CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE:

A Study of Selected Insurance Companies in Nigeria

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Abstract

This paper examines the impact of corporate governance on the performance of insurance companies in Nigeria. The study covers the period of 5years between 2011 and 2015, uses multiple regression analysis to test the significant effect of each independent variables on dependent variable and data were obtained through secondary data. It was reveals that board size contributes negatively while leverage contributes positively to return on asset. Management team was removed automatically by the package due to multi collinearity problem. The study concluded that corporate governance does not have significant impact on the performance of insurance companies in Nigeria and recommends that NAICOM should improve on supervision of the nation's insurance industry activities by strengthening its inspection and enforcement divisions. This is necessary to ensure that the code of good corporate governance for insurance industry is strictly adhered to by practitioners and other stakeholders. Compliance with code of good corporate governance would promote safe and sound insurance practice in the insurance industry.

Keywords: corporate governance, financial performance, stakeholders, NAICOM, compliance

Introduction

As a segment of the financial industry a significant contribution is expected from insurance company to the growth of Nigeria economy. However, the effect is exceedingly soft that cannot be felt on the economy. Insurance companies remain a fringe player in the Nigeria financial system and the reason for this perennial low performance is not far-fetched. The major concerns is the spate of Corporate Governance that derailed investors' confidence and built more financial recklessness and the overwhelming incidence of corporate fraud relating to overstated accounts, have informed renewed global emphasis on the need for corporate governance. Arguably, there is a growing concern that good Corporate Governance has a positive link to national economic growth and development. Nwachukwu (2007), posits that Checks and Balances in an organization are strengthened through Corporate Governance. A first class company without a strict corporate enforcement mechanism may paint misleading pictures of financial performance of their company to lure unsuspecting investors. To this end, adherence to good Corporate Governance is recognized as crucial to the success, growth and development of the corporate sector. Corporate Governance in this context can be seen as the process and structure used to manage business affairs of the company towards enhancing prosperity and corporate accounting with the ultimate objectives of realizing shareholders long term value while taking into account the interest of other stakeholders. Corporate Governance is the system by which organizations are directed and controlled. It's a set of relationships between company directors, shareholders and other stakeholder's as it addresses the powers of directors and of controlling shareholders over Non-Controlling Interest (NCI), the rights of employees, rights of creditors (payables) and other stakeholders (Murrithi 2009). Mang'unyi (2011), opines that corporate governance is an internal system encompassing policies, processes and people, which serve the needs of shareholders and other stakeholders, by directing and controlling management activities with good business savvy, objectivity, accountability and integrity. Najjar (2012) in his own view observed that any governance principle adopted by the insurance industry should be flexible enough to take into account the variety of insurers within its purview because each insurance company tailors its Corporate Governance procedures according to its own circumstances. Corporate Governance increases competitiveness and makes criminal activities more difficult. The presence of an effective corporate governance system helps to provide a degree of confidence that is necessary for proper functioning of a market economy and economic growth. Good Corporate Governance in the insurance sector therefore requires set of comprehensive internal control procedures and policies established by board of directors and implemented by skills personnel, led by effective management. The compliance with the rules, laws and regulation; principles guiding insurance business is capable of improving company performance. Separation of power between the board and management team may give rise to efficiency and good performance. Corporate Governance deals precisely with problems of conflict of interest, design ways to prevent corporate misconduct and aligns the interest of stakeholders using incentive mechanism. A variety of Corporate Governance frameworks have been developed and adopted in different parts of the world. According to Mulili and Wong, (2010), countries that followed civil law (such as France, Germany, Italy, and Netherlands) developed corporate frameworks that focused on stakeholders. On the other hand, countries that had a tradition of common law (e.g. Australia, United Kingdom, USA, Canada and New Zealand) developed frameworks that focused on stakeholders return or interests.

Consequentially, the absence of good Corporate Governance is a major cause of failure of many well performing companies. The economic well-being of a nation is the reflection of the performance of its companies. Thus the low level of development of developing nations is attributed to the low level of good Corporate Governance practices. Hence the emphasis placed on good Corporate Governance in the existing literature as the most important problem facing the development of various African countries, such as Nigeria, Ghana, Congo, Cape Verde, Kenya, Mali etcetera, the main objectives of this study is to examine the relationship between Corporate Governance and Organizational Performance.

Literature

Conceptual framework

Corporate Governance requires corporations exercising menses accountability to shareholders and the public, and also monitoring the management of organizations in running their businesses. Corporate Governance is normally of two categories namely: self and statutory. Self-regulation involves aspects of Corporate Governance that are difficult to legislate. The issues in this category involve the human element. This expresses the relationship and the independence of the board of directors with the management and the appraisal of directors' performance. On the other hand, self-regulation is the frame work of Corporate Governance that can be explained in legal terms. The legislative and regulatory rules include duties ,obligations, rights and liabilities of directors, controlling shareholders and company officers and disclosure and transparency (Abubakar 2009:28).Organization for Economic Co-operation and Development (OECD, 2009) views the role of Corporate Governance as twofold: first, it covers the manner in which shareholders, managers, employees, creditors, customers and other stakeholders interact with one another in shaping corporate strategies; and second, it relates to public policy, and an adequate legal regulatory framework, which are essential for the development of good systems of governance (OECD, 2009). Corporate Governance increases investors' confidence and goodwill. It also ensures transparency, accountability, responsibility and fairness (Olajide 2012).

Corporate Governance in Nigeria

Corporate Governance has gained prominence in Nigeria as is the case in other countries. This has been caused partly by corporate failure or poor performance of public and private companies Barako, Hancock and Izan (2006). The history of Corporate Governance date back to year 2002 where a seventeen-man committee led by Atedo N.Peterside was set up with the following terms and references which are: to identify the weaknesses in the current Corporate Governance practices with respect to public companies, to examine practices in other jurisdictions with a view to adopting international best practices in Corporate Governance in Nigeria, to make recommendations on necessary changes to current practice, to examine any other issues relating to Corporate Governance in Nigeria.

The report of the committee was adopted and launched in October, 2003 as the code of Corporate Governance for public companies in Nigeria. The code includes: Board Composition, Director Responsibilities, Shareholders Right and Privileges', and Audit Committee.

Overview of insurance company in Nigeria

Igbojekwe (2006) defines insurance as the identification of a purchaser of an insurance contract against losses which may arise from the occurrence of specified type of events after the payment of a consideration called premium. Insurance businesses are divided mainly into Non-life and Life insurance. Non- life (General) insurance policies, including automobile and homeowners policies, provide payments depending on the loss from a particular financial event while life insurance policy is a contract with an insurance company, in exchange for premium payments, the insurance company provides a lump sum payment, known as a death benefit, to beneficiaries upon the insured's death. Life (Long-term) insurance is an insurance business in which the benefits due to the policy holders become payable on the attainment of a stipulated age, at death or on the occurrence of a specified event whichever occur earlier. The primary objective of insurance is to provide protection from identifiable risks that may arise in a particular point in time. However, the poor performance of insurance in Nigeria stemmed from several years of non-claims payments by underwriting firms, translated to some bad publicity of the industry and consequently, confidence in the industry eroded significantly, (Agabi 2009). Because of the confidence crisis of the industry, Nigerians no longer considered insuring a necessity. In fact, it became a pariah industry. The Insurance industry in Nigeria has for almost four decades seen a number of chances being introduced and adopted. It is however, worrying to know that six insurance firms have either collapse or has been placed and overseen under statutory management; representing an average of one insurance company after every four years. This includes Phoenix Insurance, Lion of Africa Insurance Company, Sun Insurance Company Ltd, Admiral Insurance Company Ltd, Crusader Insurance Plc, and Fire and Equity Insurance Company Ltd.

In response to this trend, the government of Nigeria responded by establishing the National Insurance Commission (NAICOM) which is the prudential regulator of Insurance industry in Nigeria while the regulatory statute is the Insurance Act, 2003 and 2004 (as amended), Companies and Allied Matters Act Cap C20 LFN 2004 (CAMA 2004) and International Financial Reporting Standard on Insurance Contract (IFRS 4 on Insurance Contract). NAICOM is also responsible for supervising and developing the Insurance industry in collaboration with other stakeholders such as agents and brokers. To tackle the hindrances bedeviling the industry, National Insurance Commission (NAICOM) began an overhauling of the system by announcing new minimum capital requirements in 2005 (which led to mergers and acquisitions); setting up a code of good corporate governance for the Insurance industry in Nigeria (in 2009) and most recently putting in place new quarterly reporting guidelines (in line with IFRS Standards). It is expected that these mechanisms would engender structural soundness, a well-capitalized industry, high standards of conduct, reasonable profit declaration, and finally a domino effect on the GDP. Ndung'u (2012) explained further, the future trend of the Insurance and Reinsurance market in Africa was to be spread across countries with free movement and with the opportunity to exploit full cross-border growth. The industry should therefore prepare for this eventuality in a timely manner.

CEO Duality and Firm Performance

A lot of studies that have examined the separation of office of board chair from that of CEO generally sought to reduce agency costs for a firm. Kajola (2008) found a positive and statistically significant relationship between performance and separation of board chairman and CEO. Yermack (1996) also found firms are more valuable when different persons occupy the CEO and board chairman. The results of the studies show that boards that are structured to be independent of the CEO are more effective in monitoring corporate financial accounting process and therefore more valuable (Klein 2002). Abor and Biekpe (2005) demonstrate that duality of both functions constitute a factor that influence the financing decision of the firms with structure separating those two functions are more able to maintain the optimal amount in capital structure than firms with duality.

Good Corporate Governance

Having a good Corporate Governance enhances organizational strategies such as establishment of strategic objectives and the right corporate value, clear line of responsibility and accountability are set and enforced (well organizational structure), it leads to effective and efficient supervision, good and transparent succession plans, periodic appraisal of staff on issues of Corporate Governance etcetera.

Firm Financial Performance

Financial performance which assesses the fulfillment of a firm's economic goals has been long being an issue of interest in managerial researches. Firm financial performance relates to the various subjective measures of how well a firm can use it given assets from primary mode of operation to generate profit. Kothari (2001) defined the value of a firm as the present value of the expected future cash flows after adjusting risk at an appropriate rate of return. According to Eyenubo (2013) it is the success in meeting pre – defined objectives, targets and goal within a specified time target. Qureshi, (2007), put forward four different approaches in which the value of a firm has been identified in corporate finance literature. These are: the financial management approach which focus on the evaluation of cash flow and investment level before identifying and assessing the impact of financial sources on firm value; the capital structure approach which studies the impact of capital structure changes on the value of firm and how different factors impact directly or inversely the debt and equity component of the firm capital; the resource of based approach which explains the value of firm as an outcome of firm's resources; and finally, the sustainable growth approach which is a summary of the above three approaches to firm value, taking into account the firm's operating performance, it investment and financial needs the financing sources, and its financing and dividend policies for sustainable development of firm's operating resources and maximization of firm value. This study examines two key accounting measure of firms' financial performance which are Return on Asset and Profit Margin.

Return on Asset (ROA)

Return on asset is an indicator of how profitable a company is relative to its total assets. It gives an idea as to how efficient management is at using its assets to generate earnings, which measures efficiency of the business in using its assets to generate earnings, that is, it measures efficiency of the business in using its assets to generate net income. It is a profitability ratio. Calculated by dividing a company's annual earnings by its total assets, ROA is displayed as a percentage. Sometimes this is referred to as "Return on Investment". Return on Assets is the after tax income. It can be found on income statement. Average total assets are calculated by dividing the sum of total assets at the beginning and at the end of the year can be obtained from year ending balance sheet (statement of financial position) of two consecutive financial years.

The formula to calculate return on assets is:

Statement of financial position

$$ROA = \frac{\text{Annual Net Income}}{\text{Average Total Assets}}$$

Profit Margin (PM)

Due to the sample that were used for this study from the Nigeria Stock Exchange (NSE), operating and financial arrangement vary so much that different entities are bound to have different levels of expenditure, so comparing one to another has little or no meaning. Profit margin is a company's pricing strategies and how well it controls cost. Profit margin is profit after tax divided by revenue of the selected samples of firms. Thus, it is represented by;

$$PM = \frac{\text{Profit after Tax}}{\text{Revenue}}$$

Theoretical Review

Corporate Governance has no single acceptable definition; this is often attributed to the huge difference in countries Corporate Governors Codes Solomon (2010). The definition varies based on the framework cultural situation of the countries under consideration Armstrong and Sweeney (2002). CMA Act (2002) defines Corporate Governance as the process and structure used to direct and manage business affairs of the Company towards enhancing prosperity and corporate accounting with the ultimate objective of realizing shareholder long term value while taking into account the interest of other stakeholders. According to Glossary (2013) Corporate Governance is about promoting corporate fairness, transparency and accountability while Adedokun (2003) sees Corporate Governance as the framework for accounting for decision making, it is effective management relationship within the organization integrity to enhance firm performance for the benefit of all stakeholders. Okeohalam and Akinboade (2003) outlined specific benefits of Corporate Governance to include moral uprightness among organization work force and it could be counted to safeguard the resources of all stakeholders. In addition, it improves the confidence of the investing public and attracting foreign investors to the company in particular and economy in general. Corporate Governance enhance the performance and ensure the conformance of corporation to creating and maintaining a business environment that motivate managers and entrepreneurs to maximize firm operational efficiency, return on investment and long term productivity growth (Adekunle & Aghedo 2014). The ultimate outcomes of this Corporate Governance benefit are higher cash flows and superior performance of the firm Love (2011). A developing economy like Nigeria needs a well governed and managed business enterprises or organization that can attracts investment, create job opportunities and wealth for the youth remain viable, sustainable and competitive in the global market.; a good Corporate Governance is foundation for national economic development.

Various theories have been put forward to help us understand the concept of Corporate Governance. The agency theory and the stakeholder theory are the main theories underlying the concept of Corporate Governance, (Mulili & Wong 2010). However, other theories were also discussed.

Agency Theory

Agency theory is defined as the relationship between the principals, such as shareholders and agents such as the company executives and managers. In this theory, shareholders who are the owners or principals of the company, hires agents to perform the work. Principals delegate the running of business to the directors or managers, who are the shareholder's agents Clarke (2004). Agency theory suggests that employees or managers in organizations can be self-interested. The agency theory shareholders expect 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 Padilla (2000). The agent may be succumbed to self-interest, opportunistic behavior and falling short of congruence between the aspirations of the principal and the agent's pursuits. Even the understanding of risk defers in its approach. Although with such setbacks, agency theory was introduced basically as a separation of ownership and control, Bhimani (2008). The agents are controlled by principal-made rules, with the aim of maximizing shareholders value. Hence, a more individualistic view is applied in this theory Clarke (2004).

Indeed, agency theory can be employed to explore the relationship between the ownership and management structure. However, where there is a separation, the agency model can be applied to align the goals of the management with that of the owners. The model of an employee portrayed in the agency theory is more of a self-interested, individualistic and are bounded rationality where rewards and punishments seem to take priority, Jensen and Meckling (1976).

Stewardship Theory

A steward is defined by Davis, Schoorman and Donaldson (1997) as one who protects and maximizes shareholders wealth through firm performance, because by so doing, the steward's utility functions are maximized. In this perspective, stewards are company executives and managers working for the shareholders, protects and make profits for the shareholders. Stewardship theory stresses not on the perspective of individualism, but rather on the role of top management being as stewards, integrating their goals as part of the organization. The stewardship perspective suggests that stewards are satisfied and motivated when organizational success is attained. It stresses on the position of employees or executives to act more autonomously so that the shareholders' returns are maximized. Indeed, this can minimize the costs aimed at monitoring and controlling behaviors. On the other end, Daily et al. (2003) argued that in order to protect their reputations as decision makers in organizations, executives and directors are inclined to operate the firm to maximize financial performance as well as shareholders' profits. In this sense, it is believed that the firm's performance can directly impact perceptions of their individual performance. Moreover, stewardship theory suggests unifying the role of the Chief Executive Officer (CEO) and the Chairman so as to reduce agency costs and to have greater role as stewards in the organization. It was evident that there would be better safeguarding of the interest of the shareholders.

Stakeholder Theory

Wheeler, Colbert and Freeman (2003) argued that stakeholder theory was derived from a combination for the sociological and organizational disciplines. Stakeholder theory can defined as any group or individual who can affect or is affected by the achievement of the organization's objectives. Stakeholder theories suggest that managers in an organization have a network of relationships to serve-this include the suppliers, employees and business partners. And it was argued that this group of network is important other than owner-manager-employee relationship as in agency theory. On the other end, Sundaram and Inkpen (2004) contend that stakeholder theory attempts to address the group of stakeholders deserving and requiring management's attention.

Resource Dependency Theory

Whilst the stakeholder theory focuses on relationships with many groups for individual benefits, resource dependency theory concentrates on the role of board directors in providing access to resources needed by the firm. Hillman, Canella and Paetzold (2000) contend that resource dependency theory focuses on the role that directors play in providing or securing essential resources to an organization through their linkages to the external environment. Indeed, Johnson (1996) concurs that resource dependency theories provide focus on the appointment of representatives of independent organizations as a means for gaining access in resources critical to firm success. For example, outside directors who are partners to a law firm provide legal advice, either in board meetings or in private communication with the firm executives that may otherwise be more costly for the firm to secure. It has been argued that the provision of resources enhances organizational functioning, firm's performance and its survival. Daily (2003) according to Hillman, Canella and Paetzold (2000) that directors bring resources to the firm, such as information, skills, access to key constituents such as suppliers, buyers, public policy makers, social groups as well as legitimacy.

Empirical framework

In the study of Esra and Allan (2015), examined the impact of corporate governance characteristics on firm's performance, covers the period 2007 – 2011. The study sampled 42 out of 48 financial companies in Bahrain. Descriptive analysis was used to estimate the data gathered from the samples companies. The researchers found out that performance measured by return on asset and return on equity are significantly related to corporate governance. David and Tobias(2013), investigated the effects of corporate governance on the financial performance of listed insurance companies in Kenya, covers the period 2007 – 2011, uses descriptive and inferential statistics in analyzing the data. Their findings reveal that there is a strong relationship between the corporate governance and firm's financial performance. Adekunle and Achendo (2014), in their study, they examined the relationship between corporate governance and financial performance of randomly selected quoted firms in Nigeria. Using ordinary least square regression to estimate the relationship between the variables employed. The researchers found out that CEO status also has a positive relationship with firm performance but insignificant at 5% level of significance. They recommended that board should be majorly dominated by independents directors and board size should be in line with corporate size and activities. Peters and Bagshaw (2014) examine the effect of Corporate Governance mechanisms on firm financial performance using listed firms in Nigeria as a case study. Covers the period of 2010 – 2011, using descriptive analysis to estimate the data obtained through the corporate website of the respective firms and website of the Securities and Exchange Commission. Their results indicated that the nature of control over the sector have an impact on companies' decision to disclose online information about their Corporate Governance in Nigeria. The study recommends that effort should be made in setting up a follow-up and compliance team to make sure that all firms across Nigeria sector do not only comply but meet up with the different expectations of regulatory body as mandated in the code of Corporate Governance.

Methodology

In testing the relationship between Corporate Governance and Performance of Insurance Companies in Nigeria, the study considered secondary data through the annual report financial statement of two selected insurances companies, covering the period of 5 years for each of the selected insurance companies. Financial ratio analysis was used to derive return on asset that represents dependent variables while board size, management team and leverage were considered as independent variables. This study makes use of *ex-post facto* research design since it is based on past events in form of post mortem in view of the nature and purpose of the study.

In achieving the objectives of this study, inferential analysis was used through ordinary least square method of multiple regression models.

Model specification

ROA=f (BSIZE, MTEAM, LRAGE)

ROA = $\beta 0 + \beta_1$BSIZE + β_2MTEAM+ β_3LRAGE + μ

ROA = Return on Asset

BSIZE=Board Size

MTEAM= Management team

LRAGE= Leverage

μ= Error Term

Summary of the result

Regress ROA MT BS LV

Note: MT omitted because of collinearity

TABLE 1:

Source	SS	df	MS		
				Number of obs =	5
				F(2, 2) =	0.80
Model	.001684615	2	.000842308	Prob > F =	0.5567
Residual	.002115384	2	.001057692	R-squared =	0.4433
				Adj R-squared =	-0.1134
Total	.0038	4	.00095	Root MSE =	.03252

TABLE 2

ROA | Coef. Std. Err. t P>|t| [95% Conf. Interval]

MT	0 (omitted)					
BS	-.0180769	.0305884	-0.59	0.614	-.1496882	.1135344
LV	.1038462	.1104724	0.94	0.446	-.371478	.5791703
_cons	.1373077	.2847388	0.48	0.677	-1.087824	1.36244

Interpretation

The model is expressed as:

ROA = 0.1373077 - 0.0180769BS + 0.1038462LV

From table 1, it is the mean square for the model and residual are 0.000842308 and 0.001057692 respectively with F-value of 0.80, having p-value of 0.5567. The independent variable management team (MT) is omitted because of collinearity. The p-value is an indication that the model is not significant, also, which implies that the model is not sufficient and adequate in relating return on asset with board size and leverage. Moreover, though board size contributes negatively while leverage contributes positively to return on asset with the two factors jointly explaining 44.3% variation in return on asset. However, both business size and leverage are not significant.

Conclusion

Based on the findings of the analysis and data gathered to represents Corporate Governance and Performance of Insurance Companies in Nigeria, the study concluded that Corporate Governance does not have significant effect on the performance of insurance companies in Nigeria during the years under review. This is as a result of low compliance and slipped away from the laid down standard rule of Corporate Governance by most of insurance company in Nigeria.

Recommendations

i. NAICOM should improve on supervision of the nation's insurance industry activities by strengthening its inspection and enforcement divisions. This is necessary to ensure that the code of good Corporate Governance for insurance industry is strictly adhered to by practitioners and other stakeholders. Compliance with code of good Corporate Governance would promote safe and sound insurance practice in the insurance industry.

ii. The management staffs have important roles to play in promoting sound internal control system in insurance companies. This would ensure that laid down procedures are reviewed regularly to promote good Corporate Governance. It is also necessary in order to redeem the image of the insurance industry, and perception of insurance by the public.

iii. The board composition should comprise Minority Shareholders, this will protect other stakeholders. NAICOM should prevent person related by blood from the office of Chief executive officer and Chairman.

iv. The composition of the audit committee should be clearly spelt out so as to enable them perform their oversight functions effectively as required.

v. Insurance companies in Nigeria should properly define Corporate Governance and its mechanisms and implement them effectively in order to reach the company's long- term goals, build stakeholders' confidence and generate positive investment flow.

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