International Journal of Advance Research, IJOAR .org
Volume 2, Issue 2, February 2014, Online: ISSN 2320-9127

EFFECT OF CORPORATE GOVERNANCE ON BUSINESS FINANCIAL PERFORMANCE OF PROFIT ORIENTED ORGANISATIONS IN SOUTH WESTERN NIGERIA

OSHO, Augustine Ejededawe

Bursary Department, Ekiti State University, P. M. B. 5363, Ado Ekiti, Nigeria
E-mail: droshoaugustine@yahoo.com
G-mail: ejededawe01@gmail.com

KeyWords

Business Financial, Corporate Governance, Financial Performance, Mechanisms, Organisations, Profit Oriented.

Abstract

The concept of corporate governance has attracted considerable attention, domestically, in recent years. Previous research, largely conducted using international data, has suggested that better governed firms outperform poorer governed firms in a number of key areas. Recent global events concerning corporate failures have put back on the policy agenda and intensified debate on the efficacy of corporate governance mechanisms as a means of increasing firm financial performance. This study examined the effect of corporate governance on business financial performance of profit-oriented organizations in South Western Nigeria. Five hundred and twenty five staffs of fifty selected profit oriented organizations in South Western States of Nigeria were randomly selected for the study. Two hypotheses were tested in the study. Findings from the study revealed that the foundation for good corporate governance is sound business strategy along with competent and responsible management term. Thus, it was recommended that corporate governance must take into the account the drivers of reforms positively.

Introduction

Businesses exist to meet the needs and wants of a society. A business is any activity that seeks to make profit by providing goods and services to others. Businesses use inputs from the environment and transformed them into outputs such as food, clothing, housing, medical care, transportation as well as other things that add meaning to human existence (leisure and recreation) (Nickeis etals., 1999) . There are different types of business organizations - the profit and the not-for-profit organizations. The former are interested in making monetary gains for its owners, while the latter do not seek monetary gains for their owners. The performance of these businesses is predicated on several factors. Many businesses have failed to meet the objective or purpose of its formation. This has been the experience in all economies. It is more worrisome in the developing economics of the world where managers lack the requisite managerial skills in management. It is one thing to formulate individual and organizational objectives, and another thing is to achieve the set targets, sustain task-level and later improve on performance. The fact that most of the businesses (both large and small scale business) that we saw in our communities, states and country are no more in existence, means that something is wrong somewhere.

Company performance is very essential to management as it is an outcome which has been achieved by an individual or a group of individuals in an organization related to its authority and responsibility in achieving the goal legally, not against the law, and conforming to the morale and ethic. Performance is the function of the ability of an organization to gain and manage the resources in several different ways to develop competitive advantage. There are two kinds of performance, financial performance and non-financial performance (Hansen and Maryanne 2005). Financial performance emphasizes on variables related directly to financial report. Company's performance is evaluated in three dimensions. The first dimension is company's

productivity, or processing input into output efficiently. The second is profitability dimension, or the level of which company's earning is bigger than its cost. The third dimension is market premium, or the level of which company's market value is exceeding its book value. In this study, financial performance only focused on one dimension as stated by Walker (2001), profitability. The reason choosing the standard are: the implementation of net profit before tax eliminates the effects of converting of tax structure to profitability level; and identifying of the company's effectiveness in managing the resources.

Iswatia and Muslich (2007) stated that the profit information is prime attention in appraising performance or responsibility of the management, and profit information helps the owner of stake holders appraise the company's profitability in the long run. In financial report, profits also functions as parameter to evaluate management performances, so that the investor's attention only on profit information without paying attention the procedure which is applied by the company to produce profit. This concern urges managers in maximizing the ratio of profitability. While economic performance in the short term can be measured approximately through profitability ratios (e.g. in terms of return on sales [ROS], return on owners' capital employed [ROCE] and return on equity [ROE]—an approach frequently used in empirical studies in the USA and Europe, Edwards 1998; Hart and Ahuja (1996) to assess the relationship between environmental and economic performance. However, this omits a number of important and more long-term aspects of business competitiveness.

Given the serious difficulties in defining competitiveness, some authors have started to measure sustainable competitiveness as that part of competitiveness that is determined or strongly influenced by the management of environmental and social issues. Lankoski (2000) applies this idea to environmental aspects and points out that economic performance is a multicausal issue, and that therefore any causal effect on overall economic performance (or overall

competitiveness) by a single explanatory factor (such as, environmental performance) is likely to be small. Therefore, an operationalisation of sustainable competitiveness (as a sub-segment of overall business competitiveness) can be based on the self-assessment of companies, an approach successfully used by Sharma (2001) with US and Canadian companies to measure organisational capabilities and competitive benefits, and by Wagner (2003) to assess the influence of strategy choice on the link between environmental performance on environmental competitiveness. Such an approach requires definition of a set of items to approximate a theoretical concept of sustainability competitiveness. Such items can include different drivers that are hypothesised to increase competitiveness, as well as outcomes that are perceived to be results of high competitiveness or environmental competitiveness. In view of this, business financial performance can be influenced by Corporate Governance.

The term "Corporate Governance" has been identified to mean different things to different people. Magdi and Nadereh (2002) stress that corporate governance is about ensuring that the business is run well and investors receive a fair return. Organisation for Economic Cooperation Development (OECD) (1999, 2004) provides a more encompassing definition of corporate governance. It defines corporate governance as the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs.

The foundation for good corporate governance is sound business strategy along with competent and responsible management term. In recent time, the world has witnessed the failure of large corporate organizations which has been attributed to large scale fraud by directors in connivance with auditors. There is the case of Enron in the U.S. A., and many cases in the U.K such as Polly

Peck, Maxwell Communications and BCCI (Institute of Chartered Accountants of Nigeria, 2008). This development resurrected once more the debate for corporate governance to be in place which will ensure that companies are well managed by the directors and other management staff to whom shareholders have entrusted this function. Given that in most listed companies, shareholders have opportunity to find out about the management of the company only at the Annual General Meetings, which today are often poorly attended, there is, therefore, the need to ensure good corporate governance on the part of the managers of the company as this will not be achieved at Annual General Meeting.

Recent global events concerning high profile corporate failures have put back on the policy agenda and intensified debate on the efficacy of corporate governance mechanisms as a means of increasing firm financial performance. It is generally believed that poor Corporate Governance has been the 'Achilles heel' of many corporations in both rich and poor nations. This is particularly true of Nigeria, where corruption is endemic (Clinton, 2009). However, the Federal Government is keen to attract foreign investments into the country. Given the high correlation between corporate governance and investors' decisions, the government is keen to position the country to take advantage of the opportunities in the global market by adhering to principles of good governance. Yet, not much is known about the state of or the current framework for, corporate governance in Nigeria (African Economic Research Consortium, 2005).

Good Corporate governance seeks to create an institutional framework that encourages all participants to contribute towards better corporate performance through an alignment of their objectives. As has been aptly described by Sir Adrian Cadbury (1996) in the preface to the World Bank Publication 'Corporate Governance: "Corporate Governance is concerned with holding the

balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align, as nearly as possible, the interests of individuals, corporate and society" (SEC-UNDP 2003).

In achieving a balance between the diverse objectives of participants of the governance system, good Corporate Governance should set out a framework that lends adequate protection to the interests of stakeholders and reinforces the fiduciary responsibilities of those vested with the authority to act on behalf of the stakeholders. The Corporate Governance framework should recognize the rights of stakeholders as established by law. It should also encourage fair practices on part of the Board of Directors and encourage them to promote the objectives of the company (SEC-UNDP, 2003).

Corporate Governance mechanisms are designed to reduce the inefficiencies that arise from moral hazard and adverse selection. For example, to monitor managers' behaviour and independent third party (the external auditor) attests the accuracy of information provided by management to investors. An ideal control system should regulate both motivation and ability.

The research suggests that both market and non-market mechanisms could be used to promote the alignment of interest of managers and stakeholders. The managerial labour market and the market for corporate takeover tend to exert pressures both within and outside the firm in order to achieve such an alignment of interest. Fama (1980) assets that a firm can be viewed as a team, whose members realize that in order for the team to survive, they must compete with other teams, and that the productivity of each member has a direct effect on the term and its members. Thus, within the firm, each, manager has the incentive to monitor the behaviour of other managers, whether subordinates or superiors. Secondly, Fama argues that the firm is in the market for new managers and the reward system must be based on performance in order for it to

attract good managers or even to retain existing ones. Demsetz and Lehn (1985) provide an explanation for the weakness of the market induced mechanisms as a means of protecting stakeholder interests. They observe that the free rider problem tends to prevent any of the numerous owners of equity from bearing the cost of monitoring the managers.

Empirical works abound on the mechanisms aimed to help reduce the agency problem. abstracting from other dimensions of corporate governance (such as incentive schemes) focus on four mechanisms board composition, board size, ownership concentration and appointment of an expatriate CEO.

Good Corporate Governance therefore includes those structures, practices and procedures put in place by the Board of Directors as well as persons duly appointed by the proprietors to direct and manage the business of the company. It must ensure transparency, accountability and enhanced shareholders value. The companies shall operate within the framework of appropriate rules and regulations, under which was incorporated as well as rules and regulations released by relevant regulatory authorities from time to time (National Insurance Commission 2009).

Purpose of the Study

The main aim of this research is to examine the effect of Corporate Governance on business financial performance of profit oriented organizations in South Western States of Nigeria. To achieve this broad aim, the following objectives are in focus:

1. Examine the extent to which Corporate Governance variables, insider shareholding on firm, composition of board members, board size, block holdings or ownership concentration and appointment of an expatriate CEO may affect the business financial performance;
2. Examine whether or not the separation of the posts of CEO and Board Chair is of any value in the promotion of business performance.

Research Questions

For the purpose of this study, the following research questions were raised to guide the study:

1. Is there a difference in the extent to which Corporate Governance variables, insider shareholding on firm, composition of board members, board size, block holdings or ownership concentration and appointment of an expatriate CEO may affect the business financial performance?
2. Would separation of the posts of CEO and Board Chair have any value in the promotion of business performance?

Research Hypotheses

The hypotheses formulated for the study are as follows:

$H1_1$: There is significant difference of insider shareholding on firm, composition of board members, board size, block holdings or ownership concentration, appointment of an expatriate CEO and Corporate Governance will significantly, independently and jointly predict business financial performance.

$H1_2$: Separation of the posts of CEO and Board Chair will have significant influence on business performance.

Research Methodology

The researcher employed ex-post facto design and the data were results of the 525 members of staff from 50 selected firms and organisations from South Western States of Nigeria sampled. The populations for this study consist of all profit-oriented corporate organizations and business organizations randomly selected for the study, located in the South Western Nigeria (i.e Ekiti,

Ondo, Osun, Oyo, Lagos and Ogun-state). The hypotheses were tested using Multiple Regression and independent t-test analysis.

Analysis and Discussion

Hypothesis 1

Insider shareholding on firm, composition of board members, board size, block holdings or ownership concentration, appointment of an expatriate CEO and corporate governance will significantly, independently and jointly predict financial performance.

Table 1: A Summary of Multiple Regression Analysis showing the influence of insider shareholding on firm, composition of board members, board size, block holdings or ownership concentration, appointment of an expatriate CEO and corporate governance on financial performance in profit oriented organisations in the South Western States of Nigeria.

Predictors	B	T	P	F	P	R^2
Insider shareholding/firm value	0.02	1.35	>.05			
Composition of board members	0.13	5.29	< .05			
Board size	0.55	70.23	<.05	857.47	<.05	.91
Block holding/Ownership concentration	0.19	6.65	<.05			
Expatriate as CEO	0.01	0.85	>.05			
Corporate Governance	.12	4.60	< .05			

N = 525, β = Standardized regression weight computed at the end of each step, R^2 = Adjusted R^2.

Table 1 above showed insider shareholding on firm, composition of board members, board size, block holdings or ownership concentration, appointment of an expatriate as CEO and corporate governance jointly and significantly predict perceived financial performance in profit oriented organisations $F(6, 524) = 857.47$, $P < .05$, $R^2 = .91$.

The table also revealed that insider shareholding on firm (β =0.02, t = 1.35; P< .05) and appointment of expatriate as CEO (β =0.0, t = 0.85; P>.05) did not respectively significantly independently predict perceived financial performance in profit oriented organizations

Meanwhile, composition of board members (β = 0.13, t = 5.29; P< .05), board size (β =0.55, t = 70.23; P<.05), block holdings or ownership concentration (β =0.19, t = 6.65; P<.05), and corporate governance (β =0.12, t = 4.60; P<.05) significantly independently predict perceived financial performance in profit oriented organizations

The table further revealed that 91% of the variance in perceived financial performance in profit oriented organizations was accounted for by the identified independent variables. Therefore, it can be said that hypothesis 1 was significantly supported by the study's findings

Hypothesis 2

Separation of the posts of CEO and board chair will have significant influence on business performance

Table 2: Summary of independent t-test showing the effect of position on business performance

Is your CEO also your board chairman?	N	Mean	SD	Df	T	P
YES	45	94.27	15.21			
				523	0.46	> .05
NO	480	95.28	14.12			

Table 2 above revealed that separation of the posts of CEO and board chair will not have significant effect on business performance in the profit oriented organisation (t (523) = 0.46; P > .05). Thus, hypothesis two which stated that separation of the posts of CEO and board chair will have significant influence on business performance is rejected. This shows that separation of the posts of CEO and board chair will have no significant effect on business performance in the profit oriented organization.

Conclusion

There has been a renewed interest within academic circles as well as amongst policy makers in both government and industry in the need to strengthen mechanisms to ensure that managers and directors take measures to protect the interest of a firm's stakeholders.

The events at Nigerian banking sector, Nigerian stock market and other cases of spectacular collapse have helped to bring to the limelight the important role that the strengthening of corporate governance mechanisms could play to improve business financial performance.

The importance of effective Corporate Governance to corporate organizations and economic performance can-not be over-emphasized in today's global market place. Companies perceived as adopting international investors than those whose practices are perceived to be below international standards. Good Corporate Governance is largely the result of a sound internal monitoring system, an effective regulatory environment and adequate disclosure and transparency requirements (SEC-UNDP, 2003).

Good corporate governance offers the promise of a fair return on capital invested through improved efficiency (Metrick and Ishii, 2002).

Finally, the research seeks to broaden understanding of stakeholders on Corporate Governance issues and multifaceted tasks to enhance knowledge and ensure due participation of stakeholders in the Corporate Governance framework.

Recommendations

Based on the findings of this study, the following recommendations were suggested.

1. The appointment of the members of the board of a corporation should be based on people with the requisite business and industry experience relevant to the corporation's enterprise.

2. Smaller Boards with the majority of the members being non-executive members are more cohesive and efficient. In addition, the paramount duty of the board, apart from directing the corporation, is to appoint a well-qualified and ethical Chief Executive Officer ("CEO") and oversee the CEO and the other senior management officers in a competent and ethically operational manner.

References

African Economic Research Consortium AERC (2005): Corporate Governance Mechanism and firm financial performance in Nigeria, Nairobi. The Regal Press Kenya, Ltd. (March).

Cadbury, Sir Adrian, (1992): "The Code of Best Practice". *Report of the Committee on the Financial Aspects of Corporate Governance,* Gee and Co. Ltd, Availability online form.

Clinton, H. (2009): "Town Hall Meeting of Hillary Clinton, US Secretary of State in Nigeria". The Nation, August.

Demsetz, H. and Lehn, K. (1985): "The structure of corporate ownership: Causes and Consequences". Journal of Political Economy, 93(6): 1155-77.

Edwards (1998): "Board characteristics, accounting report integrity, and

corporate performance: *The case of Nigerian quoted companies", Unpublished final report presented at the AERC biannual research workshop,* Nairobi, Kenya, May.

Fama, E.F. (1980): "Agency problems and the theory of the firm". Journal of Political Economy, 88 (2, April):288-307.

Hansen, Don R. and Maryanne M. Mowen (2005): *Management Accounting* 7th Edition Singapore: South-Western, a division of Thomson Learning Inc.

Hart, S., Ahuja, G. (1996): Does it pay to be given? An empirical examination of the relationship between emissions reduction and firm performance. *Business Strategy Environment* 5 30-37.

Institute of Chartered Accountants of Nigeria (ICAN), (2008): Financial Reporting and Audit Practice. Info Change News and Features, (2003).

Iswatia,Sri, and Muslish, (2007): Memprediksi Kinerja Keuangan dengan Modal Intelektual pada Perusahaam Perbankan Terbuka di Bursa Efek Jakarta. Ekuitas, X1(2), 159-174.

Lankoshi, (2000): Fundamental of Money, Banking and Financial Institution. New York: Harper and Row Publisher.

Magdi, R. and Nadareh, R. (2002): "Corporate governance: A framework for implementation", *Britain World Group Journal*, Vol 20, pp 123- 132.

Metrick, A and Ishii, J. (2002): "Firm-level corporate governance". *Paper presented at Global Corporate Governance Forum Research Network Meeting,* Washington, D.C. April.

National Insurance Commission, (2009): *Code of Corporate Governance for Insurance Industry in Nigeria* (NAICOM).

Nickels, McHugh and MuHugh, (1999): Nickeis, WG, McHugh, JM, McHugh, SM. (1999): Understanding Business. 5th Edition. New York: South-Western College Publishing.

Organisation for Economic Cooperation and Development, (1999, 2004): Principles of Corporate Governmen*t* Paris: (OECD). paper presented at the 3rd *African Finance JournalConference*, Accra, Ghana, 12th – 13th July.

SEC-UNDP. (2003): Project on Corporate Governance (12 July). http://www/secp.gov.pk/divisions/portal CS/PDF/Project Report. PDF

Sharma, (2001): FIMIAM: Financial Method of Intangible Assets Measurement. Journal of Intellectual Capital, 3(3), 323-336.

Wagner, G.M (2003): “The endogenous impact of leverage on firm value”, Pacific- Basin Finance Journal, Vol 13, pp 301- 318.

Walker, Dana Charles, (2001): Exploring the Human Capital Contribution to Productivity, Profitability, and the Market Evaluation of the Firm. http:/wwwlib.umi.com/dissertations/preview_all/3010003.