

Corporate Governance and Financial Performance of Quoted Manufacturing Companies in Nigeria

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Abstract. This study explored the effect of corporate governance mechanisms and financial performance of quoted manufacturing companies in Nigeria using 50 listed manufacturing companies on the Nigerian Stock Exchange market within the period of 5 years 2009-2013. The study used six key variable for corporate governance while Return on Assets and Return on Equity were used as a measurement of performance. Based on a regression analysis, results shows that women on board of directors (BWN), number of executive directors (NED) and number of non-executive directors (NNED) have direct relationship with ROA, and these conform with *a priori* expectation. However, only number of directors (NDTS) reported a negative significant impact on ROA. On the part of return on equity (ROE), only of executive directors (NED) reported a positive significant impact on ROE. This study recommended that; industry specific effects should be taken into consideration before formulating codes of corporate governance that determine the characteristics of the board structure.

Keywords: Audit Committee, Board of Director, Corporate Governance, Profitability, Performance

1. Introduction

Often time the growth and development of an economy is much reliant on the joint effort of the economic agents which are individuals, firms and government. For a Nation to improve on its GDP, the performance of firms operating in various industries must be encouraging and advancing. However, several factors could hinder a firm from performing as expected and as a result contributing less to the economic growth. In Nigeria, the role of the manufacturing sector in the national development cannot be overemphasised, however, several factors which include high cost of production, increased exchange rates, increased cost of energy input, poor and inadequate infrastructural facilities, have been identified as some of the factors affecting the performance and effectiveness of firms in the manufacturing industry. While the factors identified above represent external forces affecting the performance of a firm, it is also important to evaluate how

the internal factors and structure of a firm affects its performance. The system by which companies are directed and controlled in the interests of shareholders and other stakeholders which is also known as corporate governance is also an important issue that is crucial to the performance of a firm.

As argued in the literature, corporate governance is a mechanism used in monitoring those parties within a company who control the resources owned by investors for the purpose of promoting corporate performance and accountability. In addition, corporate governance also serves the purpose of increasing the level of confidence and transparency in the company's activities for all investors. The collapse of high profile entities such as Enron Corporation, Worldcom, Tyco, and Parmalat and in Nigeria, cases such as Cadbury have led to contemporary discussions on the best mechanisms for protecting stakeholders' interest and ensuring shareholders wealth maximization. Based on the foregoing, it is important to investigate how corporate governance mechanism affects the performance of a firm. The issue of corporate governance has been given due recognition in the accounting literature (Stephen and Benjamin; 2013), however, not many studies are industry specific while examining the impact of corporate governance on firms' performance, hence this study differ from other studies in that it focuses on firms in the manufacturing sector. Furthermore, this study will empirically explore this subject matter by finding the relationship between some selected corporate governance mechanisms and financial performance of quoted manufacturing companies in Nigeria.

The study is therefore divided into four sections: section one discuss the background

to the study while section two contains literature review. Section three detailed the methodology, analysis and discussion of results while the last section deals with conclusion and policy recommendation.

2. Literature Review

Corporate governance has been conceptualised by different authors as the mechanism used in governing and controlling an organisation (Sanda, Mukaila and Garba 2005; Yinusa and Babalola, 2012; Owolabi, Owolabi, and Olotun, 2013; Momoh and Ukpong, 2013; Okoi, Stephen, and Sani, 2014; Balasingham and Robert, 2015; Duncan and Kabare, 2015)

In the Cadbury 1992 report, corporate governance is defined as the system by which companies are directed and controlled. This definition actually captured what corporate governance means, however, it fails to highlight the key governance components and the actual objective of corporate governance hence, it may be classified as non-comprehensive definition of corporate governance. Organisation for Economic Co-Operation and Development (OECD) defined corporate governance as a key element in improving economic efficiency which involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. This definition actually points out the essence of corporate governance and also highlights the parties involved in corporate governance practices. Hence, this definition is adopted for the purpose of this study. The key components of corporate governance as often discussed in the literature are: The role and responsibilities of the board of directors, the composition and balance of the board of directors, financial reporting, narrative reporting and auditing, Directors'

remuneration, audit committees, risk management and internal control, Shareholders' right and corporate social responsibility.

2.1 Theoretical Framework

This study reviewed theories that point out that there is a positive reinforcing effect on firm performance but for the purpose of this study, agency theory would be the best theories to justify the effect of corporate governance on financial performance of manufacturing companies in Nigeria.

The *agency theory* has its roots in economic theory (Fama, 1980) and it dominates the corporate governance literature. Daily, Dalton and Canella (2003), point to two factors that influence the prominence of agency theory. Firstly, the theory is a conceptually simple one that reduces the corporation to two participants, managers and shareholders. Secondly, the notion of human beings as self-interested is a generally accepted idea.

In its simplest form, agency theory explains the agency problems arising from the separation of ownership and control. It "provides a useful way of explaining relationships where the parties interests are at odds and can be brought more into alignment through proper monitoring and a well-planned compensation system" (Davis, Schoorman and Donaldson 1997). Principal-agent research is concerned with a general theory of the principal-agent relationship, a theory that can be applied to any agency relationship e.g. employer employee Eisenhardt (1989) or lawyer-client describes such research as abstract and mathematical and therefore less accessible to organizational scholars. This stream has greater interest in general theoretical implications than the positivist streams have tended to focus on identifying circumstances

in which the principal and agent are likely to have conflicting goals and then describe the governance mechanisms that limit the agents' self-serving behaviour. This stream has focused almost exclusively on the principal-agent relationship existing at the level of the firm between shareholders and managers. Jensen and Meckling (1976), who fall under the positivist stream, propose agency theory to explain, inter alia, how a public corporation can exist given the assumption that managers are self-seeking individuals and a setting where those managers do not bear the full wealth effects of their actions and decision.

Therefore, agency theory appears to be the mother theory of corporate governance from which other theories have sprung up, though, it still suffers some limitations. One of the limitations is that the stewardship attribute of agents is not taken into cognizance. The theory does not also recognize the existence of other stakeholders' besides the shareholders.

Agency theory would be used in other to determine the effects numbers of meetings attended by board and how large the board size which include the directors, non-executives directors, the executives directors, independent and non-independent executive directors on agency costs because agency theory states that the management and the owners have different interest as such that companies separate the functions of management from ownership would lead to conflicts. The divergence of interest between owners and management lies in maximizing the wealth of the owner with the benefit, incentives will be received by the management.

2.2 Review of Empirical Literature

The board is an important internal mechanism for resolving the agency problems, since it is primarily responsible for recruiting and monitoring the executive management to protect the interests of the shareholders. Many researches' have studied the effect of board size as a measure of the quality of corporate governance on firm performance. Though the Securities and Exchange Commission Code of Corporate Governance in Nigeria (2003) stipulates that the size of a board should not exceed fifteen (15) persons or be less than (5) persons in total, the question still remains on what the optimal size of a board should be. Among other scholars, Kashif (2008) suggest that the board size be chosen with the optimal combination of both inside and outside directors for the value creation of the company.

Ning, Davidson, & Wang (2010) assert that when board size increases, agency problems in the boardroom increase simultaneously, therefore leading to more director free-riding problems and internal conflicts among directors. Drawing from this pattern of thought, agency theory encourages smaller boards because of the ease of decision making and reduced tendency of conflict of interest.

Some empirical evidence shows that meeting frequency is an important dimension of an effective board. Danoshana and Ravivathani (2013) reviewed in their study that the case of ROA with Meeting Frequency, coefficient is -0.271, test of p-value is $0.0001 < 0.05$. This result depicts that, Meeting Frequency has a significant negative impact on ROA and an increasing in meeting frequency will reduce the ROA by 27% and in the case of ROE, Coefficient is -0.977, test of p-value is $0.0000 < 0.05$. Significant negative impact relationship exists between Meeting Frequency and ROE

and ROE will have 98% negative impact due to the increases in Meeting Frequency. So meeting frequency has significant impact on the firm performance of financial institutions. Therefore, their study reveals that, increasing Meeting Frequency will result poor financial performance, because of increases in cost of management.

3. Methodology

The study therefore covers six keys governance variables which are (Numbers of Directors, Numbers of Non-Executive Directors, and Numbers of Women on board, Numbers of Executive Directors), Board Size, and Numbers of Board Meeting. An empirical model is formulated which is based on the use of panel data methodology. This study employs panel data analysis which is a combination of time series and cross sectional data analysis because it is the most useful for it. This study also would adopt the models of Kajola (2008) which specifies the model given below:

$$Y_{it} = \beta_0 + \beta_1 F_{it} + e_{it} \quad (i)$$

Where:

Y_{it} = Dependent variable (Financial Performance)

β_0 = Constant

β_1 = Coefficient of the explanatory variable (corporate governance mechanism)

F_{it} = Explanatory variable in the estimation model

e_{it} = Error term (assumed to have zero mean and independent across time period)

Also, for the purpose of this study below are the models representing each of the hypothesis;

H₁: Board size does not have significant influence on the performance on manufacturing firms in Nigeria.

$$\text{FinPerf}_{it} = \beta_0 + \beta_1 \text{Bsize}_{it} + e_{it} \quad (ii)$$

H₂: Numbers of board meetings has no significant impact on manufacturing firm's financial performance in Nigeria.

$$\text{FinPerf}_{it} = \beta_0 + \beta_2 \text{NMEET}_{it} + e_{it} \quad (\text{iii})$$

H₃: Corporate governance has significant impact on financial performance of manufacturing companies in Nigeria.

$$\text{FinPerf}_{it} = \beta_0 + \beta_2 \text{NDTS}_{it} + e_{it} \quad (\text{iv})$$

$$\text{FinPerf}_{it} = \beta_0 + \beta_2 \text{BWN}_{it} + e_{it} \quad (\text{v})$$

$$\text{FinPerf}_{it} = \beta_0 + \beta_2 \text{NED}_{it} + e_{it} \quad (\text{vi})$$

$$\text{FinPerf}_{it} = \beta_0 + \beta_2 \text{NNED}_{it} + e_{it} \quad (\text{vii})$$

Therefore, the mathematical model is expressed below:

$$\text{FinPerf}_{it} = f(\text{corporate governance variables, control variables})$$

The regression model for the empirical analysis is therefore given as follows:

$$\text{FinPerf}_{it} = \beta_0 + \beta_1 \text{Bsize}_{it} + \beta_2 \text{NMEET}_{it} + \beta_3 \text{NDTS}_{it} + \beta_3 \text{BWN}_{it} + \beta_3 \text{NED}_{it} + \beta_3 \text{NNED}_{it} + \beta_4 \text{goppt}_{it} + e_{it} \quad (\text{vii})$$

Where;

Dependent Variables

FinPerf_{it}: Two variables were used to measure performance to determine the strength. The variables which are captured as proxies of performance in this study include:

ROE_{it}: return on equity (profit after tax/total equity shares in issue) for company *i*(cross sectional) in time *t*

ROA_{it}: return on assets (profit after tax/total assets) for company *i*(cross sectional) in time *t*

Independent Variables

BSIZE_{it}: board size (number of directors on the board) for company *I* (cross sectional) in time *t*

NMEET_{it}: Frequency of board meeting (numbers of meetings attended) for company *i* (cross sectional) in time *t*

NDTS_{it}: Numbers of the Directors of the company in time *t*

BWN_{it}: Numbers of women on board of the company *i* (cross sectional) in time *t*

NED_{it}: Numbers of Executives Directors of the company *i* (cross sectional) in time *t*

NNED_{it}: Numbers of Non-Executives Directors of the company *i* (cross sectional) in time *t*

Control Variable

Growth (GOPPT): Is measured by the percentage change in the value of the asset. The Ordinary Least Square panel regression model is the estimation techniques adopted in this study. Initially equation 1 above assumed a simplest approach by running pooled regression. However, in order to account for the deficiency of over simplification associated with the pooled regression, the fixed and the random effects ordinary least square estimation conducted.

A prior expectation of the study explains the anticipated outcome of an occurrence. In this regard, it explains the anticipated outcome of the research hypotheses. Thus, it is expected that corporate governance mechanism have positive or negative impact on financial performance of manufacturing firms in Nigeria. Board size and the numbers of meetings are expected to have significant impact on firm's performance; they are likely to be influence by growth of the firm which would enhance their performance. Also, it is expected that frequency of board meeting would likely have a negative impact on financial performance of the firm because its increases the cost since agency cost reduce the performance of firms.

4. Analysis and Discussion of Result

This section of the research study dealt with descriptive and econometric analysis of the effects of corporate governance on financial performance of 50 listed manufacturing

companies on the Nigerian Stock Exchange market within the period of 5 years 2009-2013. The time frame for the analysis is chosen based on availability of data from various sources. The data sourced for the analysis of this study are presented and employed to estimate the panel regression model specified in the previous section using the E-Views version 9.1.

The descriptive characteristics of the 50 pooled-company data employed in the estimation of the panel static regression models for corporate governance and financial performance is shown on Table 1, while Table 2 presents the correlation matrix. The trend review of some of the data is resented at the Appendix A. The summary statistics of the pooled data for 50 selected companies shown on Table 1 indicate the average, maximum, minimum, standard deviation, skewness, Kurtosis, Jarque-Bera and coefficient of variation of all the variables between 2009 and 2013.

The average values of return on asset (ROA) and return on equity (ROE) are 0.0353 and -0.00462 respectively. Both financial profitability indicators have their minimum value to be negative with -1.729 and -1.655 respectively, indicating the low performance rate of the listed companies. On the part of corporate governance, the average value of number of directors (NDTS), number of women on board of directors (BWN), number of executive directors (NED) and number of non-executive directors (NNED) are 9.31, 1.34, 1.94 and 7.61 respectively.

The average value of number of meeting (NMEET) is 5.088. Their minimum values are relatively lower to their mean values. The mean value of board size representing total asset (BSIZE) and growth opportunity (GOPPT) are 38,547,133 and -3.37 respectively.

In addition, the standard deviation reports the rate at which these variables deviate from their individual mean values. Return on asset (ROA), return on equity (ROE), total asset (BSIZE), and growth opportunity (GOPPT) have high deviate rate in varying magnitude from their means, as their standard deviation values are greater than average values. Moreover, return on asset (ROA), return on equity (ROE), growth opportunity (GOPPT) and number of meeting (NMEET) were found to be negatively skewed with a value of -4.8, -15.5, -3.99 and -0.17 respectively, whereas, other variables reported rightward skewness. As well, the Kurtosis identified 3.0 suggesting the normal distribution of these corporate governance and financial performance indicators and their determining variable factors. From the table, none of the variables are normally distributed except for number of non-executive directors (NNED) which approximately equal to three (3). Of all the other variables, five (5) are leptokurtic in nature while the remaining two (2) are platykurtic. More so, the Jarque-Bera statistics revealed that all the indicators are significant at 0.05 critical values denoting that they are normally distributed.

Table 1: Descriptive Statistics for 50 selected companies on NSE Market Pooled Data

	Mean	Max.	Min.	Std. Dev.	Skewness	Kurtosis	Jarque-Bera	Prob.	Obs.
ROA	0.0353	0.3879	-1.729	0.1987	-4.800	38.368	12759.3	0	228
ROE	-0.0046	0.1228	-1.655	0.1058	-15.454	241.699	596222.4	0	247
NDTS	9.3146	17	3	2.8965	0.3332	2.6109	5.7556	0.05	232
BWN	1.3387	4	1	0.6488	1.8704	5.7340	110.92	0	124
NED	1.9361	9	1	1.3047	2.1802	9.2489	529.82	0	219
NNED	7.6087	17	3	2.8352	0.5893	3.0310	13.320	0.001	230
BSIZE	385473	6.7E+08	68934	785443	4.4825	29.469	7484.62	0	230

GOPPT	-3.3725	33.165	-100	20.6423	-3.9918	19.171	3103.35	0	229
NMEET	5.088	6	4	0.8874	-0.1724	1.2969	31.454	0	250

Source: Author’s computation (2016).

The Table 2 reveals the partial correlation between the indicators of corporate governance and financial performance. From the two financial performance indicators (ROA&ROE) and corporate governance indicators (NDTS, BWN, NED, NNED), the magnitudes of their various relationships are low, where none of them (independent variables) are up to 0.6, although, positive and negative signs vary among them. Other indicators that reported high correlation values with financial performance was between ROE and BSIZE (0.865). The strongest associations among the variables are fairly moderate with either a positive or negative value. Furthermore, some degree of correlation is expected among determining indicators since they are mostly employed to enhance financial performance. Nevertheless, the moderate to low degree of association among the variables make them suitable for the analysis.

Table 2: Correlation Matrix

	ROA	ROE	NDTS	BWN	NED	NNED	BSIZE	GOPPT	NMEET
ROA	1.000								
ROE	0.559	1.000							
NDTS	0.277	0.550	1.000						
BWN	-0.073	-0.004	0.045	1.000					
NED	0.350	0.402	0.525	0.616	1.000				
NNED	-0.125	0.105	0.556	-0.537	-0.353	1.000			
BSIZE	0.375	0.865	0.575	0.051	0.395	0.187	1.000		
GOPPT	0.073	-0.020	0.101	0.046	0.169	-0.007	-0.018	1.000	
NMEET	0.285	0.074	0.194	0.020	0.121	0.083	0.068	0.230	1.000

Corporate governance has significant impact on financial performance of manufacturing company in Nigeria

The fixed effect methods were employed in estimating the panel regression models that examined the impact of corporate governance on financial performance of 50 listed manufacturing companies on the NSE market. The estimated coefficients between the fixed and random effects’ models were compared using the Hausman test with the null hypothesis “random effects are uncorrelated with the explanatory variables”.

Table 3:

Fixed Effect Results of Corporate Governance Indicators and Financial Performance of 50 Listed Manufacturing Companies on NSE Market (Pooled Result)

Dependent Variable:	Financial Performance	
	ROA Model	ROE Model
Constant	-0.02778 (0.03351)	-0.0085 (0.0214)
NDTS	-0.02965 (0.0119)**	-0.0048 (0.0076)
BWN	0.02405 (0.01971)	-0.00062 (0.0126)
NED	0.04113 (0.01543)*	0.0076 (0.0099)
NNED	0.01846 (0.01203)	-0.0056 (0.0027)**

Adjusted R²	0.4345	0.3919
S.E. of Reg.	0.1662	0.1061
F-stat	2.3379*	3.1907*
Hausman Test	18.865**	15.702**
No of Obs.	250	250
Cross-Section	5	5

Source: Author's computation (2015).

*Heteroskedasticity-consistent standard errors in parenthesis; Statistical significant coefficients at 10%, 5% and 1% respectively are denoted by ***, ** and *. All regressions use the fixed cross-section effects no weights standard errors and covariance (d.f. corrected).*

The Hausman test result presented in Table 4.6a reveals that we do reject the null hypotheses for all the considered models at either 1%, 5%, or 10% significance levels based on the calculated Chi-Square values. The fixed effect model was found more consistent and efficient for the purpose of this study. Also, two forms of estimated panel regression models were reported for this hypothesis with respect to return on asset (ROA) and return on equity (ROE). The fixed regression results of corporate governance on return on asset and return on equity as measures of financial performance models were reported on Table 4.6a above.

The estimated model for ROA indicate that women on board of directors (BWN), number of executive directors (NED) and number of non-executive directors (NNED) have direct relationship with ROA, and these conform with a priori expectation. On the basis of impact intensity, 10 units increase in BWN, NED and NNED improves return on asset by a 0.24%, 0.41% and 0.19% points respectively. NED was found to be significant at 0.05 critical levels. However, only number of directors (NDTS) reported a negative significant impact on ROA with a 0.30% point increase due to a 10 units increase. The F-test shows that there is significant relationship between

corporate governance and return on asset in Nigerian manufacturing industry.

On the part of return on equity (ROE), only of executive directors (NED) reported a positive significant impact on ROE with a 0.08% point decrease due to a 10 units increase. In addition, number of directors (NDTS), women on board of directors (BWN) and number of non-executive directors (NNED) have indirect relationship with ROE, and these does not conform with a priori expectation. On the basis of impact intensity, 10 units increase in NDTS, BWN and NNED deteriorates return on equity by a 0.05%, 0.006% and 0.06% points respectively. NNED was found to be significant at 0.05 critical levels. The F-test shows that there is significant relationship between corporate governance and return on equity in Nigerian manufacturing industry. Thus, there is significant relationship between corporate governance and financial performance of Nigerian manufacturing industry.

4.1 Discussion

The study reports that a mixed outcomes between corporate governance indicators and financial performance in Nigerian manufacturing companies with different indicators of boards size. Indicators such as women on board of directors, number of executive directors, and number of non-executive directors have positive impact on ROA of manufacturing companies in Nigeria. Also, with a priori expectation and agency theory as these indicators are expected to enhance firms' ability to efficiently allocate and manage their

companies' resources. The Nigerian manufacturing industry satisfies the stipulated numbers of board by the Securities and Exchange Commission Code of Corporate Governance in Nigeria (2003) in terms of minimum number of 5 persons, although with varying composition. However, the maximum numbers stated at 15 persons were not followed as some manufacturing companies have more than the stipulated value (see maximum value in Table 4.1). The negative impact indicated by number of directors (NDTS) (with a maximum number of 17 persons) on ROA supports Ning, Davidson, & Wang (2010) assertion that "when board size increases, agency problems in the boardroom increase simultaneously, therefore leading to more director free-riding problems and internal conflicts among directors".

The number of meeting has a negative significant impact on ROA and ROE with a co-efficient of -0.0056 and -0.0090 respectively. This suggests that number of meetings has a significant impact on the financial performance of organization, which is in line with the findings of Danoshana *et.al* (2013).

In respect to ROE, the study shows that the number of non-executive directors and number of executive directors have negative impact on ROE. Although, number of executive directors reported inconsistent sign but it is considered to have a negative impact on ROE. It also follows the argument raised by Ning, *et.al* (2010) that the higher the board size, the problem of agency in the boardroom increase simultaneously since decision tends to be delayed. This revealed that the findings negate the assertion of Ming-Feng and Shioh-Ying (2015) that institution with high shareholding proportion or great shareholding concentration gives managers incentives to manipulate

discretionary accruals for short-term profitability.

Nevertheless, number of directors, and number of women on board of directors have positive impact on ROE. The study shows that women participation as part of board member has greater impact on financial performance evidenced from both ROA and ROE. Also, there is inconsistency in financial performance measure and number of directors as a negative and positive relationship was reported with ROA and ROE respectively. The positive relationship of number of directors and ROE is consistent with Ming-Feng, *et.al* (2015) postulation that "the bigger the board size, the more ability for the board to monitor whether the managers conduct earnings management behaviour or not".

5. Conclusion

Based on the discussion of findings stated in the above sub-section it was observed that there is a mixed outcome in terms of relationship between corporate governance and financial performance as different indicators used as proxy them. Irrespective of these differences, women participation as board members has significant impact on manufacturing performance. This study supports the agency theory that corporate governance enhances firms' ability to efficiently allocate and manage their companies' resources; and the number of meeting has an indirect impact on financial performance, suggesting that the lower the number of meetings, the better the financial performance of manufacturing industry. The study also revealed that number of board meetings enhance financial profitability. The bigger the size of the total assets of a manufacturing industry the better it grows and attract a good performance.

6. Recommendations

Over the reviewed period under study, several implications have degenerated from empirical results of this research study. However, to make certain that financial performance are greatly improved upon in the manufacturing industry; the following policy options are recommended:

Firstly, industry specific effects should be taken into consideration before formulating codes of corporate governance that determine the characteristics of the board structure. The Securities and Exchange Commission should take into cognizance this condition in formulating a code of corporate governance.

Secondly, the Corporate Governance Committee of companies should endeavour to do a regular appraisal of their corporate governance compliance status as it affects performance. This is because the study is able to identify that corporate governance has an impact on firm performance.

Conclusively, diminishing profits should be investigated because it is apparent that there are scenarios where profits keep reducing till they eventually turn to losses.

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