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THE EFFECT OF CORPORATE GOVERNANCE ON FINANCIAL PERFORMANCE OF LISTED COMPANIES IN NIGERIA

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Abstract

The study investigates the effect of corporate governance on financial performance of listed companies in Nigeria. The objectives of this study were to respectively analyze and determine, individually and jointly, the influence of board size, board composition and audit committee size on corporate performance (CP).The study employed exploratory research design. Ten (10) listed firms were chosen through a purposive sampling technique and data extracted from the annual reports of these listed company from year 2010 to 2016. A panel data regression was used to analyze the data. CG was proxied with board size (BS), board composition (BC) and audit committee size (ACS) while performance was proxied with net profit margin (NPM). Findings revealed that board size had a significant negative correlation with NPM, board composition had a significant positive correlation with NPM, audit committee size had an insignificant correlation with NPM and board size, board composition and audit committee size had a significant joint effect on NPM. The study therefore recommends that smaller board size will increase performance and the board composition should consist more of the non-executive directors while the audit committee also should be reviewed from time to time.

Keywords: Financial performance; Board composition and size; corporate governance, Audit committee.

1. Introduction

The performance of listed firms in Nigeria is a topic of significant concern and interest among stakeholders, including investors, regulators, and policymakers. Despite the considerable growth and development of the Nigerian economy in recent years, some persistent challenges and issues affect the performance of listed firms, hindering their ability to achieve optimal results and contribute effectively to economic prosperity. The incessant scandals, crises and wreckage of organizations around the world are so alarming that the global financial market has been greatly destabilized and the growth of economies impeded. Notable organizations such as Arthur Anderson, Enron, Kmart, Adelphia communications, and WorldCom area few of the numerous international organizations that have collapsed as a result of the heightened crises. The sustained crises have not left Nigeria out of the Whole saga. It affected companies such as Intercontinental bank, Oceanic bank, Cadbury, etc. thereby contributing to the downturn of the economy. With all of these, companies' sustainability has become an issue in determining the survival and continued growth of a country (Apodore &Zainol, 2014).The priority of any organization is to effectively, efficiently and ethically manage the company for profitable long term growth and perpetual existence; the policies and practices of management must also align with the interest of shareholders and other stakeholders. Thus, the development of good corporate governance is essential in order to protect corporate stakeholders, and maintain factors for control and prevention of collapse and long lasting economic depression.

In the achievement of the business objectives, corporate governance is a major factor and it is concerned with the relationships that exist among firms' management, board of directors, shareholders and other stakeholders. Osundina, Olayinka and Chukwuma (2016) emphasized that corporate governance is a non-financial factor that affects the performance of companies and increases accessibility of external finance that brings sustainable economic growth. Weak corporate governance may manifest in form of non-accountability and transparency to stakeholders, bribery scandals, violation of the rights of the minority shareholders, official recklessness among the managers and directors, weak internal control system, insider abuses and fraudulent practices (Olumuyiwa & Babalola, 2012). Also, non - distinction between ownership and control of organization has been identified to be a major reason for weak corporate governance.

The shareholders, who are the principals in an agency relationship delegate control to directors and managers who are the agents to enhance smooth and efficient flow of operations. In most cases, the directors/ managers act for their own self-interest without regard for shareholders' returns on investment. This leads to conflicts between both parties; this is regarded as agency conflict which has a consequent loss. This is evident from the reasons for the collapse, in Nigeria, in 2009/ 2010, of some listed companies especially the eight (8) Universal banks which resulted in a loss of over N1.2 trillion shareholders' funds, as reported by Famogbiele (2012). Therefore, it is necessary for the board to uphold transparency and fairness to shareholders and other stakeholders to abate agency cost which has a consequent negative effect on the corporate performance. Several researches and debates on whether corporate governance components such as board size, board composition, audit committee and distinction between ownership and control have any influence on the performance of the firms have been carried out but diverse conclusions on the discourse have been found. Hence, this research work is expected to contribute to the previous body of literature.

Companies in all sectors whose aim is to maximize profit will need to finance their business with both debt and equity. However any firm in Nigeria is faced with a problem of the relationship between corporate governance and financial performance, which corporate governance mechanism are more effective, as well as regulatory environment on corporate governance.

The general objective of the study is to provide empirical evidence on the relationship between corporate governance and financial performance of firms. The specific objectives are:

i. To examine the influence of board size on financial performance of listed firms in Nigeria.

ii. To determine the impact of board composition on financial performance of listed firms in Nigeria.

2. Literature Review

2.1 Conceptual Definition

2.1.1 Corporate Governance (CG) Concept

According to the Organization of Economic Cooperation and Development- OECD (2005)"Corporate Governance is the system by which business corporations are directed and controlled"

The corporate governance structure specifies the distribution of rights and responsibilities among the major stakeholders/participants in the corporation, such as the board, managers, shareholders and even the 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 objectives are set, and the means of attaining those objectives and monitoring performance. "Securities and Exchange Board of India–SEBI Committee (2003) defines corporate governance as “the acceptance by management, of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company”. It ensures financial reports reliability and efficient use of resources thereby increasing the reputational effects among internal and external stakeholders.

According to Dar el at (2011) corporate governance reduces transaction cost, cost of capital and vulnerability of financial crises. It leads to the increment of shareholders wealth, survival of companies in turbulent periods, development of capital market and strengthens the global economy.

2.1.2 Corporate Taxation

Profitability is a measure of performance and it defines how well a firm has judiciously utilized the available limited resources in all its operations; however, profitability is only a means to an end. Yusuf, Tambaya and Badamasi (2016) see profit as the rallying point of all stakeholders.

According to them, performance of the firm guarantees the payment of dividend, interest, wages, and taxes of shareholders, lenders, employees and government respectively. Therefore, good corporate governance increases performance (Osundina *et al*, 2016, Dar *et al*, 2011) and ensures a firm’s commitment to all its stakeholders are met and which invariably increases the firm’s accessibility to funds, reduces financial crises and engenders sustainable economic growth. To this extent, the ultimate objective of a firm has been reasonably argued as not the welfare of the owners/shareholders but effective and efficient corporate performance which meets and satisfies the needs and intents of all stakeholders, as any breach and/ or deviation could be disastrous to the Profitability and eventually the corporate goal.

2.1.3 Effective and Efficient Performance

Profitability is a measure of performance and it defines how well a firm has judiciously utilized the available limited resources in all its operations; however, profitability is only a means to an end. Yusuf, Tambaya and Badamasi (2016) see profit as the rallying point of all stakeholders. According to them, performance of the firm guarantees the payment of dividend, interest, wages, and taxes of shareholders, lenders, employees and government respectively.

2.1.4. Corporate Governance [CG] Structure

A business organization has the responsibility to satisfy the need of stakeholders who affect or get affected by the actions of the company. Dar, *et al* (2011) made it known that there are internal stakeholders (board of directors, executives and employees) and external stakeholders (shareholders, debt holders, trade creditors, suppliers, customers, government and communities).

The shareholders as one of the stakeholders play a vital role in the organization as the owners and key financiers of the company. Debenture holders are creditors because funds are borrowed from them. They receive priority interest on the principal at regular intervals from the company and at a fixed period; the principal shall be repaid or converted as the case maybe. There are certain rights which the shareholders have that debt holders cannot exercise such as taking major decisions in fundamental corporate changes, involvement in the election and removal of certain officers that manage and control the organization. Still, the debt holders are the first to be paid their interest before the shareholders can receive their return.

2.2 Empirical Review

Kajola (2008) investigated the relationship between indicators of corporate governance (board size, board composition, and chief executive status and audit committee) and performance which are proxied with return on equity and profit margin. He sampled 20 Nigerian listed firms from periods 2000 to 2006 and adopted panel data methodology and OLS to analyse. Results found proved a positive significant relationship between ROE and board size and chief executive status; positive relationship between profit margin and chief executive status; and insignificant relationship between the two performance ratio, board composition and audit committee. Utilizing the regression method, Ammar *et al* (2013) from a sample of 160 firms in the Karachi

Stock Exchange (KSE) for periods 2007 to 2011 gathered that there exist a positive association between board size and firm performance while a negative relationship existed between nonexecutive directors' percentage, chief executive officer duality and performance .Osundina *et al*(2016) studied the relationship between corporate governance measured by board structure index, ownership structure index and audit committee index and performance measured by ROA of selected Nigerian manufacturing companies. 30 sampled companies were investigated from period 2010 to 2014. Results indicated that board Elects. Elects Owns Stake in Shareholders, Management Company- Governance and Nomination Committee,-Human Resources, Committee,-Risk Management, Committee,-Internal Audit, External, Auditors, Other, Stakeholders, Regulatory Bodies, Creditors, Board of Directors

Audit Committee, Elects Appoints Manages Elects Supervises Regulates Lien on structure index had a significant positive relationship with performance. It was also discovered that audit committee index had a positive but insignificant relationship with performance while ownership structure index had an insignificant negative relationship with ROA.

Thuraisingam (2013) in the study of the relationship between corporate governance and company performance of financial service industry with a sample of 33 banks listed in the CSE of Sri Lanka from year 2008 to 2011 and adopting simple linear regression model, discovered an insignificant association between board size, board composition, audit committee (measures of corporate governance) and measures of performance i.e. ROA and ROE. Ibrahim and AbdulSamad (2011) looked at the relationship of corporate governance mechanism and performance between family and non-family ownership of public listed firm in Malaysia from 1999 through 2005 as measured by Tobin's Q, ROA and ROE. Results revealed that family ownership experiences higher value than non-family ownership based on ROE. Xavier *et al* (2015) had a study on the effect of corporate governance measured by board size,CEO duality, institutional ownership and board composition on financial performance of commercial banks in Rwanda. With a sample of 92 senior managers and a descriptive researchdesign, findings revealed that board size, board composition, CEO duality and institutionownership have no effect on performance. Ahmed and Hamdan (2015) investigated impact of corporate governance on firm performance in Bahrain Stock Exchange (BSE), 42 financial companies were sampled from period 2007 to 2011 and descriptive results indicated that ROA and ROE are significantly related to corporate governance but EPS shows no relationship with corporate governance. The findings revealed that board size has significantly weak negative relationship with ROA but it was found to be insignificant to ROE. The other finding indicated that there was no relationship between board independence and firm performance.

2.3 Research Hypotheses

The following hypotheses for the study have been stated in null form:

H1: Board size has no influence on financial performance of listed firms in Nigeria.

H2: Board composition has no significant impact on financial performance of listed firms in Nigeria.

2.4 Theoretical Review

Agency theory which regards the shareholders as the principal and the managers as the agent through which the corporate objective of the company is achieved. According to Sanda, Mikailu and Garba (2005) the presence of information asymmetry can make agents to pursue interest that may be detrimental to the interest of the principal. The process of aligning these two interests can ignite conflict between the interest groups. Due to the perceived conflict of interest shareholders are thus exposed to agency cost such as audit cost done to align shareholders wealth with that of management. In agency theory, unlike stakeholder theory managers only optimize principal's objective rather optimizing multiple objectives.

3. Methodology

3.1 Research Design

The data used for this study were secondary data derived from the annual financial statements of the selected companies. The period considered for this study is from 2010 to 2016 i.e. seven (7) years. The study involves time series and cross sectional data. Panel data regression analytical technique was used to observe all variables for the period. The dependent variable, performance, was measured using the net profit margin (NPM) while the independent variable, corporate governance had board size (BS), board composition (BC) and audit committee size (ACS) as its indicators.

3.2 Study Population

The population for this study includes some companies listed on the Nigerian Stock Exchange. Hence the use of the Ten (10) companies. The companies are Guiness Nigeria Plc., Julius Berger Nigeria Plc., Champions Breweries Plc., Chams Plc., Honeywell Flour Mills Plc., Forte Oil Plc., Oando Plc., Presco Plc., Lafarge Cement WAPCO Nigeria Plc, and Nigerian Breweries Plc.

Table 1: Description of variables

Variable	Abbreviation	Measurements
Board Size	BS	Number of all directors on the board
Board Composition	BC	Non-executive directors/Total number of directors
Audit Committee Size	ACS	Number of audit committee members

Source: Annual Report and Accounts

3.3 Sample population

The study was quantitative in nature. Purposive sampling technique was adopted to select Ten (10) companies listed on the Nigerian Stock Exchange market. This was due to the fact that data needed were not sufficient in the annual reports of all the listed companies.

$$PMt = \beta_0 + \beta_1 BSt + \beta_2 BCt + \beta_3 ACt + \varepsilon^t \qquad (1)$$

Where:

- **PMt** = **Profit Margin** at time **t** (dependent variable, representing the financial performance of the firm).
- **β_0** = **Intercept** (constant term, the baseline level of profit margin when all independent variables are zero).
- **β_1BSt** = Coefficient for **Board Size (BS)** at time **t** (represents the effect of board size on the profit margin).
- **β_2BCt** = Coefficient for **Board Composition (BC)** at time **t** (represents the effect of board composition on the profit margin).
- **β_3ACt** = Coefficient for **Audit Committee Size (ACS)** at time **t** (represents the effect of audit committee size on the profit margin).
- **ε^t** = **Error term** (captures other factors affecting profit margin that are not included in the model).

et, the error term which account for other possible factors that could influence NPM*it* that are not captured in the model.

4. Results and Discussion

4.1 Descriptive statistics

The hypotheses postulated were tested using regression analysis

Table 2: Influence of board size on financial performance

Variable	F	R	R^2	Adj R^2	P	Remark
Board size	36.00	-0.938	0.88	0.856	0.02	Sig

Dependent variable: NPM

Table 3: Impact of board composition on financial performance

Variable	F	R	R^2	Adj R^2	P	Remark
Board composition	32.268	0.931	0.866	0.839	0.02	Sig

Dependent variable: NPM

4.2 Discussion of Result

Hypothesis 1: Board size has no influence on financial performance of listed firms in Nigeria. From table 1 above, the result (R = -0.938, R2 = 0.88, P < 0.05) depicts that there is a negative correlation between board size and net profit margin. This implies that the lower the board size, the higher the NPM which indicate that the value of NPM for the sampled companies increases by 93.8% as board size reduces by 1%. The coefficient of determination (R2) shows that board size accounts for a variation of 88% of the total value of NPM which means that other factors outside the model only accounts for the remaining 12%. It shows that the model has a goodness of fit. The probability value P < 0.05 indicates that the relationship between board size and NPM is statistically significant at 0.05 level. Hence, the hypothesis is rejected.

Hypothesis 2: Board composition has no significant impact on financial performance of listed firms in Nigeria. From table 2, the result (R = 0.931, R2 = 0.86, P < 0.05) depicts that there is a positive correlation between board composition and net profit margin. This implies that the greater the number of nonexecutive directors on the board, the higher the NPM which indicate that the value of NPM for the sampled companies increases by 93.1% as board composition increases by 1%. The coefficient of determination (R2) shows that board composition accounts for a variation of 86% of the total value of NPM which means that other factors outside the model only accounts for the remaining 14%. It shows that the model has a goodness of fit. The probability value P <0.05 indicates that the relationship between board composition and NPM is statistically significant at 0.05 level. Hence, the hypothesis is rejected.

5. Conclusion and Recommendations

The study examined the effect of corporate governance on corporate performance of selected companies listed on the Nigerian Stock Exchange. Findings showed that there is a significant negative relationship between board size and performance. The negative correlation indicates that the smaller the board size, the higher the performance and vice versa. The smaller board size will always be prompt in decision making and rule out all unnecessary delay and bureaucracy. This result corroborates with the findings of Ming-Cheng et al (2009). But on the contrary, Rimon et al(2014) results revealed positive and insignificant relationship between board size and ROA whileAdekunle and Aghedo (2014) found a positive and significant relationship between board size and performance. Also, Dar et al (2011) findings showed an insignificant positive relationship between board size and performance. Board composition and performance, on the other hand had a significant positive relationship which explains that board composition should be more of the non-executive directors than the executive directors. This will reduce the problem of agency cost that is inherent in agency relationships that exist between the shareholders and the executive directors. This is in line with the results of Adekunle and Aghedo (2014). In contrast to this, Kajola (2008) found an insignificant relationship between board composition and performance. Though, audit committee size had an insignificant relationship with performance, nevertheless, it should not be ignored. Rather, the composition of the audit committee should be reviewed from the Nigerian statutory membership of three shareholders and three management/ directors (50:50). It is suggested that the audit committee should consist more, if not all, of shareholders. The audit committee should consist of men of experience and integrity; they are to be directly responsible tothe shareholders and be independent of the board of directors and the management. This will augur for more transparency, better checks and balances and enable the shareholders to assert their rights.

In line with this result is the work of Kajola (2008) while Dar et al (2011) results revealed a significant and negative correlation between audit committee size and performance and Anthony(2007) concluded that audit committee size has a positive influence on both accounting based measure of performance (ROA) and market based performance measure (Tobin’s Q). Also, considering the joint effect of all independent variables on corporate performance, it was revealed that there exist strong positive relationships among them. Thus, it is recommended that companies should have a small board size which consist of more non-executive directors (representatives of the shareholders) rather than the executive directors; this seems to be in agreement with Famogbiele (2012) who says that it is only the CEO from the management that should be on the board for efficient democratic decision of the board, and invariably, a sound corporate governance. The audit committee members should also be allowed to operate independently and the composition of the audit committee should be reviewed periodically.

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