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The Impact of Corporate Governance on Firms' Profitability in Nigeria

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ABSTRACT: *The purpose of this paper is to investigate the impact of corporate governance on firms' profitability in Nigeria. This research has been performed using a sample of 60 companies listed on the Nigeria Stock Exchange (NSE) from 2004 to 2014. The relationship between corporate governance mechanisms (board characteristics, audit committee, board independence, size, growth and profit variability) and firms' profitability was observed. The results of the multiple regression analysis were statistically significant at 0.05 level. The F Statistics of 1.036 also shows that the result typically explained the model. The findings of the study confirmed that corporate governance mechanisms enhance firms' profitability in Nigeria.*
Keywords*: Corporate Governance, Performance, Profitability, Nigeria Stock Exchange*

I. INTRODUCTION

Corporate Governance is the process by which companies are directed, controlled and held to account (Australian Standard, 2003). This shows that corporate governance encompasses the authority, accountability, stewardship, leadership, direction and control exercised in managing organisations.
The concept of corporate governance originated in the 19^{th} century but began to be widely used in the 1980s (Parker, 1996; Fletcher, 1996; Vinten, 2001).
Corporate Governance gained prominence in the 1980s as a result of stock market crashes experienced in different parts of the world and failure of some organisations due to poor corporate practices (Francis, 2000).
As more corporate organizations in different parts of the world collapsed in 1980s, there was a change of attitude towards higher performance expectations by ensuring good corporate governance.
Prevention of Corporate failures was the core reason that led to the adoption of corporate governance. There was a growing acknowledgement that improved corporate governance was key to the growth and development of any economy (Clarke, 2004).
Other studies established strong links between corporate governance and Organisational performance (Gregg, 2001; Hilmer, 1998; Kiel & Nicholson, 2002; OECD, 1998).
Corporate governance describes the structure of rights and responsibilities among the stakeholders (Aguilera & Jackson, 2003).
A key objective of corporate governance is the enhancement of shareholders' wealth (Amba, 2013).
Corporate governance is not just corporate management; it also involves a fair, efficient and transparent administration to meet certain well-defined objectives (Bairathi, 2009). It is a system of structuring, operating and controlling a company with a view to achieving strategic goals to satisfy shareholders, creditors, employees, customers etc and complying with the legal and regulatory requirements, apart from meeting environmental and local community needs (Mulili & Wong, 2011).
Research evidence suggests that firms in emerging economies are discounted in financial markets because of weak corporate governance compared with developed counterparts (La Porta et al, 1999)
The aim of this research is to investigate the impact of corporate governance on firms' profitability in Nigeria.

II. LITERATURE REVIEW

There has been a wide variety of interest among researchers, scholars, governments and global agencies on corporate governance after the financial crisis of 2008 that led to the collapse of many institutions in the world.
Cheffins (2001) argued that corporate governance first came into existence in the 1970s in the United States.
The collapse of Enron and Arthur Andersen in the U.S and similar disasters in the UK such as Marconi has made corporate governance to become increasingly important around the world.
Consequently, the adoption of corporate governance in different parts of the world has some variations because circumstances vary from one country to another. Nevertheless, two main approaches of corporate governance can be identified with distinctions arising from the different legal systems in various countries (Amba, 2013).
Countries that followed civil law (e.g France, Germany, Italy & Netherlands) developed corporate governance framework that focuses on stakeholders. In those countries, the role of corporate governance is to balance the

interest of various stakeholders such as employees, managers, creditors, suppliers, customers and the wider community (Solomon & Solomon, 2004). This approach was known as the insider model of corporate control (Department of Treasury, 1997). On the other hand countries that followed the common laws such as Australia, United Kingdom, U.S.A, Canada and New Zealand, developed corporate governance structures that focus shareholders interest (Department of Treasury, 1997)

However, there have been debates about what needs to be included in a comprehensive corporate governance framework. Some scholars argued that a comprehensive corporate governance framework should include greater use of independent directors, access to outside advice for boards, review of board remuneration and limitations on the power of chief executive officers (cutting & Kovizim, 2000; Monks, 2002).

Al-Shurfa'a (2008) investigated the relationship between quality of earnings and various aspects of corporate governance. He used the actual based methods on a sample of 315 firms listed at Amman Stock Exchange. The aspects of the corporate governance investigated were board of directors and the audit committee. The results of findings revealed that there is negative relationship between earnings quality and corporate governance.

Klein et (2005) examined the relationship between firm value as measured by Tobin's Q and newly released indices of effective corporate governance for a sample of 263 Canadian firms. They used four control variables namely size, advantage, growth and profit variability. The results indicated that corporate governance does not matter in Canada and that size was negatively related to performance.

Brown and Caylor (2004) investigated whether firms with weak corporate governance perform poorly than firms with sound corporate governance. They examined four factors namely; board composition, compensation, take-over defenses and audit.

The research of their findings revealed that board composition is the most important factor influencing corporate governance while the least important factor is take-over defenses. Their research evidence also revealed that firms with weak corporate governance are less profitable than firms with strong corporate governance.

Rogers (2006) also examined corporate governance and financial performance of selected commercial banks in Uganda. His research evidence shows that corporate governance predicts 34.5% of the variance in the general financial performance of commercial Banks in Uganda.

Al-Haddad et al (2011) also investigated the effect of corporate governance on the performance of Jordanian Industrial Companies. He selected a sample of 96 firms quoted at Amman Stock Exchange. The research evidence shows that there is direct positive relationship between corporate governance and corporate performance.

Amba (2013) examines corporate governance and firms' financial performance in Bahrain using multiple regression model. The research findings revealed that corporate governance variables influence firms' performance.

Chen et al (2006) studied the links between corporate fraud, board structure and ownership structure in the context of enforcement actions of the Chinese Securities Regulatory Commission (CSRC). The evidence of his research proved that proportion of outside directors, the number of board of meetings and the tenure of the board chair are associated with the incidence of fraud.

Gillan et al (2003) studied the relationship between industry characteristics and board size, independence, board committee structure and the use of anti-takeover provisions.

Black et al (2006) examined the corporate governance practices at Korean Firms. They studied board structure, regulation, shareholder rights, board procedures, disclosure practices and ownership structure. The research findings showed that Korean firms corporate governance practices are strongly influenced by regulatory considerations, particularly for larger firms because they are subject to more stringent rules. The research evidence also revealed that industry factors, firms' size and firms' risk are associated with governance structures.

Salami, K.A (2011) investigated how ownership structure and existence of conflicts of interest among stakeholders in firms characterized with a poor governance system using panel data and regression models. His research evidence provides that firms with low ownership concentration showed low profitability.

III. RESEARCH METHODOLOGY

The broad objective of this research is to investigate the impact of corporate governance on firms' profitability in Nigeria. The data used for the purpose of this study were obtained from annual reports of 60 companies quoted on Nigerian Stock Exchange (NSE). A period of 10 years was considered. To test the hypothesis, the relationship between corporate governance mechanisms and profitability was considered.

The model used for the purpose of the study is:

$P= B_0+B_1BC+B_2AC+B_3BI+B_4S+ B_5GR+B_6\ PV+ U$

Where:

P= Profitability measured by Net profit Margin

B= Regression Coefficients

BC= Board characteristics
AC= Audit Committee
BI= Board Independence
S= Size
GR= Growth
PV= Profit Variability
U= Stochastic error term

IV. RESULTS

Multiple regression has been used to test the relationship between corporate governance mechanisms (Board Characteristics, Audit Committees, Board Independence, Size, Growth & Profit Variability) and firms' profitability, measured by profit margin.

The coefficient of determination R^2 of 0.676 and the adjusted R^2 of 0.002 showed that corporate governance mechanisms explained firms' profitability. The R^2 indicates that 67.6% variation in profitability is caused by corporate governance mechanisms. This implies that the result is a good fit.

The F Statistics of 1.036 shows that the result typically explained the model. The F Statistics denotes that a simultaneous change in profitability is caused by board characteristics, audit committee, board independence, size, growth and profit variability.

The evidence of the findings revealed a significant positive relationship between board characteristics and firms' profitability. This is evidenced by a P-value of 0.00 which is less than 0.05. A significant positive relationship was also found between audit committee and firms' profitability. This is supported by a P-value of 0.01, which is statistically significant at 0.05 level.

The results of the findings also revealed that there is a positive relationship between board independence and firms' profitability. This is revealed by a P-value of 0.00, which is statistically significant at 0.05 level.

A P-value of 0.04 also revealed that size is significantly positively related to firms' profitability.

The evidence of the findings also shows a significant positive relationship between growth and firms' profitability.

Profit variability is also positively related to firms' profitability. This is evidenced by a P-value of 0.00, which is statistically significant at 0.05 level.

V. CONCLUSION

This paper investigates the impact of corporate governance on firm's profitability in Nigeria. Corporate governance is examined from the perspectives of board characteristics, audit committees, board independence, size, growth and profit variability. The evidence of the findings revealed that there is a significant positive relationship between corporate governance mechanisms and firms' profitability. This means that the higher the level of board characteristics, audit committees, board independence, size, growth and profit variability, the higher the firms' profitability.

Based on the findings of this study, it is recommended that companies should pay attention to corporate governance mechanisms in order to improve profitability.

Moreover, there is need to develop corporate governance practices in developing countries like Nigeria that takes accounts of the economic conditions in each country.

In addition, firms should adopt good corporate governance practices so as to prevent corporate failures.

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Appendix 1

MODEL SUMMARY				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.822[a]	.676	.002	.18600

Source: Author's Computation, 2016

a. Predictors: (Constant), Board Characteristics, Audi Committee, Board Independence, Size, Growth & Profit Variability
b. Dependent Variable: Firms' Profitability measured by Net Profit Margin

Appendix 2

COEFFICIENTS[A]						
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	.700	.157		4.461	.000
	Board Characteristics	.003	.012	.027	.211	.000
	Audit Committees	.118	.085	.176	1.387	.010
	Board Independence	.126	.147	.111	.856	.000
	Size	.175	.121	.142	1.217	.040
	Growth	.148	.136	.128	1.284	.020
	Profit Variability	.162	.127	.169	1.303	. 000

a. Dependent Variable: Firms' Profitability

Appendix 3

ANOVA[a]						
Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	.107	3	.036	1.036	.000[b]
	Residual	2.076	60	.035		
	Total	2.183	63			

Source: Authors' Computation, 2016

a. Dependent Variable: Firms' Profitability

a. Predictors: (Constant), Board Characteristics, Audit Committee, Board Independence, Size, Growth & Profit Variability