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BOARD COMPOSITION AND FIRM PERFORMANCE OF LISTED MANUFACTURING FIRMS IN NIGERIA

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Abstract: A robust board composition that is able to carry out effective oversight functions and necessary scrutiny has the capacity to drive firm performance. This study investigates the impact of board composition on the financial performance of listed manufacturing firms in Nigeria, utilizing 15 listed manufacturing firms for the period 2014 to 2023. Return on asset (ROA) is used to capture firm financial performance, which was regressed on board composition, and two other corporate governance variables of board size and board gender diversity, in addition to a firm-internal control variable, size. It employs descriptive statistics, correlation matrix, OLS and panel data estimation technique. The results indicate that board composition has a positive and significant impact on firm financial performance in Nigeria. Board size and the diversity of board gender also have significant impact on firm financial performance It is further found that that firm size has a weak impact on ROA firms in Nigeria. Based on these findings, findings, it is recommended that effective and well-composed board be put in place by firms, alongside other corporate governance variable, such as board size and gender diversity to drive firm performance in Nigeria.

JEL Classification: G30, G34, L25

Keywords: Board composition, Firm performance, Listed firms Corporate code of governance, Panel Data.

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1. INTRODUCTION

The effect of board composition on the performance of firms has garnered increased theoretical and empirical attention in corporate governance research in recent times. This is as a result of the critical role of corporate governance in the determination of the success or failure of any corporate entity. Corporate governance, which is the process and structures by which the business and affairs of an institution are directed and managed in order to improve long-term shareholder's value by enhancing corporate performance and accountability, while taking into account the interest of other stakeholders is key to corporate survival and performance (Young, 2003). Corporate governance involves building credibility, ensuring transparency and accountability as well as maintaining an effective channel of information disclosure that would foster good corporate performance (CBN, 2006). Corporate governance involves overseeing and directing an organization in way that ensures transparency and accountability in the exercise of power and patronage by firms (Miyajima et al, 2003). In Nigeria, where the business environment is faced with distinctive challenges and opportunities, understanding the impact of board composition on firm performance is particularly crucial.

Most firms' goal which is to operate in the foreseeable future is vigorously pursued by efficient corporate governance structure, particularly the composition and structure of boards. To this end, many firms have continued to operate effectively in terms of asset returns despite the harsh economic conditions; the secret, which has often been linked with the organizational structure at the corporate management level. In the same vein, crashes that have been observed in many firms (especially financial firms) have often been directly linked with failing corporate governance (Sanda, Garba & Mikail, 2008). The germane upshot of these diverse outcomes therefore lies on the patterns and directions of corporate handling of firms in relation to its earnings management. To meet stakeholders' expectations, management would want to prepare their financial statements in a manner that shows that the company is performing well. Managements in a bid to project the image of the company in a positive light tend to engage in activities that result in the management of earnings (Kao & Chen, 2004).

Given the rise in the dynamism of the ownership-control relationship, it became imperative for strong institutional mechanism to regulate the separation

of ownership of firms from control created the agency problem as identified in the original work of Jensen and Meckling (1976). In the same vein, critical components of corporate governance also constitute the factors that determine its effectiveness in the organization. In particular, the board of directors provide a formidable platform for the corporate organization to thrive. The overall goals and strategic paths of the organization are developed within the confines of the board. Effective board composition thus implies a strong and efficient firm real earning of firms (Osma 2008). In this direction, the nature of the board (board structure) is therefore a critical aspect of corporate governance since it provides the strongest background for the success or failure of corporate organization. Although many other corporate governance factors may play important role earnings management, the nature or structure of the board still holds the key to effective corporate governance.

Several authors (e.g., Osma, 208; Susanto, & Pradipta, 2016) present evidence indicating that board structure is of first-order importance in determining real earnings management. In general, the authors attribute this importance to two factors. The first is that expropriation by managers is likely to become more severe during these periods because the expected return on investment falls. The second is that during crises, the quality of corporate governance is likely to attract more scrutiny. Thus, any preexisting weaknesses are more visible in structure of board and their activities. The motivation for focusing on the board of directors in the corporate governance study is as follows. First, corporate boards are one of the most important, internal corporate governance mechanisms that monitor and advise management in fulfilling the mandate to protect shareholder interests (see Fama & Jensen, 2008; Hermalin & Weisbach, 2003; Adams and Ferreira, 2007; and Harris and Raviv, 2008). For instance, Mace (1971) states that, directors serve as a source of advice and counsel, serve as some sort of discipline device, and act in crisis situations". This functions are made possible since the board has a fairly direct link with owners of the firm.

Second, in fulfilling its mandate, a key function of the board is the reviewing and guiding the firm's risk-management policy. In light of the fact that managerial excessive risk-taking behavior has been cited as one of the major causes of the current financial crisis, it indicates that in many companies, both financial and non-financial, boards failed to set up appropriate risk strategies

and monitor managers' risk-taking behavior in a timely and effectively manner (Kirkpatrick, 2009). Although weak corporate boards may not be the direct cause of the current crisis, corporate board practices could affect the extent to which firms are vulnerable to the financial crisis. Third, although substantial empirical research exists on the relationship between corporate and real earnings management, the effect of board composition and structure on earnings has not received any known empirical attention. It is the recognition of these facts and the perceived gap in literature that has motivated this study.

Following the introductory section, section 2 deals on the review of literature- theoretical and empirical. Section 3 presents the methodology, model specification and data. Section 4 empirically analyzes the r4sults, while section 5 concludes the paper, with some policy recommendations.

2. LITERATURE REVIEW

2.1. Conceptual Issues

Board composition relates to structure arrangement or configuration of a board in an organization. The need for board composition arises because of the separation of management and ownership in the modern corporations. The need for well- structure and well-composed boards hinges on the agency theory which argues that the managers may have opportunistic tendency to maximize their own welfare (Merrett & Houghton, 1999). This agency problem can be mitigated through the protections derived from good corporate governance structures, and in this context board structure. Corporate boards play a critical role by offering direction and guidance to any corporate entity (Coleman & Biekpe, 2007). The classical problem is the separation of ownership and control, i.e. the agency cost resulting from a divergence of interest between the owners and the managers of the firm, (Jensen and Meckling 1976).

2.2. Theoretical Literature

2.2.1. Agency Theory

Agency theory sees firm as a contractual relationship between resource owners and resource managers. An agency relationship arises wherever one or more individuals, called principals, hire one or more other individuals called agents, to perform services and also engage in decision- making (Bamberg & Klaus,

1987). Agency theory explains the relationship between principals and their agents. This is a relationship where the principal hires and delegates duties to an agent to perform on his behalf. The theory attempts to deal with two problems: first, to align goals of the principal and agent and make sure these goals are not in conflict (agency problem), and secondly, that the principal and agent reconcile their different level of tolerance to risk (Jensen & Meckling, 1976; 1986; Eisenberg, Sundgren, &, 1998).

The agency problem arises on account of conflict of interest due to the separation of ownership and control, and the fact that management has more insider information, this leads to owners incurring costs in order to monitor the affairs of the agents (managers). The agency theory expects the agents to act and make decisions in the principal's interest. On the contrary, the agent may not necessarily make decisions in the best interests of the principals. The managers might put their interests over those of the owners and this might mean overstating or understating numbers reported, corporate governance would help alleviate these agency problems (Chi-Keung & Brossa, 2013). In agency theory, the agent may succumb to self-interest, opportunistic behaviour and falling short of congruence between the aspirations of the principal and the agent's pursuits. The positive theory of agency argues that the managers may behave opportunistically to maximize their own welfare, (Merrett & Houghton, 1999). This agency problem can be mitigated through the protections derived from good corporate governance structures, (Okeahalam & Akinboade, 2003) (board structure in this context).

2.2.2. Stewardship Theory

Stewardship theory was developed by Donaldson and Davis (1991). A steward is someone who protects and takes care of the needs of others. Thus, stewardship theory means that the company executives protect the interests of the owners or shareholders and make decisions on their behalf (Keay, 2017). The stewardship theory, in contrast to the agency theory, assumes that there is no conflict of interest between the principal and agent. It postulates that the managers are concerned about the welfare of the owners and financial performance of the company. The theory, thus suggests that managers and board members act in the best interests of the organization, and that their primary objective is to achieve organizational goals

The stewardship perspective suggests that when organizational success is attained, stewards are satisfied and motivated. This theory emphasizes on employees or executives to act more independently so that shareholders' returns can be maximized. The theory, unlike the agency theory holds the view that the steward is able to unify the different interest of stakeholders and that he will willingly act in a way that will protect the interest and welfare of others, above his, particularly, with respect to goal-oriented decisions that enhance the \financial performance of the firm (Hernandez, 2012

2.3. Empirical Literature

2.3.1. Board Independence and Firm Performance

Greiner (2013) finds that strong corporate governance in the context of board independence signals to investors an efficient reallocation of resources. According to the author, investors may be unable to unravel managers' intentions for REM; their consideration of corporate governance may facilitate efforts in evaluating managers' ability to pursue self-interested activities. Strong independent boards may reduce risk of loss from opportunistic managers attempting to expropriate wealth from investors. Cheng, Lee & Shevlin (2015) found out that independent board has a very stronger effect in very complex firms where key executives play a very important role by examining if these key executives have the ability to hinder the level of them engaging in real earnings management.

Iraya, Mwangi and Muchoki, (2015), using evidence from Nairobi examine the effect of board independence on firm performance. They find evidence that board dominated by outsiders are better in terms of monitoring the activities of management. Accordingly, since they are external, this makes them independent of the influence of the organizations management, in addition to their expertise which are effective means of preventing management from acting solely in their own interests.

Other studies that that found the positive effect of board independence on include Denis (2001), Iraya et al (2015). Peasnell, Pope, and Young, (2005) show evidence that existence of outside members may provide a useful monitoring tool to the board, as they do not play a direct role in the management of the company, and as a result, may produce higher and better quality financial reports and prevent the distortion of information.

Studies that found a negative relationship between board independence and performance include Kao and Chen (2004); Peasnell, Pope and Young (2005); Lin and Hwang, (2010). Specifically, Jaggi and Leung (2007) found a significant negative relationship between earnings management and the presences of higher fraction of outside directors, which suggest that a higher fraction of outside board members provides better supervision of management to control earnings management activities. Jesus and Emma (2013) found evidence that in relation to board independence, a better number of board independence affects earnings management negatively. Susanto & Pradipta (2016) found a significant relationship between board independence and real earnings management.

Some studies examine the effectiveness of outside independent directors on the board in overseeing real activity-based management of firms (Osma, 2008; Visvanathan, 2008; Kang & Kim, 2012). Osma (2008), particularly used research and development (R & D) to analyze the effectiveness of independent boards and also to monitor the roles of directors on corporate performance. They found out that independent directors are capable of identifying and constraining R&D cutoffs and as result, stimulate firm per4formance.

2.4.2. Board of Directors Gender and Firm Performance

Studies that have examined the impact of the ratio of female directors on board on firm performance Carter, Simkins and Simpson (2003); Khrishnan and Parsons (2008). The study by Adams et al. (2010) found that excessive executive directors on the board are more likely to be monitored by female directors more effectively and can think independently. Invariably, more females on the board act as essential tool for providing better quality financial information and checking opportunistic activities. Other studies that have examined the effect of board gender on firm performance include Ahmed, Hossain, Adams (2006), García-Meca and Sánchez-Ballesta (2009), Sitthipongpanich and Polsiri, (2013), amongst others. These studies in general found that more female gender on the board has a significant impact on firm performance.

2.4.3. Board Size and Firm Performance

The board size constitutes the number of executive and non-executive directors in the board. It is one of the factors mainly used by researchers as a proxy

for the strength of corporate governance (Denis, 2001). Studies that found a significant positive relationship between board size and firm performance are Vafeas (2000), Ahmed, Hussain, & Adams, (2006), Pradipta (2011), Jesus and Emma (2013), amongst others. On the contrary, Song and Windram, (2004) and Peasnell et al (2005), found no significant relationship between board size and firm performance.

3. METHODOLOGY

3.1. Population and Sample

The population of the study consists of the whole manufacturing firms in the Nigerian Stock Exchange (NSE). However, to constitute sample size out of the population of the study, the purposive non-probability sampling method is adopted in the collection of samples for this research. Based on this method, fifteen (15) manufacturing firms are selected for the sample of the study. The common criteria used for the selection include type of availability of board information, and accessibility. The concept of non-probabilistic procedure allows more information within the distribution and accords the research work more scientific feature, thereby concretizing the validity of the research findings.

3.2. Data Sources

The study utilizes annual time series data mainly from the secondary sources. The underlying data for the variables of interest are obtained from the banks published annual Financial Reports at the Nigerian Exchange Limited (NGX). The period for the study is seven (6) years covering 2014 to 2023

3.3. Model Specification

To examine the effect of board composition on the performance of listed manufacturing firms, measured by the return on asset, the functional model is captured as:

$$PERF_{it} = f(BCOMP_{it}, X_{it}) \quad (1)$$

Where PERF = Firm financial performance, *i* is firms, *t*, is time fixed specific effect, BCOMP is board composition, and X is a vector of other corporate governance and internal variables that influence firm financial

performance, which include board size (BS), board gender (BGEND) and firm size (FS). But firm financial performance is measured as return on asset (ROA). Taking cognizance of the foregoing, the extended functional model is captured as:

$$ROA_{it} = f(BCOM_{it}, BS_{it}, BGEND_{it}, FS_{it}) \quad (2)$$

The empirical specification of the model is captured as:

$$ROA_{it} = \alpha_0 + \alpha_1 BCOMP_{it} + \alpha_2 BS_{it} + \alpha_3 BG_{it} + \alpha_4 FS_{i,t} + \varepsilon_{it} \quad (3)$$

Where the variables are as earlier defined., and ε *is* random error term

3.4. Definition of Variables and Measurement

The definitions of the variables in the model, and their measurement are provided in Table 1.

Table 1: Definition of Variables and Measurement

Variable	*Measurement*
Return on asset (ROA)	Net profit to total assets ratio
Board composition (BCOMP)	Number of independent directors to total number of directors on the board.
Board size (BS)	Number of directors on the board (total number of board members)
Board gender (GBEND).	Proportion of female directors on the board to total number of directors
Firm size (FS)	A firm internal control variable, that is measured as log of total assets

Source: Authors' compilation.

3.5. Method of Estimation

The model specified in (2) is based on the panel regression analysis procedure that is adopted in this study. The main advantage of the panel data analysis is that it comprehensively takes the individual characteristics of the different firms used in the study. It is generally observed that firm-level behaviour is a strong factor in the determination cross-sectional behavior. This differentiation may bring endogeneity bias into the estimation. The panel data analysis helps to correct this inherent estimation problem. The basic class of models that can be estimated using panel technique may be written as:

$$Y_{it} = f(X_{it}, \beta) + \delta_i + \gamma_t + \epsilon_{it} \quad (3)$$

The leading case involves a linear conditional mean specification, so that we have:

$$Y_{it} = X_{it}'\beta\delta_i + \gamma_t + \epsilon_{it} \quad (4)$$

Where Y_{it} is the dependent variable, and X_{it} is a -vector of regressors, and ϵ_{it} are the error terms fo r i = 1, 2,…, M cross-sectional units observed for dated periods t = 1, 2, …, T. The α parameter represents the overall constant in the model, while the δ_i and γ_t represent cross-section or period specific effects (random or fixed).

A central assumption in random effects estimation is the assumption that the random effects are uncorrelated with the explanatory variables. One common method for testing this assumption is to employ a Hausman test to compare the fixed and random effects estimates of coefficients in order to determine the best model for the financial performance model. This test is also used to examine the randomness of the data distribution in this study. Two techniques are employed in the empirical analysis of this study. These involve the use of descriptive statistics which gives the summary measures and initial characterization of the data series. The second is the panel data estimation in order to investigate the influence of each of the board structure variables earnings management.

4. RESULTS AND DISCUSSION

4.1. Descriptive Statistic

The descriptive statistics for the variables used in the analysis is presented in Table 2.

Table 2: Descriptive Statistics

	ROA	*BCOMP*	*BS*	*BGEND*	*FS*
Mean	7.70	6.44	8.06	2.77	18.62
Median	7.12	5.11	7.90	2.11	17.23
Maximum	10.25	7.08	14.06	4.22	74.22
Minimum	0.07	1.24	4.98	0.00	9.25
Std. Dev.	2.30	0.65	2.15	1.40	10.11
Skewness	1.95	1.18	1.54	2.16	1.98
Jarque-Bera	16.21	1.35	14.88	16.84	20.78

Source: Authors' computation

The descriptive statistics show a mean value of ROA of 7.70 percent, with a median value of 7.12 percent, an indication of dissimilarity ROA performance among the firms. Apparently, more firms have higher ROA than the observed mean, while other have extremely low values. The maximum and minimum values are 10.25 and 0.07, The standard deviation is 2.30, and the Jacque-Bera statistic of 16.21 is significant, an indication that the firms are not uniformly distributed, and as such, non-symmetric distribution. The corresponding averages of board composition, board independence, board gender, and firm size are 6.44, 8.06, 2.77, and 18.62, respectively.

4.2. Correlation Analysis

Table 3 presents the results of the correlation matrix.

Table 3: Correlation Matrix

	ROA	*BIND*	*BS*	*BGEND*	*FS*
ROA	-				
BCOMP	0.08	-			
BS	0.14	0.19	-		
BGEND	0.11	0.09	0.17	-	
FS	0.16	0.12	0.13	0.10	-

Source: Authors' computation

The correlation matrix indicates that board independence, board size, board gender and firm size are positively correlated with ROA of firms. Thus, growth in these corporate governance variables tends to have positive co-movement with firm performance, measured by ROA. Thus, well-composed boards tend to induce i firm performance. The correlations among the independent variables show that increase firms size is positively correlated with board independence, board size, and board of director's gender.

4.3. Pooled OLS and Multivariate Panel Data Results

Table 4 presents the results of the Pooled OLS and Panel data. The goodness of fit statistics for the model for the OLS estimates are not quite good, given the low coefficient of determination of 0.19, which indicates that only 19 percent of the net systematic variations in ROA of listed firms are explained by the explanatory variables. This show low explanatory and predictive power. The coefficient of board independence is significant at the 5 percent level, while that of firm size passes the significance test at the 10 percent level. Next, we

employ the Hausman test to select the appropriate strategy for the panel data, given that the OLS estimates above cannot be relied on for policy directions, since the estimates inherently possess endogeneity issues. The results of the Hausman test reported in Table indicate a Chi-Square statistic of 10.82, with a corresponding probability value of 0.03, which is significant test at the 5 percent level. Thus, we reject the null hypothesis that unobserved firm specific heterogeneity is uncorrelated with regressors, and thus base our analysis on estimates provided by the fixed effect model, as the random effect estimates are likely to be biased and inconsistent. The estimates provided by the fixed effect is thus relied on for policy purpose**.**

In the fixed effect results, the diagnostic statistics show that the adjusted R-squared value is now 0.90, an indication that 90 percent of the net systematic variations in ROA of the listed firms in Nigeria is explained by the regressors. The F- statistic of 26.2 is highly significant at the 1 percent level, and validates the existence of a significant linear relationship between the explanatory variables and the dependent variable, and suggests that the explanatory variables are jointly significant in the determination of the real earnings management of listed firms in Nigeria. The Durbin Watson statistic of 1.80 shows that there is no serial correlation in the model, implying that the model can be used for structural and policy analysis.

Table 3. Results from Pooled OLS and Panel Multivariate Estimation

Dependent Variable: ROA

Variable	*Pooled OLS*		*Fixed Effect*	
	Coefficient	*T-Ratio*	*Coefficient*	*T-Ratio*
C	0.073	1.551	0.084	1.214
BCOMP	0.014	2.093	0.073	2.222**
BS	0.108	1.082	0.211	2.201**
BGEND	0.33	1.701	0.037	2.172**
FS	0.073	1.831*	0.214	1.884*
			Haussmann Test= 10.82 (0.03)	
	R^{-2} = 0.19 DW=0.58		R^{-2} = 0.90 F-value = 26.20 DW=1.80 VIF =2.25	

***Statistical significance at the 1%leve

** Statistical significance at the 5 % level

* Statistical significance at the 10% level

Standard errors of coefficients in parentheses

Source: Authors' computation

An examination of the individual performance of the variables in the model, the coefficients of the independent variables are appropriately signed in line with theoretical expectations. The coefficient of board composition is positive and statistically significant at the 5 percent. This implies that improve composition of boards tend to stimulate the asset performance of firms in Nigeria. The coefficient of board size is statistically significant test at the 5 percent level. This implies that better board size raises ROA of firms in Nigeria. Thus, large board size tends to induce checks and balances and corporate oversight functions that enhance firm financial performance. The coefficient of board of directors' gender-indicated by number of female directors on the board is positive and significant at the 5 percent level. The findings are in line with the findings of Adams et al. (2010) that female directors are able to think and act effectively and independently. Finally, the coefficient of firm size is positive, although fails the significance test. The implication is that size does not significantly influence the performance of manufacturing firms in Nigeria. The post-estimation diagnostic results show a mean variance inflation factor (VIF) of 2.25, which indicates that the model result is multicollinearity-free The results can therefore be relied on for policy formulation and implementation purposes.

5. CONCLUSION

The significance of effective and well-organized board, that is able to carry out robust oversight functions for the performance of firms cannot be under-estimated. As a strong corporate governance mechanism, corporate boards are one of the, most important, internal corporate governance mechanisms that monitor and advise management in fulfilling the corporate mandate in and resolving the supposed agency problem- where there is conflict of interest between shareholders and mangers. The Security and Exchange Commission (SEC) place greater emphasis on the structure, composition and size of boards. The empirical findings of this study has clearly shown that effect board structure which is an integral component of corporate governance is important to managing real earnings of firm, and by extension, firms' earnings quality. Without strong board structure that is able to minimize manager opportunistic behaviours and irrationality, corporate organizational crises may arise, leading to poor performance and in the extreme, financial crisis, due to managerial

excessive risk-taking behavior. In this regard, weak corporate boards could trigger crisis.

Based on the findings of this study, it is suggested that firms put in place strong board composition and other corporate governance structures that will see to the continued survival, success and performance of firms. In Nigeria, the Securities and Exchange Commission (SEC), and other corporate governance regulatory bodies should be active in this respect in terms of entrenching unwavering standards through corporate governance code. Good corporate governance, will not only improve firm financial performance through oversight functions, credibility building, transparency and accountability but enhance long-term shareholder's value, increased public patronage, increased the market value of the firm, and make it more competitive in domestic and global space.

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