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Corporate Governance Mechanism and Financial Performance of Quoted Non-Financial Companies in Nigeria

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Abstract
The study investigates effect of corporate governance mechanisms on financial performance of quoted non-financial companies on the Nigerian Stock Exchange. The specific objectives of the study were to determine whether corporate governance proxied by board size has any effect on firm financial performance using Return on Equity (ROE) and Net Profit Margin (NPM) as a measure of firm financial performance. Ex-post facto research design was used and a sample of 75 quoted non-financial companies with complete and comprehensive published annual reports for the period under review (2010-2019) was used for the study. The Generalised Least Square (GLS) regression was employed to investigate the relationship existing between the variables. The result reveals that Board size has a positive and significant effect on Return on equity and Net profit Margin. The study concluded that corporate governance has greater effect on financial performance of sampled companies. In the light of the above findings, the study recommends that companies should improve the quality of their corporate governances' practices as this can also improve investor confidence, reduce agency costs and signal positive firm performance.
Keywords: Corporate Governance, Financial Performance, Non-Financial Companies
JEL Classification: M40, M41, G34

1. Introduction

Strict adherence to corporate governance principles is key if an entity must achieve corporate goals which include profit and shareholders wealth maximization. Corporate governance is concerned with ways in which all stakeholders of a firm attempt to ensure that managers and other insiders adopt a system that safeguard the interests of the stakeholders (Waleed, Mohammed, Mosab & Najib, 2020). A typical firm is characterized by numerous owners having no management function, and managers with no or little equity interest in the firm. The free-rider problem associated with diffused ownership of equity tends to prevent any shareholder from taking

unilateral action to bear the costs of monitoring the managers, who may pursue interests that conflict with those of the shareholders. Corporate Governance is a system or an arrangement that comprises of a wide range of practices (accounting standards and rules concerning financial disclosure, executive compensation, size and composition of corporate boards) and institutions (legal, economic and social) that protect the interest of corporation's owners.

Empirical studies have shown that corporate governance plays an important role in improving the financial performance of a firm and there is a direct relationship between the two (Klapper & Love, 2003; Eissa, Faozi & Anwar, 2019; Gompers, Ishii, & Metric, 2003; Fama & Jensen, 2012; Durga, 2019). Literatures on corporate governance suggest that the roles of regulatory authority, board, management, suppliers, customers and creditors are important in improving firm performance. Good corporate governance is primarily concerned about the protection of the rights of shareholders which plays an important role in the development of capital market all over the world by protecting their interests (Mohammed, 2019; Kahan & Rock, 2003).

Firm financial performance is a concept that supports the effective and efficient use of financial resources to achieve overall corporate objectives which include both shareholders wealth maximization and profit maximization objectives. Firms with good track records in term of financial performance tend to attract more investors. Firm financial performance is one of the determinants used by investors to make investment decision. Financial performance has received significant attention from researchers especially in accounting and strategic management. The reason for this is not farfetched as financial performance has implications to organization's health and long-term survival. Financial performance is viewed as the efficient and effective use of resources by an organization for the accomplishment of its objectives resulting to increase in share price, sales, market share, profitability, earnings and cash flows and meeting the expectations of its various stakeholders. Empirical studies have shown that firms with stronger stockholder rights, that is, better governed firms are more valuable (Gompers, et al., 2003; Bebchuk, Cohen, & Ferrell, 2004).

Studies have shown that good corporate governance reduces the likelihood of corporate failure resulting from poor financial performance. There is still considerable argument of late concerning the effect of corporate governance on the financial performance of corporate entities. This is because studies have provided evidence of mixed results between certain corporate governance mechanisms and expected outcomes. For instance, Adeusi (2013); Umar and Sanni (2020) found that increased board size is positively related with financial performance (ROA) of banks while Uwuigbe

(2012) and (Mustapha, Rashid, Bala & Musa (2020) discovered that the size of the board and the financial performance of banks measured in terms of ROA were significant and negatively related. Ishaya (2013) found that board composition has a significant but positive affiliation with firms' financial performance while Olatunji and Ojeka (2011) evidenced a significant but negative relationship between board composition and financial performance.

This study used corporate governance proxied as board size against two measure of financial performance (ROE and NPM). Aside from Davin (2021), that has adopted this approach in a corporate governance firm financial performance study using Nigerian banks not much empirical evidence exist in this regard in Nigeria and hence the present study utilized a different sector (non-financial) and thus provide a unique and incrementally relevant evidence which is boosted by the fact that corporate governance for banks addresses many matters peculiar to banks which do not apply to non-financial institutions (PricewaterhouseCoopers, [PWC], 2015). Consequently, the objective of the study is to examine the relationship between corporate governance mechanism (board size) and firm financial performance in Nigeria using non-financial sectors of the economy. In order to achieve the stated objective, the following research questions were asked. What is the relationship between board size and return on equity of quoted non-financial Companies in Nigeria? What is the relationship between board size and Net Profit Margin of quoted non-financial Companies in Nigeria?

2. Review of Related Literature

2.1 Conceptual Review

2.1.1 Concept of Corporate Governance

Researchers, authors and some scholars view corporate governance from different perspective. Some notable organizations also contributed to the development and definitions of corporate governance. Cadbury (1992) defined corporate governance as an instrument used to discipline organizations. The Organization for Economic Cooperation and Development [OECD], 2010, considers corporate governance as the system by which business corporations are directed and controlled. In another words, corporate governance has as its core the decision-making process at the level of the board of directors and top management and the mechanisms, internal or external, that guaranty that decision-process outcomes, are according to the objectives of the firm and its shareholders (Mulbert, 2010). Strandbery (2001) views corporate governance as being determined by the equity allocation among inside and outside investors.

Corporate governance is also seen to concern the relationship between the internal governance mechanism of corporations and society's

conceptions of the scope of corporate accountability (Deakin & Hughes, 1997). Fama and Jensen (2012) argued that corporate governance is a framework that controls and safeguards the interest of all stakeholders of an entity. The stakeholders include mangers, employees, customers, shareholders, executive management, suppliers and the board of directors. To them, the essence of corporate governance is to protect and safeguard the investment of shareholders.

2.1.2 Concept of Financial Performance

The performance or value of a firm can be seen as the amount of utility or benefits derived from shares of a firm by the shareholders. Firms with high value from the sales of their shares can be said to be performing well financially. Such high valued firms attract investors a lot thereby increasing the firm's prospect of further expansion. Performance is however, a difficult concept, in terms of definition and measurement. It has been defined as the end result of activity, and the appropriate measure selected to assess corporate performance is considered to depend on the type of organization to be evaluated and the objectives to be achieved through that evaluation (Jat, 2006). Zuriekat, Salameh and Alrawashdeh (2011) in contrast opines that performance measurement systems are considered information systems that are used to evaluate both individual and organizational performance. Until recently, firms concentrated on the use of financial performance measures as the basis of performance evaluation.

Hill and Jones (2009) similarly asserted that the key measure of an organization's financial performance is its profitability. For the purpose of this study, firm financial performance was measured using Return on Equity (ROE) and Net Profit Margin.

2.1.3 Board Size and Firms Financial Performance

This refers to the total number of directors on the board of any corporate organization. It appears that a major challenge in board size-financial performance nexus is determining what an optimal board size is. Till date there appears not to be any absolute consensus regarding what number constitutes a large board and which can be referred to as a small board. The determination of what the optimal board size should be is still without unanimity.

The empirical results thus far reflect mixed outcomes in the sense that some scholars (Kashif, 2008; Zubaidah, Nurmala, & Kamaruzaman, 2009) concluded that board size have a positive impact on firm financial performance. Zahra and Pearce (2009) opine that there is high possibility that a lager board will make better and inform decisions. Ning, Davidson and

Wang (2010); Connell and Cramer (2010), concluded that a negative relationship exists. Li and Niu, (2006); Frick and Andreas (2010) results report a non-consistent relationship between board size and firm financial performance. Though the SEC Code of corporate governance in Nigeria (2003) stipulates that the size of a board should not exceed fifteen (15) persons or be less than (5) persons in total, the question still remains on what the optimal size of a board should be. Among other scholars, Kashif (2008) suggested that the board size should be chosen with the optimal combination of both inside and outside directors for the value creation of the company. In Malaysia, Kenya, Liberia, Zambia, the corporate governance code of these countries does not specify the size of the board.

2.2 Theoretical Review

2.2.1 Stakeholder Theory of Organizational Management

Numerous articles and books written on stakeholder theory generally credit Freeman as the "father'' of stakeholder theory which was first mention in his book in the year 1983. Freeman's Strategic Management: A Stakeholder Approach is widely cited in the field as being the foundation of stakeholder theory, although Freeman himself credits several bodies of literature in the development of his approach, including strategic management, corporate planning, systems theory, organization theory, and corporate social responsibility. A related field of research examines the concept of stakeholders and stakeholder salience, or the importance of various stakeholder groups to a specific firm.

Stakeholders are those groups who have an interest in the actions of the corporation (Freeman & Reed, 1983). Stakeholders can be recognized by the legitimacy of their assertion which is sustained by a connection of exchange with the firm. Primary stakeholders are those without whose on-going support, the corporation lack perpetuity while secondary stakeholders are those who influence the firm but are not in a formal contract with the firm (Clarkson, 1995). Thus, stakeholders are those who have formal and informal ties to the firms. This theory is of the opinion that stakeholders have rights which corporations should uphold by reason of social contract (Goodijk, 2003; Donaldson & Preston, 1995).

The stakeholder theory views the firm from a broader perspective. The traditional stakeholder model opines that the corporation is responsible to a wider constituency of stakeholders other than shareholders. One of the arguments by Abram (1951) against the strictly agency theory is it narrowness, by identifying shareholders as the only interest group of a corporate entity necessitating further exploration. Other stakeholders or constituents of a firm include: employees, suppliers, creditors, customers,

banks, governments and social constituents as members of the society and community in which the firm is located. McDonald and Puxty (1979) asserted that companies are no longer the instrument of shareholders alone but exist within the society and, therefore, has responsibilities to that society. There is no doubt that stakeholders' pressure on corporation have brought hot debate on the need to examine the effects on financial performance hence the need for such research to be guided by this all-important theory.

This study is in agreement with stakeholder's theory and also the study is anchored on stakeholder's theory because it is a theory of organizational management and business ethics that addresses morals and values in managing organizations shareholders and any individual or constituency that contribute in any form.

2.3 Empirical Review

Davin (2021) examined the effect of *corporate g*overnance mechanisms on firms' financial performance of some selected deposit money banks in Nigeria by taking a sample of 10 deposit money banks starting from the year 2011 up to 2020. Generalized regression estimation was employed in this study and the result revealed that board size was negatively and significantly related with the financial performance (ROA) of sampled banks.

Owiredu and Kwakye (2020) examined the effect of corporate governance on financial performance of ten (10) commercial banks in Ghana (2007-2016). The study used Board Size, CEO Duality, Board Independence, Foreign Ownership and Institutional Ownership as variables for corporate governance while return on asset and return on equity were used as measure of financial performance. Using regression analysis technique, the study found a significant positive relationship between board size and financial performance measured by ROA and ROE of banks in Ghana. Additionally, the study found a statistically positive relation between foreign ownership and financial performance measured by ROE and ROE

Mustapha et al., (2020) investigated the relationship between corporate governance and financial performance of fifteen (15) banks listed in the Nigeria Stock Exchange for the year 2013 to 2015. Three board attributes (board independence, board meetings and board gender) were used as proxies of the independent variables while ROA was chosen as a measure of performance. Using linear regression analysis, the results indicated that the relationship between board independence and ROA was negatively insignificant. Board meeting and ROA were found to be negatively significant. However, the relationship between board genders, board size and ROA were negatively insignificant while the relationship between firm size and ROA was positively significant.

Lina and Laith (2020) investigated the effect of corporate governance characteristics on the performance of all listed Jordanian Banks (2014 to 2017). The study employed Multiple regression analysis method and the results revealed significant effects of the board size, board diligence, audit committee size and audit committee diligence separately on ROE by considering two controlling variables; namely, firm size and return on assets. Board size, board diligence, audit committee size and audit committee diligence were proxies for corporate governance while return on equity and return on asset were proxies for financial performance.

Umar and Sanni (2020) investigated the effect of corporate governance on performance of fifteen (15) quoted Deposit Money Banks in Nigeria (2015-2019). Using Panel regression techniques, findings showed that there was significant relationship between board composition, board size and firm size and the ROA of Deposit Money Banks in Nigeria. Board size, Board composition and Firm size were used as proxies for corporate governance and return on asset as a measure of performance.

Urhoghide and Korolo (2018) investigated effect of corporate governance on performance of quoted oil and gas companies in Nigeria. Board size, board diversity, board diligence, board political affiliation, and corporate governance disclosures were used as corporate governance mechanism while profit after tax was used as a measure of firm financial performance. The study used the published annual reports spanning the period 2008 to 2015. A sample of twelve (12) out of the fourteen (14) quoted companies in the oil and gas sector were used for the study. The Generalised Least Square (GLS) regression was employed to examine the relationship existing between the variables. The study found that Board size, board gender diversity and corporate governance practices had significant positive impact on financial performance. Board diligence and corporate governance reforms were positive but not significant while board political affiliation had significant negative relationship with financial performance of quoted oil and gas companies in Nigeria.

Kajola, Onaolapo and Adelowotan (2017) investigated the relationship between board size and financial performance of thirty-five (35) non-financial firms listed on the Nigerian Stock Exchange for the period 2003-2014. Using panel data regression analysis and Fixed effects model as estimation technique, result revealed a positive and significant relationship between board size (surrogated by the natural log of number of directors on the board) and the two financial performance proxies (Return on assets and Return on equity).

Akeju and Babatunde (2017) investigated corporate governance and financial reporting quality in Nigeria. The study used 40 companies listed on

the Nigeria Stock Exchange (NSE) from 2006 to 2015. The relationship between corporate governance mechanisms (board characteristics, audit committees, board independence, board size and growth) and financial reporting quality was observed. Multiple regression analysis was employed. The findings of the study revealed that corporate governance improves the financial reporting quality in Nigeria. The study also found that large boards provide wider diversity of backgrounds, diversity in communications skills, and experience and business contacts outside the company

Osundina, Olayinka and Chukwuma (2016) investigated the relationship between corporate governance and financial performance of thirty (30) companies out of a total population of 45 manufacturing companies listed on the Nigerian Stock Exchange, for a time period of 2010 to 2014. The study used multiple regression to ascertain the relationship between independent variable (Board Structure index, Ownership Structure index and Audit Committee index) and dependent variable (return on asset). The study found that Board structure index and audit committee index had a significant positive relationship with performance (ROA) of the sampled manufacturing companies, while Ownership structure index had an insignificant negative relationship with performance (ROA) of the sampled manufacturing companies.

In a study conducted by Odili, Ikenna and Orikara (2015) to ascertain the influence of corporate governance on banking sector performance in Nigeria, it was discovered that Board Independence, Directors' Shareholding and Audit Committee Meetings had positive and significant effects on banking sector's performance while Board Size showed negative and also significant effect on the performance of the banking sector in Nigeria. Ordinary least square estimation method was employed to analyze the data. Board Independence (BI), Board Size (BS), Director Shareholding (DSH) and Audit Committee Meetings (ACM) were used as dimensions for corporate governance and return on equity was used as a measure for performance.

Simon and Enoghayinagbon (2014) examined the relationship between corporate governance and financial performance of quoted firms. The ordinary least square regression was used to estimate the relationship between corporate governance and firm performance. Four corporate governance variables were selected namely: composition of board member, board size, CEO status and ownership concentration which served as the independent variables and ROA was used as a measure of financial performance. Findings from the study showed that there was positive relationship between composition of board member and board size as independent variables and financial performance. However, ownership

concentration had negative relationships with return on asset (ROA) but positive relationship with profit margin (PM).

Momoh and Ukpong (2013) investigated corporate governance and its effects on the Nigerian insurance industry. The Dependent and independent variables were Dividend Yield (Dividend per share/market price per ordinary share) and Return on Equity, Profit margin respectively. Data for this study were collected from five insurance companies listed on the Nigerian Stock Exchange. Reliability and statistical inference analytical tools were used. The result revealed that there was a significant relationship between corporate governance and insurance industry financial performance.

3. Methodology

This research work employed the ex-post facto research design. The study used secondary data retrieved from corporate annual reports of the sampled companies for the period 2012-2021 financial years. The study utilized only corporate annual reports that were readily available. The population of the study comprises of all non-financial companies quoted on the floor of the Nigerian Stock Exchange. As at December 2021, there are 134 non-financial companies quoted on the Nigerian Stock Exchange (NSEFactbook, 2021) and this constitutes the population for the study. However, after filtering the data and removing those with incomplete data, companies whose full annual report were not accessible and also companies that were listed after the 2012, the study arrived at a sample of 75 firms and this was eventually used for the study. The method of sampling was done using the simple random sampling technique.

3.1 Model Specification

The study utilized the Generalized Least squares (GLS) regression estimation. The reason for the GLS regression is that GLS regression has the additional advantage that it corrects for the omitted variable bias and it allows for the examination for variations among cross-sectional units simultaneously with variations within individual units over time (Baum, 2008). This study adapted the model of Davin (2021) which examined corporate governance and firm performance in Nigerian Banks. The model is specified thus:

$$ROA_{it} = \beta_o + \beta_1 BOS_t + e_t \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots (1)$$

This study modified Davin (2021) model by incorporating return of equity (ROE) and net profit margin (NPM). Importantly, also this study is unique because two dependent variables were used against one independent variable. The functional models is first presented

$ROE = F(Bsize)$ ……………………………………………………………… (2)
$NPM = F(Bsize)$ ……………………………………………………………… (3)
Where:
ROE: Return on Equity
NPM: Net Profit Margin
BSIZE: Board Size

Consequently, the models for this study are presented below:
$ROE_{it} = \lambda_o + \lambda_1 Bsize_{it} + \mu_{it}$ …………………………………………… (4)
$NPM_{it} = \lambda_o + \lambda_1 Bsize_{it} + \mu_{it}$ …………………………………………… (5)
Where:
FP = Financial performance proxied by ROE and NPM
BSIZE = Board size
J = jth firm
t = time period

4. Results and Discussion

Table 1: Descriptive Statistics

	NPM	ROE	BDS
Mean	0.409	0.381	8.9529
Median	0.237	0.548	9
Max	0.691	0.657	19
Min	-0.360	-0.496	4
Std. Dev.	0.288	0.159	2.516
Skewness	-0.42	-0.66	0.629
Kurtosis	2.039	3.8547	3.5259
Obs	723	723	723

Source: Researcher's Computation Using STATA (2022)

The descriptive statistics of the data is presented in table 1. AS observed, NPM has a mean of 0.409 with a standard deviation of 0.288. The maximum and minimum values stood at 0.691 and -0.360 respectively. ROE measure of financial performance has an average value of 0.381 with maximum and minimum values of 0.657 and -0.496 respectively and the standard deviation of 0.159 suggest considerable clustering around the distribution mean. Board size has an average value of approximately 9

which implies that the average board size for the sample is 10 members. There is still a lot of controversy in management literature regarding the appropriate number of individuals that should make up an ideal board size. The conclusions seem to be that a company should select a board size that is representative of all stakeholder interest. The maximum and minimum values stood at 19 and 4 respectively and the dispersion of the data about the mean is at 2.516. The findings of the study reveals that BDS has a positive and significant effect on ROE and NPM, which implies that increasing the board size has a positive impact on firm financial performance.

Table 2: NPM Regression Result

Variable	Aprori sign	Random Effects Estimates	Fixed Effects Estimates	Pooled OLS
C		0.4880* (0.0764) {0.000)	0.0002 (0.000) {0.2927)	0.4904* (0.1038) {0.000}
BDS	+	0.0035** (0.0019) {0.0757}	0.0239* (0.000) {0.0000}	0.0009 (0.0011) {0.3834}
AR(1)			-0.0036* (0.0003) {0.000}	0.3339* (0.0214) {0.000}
Model Parameters				
R^2	0.2187		0.6811	0.1907
Adjusted R^2	0.1809		0.6056	0.1531
F-statistic	7.998		63.950	7.809
Prob(F-stat)	0.000		0.000	0.000
Durbin-Watson	1.029		1.97	1.430
Model Diagnostics				
χ^2_{Hetero} $\chi^2_{Serial/Corr}$ $\chi^2_{Wald\text{-}Test}$	(0.966) (0.144) (0.000)		χ^2_{Norm} $\chi^2_{Hausman}$	0.509 15.866 (0.000)

Source: Researcher's Computation Using STATA (2022)

Table 2 shows the regression results examining the impact of corporate governance on firm net profit margin. The net profit margin is the ratio of net profits to revenues for a company or business segment. Expressed as a percentage, the net profit margin shows how much of each Naira collected by a company as revenue translates to profit. Net profitability is an important distinction since increases in revenue do not necessarily translate

into increased profitability. The result also reveals that BDS has a positive (0.0239) and significant (p=0.000) effect on NPM which is also significant at 5% which implies that increasing the board size has a positive impact on firm NPM and this result is in tandem with aprori expectation.

The $\chi^2_{Hausman}$ statistic and p-value (15.866, p=0.00) indicates that the fixed effects model estimation is the appropriate estimation for the model indicating the existence of significant correlations between firms' specific disturbances and the beta's. The model reveals that R^2 and Adj R^2 stood at 68.11% and 60.56% respectively which suggests that firm corporate governance accounts for about 68% of systematic variations in firm performance of the firms in the sample. The χ^2_{Hetero} p-value (0.966) implies the homoscedastic behaviour of the errors and the $\chi^2_{Serial/Corr}$ p-value (0.144) also reveals the absence of serial correlation. In addition, χ^2_{Norm} p-value (0.509) reveals that the series follow a normal distribution. The F-stat of 75.89 (p-value = 0.00) which is significant at 5% and suggest that the hypothesis of a significant linear relationship between the dependent and independent variables cannot be rejected. It is also indicative of the joint statistical significance of the model.

4.1 Discussion of Findings

From the estimation results in table 1 and table 2, the analysis of coefficients reveals that BDS has a positive and significant effect on firm ROE which implies that increasing the board size has a positive impact on firm financial performance and this result is in tandem with aprori expectation. Hence, we reject the hypothesis that board size has no significant effect on corporate financial performance. The finding is in tandem with Umar and Sanni (2020); Urhoghide and Korolo (2018); Kajola et al. (2017). Akeju and Babatunde (2017) which found that large boards provide wider diversity of backgrounds, diversity in communications skills, experience and business contacts outside the company which leads to improvement in financial performance. However, there is still no consensus regarding what constitutes an appropriate or optimal board size. But several studies are of the view that a board size that is too large is a draw back on firm performance due to issues of delay in decision making and a fall in board efficiency following from diminishing marginal utility of additional board membership.

In contrast, to the study findings, other studies show that increasing the number of individuals on the board does results in a decline in firm performance. For example, Odili et al. (2015) argued that as board size becomes larger it will be more difficult for board members to reach a

consensus due to the more diverse opinions and ideas. Therefore, large boards are slower and less efficient in making decision.

Furthermore, the Net profit Margin estimation results reveals that BDS has a positive and significant effect on NPM which is also significant which implies that increasing the board size has a positive impact on firm NPM. Hence, we reject the hypothesis that board size has no significant effect on corporate financial performance. The finding is in tandem with Umar and Sann (2020). In contrast, to the study findings, other studies show that increasing the number of individuals on the board does results in a decline in firm performance. For example, Odili et al. (2015) argued that as board size becomes larger it will be more difficult for board members to reach a consensus due to the more diverse opinions and ideas. Therefore, large boards are slower and less efficient in making decision.

5. Conclusion

In the light of the above going debate, as to whether a large or a small board size is appropriate. Our findings indicated that an increase in the board size would result to a rise in return on assets and net profit margin. However, caution needs to be taken while drawing inferences from such results. Hence this study recommends that in light of the above findings and ongoing debate that neither a small board size nor a large board size can be deemed appropriate. Therefore, in either increasing or reducing the board size certain factors should be considered; Stage of development of the company; representational requirements; diversity; area of expertise; skills and abilities.

Furthermore, it is advisable to start with a small board size and increase its members if need be given the above mentioned factors. As there are no hard and fast rules, as each companies needs differ across same industry and different business lines. In the light of the above findings, the study therefore recommends that companies must ensure that they maintain a board size that is not large. Although there is yet no consensus as to what number constitutes a large board, it is the opinion of the researcher is that companies maintain not less than eight (8) members this again depends on the size and other peculiarities of the companies.

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