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**MODERATING EFFECT OF CORPORATE GOVERNANCE**  
**BETWEEN RECAPITALIZATION AND BANK'S**  
**PERFORMANCE: PROPOSED FRAMEWORK**

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*Abstract*

The reason for this study is to primarily evaluate the existing studies on the relationship between recapitalization on the bank's performance by using corporate governance as a moderator. Many studies examine the relationship between recapitalization and the bank's performance. However, the nature and existence of this potential relationship are found to be mixed and inconclusive (i.e., positive, negative, or no relation at all). These have prompted scholars, experts, and authorities to re-examine the relationship between recapitalization and the bank's performance. Accordingly, questionnaires will be distributed to regional manager, branch manager, or any senior manager in the selected banks of the Nigerian banking sector. Partial Least Square Structural Equation Modelling (PLS-SEM) and SPSS software will be used to analyze the data. This study addresses the research deficit and proposes a conceptual and theoretical framework for measuring the effectiveness of recapitalization and bank performance, which could be used by banks and other regulatory bodies. Furthermore, a recommendation for future research in the area is also suggested.

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**Keywords:** Recapitalization, Merger & Acquisition, Intervention, Banks performance, Corporate Governance.



## 1. Introduction

The global financial crisis (GFC) of the last decade has been described as the most severe crisis since the Great Depression of 1940 (Fernandes, Farinha, Martins, & Mateus, 2016). However, different countries had various experiences and method for approaching their banking recapitalization and how they affect banks performance. For example, the banks recapitalization experiences of Malaysia, Indonesia and Thailand were directly affected by the 1997 Asian financial crises (Ernovianti & Ahmad, 2017; Etri, Nor, & Mazlan, 2016; Sufian & Shah Habibullah, 2013), while other European countries and USA banking recapitalization was as a direct response to the 2007 to 2008 GFC (Georgakopoulos, 2017; Tomec & Jagrić, 2017). Despite the full implementation of Basel regulatory capital requirement by most countries, but still is not clear if such measures were able to achieve the desired results for stability in the most of the country's banking sector (Tahir, Adegbite, & Guney, 2017).

This study is hence at proposing a framework that selects the most appropriate variables best address recapitalization and banks' performance problems peculiar to Nigeria, and introducing a moderation variable (CG) that will strengthen the inconsistency and weak relationship between recapitalization and banks performance as suggested by (Baron & Kenny, 1986; Fairchild & MacKinnon (2009); Hair, Hult, & Ringle 2017; Rezaul Kabir, 2017). Similarly, it is widely acclaimed that a better corporate governance practice enhances firm's performance (Adams & Mehran, 2012; Brickley & James, 1987; Chung, Wright, & Kedia, 2003; Francis, Hasan, & Wu, 2012). However, Gani and Jermias (2006) reported that the restrictive used of single dimensional financial based measures contributed to inconsistency in the relevance findings. This study will use both financial and non-financial measures of performance as suggested (Hussain & Hoque, 2002; Kaplan & Norton, 2001) more especially those recommended, fit and selected for performance evaluation in banking through expert questionnaires (Wu, Tzeng, & Chen, 2009).

Conclusively, this paper adopts the agency and resource dependence theories as integrated by (Hillman & Thomas, 2003). Agency theorists see the primary function of CG characteristics as monitoring the actions of agents "managers" to protect the interests of principals "shareholders" (Eisenhardt, 1988; Jensen & Meckling, 1976). Moreover, Berle and Means (1933) explored that, the theoretical underpinning of CG monitoring functions derived from agency theory while Empirical studies in the resource dependence theory have shown the relationship between capital provision and firm's performance. However, among the conventional methods of measuring recapitalization, to the authors are going to use a reputation index (Islam, Ahmed, & Hasan, 2012; Moskowitz, 1972) to measures recapitalization in Nigeria. The authors will have to develop a questionnaire and ask the knowledgeable observer to rate the firm on three dimensions of recapitalization and 23 items of financial and non-financial performance in banking as suggested by (Wu et al., 2009). Additionally, the outcome of this paper shall be of immense importance to academics, regulators, shareholders, and policymakers as it will reveal the contribution in strengthening the functions of recapitalization approaches in ensuring decent banks' performance. The paper is subdivided into four parts from the introduction, literature review, conceptual framework, conclusion, and reference.

## 2. Problem Statement

In Nigeria, it was emphasized that the poor corporate governance practices and poor managerial performance were notably contributed to the problem of banks recapitalization (Adegbite, 2015; Shehu, Zuriana, Jamil, & Mohamed, 2014; Yakasai, 2001). Correctly in the banking industry, it was observed that, the poor performance and poor CG had been recognized as the primary culprits of the banking distress in Nigeria, which led to the commercial banks recapitalization in 2006 and specialized banks recapitalization in December 2007 (Acha, 2012; CBN, 2010; Sanusi, 2010). However, in July 2009 CBN and Nigeria Deposit Insurance Corporation (NDIC) carried out a unique examination of all 24 universal banks in Nigeria, with the aim of assessing their state of health, with particular focus on capital adequacy, risk management, liquidity and corporate governance practices (Chiakelu, 2010; NDIC, 2011; Oleka & Mgbodile, 2014). In addition, Ten banks were adjudged to be in grave states with deficiencies in capital adequacy and eight out of them also had significant flaws in risk management practices, liquidity, and corporate governance policies whereas, the aggregate of a non-performing loan of these banks was 40.81% (CBN, 2010; Sanusi, 2011). Moreover, the Executive Directors (ED) of these eight banks were replaced immediately, while fresh capital was injected to the all 10 banks by means of bailed out amounting to N620 billion, in the form of Tier two Capital intervention by the CBN (Alford, 2011; CBN, 2010; Sanusi, 2010; Shehu et al., 2014).

## 3. Research Questions

The article discusses these research questions to reveal an effective solution to the effect of recapitalization and the bank's performance-

- Does merger and acquisition have any effect on the performance of the Nigerian banking sector?
- Does equity issues have any effect on the performance of the Nigerian banking sector?
- Does the intervention have any effect on the performance of the Nigerian banking sector?
- Does corporate governance moderate the relationship between recapitalization and performance of the Nigerian banking sector?

## 4. Purpose of the Study

Even with the importance of the banking sector in regulating and stabilizing the economy, many empirical studies concerning the relationship between recapitalization and the performance of banks in both developed and developing economies appeared to be mixed, inconsistency, contradiction and couple with weak findings. For instance, in the studies of (Beccalli & Frantz, 2016; Donou-Adonsou & Sylwester, 2017; Ernovianti & Ahmad, 2017; Etri, Nor, & Mazlan 2016; Yusupov, 2012) found positive and (Aybar & Ficici, 2009; Beccalli, Frantz, & Lenoci, 2016; Bibi, Balli, Matthews, & Tripe, 2018; Forssbaeck & Nielsen, 2016; Tomec & Jagrič, 2017) found negative while (Adedeji, Babatunde, & Adekanye, 2015; Liao & Williams, 2008) found no relation. Furthermore, most researches conducted globally and Nigeria in particular, are having some other kind of shortcomings which results in usual conflicting findings, inconsistency, limited scope, and inconvenience samples, and usually focused mainly on the direct

relationships between a single strategy or approach of recapitalization and performance, thus neglecting the indirect path through roles and strategic initiatives.

## 5. Research Methods

Questionnaires will be used and distributed to regional manager, branch manager, or any senior manager in the selected banks of the Nigerian banking sector. Partial Least Square Structural Equation Modelling (PLS-SEM) and SPSS software will be used to analyse the data. Moreover, this study will use probability sampling with an emphasis on the stratified sampling method.

## 6. Findings

Etri Nor and Mazlan (2016) described recapitalization as a rescue plan by the central bank of a country through capital injections and acquisitions of weaker banks by stronger banks. According to Petrovic and Tutsch (2009) suggested that the distressed banks with a view to capital restructuring can involve in either private or public recapitalization in order to be recapitalized. Similarly, Beccalli and Frantz (2016) have extensively discussed the primary motivation for private recapitalizations, which is to reduce risk-taking hypothesis through solvency risk to achieve the existence of better operating performance. Moreover, the authors revealed that the motivation for banks public recapitalization is associated with the larger size, lower liquidity, and higher growth at the bank level but lower growth at the country level. Additionally, the authors further revealed that state intervention happens in more challenging situations where private recapitalization solution are difficult to achieve.

### - Recapitalization Approaches

Based on the discussion of the previous Coates and Scharfstein (2009) reported that the bank's recapitalization has three basic approaches, through either equity issue which comprised public offering and private placement, intervention, and sales of banks (M&As) as shown in table 1 below.

**Table 01.** Proxies in recapitalization

S/N	Authors and year	Proxies in Recapitalization
1	(Aduloju et al., 2008)	(i) Merger and Acquisition
2	(Coates & Scharfstein, 2009)	(ii) Equity issues a. Initial public offering b. Private placement (iii) Intervention

The basic strategies used by previous authors to measure recapitalization

### - Merger and Acquisition Approach

One of the most notable developments at the global level affecting the banking industry for the last couple of decades has been the unprecedented level of merger & acquisition (M&A) activities (Altunbaş & Marqués, 2008). Delong (2001) argued that bank mergers that are concentrating (in terms of activity and geography) produce superior bank performance relative to those that are diversifying. Delong and Deyoung (2007) reported that 216 M&A of the USA banking companies that started between 1987 and 1999 has a

long-term effect on financial performance and found that the merger increased long-term ROA and improved efficiency.

#### **- Equity Issues**

Firms with a higher growth rate than face capital constraints will go for equity issue, these transaction types give the firm, its managers, and investors access to public capital markets (Poulsen & Stegemoller, 2008). According to Coates and Scharfstein (2009), for this approach of recapitalization, banks can issue equity to the private investors, and it is possible for the banks to raise a significant amount of capital through equity issues, whether as initial public offerings (IPO) or private placements. Additionally, equity issue could be structured as a rights issue in which the current shareholders are given the right to acquire more equity at a given price, at a discount market or fair value in order to encourage new investment.

#### **- Initial Public Offerings (IPO)**

Initial public offering (IPO) is the fresh issue (first sale) of stocks issued by a private firm to raise capital in the capital market by which the issuer firm is transformed into a public company (Boonchuaymetta & Chuanrommanee, 2013; Carter & Manaster, 1990). The decisions relating to the financing of a firm is always very complex to evaluate, but ordinarily, its depend on the availability of instruments, sources, and methods of funding of (Ragupathy, 2011). Raising capital via IPOs and the current financial ecosystem provides many opportunities for company owners to increase resources in multiple capital markets (Sundarasan, Goel, & Zulaini, 2017).

#### **- Private Placement**

The private placement has considerable advantages in the public market because of the lower cost of raising capital and in terms of dealing with a single, small group or a big group of investors (Ragupathy, 2011). Taylor and Taylor (1998) define private placement as an equity or debt security transaction that is exempted from registration. Moreover, the authors reported that a sale qualifies as an exempted private placement if there is a limited number of purchasers and have access to all vital information about the issuer and the issue. The empirical study found that large shareholders participated in private placement for capital operation they have restrained the issuance of low pricing, protected the interests of small and medium-sized investors, balanced the interests of large shareholders, in the meantime also promoted the long-term development of the enterprise (Ruan, Song, & Zheng, 2018).

#### **- Intervention**

Laeven and Fabia Valencia (2013) define government intervention as a Significant banking policy measures in response to significant losses in the banking industry. According to Coates and Scharfstein (2009) reported that one of the vital approaches to recapitalize the banks is through intervention. The global financial crisis has onwards spread around the world and impacted the performance of banking sector in major economies and drew the attention of several governments to have used a variety of intervention to recover their financial systems. For instance, Ding, Wu, and Chang (2013) used the data collected from

Bloomberg of five major Asian countries which includes Hong Kong, Japan, Taiwan, South Korea and Singapore over the eleven-quarter from the last quarter of 2007 to the second quarter of 2010 on six financial performance indicators reflecting profitability, credit risk and solvency. The authors compared the bank's performance before and after government intervention during the global financial crisis; the empirical results showed that on average the bank performance in terms of solvency, credit risk, and profitability improves significantly after government intervention. Moreover, recapitalization through the government intervention in the Nigerian banking industry can be traced to the GFC which began in the US and Europe and then moved over to several nations in which Nigeria fell among (Shehu et al., 2014).

#### **- Performance**

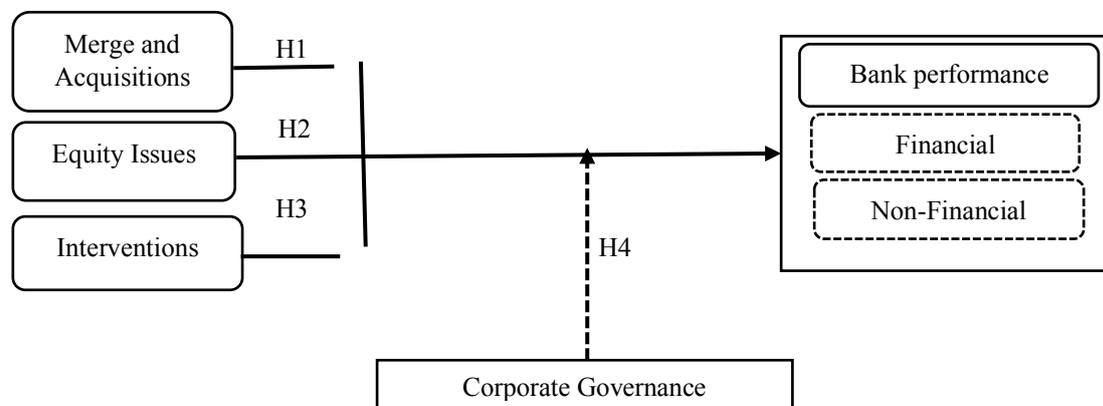
Performance of an organization can be defined in many ways. For instance, Antony and Bhattacharyya (2010) described the performance as the measures that are used to assess and evaluate the success of an organization to create and deliver the values to its external as well as internal customers. Moreover, Many researchers also such as (Akbari, Shaverdi, & Fallah Tafti, 2011; Stankevičienė & Mencaitė, 2013) have stressed that in the service sector, as the banking industry, it is necessary to make use of multidimensional performance measurements. The perception of non-financial measures are better for forecasting of a long run firm's performance, as well the business leaders to monitor their company's efficiency effectively (Hussain & Hoque, 2002; Kaplan & Norton, 2001). The BSC breaks the traditional limitations of performance evaluation from the four (one financial and three non-financial performance (customer, internal business process, and learning & growth (Kaplan & Norton, 1996). It emphasizes both aspects of financial and non-financial performance, internal and external business measures, long-term and short-term strategies. According to Kim and Davidson (2004), the BSC is also utilized as a framework to develop performance evaluation indicators for banks. In conclusion, this study will adopt the 23 evaluation indexes that are selected as being suitable for banks performance in terms of BSC perspectives through expert questionnaires (Wu et al., 2009).

#### **- Corporate Governance**

Corporate governance in financial institutions, especially banks is unique when compared to non-bank financial institutions (Bastomi, Salim, & Aisjah, 2017). The of manager's behaviour and bank owners became the primary factor that needs attention in the implementation of corporate governance which shows that improving the implementation of corporate governance can reduce credit risk and operational risk and increase financial performance (Bastomi et al., 2017). If good corporate governance not put in place, banking supervision cannot be well- functioning (Nworji & Olanrewaju David, 2011). Moreover, agency theory suggests that strong corporate governance leads to better accounting outcomes and improves performance (Jensen & Meckling, 1976). So basically, weak corporate governance can lead a bank to lose the ability to manage its deposits, assets, and liabilities which could, in turn, trigger a bank to run in a liquidity crisis. As indicated earlier this study aims at the strengthen the relationship between recapitalization and banks performance and introduced corporate governance as a moderator variable as suggested by Baron and Kenny (1986), Frazier, Tix, and Barron (2004) Fairchild & MacKinnon (2009) to analyzed the moderation effect as a test whether the prediction of a dependent variable affects the strength

or direction of the relation between a predictor and an outcome by changing, reducing, or enhancing the influence of the predictor (Figure 01).

### Conceptual Framework



**Figure 01.** Proposed conceptual framework and hypothesis development

## 7. Conclusion

The research finding depends on the results of hypotheses test. However, this study review and theoretically examine the relationship between recapitalization strategies (merger and acquisitions, equity issues, and intervention) and bank performance (financial and non-financial) with the interaction effect of corporate governance between the two variables. Moreover, CG influence of performance measurement in providing adequate information to support the CG of banks who have the function of advising the managements' overall strategic system of control and monitoring which will result in a better banks performance. Also, having an understanding on how the importance of recapitalization relates with bank performance, it will enable the various parties such as regulatory authorities (e.g., CBN, NDIC) board of directors, and management of banks to formulate policies, make appropriate decisions and implementation of strategies. More so, intended scholars in this area of research can empirically provide evidence(s) on the established relationship between the variables selected in this study and add other additional control variables such as bank size, bank age, etc. can be considered by future researchers.

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