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Effect of Corporate Governance on Financial Performance: Evidence From the Construction and Real Estate Companies in Nigeria

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Abstract: This study examined the effect of corporate governance on financial performance: Evidence from the construction and real estate companies in Nigeria. The ex post facto research design was adopted for the study with a population of six (6) listed construction and real estate companies in Nigeria as listed by the Nigerian Exchange Group in 2022. Data were retrieved from the annual reports of the selected construction and real estate companies for the period 2017 to 2021. Multiple regression analysis was used to analysed the data gathered with the aid of Stata12 statistical software. The study revealed a positive but insignificant effect of board size on net profit margin. A negative and insignificant effect of board independence on net profit margin and a positive and significant effect of audit committee on net profit margin. The study recommended that more financially literate board should be advocated for than the size of the board. The non-executive directors in the board composition should be reviewed from time to time so as to ensure they are truly independent. And finally, that audit committees of listed construction and real estate companies should be proactive in ensuring full compliance to corporate governance code 2018 for enhance financial performance.

Keywords: Corporate Governance, Board Size, Board Independence, Audit Committee, Financial Performance, Net profit Margin.

1. Introduction

Financial performance has been highly sort for by corporate organisations as an evidence for growth. It is viewed as the efficient and effective use of resources by a firm for the achievement of corporate objectives resulting in the increase in share price, market share, profitability and meeting the hopes of numerous stakeholders (Ibrahim & Abdullahi, 2019). Owners (shareholders) of businesses requires services of qualified personnel to drive home this goal. Firms can achieve its goal and increase financial performance if there is in place a good corporate governance practice. Corporate governance is needed to align the interest of owner and managers. The key elements of corporate governance are a concern with the enhancement of corporate performance via the supervision, or monitoring, of management performance and ensuring the accountability of management to shareholders and another stakeholder base on the regulatory framework (Keasey & Wright, 1997; Arora & Bodhanwala, 2018). Good governance practices would possibly have a significant impact on company performance with strategic decisions and effective monitoring conducted by the board of directors.

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In Nigeria, the new code of corporate governance 2018 requires a mandatory implementation. The implementation of this Code will be monitored by the Financial Reporting Council of Nigeria (FRC) through the sectoral regulators and registered exchanges who are empowered to impose appropriate sanctions based on the specific deviation noted and the company in question. The board of directors as the center of corporate ethic, in most cases involved in unethical practices. Certain boards of directors and audit committees failed to constrain "creative" accounting so as to keep up their earnings numbers to favour the shareholders and executives. This act has contributed immensely to the collapse of most corporate organizations.

The construction and real estate companies in Nigeria are not in exception to this. The industry has witnessed some setbacks. With the continuous collapse of buildings in Nigeria, architects want authorities to strengthen the corporate governance in the construction and real estate industry (The Guardian, 2022). From the collapse of Enron, Parmalat and WorldCom it has been highlighted that even reputable boards may struggle to effectively monitor executive directors. The causes of failed supervision range from critical information asymmetries on boards to the inability of non-executive directors to monitor powerful CEOs. To curb this ugly situation, regulators and practitioners have advocated for board independence in corporate governance codes and corporate legislation as a means to enhance board control.

Corporate governance and its effect on financial performance has been a relevant topic discussion amongst scholars and researchers alike. Studies have been carried in various sectors on corporate governance and financial performance (Kiptoo et al., 2021; Islami et al., 2020; Ayodeji & Okunade, 2019; Joshua et al., 2019; Musah & Adutwumwaa, 2021; Okoye et al., 2020). These studies resulted in diverse findings. This present study aims to provide empirical evidence from the construction and real estate sector in Nigeria, thereby examined the effect of corporate governance on financial performance of listed construction and real estate companies in Nigeria.

Operational Framework

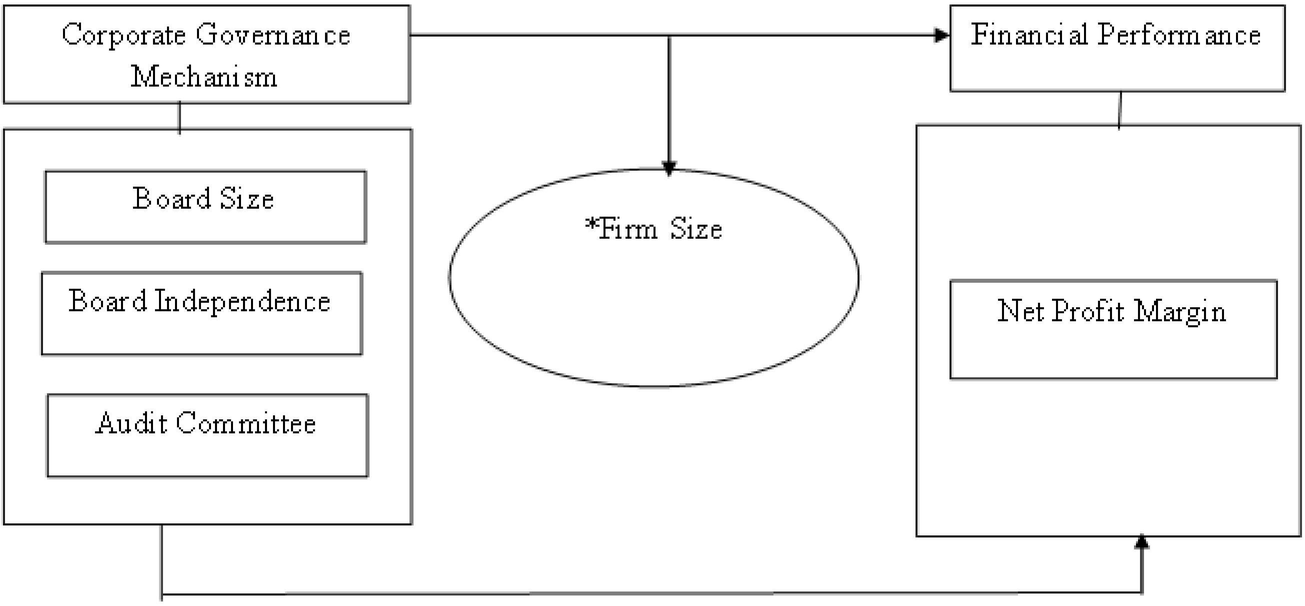

Figure 1: Operational Framework of Corporate Governance and Financial Performance

Sources: Ayodeji & Okunade, 2019; Islami et al., 2020; Joshua et al., 2019; Kiptoo et al., 2021; Musah & Adutwumwaa, 2021; Okoye et al., 2020.

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The following research hypotheses were stated in a null form;

$H_0$1 There is no significant effect of board size on net profit margin of listed construction and real estate companies in Nigeria.

$H_0$2 There is no significant effect of board independence on net profit margin of listed construction and real estate companies in Nigeria.

$H_0$3 There is no significant effect of audit committee on net profit margin of listed construction and real estate companies in Nigeria.

2. Literature Review

Corporate Governance

Corporate governance can simply be defined as a system or mechanism by which companies are directed and controlled (Cadbury, 2002). Also, The Organization for Economic Co-operation and Development (OECD, 1999) defined 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 participants in the corporation and spells out the rules and procedures for making decisions on corporate affairs. Omesi and Ordu (2021) viewed corporate governance to consist of structures, systems and processes utilized by the various organ of the firm as an effort to provide value added to the firm, sustainable in the long term by taking into consideration the interest of the stakeholders. Similarly, corporate governance is defined as the processes and procedures utilized to direct and manage the activities and events of a firm to balance the achievement of corporate objectives with the alignment of corporate behaviour to the expectation of the society and accountability and transparency to shareholders and stakeholders (Christiana & Alexander, 2018).

Board Size

The board of directors is saddled with the responsibility to drive organization's corporate governance standard and create long term value. Having a board that will develop a process that will ensure full corporate governance, industry best practices and growth that will take the organization to the next level is the focus now. When these objectives are achieved, they provide guarantee and tangible assurance to investors that their investment are secure and to the buyers that their funds will not be mismanaged (Idowu, 2020).

The corporate governance Code, 2018 does not prescribe a minimum or maximum board size. As recommended by the corporate governance Code 2018, "the effective discharge of the responsibilities of the Board and its committees is assured by an appropriate balance of skills and diversity (including experience and gender) without compromising competence, independence and integrity". In such well managed organisations, the interests of the Board and management are aligned with those of the shareholders and other stakeholder (Corporate Governance Code, 2018). Board size denotes the total number of directors in a board who are in possession of voting rights. There are diverse findings toward board size. Some study revealed that large board size contributes positively in harnessing knowledge, opinions and quality proposals that would culminate in enhance financial performance (Lekgotho, 2018; Fratini & Tettamanzi, 2015) where others favoured a small size for efficient and timely resolution on issue (Zabri et al., 2015; Maune, 2017).

Board Independence

The board of directors holds fiduciary responsibilities to lead and direct a company and ensure the correctness of management's approach in transforming the corporate goals. Thus, it is critical for the

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company to ensure that the board composition is independent of management. The inclusion of outside executives on the board is termed "board independence". This plays a vital mechanism to test the efficacy of a board (Ayodeji & Okunade, 2019). In the view of Boshnak (2021), the appointment of independent directors is an important means of minimizing the potential conflict between principals and agents and should thereby improve the financial performance of the firms.

Audit Committee

An audit committee is an important corporate governance mechanism in firms which protect the interests of shareholders and oversee financial reporting (Mallin, 2006). It is a key monitoring mechanism, both in respect of shareholders and for other stakeholders' interests. The composition of audit committee is referred to as the number of directors appointed to be members of the audit committee, in this regard there could be small, medium and large audit committee (Boshnak, 2021). As recommended by corporate governance code (2018), subject to the provisions of extant laws, every public company should establish a statutory audit committee which shall perform the following functions: i. Ascertain whether the accounting and reporting policies of the Company are in accordance with legal requirements and agreed ethical practices. .ii Review the scope and planning of audit requirements. .iii Review the findings in management letter in conjunction with the external auditor and management responses thereon. .iv. Keep under review the effectiveness of the Company's system of accounting and internal control. v. Make recommendations to the Board regarding the appointment, removal and remuneration of the external auditors of the Company. .vi. Authorise the internal auditor to carryout investigations into any activities of the Company which may be of interest or concern to the committee.

Financial Performance

Chepkemoi (2013) opined that financial performance highlights the status of an organization's financial output, emanating from management decisions which are executed by the personnel in various departments. The firm's level of goal achievement in terms of shareholders wealth maximization is well articulated by the information presented in the financial statements (Chimaleni et al., 2015). It is viewed as the efficient and effective use of resources by a firm for the achievement of corporate objectives resulting in the increase in share price, market share, profitability and meeting the hopes of numerous stakeholders (Ibrahim & Abdullahi, 2019).

Net Profit Margin

Net Profit Margin Ratio" is a financial ratio used to calculate the percentage of profit a company produces from its total revenue. It is also seen as the percentage of revenue left after all expenses have been deducted from sales. Net profit margin measures the amount of net profit a company obtains per naira of revenue gained. Net profit margin helps investors assess if a company's management is generating enough profit from its sales and whether operating costs and overhead costs are being contained. It is a key indicator of the financial health of an organization (Murphy, 2021).

Theoretical framework

The theoretical framework of this study is anchored on the resource dependency theory. The proponent of this theory is Pfeffer in 1978. The resource dependency theory is the result of studies on Board composition by sociologists who have focused on the study of interlocking directorates and their implication on institutional and societal power. Resource dependency theory concentrates on the role of board directors in providing access to resources needed by the firm (Abdullah & Valentine, 2009). Corporate Board are viewed as means to manage external dependency (Pfeffer and Salancik, 1978), reduce environmental uncertainty (Pfeffer, 1972) and transaction costs associated with the environmental

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interdependency. Each director may bring different linkages and resources to a Board. Board composition will thus theorize to reflect a matching of the dependencies facing an organization to the resources acquisition potential of its Board members (Hillman et al, 2000).

Empirical Review

A study by Kiptoo et al. (2021) on corporate governance and financial performance of insurance firms in Kenya used data collected from 51 for 2013-2018. The study concluded that corporate governance significantly affects the financial performance of insurance firms. Also, the findings showed that board composition negatively and significantly affects financial performance.

Musah and Adutwumwaa (2021) examined the effect of corporate governance on financial performance of rural banks in Ghana. Descriptive statistics, correlation analysis and regression analysis were used in data analysis. The study revealed a positive but statistically insignificant association between CEO duality and ROA and ROE. The study further revealed a positive association between board size and ROA and ROE even though that of ROA was statistically insignificant. Also, board independence was found to be a significant determinant of rural bank financial performance.

Islami et al. (2020) examined the effect of corporate governance on financial performance of Islamic banking in Indonesia. The data were collected from each bank's annual report in a period 2014-2018, thus 9 Islamic Banks were taken by purposive sampling. Path analysis was used for data analysis and the result revealed that board of director had significant influence to ROA, however independent commissioner and sharia supervisory board had no significant influence to ROA, on the other hand only independent commissioner and ROA had significant influence to EVA.

Okoye et al. (2020) examined the effect of corporate governance on the financial performance of commercial banks in Nigeria. The ex-post facto design was adopted for the study. data were retrieved from the Financial statements of the selected banks for the period 2003–2016. The Generalized Method of Moments (GMM) analytical technique based on STATA 13 statistical procedure was used to analyse the data. The study revealed that board size, directors' equity, and firm size substantially affect Nigerian banks' financial performance. Besides, the study showed a robust effect of lagged return on equity on the current level of performance. Therefore, the study asserts that governance in business entities strongly affects their financial performance**.**

Ayodeji and Okunade (2019) examined the relationship between board independence and financial performance of deposit money banks in Nigeria and Canada. The panel data methodology was used with a blend of time-series and cross-sectional features. The study applied secondary data extracted from annual financial statements of Deposit Money Banks quoted on the Nigerian Stock Market and in the Canadian stock market between the ten years period of 2008 and 2017. The study revealed the existence of a significant relationship between board independence and profitability of deposit money banks in Nigeria and Canada. It also revealed that audit committee independence promoted financial performance of the deposit money banks in Nigeria while in Canada it was positive and insignificant.

Joshua et al. (2019) examined the effect of corporate governance on financial performance of listed deposit money banks in Nigeria for 2007–2016. Data were obtained from the annual financial reports of selected banks. Data were presented using tables and analysed using panel data regression. The findings of the study revealed that board size had a positive but insignificant relationship with performance. It was also observed that audit committee, board composition and bank size all had positive and significant relationships with return on asset.

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3. Methodology

Ex-post facto research design was adopted for this study with a population of six (6) listed construction and real estate companies in Nigeria as listed by the Nigerian Exchange Group in 2022. The entire population was used as the sample size of the study using the census approach. Data were retrieved from the annual reports of the selected listed construction and real estate companies for the period 2017 to 2021. However, Roads Nig Plc. did not have a complete set of data for the period and was excluded resulting in 50 firm year observations. Multiple regression analysis was used to test the formulated hypotheses computed with the aid of Stata12 statistical software.

Model specification

Panel Regression Model

FP= f(BOS+ BOI+ AUC+ FSZ+μ)………………………(3.1)

NPM= f(BOS+ BOI+ AUC+ FSZ+μ)………………………(3.2)

Therefore, the model is

$NPM_{it} = \alpha_0 + \alpha_1 BOS_{it} + \alpha_2 BOI_{it} + \alpha_3 AUC_{it} + \alpha_4 FSZ_{it} + \varepsilon_{it}$ -------------(3.3)

Operational Measurement of variables

Net Profit Margin (NPM): Net Profit margin = $\frac{Profit\ After\ Tax}{Total\ Revenue} * 100$

Board Size (BOS): Total number of board of directors which comprises both executive, non-executive directors and independent directors. This number is obtained from the annual report.

Board Independence (BOI): It is measure as the total number of independent and non-executive directors. This number is obtained from the annual report.

Audit Committee (AUC): It is measure as the number of persons or members that comprises the statutory audit committee. This number is obtained from the annual report.

Firm Size (FSZ): It is measured as the natural logarithm of total asset.

4. Results/findings

Table 1: Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
bos	50	7.32	2.510712	5	13
boi	50	4.16	1.419399	2	7
auc	50	5.06	.8184106	4	6
npm	50	-.9586565	150.8745	-802.6203	118.6165
fsz	50	16.72971	1.695361	14.64753	19.93543

Source: Output from STATA version 12

The table 1 above shows that the average mean of board size (bos) generated by the sample firms is 7.32 with a minimum of 5 and maximum of 13, and a standard deviation of 2.51. This shows that a board size

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that is neither too small or too large. Table 1 above also shows that the average mean of board independence (boi) generated by the sample firms is 4.16 with a minimum of 2 and maximum of 7 and a standard deviation of 1.42. Audit committee (auc) shows an average mean of 5.06% with a minimum of 4 and maximum of 6; and a standard deviation of 0.82. Also, table 1 above shows that net profit margin (npm) has an average mean of -0.96% with a minimum of -802.62% and maximum of 118.6% with a standard deviation of 150%. This shows that this industry is profitable as represented by its minimum and maximum values. Furthermore, table 1 shows that the average mean of firm size (fsz) generated by the sample firms is 16 with a standard deviation of 1.69 and a minimum of 15 and maximum of 20 approximately.

Table 2: Test of Multi-Collinearity

Variable	VIF	1/VIF
bos	8.35	0.119794
boi	6.56	0.152489
fsz	3.42	0.291973
auc	2.00	0.499486
Mean VIF	5.08	

Source: Output from STATA version 12

From table 2 above on the test of multicollinearity among the independent variables, it revealed that the variance inflation factor value is well below 10. Therefore, independent variables used in this study do not suggest multicollinearity problem.

Table 3 below explains hypotheses one, two and three

Table 3: Regression Result on $NPM_{it} = \alpha_0 + \alpha_1 BOS_{it} + \alpha_2 BOI_{it} + \alpha_3 AUC_{it} + \alpha_4 FSZ_{it} + \varepsilon_{it}$ -----(3.3)

Source	SS	df	MS
Model	175994.139	4	43998.5348
Residual	939398.935	45	20875.5319
Total	1115393.07	49	22763.124

Number of obs =	50
F(4, 45) =	2.11
Prob > F =	0.0955
R-squared =	0.1578
Adj R-squared =	0.0829
Root MSE =	144.48

npm	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
bos	29.44346	23.75231	1.24	0.222	-18.39615	77.28308
boi	-51.44933	37.23893	-1.38	0.174	-126.4524	23.55373
auc	-83.97373	35.68518	-2.35	0.023	-155.8474	-12.10008
fsz	9.353201	22.53135	0.42	0.680	-36.02726	54.73366
_cons	265.9751	271.6437	0.98	0.333	-281.1433	813.0936

Source: Output from STATA version 12

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Hypothesis One

$H_0$1: There is no significant effect of board size on net profit margin of listed construction and real estate companies in Nigeria.

Table 3 above shows the Model fitness at Prob (F-statistic) = 0.0955. The independent variables explained the variation in construction and real estate financial performance by 16% approximately. Also, it reveals a positive but insignificant effect of board size on net profit margin (p-value=0.222). This implies that that a 1% increase in board size will bring about 29% increase in net profit margin. This led to the acceptance of (**Ho1**) that there is no significant effect of board size on net profit margin of listed construction and real estate companies in Nigeria.

Hypothesis Two

$H_0$2: There is no significant effect of board independence on net profit margin of listed construction and real estate companies in Nigeria.

Table 3 above reveals a negative and insignificant effect of board independence on net profit margin (p-value=0.174). This implies that that a 1% increase in board independence will bring about 51% decrease in net profit margin. This led to the acceptance of (**Ho2**) that there is no significant effect of board independence on net profit margin of listed construction and real estate companies in Nigeria.

Hypothesis Three

$H_0$3: There is no significant effect of audit committee on net profit margin of listed construction and real estate companies in Nigeria.

Furthermore, Table 3 above it reveals a positive and significant effect of audit committee on net profit margin of listed construction and real estate companies in Nigeria (P-value=0.023). This implies that a 1% increase in audit committee will bring about 84% decrease in net profit margin, all other variables held constant. This led to the rejection of (**Ho3)** and conclusion that there is a significant effect of audit committee on net profit margin of listed construction and real estate companies in Nigeria.

5. Discussion of findings

The study revealed a positive but insignificant effect of board size on net profit margin which led to the acceptance of (Ho1) that there is no significant effect of effect of board size on net profit margin of listed construction and real estate companies in Nigeria. This finding is in line with the finding of Joshua et al. (2019) that revealed that board size had a positive but insignificant relationship with performance. This finding is further corroborated by the work of Musah and Adutwumwaa (2021); and Onakoya et al. (2014) that concluded that the association between board size and ROA is positive and statistically insignificant. This finding implies that irrespective of the board size, construction and real estate company's financial performance remain untouched instead more financially literate board should be advocated for. This finding is in contrast with the conclusion of Okoye et al. (2020) that board size, directors' equity, and firm size substantially affect Nigerian banks' financial performance.

Also, the study revealed a negative and insignificant effect of board independence on net profit margin that led to the acceptance of (Ho2) that there is no significant effect of board independence on net profit margin of listed construction and real estate companies in Nigeria. This finding is in line with the finding of Islami et al. (2020) that concluded that independent commissioner and sharia supervisory board had no significant influence to financial performance but contradicted the finding of Ayodeji and Okunade (2019) that revealed the existence of a significant relationship between board independence and profitability of deposit money banks in Nigeria and Canada.

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Furthermore, the study revealed a positive and significant effect of audit committee on net profit margin that led to the rejection of (Ho3) and conclusion that there is a significant effect of audit committee on net profit margin of listed construction and real estate companies in Nigeria. This finding is in line with the finding of Joshua et al. (2019) that observed that audit committee, board composition and bank size all had positive and significant relationships with financial performance. This finding is corroborated by the finding of Kiptoo et al. (2021). It contradicts the finding of Al-Homaidi et al. (2019) that revealed an insignificant effect of audit committee size, and audit committee diligence on net interest margin. It also disagrees with the finding of Olayiwola (2018) that concluded that audit committee size had an insignificant correlation with net profit margin.

6. Conclusion

Corporate governance mechanism within a firm is essential for its growth as it specifies the distribution of rights and responsibilities among different participants in the corporation and spells out the rules and procedures for making decisions on corporate affairs. So, a weak governance structure is detrimental to the firm's performance. Therefore, this study concluded that board size and board independence have an insignificant effect on net profit margin whereas audit committee revealed a significant effect on net profit margin.

7. Recommendations

The following recommendations were made in respect to the findings;

a. More financially literate board should be advocated for than the size of the board as this study revealed that board size has a positive but insignificant effect on financial performance.

b. The non-executive directors in the board composition should be reviewed from time to time so as to ensure they are truly independent.

c. Audit committees of listed construction and real estate companies should be proactive in ensuring full compliance to corporate governance code 2018 for enhance financial performance.

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