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Relationship between Corporate Governance and Companies Performance in Nigeria

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Abstract

A company's corporate governance structure has a significant impact on how responsive it is to outside forces affecting its performance. Higher performance has been observed in companies with sound governance. Despite the fact that corporate governance has many facets, this study examined how board composition and size affected three performance indicators: ROA, Tobin's Q, and Growth in Sales of non-financial listed companies on the Nigerian Stock Exchange. The study was conducted using annual data from 2014 to 2023 and according to the panel data methodology framework. Despite the somewhat ambiguous outcomes on these performance metrics, Nigerian companies are urged to keep their boards smaller and the legally mandated makeup of their boards in place for optimal performance.

Keywords: Corporate Governance, Company-Performance, Return on Assets (ROA), Tobin's Q, Growth in Sales.

Introduction

Businesses have long understood that strong governance increases trust and yields positive returns. Therefore, a company's ability to respond quickly to outside forces affecting its performance is greatly influenced by the structure of its corporate governance.

It is important to note that for more than two decades, industrialized market economies have prioritized the idea of corporate governance on their legislative agendas, particularly for very large corporations. In addition, the idea steadily gained traction on the African continent. In fact, it is thought that the Asian crisis and the comparatively subpar performance of the African corporate sector have turned corporate governance into a hot topic in the discourse surrounding development (Isik & Ince, 2016). Good corporate governance raises valuations and improves the bottom line, according to a number of recent research. Gompers et al.'s study from 2023, for instance, revealed that businesses with robust shareholder rights generated 8.5 percent higher yearly returns than those with feeble rights.

It is anticipated that poorly governed companies will be less profitable, more likely to face bankruptcy, have lower valuations, and pay out less to shareholders; on the other hand, wellgoverned companies should be more profitable, less likely to face bankruptcy, have higher valuations, and give shareholders more cash. Additionally, Claessens (2023) contends that improved corporate frameworks help corporations by improving performance, lowering capital costs, increasing access to funding, and treating all stakeholders fairly. It has been argued that insufficient corporate governance not only contributes to subpar company performance and hazardous financing practices but also fosters macroeconomic crises such as the East Asia crisis of 1997. According to certain academics, boosting investor confidence and market liquidity are directly correlated with effective corporate governance (Donaldson, 2023).

Review of literature

It is undeniable that the principal-agent theory is typically regarded as the starting point of any discussion regarding corporate governance. Berle and Means' famous thesis, "The Modern Corporation and Private Property," provides the theoretical foundation for the majority of the current corporate governance research (2019). The thesis outlines a basic agency issue in contemporary corporations where ownership and control are segregated. Modern companies are known to suffer from a division of ownership and control. They are managed by qualified administrators (agents) who answer to independent shareholders (principals) rather than to one another. This perspective aligns with the principal-agent framework. In this context, the essential question is: How can managers prioritize shareholder interests over the costs associated with principal-agent theory? In this sense, the principals face two primary issues. First, they must choose the most competent managers, which presents an adverse selection challenge. Providing the management with the proper incentives to exert the necessary effort and make decisions in line with shareholders' interests (e.g., assume the appropriate level of risk and do not indulge in empire building).

The ownership and control of companies vary throughout nations, which is one way that corporate governance systems differ between them. As a result, several corporate governance systems can be identified based on the controlling shareholder and the extent of ownership and control. Certain systems are defined by widely distributed ownership, also known as outsider systems, while other systems typically display concentrated ownership and control, also known as insider systems. Within the corporate governance frameworks of the United States and the United Kingdom, powerful management and broadly distributed weak shareholders face a fundamental conflict of interest. However, in insider systems (such as those in Germany and Japan), the main struggle is between weak minority shareholders and controlling shareholders, sometimes known as block holders (Brickley et al., 2017).

There are several definitions for the term "corporate governance." From the investor's point of view, *corporate governance* is defined by Metrick and Ishii (2022) as "both the commitment to operate a company, efficiently given investment and the promise to repay a fair return on capital invested." This term implies that a company's capacity to obtain capital affects corporate governance. Because it makes it easier to discern between companies, Metrick and Ishii contend that company-level governance may be particularly crucial in developing markets with weaker institutions. Corporate governance is "the system by which companies are directed and controlled," according to the Cadbury Committee (1992).

Mayer (2017) claims that corporate governance is about finding ways to align managers' and investors' interests and make sure companies are operated with the interests of investors in mind. The relationship between a company's internal governance structures and society's perception of the extent of corporate responsibility is the focus of corporate governance (Deakin & Hughes, 2017). Keasey et al. (2017) defined it further as "the structures, processes, cultures, and systems that engender the successful operation of corporations." A further definition of *corporate governance* is the entire collection of actions performed within the social unit known as an enterprise to encourage economic agents to engage in the creative process, create some organizational surplus, and set up a fair distribution between the partners, taking into consideration what they have brought to the organization (Maati, 2019).

From the above discussions, it is possible to assert more broadly that, by defining the nature of the relationship between the company and important corporate constituencies, various corporate governance systems will represent what are regarded as valid lines of accountability. As a result, corporate governance frameworks can be viewed as tools for defining the ownership and control structures of economic entities. Within this framework, "economic and legal institutions that can be reformed through the political process—sometimes for the better" are corporate governance mechanisms (Shleifer & Vishny, 2017). Corporate governance structures that are currently in place are both shaped by company law and other types of regulation, such as accounting standards and stock market listing guidelines. Regulation affects "the way in which companies are owned, the form in which they are controlled, and the process by which changes in ownership and control take place," which has an impact on corporate governance (Jenkinson & Mayer, 2019). According to the Cadbury Committee (1992), corporate governance outlines the proper management, direction, and control of businesses. It involves keeping an eye on and holding accountable people who lead and oversee management.

Corporate governance and Firm performance

The relationship between corporate governance and firm performance has been the subject of prior empirical research, with conflicting findings (see Klapper & Love, 2022; Gompers, 2023; Black et al., 2023; and Sanda et al., 2013). According to research by others, like Baysinger and Butler (2019), corporations with strong governance do better. The size and makeup of the board are the primary characteristics of corporate governance that this research has highlighted.

There is a belief that larger boards improve corporate performance because they offer a variety of expertise to aid in decision-making. Still, the current consensus favors smaller boards. Large boards are simpler for a CEO to dominate and are less successful, according to Jensen (2013) and Lipton and Lorsch (2012). Oversizing a board makes it more challenging to coordinate and handle issues. Additionally, smaller boards facilitate faster decision-making and lessen the chance of individual directors' free riding. Gompers (2023) reports that the market valuations of companies with smaller boards typically exceed those with larger boards in US industrial corporations. Additionally, Eisenberg et al. (2020) discovered a negative relationship between profitability and board size when using a sample of small and midsize firms. In a Nigerian study, Sanda et al. (2013) found that firm performance is positively related to small, as opposed to large boards.

Despite extensive research, there still needs to be a consensus on whether directors should be outsiders or staff members of the company (inside directors). Inside directors have a better understanding of the company's operations, so on the one hand, they can watch top management if

they see a chance to take over positions held by executives who lack competence. However, outside directors should serve as "professional referees" to make sure that insider rivalry encourages behavior that maximizes shareholder value (Fama, 2018). According to John and Senbet (2019), boards of directors become more independent as the percentage of outside directors rises. There needs to be more theory on the determinants of an optimal board composition, despite the argument (Fama & Jensen 2018; Baysinger and Butler 2019) that a board's success depends on the ideal balance of inner and outside directions. (Hermalin & Weisbach 2022).

Klapper and Love (2022) analyze the performance and corporate governance of a sample of companies across 14 nations, the majority of which are developing economies. They discover that improved corporate governance is linked to improved performance measured by Tobin's q and ROA and that strong governance appears to be more important in nations where investors have less protection under the law.

In connection with the previous discussion, John and Senbet (2018) offer an extensive analysis of the Stakeholder's theory of corporate governance. The existence of several parties with conflicting interests in the companies' activities is the primary concern highlighted by the theory. Additionally, they stressed the significance of non-market factors for business success, such as committee structure and board size.

In general, corporate governance refers to the collection of procedures that managers use to inform their judgments in situations when ownership and control are not combined. The size and makeup of the board are two common criteria used to gauge corporate governance, as was previously mentioned.

This paper aims to investigate the impact of specific corporate governance variables, namely Board size (BDS) and Board composition (BDC), on performance variables of Tobin's Q, Return on assets (ROA), and Return on equity (ROE). While acknowledging the importance of certain control variables, such as firm size (SZE), asset structure (AST), age of the firm (AGE), and debt structure (DBT), it is recognized that corporate governance involves a set of complex indicators that are subject to significant measurement error. Because of measurement and the availability of data, the variables are carefully selected.

Methodology

Essentially, the study uses secondary data from the yearly financial statements of the top 20 nonfinancial companies listed on the Nigeria Stock Exchange. Because listed corporations are mandated by law to submit end-of-year financials, their use is mostly due to data availability and reliability. According to studies by Faccio and Lasfer (2020), banks and other financial institutions are excluded because of their enormous debt structure, which is significantly different from that of the other enterprises.

The study's data set spans the ten years from 2014 to 2023. The yearly financial reports of the examined corporations provided additional governance data and factors. Multiple regression analysis is the analytical technique employed in the majority of prior research investigating the relationship between corporate governance and company performance indicators. As a result, the study uses an altered version of Miyajima et al. (2003)’s econometric model, which is provided as follows:

Where represents firm performance variables; Tobin's Q (TOB), Return on Assets (ROA), and Sales growth rate (SGR), for firm I in time t. is a vector of corporate governance variables; Board

Size (BDS) and Board Composition (BDC=number of outside directors/total number of directors) and e, the error term. Cit is a vector of control variables: the Size of the Firm (SZE), the ratio of fixed assets to total assets (AST), and the Debt structure of these firms (DBT).
The variables for the study were chosen based on data availability and computational purposes.

Dependent Variables (Company Performance Variables)
TOB=Tobin's Q with measurement is shown in the appendix.
ROA=this is defined as return on assets and is computed by dividing profits before interest and Tax payments by total assets;
The sales growth rate is calculated by dividing the difference between current sales and Previous year's sales volumes by previous year's sales volume.

Independent Variables (Governance Variables)
BDS=this is the number of members serving on a firm's board;
BDC=the board composition is the ratio of outside directors to the total number of directors (i.e. Number of outside directors divided by total number of directors).

Control Variables
SZE= this is the size of the firm measured by the value of its asset base. For the regression analysis, we take the log of the assets because the values are widely spread;
AST=this is the ratio of fixed assets to total assets in trying to measure how much of the assets base represents fixed and for that matter, structures and equipment;
DTB=this the debt structure of a firm measured by the total of debts (both short and long term) divided by the total assets.
The main purpose of the control variables is to acknowledge that a variety of factors might impact a firm's performance, including listed companies.
There is the use of both parametric and non-parametric techniques. The panel data regression was performed using a variety of choices, including fixed effects, random effects, OLS, GLS, and a dynamic panel. The GLS panel was the strongest of all. As a result, the GLS panel regression findings shown in the following tables were reported.

Data analysis and discussion
Table 1: Descriptive statistics of dependent and independent variables

Min	Mean	Median	Std. Dev	Max	Mean	Jarque-Bera	Kurtosis
BDS	5	8.22	8	1.7900	13.0000	35.727250	4.159575
BDC	0.091	0.239	0.231	0.1135	0.8090	20.27343	1.571121
TOB	0.12	0.661	0.585	0.3590	1.4770	8.195276	2.410295
ROA	-0.7	0.201	0.197	0.1950	0.6900	23.6609	4.562505
SGR	-0.243	0.378	0.347	0.2580	1.9270	265. 2342	8.077588
AST	0.015	0.268	0.514	24.5750	0.8670	285745.4	189.9821
SZE	10	13.33	12	4.1200	32.0000	1316.471	9.384385
DTB	0.096	1.134	0.772	5.0480	70.1870	268706.3	184.2857

The typical board size of the companies under study is approximately eight (8), indicating that Nigerian companies have very moderate board sizes. It is evident from the largest board size of

thirteen (13) and the variation of 1.97 that the board sizes of Nigerian companies are comparatively similar. According to studies like Jensen (2013) and Lipton & Lorsch (2012), who contend that large board sizes are less beneficial for corporate success, this is basically favorable for company performance. Nonetheless, in terms of corporate performance, Nigerian corporate boards exhibit lower levels of independence, which is in line with John and Senbet (2018). Because a sizable percentage of these boards—roughly 80.9% at most and 76% on average—are appointed by employees of the respective companies.

With a mean ratio of 0.67, most corporations are performing poorly overall when it comes to Tobin's q as a performance metric. It follows that the majority of corporations fail to break even in this regard. The minimum performance is 12%, while the maximum performance is approximately 14.8%. Regarding return on assets (ROA), there is significant variation within businesses. With a rather significant deviation of 0.195 amongst firms, the least reported performance for the time is -70%, while the mean performance is 20%. With a minimum operating performance of -24%, the sales growth rate (SGR) is stronger. The mean rate of sales increase is approximately 38%, while the maximum rate is approximately 19.3%.

According to the descriptive data, fixed assets account for the majority of a company's assets in Nigeria. The intriguing thing about this is that, with a standard deviation of roughly 24.57, the majority of these businesses are well distributed when it comes to how much of their total assets are composed of fixed assets. The minimum and maximum values of 0.015 and 0.867, respectively, support the case even more.

The majority of the companies are dependent on more debt in their capital structure to finance their assets, as evidenced by the fact that all of the examined companies have relatively similar asset bases (mean value of 1.13).

Research Results and Discussion

The regression analysis of the link between the governance variables and Tobin's q (TOB) is presented in Table 2. The findings unequivocally show that there is a mixed outcome between this performance indicator and the governance variables.

In contrast to research by Jensen (2013) and Lipton & Lorsch (2012), the analysis demonstrates that Tobin's q increases with board size. This supports research that suggests larger boards improve company performance because their members bring a variety of expertise to bear on decision-making; the larger the board, the better the performance. When attempting to explain Tobin's q for Nigerian companies, board size is a crucial factor.

The board composition and size both have a negative association with Tobin's q, suggesting that a corporation's performance generally declines as the number of external board members increases. The negative association runs counter to earlier empirical research on outside directors' beneficial monitoring and advisory roles to company shareholders conducted by Brickley and James (2017) and Byrd and Hickman (2012). Furthermore, Baysinger and Butler (2019) demonstrated that the market benefits companies that name outside directors. Instead, it must be stated that this variable is not important.

Contrary to expectations, the analysis indicates that, while not statistically significant, the firm's size has a negative impact on Tobin's q. This could be explained by the fact that if a company's assets are not used effectively, their size, as indicated by its asset base, only sometimes translates into improved performance. It follows that most Nigerian companies need to make the most of

their scale to improve their performance. On the other hand, it appears from the asset structure results that most companies would want to have a larger proportion of current assets in their portfolio. Due to the study's finding that Tobin's Q performs better with the more fixed assets, there are. As a result, the descriptive findings that point to a comparatively distributed asset structure—with a small percentage of assets being fixed—are being verified.

The study goes on to demonstrate that corporations that have significant debt loads in their asset portfolios may outperform those that do not. The strongly positive regression coefficient for total debt suggests that higher performance is correlated with higher debt levels. The data support the claims made by Roden and Lewellen (2015) and Petersen and Rajan (2014) that profitable businesses take on greater debt. Once more, this implies that profitable businesses rely more on debt as their primary source of funding. The findings are shown in the table that follows.

Table 2

Dependent Variable: TOB

White Herteroskedasticity-Consistent Standard Errors and Covariance.

Variable	Coefficient	Std.Error	t-statistic	Prob.	
BDS	0.099222	0.003828	25.91706	0.0000	BDC
-0.013756	0.110004	-0.125052	0.9006		
LOG (SZE)	-0.003565	0.003337	-1.068437	0.2867	
AST	0.000132	2.58E-05	5.112696	0.0000	
DTB	0.008418	0.000745	11.29666	0.0000	C
	0.064966	0.078067	0.832179	0.4064	

Weighted Statistics.

R-squared	0.864457	Mean dependent var	1.049009
Adjusted R-squared	0.860061	SD dependent var	0.834732
SE of regression	0.312260	Sum squared resid	18.03863
F-statistics	196.6475	Durbin-Watson stat 0.732216	Prob (F-statistic) 0.000000

All the other independent variables in Table 3—aside from board size—have no discernible effect on the profitability of the companies when it comes to return on assets (ROA).

Contrary to what Tobin's q suggests, the size of the board is positively correlated with ROA, indicating that companies ought to have larger boards. Research by Jensen (2013), Lipton and Lorsch (2012), and Sanda et al. (2013) conflicts with these findings. Given the research above, the main issue is actually determining the ideal board size for Nigerian companies to operate effectively.

Similar to Tobin's Q, board composition has a detrimental influence on a company's profitability, reinforcing the idea that a board's independence is not actually necessary for any company to operate profitably. There needs to be more theory on the factors that determine an ideal board composition, despite research by Fama and Jensen (2018) and Baysinger and Butler (2019)

asserting that a board's success depends on the ideal combination of inside and outside directions. (Hermalin & Weisbach, 2022).

Once more, against expectations, the debt structure and company size have a negligible negative impact on ROA. Even while the asset structure increases profitability, none of the other factors can fully account for the profitability performance of the organizations shown in the table below.

Table 3

Dependent Variable: ROA

White Heteroskedasticity-Consistent Standard Error &Covariance.

Variable	Coefficient	Std. Error	t-statistic	Prob.
BDS	0.040104	0.004672	8.584524	0.0000
BDC	-0.071255	0.105788	-0.673566	05014
LOG (SZE)	-0.000432	0.002836	-0.152452	0.8790
AST	9.020000	6.45000	1.399720	0.1633
DTB	-7.04000	0.000205	-0.3436810	0.7315
C	-0.109770	0.065710	-1.670518	0.0965

Weighted Statistics

R-squared	0.178621	Mean dependent var	0.229453		
Adjusted R-squared	0.151982	SD dependent var	0.199785		
SE of regression	0.183978	Sum squared resid	6.261852		
F-statistic	6.705172	Durbin-Watson Stat	1.162737	Prob	(F-static) 0.000002

The regression findings of the interaction between the governance variables and the sales growth rate (SGR) are shown in Table 4. This time, there is a negative correlation between the board size and sales growth. The negative correlation between board size and sales growth aligns with research conducted by Jensen (2013) and Lipton and Lorsch (2012), among others, which suggest that larger boards have lower efficacy. Oversizing a board makes it more challenging to coordinate and handle issues. Another argument is that smaller boards make more decisions and are less likely for individual directors to engage in free-riding. Additional empirical studies corroborate the argument. For instance, Yermack (2016) provides evidence that major industrial enterprises in the United States place a higher market value on corporations with smaller boards. Once more, Sanda et al. (2013) discovered in a Nigerian study that small boards, as opposed to large ones, are positively correlated with company performance.

The pace of growth in sales is inversely correlated with board composition. This finding defies past research, which supports John and Senbet's (2018) assertion that a board's independence and performance increase with the number of outsiders on it. It is argued that as the percentage of outside directors rises, boards of directors become more independent.

The regression analysis, which used sales growth rate (SGR) as a performance variable, shows a negative relationship between SGR and the board size of Nigerian companies. Therefore, smaller boards are anticipated to improve performance. Studies by Jensen (2013) and Lipton and Lorsch

(2012) are in line with this. The idea is that when a board gets too huge, it becomes impossible to coordinate and process problems. Another argument is that smaller boards make more decisions and are less likely for individual directors to engage in free-riding. Additional empirical studies corroborate the argument. For example, Yermack (2016) shows that the market places a higher value on companies with smaller boards when it comes to major industrial enterprises in the United States. According to Sanda et al. (2013), small boards have a positive relationship with company performance compared to large boards.

The SGR regression demonstrates once more the negative relationship between SGR and the makeup of corporate boards in Nigeria, suggesting that lower performance results from having more outsiders on a board.

As would be expected, SGR is positively correlated with the firm's size, debt load, and asset composition. Inferentially, the research indicates that companies in Nigeria that heavily rely on debt and have a large percentage of fixed assets in their portfolio typically outperform those with a higher debt load in their capital structure. These factors play a substantial role in explaining SGR, in contrast to the governance variables. Therefore, in order to benefit from economies of scale, firms in Nigeria should tend to take on more debt and grow in size. The outcomes are shown in table 4 below.

Table 4:
Dependent Variable: SGR

White Heteroskedasticity-Consistent Standard Errors & Covariance.

Variable	Coefficient	Std. Error	t-statistic	Prob.	
BDS	-0.014693	0.007743	-1.897544	0.0593	
BDC	-0.143465	0.169234	-0.847734	0.3977	
LOG (SZE)	0.010347	0.004400	2.351302	0.0198	
AST	0.001295	7.01000	18.47214	0.0000	
DTB	0.009483	0.001021	9.286916	0.0000	C
	0.331298	0.093626	3.538512	0.0005	

Weighted Statistics

R-squared	0.109657	Mean dependent var	0.420608
Adjusted R-squared	0.080781	SD dependent var	0.282991
SE of regression	0.280908	Sum squared resid	14.59820
F-statistic	3.797519	Durbin-Watson stat	1.752804
Prob (F-statistic)	0.001363		

Conclusion

Since corporate governance improves the organizational climate for a company's internal structures and performance, its significance cannot be overstated. In fact, corporate governance increases a company's corporate entrepreneurship and competitiveness by bringing new dimensions to the efficient management of a corporate entity through the use of external, independent directors.

The study looked at the connection between the firm performance of Nigerian-listed nonfinancial firms and various metrics of corporate governance, including board size and makeup. Along with other research, the banks and other financial firms were left out because of their enormous debt loads. With a mild deviation of 1.79, the sample mean board size was determined to be eight, and the maximum size to be thirteen. In terms of board composition, the sample as a whole appears to have more inside directors on the boards, as indicated by the mean ratio of almost 24%. This further implies that, in line with John and Senbet's (2018) argument, boards in Nigeria are not considered autonomous. The companies' comparable asset bases, the proportion of fixed assets in total assets, and the fact that most rely more on debt financing than equity financing all point to similar company sizes.

The regression results also demonstrate that, as performance variables, board size has a negative relationship with sales growth rate but a positive relationship with Tobin's q and ROA. This contributes to the continuing discussion over how irrelevant board size is for different performance metrics. Despite being negligible and unexpected, the makeup of the board clearly has a detrimental effect on the success of Nigerian businesses.

The study also clearly demonstrates that a company's performance improves with the number of fixed assets in its asset portfolio, with companies that mostly rely on debt financing outperforming those that use equity financing. The performance of the enterprises was not significantly impacted by their size.

Therefore, it is clear that corporate governance frameworks affect Nigerian companies' performance.

Given the preceding study, it is evident that listed firms in Nigeria exhibit comparatively inconsistent outcomes with respect to corporate governance and other performance metrics. It is important to note, nevertheless, that this is in line with prior research.

Therefore, the future focus would be on the banking and financial services industry after this work.

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