
BOARD OF DIRECTORS' INDEPENDENCE ON BANKRUPTCY RISK OF DEPOSIT MONEY BANKS IN NIGERIA

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Abstract: *The study ascertained the effect of board of directors' independence on bankruptcy risk in deposit money banks in Nigeria. Ex-post facto research design was adopted for the study. A sample of eight deposit money banks was purposively selected while other banks were inevitably excluded for unavailability of data. Data were generated from the annual reports and accounts of the selected banks in Nigeria. Panel data were analyzed with descriptive statistics, and panel regression analysis was used to test the hypothesis. The study shows that the board of directors' independence had a negative and significant effect for Nigerian deposit money banks, while that of South African showed a positive and has a significant effect on bankruptcy risk. Based on this, there is need to strengthen the board of director's independency, such as having more independent directors so as to monitor management decisions and prevents opportunistic behaviour, reducing the risk of bankruptcy.*

Keywords: *Directors' independence, Bankruptcy risk and Deposit money banks*

Introduction

The more board independence, the more the investment and the higher the financial performance, board independence could lead to better decisions that are in the best interest of the organization and good decisions assist towards achieving an improved financial performance. Despite the importance of the financial growth to businesses, it could be influenced by the board characteristics. Board characteristics are every attributes and features of a firm's board that permits the successful and efficient pursuit or full realization of the interests of the various stakeholders (Augustine, & Juliet, 2022). The attributes could be quantitative or qualitative, the quantitative (tangible) variables include audit committee independence, remuneration committee, board gender diversity, and board of director's independence and on the other hand, the qualitative or intangible variables include quality decisions, production of positive values (Kamaludin, et al 2020).

Financial distress is a broad concept used to describe situations in which firms face financial difficulty. The most common terms used interchangeably for financial distress are 'failure', 'default',

‘insolvency’, and ‘bankruptcy’ (Geng, et al, 2015). However, bankruptcy is the extreme and irredeemable outcome of financial distress and as such many financially distressed firms escape bankruptcy due to early reconstruction of operations. There are many definitions of financial distress because different countries have different accounting procedures and rules. It is generally believed that it is a situation where operating cash flow does not exceed negative net assets (Li et al., 2014). Geng et al. (2015) stated that some of the methods that have been used for financial distress prediction include discriminant analysis, logit or probit regression model, linear conditional probability models, neural network, decision trees, case based reasoning, genetic algorithm, rough sets, support vector machine, and others. However, the assumptions underlying the majority of these methods are far from real world situation. Extant research has focused on the discovery of better models for financial distress prediction (Ayoola & Obokoh, 2018). In Nigeria, Okoye and Okoye (2022); Ayoola and Obokoh (2018) investigated the effect of board characteristic on bankruptcy prediction in Nigerian banks which data ended in 2020, thereby created a periodic gap. This study therefore, sought to assess the effect of board of directors’ independence on bankruptcy risk of deposit money banks in Nigeria.

Conceptual Review

Board Independence Committee

Independent directors are the non-executive directors appointed into the board to represent the shareholders. Board independence is by and large influenced by how it is composed. A board is said to be independent if made up of more non- executive directors. The independent outside director brings to fruition the desired neutrality and minimize bias in the board process (Bhakat & Black, 2002). In line with this, Elshandidy et al. (2013) argued that having a good number of independent directors on the board would foster greater disclosure by the company. However, Gul and Leung (2004) documented that the presence of independent directors may not likely address the issue of disclosure as a result of complex board structure, hence, hypothesized that independent board of directors does not have significant effect on risk disclosure of Nigerian banks.

The global economy appears to have become caught up in what might be described as outside directors, euphoria (Dahya & Connell, 2017). Olubunmi (2021) study the effect of diversity on the financial performance of the board of directors of Nigerian citation companies. The results revealed that board independence, board gender diversity, and board size have a positive impact on the after-tax profits of selected listed companies in Nigeria. Similarly, Oyewale et al. (2019) study the relationship between board independence and the financial performance of listed manufacturing companies in Nigeria was investigated in this study. The result confirms that there is a significant positive linear relationship between board independence and financial performance of listed manufacturing companies in Nigeria.

To this end different studies have established negative result, Jibril and Maikano (2022) and Akpan and Amran. (2017) examine the relationship between board characteristics and company performance in Nigeria. The studies established that there is no relationship between boards' equity, board independence, and board age.

Bankruptcy Prediction

In addition, a prediction (Latin *præ-*, "before," and *dicere*, "to say"), or forecast, is a statement about a future event. A prediction is often, but not always, based upon experience or knowledge. There is no universal agreement about the exact difference between the two terms; different authors and disciplines ascribe different connotations. Although future events are necessarily uncertain, so guaranteed accurate information about the future is in many cases impossible, prediction can be useful to assist in making plans about possible developments; Howard H. Stevenson writes that prediction in business "... is at least two things: Important and hard (Stevenson, 2008).

Bankruptcy prediction has been one of the most challenging tasks in accounting since the study of FitzPatrick in 1930's and during the last 60 years an impressive body of theoretical and especially empirical research concerning this topic has evolved (Zavgren, 1983). The Altman models have been challenged by approaches directly producing probabilities of bankruptcy, such as the logit model, as well as by more advanced machine-learning methods. Direct application of the Z-Score or its variants has proved problematic in other countries, under other legal regimes (accounting principles), and in other time frames. However, indirect applications (e.g., models with the same variables estimated for a new data set) are still acceptable. Let us cite here the paper by Altman et al. (2017) that shows the validity of the Z-Score approach internationally with large data sets, also compared to logit models that performed similarly or better. It is also worth referencing the paper by Barboza et al. (2017), which compares several machine-learning methods to discriminant analysis and logistic regression in predicting bankruptcy. It turns out that the Altman Z-Score variables fare relatively well in other setups and models.

Today a large area of finance is dedicated to forecasting financial distress or bankruptcy, employing appropriate methodology. Nonetheless, it seems that the finance profession in academia still does not recognize this new methodology as staple content in core corporate finance and accounting courses. The notable exceptions are textbooks by Damodaran (Applied Corporate Finance, 5th ed., Damodaran, 2015) and Berk and DeMarzo (Corporate Finance, 4th ed., Berk & DeMarzo 2017).

The methodology of bankruptcy modelling may be attributed to financial micro econometrics and more recently, to advanced data analysis. Financial micro econometrics "emerges as a natural consequence of applying statistical and econometric methods to corporate finance, accounting, and other fields of finance; the applied edge of research in accounting and corporate finance is inevitably

linked with the use of notions such as statistical sample, population, and the operation on sets of microdata” (Gruszczyński 2018).

Empirical

Dalia (2023) examined the relationship between corporate governance and intellectual capital from 2017 to 2021. The modified Altman Z Score model was used to measure bankruptcy risk, and the value-added intellectual coefficient (VAIC) model was used to measure intellectual capital. The results also show an insignificant influence of board independence and audit committee size on intellectual capital efficiency. Moreover, this study finds that companies with intellectual capital efficiency are less likely to go bankrupt. Furthermore, the results indicate that board size, independence, and meetings have a significant negative effect on bankruptcy risk. Keerthana and Balagobei (2022) examined the impact of board characteristics on the financial distress of listed companies in Sri Lanka from 2019 to 2021. Panel regression analysis was employed, and 36 listed companies representing the consumer service sector in Sri Lanka were selected as the sample. This research focuses on five aspects of board characteristics consisting of board size, board composition, CEO duality, board meetings, and directors' ownership while financial distress was measured using Altman's Z score model. The results reveal that board size, board composition, and directors' ownership have a significant positive impact on financial distress whereas CEO duality has a significant negative impact on financial distress. Maina (2020) established the relationship between board characteristics and financial distress of listed commercial banks in Kenya. Correlation research design was adopted. A Census study of 11 listed commercial was adopted. Secondary data was collected from years 2011 to 2018. Inferential analysis and descriptive statistics were used to analyze data which was presented in tables, graphs and figures. The study further found a positive and insignificant relationship between independent directorship and financial distress. Governance disclosure had a positive and significant effect on financial distress. Governance disclosure has a positive and significant moderating effect on relationship between ownership structure, board structure and financial distress. Partha, et al (2019) assessed the effect of audit committee characteristics on the relationship between financial distress and income maximization actions. The study collected data among 37 companies that were listed in Indonesia Securities Exchange from 2015 to 2018. Regression modelling analyzed the data. Study findings documented that the committee financial expertise weakened the relationship between financial distress and income maximization actions. Audit committee independence had positive and significant moderating effect on the relationship between financial distress and income maximization actions. Alkilani, Hussin and Salim (2019) studied the effect of audit committee characteristics on audit opinion of Jordan companies. Judgemental sampling was adopted in selection of 117 companies listed in Amman Stock Exchange. Accounting committee characteristics examined were expertise, independent directorship, meetings and size. Logistics regression modelling was fitted. It was

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documented that audit committee characteristics had significant influence on modified audit opinion. Salloum, Azzi and Gebrayez (2019) explored the effect of audit committee characteristics on financial distress of financial institutions in Middle East. A sample of 54 Lebanese banks was examined for periods 2009 to 2011. Financial distress was operationalized through evaluation of profitability. Regression findings revealed an inverse and significant relationship between frequency of audit committee meetings and financial distress. Aman (2019) sought to assess the determinants of financial distress in Ethiopian banking sector. Quantitative research design was applied, and data collected from 15 banks from 2012 to 2016. Univariate and multivariate statistics analyzed the data. Study findings documented that profitability and liquidity had positive and significant influence on financial distress (debt service coverage). Further, inflation, solvability, firm size had inverse significant effect on debt service coverage. The model had higher odds of being spurious since there was a mix of time series and panel data. Khurshid, et al (2018) evaluated the impact of corporate governance on likelihood of financial distress of non-financial companies in Pakistan. Particularly, the study examined the effect of board composition, ownership structure, audit quality, board size, CEO's duality, board independence, insider's directorship, institutional investment and financial distress. Binary logistics model was fitted on secondary data gathered from 2009 to 2016. Study findings documented that there was significant negative impact on likelihood of financial distress between board size, insider director's ownership and audit quality. Fashan and Fitriana (2018) undertook a study to identify the impact of corporate governance and intellectual property rights on financial distress of listed manufacturing companies from 2014 to 2016 in Indonesia securities exchange. Purposive sampling was adopted in selected of 249 manufacturing companies. Univariate, bivariate and multivariate data analysis procedure were adopted. Study findings documented that there was no significant association between corporate governance and financial distress of manufacturing companies. Fuad (2017) sought to assess the impact of audit committee characteristics on financial distress of listed companies in Indonesia Securities Exchange. Judgemental sampling was adopted in selection of 123 service-based companies listed from 2013 to 2015. Financial distress was operationalized as firms which had recorded losses of two consecutive years. Binary logistics regression model was fitted. Study findings documented that there was an inverse effect of audit committee competence and financial distress. Further, there was an inverse and insignificant effect of audit committee meeting and financial distress. Jalan, Kale, and Meneghetti (2016) examined the effect of leverage and bankruptcy risk on corporate incentives to shelter income from taxes. Their empirical tests provide evidence that is consistent with these theoretical predictions. They show that leverage and bankruptcy risk relate negatively to sheltering and that the negative effects of bankruptcy risk and debt on sheltering are stronger for riskier firms; and weaker for larger, better governed, more profitable firms, and for firms that are in the "public eye". Masoumeh (2016)

investigated the relationship between earnings management and quality of earnings for the bankrupt and non-bankrupt firms listed in the Tehran Stock Exchange from 2007 to 2012. Also, the future profitability was measured by each of the three variables, future change of earnings, future cash flow from operation, and future non-discretionary earnings. The results of estimating unbalanced panel data technique for 55 firms subjected to bankruptcy of Altman's model, and 198 non-bankrupt firms, shows that the bankrupt firms tend to use opportunistic earnings management, and the non-bankrupt choose efficient earnings management. Ahmadpour and Shahsavari (2014) investigated the earnings quality management and impact on the profitability of future profits of Tehran's stock exchange bankrupt companies. The results with the technique panel data for 55 companies subject to the verge of bankruptcy Altman's model, stating that these companies have a disproportionate composition and proceeded to increased profit management. The results of opportunistic theory of earnings management support and show that the future profitability of earnings quality work. Campa, Del Mar and Miñano (2014) conducted a study on the response to the question whether Spanish companies go bankrupt, compared to their counterparts, during the years prior to the procedure of bankruptcy law tend to manage earnings or not? In the analysis of a sample matched bankrupt companies, it became clear that earnings management of bankrupt companies is more than those in non-bankrupt them. They achieved this accomplishment of accrual and manipulation of actual items. Findings showed that management tools profit operates by industry in which the company and the years of pre-bankruptcy are changed. Ezejiofor, Nzewi and Okoye (2014) determined the effect of Altman Model to predict possibility on corporate bankruptcy/ failure in Nigerian banking sector. Data were collected from annual reports and accounts of the banks. Altman prediction was applied. Findings show that the Model was capable of measuring accurately the failure potential of sound and healthy banks.

Methodology

Research Design

Ex-Post-Facto research design was used for the study. This involves use of financial accounts of the banks under assessment for the period, 2012-2024 to generate the financial ratios that discriminated the most in prediction of healthy banks using Altman Model. The population of the study comprised of listed banks in the Nigeria. Given the above, the study population is made up of twenty eight (28) banks in Nigeria. As a result, the "purposive sampling technique was applied (Non-random sample). The study employed eight Nigerian deposit money banks licence with international authorization.

Source of Data

Data were generated from from the annual reports and accounts of the selected banks in sub-Sahara Africa. The statement of financial position and comprehensive incomes provided data will use in computing the selected ratios from 2013-2024. Hence, the decision to select 2012 year which is based on the most recent year of adoption as evidenced in Nigeria.

Model Specification

The data required were those of the dependent variable that include: Altman prediction model (working capital, retained earnings, earnings before interest and tax, equity as well as total assets and total book debts) and independent variable, board independence. This was obtaining from the audited reports and accounts of the banks under assessment.

The study used Altman Model given as Zeta “Z”

$$Z=1.2X_1 + 1.4X_2+ 3.3X_3 + 0.6X_4 + 1.0 X_5,$$

Where:

- X_1 = Working capital to total assets
- X_2 = Retained earnings to total assets
- X_3 = Earnings before interest and taxes to total asset
- X_4 = Value of equity to total book debt
- X_5 = Gross earnings to total assets

The decision rule is that:

- (i). For $Z < 1.81$ Bankruptcy region
- (ii). For $1.81 < Z < 2.675$ High bankruptcy potential
- (iii). For $2.675 < Z < 2.99$ Low bankruptcy potential
- (iv). For $Z > 2.99$ Strong (No sign of bankruptcy at all).

The Altman Model will be modified thus to incorporate corporate governance:

$$ATMN_{it} = a_0 + \beta_1 BIND_{it} \text{ urt} \dots\dots\dots i$$

Where;

ATMN= Altman Prediction Model

BIND = Board independence

Method of Data Analysis

Data were analyzed with descriptive statistics, and the hypotheses will be tested with Pearson correlation, and multiple regression analysis. Since the focus of the study is to examine the effect of asset composition on financial performance, regression analysis becomes appropriate tool for it.

Descriptive statistics employed to summarily describe the mean, median, standard deviation, kurtosis and skewness of the study variables. Inferential statistics will also be utilized with the aid of E-Views 9 using:

- i. Coefficient of correlation: which is a good measure of relationship between two variables that tell us about the strength of relationship and the direction of the relationship as well?
- ii. Panel Regressions analysis: Regression analysis predicts the value the dependent variable based on the value of the independent variable and explains the impact or effect of changes in the values of the variables.

Decision Rule

Accept the alternative hypothesis, if the Probability value (P-value) of the test is less than 0.05 (5%). Otherwise reject.

Data Analysis and Results

Data Analysis

Table 1: Descriptive Statistics

| | ATMN | BIND |
|--------------|----------|-----------|
| Mean | 54.87547 | 13.76923 |
| Median | 0.210044 | 16.00000 |
| Maximum | 652.9549 | 17.00000 |
| Minimum | 0.055106 | 9.000000 |
| Std. Dev. | 174.1820 | 3.528609 |
| Skewness | 3.132913 | -0.490033 |
| Kurtosis | 10.90951 | 1.347170 |
| Jarque-Bera | 441.2242 | 16.00030 |
| Probability | 0.000000 | 0.000335 |
| Sum | 5707.049 | 1432.000 |
| Sum Sq. Dev. | 3124955. | 1282.462 |
| Observations | 104 | 104 |

Source: E-views 9 (2025)

From Table 1, it could be observed that the mean values of the bankruptcy risk (ATMN) stood at 54.875. Considering that the scientific value of Nigerian firms. The board independent (BIND) has the mean values stood at 13.769 Nigerian banks which implied that banks in Nigeria maintained optimum board independence.

The kurtosis of 10.90951 and 1.347170 for Nigerian banks ATMN and BIND showing a distribution that is strong, suggesting a concentration of values around the mean with potential outliers. The Jarque-Bera probability of 0.000000 and 0.000335 confirmed that the ATMN, and BIND data is significantly non-normally distributed showed that traditional parametric analyses may need to be approached with caution. On the Jarque–Bera test of goodness-of-fit, the result suggested that only the data on firms in the Nigerian sample banks followed a normal distribution.

Test of Hypothesis

Ho: Board of directors' independence has no significant effect on bankruptcy of risk deposit money banks in Nigeria.

Table 2: Regression analysis between BIND and ATMN

Dependent Variable: ATMN

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Method: Panel Least Squares

Date: 06/11/25 Time: 07:57

Sample: 2012 2024

Periods included: 13

Cross-sections included: 8

Total panel (balanced) observations: 104

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|--------------------|-------------|-----------------------|-------------|----------|
| C | 345.9983 | 62.75989 | 5.513048 | 0.0000 |
| BIND | -21.14300 | 4.416612 | -4.787153 | 0.0000 |
| R-squared | 0.283457 | Mean dependent var | | 54.87547 |
| Adjusted R-squared | 0.275451 | S.D. dependent var | | 174.1820 |
| S.E. of regression | 158.1654 | Akaike info criterion | | 12.98420 |
| Sum squared resid | 2551661. | Schwarz criterion | | 13.03506 |
| Log likelihood | -673.1785 | Hannan-Quinn criter. | | 13.00481 |
| F-statistic | 22.91684 | Durbin-Watson stat | | 2.720898 |
| Prob(F-statistic) | 0.000006 | | | |

Source: E-views 9 Output (2025)

In table 2, a simple least square regression analysis was conducted to test the effect between board of directors' independence (BIND) and bankruptcy risk (ATMN) for Nigerian deposit money banks. The R-squared is coefficient of determination which tells us the variation in the dependent variable due to changes in the independent variable. From the findings in the table 2, Nigerian value of R squared was 0.28, an indication that there was variation of 28% on ATMN due to changes in BIND. This implies that 28% changes in ATMN could be accounted for by BIND, while 72% was explained by unknown variables that were not included in the model.

The Durbin-Watson Statistic of 2.72 suggested that the model does not contain serial correlation. The F-statistic of the regression is equal to 22.917. The associated F-statistical probability is 0.000.

The hypothesis of this study stated that board of directors' independence has no significant effect on bankruptcy risk of deposit money banks in Nigeria. The evidence provided by the regression result of model showed that the variable of board of directors' independence had a negative coefficient of -21.14300 and a p-value of 0.000 which was significant at 5% level for Nigerian deposit money banks. It meant that there was a significant effect between board of directors' independence and bankruptcy risk in Nigeria.

The regression result revealed that board of directors' independence had a negative coefficient of -21.14300 and a p-value of 0.000 which was significant at 5% level for Nigerian deposit money banks; while the outcome of model 2 showed a positive coefficient of 0.888108 (p-value 0.020) for deposit money banks in South Africa, and also has a significant effect. This result affirmed the study of Okoye and Okoye (2022) showed that board of directors' independence has a positive significant effect on bankruptcy risk of deposit money banks in Nigeria. Dalia (2023) indicate that board independence, has a significant negative effect on bankruptcy risk. Also the study of Mohammed and Onipe (2023) found that board independence shows negative significant effects.

However, the study disagreed with Maier and Yurtoglu (2022) who found that board independence and decrease bankruptcy risk in financially non-distressed firms, they have the opposite effect in financially distressed firms; Aliyu, Onipe and Samuel (2023) showed that board independence show insignificant effects.

Conclusion

This study ascertained the effect of board of directors' independence on bankruptcy risk in deposit money banks in Nigeria. Data were generated from 2012 to 2024 from the audited annual reports and accounts of the sampled deposit money banks in Nigeria. Using regression analysis, the study discovered that board of directors' independence had a negative and significant effect bankruptcy risk for Nigerian deposit money banks. Based on this, there is need to strengthen the board of director's independency, such as having more independent directors so as to monitor management decisions and prevents opportunistic behaviour, reducing the risk of bankruptcy.

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