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Corporate Governance and Share Price: Evidence from listed Firms in Nigeria

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Abstract

Most companies in Nigeria adopt corporate governance practices without really knowing the resultant effects on share price. Although there have been numerous research efforts on corporate governance and company performance in Nigeria, little has been done concerning finding out the effects of the corporate governance practices of listed Nigerian companies on share price, which is one of the most obvious aspects of company affairs. This study therefore aims to find out the relationship between corporate governance practices and share price. The corporate governance mechanisms under study are ownership structure and the audit committee, while share prices over a three-year period have been related to these mechanisms. The sample size comprises thirty companies listed on the Nigerian Stock Exchange, while the regression and correlation analysis were used to test the hypotheses. The empirical findings suggest that ownership structure have a negative association with share price, whereas the audit committee is positively related to share price. The study recommends that *board members' shareholding should be regulated to ensure an optimal share price disposition.*

Keywords: Ownership structure; Audit Committee, Share Price; Governance

Introduction

Several studies on companies around the world in the last two decades suggested that the heightened focus on corporate governance has no positive impact on corporate performance (Daily & Dalton, 1992; Daily & Ellstrand, 1996; Rosenstein &Wyatt 1997; Weir, Laing & McKnight, 2001 and Bhagat and Bolton, 2005). However, interest in corporate governance has grown tremendously in the past decade with the general feeling that sound financial performance excuses poor governance (Pic, 1997). Corporate scandals, environmental concerns and globalisation have all played their part in raising shareholders' and public awareness on how companies should be governed. The recent international disasters in financial reporting including Enron and Worldcom in the US, Parmalat in Italy, the Maxwell saga in the UK, Daewoo in Korea, Leisurenet and Regal Bank in South Africa, CADBURY and Oceanic bank in Nigeria confirmed the growing need for transparency in governing companies.

In other studies, it was observed that good corporate governance has been evident to be associated with greater firm performance (Carcello and Neal 2003; Attiya and Robina, 2007). As seen in these studies, in any organisation, the share price is the first brief pinpoint when one thinks about an indicator for the performance of a listed company. If it is on an increase, the default reaction is that things are going well in that corporation and people do buy the shares. However, if it is on a decline, one may not be so sure about the way the business is shaping up its operations. As observed by Klein (1998), implementing a better corporate governance practice is anticipated to improve the monitoring of management and reduces information asymmetry problems. This invariably will increase the firm's value.

In the same vein, Sanda, Mukailu and Garba (2005) observed that, in developing economies especially in Nigeria, failure to implement standard corporate governance procedures has been the bane of the financial disposition of numerous corporations today. Also, the lack of investor participation in the assets of a company, usually affects its share price history; which summarizes the quality of operations of the company. In addition as observed by Heaps (2010), many listed companies are ignorant of

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the relationship that subsists between their corporate governance structures and their seemingly impressive or unattractive share prices. Most of these companies adopt corporate governance practices without really knowing the resultant effects on share price. Furthermore, despite numerous research efforts on corporate governance and company performance in Nigeria, little has been done concerning finding out the effects of the corporate governance practices of listed Nigerian companies on one of the most obvious aspects of company affairs i.e. share price.

It is against these backdrops that this study therefore aims to find out the relationship between corporate governance mechanisms and share price among listed firms in Nigeria. This paper is divided into four sections. The introduction part constitutes section one, while section two covers the review of related literatures and previous empirical studies. Section three covers the methodology and the result of empirical analysis and the final section includes the discussion of findings, conclusion and recommendations.

The Scope of study

This study covers the banking and the manufacturing industries in Nigeria. Fifteen firms each were selected from both listed banks and manufacturing firms, in other to investigate the effects of corporate governance mechanisms (ownership structure and audit committee's independence) on firms' share price.The annual reports of the selected firms for three years period between 2007 and 2009 were studied. This period, being the period when most of the corporate scandals occurred.

Research hypotheses

In other to achieve the objectives of study, the following hypotheses stated in their null form were tested:

Hypothesis 1: *The ownership structure of listed companies in Nigeria has no significant relationship with their share prices.*

Hypothesis 2: *There is no significant relationship between the audit committee's independence and share prices of listed companies in Nigeria.*

Literature review

Corporate governance defined

There are numerous literatures on corporate governance today. In understanding the concept of corporate governance, the definition by

Organization for Economic Cooperation and Development (OECD) is a good starting point. The principles of corporate governance are widely recognized benchmarks in corporate governance. In the financial sector, they are one of the key sets of standards for an excellent financial system as used by the Financial Stability Forum. They are used by the International Monetary Fund (IMF) and World Bank in country assessments, and by other international bodies such as The International Organization of Securities Commissions (IOSCO) in standard setting (World Bank, 1999).

The OECD principles of 1999, define corporate governance as involving "a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring. The presence of an effective corporate governance system, within an individual company and across an economy as a whole, helps to provide a degree of confidence that is necessary for the proper functioning of a market economy."

Corporate governance and shareholder returns

Several literatures have linked corporategovernance to firm's performance (Gompers, Ishi and Metrick, 2003; and Drobetz, Schillhofer and Zimmermann, 2004), the multiplicityof results is also increasing. All these studies only differ by the difference in methodologies, the performance proxies and differences in governance indices throughout the world. Good corporate governance can serve as an instrument for enticing investors as well as influencing the stock price. The average premium investors who are willing to pay for good governance have been estimated to be between 11% and 16% in the US (Agrawal et al. (1996). In Europe, Brown and Caylor (2004) showed that better corporate governance is related to better firm performance, and his study concluded that better governed firms perform better than poorly governedfirms.

Gompers *et al.* (2003) found a significant association between a corporate governance index built from 24 provisions and stock returns. More specifically, they found that investors who are investing in firms, which are ranked high, based on this index, are on average earning 8.5 % abnormal returns. They also observed that weaker governance measures exhibit lower firm valuations, while in addition they are more engaged in acquisitions and capital investments.

In developing economies, Klapper and Love (2003) found evidence for the relationship between firm's performance and corporate governance. By employing a corporate governance ranking, developed by Credit Lyonnais Securities Asia, and using asample of 495 companies from 25 developing markets they found that a positive relationship existed between the corporate governance ranking and financial ratios.

In the case of Germany, Drobtez, Schillhofer and Zimmerman (2004) concluded that a corporate governance rating is positively correlated with firm value. They discoveredthat an investment strategy that bought companieswith high corporate governance ratings and sold shortcompanies with a low rating, would have gained 12%annualised abnormal returns for the sample period.With regard to the effect of corporate governance on the expected rate of return for shareholders, Lombardoand Pagano (2000) suggested that the expected rateof return should compensate investors for expectedmonitoring, auditing, and other private costsassociated with different corporate governancesystems. In their model, stronger corporategovernance mechanisms in firms reduce the expectedreturn on equity to the extent that it reduces theshareholders' monitoring and auditing costs.

Corporate governance in Nigeria

Corporate governance has recently assumed considerable significance as a veritable tool for ensuring corporate survival. This is because business confidence usually suffers each time a corporate entity collapses. In Nigeria, most of the business failures in the recent past are attributed to failure in corporate governance practices. For instance, the collapse of banks in Nigeria in the early 1990s and onwards was as a result of inadequate corporate governance practices such as insider-related credit abuses, poor risk appreciation and internal control system failure (Sanusi, 2010). To stem the tide in corporate failure, scholars and practitioners (Sanda et al, 2005; Ogidefa, 2008 and Rasid, 2008) have consistently advocated different approaches to corporate governance. According to Ogidefa (2008), a critical tool in corporate governance is disclosure and transparency. This as opined by Ogidefa negates adequate disclosure on the risk profile by most Nigerian firms.

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The topic of corporate governance gained importance in Nigeria during the post structural adjustment programme (SAP) era. This era witnessed the growth of private ownership of productive resources and the multiplication of banks and financial institutions. Because of the weak corporate culture in these banks, the nation witnessed a very high incidence of corporate failure and distress (Oluyemi, 2006). To regain the confidence of the public, the Securities and Exchange Commission set up a committee in 2000 whose report was the first to articulate a code of best practices for public companies in Nigeria. This was followed by a similar code by the Central Bank of Nigeria (CBN) in 2006 to address corporate governance practices in Nigerian banks. The Central Bank of Nigeria (2006) traces the need for a new code of corporate governance in Nigerian banking industry to the poor corporate governance practices in the banks which have been identified as major factors in virtually all known instances of corporate collapse.

The occurrence of the high profile corporate governance scandal involving Cadbury Nigeria Limited also reiterated the need for stringent measures as regards compliance to corporate governance policies and codes. In June 2006, the Security and Exchange Commission (SEC) expressed concern on issues arising from Cadbury's annual reports and accounts for 2005, particularly in the areas of inadequate disclosure, non compliance with corporate governance code and obtaining loans for the payments of dividends to shareholders, contrary to SEC regulation. The apex regulatory body in the capital market (SEC) also penalised and reprimanded Akintola Williams, Deloitte (AWD), the external auditor of the company and the Union Registrars Ltd for violating the provisions of the investments and securities act of 1999. Ever since, corporate governance practices in Nigeria has been a major discuss.

Data analysis method

This study examined the relationship between corporate governance mechanisms proxied by ownership structure and audit committee and share price (dependent variable) of 30 listed firms in Nigeria between 2007 and 2009.

To enable the examination of the relationship between corporate governance and share price, a linear regression model equation was used. The constructs include corporate governance and share price. The regression equation can be computed as:

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$Y = \beta_0 + \beta X_1 + \mu_{it}$.. *(1)*

Where:

y =Share Price (Dependent variables)

x = Corporate Governance (Independent variables)

β= Coefficient

μ_{it} = Error term

Equation 1 can be more clearly defined as:

Share Price = f (Corporate Governance) + c.................................... *(2)*

Equation 2 is further expanded by introducing the constructs of corporate governance, and including a control variable (Earnings per Share), hence formulating equation 3. This is to enhance predictability and easy analysis of the relationship which is between the two constructs (corporate governance and share price).

Share Price = (Ownership structure and Audit committee Independence) + Earnings per share (EPS).. *(3)*

The above can be deduced to:

$SP_{it} = OWS_{it} + ADCI_{it} + EPS_{it}$ ....*(4)*

The model specification based on regression is:

$SP_{it} = \beta 0 + \beta_1 OWS_{it} + \beta_2 ADCI_{it} + EPS_{it} + \mu_{it}$.. *(5)*

Where-

SP= Share Price; which is the price at which one unit of a company's stock is sold. The share price is calculated by adding up the daily average share prices of the companies under study and dividing the result by the number of days the shares are traded.

ADCI= Audit Committee; which is derived by dividing the number of shareholders in the committee by the total number of members.

OWS= Ownership structure; which is the percentage of board members who own shares against total board members.

EPS= Earnings per share; which represents how much money shareholders would receive for each share of stock they own if the company distributed all of its net income for the period. This is obtained from the annual reports of the companies under study.

β = Coefficient of parameters

μ= Error term, which captures other explanatory variables not explicitly included in the model.

$_{it}$ = time coefficient; i.e. for firm $_i$ in year $_t$

The study adopts the regression analysis method in analysing the impact of the independent variables on the performance of the listed manufacturing firms in Nigeria. The Pearson correlation also measured the degree of association between variables under consideration.

Descriptive statistics result
Table 1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
SHARE PRICE	90	1.85	264.17	26.8298	43.02938
OWNERSHIP STRUCTURE	90	.28	100.00	49.1418	37.77444
AUDIT COMMITTEE INDEPENDENCE	90	.00	.50	.4772	.06251
EARNINGS PER SHARE	90	-542.93	180.52	4.2544	67.12403
Valid N (listwise)	90				

Source: (Computed output SPSS, 2013).

Table 1 provides a summary of the descriptive statistics of both the dependent and the independent variables for all the companies in the sample. It shows the maximum, minimum, average and the standard deviations of the variables used.

The results from the analysis of the share price (SP) shows that the highest share price is 264.17 and the lowest is 1.85 with a standard deviation of 43.03%. Using the mean, the statistics on ownership structure (OWS) indicate that a barely significant portion (49.14%) of shareholder board members own shares among the total members of the board of directors. The statistics on the audit committee (ADC) show that the shareholder to director ratio (47.77%) is less than expected (50%), although it is expected that the number of shareholders equate the number of directors on the committee. The results also indicate that the mean of earnings per share (EPS) is 4.25%, while the maximum and minimum are 180.52 and -542.93 respectively.

Restatement of hypotheses:

Hypothesis 1: *The ownership structure of listed companies in Nigeria has no significant relationship with their share prices*.

Hypothesis 2: *There is no significant relationship between the nature of the audit committee's independence and share prices of listed companies in Nigeria.*

Table 2: Correlation Result

		Share Price	Ownership Structure	Audit Committee	Earnings Per Share
Share Price	Pearson Correlation	1	-.020	.093	.013
	Sig. (2-tailed)		.854	.384	.906
	N	90	90	90	90
Ownership Structure	Pearson Correlation	-.020	1	-.070	-.230(*)
	Sig. (2-tailed)	.854		.513	.029
	N	90	90	90	90
Audit Committee	Pearson Correlation	.093	-.070	1	.017
	Sig. (2-tailed)	.008	.513		.877
	N	90	90	90	90
Earnings Per Share	Pearson Correlation	.013	-.230(*)	.017	1
	Sig. (2-tailed)	.906	.029	.877	
	N	90	90	90	90

** Correlation is significant at the 0.01 level (2-tailed).
*Correlation is significant at the 0.05 level (2-tailed).
Source: Researcher's Field Summary Result (2013)

From the correlation results in table 2, a negative correlation coefficient (r) of -0.20 was observed between the dependent variable (SP) and ownership structure (OWS). Based on the correlation analysis criteria, the coefficient value of -0.20 means that there is a very low negative relationship between share price and ownership structure. Furthermore, the correlation result was insignificant at any of the levels.

However, a positive correlation coefficient (r) of 0.093 was observed between share price (SP) and the audit committee (ADC). The coefficient value of 0.093 means that there is low positive relationship between share price and the audit committee. The correlation result was also highly significant at 1% and 5%. This invariably suggests that the higher the number of shareholders compared to directors on the audit committee, the better the share price value of the company.

Control variable (EPS)

A positive correlation coefficient (r) of 0.013 was observed between EPS and Share Price. This indicates a low positive relationship between EPS and share price. The results were however insignificant at 1% and 5%. This means that EPS has a positive relationship with the share price value of a company.

Regression analysis

Table 3: Model summary (b)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.476(a)	.226	.190	38.72452

a) Predictors: (Constant), Earnings Per Share, Board Composition, Ownership Structure, Audit Committee

b) Dependent Variable: Share Price

Source: Computed output (SPSS, 2011)

Table 3 shows how much of the variance in the dependent variable (SP- share price) is explained by the independent variables in the model (ownership structure, audit committee and earnings per share). In this case, the R square value is 0.226 means that the model explains 22.6% of the variance in the

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dependent variable (share price). While the Adjusted R Squared compliments this variance.

Table 4: ANOVA (b)

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	37320.921	4	9330.230	6.222	.000[a]
	Residual	127464.996	85	1499.588		
	Total	164785.917	89			

a) Predictors: (Constant), Earnings Per Share, Board Composition, Ownership Structure, Audit Committee

b) Dependent Variable: Share Price

Source: Computed output (SPSS, 2011)

The significance of the F -value in table 4 above shows that the model employed is not biased.

Table 5: Coefficients (a)

	Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	7.021	32.586		.215	.830		
	Ownership Structure	-.048	.112	-.042	-.429	.669	.939	1.065
	Audit Committee	212.026	72.509	.308	2.924	.004	.820	1.219
	Earnings Per Share	-.006	.063	-.010	-.098	.922	.946	1.057

a) Dependent Variable: Share Price

Source: Computed output (SPSS, 2011).

As observed in table 5, the tolerance values for all the variables tested are greater than 0.1. This indicates that there is no multi-colinearity between the independent variables. Also, the variance inflation factor (VIF) values are

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less than 10. The VIF result indicates that the variables measured are acceptable and free from multi-colinearity problem.

From the t- table, the correlation coefficient between Ownership Structure and Share Price is negative (-0.48), indicating a negative relationship between the number of shareholders on the board and share price. This invariably means that, higher number of shareholders on the board of directors has negative effects on share price. This is viewed to be because an excessive amount of shareholding among directors may allow for selfish decision making and greedy corporate planning. Also, the result further indicate that when directors own a large proportion of shares of the firm, they could pose other agency problems, especially those associated with conflicts between large and small shareholders. This relationship is seen to be insignificant at 5% and 10% level (.669). The null hypothesis is therefore accepted while the alternate hypothesis is rejected in Hypothesis 1. The result is consistent with Wei (2003) and Lin (2007).

However, the correlation coefficient between the Audit Committee and Share Price is positive (212.026), indicating a positive relationship between the composition of the audit committee and share price. This implies that the appropriate composition of the audit committee has a positive effect on share price. This relationship therefore leads to the rejection of the null hypothesis and the acceptance of the alternate hypothesis in Hypothesis 2**.** Furthermore, the relationship between the Audit Committee and Share Price is significant at 5% and 10% as it has a significance level less than 0.05 (.004).

Additionally, there is a low negative relationship between the control variable, Earnings Per Share and Share Price, (-.006) which indicates that a high EPS does not necessarily hype share price. The relationship is however not significant, as the level of significance is greater than 0.1 (0.922).

Conclusion and recommendations

This study therefore conclude that in the wake of the recent global economic recession, listed companies around the world have begun to strengthen their listed status by making moves to enhance the value of their shares, thereby ultimately enhancing shareholder's value. One of the most important moves is embedded in corporate governance, considering that it is a process designed to align interests of management with those of shareholders, and a mechanism to hold management accountable to the company's equity

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owners. Furthermore, given the requirement for firms to have an audit committee, the study also conclude that any differential in performance related to governance is usually related to the differences in audit committee characteristics (especially its independence). This is because the independence of the audit committee facilitates more effective monitoring on financial reporting and external audits. This will further improve the quality of financial decisions and exhibit more of governance characteristics. Finally, the paper concludes that when directors own a large proportion of shares of the firm, they could pose other agency problems, especially those associated with conflicts between large and small shareholders.

The study therefore recommends that there should be a moderate amount of shareholding among the board of directors in Nigeria dictated by relevant corporate bodies, to avoid excessive amount of shareholding which may allow for selfish decision making and greedy corporate planning. In addition, companies should ensure that the audit committees comprise an equal number of shareholders and directors at all times, as it has a positive relationship with share price.

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