Good Corporate Governance and Organisational Performance: An Empirical Analysis

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Abstract

The study investigates the relationship between corporate governance and the performance of organizations. It adopts quantitative methodological framework through which the primary data collected were analyzed using both Regression analysis and Karl Pearson's correlation techniques to find the relationship between corporate governance and organizational performance on one hand and the degree of relationship between corporate governance and organizational performance. The findings shows that large board size, board skill, management skill, longer serving CEOs, size of audit committee, audit committee independence, foreign ownership, institutional ownership, dividend policy and annual general meeting are positively associated with the performance of organizations. Organizations are encouraged to adopt good corporate governance practices to improve their performance and also to protect the interest of the shareholders. Most importantly the regulatory authorities must ensure compliance with good governance and apply appropriate sanctions for non compliance to help the growth and development of industries in the country. The main contribution of the study to knowledge lies in its effort in strengthening corporate governance beyond the rights and responsibilities of different stakeholders in the management of an organization into areas involving the relationship between finance providers and an organization, compliance with legal, ethical and environmental needs of the society, among others. This contribution has in no small measure enhanced our understanding about the interpretations which have shaped corporate governance in relation to organizational performance both in theory and practice.

I. Introduction

In today's global economy, the success of the national economy depends on the crucial role of organisations' competitiveness, transparency and governance structure which operate within her territory, since organisations are the entities that create economic value (ICAN, 2009). Indeed, the need for trust and transparency in the governance of corporate organizations has been one of concern for standard setters all over the world. This need has obviously spurred renewed interest in the corporate governance practices of modern corporations, particularly in relation to accountability and economic performance (ibid).

The position above could not be separated from prior submission where Nwachukwu (2007) emphasize the growing consensus that good corporate governance has positive link to national economic growth and development. The degree of trust accorded to the managers of companies by its owners is strengthened through corporate governance. Directors without corporate governance mechanism may paint misleading pictures of financial and economic performance of their company to lure unsuspecting investors. Such window dressed accounts raised concern in the U.S.A. with the collapse of the energy corporation ENRON in 2001 which filed for bankruptcy after adjusting its accounts (Demaki, 2011). WORLDCOM, GLOBAL CROSSING AND RANK XEROX are other companies in the U.S.A with similar problem. The increasing incidence of corporate fraud relating to exaggerated and fleeting reports have reinforced the renewed global emphasis on the need for effective corporate governance. CBN (2006) reported that despite the significance of good corporate governance to national economic development and growth, corporate governance was still at rudimentary stage as only 40% of publicly quoted companies, including banks had recognised corporate governance in place.

The separation of ownership from the management of business organisations spurs a divergence of interest amongst the parties. The divergence of the interests of the management and its owners has undermined investors' confidence in the Board. Hence, investors are interested about the level of accountability displayed by the Board of directors. The outcry of investors and other stakeholders as a result of mismanagement and inadequate financial disclosures given by the management has deemed it necessary for the institution of sound corporate governance procedures

The main objective of this paper is to examine the relationship between corporate governance and organisational performance. Apart from the general introduction, the paper presents the conceptual and theoretical framework in Section II. Section III highlights the methodological framework which governs the study. Section IV discusses the results of the study while Section V deals with concluding remarks.

II. Conceptual and Theoretical Framework

The term corporate governance has been identified to mean different things to different people. Magdi and Nadereh (2002) stress that corporate governance is about ensuring that the business is run well and investors receive a fair return. Prior studies by OCED (1999) provide a more encompassing definition of corporate governance. It defines corporate governance as the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different stakeholders in the corporation such as: the board, managers, shareholders, customers, employees, among others, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the companies' objectives are set and the means of attaining these objectives and monitoring performance (see: Wolfensohn ,1999; Uche ,2004; and Akinsulire, 2006).

Unlike the above scholars, Nganga, Jain and Artivor (2003) strengthen corporate governance beyond the distribution of rights and responsibilities of different stakeholders with vested interest in corporate organisations to consider the importance of protection of stakeholders, particularly in relation to how well corporate organisations are managed. The scholars define corporate governance as the set of mechanisms through which outside investors are protected from expropriation by insiders (including management, family interests and /or governments (ibid).

In placing corporate governance on a pedestal which reveals the relationship between providers of finance and corporate organisations, Shleifer and Vishny (1997) are of the opinion that corporate governance deals with the ways suppliers of finance to corporations assure themselves of getting a return on their investments. Corporate organisations need to ensure that managers do not misappropriate the capital or invest in bad projects.

Consequently, corporate governance is seen as "essentially about the prevention of theft", which can take place craftily executed by either the management or board or both of them (ICAN, 2009).

Okene (2010) citing Farar (2005) maintain that corporate governance was used as a term forty years ago. The root of the term "governance" was from the Latin words "gubarnare" and "gubernator" which refer to "steering a ship" and to the "steerer or captain of the ship" respectively. Mensah (2003) states that corporate governance is an institutional arrangement which provide the discipline and checks over excesses of controlling managers.

Much of the contemporary interest in corporate governance is concerned with mitigation of the conflicts of interest between stakeholders. Ways of mitigating or preventing these conflicts of interests include the processes, customs, policies, laws, and institutions which have impact on the way a company is controlled.

Effective corporate governance reduces "control rights" shareholders and creditors confer on managers, increasing the probability that managers invest in positive net present value projects (Shleifer and Vishny, 1997). Thus, the relationships of the board and management, according to Al-Faki (2006), should be characterised by transparency to shareholders, and fairness to other stakeholders. This will in effect mitigate the agency costs as predicted by Jensen and Meckling (1976).

The implications of the above definitions are that corporate governance is a system of corporate management and control to satisfy the strategic goals of all stakeholders while complying with the legal, ethical and other environmental needs of the society.

Theoretical Framework

There is a pressing need for theoretical and solid governance framework which is heralded through the recognition and written codification of the roles and responsibilities of boards and management. An effective board should, therefore, facilitate the efficient discharge of the responsibilities and duties imposed upon the directors by law, thereby adding value with reference to the peculiarities of each company. Also, the shareholders have got rights and privileges to protect their interest. Protecting the interest of the shareholders is often a job enhanced by the institution of a well functioning audit committee.

The Code of Best Practices (2003) identified three 'key players' in the implementation process and prescribed the functions and responsibilities for each of them. The principal actors are the ***Boards of Directors, Shareholders and Audit Committees***. The board, expectedly, will be an assemblage of distinguished individuals from diverse backgrounds. There is no gainsaying in the fact that effective corporate governance is an enduring factor which enables an establishment to evolve business excellence. It is capable of enhancing board competence and teamwork which will result in much improved benefits to the shareholders. The board has to be structured in such a way that it can achieve three ends which are stated thus:

(a) Proper understanding of, and capability to contend with, the matters of the company;
(b) Effective review and appraisal of the output of management; and
(c) Exercise of incisive and unbiased judgment.

A majority of the directors should have independent status and minds. They should be independent of management and free of all business and other relationships which could materially interfere with or be perceived to materially interfere with the exercise of independent judgment. Directors who are considered as independent by the board should be so acknowledged in the statutory annual report under the subject-matter of 'corporate governance'.

The company should state clearly the indexes of moral behaviour which are required of all the directors and top management and insist that the standards should be obeyed. The company should publish its standpoint on the issue of employees and board trading in the organisation's stocks and shares and in associated products which operate to reduce the economic risk of the securities.

The body corporate should have a structure which would independently verify and preserve the honour of the entity's financial and economic reporting. There is, therefore, the necessity for a formidable structure or framework of review and authorization to make sure that there are truthfulness and accuracy in the company's financial position furnished. Safeguarding integrity in financial reporting could be achieved through the agency of the audit committee set up and a process to bring about the independence and ingenuity of the statutory auditors.
All shareholders should have undiscriminating and timely access to material information which concerns the company's operations – financial position, governance, ownership structure and performance.

Information generated and disseminated by the reporting entity should be factual and presented in unambiguous and standardized formats, in accordance with the legal and institutional framework, namely: Companies and Allied Matters Act, Cap. C20, LFN 2004, Statements of Accounting Standards issued by the Nigeria Accounting Standards Board, International Accounting Standards issued by the International Accounting Standards Board, Nigerian Standards on Auditing issued by the Institute of Chartered Accountants of Nigeria and judicial pronouncements. The shareholder's rights should be respected and facilitated effectively.

A company ought to empower its shareholders by effectively communicating with them and making it painless for them to attend general meetings.

-Responsibilities and Functions of a Board of Directors:

Responsibilities

- The board of directors should be in firm control of the affairs of the company in a lawful, efficient and effective manner, such that the organisation may increasingly improve on its value creation; and
- The board should, with due regard to the other stakeholders' interests, ensure that the Value created is shared among the interested parties such as the shareholders and employees.

Functions

The functions of the board should include, but not limited to, the following:

- Strategic planning;
- Selection, performance appraisal and compensation of senior executive members;
- Succession planning;
- Communicating with the shareholders;
- Ensuring the integrity of financial controls and reports; and
- Ensuring that ethical standards are maintained and that the company complies with the laws of Nigeria.

--The chairman's primary responsibility is to ensure effective operation of the board and as much as possible distance himself from the day-to-day running of the company which is the primary responsibility of the chief executive officer and management team;
-The board is the main custodian of the corporation's accountability; and
-It moderates the conflicting interests of the stakeholders.

Composition of Board of Directors

- The board should be composed in such a way as to ensure the diversity of experience, without compromising compatibility, integrity, availability and independence;
- Membership of the board should rest on the following attributes:
  -Uprightness in character;
  - Distinctive competencies;
  - Knowledge on board matters;
  -Entrepreneurial bias; and
  -Sense of accountability, integrity, commitment to the task of corporate and institutional building.
- The position of the chairman and chief executive officer should ideally be separated and held by different persons;
- There should be a strong non-executive independent director as vice chairman of the board, where the position of the chairman and chief executive officer are combined in one individual.

The board member remuneration policy should be supported by full and effective disclosure, in consonance with the spirit and intent of the Companies and Allied Matters Act (Cap. C20, LFN. 2004) and Code of Corporate Governance in Nigeria, 2003.

A good corporate governance calls for a solid theoretical framework which recognises and manages risks. According to Igor Ansoff (1968), a sound and imaginative process of risk oversight and management and internal control are invaluable for corporate survival, particularly in the face of global economic and financial crisis. The system calls for the tools of identification, assessment, monitoring and managing all kinds of risks relating to production, marketing, financing, inflation, etc.

In the invincible words of Peter Drucker in his book "Managing in Difficult Times," a dynamic and forward looking organisation should, at all times and more especially during economic downturn, "feed the opportunities and starve the problems as they unfold, so as remain comfortably in business."

The Role of Shareholders

Shareholders' Rights and Privileges

- The company, through the directors, should ensure that shareholders' statutory and general rights are protected every time;
- It should be the responsibility of the shareholders to elect directors and approve the terms and conditions of their directorship positions;
- The venue of the annual general meeting should be carefully chosen such that the shareholders could attend and vote and not be disenfranchised as a result of distance and cost;
- Before the annual general meeting, notices should be dispatched at least 21 working days, with such details and annual reports, audited financial statements and other information that would enable the shareholders to vote properly on any issue.
- A separate resolution should be proposed by the board at the general meeting on each substantive issue in such a way that they could be voted for in an organized manner;
- The board has to ensure that decisions reached at the general meetings are implemented;
- There ought to be at least one director on the board to represent minority shareholders;
- Unless they are in a competing business or have conflicts of interest that warrant their exclusion, shareholders holding more than 20% of the total issued share capital of the company should have a representative on the board;
- The board should ensure equal treatment for all shareholders, such that none is given preferential treatment or superior access to information or other materials; and
- The annual general meeting should be recognized by the board as the most potent avenue to communicate with the shareholders and encourage their participation.

The Role of Audit Committee

The Companies and Allied Matters Act, 1990 states that a public limited liability company should have an audit committee (maximum of six equal representation of three members each representing the management/directors and shareholders) in place. The members are expected to be conversant with basic financial statements. The committee has the following objectives:

- Increasing public confidence in the credibility and objectivity of published financial statements
- Assisting the directors, especially the non-objective directors, in meeting their responsibilities of financial reporting
- Strengthening the independent position of a firm's external auditors by providing an additional channel of communication.

Qualification and Experience of Members of an Audit Committee

- Members of an audit committee should be able to read and understand basic financial statements and make valuable contributions to the committee's deliberation;
- An audit committee should review not only external auditor's report but also, most importantly, the report of the internal auditor;
- Members of the committee should possess the following qualities:

  -Integrity;
  -Dedication;
  -Thorough understanding of the business, its products and services;
  -Reasonable knowledge of the risks facing the company and the essential controls which it has in place;
  -Ability to offer new or different perspective and constructive suggestions; and Inquisitiveness and dependable judgement.

Corporations owe a number of legal, social and moral obligations to non-shareholder stakeholders. Examples of the stakeholders are employees, communities and customers/clients. It is held fervently that companies can create value by optimally managing social, natural, human and other forms of capital. Most companies are subject to a number of legal specifications such as trade practices, occupational health and safety, consumer protection and effluent discharge control.

In orderly societies, directors and members of top management are held personally answerable for exhibiting corporate behaviour which runs counter to the laid down norms. A board which is in charge of its destiny has to set the tone and indices of moral behaviour of the corporate entity and ensure adherence by the rank and file. Examples of the activities of social responsibility are the awards of scholarship to indigent students and the employment of the physically challenged people in the local communities. According to the chairman of Guinness Nigeria Plc, Engineer (Chief) R.A. Alabi, in his year 2005 annual statement, "the company continued with its age – long sponsorships of various sporting activities such as the Kaduna International Polo Tournament. The Water of Life Programme was expanded to cover Badia in Lagos State while discussion to commence work on state-of-the-art boreholes for Port Harcourt in Rivers State is in progress.

III. Methodology

Population of Study and Sample

The population of study consists of all the employees in the food products companies (Honey well Plc, Dangote Flour Mills Plc, Dangote Sugar Plc, Northern Nigeria Plc, National Salt Plc and Flour Mills) operating in Nigeria. 70 key employees across the seven food products companies were chosen. These are specifically the top employees in the helm of management.

Sampling Procedure

The study adopts simple random sampling. Random sampling is used because it is the best single way to obtain a representative sample from the population. Owojori (2002) stated that random sampling is one which all the members of the population have an equal chance of being selected from the sample as every other member and in which the selection of an individual for the sample did not influence the chances of any other individual of being chosen.

Method of Data Collection

In carrying out this research work, data were collected from major primary sources. The primary source of data was the questionnaire, which was carefully framed and administered to a sample of 70 respondents in the organisations selected. The questions in the questionnaire are straight forward and close ended questions. Hence, responses from the questionnaire were on the five point Likert-type questions (agreed, strongly agreed, disagreed, strongly disagreed and indifferences). The questionnaire consisted of twenty questions, which were carefully designed to collect relevant data. The research instrument was pilot studied, by expert panel including faculty members. The revised instrument and a cover letter were mailed to the specific individuals who were listed as the financial managers of the firms sampled. A reminder was sent and non-respondents were followed up with two additional mailings.

During the first questionnaire launching, 41 questionnaires were completed and returned. In the second and third mailings, a total of 23 more completed questionnaires were returned. Altogether 64 questionnaires were available for data analysis.

Method of Data Analysis

Based on the chosen sampling technique and the nature of data collected from the questionnaire, the study adopts parametric test of data analysis. In specific terms, the study utilized Karl Pearson's Product Moment Correlation and Regression analysis respectively with a value of 0.05 (level of significance) that corresponds to a 95% confidence level.

Test of Hypotheses

Following from the objectives of the study, the following hypothesis were tested:

Hypothesis I

H_0: There is no significant relationship between corporate governance and organizational performance.
H_1: There is significant relationship between corporate governance and organizational performance.

Hypothesis II

H_o: There is no significant positive correlation between the degree of relationship of corporate governance and organizational performance

$H_{1:}$ There is significant positive correlation between the degree of relationship of corporate governance and organizational performance

IV. Discussion of Results

The model estimated from Table 1 (see appendix) was significant because it showed a strong correlation value of 0.995. This result indicates a sound relationship between corporate governance and organizational performance of selected food organisations. The coefficient of determination (R^2) is 0.990, which indicate that 99 percent of the variation in organizational performance was explained by the explanatory variable (corporate governance). Also, a brief look at the adjusted R-squared value of 98.7% indicates that after removing the effect of insignificant repressor' (explanatory variable), about 1.3% variation in organisational performance is still accounted for by corporate governance. Therefore, the model is a good fit. Therefore, it is concluded by inference to Hypothesis I that, there is significant relationship between corporate governance and organizational performance.

From the Table 2 (see appendix), the estimated co-efficient of the intercept was -2.431 while the co-efficient of the explanatory variable was 0.753. On theoretical note, only the co-efficient of the explanatory variable complied with apriori expectation. The table also shows the t statistics which helped to determine the relative importance of each variable in the model and this is known by the independent variable whose values are well below -2 and above +2. Any value below -2 and above +2 will be accounted for as less improvement in the procedure and techniques. The value for the explanatory variable (corporate governance) is statistically significant, this also explain the establishment of a relationship between corporate governance and organisational performance. The explanatory variable (Corporate Governance) had a significant value of .000 which is lower than the decision rule value of 0.05. This value explains the strong relationship that exists between the variables. Therefore, it is concluded that there is significant relationship between corporate governance and organizational performance. The test statistic table shows that there is a strong, positive correlation between the degree of relationship of corporate governance and organizational performance which was statistically significant at $r = .995$ and $P = .000$. As the p-value is less than .05, we reject the null hypothesis and accept the alternative hypothesis that, there is significant positive correlation between the degree of relationship of corporate governance and organizational performance.

V. Conclusions

The study examined the relationship between corporate governance and the performance of organizations from various perspectives: better decision making, effective asset management, better competitive advantage, and improvement in level of confidence, among others. It was discovered 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 results show that generally corporate governance has positive impact on all the performance indicators of an organization.

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 organizations. 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 statements show the true position of the company's performance cannot be over emphasized. The audit committee must be well constituted to increase its independence and with the right size. Furthermore, the result is an indication that the companies 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 dividend to shareholders and generate more tax revenue to government.

Like all empirical studies, the present research also has its own limitations due to the methodology employed. Use of questionnaire to collect data always has also its own limitations, since responses could be biased because of the common method used for the collection of all data. Although extensive care has been taken when designing the questionnaire and the pilot study refined the questions, still the criticism of the survey method can never be completely ignored and should be taken into account.

From generalization of the results point of view, measuring research questions based on the opinion of the respondents would limit our generalization of the findings. As a result of this, the study could not investigate other corporate governance characteristics due to data constraints. Therefore important factors such as insider ownership, remuneration committee, nomination committee, CEOs remuneration, capital structure, disclosure and frequency of board meetings among others could not be included.

Furthermore, the performance of a company is influenced by other factors than just good corporate governance. The social, legal, economic and the political environment are equally important. It is therefore suggested that future research should consider some of these factors in exploring the impact of corporate governance on firm performance. However, the above mentioned constraint will not invalidate the findings of the study but rather pave way for future research on the concept and any related topic.

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Appendix

Table 1: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.995[a]	.990	.987	1.29507

a. Predictors: (Constant), Corporate Governance

Table 2: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-2.431	.903		-2.692	.055
	Organization Performance	.753	.038	.995	19.706	.000

a. Dependent Variable: Organization Performance