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INVESTIGATION INTO THE INTERACTION EFFECTS BETWEEN CORPORATE GOVERNANCE AND SHAREHOLDERS' WEALTH IN NIGERIA

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ABSTRACT

This research paper investigated the relationship between corporate governance and shareholders' wealth maximization among quoted manufacturing companies in Nigeria. In order to achieve the purpose of the study, three hypotheses were proposed and data collected from the annual reports and accounts of a sample of twenty manufacturing companies for a period of seven years spanning 2011 to 2017. While corporate governance was measured using audit committee size, board size and board composition, shareholders' wealth maximization was measured using market value. The data collected for the study were analyzed using multiple regression analyses. The research findings showed that an independent audit committee has a positive but statistically insignificant effect on shareholders wealth. The findings also showed that there is a positive and statistically significant relationship between the numerical size of the board of directors and shareholders' wealth maximization. Also, board composition had a positive relationship with shareholders' wealth maximization. From the findings, it was concluded that audit committee independence is not an important determinant of shareholders' wealth maximization. On the other hand, board size plays an important role in shareholders' wealth maximization. Similarly, the board of directors dominated by independent members also plays an important role in shareholders wealth maximization. It is recommended among other things that shareholders push for the increase of independent members in the board of directors.

Keywords: Corporate governance, Shareholders’ Wealth Maximization, Market value, Audit Committee, Board Composition, Board Size.

1.1 INTRODUCTION

There is the abundance of research evidence pointing to the fact that conflicts relating to self-interest are bound to surface in organizational arrangements where ownership and control are separated (Prempeh & Odartei-Mills, 2015; Fama & Jensen, 1983; Ross 1973). This is despite the fact that the reason for the separation abnitio is to engender better performance leading to shareholder wealth maximization. These conflicting interests if left to fester can lead to the manager taking decisions that are clearly suboptimal for the simple reason that the managers' personal interest is served. One of the most popular solutions advanced to ameliorate this problem is the development of the corporate governance mechanism. Corporate governance embodies the system of controls, processes, policies, and proceedings enacted by the board and management of an organization to ensure its smooth operations, maximize shareholders wealth and satisfy the interest of as many of the stakeholders as possible (Osundina, Ademola, & Ucheagwu, 2016).

The corporate governance mechanism in an organization is a conscious effort to ensure that the problems associated with the separation of ownership and control are reduced to the barest minimum if not entirely eliminated. To achieve a conflict-free relationship between the owners and management, corporate governance propose: appropriate remuneration/compensation to incentivize the manager(s) to act in the best interest of owners; sanctions/punishment to deter the manager(s) from taking adverse/suboptimal decisions capable of causing losses for owners; and monitoring oversight mechanisms to ensure that managers are constantly in check.

Corporate governance dictates the structure of the board of directors and how the different interest groups are represented, coordinated, compensated and monitored. Adewuyi and Olowookere (2008) asserted that organizations with good corporate structures are expected to have higher profits, less bankruptcy risk, higher valuations and pay out more cash to their shareholders. However, organizations with weak corporate governance structures are more likely to face existential risks including fraud, bankruptcy among others. To this end, the present study is aimed at investigating the interaction effects between corporate governance and shareholders wealth maximization among quoted manufacturing companies in Nigeria.

1.2 STATEMENT OF PROBLEM

Several studies exist on the importance of corporate governance to a business organization (Oyedokun, Sanyaolu & Bamigbade 2017; Onakoya, Ofoegbu & Fasanya, 2011). For Oyedokun, Sanyaolu, and Bamigbade (2017) stated that the corporate governance mechanism play an important role in ensuring optimal performance and wealth maximization of shareholders. Onakoya, Ofoegbu and Fasanya (2011) and Ibrahim, Ahmad, Khan (2016) opined in agreement with the above and asserted that corporate governance foster good corporate performance and leads to sustainable maximization of shareholders wealth. However, studies have also shown that weak corporate governance is detrimental to the achievement of corporate goals and objectives. For example, several high profile frauds, and business failures including Enron, and Parpalat in the US and Intercontinental Bank, Oceanic Bank, Afribank in Nigeria were directly linked to failure in corporate governance.

By nature, corporate governance practices go to the very heart of an organization performance related hence, a large body of empirical literature exists on the subject matter. However, Most of these are focused on its relationship with financial reporting (Abbott, Parker and Peters 2002; Kusnadi, Leong, Suwardy and Wang 2016; Umobong and Ibanichuka 2017; Al-Shaer, Salama and Toms 2017; Dimitropoulos & Asteriou, 2010; Kantudu & Samaila, 2015; Ibrahim & Jehu, 2018) and financial performance (Somathilake, 2018; Abdulazeez, Ndibe & Mercy, 2016; Dzingai & Fakoya, 2017; Ojulari, 2014). In the present study, we intend to call attention to and investigate an aspect of the financial performance nexus that has been given very little research attention but which goes to the very heart of justifying the existence of corporate governance - shareholders' wealth maximization. Consequently, this research effort will focus on the relationship between corporate governance mechanisms and shareholders' wealth maximization of manufacturing companies in Nigeria. Below, we set out the hypotheses of the research.

Research Hypotheses

- Board of directors’ size does not significantly affect shareholders wealth of manufacturing companies in Nigeria.
- Board of directors’ independence does not significantly affect shareholders wealth of manufacturing companies in Nigeria.

- Audit committee composition does not significantly affect shareholders wealth of manufacturing companies in Nigeria.

2.1 THEORETICAL FRAMEWORK

Agency theory according to Jensen and Meckling (1976) and Donaldson and Davis (1991) holds that managers will not act to maximize the returns to shareholders unless they are compelled by appropriate corporate governance structures which are implemented in the large business organizations to safeguard the interests of shareholders. The agency theory for example harps on the conflict of interest between managers (agents) and owners of the business (principals) and suggests mechanisms to control the actions of the agents and make their goals more congruent with those of the principal (Jensen & Meckling 1976). Corporate governance mechanism is one of the mechanisms suggested by the agency theory (Lopes, 2008; Bushman & Smith 2001; Shapiro, 2005) with its focus on the relationship between the agent and his principal. Through the established corporate governance mechanisms, the interest of the shareholders is best served and agency losses are also mitigated.

As noted by Donaldson and Davis (1991), agency loss occurs when the residual returns to shareholders fall below what they would be if the principal (shareholders) were to manage the business by themselves. The agency theory through governance structures identifies mechanisms through which agency losses can be reduced to include executive incentive schemes that reward them financially for maximizing shareholder interests (Eisenhardt 1989). Jensen and Meckling (1976) proposed some executive compensation schemes like performance-based stock options which ensures that manager' benefits just like shareholders when they act in the best interest of shareholders. Donaldson and Davis (1991) assert that such schemes tie executive compensation and benefits to shareholders returns to reward long-run value maximization of the organization and discourage short-run executive actions which hamper the growth of the organization.

2.2 REVIEW OF CONCEPTS

Corporate Governance

According to John and Senbet (1998), corporate governance deals with mechanisms through which owners of an organization and all other stakeholders exercise control over the organization's insiders and management in such a way that their interests are protected. Accordingly, the major reason for corporate governance is the separation of ownership and control, and the agency problems it engenders. Control over the organization's management is exercised through several mechanisms of corporate governance which include the board of directors and several committees which monitor the activities of management. The board of directors is vital to corporate governance mechanisms in market-based economies. It is viewed as a primary means for shareholders and other stakeholders to exercise control on top executives. They define and set the rules for the CEO regarding hiring, firing, and compensation plans and providing strategic advice (Fama and Jensen, 1983). Their effective depends on the characteristics of the board of directors defined in terms of board size, board independence/composition, CEO Duality, gender diversity, board age, board education and board activity among others. Our characteristics of interest are board composition and board size.

The board size comprises the total number of individuals on the board of directors irrespective of their other characteristics. Kim and Nofsinger (2007) and Dimitropoulos and Asteriou, (2010) argued that relatively smaller boards are likely to perform better than larger boards because are they are easier to be coordinated/observed and also avoid the free rider problem that is associated with the larger board of directors. Haniffa and Haudaib (2006) aver to this opinion by asserting that larger boards are better proficient to explore more opportunities and secure necessary resources for the firm.

The board of directors comprises executive directors and non-executive (independent) directors. A board composed of more non-executive directors than executive is considered as being independent. According to Daghsni, Zouhayer, and Mbarek (2016), the board independence is considered the most important factor influencing the effectiveness of the board of directors in reducing the discretionary and opportunistic actions of the manager. Higgs (2003) opined that non-executive directors help to curtail managerial excesses in financial statements reporting. Thus as stated by Fama and Jensen (1983), collusion by the board of directors and management can be curtailed by having a board of directors where non-executive directors are well represented.

According to Ayinde (2002), the audit committee is a standing committee established to enhance corporate accountability by working with the internal auditors and management to improve and strengthen the accounting and financial reporting practices of an organization and ensure proper conduct of corporate affairs in accordance with generally accepted ethical and legal standards. Al-Shaer, Salama, and Toms (2017) suggest that effective audit committee oversight plays a critical role in corporate governance as it helps to improve financial reporting quality and reduce opportunistic earnings management.

Shareholders' Wealth Maximization

There is strong social support for the suggestion that shareholders' wealth maximization should be the primary norm underlying the governance of business organizations (Sharfman, 2013; Macey, 2008). According to Macey (2008), the shareholders' wealth maximization revolves around the notion that the objective of a firm's management should be to maximize the present value of the expected future returns of shareholders of the firm. The returns can take the form of capital gains from the sale of equity stock or periodic dividend payments. In contrast to shareholders' wealth maximization, profit maximization is the ability of the firm to produce maximum output with the limited input or using minimum input to produce stated output.

Shareholders' wealth maximization is a long-term objective of the firm must consider both the time value of money and risk inherent in every investment decisions (Macey, 2008). Shareholders' wealth can be measured as the market value of equity stock holdings of shareholders. Considering that market value is measured as the current quoted price of a share of stock, then the individual shareholder's wealth can be calculated by multiplying the current stock price by the number of equity stock held by the shareholder - While the total shareholders' wealth will involve multiplying the current stock price by the total number equity stock outstanding.

2.3 EMPIRICAL REVIEW

Uwuigbe (2013) investigated the relationship between corporate governance practices and share price, using ownership structure and audit committee as measures of corporate governance for a period of 3 years and a sample of 30 companies listed on the Nigeria Stock Exchange. Data were analyzed using regression and correlation analysis. The findings suggested that ownership structure have a negative association with share price, while the audit committee is positively related to share price. The study thus recommended that board members' shareholding should be regulated to ensure an optimal share price disposition.

Ojulari, (2014) explored the relationships that exist between corporate governance and the performance of quoted companies in Nigeria using separation of CEO and Chairman, director's independence and Number of meetings of the board as measures of corporate governance and return on Equity, Earnings per Share and Net Profit margin as measures of performance. Taking a sample data of 25 quoted companies for a period of 2 years which were analyzed using correlation and regression analysis, which showed that corporate governance and financial performance are more positively related on a uni-variate analysis level than at a multi-variate analyses level. The result indicates that although there is a relationship between corporate governance and financial performance, the predictive power of corporate governance on companies' performance is too low to be meaningful.

Prempeh and Odartei-Mills (2015) investigated the effects of corporate governance on shareholder value maximization of listed companies in Ghana for the period 2003 –2007, using data from ten companies and proxying shareholders' wealth maximization as dividend per share and dividend yield and analyzed within the panel data framework using multiple regression analyses. The findings showed that both the board independence and size have a statistically significant relationship with shareholder wealth maximization.

Osundina, Ademola and Ucheagwu (2016) investigated the relationship between corporate governance and firm's performance in Nigerian. Data were collected from the annual reports of 30 quoted manufacturing companies for the period 2010 to 2014 and analyzed using multiple regression analysis. The findings showed a significant positive relationship between board structure and return on asset while Audit committee index had a positive but insignificant relationship with return on asset and ownership structure index had an insignificant negative relationship with performance return on asset.

Abdulazeez, Ndibe, and Mercy (2016) in "corporate governance and financial performance of listed deposit money banks in Nigeria" reported from their analysis of data collected from the annual reports of the banks that larger board size contributes positively and significantly to the financial performance of deposit money banks in Nigeria. The study thus recommended among other things that banks should increase their board size.

Dzingai and Fakoya (2017) examined the effect of corporate governance structures on firm financial performance. Secondary data of selected Johannesburg Stock Exchange (JSE), Socially Responsible Investment (SRI) Index-listed mining firms' sustainability reports, and integrated annual financial statements were used. Using panel data analysis of the random effects model, the results indicated a weak negative correlation between ROE and board size and a weak, but positive, the correlation between ROE and board independence. Furthermore, the result indicated a positive but weak correlation between ROE and sales growth and a negative and weak relationship between ROE and firm size. The findings suggest that effective corporate governance through a small effective board and monitoring by an independent board will result in increased firm financial performance.

Somathilake (2018) explored the effect of board characteristics on firm financial performance of listed companies in Colombo Stock Exchange (CSE) during the period of 2015 to 2017. The research which employed 100 listed high turnover companies for the study measured board characteristics using Board size, Education qualification, Director Independence and Female direction proportion while the financial performance was measured using Return on Assets. The study data which was tested statistically using correlation and regression analysis revealed that board size has a negative significant influence on company performance while female directors' proportion had negative and but no significant influence on company performance. Furthermore, the director's independence had a positive but not significant influence on firm performance while education qualification had a positive but not significant influence on firm performance.

3 MATERIALS AND METHODS

The data for the study was collected from secondary sources using the method of content analyses from the annual reports and accounts of 20 quoted manufacturing companies - viz: Guinness Nigeria, Lafarge, Oando PLC, Berger Paints, Mobil Nig, DN Meyer, Premier Paints, Forte Oil, Aluminum Extrusion, Nigeria Breweries, Portland Paints, Austin Laz and company, Beta Glass, Cement Company of the North, Cutix Cables, Dangote Sugar, First Aluminum Company, Greif Nigeria, Golden Penny and UAC foods. The choice of companies in the sample was on the basis of the availability of data and information. Period covered is seven (7) years from 2011-2017. The collected data consisted of corporate governance measures including audit committee composition (AUDCOMP) measured as the ratio of independent audit committee members to the audit committee size; board of directors characteristics comprising - board size (BODSIZE) measured as total number of board members and board composition (BODCOMP) measured as the ratio of independent members to the total board size. Furthermore, shareholders' wealth is measured in terms of market value of equity (MKVALUE) which in itself is measured by multiplying the current stock price by the number equity stock held by the shareholder and controlling for company size (COMPSIZ) measured as the natural log of total assets and COMPANY age (COMPAGE). The ordinary least square (OLS) regression method is adopted as a method of data analyses which is given as:

$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \ldots\ldots + \beta NXN + \mu$ . . . (1)
Where Y is the dependent variable; X_1, X_2, XN are the independent variables; β_1, β_2, β_3 are the coefficients of the independent variables; β_0 is the constant term and μ is the error term. Thus, we posit that:
Shareholders' Wealth = f (Corporate governance) . . . . . (2)

Where shareholders' wealth is measured by market value and corporate governance is measured by audit committee size board size and board composition and including company size and age as control variables, equation 1 is expanded as follows:
Market value = f (audit committee composition, board characteristics, company size, company age) . . . . (3)

Denoting audit committee composition as AUDCOMP; board size as BODSIZE; board composition as BODCOMP; and market value as MKVALUE; and company size and age as COMPSIZ and COMPAGE respectively, werestate equation 2 as:
MKVALUE = f (AUDCOMP, BODSIZE, BODCOMP, COMPSIZ, COMPAGE). . (4)
Substituting for the variables in the equation above we have:
MKVALUE = β_0 + β_1AUDCOMP + β_2BODSIZE + β_3BODCOMP + β_4COMPSIZ + β_5COMPAGE + μ . . . (5)
The a priori expectation is that: β_1, β_2, β_3, β_4, and β_5 are greater than zero.

4.1 DATA ANALYSES AND RESULTS

Table 1: Regression Result

Dependent Variable: MKVALUE
Method: Least Squares
Date: 01/29/19 Time: 13:06

Sample: 1 140
Included observations: 140

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.680663	0.329671	2.064669	0.0409
AUDCOMP	0.039644	0.239663	0.165416	0.8689
BODSIZE	0.027653	0.010937	2.528530	0.0126
BODCOMP	0.065027	0.018944	3.432578	0.0008
COMPSIZE	0.295164	0.284764	1.036521	0.3018
COMPAGE	0.002366	0.001978	1.195820	0.2339

R-squared	0.310707	Mean dependent var	0.380057
Adjusted R-squared	0.257525	S.D. dependent var	0.312066
S.E. of regression	0.299725	Akaike info criterion	0.470011
Sum squared resid	12.03793	Schwarz criterion	0.596082
Log likelihood	-26.90079	Hannan-Quinn criter.	0.521243
F-statistic	3.336304	Durbin-Watson stat	1.819788
Prob(F-statistic)	0.007149		

The regression result in table 1 shows that there is a positive relationship between the independent audit committee (AUDCOMP) and the market value (MKVALUE) of quoted manufacturing companies in Nigeria. With a coefficient of regression of 0.0396 implying that a unit increase in the independence of audit committee members will predict 0.0396 units increase in the market value of manufacturing companies. The result however further indicates that the result is statistically insignificant as the probability of the t-statistic of 0.8689 is much higher than the acceptable limit of 0.05.

Furthermore, the numerical size of the board of directors (BODSIZE) also shows a positive relationship with market value (MKVALUE) implying that an increase in the number of members will lead to higher market value. With a coefficient of regression value of 0.0276 for the relationship between board size and market value implying that a unit increase in the number of board members is predicted to lead a 0.0276 units' increase in market value. The results also show that board size is statistically significant in its effects on the market value of manufacturing companies. This can be seen from the value of the probability of t-statistic of 0.0126 which lower than the critical probability of the t-statistic value of 0.05.

The result for the relationship between board composition (BODCOMP) also reported a positive relationship - with a coefficient of regression value of 0.0650 with the implication that a unit increase in the number of independent board members will lead to a 0.0650 units increase in the market value of manufacturing companies in Nigeria and vice versa. The value of the probability of t-statistic of 0.0006 implies that the result is statistically significant at the 0.05 critical limits.

Finally, it was noted that two out of the three variables used as measures of corporate governance (board size and board composition) had a statistically significant relationship with market value as a measure of shareholders' wealth. This is considering that the probability of t-statistics gave values of 0.8689, 0.0126, 0.0008 respectively for audit committee composition (AUDCOMP), the board of directors size (BODSIZE) and board of directors' composition (BODCOMP). From this result, we conclude that board size and board composition significantly affect shareholders' wealth in quoted manufacturing companies in Nigeria. However, the audit committee composition does significantly affect shareholders' wealth.

4.2 DISCUSSION OF FINDINGS

This research paper investigated the relationship between corporate governance and shareholders' wealth maximization among quoted manufacturing companies in Nigeria for the period 2011 to 2017. The findings of this research revealed that an independent audit committee has a positive effect on shareholders wealth by increasing market value equity stock. An independent audit committee will be more committed to their role than one dominated by executive board members. However, the finding is not statistically significant implying the effect of the audit committee on shareholders' wealth is weak and cannot be relied on to explain the changes in shareholders' wealth. Osundina, Ademola and Ucheagwu (2016) investigated the relationship between corporate governance and the firm’s financial performance in Nigerian and showed that the audit committee index had a positive but statistically insignificant relationship with return on asset. However, Uwuigbe (2013) in a similar study found a positive relationship between audit committee composition and shareholders' wealth maximization.

The findings also showed a positive and statistically significant relationship between the numerical size of the board of directors and the market value of manufacturing companies in Nigeria. This finding implies that an increase in the number of board members will lead to higher growth in shareholders' wealth. This finding agrees with that of Abdulazeez, Ndibe, and Mercy (2016) who examined how corporate governance impact on the financial performance of listed deposit money banks in Nigeria and found that larger board size contributes positively and significantly to the financial performance of the banks. However, this finding contradicts that of Somathilake (2018) who found that board size had a negative and significant influence on company performance.

The findings further showed that board composition has a positive relationship with the market value of manufacturing companies in Nigeria - with the implication that an increase in the number of independent board members will lead to increase in the market value of manufacturing companies. Ojulari, (2014) explored the relationships that exist between corporate governance and the performance of quoted companies in Nigeria and showed that although there is a positive relationship between the corporate governance and financial performance, the predictive power of corporate governance on companies’ performance is too low to be meaningful. Dzingai and Fakoya (2017) in their findings suggested that effective corporate governance through a small effective board and monitoring by an independent board will result in increased firm financial performance.

Finally, it is imperative to note that all corporate governance measures used in the study were positively related to shareholders wealth maximization. The implication of this is that corporate governance is a very important factor in the ability of manufacturing companies to deliver optimal performance for all stakeholders in the organization. Uwuigbe (2013) who investigated the relationship between corporate governance practices and share price reported similar findings by showing that the audit committee is positively related to share price. Similarly, Prempeh and Odartei-Mills (2015) also found that both the board size and independence have a statistically significant relationship with shareholder wealth maximization.

5 CONCLUSION AND RECOMMENDATIONS

From the findings, it is concluded that audit committee independence is not an important determinant of shareholders' wealth in manufacturing companies in Nigeria. On the other hand, board size plays an important role in shareholders' wealth maximization. Similarly, the board of directors dominated by independent members also plays an important role in shareholders wealth maximization. Based on the above conclusions, it is recommended that shareholders push for the increase of independent members on the board of directors. It is further recommended that manufacturing companies review the methods of appointing audit committee members in order to ensure that audit committee members are able to deliver better results in the future.

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