EFFECT OF CORPORATE GOVERNANCE MECHANISMS ON PERFORMANCE OF NON-FINANCIAL FIRMS IN NIGERIA

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Abstract

The study examined the effect of corporate governance mechanisms on performance of non-financial firms in Nigeria. Secondary data collected from published accounts were analysed with (random effects and fixed effects) using panel regression models through the use of STATA 14 software. Thirty four ten (34) non-financial listed firms on the Nigeria Stock Exchange were selected using the purposive sampling technique. The study covered the period 1990 to 2015. Independent variables used were board size; outside board directors, directors shareholding; independent audit committee, block holding; leverage and firm size while return on equity was adopted as dependent indicator. Findings from the study revealed that some corporate governance mechanisms (leverage; enlarged board size) have positive significant relationship on firm performance, while others (directors' shareholding; block holding) have negative significant link with firms' performance. However some corporate governance indicators (outside board directors; independent audit committee; firm size) do not have significant correlation with performance of the non-financial firms in Nigeria. Hence, the study recommends that firms should maintain a maximum of twelve directors (insiders and outsiders) who must be professionally qualified to perform oversight functions in order to enhance firm performance. The insider directors should also be encouraged to procure sizeable units of company's shares so as to reduce the agency cost.

Keywords: Corporate Governance Mechanisms, Firm Performance,

Introduction

The 19th Century according to Ross, (1973), Jensen & Meckling, (1976) and Fama, (1980) saw owner(s) of firms take up management responsibilities together with the burden of ownership. The 20th century, however, came with tremendous changes due to new communication technologies and mass production machineries. This gave rise to a wave of mergers, as firms (corporations) consolidate to exploit available opportunities. Again corporations became too large and profit driven to be owned and managed by individual or group. In the end owners of corporation began employing professionals to share managerial responsibilities of the corporation while still retaining to a large extent control.

This change, despite its attendant strengths has also opened ways for managers to maximise personal objectives sometimes at the expense of owner(s) of corporations. Berle & Means (1993) said that since managers of corporations were no longer its owners, there could be conflict of interest between maximising profit for the owners and managers' personal interest (Li, 2011) adding that managers' interest were best served by maximising sales after achieving a level of profit which satisfies shareholders. Li, (2011) also added that managers

could explore their expertise and superior knowledge to the disadvantage of owners of corporations.

Therefore, the idea of corporate governance is a measure which owners or shareholders of corporations adopt to protect their interest while having their businesses managed on their behalf. The history of Corporate Governance can be traced to Smith (1838) when he drew attention with the Wealth of Nations to an important governance issue in his commentary on Joint Stock Companies. The directors of such companies however were the managers of other people's money rather than their own. Smith argues that it could not well be expected that the managers would watch the people's money with the same vigilance which the partners in private corporations frequently watch over their own.

Most of the corporate failures in both developed and developing economies that led to the global financial crisis of 2009 can be traced to poor corporate governance (Entron, World.com in the United States; Transmile, Megan, Media and Nasioncom in Malaysia and Cadbury, Intercontinenntal Bank, AfriBank Oceanic Bank in Nigeria (Kwambo, & Abdul-Qadir 2013). Consequently, the continuous decline of firms performance made some companies especially in Nigeria to relocate to neibouring countries. Despite bailouts by several governments and introduction of codes of corporate governance by regulatory agencies, poor corporate governance remains unabated especially in Nigeria with devastating effect on firm performance. For example the financial problem experienced by Skye Bank Plc. in 2016 was traced to poor corporate governance and it was swift intervention of Central Bank of Nigeria that saved the bank from total collapse (Nwogwugwu, 2016). It is surprising that majority of the empirical studies on effect of corporate governance mechanisms on firm performance from most developed countries (such as Jensen 1993, Conyon & Peck (1998) Eisenberg, Sundgren, &. Wells, 1998, Kiel & Nicholson, 2002, Cheng, Evan & Nagarajan, 2008, Guest, 2009, Bruno, 2013, El-Faitouri, 2014, Gupta & Newalka, 2015, and Afrifa, & Tauringana, (2015), did not reach a concensus but are with varied conclusions. Therefore this study used 34 non-financial firms listed on the Nigerian Stock Exchange to examine the effect of corprate governance mechanisms on performnance of Nigerian listed firms.

The general objective of the study is to examine the effect of corporate governance mechanisms on return on equity of non-financial firms in Nigeria.

The specific objectives are:

i. Examine the effect of board size on return on equity of non-financial firms in Nigeria.
ii. Evaluate the effect of outside board directors on return on equity of non-financial firms in Nigeria.
iii. Assess the effect of directors' shareholding on return on equity of non-financial firms in Nigeria.
iv. Examine the effect of independent audit committee on return on equity of non-financial firms in Nigeria.
v. Study the effect of block holding on return on equity of non-financial firms in Nigeria.
vi. Examine the effect of leverage on return on equity of non-financial firms in Nigeria.
vii. Evaluate the effect of firm size on return on equity of non-financial firms in Nigeria.

viii. Examine the effect of enlarged board size on return on equity of non-financial firms in Nigeria.

In line with the objectives of the study the following null hypotheses were tested:

$H_0$1: board size has no significant effect on return on equity of non-financial firms in Nigeria.

$H_0$2: outside board directors has no significant effect on return on equity of non-financial firms in Nigeria.

H_0**3**: directors shareholding has no significant effect on return on equity of non-financial firms in Nigeria.

$H_0$4: independent audit committee has no significant effect on return on equity of non-financial firms in Nigeria.

$H_0$5: block holding has no significant effect on return on equity of non-financial firms in Nigeria.

$H_0$6: leverage has no significant effect on return on equity of non-financial firms in Nigeria.

$H_0$7: firm size has no significant effect on return on equity of non-financial firms in Nigeria.

$H_0$8: enlarged board size has no significant effect on return on equity of non-financial firms in Nigeria.

The rest of the paper covers review of related literature; research methodology; presentation and interpretation of results; summary; conclusion and recommendation.

Review of related literature

Corporate Governance

Corporate organisations have become major actors in the political economy of many countries. Under the current neo-liberal economic philosophy they are regarded as the engine of growth and development. Based on this premise the performance of these organisations are of interest to both the government and the citizens. Essentially, various measures, models and concepts have been developed globally and nationally to ensure that these corporate organisations not only survive but operate in the best interest of all stakeholders including the government. One of the most important concepts recently developed by business and financial experts is corporate governance (Sanusi, 2002).

For over two decades, the concept of corporate governance had been identified as key to the survival of business corporations all over the world. This is better expressed by a former Governor of the Central Bank of Nigeria, Sanusi, (2002) thus: “Issues of corporate governance have become so pervasive in recent years and the lessons learned from experiences of corporate organizations have become major actors in the political economy of many countries. Under the current neo-liberal economic philosophy they are regarded as the engine of growth and development. Based on this premise the performance of these organisations is of interest to both the government and the citizens”.

Wilson (2006) defined corporate governance as the manner in which corporations are directed, controlled and held to account with special concern for effective leadership of the corporations to ensure that they deliver on their promise as the wealth creating organ of the society in a sustainable manner.

In his own view, Jayashree (2006) in Oso, & Bello (2012) defined corporate governance as a system of making directors accountable to shareholders for effective management of the companies in the best interest of the company and the shareholders along with concern for ethics and values. Drawing from the Gandhian principles of trusteeship and the Directive Principles of the Indian Constitution, the Report of Securities and Exchange Board of India (SEBI) Committee defines corporate governance as the acceptance by the management of the inalienable rights of shareholders as the true owners of the corporation and their own role as trustees on behalf of the shareholders. Furthermore, corporate governance is described as the set of processes, customs, policies, laws and institutions affecting the way a corporation or company is directed, administered or controlled (Oso & Bello, 2012). It also includes the relationship among the many stakeholders involved, the board of directors, employees, customers, creditors, suppliers and the community at large (Cadbury Committee, 1992). Report of Cadbury Committee (1992) also defines corporate governance as the system by which companies are directed and controlled.

Corporate Governance Mechanisms and Return on Equity

Hussain, Ashfaq, & Muhammad, (2016) examined corporate governance structure by using the data of 80 non-financial firms listed on Karachi Stock Exchange Pakistan during 2010 to 2014. Hypotheses of the study were tested by using both descriptive and inferential statistics. The findings indicated that board size and audit committee is positively related to the firm performance ROE. In contrast, board composition and CEO duality are negatively related to the firm performance ROE. As far as controlling variables is concerned, leverage is negative, whereas firm size is positively related to ROE as measure of performance. Empirical findings concluded that corporate governance practices affect the firm performance. Therefore, it is suggested that managers should understand the governance mechanisms to work more efficiently in the firm.

Mule, & Mukras, (2015) investigated the relationship between financial leverage and the financial performance of listed firm in Kenya. They used annual data for the period 2007 to 2011. Various panel procedures were used. The study found that financial leverage has negative but insignificant effect on ROE

Bebeji, Muhammed, & Tanko, (2015) examined the effects of board size and board composition on the performance of Nigerian banks. The financial statements of five banks were used as a sample for the period of nine years and the data collected were analysed using the multivariate regression analysis. They find that board size has significant negative impact on the performance (ROE) of banks in Nigeria. This signified that an increase in Board size would lead to a decrease in ROE. On the other hand, board composition has a significant positive effect on the performance of banks in Nigeria. This shows that an increase in Board composition led to a increase in ROE. It is recommended that banks should have adequate board size to the scale and complexity of the organisation's operations and be composed in such a way as to ensure diversity of experience without compromising independence, compatibility, integrity and availability of members to attend meetings. The board size should not be too large and must be made up of qualified

professionals who are conversant with oversight function. The Board should comprise of a mix of executive and non-executive directors and headed by a Chairman.

Dabor, Isiavwe, & Ajagbe, (2015) investigated the impact of corporate governance on firm performance of selected companies quoted on the Nigerian Stock Exchange. A sample of 248 companies was selected employing simple random sampling technique. The researchers used the econometrics analysis software E-views 7.0 to analyse the data. Return on equity was used as gauge for firm performance, while board size, board independence, board gender diversity and ownership structure were variables used for measuring corporate governance. The results revealed that there is significant negative relationship between board size and firm financial performance. Board independence, ownership structure while board gender diversity do not have significant impact on firm performance. The study suggested that statutory bodies should enact laws that will mandate all firms to maintain small board size.

Assefa, & Megbaru, (2014) examined the effect of corporate governance structure on financial performance of firms. They used return on equity and operating profit margin as dependent variables whereas board size, board independence, frequency of board meetings, audit committee and board ownership were used as independent indicators, and financial leverage and firm growth rate were used as control variables. The researchers used both correlation analysis and pooled panel data with cross-sectional nature. The econometric regression result showed that, board size is negatively and significantly associated to all the two indicators of financial performance: return on equity and operating profit margin. Both Board independence and Board ownership have positive relationships and significant effects on the two indicators of commercial banks financial performance. The result showed that audit committee negatively and significantly correlated to return on equity though with negative and insignificant impact on operating profit margin. Frequency of board meeting has positive impact on performance in terms of its direction of connection and immaterial in its affiliation with the two financial performance indicators of commercial banks under investigation.

Uadiale, (2010) examined the impact of board structure on corporate financial performance in Nigeria. Dependent variables used to proxy financial performance were return on equity (ROE) and return on capital employed (ROCE). Based on the extensive literature, four board characteristics (board composition, board size, board ownership and CEO duality) were identified as independent variables. The Ordinary Least Squares (OLS) regression was used to estimate the relationship between corporate performance measures and the independent variables. Findings from the study showed that there is strong positive association between board size and corporate financial performance (ROE). Evidence also exists that there is a positive association between outside directors sitting on the board and corporate financial performance (ROE). However, a negative association was observed between directors' stockholding and firm financial performance measured (ROE). In addition, the study revealed a negative association between ROE and CEO duality, while a strong positive association was observed between ROCE and CEO duality. The study suggested that large board size should be encouraged and the composition of outside directors as members of the board should be sustained and improved upon to enhance corporate financial performance.

Olowookere (2008) investigated the impact of corporate governance on firm financial (ROE) and productivity performance as well as comparing the effect of corporate governance on before and after the introduction of Code of Corporate Governance in Nigeria. He utilised data for 64 non-financial firms listed on the first tier securities market of the Nigerian Stock Exchange for the period 2002 to 2006. Panel regression estimates show that board size and Debt have significant positive association with return on equity (ROE) while outside board directors, director shareholding, size and square of board size have negative correlation.

Zeitun, & Tian, (2007) investigated the relationship between ownership structure/ concentration and firm performance in Jordanian publicly traded firms for a sample of 59 firms' from1989 to 2002. They found that there is a significant relation between ownership concentration C5 (the percentage of the first five largest shareholders) and the accounting performance measure ROE. Secondly, the HERF is not significant at any level of significance in any measure of performance. The insignificance of the Herfindahl (HERF) index showed that there could be a nonlinear relationship between ownership concentration and a firm's performance. Third it they also observed that there is a negative significant relation between government ownership and firm's accounting performance (ROE),

Sanda, Mikailu & Garba, (2005) examined the relationship between internal governance mechanisms and firm financial performance. They used pooled OLS regression analysis on panel data for the period 1996 to 1999 for a sample of 93 firms listed on the Nigerian Stock Exchange. They found that board size has significant positive relationship with return on equity.

Research Methodology

The study covered the period 1990 to 2015. The 34 sampled firms were selected using judgmental sampling technique while ex-post- facto research design was employed (Adefila, 2008). Secondary data were sourced from companies' Annual financial statements and Nigeria Stock Exchange (NSE) Factbooks (1990 to 2015)**.** It comprises measure of firm performance accounting based denoted by return on equity and corporate governance indicators selected from the literature reviewed by the researcher which included: board size, outside board, director shareholding, block holding, independent audit committee, firm's size and leverage. Panel regression models were employed to analysis the data.

Model Specification

$$\mathrm{ROE_{it}} = \alpha + \beta_1 \mathrm{BS_{it}} + \beta_2 \mathrm{OBD_{it}} + \beta_3 \mathrm{DSH_{it}} + \beta_4 \mathrm{BH_{it}} + \beta_5 \mathrm{IAC_{it}} + \beta_6 \mathrm{BS^2{}_{it}} + \gamma_1 \mathrm{L_{it}} + \gamma_2 \mathrm{FS_{it}} + \lambda_i + v_{it}$$

Where: ROE indicates return on assets, BS represents board size, OBD connotes outside board size, DSH indicates directors shareholding, BH represents block holding, IAC denotes independent audit committee, BS^2 is square of board size, L is leverage and FS is firm size, α means intercept, λ_i captures individual firm effect (that is individual firm differences) and v_{it} is the random error term which satisfies the Mousa, & Desok (2012) characteristics.

Data presentation and interpretation

Table 1: Summary Statistics of Measures of Corporate Governance (Independent Variables) and Measures of Firms' Performance (Dependant Variables)

Variables		Mean	Std. dev	Min	Max	Observ ations	
BS	overall	9.927102	3.929243	0	25	N =	884
	between		2.8762	3.884615	20.38462	n=	34
	within		932.711282	-3.49975	17.65787	T =	26
OBD	overall	65.17175	14.94925	0	88.24	N =	884
	between		7.214526	48.67885	78.99577	n=	34
	within		13.13756	-.1232474	89.04829	T =	26
DSH	overall	7.526404	15.37202	0	86.94	N =	884
	between		10.8653	.0584615	50.55808	n=	34
	within		10.99484	-43.03167	69.8191	T =	26
IAC	overall	49.65017	5.447123	0	75	N =	884
	between		1.860082	43.82808	54.55154	n=	34
	within		5.127249	.2905549	73.68863	T =	26
BH	overall	43.74602	26.02038	0	91.36	N =	884
	Between		23.51197	3.744231	85.28115	n=	34
	Within		11.68846	-23.93706	112.2176	T =	26
L	overall						
	Between	672522	.3391694	-.42	3.88	N =	884
	Within		1949597	.3380769	1.126538	n=	34
			.279065	-.337478	3.605868	T =	26
FS	overall						
	Between	15.3978	2.306654	10.23	22.19	N =	884
	Within		1.76648	12.80154	19.54538	n=	34
			1.506665	11.12895	18.94126	T =	26
Return ~t	overall	.681771	19.77636	-22.38	638.16	N =	884
	between		3.892014	-.6596154	24.63885	n=	34
	within		19.39834	-115.5825	614.2029	T =	26

From table 1 the regression the summary statistics show that on the average the board size, outside board directors and directors shareholdings are 9.9217, 65.1718 and 7.5264 respectively while that of independent audit committee, block holding, leverage and firm size are 49.6502, 43.7460, 0.6713 and 15.3978 correspondingly. The standard deviation of gauges of corporate governance mechanisms are 3.9292, 14.9493, 15.3702 and 5.4471 for board size, outside board directors, directors shareholding and independent audit committee while block holding, leverage and firm size posted 26.0204, 0.3392 and 2.3067 correspondingly. It is also noted that the identified corporate governance mechanisms are diverse over time. For example the minimum for board size, outside board directors, directors' shareholding, independent audit committee and block holding is zero (0) while leverage and firm size have -0.42 and 10.33 respectively as their minimum. On the other hand, the maximum for board size, outside board

directors, directors' shareholding and independent audit committee are25, 88.24, 86.94 and 75 correspondingly while block holding, leverage and firm size recorded 91.36, 3.88 and 22.19 respectively

The summary statistics for dependent variable show that on the average the return on equity of firms in Nigeria is about 0.6818 while the standard deviation is 19.7764. The large value of standard deviation indicates that there is wide spread in the performance of firms in Nigeria

Table 2: Fixed Effect Regression Results of Effect of Corporate Governance Mechanisms on Return on Equity

VARIABLES	Non-financial Firms
BS	-1.809**
	(0.743)
OBD	-0.0772
	(0.0579)
DSH	-0.133*
	(0.0758)
IAC	0.171
	(0.136)
BH	-0.160**
	(0.0753)
L	5.955**
	(2.755)
FS	-0.488
	(0.554)
BS^2	0.105**
	(0.0426)
Constant	15.75
	(12.07)
Observations	884
R-squared	0.074
F-statistic	4.08***
Number of company	34
Hausman test	

Standard Error in parentheses,*** p<0.01 significant at 1%, ** p<0.05 significant at 5%, * p<0.1 Significant at 10%

From the regression result in table 2, board size and square of board size are statistically significant at 5% level respectively with return on equity but both have wrong signs. This implies

that with lower board size the firm's performance declines but as the board size increases the firms performance improve. However, this finding tallies with Kumar et al, (2013) who reported a significant negative relationship between board size and the performance of a firm measured by ROE.

Block holding has negative significant correlation with return on equity with p value 0.05 indicating that increase in number of institutional investors depletes the performance of firms measured by return on equity This is consistent with the findings of Olowookere, 2008 and Fauzi et al (2012) observed an inverse correlation between block holding and return on equity. However, Leverage has positive significant relation with return on equity with p value 0.05. This implies that the higher the level of leverage the more the return on equity for non-financial firms. These findings contradict the studies of (Mule et al 2015; Hussain et al 2016) who observed a negative correlation between leverage and return on equity. On the other hand, independent audit committee and outside board directors are correlated but not significant,

Conclusion

This study examined the relationship between corporate governance mechanisms and non-financial firms performance in Nigeria. Findings from our determination test indicate that about 7.4% of the variability in non-financial firms' performance (measured by return on equity) can be explained by the attributes of corporate governance indicators. Remarkably, the study observed that a negative significant relationship exist between board size; directors shareholding; block holding and performance of non-financial firms in Nigeria. On the other hand positive significant correlation occurs between leverage; enlarged board size and performance of non-financial firms in Nigeria. This outcome corroborate the suggestion that the higher the level of leverage the higher the return on equity as the bond holders are able to put the management on check to improve on performance as they must pay both principal and the interest elements. In addition, based on the hypotheses tested, findings from the study further provided evidence to support the arguments that outside board directors; independent audit committee; firm size have linkage with non-financial firms' performance gauged by return on equity. Hence, study concludes that firms should enlarge the size of board of directors with professionally qualified personnel reasonably who will bring their expertise to improve oversight functions of director with a view to enhance performance. They also encourage directors shareholding especially the internal directors in other to jack up their commitment to the firm and reduce agency cost. A salient limitation of this paper is the corporate governance indicators selected which do not account for reasonable percentage of the dependent variable. To address this limitation, future research can incorporate other corporate governance variables to improve their influence on the predictor.

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