CORPORATE GOVERNANCE AND PERFORMANCE IN PZ

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Abstract

The study examined the relationship between corporate governance and performance. The objective of the study was to examine board composition and diligence on organizational performance. Survey research design was adopted in this study. The population of study covers staff of PZ. The sample size selected is one hundred and ten (110) using the stratified random sampling. Primary data was used in this study and Chi-square statistical tool was used to analysed data. The empirical findings show that the adoption of good corporate governance practices enhances transparency of company's operation, assures accountability and improve firm's profitability. It also helps to protect the interest of the shareholders by aligning their interest with that of the managers. The results show that generally corporate governance has positive impact on the profitability. The factors of board size, management skills, CEO tenure, size and independence of audit committee, foreign and institutional ownership, dividend policy and annual general meeting, all have positive correlation with the performance of the organization.

Keywords: Corporate governance, Profitability, Organization, Performance

Introduction

Corporate governance has become a topical issue because of its immense contribution to the economic growth and development of nations. The absence of good corporate governance is a major cause of failure of many well performing companies. Existing literature generally support the position that good corporate governance has a positive impact on organizational performance; Gompers et. al (2003), Claessen et. al (2002) and others. The economic well-being of a nation is the reflection of the performance of its companies. Thus, the low level of development of developing nations is attributed to the low level of good corporate governance practices. As a result, such countries have been identified by the World Bank and other writers as having inadequate capacity to effectively manage their resources, hence, the overriding emphasis placed on good corporate governance in the existing literature as the most important problem facing the development of countries, such as Nigeria.

The concept of corporate governance has been defined as “dealing with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment” (Shleifer & Vishny, 1997). It deals precisely with problems of conflict of interest, design ways to prevent corporate misconduct and aligns the interests of stakeholders using incentives mechanism (Shleifer and Vishny, 1997). Good corporate governance is a desired feature of a liberalized market to ensure the flow of both foreign and domestic capital for accelerated economic development. This is because it increases investor confidence and goodwill, ensures transparency, fairness, responsibility and accountability.

Several studies in the developed countries have confirmed the positive relationship between good corporate governance and organizational performance (see Attiya and Robina, 2007; Agrawal and Chadha, 2005; Serrat, 2011). However, research has been done on the subject in developing countries, and even less in Nigeria, hence, the objective of this study is to fill the gap in knowledge by examining the effect of corporate governance and its consequences on organizational performance.

Objectives of Study

Other specific objectives of this study are to:

1. Examine the impact of board diligence on organizational performance.
2. Determine the effects of board composition on organizational performance.

Research Questions

1. Is there a significance impact of board diligences on organizational performance?
2. Is there any effect of board composition on organizational performance?

Research Hypotheses

- H₁:** There is no significant impact of board diligences on organizational performance
- H₂:** There is no effect of board composition of organizational performance

Literature Review

In the wake of these developments, corporate governance frameworks have been formulated by a variety of regulatory agencies and national governments over the last decades across different countries, and similar policy guidelines issued by the Financial Reporting Council Service Authorities; the UN's Bank of International Settlement's Basel Committee guidelines on Corporate Governance; the OECD Principles of Corporate Governance (1999 '86 2004); in Nigeria the Securities and Exchange Commission (SEC) Code of Best Practices for Public Companies (2003), Code of Corporate Governance for Banks and Code of Corporate Governance for Licensed Pension Operators (Nwadioke, 2009). These well-documented guidelines have provided the main instruments used in regulating the operations of firms. In spite of the soundness and widespread subscription to these corporate governance codes, financial scandals and prospects of organizational failure still continue to be of deep concern to stakeholders.

The OECD provisions, for instance, is considered to be adequate in addressing issues of executive remuneration, risk management, board practices and exercise of shareholders rights. However, weakness in corporate governance appears to be a function of ineffective implementation of the codes (OECD, 2009). Pursuance of good corporate governance would therefore mainly stem from the political will of organizational managers to adhere to specified best practices. The rewards of good corporate governance include reduction of waste on non-productive activities such as shirking, excessive executive remuneration, perquisites, asset-stripping, tunneling, related-party transactions and other means of diverting the firm's asset and cash flows. It also results in lower agency costs arising from better shareholder protection, which in turn engenders a greater willingness to accept lower returns on their investment. The firm ultimately ends up enjoying higher profits as it incurs lower cost of capital. Importantly, firms become more attractive to external financiers in direct proportion to a rise in their corporate governance profile. Finally, managers become less susceptible to making risky investment decisions, and focus more on value-maximizing projects that generally facilitate organizational efficiency.

Basic Principles of Corporate Governance

For a good and successful practice of corporate governance the world over, its basic commonly accepted principles must be adhered to. These principles include:

1. **Rights and Equitable Treatment of Shareholders:** This implies that there are certain fundamental rights to the shareholders which organizations must respect and strictly uphold. Shareholders should equally be allowed to exercise their rights without fear or favour. Organizations are duty bound to give clear interpretation of these rights for better understanding by the shareholders as well as ensuring shareholders' participation in the affairs of the corporation through general meetings.
2. **Interest of Stakeholders:** Corporations are obliged to recognize, in their policies and other aspects of operations, their legitimate stakeholders as having legal and other obligations which should be fulfilled at all time.
3. **Role and responsibility of the Board of Directors:** As a matter of fact, board members should be constituted by people and expertise with the required knowledge. Put differently, technocrats of excellent skills and comprehensive understanding should form the board to be able to deal with various business issues in order to review and challenge management performance. The size of the board should be sufficient enough with appropriate level of commitment to fulfill its responsibilities and duties.
4. **Integrity and Ethical Behaviour:** This is quite central to the practice of good governance. It involves ethical and responsible decision making which is necessary in managing risk and avoiding lawsuits. Corporate organizations should evolve a clear-cut code of conduct to guide the conduct of their directors and executives. This enhances their sense of duty and consciousness of the interest of all stakeholders.
5. **Disclosure and transparency:** Corporate governance requires high level of accountability; hence, organizations should make concerted efforts to publicize the roles and responsibilities of board management in order to make them accountable to the shareholders. Also, there should be set of procedures to ensure independent verification of the company's financial reporting to

safeguard the integrity of the organization. All investors should equally have access to timely and balanced disclosure of materials and factual information concerning the organization.

However, to make these principles very effective, certain mechanisms have been designed by experts to control and reduce the inefficiencies that could arise from moral hazard and adverse selection in relation to corporate governance. For instance, the behaviour of managers can be monitored and checked by an independent third party in the name of external auditor who attests to the accuracy of the information provided by the management to investors. Other mechanisms of control for the effectiveness of these principles include: monitoring by the board of directors, internal control procedures and internal auditors, balance of power, standard remuneration, competition, takeovers, media pressure and surveillance, government regulations and so on.

Theoretical Framework

The need to anchor the concept and practice of corporate governance within the framework of certain theories cannot be overemphasized. These include among others, agency theory, stewardship theory, ethical theory, stakeholders' theory and corporate social responsibilities theory.

Agent Theory

One of the theoretical principles underlining the issues of corporate governance is the agency theory developed by Jensen and Meckling (1976) resulting out of the separation of ownership and control. Investors have surplus funds to invest but due to technical constraints such as inadequate capital and managerial expertise to manage the funds, employ the services of managers to invest their funds in profitable ventures to generate good returns and the managers rewarded for their service.

Agency problem however arise because the actions of managers do not always promote the interest of the financiers, some of their actions are very detrimental to the fortunes of the financiers. Thus, agency problem as described by Jensen and Meckling (1976) focuses on the consumption of perquisites by managers and other types of empire building (La Porta et. al, 2000).

It is interesting that, these managers often tend to entrench themselves in power. According to Shleifer and Vishny (1989), managers can expropriate shareholders by entrenching themselves and staying at the job even if they are no longer competent or qualified to run the firm. Managerial expropriation of funds can also take more elaborate forms than just taking cash out, such as transfer pricing (Shleifer and Vishny, 1997). Such transfer pricing, asset stripping, and investor dilution, though often legal, have largely the same effect as theft (La Porta et. al. 2000). Additionally, managerial expropriation could also the take the form of diversion of corporate opportunities from the firm, installing possibly unqualified family members in key managerial positions, or overpaying executives, using the profits of the firm to benefit themselves rather than return the money to their investors (La Porta et. al, 2000). As a result of the interest of the opportunistic, self-interested managers, there was an agency loss which is the extent to which returns to the residual claimants, the owners, fall below what they would be if the owners, exercised direct control over the company (Jensen and Meckly, 1976).

The remedies to this conception of the agency problem within corporate governance involves the acceptance of certain agency costs involved either in creating incentives or sanctions that will align executive self-interest with the interest of shareholders, or incurred in monitoring executive conduct in order to constrain their opportunism (Roberts, 2004). Thus, principles of corporate governance are meant to control the internal and external entrenchment practices of executives through internal and external control mechanisms which either align the interest of executives with the shareholders or monitor them directly (Boyd, 1994; Gibbs, 1993; Hill et. al, 1998; Walsh et. al, 1990).

Stewardship Theory

The stewardship theory emerged as a result of seminar work by Donaldson and Davis (1991). The theory is based on the assumption that the interest of shareholders and the interest of management are aligned therefore management is motivated to take decisions that would maximize performance and the total value of the company. The theory believes that there is greater utility in cooperative than individualistic behaviour and hence, whilst the actions of management would be maximizing shareholder wealth, it would at the same time be meeting their personal needs. The managers protect and maximize shareholders wealth through firm performance because by so doing, their utility functions are maximized (Davis et. al, 1997). To achieve this goal congruent, the shareholders must put in place appropriate empowering governance structures and mechanisms, information and authority to facilitate the autonomy of management to take decisions that would maximize their utility as they achieve organizational rather than self-serving objectives.

For CEOs who are stewards, their pro-organizational actions are best facilitated when the corporate governance structures give them high authority and discretion (Donaldson and Davis, 1991). Davis et. al (1997) identified five components of the management philosophy of stewardship as trust, open communication, empowerment, long-term orientation and performance enhancement.

Resource Dependency Theory

The resource dependency theory was developed by Pfeffer (1973) and Pfeffer and Salancik (1978) with the objective to emphasizing the important role played by board of directors in providing access to resources that would enhance the company's performance and protect it against externalities. Companies require resources in areas of finance, human, technical, information, communication and technology to function properly and to achieve their objectives. Daily et. al (2003) posit that the accessibility to resources enhances organizational functioning, performance and survival. I-Tillman et. al (2000) argues that resource dependency theory focuses on the crucial role that the directors play in providing or securing essential resources to the company through their linkages to the external environment. They contend that, directors bring resources to the company in the form of information, skills, access to key constituents such as suppliers, buyers, public policy makers, social groups as well as legitimacy.

Organizations depend on each other for business because they form the largest proportion of the organization's customer base, meaning the actions of one organization can greatly influence the financial performance of the other either positively or negatively, thus the need for organizations to establish relationships at board levels. Johnson et. al (1996) agree that the theory provides focus on

the appointment of representatives of independent organizations as a means of gaining accessibility to resources critical to the organization's success.

According to Pfeffer and Salancik (1978), boards provide advice, counsel and know-how, legitimacy and reputation, channel for communicating information with external organizations, and preferential access to commitments or support from important factors outside the firm. The boards perform these functions through social and professional networking (Johansson and Huse, 2000) and interlocking directorates (Lang and Lockhart, 1990). Abdullah and Valentine (2009) classified directors into four categories of insiders, business experts, support specialists and community influential. Zahra and Pearce (1989) posit that the diverse background of the directors enhance the quality of their advance. The theory favours larger boards (Dalton et. al, 1999; Booth and Deli, 1996; Pfeffer, 1973; Provan, 1980).

Stakeholder Theory

Agency theory holds a contractual view of the relationship between managers and shareholders where the managers have the sole objective of maximizing the wealth of shareholders. Stakeholder's theory considers this view to be too narrow since manager's actions have effect on other interested parties than just shareholders. The theory was developed by Freeman (1984) with emphasis on the need for managers to have corporate accountability to stakeholders instead of shareholders. Stakeholders are "any group or individual that can affect or is affected by the achievement of a corporation's purpose" (Freeman, 1984). Donaldson and Preston (1995) defined stakeholders as identifiable groups or persons who have legitimate interest in an organization and these interests have intrinsic value. The theory is interested in how managerial decision making affects all the stakeholders and no one interest should be able to dominate the others (Donaldson and Preston, 1995).

Stakeholder theory, like the resource dependency theory, also proposes the representation of the various interest groups on the organization's board in order to ensure consensus building and to avoid conflicts. The board therefore serves as arbitration over the conflicting interests of the stakeholders and brings about cohesion needed for the achievement of the organizational objectives (Donaldson and Preston, 1995). In spite of the good intentions of the theory, it has been criticized for putting too much burden on managers by making them accountable for solving problems resulting from conflicting interests. This situation has given managers the discretionary powers to decide on whose interest to serve (Jensen, 2001). Jensen (2001) suggested that managers should pursue objectives that would lead to increasing the long-term value of the firm since this would not be attained by ignoring the interest of some of the stakeholders. Jensen (2001) also criticized the theory for adopting a single-valued objective of maximizing wealth of its stakeholders. According to him, the performance of an organization is not only measured by returns to the stakeholders but equally important is the management of information in the organization with particular reference to vertical communication, interpersonal relationships in the organization and the working environment. He refines the theory to "enlighten stakeholder theory" to take care of the shortcomings.

With this, the company should take into consideration the interests and influences of people who are either affected or may be affected by company's policies and operations (Fredrick et. al, 1992). As a result of the complex nature of the stakeholder relationship and the need for the better management of the various stakeholders, Donaldson and Preston (1995) have concede that stakeholder's theory cannot be a single theory but categorized them into three different approaches of descriptive, instrumental and normative.

Ethical Theory

Ethical theory as it were, is a build-up on the concept of ethics in general. The term ethics comes from the Greek word *ethos* meaning something like morals. By this simple submission, morality is the whole of opinions, decisions and actions with which people express what they think is good or right. Hence, one of the major cardinal thrusts of ethical theory is utilitarianism. It implies, as widely cited from the popular work of Jeremy Bentham (1748 – 1832) by Schofield (2006) that ethical theory sometimes focuses not on actions but majorly on consequences. The term utilitarianism is derived from the Latin word *utilis*, meaning "useful". Therefore, in utilitarianism, the consequences of actions are measured against values. These values can be happiness, welfare, high productivity, expansion etc. by way of emphasis, the cardinal point in this theory is that, it is essential to give the greatest happiness to the greatest number of people. So, for a successful practice of corporate governance in Nigeria and beyond, practical application of utilitarianism is a core requirement. The utility of shareholders and other stakeholders should be paramount in the minds of the corporate managers. The agents should make all efforts to ensure that principals have satisfactory values with regards to their investment.

The actions of the agents will be adjudged morally right in the process of running the corporations on behalf of the actual owners – the shareholders, if the latter's interest is well represented, whereas it will be adjudged wrong if their actions inflict pain on the interest of the principals.

Data Collection Instrument

Survey research design was adopted in this study. The population of study covers the entire staff of PZ. Primary data was employed in this study. The questionnaire was the major research instrument used to collect data form respondents.

The Analysis of Data

Hypothesis One

H₁: There is no significant impact of board diligences on organizational performance

The formula for computing the chi-square (χ^2) value for the data is:

$$\chi^2 = 45.94$$

Given the level of significance (α) = 0.05

Where:

$$\begin{aligned} \text{Degree of freedom (df)} &= (r - 1)(c - 1) \\ &= (5 - 1)(5 - 1) \\ &= 4 \times 4 \\ &= 16 \end{aligned}$$

At $\alpha = 0.05$, the tabulated value for 18 degree of freedom is 26.296

Decision rule:

Reject H_0 and accept H_1 if the calculated value is greater than the tabulated value and accept H_0 and reject H_1 if the calculated value is less than the tabulated value

Decision:

The calculated value of 45.94 is greater than the critical value of 26.296; therefore, we reject the null hypothesis (H_0) and accept H_1 . This shows that there is significant impact of board diligence on organizational performance.

Hypothesis Two

H₂: There is no effect of board composition on organizational performance

$$\chi^2 = 43.40$$

Given the level of significance (α) = 0.05

Where:

$$\begin{aligned} \text{Degree of freedom (df)} &= (r - 1)(c - 1) \\ &= (4 - 1)(5 - 1) \\ &= 4 \times 4 \\ &= 16 \end{aligned}$$

At $\alpha = 0.05$, the tabulated value for 18 degree of freedom is 26.296

Decision rule:

Reject H_0 and accept H_1 if the calculated value is greater than the tabulated value and accept H_0 and reject H_1 if the calculated value is less than the tabulated value

Decision:

The calculated value of 43.40 is greater than the critical value of 26.296; therefore, we reject the null hypothesis (H_0) and accept H_1 . This shows that there is effect of board composition on organizational performance.

Discussion of Findings

Based on the literature written so far on this topic, data collected and the data analysis of the data, the research showed that there is significant impact of board diligence on organizational performance and there is effect of director's shares on shareholders' interest and the positive impact of board size and board composition on organizational performances.

The empirical findings show that the adoption of good corporate governance practices enhances transparency of company's operations, ensures accountability and improves firm's profitability. It also helps to protect the interest of the shareholders by aligning their interest with that of the managers. The study examined the relationship between corporate governance and the performance of organization. The results show that generally, corporate governance has positive impact profitability. The factors of board size, board and management skill, CEO tenure, size and

independence of audit committee, foreign and institutional ownership, dividend policy and annual general meeting, all have positive correlation with the performance of the organization.

The findings show that the organization must have the right board size which is highly independent from the management of the company and with the appropriate skills. This would ensure that the board is well diversified and have the competence to give the strategic direction of the company. Also being able to monitor management and ensure that internal controls are instituted and working. The annual reports and the financial statements of the companies are the main means of communication between the company and the stakeholders. Therefore, the sensitive role of the audit committee by ensuring that the financial statement shows the true position or the company's performance cannot be overemphasized. The audit committee must be well constituted to increase its independence and with the right size. Again, the evidence shows that foreign and institutional shareholders bring a lot of advantages to the local companies that improve their performance.

The ultimate importance of corporate governance has been documented by several studies that include Bebchuk, Cohen and Ferrell (2006), Black and Khana (2007), Brown and Caylor (2009), Bruno and Claessens (2007), Chhaochharia and Leaven (2007), El Medhi (2007), Gompers, Ishii and Metrick (2003), Klapper and Love (2004), Kyercboah and Coleman (2007), Larcker, Richardson and Tuna (2007), Nevona (2005) and Verhoeven (2007). Some other studies have however argued against a positive relationship between corporate governance and firm performance (Ferreira and Laux, 2007; Gillan Hartzell and Starks, 2006; Pham, Suchard and Zein, 2007). The companies should take measures to attract these all-important segments of the investor population.

Furthermore, the result is an indication that the organizations are well positioned to support the economic growth and development of the country. With good corporate governance record, the companies would be able to generate more resources to create more employment opportunities, support businesses through prompt payment of accident claims, pay dividends to shareholders and generate more tax revenue to government. Again, through efficient management of their financial resources, they would be able to support the growth of investment in the economy through their financial intermediation role by channelling resources to the critical areas of the economy.

Summary of Findings

This study explored the impact of corporate governance and organizational performance. The analysis and empirical findings showed that there are various significant impact of board diligence on organizational performance and that there is no effect of director's shares on shareholder's interest and profit margin.

The findings above are in line with earlier findings of Kojola (2008) which found that there is link between four corporate governance mechanisms (board size, board composition, chief executive status and audit committed) and return on equity.

The result of the second hypotheses revealed a positive relationship between corporate governance measures and net profit margin. In the same vein, result from the analysis revealed that there is

significant relationship between corporate governance and organizations financial performance. This result is in agreement with previous empirical studies (Yemack, 1996; Yuan, 2003; Sanda et. al, 2005; Kojola, 2008).

There is no doubt that several studies have been conducted so far (and is still ongoing) to determine the relationship between firm performance measures and corporate governance mechanism, however, the outcomes of these studies are mixed. All the performance measures are significant with their expected positive signs. That means, better governed firms have higher net profit margins, return on equity and dividend yield than poor governed firms.

It was also observed that there is no uniformity in the disclosure of corporate governance practices made by the companies. Though they all disclose their corporate governance practices, what is disclosed does not conform to any particular standard. More so, their disclosure on director's remuneration is not extensive. This study reveals that there is a positive and significant relationship between return on equity and corporate governance; there is positive and significant relationship between net profit margin and corporate governance; there is positive and significant relationship between dividend yield and corporate governance.

Although our results show that corporate governance code potentially improves the governance and decision-making process of firms listed on the Nigerian Stock Exchange, we need to point out that adequate firm governance standards cannot replace the solidity of the firm. The low production and bad management practices cannot be covered with transparent disclosures and good ethical standards.

Conclusion

Today, the society and government are demanding more from business than just declaring profit and paying tax. Today's businesses must be socially responsible, morally upright, transparent and accountable in its behaviour and activities. Its relationship can no more be limited to that between managers and shareholders. As a quasi-public institution, it is answerable to a variety of shareholders and expected to meet the social and economic needs of many interest groups. In response to this change in the philosophy of business management and paradigm shift toward a more transparent and morally responsible business and also the changes in the environment in which business operation has positioned the issue of corporate governance very prominently worldwide. It imposes not only legal but more obligations on business. It calls for a change in the behaviour and attitude of business and operators in their relationship with the society and various stakeholders.

This is where reputation and relationship management come in. managing reputation and relationship calls for an articulate corporate communication mechanism which should be able to gather, analyze and disseminate the views and perspectives of all stakeholders. It should be able to incorporate the knowledge obtained from such an exercise into the policy and decision-making process of the organization.

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