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An Assessment of the Relationship Between Corporate Governance and Profitability: A Case Study of a Commercial Bank in Namibia

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ABSTRACT

The study aims to bridge a research gap by examining the relationship between corporate governance and profitability of a major commercial bank in Namibia. A quantitative methodology with data from the bank's financial ratios for the years 2017–2021 as well as business characteristics and corporate governance processes was adopted. As proxies for company profitability, market-based metrics like Tobin's Q and accounting-based metrics like return on asset (ROA) were employed. Additional secondary data was gathered from the bank's publicly available financial records. SPSS version 26 was used in the study's quantitative correlational design data analysis. The study finds a significant positive correlation between the ROE and the net profit margin. In addition, there is a positive relationship between the ROE and board size as well as between board size and net profit margin. However, the findings indicate a negative correlation between the Board independence and net profit margin as well as between the board independence and ROE but a positive relationship between the board independence and board size. The study finds that the profitability of the bank is not significantly influenced by either board independence, board size or ROE. However, the board size negatively impacts profitability. Similarly, the ROE and board independence positively impacts profitability. The study concludes that ROE is significant when the profitability of the bank is analysed compared to the board size and board independence. This study reduces a literature gap in Namibia, a relatively small emerging market that is very poorly represented in the literature. It has implications to bank managers, directors, and policy makers in guiding companies' sustainability.

Keywords: Corporate Governance, Profitability, Commercial Banks

1. INTRODUCTION

The primary goal of the study is to determine how corporate governance (CG) affects banks' profitability by examining a case study of a commercial bank in Namibia. The Cadbury Committee, which was established in the UK in 1991 to improve corporate governance standards, is credited with coining the most well-known definition of the term: "Corporate governance is the system by which companies are directed and controlled" (Cadbury Committee, 1992). According to Lu and Batten (2001), corporate governance (CG) is defined as governmental and private institutions, including rules, regulations, and established business practices, that together command the link between managers of corporate entities and entrepreneurs, on the one hand, and investors, on the other, in a very free enterprise. The study aims to establish a link between CG and the bank's financial success. Incorporating the values of leadership, sustainability, and good corporate citizenship, corporate governance typically aims to advance to larger corporate responsibility, transparency, and stakeholder principles.

Corporate Governance has turned into a serious topic in developed countries and around the globe following events like company collapses and corporate frauds. In recent years, it has attracted attention in emerging economies. In today's world corporate governance enables businesses to focus on their strengths. Entities are expected to be held accountable for their conduct and efforts when their objectives are made public, and consequently more desirous to stay away from corporate deception and fraud. This is key because confidence in businesses is shrinking. According to the communications and marketing firm Edelman, a global research firm, consumer confidence in business, the media, the government, and non-governmental organisations has decreased over the past 20 years, according to the company's annual Edelman Trust Barometer.

When examining the influence of CG and profitability of entities, the agency theory is understood to be relevant and appropriate. The agency theory refers to the linkage of the agents to the principals. Managers of the entities act as agents while the shareholders are known to be principals (Donaldson & Davis, 1991). Those that represent the management should always take measures in the best interests of the owners. However, this may not always be the case according to Adam Smith as explored by Ross (1973). Gillian (2006) argues that the chairperson and CEO must not be one person as this separation allows and gives balance between two persons.

Another relevant theory would be the Stakeholder theory. Stakeholders refer to anyone, individual or group who has an influence on the organization objectives. Stakeholders are or include the Suppliers, employees, customers. This theory supports that the management should consider the interest of their stakeholders in its governing process as they are as important as the managers and business owners. Further, the Resource dependency theory would be relevant as we look at the role of board of directors and how they give access to the resources the company needs. Hillman et al. (2000) stated that the providers of wealth to the company are the Shareholders and directors. The resources provided by the directors are information, skills, buyers as well as the legitimacy of the company, a finding supported by Kamotho et al. (2022), who argues that they also have a fiduciary duty to provide decisions useful to other stakeholders of the company.

Over the years, companies in African countries and around the world have shown that good corporate governance goes hand in hand with better financial health of companies. Sajid et al. (2012) argues that this is the influence CG has on capital structure, Board composition, risk and size positively correlated with corporate governance and negatively correlated with profitability.

The Board of Directors (BOD) plays a major part in the management of a company (Fama & Jensen, 1983). Some studies have found that larger boards are expected to perform better, while others argue that smaller boards are more likely to result in better company performance. Walls and Hoffman (2013) argue that larger boards can lead to coordination and communication problems, and managers can take control. On the other hand, some studies suggest that the smaller the board, the more likely communication is better and decision making (Lipton & Lorsch, 1992). According to Nicholas (2017), Board size has not been spoken about so much as there is an increased attention on board composition, especially when it relates to diversity, female directors and directors that are independent. In the not-too-distant past, corporate boards featured a significant number of directors surrounding both sides of their vast conference room tables. However, the growing emphasis on compliance and best practices for effective corporate governance places a greater premium on board director quality over the board of director quantity. Many people are questioning if smaller groupings of the board of directors are more successful than boards that are in large numbers considering new best practices According to a recent study and some new trends, today's boards are discovering that larger boards of directors still have a role, but in the great scheme of things, less is more. (Nicholas, 2017).

The agency theory would suggest that when the board is independent of the management who runs the day-to-day operations, they tend to make decisions which are good for the company. This separation may help in protecting the reputation of the company and themselves as directors. Non-executive directors on the board give managers the fear of conflict of interest with that of the entity because the non-executive directors monitor their work.

The CEO duality is another major aspect of good corporate governance (Nazir et al., 2012). This refers to the business operation whereby chief executive officer is the chairman of the board of directors for the same company. Such a situation gives more power to the CEO to make critical decisions, even though the CEO reports to the Board, allowing him/her to supersede some of these formalities. The CEO-Chairman is believed to be more visible in management progression, decision making and on how the company perform financially. Although it is in direct proportion with equity indicating the CEOs to have a huge difference in remunerations (Allan, 2012).

The collapse of big companies across the world, the likes of Enron, Ansett Airlines, and WorldCom activated a worldwide awareness to clear problems concerning CG. Nonetheless, from a major fall (collapse) in Australia,

there has been a greater emphasis on disclosures and how the board of directors and auditors should be independent; and why the boards should always act within the best interest of the stakeholders. Poor CG practices within those companies may have contributed to their collapse. Research is needed to identify the much work that must be done to scrub up these challenges and enhance company sustainability. Failure to do this will lead to more company failures and malfunctions. Consequently, this study attempts to fill this void by investigating the relationship between CG and company profitability in a commercial bank setting in Namibia.

1.1 Delimitations of the study

The aim of this research is to look over the connection between CG on the profitability of the bank. The bank governance mechanisms are board size, board independence, audit committee, number of board meetings and the executive remunerations. However, numerous additional board characteristics and company practices weren't covered during this study. The audit committee meetings, how diverse the board is and how the board share ownership.

1.2 Limitations

Limitations refer to those variables that influence the study's potential shortcomings. Limitations are those characteristics of methodology that are shortcomings because of unavailability of resources (Brutus et al., 2013). The utilization of secondary information to get financial and company governance information was a key potential source of limitation during this study due to company secrecy and disclosure policies. The reliability of secondary source information obtained advantage is that it can be impartial. The Secondary information is derived from the bank presented financial reports and given the recent reporting of accounting scandals in many firms, several data on the financial statements can be manipulated. Since data was gathered from the bank financial information for the past five years, inflation and natural phenomenon Covid-19 during the period of review could have influenced how the bank performed than how the bank was governed at the time.

2. RESEARCH METHODOLOGY

2.1 Research Design

A quantitative correlational design was used because the purpose for this study was to investigate the correspondence of variables that are known (Stanley, 2011). A correlational design uses multiple quantitative variables to see if there is a link among the variables. In theory, multiple quantitative variables can be associated provided the variables can be scored (Moenga, 2015).

2.2 Population and sampling

Humans, sets, firms, individuals, products, and the circumstances surrounding their exhibition comprise the population of the research, according to Welman and Kruger (2005). There is no population since the study was a content analysis over a five-year period, no humans are involved.

According to Polit and Hungler (1999), a sample is what a population is represented with when the components of samples are collected randomly from a set of sampling components listing all in the population. The selection of this study sample is predicated on the provision of information. Researchers have a special name for this called non-probability sampling (Berete, 2011). The data collected for the bank is from the annual report for the five years. These periods were chosen because of the availability of the information and not being old.

2.3 Research Instruments

Consequently, various meanings of corporate administration have arisen looking on what the analyzers attentiveness is and their motive (Mulili & Wong, 2011). correspondingly, previous researchers have made use of some instruments to look at CG and profitability variables. Since the information used for this research is secondary, the annual reports were utilised to extract the values of the independent variables.

2.4 Data Collection Techniques

The technique in use is solely utilising secondary information from the commercial bank annual reports, which are found on the company website. Secondary data offer information on financial statements which aided the analysis of monetary performance. The information collected consisted of the number of board members, the independent directors, net profit margin and the return on equity. The information collected is for the five years (2017-2021). The needed data was collected using a supplementary data collection sheet.

Table 1: *Summary of the variables used and how they were measured.*

Variable type	Variable name	Definition and measurement
Dependent variables	Net Profit Margin	The Net profit for the year divided by Sales/Revenue
Independent Variables	Board size	Measured by the number of board of directors on the bank board
	Board independence	Measured by the proportion of independent board on the bank board
	Return on Equity (ROE)	The measure of a company's net income divided by its shareholders' equity

2.5 Data analysis and presentation

To examine the influence of CG on the bank's profitability the study used regression analysis. The different governance approaches concerning independent directors, board composition, and ROE were examined using summary analysis such as mean, median, standard deviation, and so on, as well as statistical tests such as correlation and multiple regression. The Statistical Packages for Social Sciences (SPSS) version 26 is made use of to analyze the data.

The bank's governance independent variables which are used are (i) The number of board of directors, (ii) board composition and (iii) ROE. The dependent variable is the bank profitability of Net profit.

2.6 Reliability and Validity

The procedures that produce findings that are reliable, dependable, reproducible, and backed up by prior studies is what constitutes reliability (Hoffschwelle, 2011). Whilst validity has to do with the study's accomplishment in precisely weighing what the researcher came across and its correctness (Bleijenbergh, Korzilius, & Verschuren, 2011). In Addition, when data is acquired from peer-reviewed and academic sources, there is greater confidence in its dependability. The advancement of validity may be attributed to a clear statement of the research's' aims and objectives. (Hoffschwelle, 2011). In this study, the investigator expects to utilize year end evaluated financial reports. A positive relationship shows a better unwavering quality while a negative relationship shows a not so good unwavering quality.

The Statistical Packages for Social Sciences (SPSS) version 26 statistic is often accustomed test interrater reliability. The importance of rater reliability is within the undeniable truth that it constitutes the area to which the information is extracted within the study measuring the correctness of variables. This study uses The Statistical Packages for Social Sciences (SPSS) version 26 to analyse the data and for reliability of the data collected.

2.7 Research Ethics

The fact that ethical behaviour is found in the other domain of human activity makes it essential to research. As Welman and Kruger (2005) suggested, the idea that underpins research principles frequently centres on matters like integrity and regard for proprietary rights. Publicly available data was used, and no permission was necessary.

3. ANALYSIS AND RESULTS

3.1 Descriptive statistics

The results of the independent variables were examined and shown on Table 2 below.

Table 2: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Board independence	5	0.55	0.67	0.5900	0.04950
Board size	5	10	12	11.20	0.837
ROE	5	17.30	25.60	20.7160	3.09213
Net profit margin	5	22.65	45.20	30.9220	8.71738
Valid N (listwise)	5				

The descriptive statistic above indicates that the mean board independence was 0.59 with the minimum being 0.55 and maximum of 0.67 and a standard deviation of 0.05. The mean board size was 11.20 members with the minimum of 10 members and maximum of 12 with a standard deviation of 0.84. Moreover, the mean Return on Equity (ROE) was 20.72 with the minimum being 17.30 and maximum being 25.60 and the mean profitability of the bank, for the 5 years, as measured by the Net profit margin was 30.92 with the minimum being 22.65 and maximum being 45.20.

3.1.1 Board size

Table 3 Board size

Year	Number of board members
2021	10
2020	12
2019	11
2018	11
2017	12

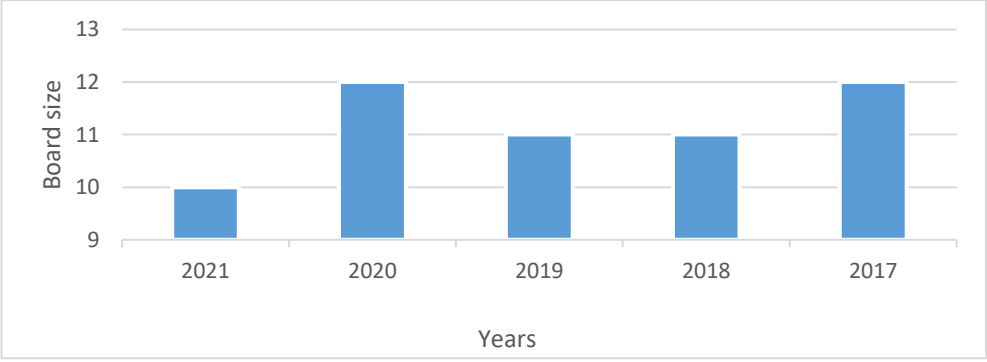

Figure 1: Board size trend

Table 3 and Figure 1 above shows that there was no definite trend in board member size on the bank board over the 5 years. As of 2017, the number of board members on the bank board exceeded 10 and only in 2021 was the number of board members at 10. The average number of members on the bank board over the five-year period was 11.20 members.

Based on a study performed in 2014 by a group of governance researchers (Lublin, 2014), fewer numbers of board members on board can be more efficient than many board members. Based on this study, the average board size is 9.5 members and that the number of board members of 14 or more members is a large board composition. The average number of board members according to Lubrin (2014) was 11.2 members. These results were consistent with those obtained in this current study.

Lubrin's study indicated that those companies whose annual revenue amounts to at least US$10 billion and have small numbers of board members performed good over the period of three years (as per study) as compared to companies with large board sizes. The study also highlighted that financial institutions are more prone to regulatory concerns than any type of business. Because of this, it's therefore reasonable for financial institutions to have many board members as they require advice and expertise from several committees. As much as the board members need to be a lot for them to divide the work among each other, it is also advised that the board remain small enough for the board members to work together collaboratively and effectively with less conflict.

3.1.2 Board independence

Table 4 *Ratio of independent members on the bank board*

Year	Board independence
2021	0.60
2020	0.67
2019	0.55
2018	0.55
2017	0.58

Table 4 above indicates that the independent board members on the bank board mean is a range of 0.55 and 0.67. The results indicate that the bank board has more independent members on their board as compared to other members of the board. This might be since independent members bring diverse skills and may be of importance in oversighting roles that they may play in managing the institutions. According to Moenga (2015), the primary part of corporate governance includes having enough number of independent board members on the board as well as an independent process of appointing them.

3.1.3 Return on Equity (ROE)

Table 5 *ROE*

Year	ROE (%)
2021	19.20
2020	17.30
2019	21.20
2018	20.28
2017	25.60

Table 5 above indicates that Return on Equity (ROE = Net Income / Shareholders' Equity) for the bank has not been constant over the 5 years. It was on a decrease from 2017 to 2020, and it started increasing again in 2021.

Based on the Annual Financial statements analysis, a sustainable and increasing ROE over time could mean that a company is good at generating shareholder wealth because it knows how to reinvest its earnings wisely, which is aimed at increasing productivity and profits. These contrasts have a falling ROE which could indicate that the management might be making bad judgments about reinvesting resources in inefficient assets.

3.1.4 Profitability of the bank (Net profit margin)

Table 6 *Net profit margin*

Year	Net profit margin
2021	32.54
2020	22.65
2019	27.15
2018	27.07
2017	45.20

The bank demonstrated mixed reporting on their net profit margin. Their performance has been decreasing since 2017 from which it increased in 2021 but below 2017 levels.

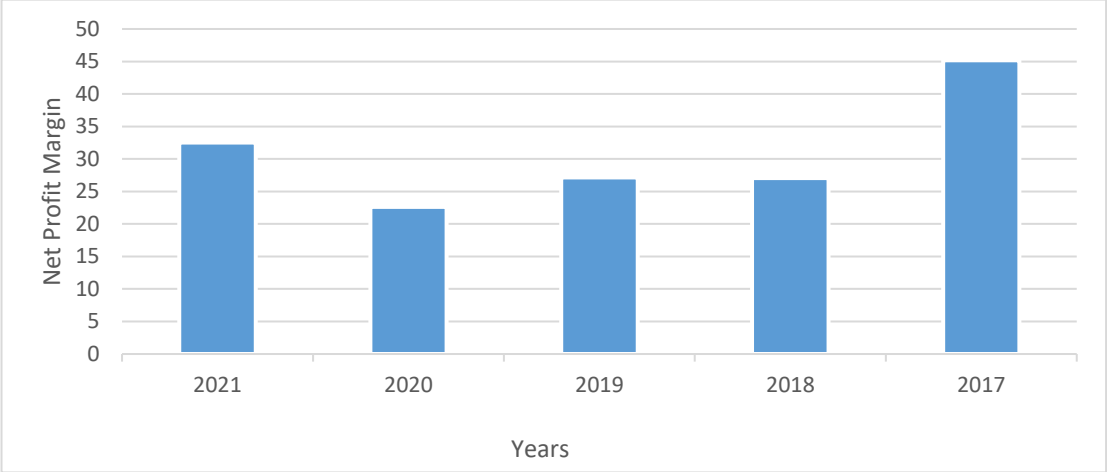

Figure 2 *Trend of the bank net profit margin over the five-year period.*

In 2017 the bank has the highest profit margin which decreased in 2018 by about 40% (18.13 profit margin). The bank profit margin remained almost constant in 2019 and decreased again in 2020, it then increased relatively in 2021, with about 30%.

3.2.1 Correlational analysis

The study used the Pearson correlation to determine the degree of relationship between the dependent and independent variables. The results are shown in the table below.

Table 7 Correlational analysis

		Net profit margin	ROE	Board size	Board independence
Net profit margin	Pearson Correlation	1	0.885*	0.150	-0.280
	Sig. (2-tailed)		0.046	0.809	0.648
	Sum of Squares and Cross-products	303.971	95.392	4.388	-0.483
	Covariance	75.993	23.848	1.097	-0.121
	N	5	5	5	5
ROE	Pearson Correlation	0.885*	1	0.288	-0.554
	Sig. (2-tailed)	0.046		0.638	0.333
	Sum of Squares and Cross-products	95.392	38.245	2.984	-0.339
	Covariance	23.848	9.561	0.746	-0.085
	N	5	5	5	5
Board size	Pearson Correlation	0.150	0.288	1	0.362
	Sig. (2-tailed)	0.809	0.638		0.549
	Sum of Squares and Cross-products	4.388	2.984	2.800	0.060
	Covariance	1.097	0.746	0.700	0.015
	N	5	5	5	5
Board independence	Pearson Correlation	-0.280	-0.554	0.362	1
	Sig. (2-tailed)	0.648	0.333	0.549	
	Sum of Squares and Cross-products	-0.483	-0.339	0.060	0.010
	Covariance	-0.121	-0.085	0.015	0.002
	N	5	5	5	5

*. **Correlation is significant at the 0.05 level (2-tailed).**

Table 7 above Indicates a significant positive correlation between ROE and the net profit margin (r = 0.885). There is a positive relationship between ROE and board size (r= 0.288) as well as between board size and the net profit margin (r = 0.150). However, results indicate that there was a negative relationship between the Board independence and net profit margin (r = -0.280) as well as between the board independence and ROE (r= -0.554). However, the board independence and board size are in direct proportion (r= 0.362).

3.2.2 Regression analysis

The effect of CG on the profitability of the bank was determined by making use of a regression analysis. Figure 3 below shows the summary of the regression model utilized in the study.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.989[a]	.978	.914	2.55804

a. Predictors: (Constant), Board_independent, Board_size, ROE

Figure 3 *Regression model summary.*

The model summary above indicates that there is a positive correlation between the variables. The R Square value is 0.978 indicating that 97% of the changes in profitability (Net profit margin) of the bank can be explained by the independent variables in this study (board independence, board size, ROE). Based of

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	297.427	3	99.142	15.151	.186[b]
	Residual	6.544	1	6.544		
	Total	303.971	4			

a. Dependent Variable: net_profit_margin

b. Predictors: (Constant), Board_independent, Board_size, ROE

Figure 4 *The analysis of variance.*

As indicated by Figure 4 above, the impact of the three independent variables (board independence, board size and ROE) on the profitability (Net profit margin) of the bank is not significant as indicated by the P value (0.186) which is greater than 0.05. The F value was (15.151).

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	-63.458	25.531		-2.486	.244
	Board_size	-5.232	2.112	-.502	-2.477	.244
	ROE	3.967	.640	1.407	6.198	.102
	Board_independent	120.002	41.070	.681	2.922	.210

a. Dependent Variable: net_profit_margin

Figure 5 *Regression model.*

The regression analysis Constant was = -63.458, the constant indicates that if each of the independent variables were to be evaluated as zero, that implies that the profitability (Net profit margin) of the Bank would indeed be classified as -63.458. Regression results indicate that the profitability (Net profit margin) of the bank is not substantially impacted by either (board independence, board size or ROE). However, the results suggest the board size to be negatively impacts the profitability (Net profit margin) (B=-5.232). On the other hand, ROE, and board independence positively impacted profitability. According to Moenga (2015), the sort of link that exists

between the variables is shown by the nature of the regression coefficients. The negative regression coefficients give an indication that there is a negative connection uniting independent and dependent variable (Moenga, 2015). The independent variables which show a positive coefficient in the model are in direct proportion with dependent variables. This implies that the increase in ROE and board independence resulted in a rise in the bank performance financially. The number of boards, however, had a detrimental influence on profitability. This suggested that reducing the number of board members would lead to an increase in the profitability of the bank.

4. DISCUSSION AND IMPLICATIONS

The study findings indicate that the relationship between the different corporate government mechanisms is significant in examining the profitability of a commercial bank. The regression analysis revealed that if all the independent variables (Board independence, board size and ROE) were to be rated as zero, then the profitability (Net profit margin) of the bank would rate -63.458 implying that the variables have a great influence on the bank profitability. Increasing the number on the board will have a reduction/decline on the profitability of the bank by a factor of 5.232. Further, a rise in ROE increases the profitability of the bank by a factor of 3.967 while a rise in board independence results in an increase in the profitability of the bank by a factor of 120.002.

When the level of significance is set at 0.05 and level of confidence set at 95%, the board size has 0.244 level of significant, ROE has 0.102 level of significant and board independence has 0.210 level of significance. This implied that in this study, the most significant variable is ROE. This means ROE had the most impact on the profitability of the bank. The second significant variable was board independence with the board size having the minimal impact. Consequently, statistically, ROE has the greatest influence on the profitability of the bank. The findings of the studies suggest board size, board independence and ROE have positive correlation on the performance of the bank.

5. CONCLUSION

The study concludes that linkage of corporate government mechanisms has a positive correlation in examining the profitability of the bank. However, ROE is significant when analyzing the profitability of the bank as compared to the board size and board independence. The study further discovered the size of the board to have no bearing on the profitability of the bank, hence when the board size increases the performance of the bank financially has declined. Moreover, the study established that the board independence, ROE, and the profitability of the bank is in direct proportion. That implied that a rise in board dependence and ROE leads to an increase in profitability. Other factors such as inflation and a Covid-19 during the study period could also have caused a decline in the profitability of the bank.

The study is therefore making the following recommendations:

- More studies are needed to measure the effect of CG on the bank with their profitability covering a longer period and to consider other CG practices to make compelling arguments.
- Similar studies should be carried out using different methodologies into how CG practices affect various companies' profitability. Their findings could aid making conclusive recommendations and adding reliability to the study findings.
- Further research that uses a longer period and more corporate government practice variables. Empirical studies on Namibian companies remain relatively under researched as no specific study to the best of the authors has been carried out in Namibia investigating impact the practice of corporate governance would have on a major bank profitability.

The study concludes that good CG helps to the growth of an organisation transparency and accountability leading to more sustainable companies. The findings of the study have implications for business executives and decision makers in analysing corporate governance issues within their companies with the goal of improving their organisation image and instituting discipline within the company management.

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