

## Chapter 3

### Conceptualizing Corporate Governance Practices on Financial Performance

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**Abstract:** *This paper highlighted some of the lessons from the corporate collapses and losses in the last few decades have highlighted the role corporate governance practices can play in maintaining viable entities and in safeguarding stakeholders' interests. Most of the corporate failures that were recorded in industries in Nigerian are examples of the risks posed by corporate governance breakdowns. It was proved that traditional governance structure could not stop expropriation of insiders and was a source of inefficiency. Due to these scandals' faith of the investors on capital market was shaken. As a result, regulatory authorities around the world made it compulsory for corporate sector to comply with the code of best corporate governance practices to promote the transparency, accountability and fairness for all stakeholders.*

**Keywords:** *Corporate Governance, Financial Performance, Stakeholders*

#### INTRODUCTION

Good corporate governance requires the strengthening of regulatory of regulatory agencies as well as boosting the capacity of corporation to appoint competent board of directors. A situation where the regulatory agency is weakened by political consideration and saddled with too many functions does not augur well for regulation. 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.

Also, low compliance to regulatory and environmental laws has resulted in the incessant reports of collapsed buildings and other ecological problems. Some staff of regulatory bodies prefer to take bribe rather than ensure that developers obtain the requisite permits and conform to statutory construction standards. These problems if properly addressed will enhance financial performance of the construction and real estate industry.

Financial performance 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). 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). Thus, financial performance is the outcome of many different activities undertaken by an organization (Obiero, 2016). Firms can achieve its goal and increase financial performance if there is in place a good corporate governance practice. Corporate organizations especially the construction and real estate companies are in dare need of good corporate governance mechanism to drive home its desired goal and objectives.

However, lessons from the corporate collapses and losses in the last few decades have highlighted the role corporate governance practices can play in maintaining viable entities and in safeguarding stakeholders' interests. Most of the corporate failures that were recorded in industries in Nigerian

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are examples of the risks posed by corporate governance breakdowns. Also, big corporate scandals in USA during the years 2000 and 2001 (Enron, WorldCom and Tyco etc.) and rest of the world left deep scars on the corporate world. These scandals pushed regulatory authorities to bring laws against complains of corruption, frauds, deception and insider trading such as Sarbanes-Oxley Act (2002). It was proved that traditional governance structure could not stop expropriation of insiders and was a source of inefficiency. Due to these scandals' faith of the investors on capital market was shaken. As a result, regulatory authorities around the world made it compulsory for corporate sector to comply with the code of best corporate governance practices to promote the transparency, accountability and fairness for all stakeholders.

### **Corporate Governance**

Corporate governance has become a burning issue all over the world. Our awareness of major corporate governance issues in Nigeria started with the discovery of overstatements in Cadbury Nigeria Plc accounts in 2007. Since then, many more have followed. The concept has been defined by various authors and scholars alike. Corporate Governance is "the system through which corporations are directed and controlled" (Cadbury, 2002). It embodies the entire process for ensuring good corporate performance and responsiveness to shareholders and other stakeholders (Iyang, 2004). The Organization for Economic Co-operation and Development (OECD, 2002) defined Corporate governance as the system by which business corporations are directed and controlled. Corporate governance defines all organizational roles, responsibilities and accountabilities at all levels. It describes and explains the management hierarchy, that is, the decision-making and accountability chain and ultimately who has the power to manage and legally represent the company in all settings.

Corporate governance spells out requirements for documenting decisions and actions as well as the thinking behind them. It also provides for corrective action for non-compliance or weak oversight, controls and management. 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). 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.

### **Board Independence.**

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. Mallin (2006) sees independent executives as directors who besides receipt of director's compensation do not bear any other significant relationship with the entity in which the decision of the board may affect their independent judgment. Whereas, inside director is an individual on the board who is a member of staff of the entity (Siegel & Shim, 2006).

The main purpose of having independent directors on the board is to increase the level of monitoring and controlling authority over management (Agrawal & Knoeber 1996; Goodstein et al., 1994; Klein, 1998; Kosnik, 1990). Cheng and Courtenay (2006) in their study revealed that board independence is positively correlated to the disclosure level for a sample of firms listed on the Singapore stock exchange. Given that such directors are independent of management, they are more objective in dealing with management and providing necessary information to outsiders such as key stakeholders. As such, the success in reducing the information asymmetry gap among insider and outsider is strongly depending on the number of independent directors on the board

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(Agrawal & Knoeber 1996; Goodstein et al., 1994; Klein 1998; Kosnik 1990). In fact, the independence of board members often results in firms making additional voluntary disclosures (Anup & Shahnag, 2013). Prior literature has shown that firms with dominating independent directors on the boards disclose more information (Fama & Jensen, 1983; Leftwich et al., 1981). In contrary to that, Bhagat and Black (1999) in their study found out that "there is no relationship between the percentage of outside directors on the board and performance".

Kamardin and Haron (2011) found that independent director is significantly related to the performance of a company. This is also confirmed by Saat et al. (2011) where a study was conducted using 221 samples of Malaysian public listed companies to investigate the influence of a high number of independent directors on firm value. The results showed that firm performance is enhanced when the board composition is solely consisting of independent non-executive directors. Paul et al. (2011) also concluded that there is no significant relationship between the percentage of the board member constituted of the independent directors and corporate performance and an organization cannot improve its economic performance by raising the independent directors on its board. Sakawa et al. (2009) also found no significant relationship between the independent directors' ratio and company performance using a sample comprising data of 522 manufacturing companies listed in the Tokyo Stock Exchange during 1991-1995.

### **Financial Performance**

The concept of financial performance has been a topic of discussion among researcher and financial analysts alike. Financial performance principally reflects business sector outcomes and results that shows overall financial health of the sector over a specific period of time. It indicates how well an entity is utilizing its resources to maximize the shareholders wealth and profitability (Naz et al., 2016). In other words, it is a financial action used in order to generate higher sales, profitability and worth of a business entity for its shareholders through managing its current and non-current assets, financing, equity, revenues and expenses. Its main purpose is to provide complete information to shareholders and stakeholders to encourage them in making decisions. It can be used to evaluate similar companies from the same industry or to compare industries in aggregation. Financial performance is the result of a firm's policies and operations in monetary terms. It is the result of many different activities undertaken by an organization (Rotich et al., 2015). The objective of measuring financial performance according to Ngui (2010) is to establish the maximum return on the capital employed in the business.

Financial performance of companies can be accessed through analysis of the financial statement. Analysis of financial statements can be used to measure the development and financial performance of a company in the past as well as the present which can also be used to estimate the company's financial condition so that it is used to know the weaknesses and opportunities that exist (Nufus & Awaluddin, 2019). Financial performance can be assessed with several analytical tools. According to Subramanyan and Wild (2014), as cited by Nufus et al. (2020), there are five important tools for financial analysis. These are:

Comparative financial statement analysis, carried out by examining the statement of financial position, income statement, or sequential cash flow statement from one period to the next period.

### **CONCLUSIONS**

Corporate organizations especially the construction and real estate companies are in dare need of good corporate governance mechanism to drive home its desired goal and objectives. Corporate governance has become a burning issue all over the world. Our awareness of major corporate governance issues in Nigeria started with the discovery of overstatements in Cadbury Nigeria Plc accounts in 2007. Since then, many more have followed. The construction and real estate industry in Nigeria have 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. There are many challenges to the effectiveness of corporate governance in Nigeria.

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they range from corrupt practices, ownership structure, slow and inefficient judicial process to lack of enforcement mechanisms by regulatory bodies.

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