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Impact of Corporate Governance on Firms' Performance: Evidence from Nigeria

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Abstract

The broad objective of this paper is to examine the corporate governance and firms' performance, in quoted firms in the Nigerian stock exchange for the period of three (3) years from 2015 – 2017. Ordinary Least Square (OLS) was used to analyze the data generated from secondary source. The study revealed that the CEO's duality and board size were observed to have negative correlations with the performance of firms while number of committees, directors' shareholdings and audit committee has positive influence on the performance of the firm. It is therefore recommended that the issues of corporate governance code of best practice should make it mandatory for listed firms to reduce their board size to eleven in numbers to ensure efficiency and effectiveness since larger board negatively affect the performance of firms as confirmed by this study.

Keywords: *Corporate governance, Firms' performance, Nigerian stock exchange, Board size, Board composition*

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Background to the Study

Recent accounting scandals in prominent companies have shaken the confidence of investors. In the wake of these scandals, many of these companies saw their equity values plummet dramatically and experienced a decline in credit ratings of their debt issues, often to junk bond status. Many of them were forced to file for Chapter 11 bankruptcy protection from creditors. Revelations about the unreliability of reported earnings continue to mount, as evidenced by an alarming increase in the frequency of earnings restatements by firms in the last few years. The widespread failure in financial reporting has largely been blamed on weak internal controls. Worries about accounting problems are widely cited as a reason for the stock market slump that followed these scandals.

Corporate governance, as a concept, can be viewed from at least two perspectives: a narrow one in which it is viewed merely as being concerned with the structures within which a corporate entity or enterprise receives its basic orientation and direction and a broad perspective in which it is regarded as being the heart of both a market economy and a democratic society. The narrow view perceives corporate governance in terms of issues relating to shareholder protection, management control and the popular principal-agency problems of economic theory.

Since the involvement of notable world companies such as Enron, Xerox and worldcom in accounting scandals, leading to the credibility of corporate financial reports under sharp suspicion, loss of investor's confidence on the financial reports, the issue of corporate governance has continued to receive much attention in literature.

As a result of the accounting scandals, the Sarbanes-Oxley Acts was enacted in 2002 to enhance corporate governance in firms. The issue of corporate governance has been viewed as the priority of financial revolution in the expectation that governance, mechanism may be reinforced, public confided retrieved, accrual and reliability of financial information assured. Corporate governance issues assume greater significance in corporate forms of organization mechanisms play an important role in determining the quality of governance in a firm.

The internal governance mechanism such as the composition and size of board, and the equity ownership structure of the firm is based on specific mechanisms and actions taken by individual firms to enforce control and accountability. Several variables have been employed to measure the relationship between corporate governance and firm's performance, most have yielded mixed findings. Sanda, Mikailu, & Garba (2005) examines the relationship between corporate governance and firm performance. The empirical relationship indicated that firms' performance was in negative and significant relationship to board size and CEO duality. On the other hand, firms' performance was in positive and significant relations to board independence and insider ownership. Against this backdrop, this study was embarked upon.

The main objective of this study is to empirically evaluate the relationship between corporate governance and firms' performance in Nigeria. However, the specific objectives include to:

i. Find out the relationship between board size and firms performance in Nigeria
ii. Examine the relationship between board composition and the performance of firms in Nigeria.
iii. Find out the relationship between audit committee and firms performance in Nigeria.
iv. Examine the relationship existing between directors' shareholdings and firm's performance in Nigeria
v. Find out the relationship between C.E.O duality and firms performance.

Literature Review

Corporate governance has, in recent years, become a topical issue both in business and academic circles. The concern in business arose out of the perceived importance that a fraction should be developed that supports moral and ethical conduct in business affairs which will create a general climate (both legal and social environment) that will promote good governance of firms- In the academic world, it is established that business decisions are not made in a vacuum. Business decision-makers have objectives outside the firm's objectives, for example managers are interested in their own personal satisfaction rather than in their employees' welfare, as well as in the good of the community (society) at large and these objectives impact on shareholder's wealth adversely. (Fama & Jensen, 1983, Shiefer & Vishny, 1997).

By definition, corporate governance is a system or an arrangement that comprises of a wide range of practices, standard, rules concerning financial disclosures, executive compensation, size and composition of corporate boards) and institutions (legal, economic and social) that protect the interest of corporation's owners. According to Laporta, Florencio, Andrei, and Robert, (2000) "corporate governance is to a certain extent a set of mechanism through which outside investors protect themselves against expropriation by the insiders. Insiders are defined as both managers and controlling shareholders.

The corporate governance structures specify the distribution of rights and responsibilities among different stakeholders in a corporation, like the board, managers, shareholders and others, and spell out the rules and procedures for making decisions on corporate affairs. This is inconformity with the view of Uche (2004) and Akinsuhve (2006). Effective corporate governance reduces the "control right" conferred in managers and increases the chances that manger's investment decisions enhance the maximization of shareholder's wealth. (Shiefer & Vishny, 1997). This, however, suggests that better corporately governed firms have better operating performance. Bebchuck, Cohen & Ferret (2004) shows that firms with stronger stockholders' right have higher value. In a latter study that used Nigeria data on twenty firms, the result shows a positive and significant relationship

between return on equity (ROE) and board size, between return on equity (ROE), board composition and audit committee, between profit margin and chief executive status. It further shows that there is no significant relationship between profit margin and board size, board composition and audit committee (Kajola, 2008). There is also a widely held view that better corporate governance is associated with better firms' performance, but the evidence is not sufficiently available in the Nigeria context. As such, providing an additional empirical evidence of the relationship between corporate governance standards and firms performance is a function of the corporate governance provisions and the level of compliance to the set standard.

The Effect of Corporate Governance Practices on the Firms' Performance

Corporate governance which is hitherto seen as the foundation for good corporate performance has received lack-lustre attention from corporate bodies globally for a considerable length of time (Ejiofor, 2009). This attitude which bordered on neglect of corporate strategies may have eventually led to the recent global high profile corporate failures. Notable among such failed corporate bodies are HIH Insurance and One-tel both in Australia, Maxwell communications Corporation, and Bank of credit and commerce international (BCC1) both in the United Kingdom; Enron and Worldcom both in the United States and Parmalat in Italy. All these failures have been attributed to poor corporate governance (Tennyson, 2010). In Nigeria, the story is not different. There have been several corporate failures a large-scale misappropriation of funds in the recent past in Nigeria, involving public organizations such as AVOQP Oil, Niger Steel Company, Anambra State Motor Manufacturing Company, Nigeria Coal Corporation, Cooperative and Commerce Bank, African Petroleum Nigeria Limited, and many of new generation banks that could not pass through the recapitalization process. These failures raise some fundamental questions such as management style, audit independence, the nefarious practices of board members, ethics, professionalism and conflict of interest. Today, almost all the surviving government establishments in Nigeria are sick and ailing. Major among the ailing government establishments in Nigeria include; Ajaokuta Steel Industry, Nigerian Refineries, Niger Gas Ltd Enugu, Flour Mill Company Enugu, etc, the primary aim of establishing these organizations were not being fully realized. In spite of the act there are regulatory bodies and agencies established to oversee corporate governance in Nigeria and ensure compliance with laid down rules and regulations, yet the corporate failures have escalated. The implication of this is that the regulatory agencies need to be reformed and restructured to reposition them and make them more effective and relevant in the 21st century.

Corporate Governance and Firm Performance: New Insights and Evidence from Nigeria

The bulk of evidence suggests a positive association between corporate governance and organizational performance (Love, 2011). In this regard, sub-optimal or outright failure of governance systems can therefore be argued to be a major contributor to the collapse of many of the well-celebrated organizations that have littered the world's corporate landscape. This failure, which translates into an inability of organizations to meet the

expectations of their various stakeholders, has often been traced to weaknesses in the internal controls infrastructures and operating environments, and a lack of commitment to high ethical standards. These weaknesses are sometimes deliberately or intentionally induced by organizational designers and controllers, and at other times they may he a result of the naive assumption that managers will always act in a way that suggests or promotes enlightened self-interest, which should ultimately have positive implications for all stakeholders (Donaldson & Preston, 1995). However, evidence emerging from some of the recently collapsed firms, hitherto assumed to be run professionally or no sound principles, succinctly demonstrates the point that there will always be discrepancies or misalignments between the various organizational stakeholders' interests. Therefore, managing these conflicting interests in a way that produces mutually satisfying outcomes for all stakeholders is at the core of the good corporate governance discussion. Expectedly, this problem has generated renewed interest in understanding the dimensions and ramifications of corporate governance, and its centrality to the well-being and survival of firms across sectors and geographic borders. Emphasis is not just on how well the organization succeeds in its profitability goal, but how well it is managed, run and internally regulated, both formally and informally (Parker, 2006), As has been demonstrated in the recent closure of News of the World in UK, corporate governance concerns clearly transcend just the financial well-being of firms.

Studies carried out so far on the subject of corporate governance in Nigeria have concentrated exclusively on firms quoted on the Nigerian Stock Exchange (Adenikinju & Ayorinde, 2001; Babatunde & Olaniran, 2009; Kajola, 2008; Sanda, Mikailu & Garba, 2005). Although the basis for this choice is understandable, it however creates a problem of exclusion and forecloses a comprehension of the corporate governance behaviors and outcomes of private medium and large firms which make up the bulk of organizations across the various business sectors of Nigeria, this present research addresses the problem by studying a mix of publicly quoted firms and private companies in a cross- sectional survey. Also, the study uses profit margin and return on assets as proxies for corporate performance, rather than the popular market or share valuation, which may be relatively restrictive for immediate and accurate assessment of the performance of privately -owned firms.

Overall, the study examines the relationship between corporate governance and the performance of Nigerian firms, using reliability of financial reporting, existence of a code of corporate governance, effective audit committee, board size, and separation of office of board chair from CEO as the variables of corporate governance, while return on assets and profit margin serve as proxies for firm performance. A comparison of corporate governance regime of public and private firms is also carried out here. This study will therefore contribute new dimensions to the growing stock of literature on the subject, as it attempts to deliver on a more robust, yet simple understanding of the impact of corporate governance on the performance of Nigerian organizations using appropriate yardsticks that recognize the problem of paucity of reliable data in the study of the phenomenon in the Nigerian setting.

Corporate Governance and Firm Performance

The term "Corporate Governance" has been identified to mean different things to different people. Magdi and Nadereh (2002) stress that corporate governance is about ensuring that the business is run well and investors receive a fair return, OECD (1999) provides a more encompassing definition of corporate governance. It defines corporate governance as the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company's objectives and the means of attaining those objectives and monitoring performance. This definition is in line with the submissions of, Wolfensohn (1999) Uche (2004) and Akinsulire (2006). Financial scandals around the world and the recent collapse of major corporate institutions in the USA, South East Asia, Europe and Nigeria such as Adelphia, Enron, World Com, Commerce Bank and recently XL Holidays have shaken investors' faith in the capital markets and the efficacy of existing corporate governance practices in promoting transparency and accountability. This has brought to the fore once again the need for the practice of good corporate governance.

Effective corporate governance reduces "control rights" shareholders and creditors confer on managers, increasing the probability that managers invest in positive net present value projects (Shleifer & Vishny, 1997). Thus, the relationships of the board and management, according to Al-Faki (2006), should be characterized by transparency to shareholders, and fairness to other stakeholders. This will in effect mitigate the agency cost as predicted by Jensen and Meckling (1976). Corporate performance is an important concept that relates to the way and manner in which financial resources available to an organization are judiciously used to achieve the overall corporate objective of an organization, it keeps the organization in business and creates a greater prospect for future opportunities.

This study is a contribution to the ongoing debate on the examination of the relationship that exists between corporate governance mechanisms and firm performance. Mixed and tenuous findings have been made from previous studies especially those ones that were conducted in the developed nations, particularly USA, UK, Japan, Germany and France.

Corporate Governance Measures in Nigeria

Over the years, Nigeria as a nation has suffered a lot of decadence in various aspects of her national life, especially during the prolonged period of military dictatorship under various heads. The political and business climate had become so bad that by 1999 when the nation returned to democratic rule, the administration of Obasanjo inherited a pariah state noted to be one of the most corrupt nations of the world (Elewechi, and Okike, 2007). Most public corporations, such as Nigerian Telecommunications Limited (NITEL), National Electric Power Authority (NEPA) and Nigerian Railway Corporation (NRC) were either dead or simply drain pipes of public resources, while the few factories that

were merely available were working below capacity. The banks with their super profits were collapsing in their numbers/leaving a trail of woes for investors, shareholders, suppliers, depositors, employees and other stakeholders. With reference to the examples cited above, it was as a result of the messy state of the nation's assets then that led to the government to make a bold step in initiating the corporate governance evolution. In view of the importance attached to the institution of effective corporate governance, the Federal Government of Nigeria/through her various agencies have come up with various institutional arrangements to protect the investors of their hard earned investment from unscrupulous management directors of listed firms in Nigeria.

Methodology

The research designs used in this study area the survey, expost-facto and descriptive research designs. The justifications for the choice of this design are that the quoted firms being studied are surveyed and data extracted from the annual reports. Similarly, the design is also ex-post facto in that the data from the firms that make up the sample cannot be subjected to the manipulation of the researcher for analysis. The descriptive research design is employed simply because the data analyzed shall be described coherently and interpreted in order to have an adequate understanding of the subject matter being investigated. The population of this study comprises of all the quoted manufacturing firms in the Nigerian stock exchange. And the sample size of this research comprises of fifty (50) quoted manufacturing firms in the Nigeria stock exchange. These sample size are selected using the convenience random sampling technique by the student-researcher.

Method of Data Collection

The method employed to collect the data for this study is the secondary data for the period of three (3) years from 2015 - 2017.

Method of Data Analysis and Model Specification

The method employed by the researcher to analyses the data generated from the field is ordinary least square multiple regression analysis embedded in E-view. The model specification to undertake the regression analysis is of the equation form as pbt = (bsiz, audcom, dsh, noc and ceodual which is now captured:

$$PBT = \beta_0 + \beta_0 bsize + \beta_2 audc + \beta_3 noc + \beta_4 dsh + \beta_5 ceodual + ut$$

Where PBT is profit before tax serving as the dependent variable while β_1,β_2, β_3, β_4, and β_5 are the coefficients of the respective independent variables in the model specification which include board size, audit committee, the number of committee, director shareholding and CEO duality, ut represents the error terms acting as a surrogate however, $\beta_0$is the intercept.

Data Analysis and Presentation

We explain the analysis of data gathered and how the analysis was presented. This begins with the descriptive statistic in section 1. This is followed by correlation analysis in section 2 supported by variance inflation factors in section 3. The regression results other in section 4.

Descriptive Statistic

Table 1: Descriptive statistics

	PBT	BSIZE	AUDC	NOC	DIRSH	CEODUAL
Mean	7.45E+08	9.41573	5.370787	3.303371	2.66E+08	1.314607
Median	190340	9	6	3	38016000	1
Maximum	3.29E+10	22	9	7	5.72E+09	2
Minimum	-56983000	4	3	1	11992	1
Std. Dev.	4.65E+09	3.107209	1.17146	1.291621	7.62E+08	0.46699
Skewness	6.430383	1.290241	0.100446	0.28057	5.580376	0.798491
Kurtosis	42.70279	5.342711	2.994807	2.960689	36.7136	1.637588
Jarque-Bera	6458.845	45.04579	0.149759	1.173405	4676.837	16.34084
Probability	0	0	0.927855	0.556158	0	0.000283
Sum	6.63E+10	838	478	294	2.37E+10	117
Sum Sq. Dev.	1.90E+21	849.618	120.764	146.809	5.11E+19	19.19101
Observations	89	89	89	89	89	89
Source: Author (2018)						

From this table, it is found that the mean value of PBT is N745000000000 and standard deviation is N465000, 000,000. The statistic of other variables includes 9 for BSIZE with a standard deviation of 3. AUDC has a mean and standard deviation of 5 and NOC has a mean of 3 and standard deviation of 1. DIRSH has a mean of N79813307. CEODUAL has a mean of one (1) and a standards deviation 0.5.

Table 2: Correlation Matrix

	PBT	BSIZE	AUDC	NOC	DIRSH	CEODUAL
PBT	1	-0.09892	-0.10476	0.084298	0.043768	-0.09296
BSIZE	-0.0989234	1	0.475406	0.101297	0.047699	-0.14598
AUDC	-0.1047612	0.475406	1	0.12759	0.225515	-0.00794
NOC	0.0842977	0.101297	0.12759	1	-0.07505	0.254442
DIRSH	0.0437682	0.047699	0.225515	-0.07505	1	-0.16498
CEODUAL	-0.092959	-0.14598	-0.00794	0.254442	-0.16498	1

Source: Author (2018)

The correlation analysis is shown on table 2 from the results; the relationship is a mix of positive and negative relationships. The matrix reveals the extent of the relationship that exists among the variables. On the basis of this table and the associated, there is no reason to suggest that there is first order multi collinearly problem or the coefficients are within the acceptance region and below the rule of thumb of 0.6

Variance Inflation Factor
Table 3: Variance Inflation Factors

Variance Inflation Factors Date: 02/15/18 Time: 05:24 Sample: 1 102 Included observations: 89			
	Coefficient	Uncentered	Centered
Variable	Variance	VIF	VIF
C	8.35E+18	33.98249	NA
BSIZE	3.47E+16	13.88684	1.349944
AUDC	2.52E+17	30.99468	1.392501
NOC	1.64E+17	8.392066	1.101995
DIRSH	0.47024	1.233831	1.098577
CEODUAL	1.29E+18	10.2415	1.136097

Source: Author (2018)

Similarly, the correlation matrix is the variance inflation factor which reveals higher order collinearly problem. From the table the value range from 1.105 and 1.178 suggesting that the variables are accepted to be included in the model.

Table 4: Pooled Regression

Dependent Variable: PBT Method: Least Squares Date: 02/15/18 Time: 04:31 Sample (adjusted): 1 93 Included observations: 89 after adjustments				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	3.98E+09	2.89E+09	1.377621	0.172
BSIZE	-1.36E+08	1.86E+08	-0.73216	0.4661
AUDC	-3.73E+08	5.02E+08	-0.74234	0.46
NOC	5.18E+08	4.05E+08	1.279384	0.2043
DIRSH	0.353836	0.685741	0.51599	0.6072
CEODUAL	-1.33E+09	1.14E+09	-1.17341	0.244
R-squared	0.046001	Mean dependent var		7.45E+08
Adjusted R-squared	-0.011469	S.D. dependent var		4.65E+09
S.E. of regression	4.68E+09	Akaike info criterion		47.4343
Sum squared resid	1.81E+21	Schwarz criterion		47.60207
Log likelihood	-2104.826	Hannan-Quinn criter.		47.50192
F-statistic	0.800436	Durbin-Watson stat		2.057301
Prob(F-statistic)	0.552507			

Source: Author (2018)

Discussion of Results

From the result, it is found that the adjusted R-squared is 0.048, indicating that 4% of the systematic variations in the dependent variable (PBT) are accounted for by the independent variable. Besides, the F-statistic of 6.05 shows that the model is not fit and proper for the analysis. The D.W statistic of 2.05 (approximately 2) indicate the absence of autocorrelation. Meanwhile the variable of BSIZE AUDC and CEODUAL are statistically negative insignificant. These variables are negatively related to the dependent variable of NOC and DIRSH are positively related but statistically insignificant to PBT (Profit before tax).

Given the analysis and results, the following are the findings;

I. About 4.6% of the systematic variation in PBT were acsorted for by the independent variables.
ii. AUD was found to be positively related and statistically significant to PBT.
iii. BSIZE was negatively related but statistically insignificant to PBT.

iv. NOC, and DIRSH were positively related but statistically significant to PBT
v. CEODUAL was negatively related but statistically insignificant to PBT.

The findings made from the analysis are robustly discussed in this section as follow;

a. Audit committee was found to be positively related to the performance of firms quoted on the floor of the Nigeria stock exchange. This portends that the role play by this component of corporate governance will largely determine the performance of the firms. This finding is not in tandem with studies of previous researchers such as Klein (2002) who reported a negative correlation between business earnings (performance) and audit committee.
b. Board size was ascertained to be negatively related to the performance of firms in the period under consideration. The board of directors play a significant function to ensuring the firms' survival in any industry. In other words, the level of a firm's performance is revealed by how much the board of director are able to do. This finding correlates with that of Lipton and Lorsch (1992). who argued that large boards are less effective and are easier for the CEO to control
c. Similarly, the numbers of committee in a firm as well as director shareholding were found to be positively associated with the performance of quoted firms. This implies that due to the influence of director shareholdings, the management of the firms is carried out in such a way so as to determine the performance of the firm.

Findings

The analysis as well as the findings made under this study shows a lot of implication in a subject matter like this that is constantly attracting the attention of professionals and the general public at large. The implication of the findings made thus far portends that larger board size has the propensity of reducing the level of performance of firms. Large board size may manipulate the earnings of a firm to satisfy their which and comprises but to the detriment of the shareholders who are mainly not members of the board. In the same vein, CEO duality affects and reduces the effectiveness of the firm. The notion whereby the chairman acts in various segments of the organization and at the same time the chief executive officer is likely to result in the manipulation of the profit generated from such company. The number of committee and the stake of the directors inform of director shareholding may ensures that the firms are operated in such a way as to achieve the main corporate purpose of profitability and the maximization of shareholder's wealth.

Conclusion

The main focus of this study was to examine the impact of corporate governance on firm's performance among quoted firms on the floor e.g. the Nigerian stock exchange, key variables such as audit committee, Board size, number of committee, director shareholding and CEO duality were employed with a view to achieving the objective of the study. The influence of these variables showed mixed findings, CEO duality, board size and senior management from the content of this study show that they are the public face of any organization. Thus, in a situation where the functions of the mentioned corporate governance a component fail, the long-run effect will be detrimental to the

success of the firm. All the corporate governance variable was this employed under this study, such variables include auditor independence, director independence and others. In order to further this study, these and other variables should be employed future researchers with a view to making inferences.

Recommendations

a. The issues of corporate governance code of best practice should make it mandatory for listed firms to reduce their board size to eleven in numbers to ensure efficiency and effectiveness since larger board negatively affect the performance of firms as confirmed by this study and other prior studies
b. The chief executive officer (CEO) of the firm should be made to act solely in that capacity as this will enable the corporate vision and mission of the organization to be pursued vigorously.
c. The directors should have made to have larger units of shares in the firm as this will enhance their commitment in that they will see themselves not just as servants to the resources owners, but also the owners of the firm whose goal will be to expect a greater return on investment.
d. The development of an effective legal framework that specifies the rights, and obligation of a company, its direction, shareholders, and specific disclosure requirements and provides for effective enforcement of law is needed to promote strong corporate governance in the system.
e. To further enhance corporate governance practice in the Nigerian companies, the executives should be subject to stock ownership guidelines, mandatory retirement age for director should exist and performance of the board should be reviewed regularly.
f. There should be structure to encourage companies to have well-developed and well-enforced, risk management system. Companies need corporate governance structure that promotes effective identification, monitoring and management of all business risks.

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