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Corporate Governance and Firm Performance: Case of Selected Oil Companies in Nigeria

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Abstract
Background*: Separating ownership from managerial control in publicly traded firms made corporate governance a matter of necessity, due to the possibility of principal agent problem. Mostly, managers protect their own self-interest without regard for shareholders' returns on investment, this often lead to agency conflict andconsequent loss. Previous studies have focused mainly on manufacturing andbanking sector, however, paucity of information exists in areas of oil firms over the years. Hence, effect of corporate governance on performance of listed oil companies in Nigeria from 2009 to 2018 were investigated.*
Methodology*: Secondary data sourced from Nigeria stock exchange covering 2009 to 2018 were used to examine effect of corporate governance on performance of six oil companies in Nigeria. Data collected include; board size, executive directors' number, non-executive directors' number, audit committees' number, net annual income, shareholders' equity, net profit/margin, assets for the period, while board composition, return on assets and equity were generated. Data collected were analysedusing Cross Sessional Random Effects Model (REM) of regression analysis.*
Results*: Unit root test indicated that all variables were stationary at level. Audit committee (0.803277), (4.363851) exhibited a positive relationship with firms' performance,though insignificant, while board composition (-2.647377)(-2.647377) and board size (-0.546097) (-2.948961) had an inverse relationship, though significant with ROE and ROA. All the variables jointly influence firms' performance positively with R^2(0.587999,0.597182) and adjusted R^2 (0.544499,0.584174)value, respectively.*
Conclusion: *Audit committees enhances firms' performance, all variables jointly improve firms' performance. Measures should be put in place to increase audit committees independence and the extent to which they disclose corporate governance information.*
Keywords: *Audit Committee, Board Composition Board Size, Return on Assets, Return on Equity, Principal-Agent, Shareholder.*

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I. Introduction

Separation of ownership from managerial control in publicly traded firms has made corporate governance a matter of necessity (Hits, 2009). This is due to the likelihood of asymmetric information which may give managers room to exhibit opportunistic behaviour (Tosi et. al 2000). In view of this problem which is tagged "principal agent problem" (Garen, 1994) the issue of how to motivate executive directors (agent) to act in the best interest of the shareholders (principal) has been a phenomenal issue across the globe in financial economics, most especially in the realm of corporate governance. Thus, the development of good corporate governance is essential in order to protect corporate stakeholders, and maintain factors for control and prevention of collapse and long lasting economic depression. The primary goal of a firm is to maximize the wealth of the shareholders (Lasher, 2008; Ross *et al.*, 2008). The wealth is created by a firm through its actions and decisions as reflected on its market value. The market value of the firm shares is the reflection of shareholders' perception of the quality of its financial decisions and performance. Therefore managers' actions and decisions should lead to shareholders' wealth maximization. Corporate governance is the widest control to mitigate agency cost and improve firm's efficiency (Baker &Anderson, 2010)

Corporate Governance has variously been defined among others to mean: "An internal system encompassing policies, processes and people, which serves the needs of shareholders and other stakeholders, by directing and controlling management activities, with good business understanding, objectivity, accountability and integrity. Sound corporate governance is reliant on external market place commitment and legislation, plus a healthy board culture which safeguards policies and processes. Stability and good management can be achieved when firms incorporate corporate governance which is all about complying with stipulated standards,

rules and regulations. Sound corporate governance increases the efficiency and value of a firm on the capital market rather than pulling it down and boost the confidence of all stakeholders. Good corporate governance enhances accountability, transparency, ensures efficient and effective use of limited resources, creates competitive and efficient managed companies, attracts and retains investors (Arinze, 2013).

According to Osundina*et al* 2016, the non-financial factor that often affect companies' performance and enhances external finance accessibility that brings about sustainable economic growth is the corporate governance. Weak corporate governance may manifest in form of non-accountability and transparency to stakeholders, bribery scandals, violation of the rights of the minority shareholders, official recklessness among the managers and directors, weak internal control system, insider abuses and fraudulent practices (Olumuyiwa&Babalola, 2012).

Majoridentified causeof weak corporate governance had been non-distinction between ownership and control of organization. Shareholders, who are the principals in an agency relationship delegate control to directors and managers who are the agents to enhance smooth and efficient flow of operations. In most cases, the directors/managers act for their own self-interest without regard for shareholders' returns on investment. The result of this is conflicts between both parties; known as agency conflict, and consequently losses. Therefore, it is necessary for the board to uphold transparency and fairness to shareholders and other stakeholders to curtail agency cost and itsharmful effect on performances. The incessant scandals, crises and wreckage of organizations around the world are so alarming that the global financial market has been greatly destabilized and the growth of economies impeded, thereby contributing to the downturn of the economy. With all of these, companies' sustainability has become an issue in determining the survival and continued growth of a country (Apodore&Zainol, 2014).

The oil sector is the backbone of the Nigerian economy. Since its inception in thelate 1950s and by 1970, the sector became the country's largestexport, from 1970s to 2012,the sector contributed about 80 percent of totalrevenue. The sector still dominates exports, despite the fact that services drive Gross Domestic Product. NBS(2016), over the years, Nigeria's economy depend heavily on crude oil export, thus make the country mono-cultured one, despite attempts by successive governments at diversification for economic development.

However, there is a paucity of research on the oil sectors' corporate governance, as most study focused manufacturing and banking sector. Hence this research work is justified as it is expected to contribute to the body of literature in this area.

1.1Research Questions

1. What are the effect of corporate governance on firm's financial performance?
2. What is the influence of board size on the firm's financial performance?
3. What are the impact of board composition on firm's financial performance?
4. What are the effects of audit committee of firm's financial performance?

1.2 Objective of the Study

The aim of this research is to examine the effect of corporate governance on the performance on the listed oil companies in Nigeria.

The specific objectives are:

1. To examine the influence of board size on financial performance of listed companies in Nigeria.
2. To determine the impact of board composition on financial performance of listed companies inNigeria.
3. To ascertain the extent to which the audit committee size affects financial performance oflisted companies in Nigeria.
4. To investigate whether size of audit committee, board composition and board size canjointly affect financial performance.

1.3 Hypotheses

The following hypotheses for the study have been stated in null form:

1. H_{01}: Board size has no influence on performance of listed firms in Nigeria.
2. H_{02}: Board composition has no significant impact on financial performance of listed firms in Nigeria.
3. H_{03}: The audit committee size does not affect financial performance of listed firms in Nigeria.
4. H_{04}: size of audit committee, board composition and board size cannot jointly predict financial.

II. Literature Review

2.1 Corporate Governance Mechanism

2.1.1 Board Composition

The composition of board is an important mechanism of board structure,they are the executives and non-executives directors.When non-executive directors dominates board, they are largely grounded in agency theory,

but when executive director dominates, the board is grounded in stewardship theory, meaning, managers are good overseers of the organization and work to accomplishhigher profits and shareholder returns (Donaldson & Davis 1994). An effective board should have non-executive directors as members (Dalton *et al*. 1998).While the responsibility of the executive directors are to see to the day-to-day running of the business, like finance and marketing and bring specialised expertise and a wealth of knowledge to the company (Weir & Laing, David 2001).

2.1.2 Board Size

The number of members of board is what is known as the board size, over the years, this affects the ability of the board to function effectively, and this has been a subject of debate, (Hermalin&Weisbach, 2003, Dalton, Daily, Johnson &Ellstrand, 1999; Jensen 1993; Yermack, 1996;). Some are in support of smaller board size (e.g. Yermack, 1996, Jensen 1993, Lipton and Lorsch1992). Lipton and Lorsch (1992) supported small board size and suggested that larger board size are often faced with the problems of social loafing and free riding which reduces board efficiency,whilelarge boards were supported by (Adam & Mehran, 2003, Pfeffer, 1972, Coles *et. al.*, 2008, Klein and Anderson et al., 2004) on the ground that they would provide greater monitoring and advice. They equally argue that as organisation becomes diversified and operate multiple segments, the need for advice becomes necessary. (Hermalin&Weisbach, 2003; Yermack, 1996).
According to Singh &Harianto (1989) to reduce dominants attributes of the CEO, large board must be put in place as this will in turn improve performance.

2.1.3 Board Committees

Board committeeis also an important mechanism that provides independent professional oversight of corporate activities and protect shareholders interests (Harrison 1987). According to (Roche 2005) the principle of separating the monitoring and execution function is put in place to monitor the execution of audit, remuneration and nomination function. In the past, corporate failure criticizedthe fact that governance structures of failed firms refuses to take corrective actions. These committees was adopted based on its importance by the business world (Petra 2007). Thus, in 1992, Cadbury Committee report recommends that there should be nomination of sub-committees by the boards to address the following three functions:

- Audit committees who oversee the accounting procedures and external audits
- Remuneration committees who decide the pay of corporate executives and
- Nominating committees who nominate directors and officers to the board.

2.1.4 **Firm Performance**

Profitability ratios evaluate how companies perform and generate cash flows, profits and earningin relation to amount invested (Palepu *et al.*2010). Theemphasis is on how effective and efficient a company is managed and generate revenue or profit. Firms' performance are measure in relation toreturn of equity (ROE), it is a profitability ratio which indicates how well managers are investing funds provided by investors.ROE is a measure of a company's annual return (net income) divided by the value of its total shareholders' equity, expressed as a percentage. Alternatively, ROE can also be derived by dividing the firm's dividend growth rate by its earnings retention rate (1 – dividend payout ratio). It is expressed as;

$$\text{ROE} = \frac{Net\ income\ \ (annual\ )}{share\,holders\ \ equity}$$

Return on assets (ROA) is another profitability measure which tells how well a company is at generating profit from their assets. Total assets of ROA are measured as company's net earnings in relation to all the resources it had at its disposal—the shareholders' capital plus short- and long-term borrowed funds. Thus, ROA is the most stringent test of return toshareholders. If a company has no debt, the return on assets and return on equity will be the same. There are two acceptable ways to calculate ROA:
Net profit margin x Asset turnover = Return on assets
Net income ÷ Average assets for the period = Return on assets

2.2 Empirical Review

Many authors have evaluated the link between corporate governance and firm performance using different measures. Some employed return on assets, some sales growth while some used return on equity as the measure of the company performance. However, the measures of company performance employed by the researchers are not the same which may be accounted as the source of mixed findings on the relevance of corporate governance on firm performance.

The concept of corporate governance in developed economies has been explained using various theories (Solomon, 2010). According to the agency theory, the purpose of corporate governance is to reduce potential conflicts between managers and the interests of the (Jensen &Meckling, 1976). The stakeholder theory

also plays an essential role in explaining governance structures because companies are made aware of all stakeholders rather than only the shareholders (Freeman, 1984). Donaldson and Preston (1995) have argued that the stakeholder theory can help to maximise firm performance and the combined benefits of all stakeholders by considering the interests of all stakeholders. In the framework, corporate governance principles are represented by the rights and equitable treatment of shareholders, the role of stakeholders in corporate governance, disclosure and transparency, and the responsibilities of the board. The corporate governance mechanism variables are board size, leadership structure, board composition and audit committee independence. The dependent variable of firm performance was assessed by measuring financial performance (return on assets and return on equity)

Hutchinson and Gul (2004) measured firm performance by considering return on equity. In this case, return on equity is measured as profit after interest and tax divided by equity. This seems to be a reasonable measure of the performance as the main objective of corporate governance is to maximise shareholders' value. The measure is directly linked with the shareholders' welfare (Baysinger and Butler; 1985). Weir and Lang (2000) and Erhardt et al (2003) employed return on asset as the measure of performance. Francoeur et al (2008) employed abnormal return (excess return) as the measure of performance. Smith et al (2006) employed four measures; gross profit margin, contribution margin divided by net sales, operating income divided by net sales and net income after tax divided by net sales. This proves that different accounting measures have been employed in assessing the contribution of corporate governance to the firm performance. However, the analysis shows that different accounting measures have been employed based on the variables investigated.

Kajola (2008) investigated the relationship between indicators of corporate governance (boardsize, board composition, chief executive status and audit committee) and performance which are proxied with return on equity and profit margin. He sampled 20 Nigerian listed firms from periods 2000 to 2006 and adopted panel data methodology and OLS to analyse. Results found proved a positive significant relationship between ROE and board size and chief executive status; positive relationship between profit margin and chief executive status; and insignificant relationship between the two performance ratio, board composition and audit committee.

Aduda et al (2013) carried an empirical test of competing corporate governance theories on the performance of firms listed at the Nairobi Securities Exchange. This study investigated significance of the board composition variables of size of the board, proportion of outside directors, and the role of CEO on firm's performance. This study found that the overall regression model for firm performance for both return on assets and Tobin Q ratio are significant. The study also found that the significance of the individual variables in the overall specific models have differing significance variables on the basis of the measure of performance selected.

Locke and Fauzi (2012) examined the relationship between board structure, ownership structure and firm performance: A study of New Zealand listed firms. They used a balanced panel of 79 New Zealand listed firms and employed a generalized linear model for robustness. The results showed that board of directors, board committees and managerial ownership have a positive and significant impact on firm performance. The results also showed that non-executive directors on the board and institutional ownership lower firm performance. Using a sample of 30 respondents Miring'u and Muoria (2011) analyzed the effect of corporate governance on performance of commercial state corporations in Kenya. Their study sought to examine how corporate governance affects performance in commercial state corporations in Kenya. The study employed descriptive survey design. Data was analyzed through descriptive statistics and multiple regression technique. The findings revealed that the board size mean for the sample was found to be 10 while minimum of 3 outside directors is required on the board. In addition the study revealed that there is a positive relationship between return on equity and board size and board composition of all state corporations.

This study considers some Corporate Governance Mechanisms from the perspective of Board Composition, Board size and Board committees.

III. Methodology

The study want to look at the effect/impact of corporate governance of financial performance of some listed oil companies in Nigeria, Secondary data was collected, from Nigeria stock exchange for 6 selected oil companies for a period of nine (10) years, covering 2009 to 2018. Data collected include; the board size (BDS), number of executive directors (BDC), number of non-executive directors, numbers of audit committee (AUDCOM), net annual income, shareholders' equity, net profit/margin, assets for the period , while board composition, return on assets and equity were generated. Data collected were analysed using E-view 9.0

3.1 Description of variables

Board Size (BS) = Number of all directors on the board (Suranta and Machfoedz, 2003).
Board Composition (BC) = Non-executive directors divided by the total numbers of directors

Audit Committee Size (ACS) = Number of audit committee members (Mukhtaruddin*et. al.*2014) Returns on equity (ROE) = Net annual income divided by the shareholders equity.
Returns on assets (ROA) = Net income divided by average assets for the period.

3.2 Measurement of Variables

Firm's performance is dependent variable measured by Return on Assets (ROA) (an accounting based performance measure)-calculated as "Profit after tax" (PAT) scaled by the average of total assets. Return on equity (ROE) is calculated as the net annual income divided by the firm to total shareholders' equity.
Board size, board composition and Audit committees are proxies of Corporate Governance Mechanisms and also considered as independent variables.

3.3 Model specification

$Y_{it} = \alpha_0 + \beta_1 BDS_t + \beta_2 BDC_t + \beta_3 AUDCOM_t + et$……1
Where,
Y*i*, is alternatively ROA*i*and ROE*i*
α is the intercept, β*i*is the regression coefficient and
*ε*is the error term, which account for other possible factors that could influence ROA*i*and ROE*it*that are not captured in the model.
The subscript *i*represents the different firms and *t* represents the different years.
The one is expanded as below;
$ROA_{it} = \beta_0 + \beta_1 BDS_{t1} + \beta_2 BDC_{t1} + \beta_3 AUDCOM_{t1} + U_{t1}$……2
$ROE_{it} = \gamma_0 + \gamma_1 BDS_{t2} + \gamma_2 BDC_{t2} + \gamma_3 AUDCOM_{t2} + £t$……...3

Hypotheses Test Rule for Unit Root

H0= P>0.05 (there is presence of unit root in the panel data)
H1= P<0.05 (there is no presence of unit root in the panel data) (i.e. Stationary)

Hausman Test Rule

The Hausman test rule states that if the individual regressors are correlated and significant with other regressors in the model, the fixed effect model is consistent and the random effect model is inappropriate. On the other hand, if the individual effects are not correlated with the other regressors in the model, both random and fixed effects are consistent and efficient. Therefore any can be used.

Hypotheses Testing for Hausman Test

H0= P>0.05 (Random Effects Model)
H1= P<0.05 (Fixed Effects Model)
If the P-value is statistically significant, accept the alternative hypothesis (Fixed Effect Model).
If the P-value is not statistically significant, accept the null hypothesis (Random Effect Model or fixed effect model).

IV. Data Analysis and Discussion

Table 1: Unit Root Test for variables

Variables	Levin Lin	Im, Pesar& Shin	ADF-Fisher	PP-Fisher	Remark
ROA	-9.92305	-3.78455	37.7360	43.2523	Stationary I(0)
Prob;	0.0000	0.0001	0.0002	0.0000	
ROE	-3.60815	-2.20550	24.7571	24.7719	Stationary I(0)
Prob;	0.0000	0.0137	0.0160	0.0159	
AUDCOM	-11.20906	-10.92198	6.90403	7.26065	Stationary I(0)
Prob;	0.0000	0.0283	0.0410	0.0227	
BDC	-4.49885	-2.20047	21.8879	22.7108	Stationary I(0)
Prob;	0.0000	0.0139	0.0157	0.0119	
BDS	-2.94623	1.51281	16.9020	18.6726	Stationary I(0)
Prob;	0.0016	0.0652	0.0766	0.0446	

Source: Data analysis 2019

Unit root test of the variables indicate that all the variables are either **I (0)** at level, **I (1)** or **I (2)** at different series. This is used to test for stationarity of variables. All the variables were stationary at level, that is, Board Size (BS), Board Composition (BC),Audit Committee Size (ACS) and Returns on assets (ROA) proved thestationarity of the variables in respect of time to run random effects panel regression analysis.

TheHausman test was carried out to determine which model is appropriate for the panel regression.

Table 2: Hausman Test for Model One

Correlated Random Effects - Hausman Test Test cross-section random effects			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	1.047870	3	0.7897

Source: Data analysis 2019

Based on theCorrelated Random Effects - Hausman Test, null hypothesis was accepted to justifythat the result of using random effect Panel Least Square Model (PLSM) is appropriate for first model.

PLSMtechnique used in the analysis was Random Effect Regression Model (RERM) that combined all the six oil companies together after using Hausman Test to test for the best model to be selected among Pooled, Fixed Effects and Random Effects and in order to analysis with Probability value of **0.7897** that support the null hypothesis of Random Effects Model appropriate used. (**P>0.05).**

Table 3: Computation of Random Effects Model (REM).

Dependent Variable: (ROA) Return on Asset Method: Panel Least Squares				
Variable	**Coefficient**	**Std. Error**	**T-Statistic**	**Prob.**
Intercept	0.696733	0.208832	3.336332	0.0379
AUDCOM	0.803277	0.544110	1.476314	0.0755
BDC	-5.088250	2.201624	-2.311135**	0.0569
BDS	-0.546097	0.185078	-2.950625**	0.0046
R^2: 0.587999. Adjusted **R^2**: 0.544499, F-statistic: 4.321819, Prob(F-statistic): 0.008238, Durbin Watson 1.52, * 10%, ** 5%, *** 10%				

Source: Data analysis 2019

The result of the joint effect of the corporate governance on firms performance using Return on Asset(ROA)shows a coefficient of determination(R-squared) = 0.59(59%)and adjusted R-squared = 0.54 (54%). This shows that 59% of the variations in the financial performance is explained by the variations in the specified independent variables (AUDCOM, BDC and BDS). The F-test = 4.321 and p = 0.008 as shown in Table 3 indicates clearly that the fairness and non-biases of the model. This result is in line with Ammar *et al* (2013), Kajola (2008). Resultfurther shows that audit committee has a direct relationship with financial performance, meaning, a unit increase in the audit committee members will increase thefinancial performanceby 80.33%. The coefficient of board committee is -5.088250and board size, -0.546097, are inversely related to financial performance, thus a unit increase in board committee and board size will reduce financial performance by 508.8% and 54.61%.

Table 4: Hausman Test for Model Two

Correlated Random Effects - Hausman Test Test cross-section random effects			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	1.175573	3	0.7589

Source: Data analysis 2019

Panel Least Square Model technique that was used in the analysis was Random Effect Regression Model (RERM) that combined all the six oil companies together after using Hausman Test to test for the best model to be selected among Pooled, Fixed Effects and Random Effects in order to analysis with Probability value of **0.7589** that support the null hypothesis of Random Effects Model appropriate to be used. (**P>0.05).**

Table 5: Computation of Random Effects Model (REM).

Dependent Variable: (ROE) Return on Equity Method: Panel Least Squares				
Variable	**Coefficient**	**Std. Error**	**T-Statistic**	**Prob.**
Intercept	6.401653	17.20956	0.371982	0.7113
AUDCOM	4.363851	2.929762	1.489490	0.1420
BDC	-2.647377	1.076718	-2.458747**	0.0482

BDS	-2.948961	0.990463	-2.977356**	0.0043
R^2: 0.597182. Adjusted **R^2**: 0.584174, F-statistic: 4.584763, Prob(F-statistic): 0.006114, Durbin Watson 1.518297, * 10%, ** 5%, *** 10%				

Source: Data analysis 2019

The result of the joint effect corporate governance on financial performance from Return on Equities(ROE)of the oil and gas industries gives a coefficient of determination, R-squared = 0.597182 (59%) and adjusted R-squared is 0.584174 (58%). This shows that 59% of the total variation in the financial performance of the oil and gas (proxy by returns on equity ROE) is explained by the variations in the specified independent variables (AUDCOM, BDC and BDS). The F-test results (4.58476) with p = 0.0061 as indicated in Table 5 specifies clearly justice and non-biases of the model. Result also showed a positive relationship between AUDCOM and financial performance, meaning that increase in the audit committee members by 1% will increase the financial performance by 43.64 percent (coefficient of AUDCOM being 4.363851 with p = 0.1420). The coefficient of board committee is -2.647377 with p-value of 0.0482, this implies that there is negative relationship between board committee(BDC) and financial performance. With respect to board size, the results indicates (coefficient of-2.948961; p-value of 0.0043) that, it (board size)is negatively related to financial performance of the captured oil firms in Nigeria. This implies thata unit increase in these variables will reduce financial performance by 26.47% and 29.49%, respectively. The robustness of the model can be seen through F-statistic value of 4.584763 with Prob; 0.006114 that is less than 0.05 level of significant. This mean, the model is good to show influence of all those independent variables on financial performance.

V. Conclusion

The significance of corporate governance cannot be overstressed because it establishes the climate for internal activities of the firm. Therefore, the study concludes that corporate governance variable such as board size and board composition have negative effect on financial performance of the six oil and gas companies captured *(i.e. Oando, Mobil, MRS Oil, Total, Forte and Conoil)*while audit committee has positive effect on the financial performance of petroleum firms in Nigeria based on the period.

VI. Recommendations

1. Board of directors and their composition should be reduced in order to equally reduce its benefits and also for effective and efficient management of the business.
2. Board should be independence enhanced and improve financial performance.
3. Board of directors should be diversified in terms of gender, skills and expertise.
4. Effective, independent and strongaudit committee should be encouraged by the board of directors and shareholders to improve corporate governance policies and practice equivalent to global standard.
5. Planned corporate plans to accomplish the effects of external variables not captured in this research must be given adequate attention in order to avoid spurious findings.

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