance their asset base so as to minimize their solvency risk and increase their size through mergers of small banks.

Banks would be able to diversify their investment portfolio and hence reducing risk.

Bank managers should be careful giving out loans whenever the economy is booming since Ghana's economy depends on few sectors.

CONCLUSION AND POLICY IMPLICATIONS

Ghanaian banks can depend on the Credit Reference Bureau in their operations.

An increase in audit committee size leads to better performance only when it adds diversity to the board;

People with different backgrounds and perspectives should be appointed for the posts of independent directors.