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RESEARCH ARTICLE

Corporate Governance and Firm Performance: Evidence from Nigeria Publicly Traded Enterprises

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The study's objective was to examine the relationship between corporate governance and firm performance in Nigerian publicly traded enterprises. Ex post facto research was used in the study to analyse data from 20 manufacturing listed companies. The data, which spans the years 2010 through 2020, was evaluated using System GMM. Profit margin and return on asset were used to measure firm performance. The study's findings demonstrated that corporate governance metrics (such as board size, audit committee size, and audit quality) have a significant impact on a company's profitability. Therefore, the findings suggest, among other things, that the government and the pertinent authorities create legislation on institutional and governmental ownership to serve as a regulator and, in the long run, improve corporate performance..

ABSTRACT

Keywords: *Corporate Governance, Firm Performance, Return on Asset, Generalized Method of Moments, Firm Size, Audit quality*

1. Introduction

An organization's economic success is determined not only by efficiency, innovation, and quality management but also by adherence to corporate governance principles. In developed economies, implementing corporate governance rules increases a company's financial success as well as its internal efficiency (Tadesse, 2004). However, unproductive corporate governance devices are hampered by a lack of openness and poor disclosure procedures. However, the universal financial calamity and major company scandals have highlighted the importance of good corporate governance systems in increasing long-term performance and sustainability (Ehikioya, 2009).

One of the most important aspects impacting a firm performance is its corporate governance. Corporate governance is concerned with how all parties (stakeholders) involved in the firm's success try to guarantee that managers and other insiders are always taking proper actions or implementing procedures that protect the stakeholders' interests. Corporate governance tools assure shareholders of adequate returns on investments. (Al- Haddad, Alzurqan, & Al_Sufy, 2011) agreed that when these tools did not function properly, outside investors would neither invest in company equity securities nor lend to the company. And this may cause the company not to have access to long-term debts and as a result, overall economic performance would suffer as many attractive business prospects would be lost, and financial difficulties at particular companies would swiftly spread to other companies, employees, and consumers.

Corporate governance was created to defend the interests of shareholders but has increasingly gained importance for other stakeholders and society (Mohammad, Aly, Dixon, & Startling, 2014). Corporate governance, according to Cadbur (1992), is the framework by which enterprises are directed and governed. To improve its performance, the corporate governance gives importance to the role and responsibilities of the board of directors, as well as the interaction with stakeholders. Corporate governance encompasses the connections between a company's management, its board, its shareholders, and other stakeholders. The goal of corporate governance is to make it easier to oversee and regulate business operations. Its essence is based on operational fairness and transparency, as well as increased disclosures to defend the interests of many stakeholders (Akshita & Shernaz, 2018). Good corporate governance guarantees that corporations consider the interests of a diverse variety of stakeholders, as well as the communities in which they operate, and that their boards are accountable to the company and its shareholders. The parties involved in a company's management system, include shareholders, investors, creditors, employees, and the government, they all have a significant influence on corporate governance practice. Good corporate governance's fundamental goal is to maximize long-term value for shareholders and stakeholders ensuring that factors like tribalism, inexperienced directors, unqualified workers, bad management, lack of standard practice, inadequate policies, and weak internal control mechanisms do not negatively affect or cause breaches in firm operations.

In general, the aim of this research is to see if corporate governance procedures and principles have an impact on firm performance by looking at how board size, board independence, outside directors, audit committee size, audit committee meetings, audit quality, and corporate governance principles affect business performance. Hence, this study aims to explore the relationship between corporate governance and firm performance.

2. Literature Review

2.1 Theoretical Literature

Agency theory and stakeholder theory will serve as the foundation for this study. Jensen and Meckling (1976) proposed the agency theory to explain the relationship between a company's owners (principals) and its managers, who act as the owners' agents when managing the company on their behalf. According to the theory, since ownership and management are held by distinct parties, conflicts of interest become very likely because owners and managers may have conflicting goals. According to the hypothesis, company owners use a variety of strategies to lessen the agency problem and, as a result, the loss it causes. The separation of powers, which presupposes that distinct individuals ought to hold the CEO and board chair posts, is notable among such alternatives (Chen, Chen & Wei, 2005).

Stakeholder theory was developed by Freeman (1984) to understand the intricate connections that exist within a corporation. The idea presupposed that a company's existence was the result of a network of interactions with other interest groups, including employees, the governments, creditors, debtors, and suppliers, in addition to the manager-owner relationship (Kock, Santalo & Dlestre, 2012). Therefore, balancing the varied and competing interests of all stakeholders and interest groups is the main task facing governance. As a result, it has been suggested that looking outside the company, or embracing external factors, is a way to adjust governance to the interests of stakeholders.

2.2 Empirical Literature

The empirical literature demonstrates that a lot of research attempts to evaluate the impact of corporate governance on firm performance. There is a sizable and expanding body of studies on the various facets and contexts of corporate governance and how they affect the performance of firms. On the relationship between various indicators of corporate governance and firm performance, this research provides conflicting findings. However, depending on whether the measuring purpose is to evaluate performance results or behavior, performance is a multi-dimensional construct that fluctuates (Akintonde, 2013). Osisioma Egbunike and Adeaga (2015) researched the impact of corporate governance on Nigerian deposit money banks' performance between 2006 and 2013. They discovered a strong relationship between deposit money bank performance and corporate governance proxy variables, as well as a positive and negative impact of these proxy variables on deposit money bank performance in Nigeria. Ahmed and Hamdan (2015) used a sample of 42 Bahraini financial companies that were listed on the Bahrain Stock Exchange between 2007 and 2011 to explore the effects of corporate governance characteristics on company performance in the Bahrain Stock Exchange. They discovered a strong relationship between Bahraini corporate governance and performance indicators such as return on assets and return on equity. Furthermore, their findings suggest the positive effects of corporate governance practices on the performance of the overall Bahrain Stock Exchange company. Udeh, Abiahu, and Tambou (2017) assessed the effect of board composition as a tool of corporate governance on return on capital used as a tool of firm financial performance in Nigeria Quoted Banks. Their findings show that the board's composition negatively affects Return on Capital Employed, albeit insignificantly.

Siyanbola, Ogbebor, Okeke, and Okunade (2019) investigated the relationship between corporate governance and earnings quality of 10 banks in Nigeria between 2008 and 2017. The results showed that cooperative governance has an insignificant impact on earnings quality. Sani, Aliyu, and Bakare (2019) examined the impact of corporate governance on the financial performance of banking firms between 2011 and 2018. The study found a significant relationship between corporative governance and firm performance. In Nigeria, Akinleye, Olarewaju, and Fajuyagbe (2019) used the panel data regression technique to investigate the relationship between corporate governance and company performance between 2012 and 2016. They discovered that corporate governance has a deleterious negative effect on financial performance. There are two opposing theories regarding the connection between board size and corporate success. First, the success of the firm can be significantly impacted by a smaller board of directors. Yermack (1996) found a negative relationship between board size and positive financial metrics like profitability and asset utilisation. Other studies imply that larger boards are expected to give corporations with greater supervision because they often have more time and expertise than smaller boards, which runs counter to the effectiveness of reduced board size. Reddy et al. (2010) provide evidence to support this claim, showing that larger

boards are closely related to board monitoring due to their capacity to distribute the workload among a larger number of directors. Badu and Appiah (2017) examined the impact of corporate board size on firm performance for a sample of 137 listed firms in Ghana and Nigeria. Their findings show a statistically significant and positive relationship between board size and firm performance. Abdulazeez, Ndibe, and Mercy (2016) investigated the effects of corporate governance on the financial performance of all listed deposit money banks in Nigeria after consolidation. They revealed that larger boards have a positive and significant impact on the financial performance of deposit money institutions in Nigeria.

Previous studies on the relationship between board independence and firm performance have produced a range of findings. A board of directors gets more independent the more outsiders it has (John & Senbet, 1998). According to Tanko and Kolawole (2010), the company's performance in terms of return on equity suffers when there are fewer outsiders on the board. They claimed that the implication was that when a board is recognised as independent, the performance of those companies improves. These findings contradict the findings of Ogunsanwo (2019) who argued that board independence has a positive effect on firm performance measured by return on asset. The audit committee is in charge of supervising and keeping track of the accounting procedure so that management can provide accurate and timely information to all stakeholders (Beasley, 1996). It is anticipated that audit committee independence will enhance the performance of the organisation because it may provide reliable accounting information (Brown & Caylor, 2004). By keeping an eye on corporate governance from the outside, audit quality can improve a company's performance. Auditors that charge higher audit fees communicate to markets that an audit with high quality could increase shareholder value (Martinez & Moraes, 2014).

This research is necessary since the existing literature is ambiguous regarding whether there is any relationship between corporate governance and firm performance. This study employs a multiple regression employing the generalised method of moments (GMM) technique, in contrast to earlier models that examined the impact of cooperative governance on firm performance. Based on the previous studies, it is postulated that corporate governance has an impact on firm performance. As a result, we offer the following null hypothesis which is in line with the general objective; Thus, we formulate the following general null hypothesis.

H_{o1}: Board size has no impact on firm performance of listed firms in Nigeria
H_{o2}: Board independence has no impact on firm performance of listed firms in Nigeria
H_{o3}: Audit committee size has no impact on firm performance of listed firms in Nigeria
H_{o4}: Audit quality has no impact on firm performance of listed firms in Nigeria

3. Methodology

Ex post facto research methods were used in the study to gather pre-existing data from the records of the firms chosen for the investigation. The audited financial statements of 20 manufacturing companies listed on the Nigerian Stock Exchange (NSE) between 2010 and 2020 were the source of the data for this study. This time frame was chosen to ensure data accessibility and take into account changes in these variables. The study was confined to twenty (20) companies because there wasn't enough data. Additionally, non-listed organisations whose financial reports were not provided as well as newly quoted firms that will result in missing data for the research period were eliminated.

The Model

In order to capture the impact of corporate governance on firm performance in Nigeria, the model for the study is consistent with previous studies by Ilemobayo, Adebimpe, and Yusuf (2020); Adegboyegun, Igbekoyi, & Alabi(2022) and Kajola, (2008). In carrying out this research paper on the effect of corporate governance on firm performance, we developed a compact form of our model as follows:

Firm Performance = f(Board size, Board independence, Audit committee, Audit quality)............(1)

Leverage and company size are included in this study as control variables as well. In econometric form, the following describes the functional relationship between corporate governance and company performance using the panel model specification:

$$FP_{it} = \beta_o + \beta_1 BS_{it} + \beta_2 BI_{it} + \beta_3 AC_{it} + \beta_4 AQ_{it} + \beta_5 LEV_{it} + \beta_6 SIZE_{it} + e_{it} \qquad (2)$$

Where:

FP_{it} = Firm performance of firm i in year t

BS_{it}= Board Size of firm i in year t

BI_{it}= Board independence of firm i in year t

AC_{it}= Audit committee of firm i in year t

AQ_{it}= Audit quality of firm i in year t

LEV_{it}= Leverage of firm i in year t

$SIZE_{it}$= Firm size of firm i in year t

β_0 = Intercept

β_{1-6}= Unknown Coefficients

e_{it} = Error term

Study Variables

Following earlier studies (Kajola (2008); Ilemobayo, Adebimpe, & Yusuf (2020)), this study uses return on asset (ROA) and profit margin (PM) as dependent variables as proxies for firm performance. Profit margin assesses how lucrative a company is, while return on asset gauges management's total effectiveness and provides insight into how effectively management uses its assets to generate revenues. The number of board members is used as a proxy for the board size. A measure of board independence is the proportion of outside directors. When a company is audited by a Big4 audit firm, audit quality assesses the audit committee's composition. The Big4 audit firms in Nigeria are Ernst & Young, Deloitte, KPMG, and PricewaterhouseCoopers. Leverage measures a firm's usage of debt whereas firm size, the control variable, indicates the size of the firm.

Table 1: Study Variables

Variables	*Measures*
Firm Performance	Return on Asset (ROA): Net income divided by total asset Profit Margin (PM): Net income divided by turnover
Board size	Number of directors on the board
Board independence	The proportion of outside directors in a company
Audit Committee	Number of audit committee members
Audit quality	"1" if firm i is audited by a Big4 audit firm at year t and "0" otherwise
Leverage	Total Debt to Total Asset
Firm size	Natural logarithm of total assets

Source: Author's computation 2022

Data Analysis

The generalised method of moments (GMM) methodology of Blundell and Bond (1998) is utilised in this study's multiple regression to estimate the model in (2) above, in contrast to earlier models that examined the impact of cooperative governance on business performance. This estimating technique can be chosen and used depending on a number of variables. First, even though the current functional connection is linear, our sample contains a lot of cross-sections (i.e., a large N) over a short amount of time (i.e., a small T). The system-GMM approach is also preferred to the difference-GMM of Arellano and Bond (1991) because it permits the insertion of more instruments, which greatly boosts efficiency. It incorporates the regressions in the first difference into an estimating run in levels using lag levels and lag difference as instruments. Because it has been demonstrated that the two-step system GMM

is substantially more asymptotically effective than the one-step technique, it is utilised for exceptionally robust analyses.

4. Result and Discussion

The table below shows the simple descriptive statistic of the variables in the model.

Table 1: Descriptive Statistics of the Variables

	ROA	PM	BS	BI	AC	AQ	LEV	LOG_SIZE
Mean	0.885558	1.097763	0.859179	1.274756	0.747510	0.541667	3.213263	5.786361
Median	0.886801	1.080889	0.903090	1.342423	0.778151	1.000000	3.187024	6.638973
Maximum	1.053938	1.218103	1.113943	1.653213	1.113943	1.000000	5.158997	7.576555
Minimum	0.666518	0.954695	0.477121	0.698970	0.477121	0.000000	1.204120	1.716540
Std. Dev.	0.102785	0.088595	0.202417	0.267210	0.170264	0.500350	0.829324	1.775048
Skewness	-0.298926	-0.082216	-0.580992	-0.509334	-0.206827	-0.167248	0.317652	-1.041655
Kurtosis	2.023547	1.985797	2.136630	2.116355	1.996243	1.027972	3.278246	2.402339
Observations	120	120	120	120	120	120	120	120

The mean PM and ROA of the sampled companies are respectively 1.097763 and 0.885558. The 20 companies used in this analysis have boards with an average size of 0.859179 and an average level of independence of 1.274756. The firms' audit committees have an average value of 0.747510. Additionally, the outcome shows that the mean value for audit quality is 0.541667. The control variable, leverage, has a mean value of 3.212836 while the mean value of firm size is 5.786361. The skewness revealed that, except for leverage, all variables were negatively skewed, which means that, due to the long left tail, these variables were concentrated on the right tail side of the distribution graph. In other words, except for leverage, their respective mean values as negatively skewed variables are lower than their median values. Kurtosis, meantime, showed that the data set included a mixture of leptokurtic and mesokurtic distributions as well as a mixture of normal and abnormal distributions. The various levels of deviation values in the control variables and corporate governance indicators reveal the degree of volatility and variation in the variables. The minimum and maximum values also reflect the variables' lowest and highest values as reported by the under-review firms.

Correlation Matrix

The degree and magnitude of the correlation between the variables are shown in Table 3. Considering that none of the variables' Pairwise correlation coefficients was higher than 0.80, multicollinearity is not a significant problem (Gujarati, 2003).

Table 3: Correlation Result

	ROA	PM	BS	BI	AC	AQ	LEV	SIZE
ROA	1.000000							
PM	0.024320	1.000000						
BS	-0.143937	0.035673	1.000000					
BI	-0.202275	0.015544	0.177197	1.000000				
AC	0.062194	-0.153569	0.102664	0.023133	1.000000			
AQ	-0.017222	-0.106954	0.051182	0.166143	0.188201	1.000000		
LEV	-0.308259	0.047804	0.067392	-0.096449	-0.194577	-0.059660	1.000000	0.023219
SIZE	-0.222639	-0.048670	0.147697	-0.020716	-0.010142	0.047036	0.023219	1.000000

Source: Author's computation, 2022

The fact that no variables in the aforementioned table have values higher than 0.8 demonstrates that high correlation was not a problem. Multicollinearity doesn't provide any problems. If the correlation coefficients between the variables are less than 0.8, the variables are deemed healthy.

Regression Result

Table 4: GMM Result

Dependent Variable	ROA	PM
Return on asset$_{t-1}$	0.05690 (0.0823)***	
Profit margin $_{t-1}$		-0.498101 (0.0448)**
Board size	0.007748 (0.04262)**	0.021803 (0.02513)**
Board independence	2.696875 (0.2968)	-35.28633 (0.1733)
Audit committee	0.005221 (0.0637)***	0.031916 (0.0805)***
Audit quality	0.020228 (0.0665)***	0.016758 (0.0196)**
Leverage	0.075611 (0.0942)***	1.100367 (0.0700)***
Firm Size	0.068003 (0.5268)	-0.174853 (0.4798)
Wald-Chi2	11.30654	72.45371
Prob.Chi2	0.0794	0.0000
Sargan test	4.523508	18.33786
P-value of Sargen test	0.33432	0.38018
Arrellano & Bond test AR (1)	-1.227936 (0.0195)**	-3.304594 (0.0010)
Arrellano & Bond test AR (2)	-1.136432 (0.2558)	-3.283733 (0.0340)**
Observations	80	80
Instrument	7	7
Number of Firms	20	20

Source: Author's computation, 2022
p- values in parentheses are for coefficients. *sig. at 1%level, **sig. at 5% level, and ***sig. at 10% level

Table 4 shows that, at the 5 % significance level, the two performance proxies (return on asset and profit margin) are significantly negatively impacted by the Board size coefficient. A larger board reduces profit margin by 0.021803 units whereas increasing board size decreases return on asset by 0.007748 units. Board independence has a

statistically insignificant impact on profit margin and return on assets. At the 10% level of significance, audit committees with a majority of outside members have a positive and significant impact on the performance of the company. An increase in the number of audit committee members will raise the return on asset by 0.005221 units and the profit margin by 0.031916 units. The performance of the firm is thought to be positively and significantly impacted by audit quality. At the 10% level of significance, utilizing the services of a big four auditor increases return on asset by 0.020228 units. The audit quality coefficient (0.016758), which has a significant level of 5%, likewise significantly and positively impacts the profit margin. The two indicators of firm performance are believed to be positively and insignificantly impacted by firm size. For every unit increase in leverage, the profit margin will rise by 1.100367 units, while the return on asset will rise by 0.075611 units. At a 10% level of significance, the coefficient of leverage is statistically different from zero.

Arellano-Bond tests for the first (AR (1)) and second (AR (2)) orders of autocorrelation produced probability values for model 1 of 0.02 and 0.26, respectively. It is normal to expect high first-order autocorrelation, but second-order autocorrelation is not a problem. This suggests that the models' specifications are accurate. For model 2, AR (1) produced a probability value of 0.00, while AR (2) produced a probability value of 0.03. The Sergan test probability value for model 1 is 0.33432, and for model 2, it is 0.38018. The number of instruments used in the system GMM is 7, which is significantly less than the number of cross-sections. The values of the Sergan test probability are more than 0.25. This supports the tools' robustness and adheres to the broad principle suggested by Roodman (2009).

Discussion of Findings

The GMM system estimator developed by Arellano and Bond (1995) econometric results are shown in Table 4. The instrument validity Sargan tests, which evaluate the dependability of additional moment circumstances, were also displayed. According to the results, the two performance indicators, return on asset and profit, are negatively impacted by board size, indicating that adding more directors will eventually result in lower performance. This is because an overburdened board will result in competing interests, lags in decision-making, and an increase in board-related expenses, all of which will lower performance in the long run. To corroborate this claim, Reddy et al. (2010) and Yermack (1996) both offer evidence. This finding, however, conflicts with past empirical studies (Badu and Appiah, 2017; Abdulazeez, Ndibe, and Mercy, 2016)) that claim that larger boards have a positive and significant impact on financial performance. The two performance metrics and board independence have no statistically significant relationship.

Findings of John and Senbet (1998), Tanko and Kolawole (2010), Ogunsanwo (2019), and Fariha, Hossain, and Ghosh (2021) do not support this conclusion; they argue that a statistically significant relationship exists between board independence and firm performance. Audit committees with a prevalence of outside members have a positive and significant impact on the company's performance. This is so because the analysis shows that the audit committee and the two performance metrics have a statistically significant relationship. This implies that growing the firm's output will result in hiring more audit experts. This is so that auditors, who are thought of as the doctors of corporate organisations, may swiftly spot problems while they are still obscure and suggest solutions in an effort to improve the health and overall performance of the company. This result is consistent with some previous studies (Javeed et al (2021), Alzeban, (2021)) where they reported a significant positive relationship between the audit committee and the performance variables. It has been discovered that audit quality influences firm profitability positively and significantly. Audit quality can boost firm performance by serving as an external monitor of how corporate governance is being implemented. Big Auditors have a solid reputation and produce high-quality audits, which helps firms operate better. The findings of Al-ahdal, and Hashim (2021) support this conclusion.

The firm's performance was found to be significantly negatively impacted by the ratio of total debt to assets. This implies that a company's performance will decline in direct proportion to the amount of debt it takes on. This is because when debt is added to a company above a certain point, the highly leveraged company directs most of its resources on debt servicing, leaving little to manage the business. Furthermore, if such debtors have a priority claim to the firm's assets, the company stands the risk of being liquidated and wound up. The results in Table 5 demonstrate yet again how a firm's size significantly influences its performance. The results from Al-Homaidi, 2020, Olawale et al., 2017, and other studies are supported by this. As a result, larger businesses often generate higher profits than smaller ones. The firm's performance was found to be significantly negatively impacted by the ratio of

total debt to assets. This implies that a company's performance will decline in direct proportion to the amount of debt it takes on. This is because when debt is added to a company above a certain point, the highly leveraged company directs most of its resources on debt servicing, leaving little to manage the business. Furthermore, if such debtors have priority claim to the firm's assets, the company stands the risk of being liquidated and wound up. The results in Table 5 demonstrate yet again how a firm's size significantly influences its performance. The results from Al-Homaidi (2020), Olawale et al. (2017), and other studies are supported by this. As a result, larger businesses often generate higher profits than smaller ones.

5. Conclusion and Policy Recommendation

This study's purpose was to investigate the relationship between corporate governance and firm performance in Nigeria utilising cross-sectional data from the annual financial reports and statements of 20 manufacturing firms listed on the Nigeria Stock Exchange's floor over a period of ten financial years. The return on asset and profit margin were used to assess firm performance, the dependent variable. The study's findings led to the conclusion that whereas other variables, such as audit committees and audit quality, had a negative and significant impact on the two measures of business performance, board size had a negative effect on firm performance as measured by return on asset and profit margin. Leverage, a control variable, has a negative effect on the firm performance metrics as well.

For Nigerian firms looking to examine how board size, board independence, audit committee, and audit quality affect firm performance, the study's conclusions have major policy implications. The results demonstrate that implementing effective corporate governance is predicted to enhance company performance when the company is led in a transparent and accountable manner. As a result, the report recommends that the board's size (membership) be increased while staying within the maximum number allowed by the code of corporate governance for firms. It also suggests that the government and relevant authorities enact laws on institutional and governmental ownership to act as a regulator and, in the long run, improve firm performance.

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