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Impact of Corporate Governance on Organizational Performance

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Abstract:
Corporate Governance is the system by which companies are directed and controlled. This study investigates the relationship that exists between corporate governance and firm performance. The specific objectives of the study is to examine the level at which an organization is corporate governance compliance, the study attempt to analyze the impact of corporate governance on organizational performance. In achieving this, questionnaires were administered to 40 managers in Cadbury Nigeria Plc. Agidingbi Ikeja, Lagos. Data were analyzed using Multinomial Linear Regression model. Conclusively, the study reveals that adoption of corporate governance has enhanced accountability and transparent disclosure of financial information, enhanced timely disclosure of financial information to stakeholders and also improved the performance of firms. The study recommends that the Corporate Governance Committee of companies should endeavor to do a regular appraisal of their corporate governance compliance status as it affects performance.

Keywords: *Corporate governance, organization, performance, accountability*

1. Introduction

Corporate governance has become a global issue over the last decade, leading to countries around the world amending their legal system and stock exchange listing requirements to conform to corporate governance principles as well as developing new codes of best practices. Recently, there has been considerable interest in the corporate governance practices of modern corporations, particularly since the high profile collapse of a number of large U.S. firms such as *Enron* Corporation and WorldCom (Adedipe, 2004:56). The development has forced national government and regional economic organizations to come up with various guidelines and codes to get businesses to behave decently. One of such institutions is the Organization for Economic Cooperation and Development (OECD), which has undertaken much work on corporate governance for a number of years.

Notably, the Cadbury report issued in the United Kingdom (UK) in 1992 laid the foundations of corporate governance not just in the UK but also in other countries around the globe. Corporate governance is largely concerned with governing the relationship between shareholders and directors. Its concept is primarily concerned with the process of customs, policies, system, laws and regulations as been applied in organizations (Love, 2011).

Basically, the research work aimsat providing answers to the following questions which are:

i. At what level does Cadbury Nigeria Plc comply with corporate governance?
ii. What is the role of corporate governance in Cadbury Nigeria Plc?
iii. What is the impact of non compliance on Cadbury Nigeria Plc performance?

2. Research Hypothesis

The following hypothesis were tested;

→ H_{01}: Cadbury Nigeria Plc does not comply with corporate governance
→ H_{02}: Corporate governance has no significant effect in the performance of Cadbury Nigeria Plc.
→ H_{03}: Non compliance of corporate governance has no impact on the performance of Cadbury Nigeria Plc.

2.1. Literature Review

An understanding of corporate governance proceeds from an examination of a number of theories that attempt to explain the basis and rationale behind this management imperative. These theories principally include the Agency, Stakeholders, Stewardship, Resource-dependency, Transaction cost and Complexity theories. Each of the theories has received comprehensive treatment in previous studies including Abdullah and Valentine (2009), Mintz, (2004), Khanna and Ken (2008), Heath and Norman (2004), Hua and Zin (2007), Sanda, Mikailu and Garba (2005). Corporate governance frameworks have been formulated by a variety of regulatory agencies and national governments over the last decades across different countries, 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.

2.2. Conceptual Framework

The conceptual framework of corporate governance pertains to the theoretical configurations, underlying postulations, and principles adopted by companies. A study of literature has shown that the conceptual framework of corporate governance is the agency theory, institutional theory and mechanisms of reducing agency costs. The conceptual framework for this study focuses on the agency relationship and the corporate governance mechanisms to reduce the cost of agency.

2.3. Agency Concept

The agency concept appears to be the mother of all corporate governance concepts. This is because business alliances are usually built on a principal-agent relationship. The principal-agent relationship has its roots in several fields of endeavor-law, economics, accounting, and strategic management. Agency theory stems from the agency relationship where an agent (board of directors, managers) is hired as a representative and business developer by a principal (shareholders, owners). If both parties to the relationship believe in utility maximization, there are good reasons to believe that the agent will not always act in the best interests of the principal (Jensen & Meckling, 1976).

Agents are expected to manage the affairs of the business in the best interest of the shareholders or principal. Rather, by exploiting information asymmetries and conflicts of interests on the board, the agents were able to act against the interests of the principals and to do so with a reasonable expectation of evading punishment (Heath & Norman 2004) Agency concept therefore provides a framework for understanding how the alignment of incentives and information asymmetry influence managers' decisions (Beaudoin, 2008).

2.4. Theoretical Framework

The basic theoretical structures of corporate governance include the Agency theory, Stakeholder theory, Stewardship theory, and Resource Dependency Theory. However the agency theory is the focal point. The theory of agency forms the theoretical core for this study because it is a foundational theory of corporate governance. It also relates to internal mechanisms of corporate governance. These theoretical perspectives are discussed herewith with emphasis on agency theory.

2.5. Stakeholder Theory

Stakeholder theory asserts that companies have social responsibility that requires them to consider the interests of all parties affected by their actions (Branco and Lucia, 2007). This confers more responsibility on the managers in terms of ensuring that no stakeholder is dissatisfied either in the short run or long run. Put simply by Sternberg (1997), stakeholder theory is the doctrine that businesses should be run not for the financial benefit of their owners, but for the benefit of all stakeholders. Rusconi (2009) posits that the fundamental basis of the stakeholder theory is normative and involves the acceptance of ideas that stakeholders are persons or groups with legitimate interests in procedural and/or substantive aspects of corporate activity and that the interest of all stakeholders are of intrinsic value. Kostyuk, Braendle, & Apreda (2007) suggest that stakeholder theory focuses on the relative differences of a stake-holder oriented corporate governance system compared to a shareholder oriented one. Consequently, it can be inferred that stakeholder theory broadens the horizon of interests attached to corporate governance with respect to firm performance.

2.6. Stewardship Theory

The stewardship theory emphasizes the principal-steward relationship believed to have its roots in the fields of psychology and sociology. It grew out of the seminal work of Donaldson and Davis (1989, 1991) and was developed as a model where senior executives act as stewards for the organization and in the best interests of the principals (Olson, 2008).The principal-steward relationship is a relationship of trust and was developed as an alternative to the agency theory. In the light of corporate governance, Donaldson & Davis (1991) suggest that stewardship theory focuses essentially on empowering structures, and supports the mechanism of CEO duality which will enhance effectiveness and produce, as a result, superior returns to shareholders than separation of the roles of chair and CEO.

2.7. Resource Dependency Theory (RDT)

Chin, Widing II, & Paladino (2004) asserts that Resource Dependency Theory has its origins in open system theory as such organizations have varying degrees of dependence on the external environment, particularly for the resources they require to operate. They express the same view as proponents of the theory who suggest that company should seek proactively to control resources in order to improve organizational performance.

The hallmark of resource dependence theory that distinguishes it from transaction cost economics is the emphasis on power and a careful articulation of the explicit repertoires of tactics available to organizations (Davis & Cobb, 2009). This follows that directors or non-executive are greatly appreciated than their inside directors counterparts because of their ability to provide the organization with resources that would enhance firm performance as put by proponents in terms of board capital and board motivation. Thus, Gkliatis (2009) described board motivation activities related to providing resources as: providing legitimacy/bolstering the public image of the company, providing expertise, administering advice and counsel, linking the company to important stakeholders or other important entities, facilitating access to resources such as capital, building external relations, diffusing innovation, and aiding in the formulation of strategy or other important company decisions. This led to the contribution of Abdullahi & Valentine (2009) on the classification of directors into four namely: the insiders, business experts, support specialists, community influential.

2.8. Corporate Governance and Performance Measures

There exists a plethora of researches measuring the relationship between corporate governance and firm performance across business environments. These literatures are reviewed in this segment identifying the variables, and the empirical findings. Mashayekhi & Bazaz (2008) in an Iranian study, use board size, board independence, board leadership and institutional investors on the board as corporate governance indices and EPS, ROA and ROE as firm performance surrogates. The regression results show that board size is negatively associated with firm performance and that the presence of outside directors strengthens the companies' performance. The study controls company size, leverage, and the number of years a given company's stock has been traded on the TSE including an unreported industry effect in the model. Kanellos & Karathannassis (2007) in a study of Athens Stock Exchange formulate a number of questions based on a number of provisions promulgated by the European and U.S.A. authorities in order to determine the quality of government practices of the sample companies.

Karpoff, Wayne, & Danielson (1994) examine the correlations between corporate governance structure and two measures of performance: return on assets and market-book value ratio. The tests exploit an unusual data base compiled by Institutional Shareholder Services, Inc. (ISS), which contains comprehensive governance profiles for the Standard & Poor's 500 Index. They found that there is a relationship between corporate governance and performance. Zheka (2006) finds strong evidence that corporate governance predicts firm performance in the transition context. Kajola (2008) examines the relationship between four corporate governance mechanisms (board size, board composition, and chief executive status and audit committee) and two firm performance measures (return on equity (ROE) and profit margin (PM). Tsifora & Eleftheriadou (2007) find the relationship between two corporate governance indicators (board size and ownership structure) and three categories of performance ratios (liquidity ratios, activity ratios, and profitability ratios). The empirical findings reveal mixed outcomes. Kyereboah-Coleman (2007) examines the effect of corporate governance on the performance of companies in five African countries by using both market and accounting based performance measures.

The results indicate that the direction and the extent of impact of governance are dependent on the performance measure being examined.

2.9. Corporate Governance Measures in Nigeria

The Securities and Exchange Commission Code of Corporate Governance in Nigeria as released in October 2003, prescribes the code of best practices which are briefly discussed under the following tripartite roles:

1. The roles of the board of directors, chairman, and chief executive officer
2. The role of the shareholders
3. The role of the audit committee

2.10. The Role of the Board of Directors, Chairman, and Chief Executive Officer

The board of directors comprises the executive and non-executive board members. The SEC
code of best practices recommends a maximum board size of 15 persons and a minimum of 5 persons. The general responsibility of the board of directors is to exercise oversight in the organizations in which they function and ensure goal congruence. Their roles therefore include:

a) Strategic planning with organizational resources in order to achieve organizational objectives.
b) Selection, performance appraisal and compensation of senior executives
c) Ensuring that a good succession plan is in place so as to ensure that the organization remains a going concern.
d) Communication with shareholders
e) Ensuring the integrity of financial controls and reports
f) Ensuring that ethical standards are maintained and the company complies with the laws of Nigeria.

2.11. The Role of the Audit Committee

The audit committee structure which was inaugurated in CAMA 1990 as amended till date recommends that there be an equal number of directors and shareholders subject to a maximum of six members. Section 359 (6) prescribes the following functions of the audit committee:

a) Ascertain whether the accounting and reporting policies of the company are in accordance with legal requirements and agreed ethical practices;
b) Review the scope and planning of audit requirements;
c) Review the findings on management matters in conjunction with the external auditor and departmental responses thereon;
d) Keep under review the effectiveness of the company's system of accounting and internal control;
e) Make recommendations to the Board in regard to the appointment, removal and remuneration
f) of the external auditors of the company; Authorize the internal auditor to carry out investigations into any activities of the company which may be of interest or concern to the committee.

The SEC Code of best practices stipulates that the function of the audit committee shall include

i. Assisting the board in fulfilling its oversight responsibilities.

ii. Reviewing the financial reporting process, the system of internal control and management of financial risks, the audit process, and the company's process for monitoring compliance with laws and regulations.
iii. Maintain effective relations with the board of directors, management and both internal and external auditors.
iv. Understanding the detailed responsibilities of committee membership, company's business, operations and industry specific tasks.

2.12. Research Design

The survey research design method was used in this study. It involves using a self-designed questionnaire in collecting data from the respondents. This method was chosen in order to make reference to phenomena as they exist in real life and it is relatively economical in terms of time and resources.

Population is a finite set of objects whose properties are to be studied (Ifenowo 2012). Target population refers to population whose properties are estimated through a sample; usually the same as the total population. The population for this study comprises of the workers in Cadbury Nigeria Plc. The total targeted population size is 60 managers in all the three departments, which includes the senior manager, junior manager and the supervisors.

2.13. Research Instrument

For the purpose of this research work, closed ended questionnaire was used. The questionnaires were distributed to selected departments which includes legal, finance and production department. Questionnaires were administered in relation to the topic which was in two sections. Section A for personal information about correspondents such as age, sex, qualification etc. Section B was designed in relation to the topic in order to ascertain relevant data to get a valid conclusion.

2.13.1. Reliability and Validity

In order to establish the reliability of this instrument, a pilotstudy was carried out on a sample of twenty (40) staff of Cadbury Nigeria Plc., using a test-retest method. The result of the reliability test was 0.52 showing that the instrument is reliable. In confirming the validities of the instrument, face and content validities were ensured by conference of experts.

3. Method of Data Analysis

To analyze and test the hypothesis and the package used was computer analysis through the use of SPSS Statistical package for social sciences. Organizational performance (dependent variable) will be examined to see its dependency on corporate governance (independent variable) using multinomial linear regression equation.

Formula: $Y=B0+B_1X_1+B_2X_2+\ldots\ldots\ldots\ldots\ldots\ldots B_nX_n+M$

4. Analysis and Results

4.1. Hypothesis One

- → H_0: Cadbury Plc does not comply with corporate governance.
- → H_1: Cadbury Plc does comply with corporate governance.

Decision Rule: Reject the null hypothesis if the significant value (p-value) is less than $\alpha = 0.05$ otherwise we do not reject the null hypothesis.

Likelihood Ratio Tests				
Effect	Model Fitting Criteria	Likelihood Ratio Tests		
	-2 Log Likelihood of Reduced Model	Chi-Square	df	Sig.
Intercept	10.087[a]	.000	0	.
Q15	679.277[b]	669.190	12	.000
Q19	679.277[b]	669.190	16	.000
Q9	24.879[b]	14.792	8	.063

Table 1

This table shows which of the independent variables are statistically significant. It is evident that the variables were statistically significant at $p = .000$ (the "**Sig."** column) less than α hence have a strong and positive correlation. The compliance brought about an enhanced accountability and transparent disclosure of financial information as revealed through the correlation of the tested variables. Hence we accept H_1 and conclude that Cadbury Plc does comply with corporate governance.

Model Fitting Information				
Model	Model Fitting Criteria	Likelihood Ratio Tests		
	-2 Log Likelihood	Chi-Square	df	Sig.
Intercept Only	83.150			
Final	10.087	73.063	40	.001

Table 2

From the above table, the "Final" row present information on whether all the coefficients of the model are zero (i.e., whether any of the coefficients are statistically significant). And from the table, all the variables tested have a strong positive correlation as the significant value p = 0.001 less than α = 0.05, we reject the null hypothesis and conclude that Cadbury Plc does comply with corporate governance

4.2. Hypothesis Two

→ H_0: Corporate governance has no significant role in the performance of Cadbury Nigeria Plc.
→ H_1: Corporate governance has significant role in the performance of Cadbury Nigeria Plc.

Likelihood Ratio Tests				
Effect	Model Fitting Criteria	Likelihood Ratio Tests		
	-2 Log Likelihood of Reduced Model	Chi-Square	df	Sig.
Intercept	.000[a]	.000	0	.
Q15	12.720[b]	12.720	6	.048
Q19	.000[b]	.000	8	1.000
Q9	.000[b]	.000	4	1.000

Table 3

It is evident that the variables (Q15) was statistically significant at *p* = .048 (the "Sig." column) less than α hence have a strong and positive correlation. Hence, we accept H_1 and conclude that Corporate governance has significant role in the performance of Cadbury Nigeria Plc.

Model Fitting Information				
Model	Model Fitting Criteria	Likelihood Ratio Tests		
	-2 Log Likelihood	Chi-Square	df	Sig.
Intercept Only	45.474			
Final	.000	45.474	20	.001

Table 4

All the variables tested have a strong positive correlation as the significant value p = 0.001 less than α = 0.05, we reject the null hypothesis and conclude that Cadbury Plc does comply with corporate governance.

4.3. Hypothesis Three

→ H_0: Non compliance of corporate governance has no impact on the performance of Cadbury Nigeria Plc
→ H_1: Non compliance of corporate governance has impact on the performance of Cadbury Nigeria Plc

Likelihood Ratio Tests				
Effect	Model Fitting Criteria	Likelihood Ratio Tests		
	-2 Log Likelihood of Reduced Model	Chi-Square	df	Sig.
Intercept	9.095[a]	.000	0	.
Q15	32.947[b]	23.852	12	.021
Q19	41.336[b]	32.240	16	.009
Q9	10.475[b]	1.380	8	.995

Table 5

The variable tested (Q15, Q19) were statistically significant at *p* = .021 and 0.009 respectively (the "Sig." column) less than α hence have a strong and positive correlation. It can be inferred that non compliance could lead to a reduced accountability and hence performance. Hence we accept H_1 and conclude that Non compliance of corporate governance has impact on the performance of Cadbury Nigeria Plc.

Model Fitting Information				
Model	Model Fitting Criteria	Likelihood Ratio Tests		
	-2 Log Likelihood	Chi-Square	df	Sig.
Intercept Only	77.306			
Final	9.095	68.210	40	.004

Table 6

From the table, all the variables tested have a strong positive correlation as the significant value p = 0.004 less than α = 0.05, we reject the null hypothesis and conclude that Cadbury Plc does comply with corporate governance.

From the above analysis, the appropriate regression model for this analysis is multinomial logical regression model that Y is related to X_1, X_2, X_3, as

$$Y = B_0 + B_1x_1 + B_2x_2 + B_3x_3 + e \text{ (random error)}$$

The research related questions reveal that corporate governance is practiced in the organization and its impact is felt in the company. The effects are seen as positive and the company also has a code for corporate governance, the code is in effect because the company non-compliance to corporate governance has an impact on the performance of your company. The code is not only in words but is communicated to all members of staff in the company. The respondents also agreed that the adoption of corporate governance has enhanced accountability and transparent disclosure of financial information enhanced timely disclosure of financial information to stakeholders and also improved the performance of Cadbury. Finally, the respondents reported that the board possesses adequate competence necessary to perform their oversight function and internal control policy is one of the tactics they use.

5. Conclusion

It was found that corporate governance variables used for the study had positive association with performance. Specifically, it was established that accurate and reliable financial reporting enhances organizational performance, as good operating results, more than any other factor, strongly motivates managers, just as poor performance alerts all stakeholders on the need to pay closer attention to the operations of the firm. However, the burden of ensuring transparency in financial reporting rests with organizational managers, who have better information and knowledge about the firm's operations. The existence of a company-specific code of conduct built around the contemporary corporate governance principles, which management and employees identify and relate with, helps in strengthening and facilitating the institutionalization of corporate governance. This in turn translates into self-regulating internal controls that induce lowered operating and agency-related costs.

The study shows that the adoption of corporate governance has enhanced accountability and transparent disclosure of financial information enhanced timely disclosure of financial information to stakeholders and also improved the performance of Cadbury.

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