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Corporate Governance Mechanisms and Financial Performance of Quoted Insurance Companies in Nigeria

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ABSTRACT
The study empirically investigates the relationship between corporate governance and financial performance of quoted insurance companies in Nigeria within the period 2009 - 2015. It also ascertains the relationship between board size, board independence, audit committee supervision, board gender diversity and financial performance of quoted insurance companies in Nigeria. The study employs panel data of nineteen (19) sampled insurance companies quoted on the Nigerian Stock Exchange. Data were collected from annual audited reports of the quoted insurance companies. Panel OLS regression methodology was used to analyze the data and the data were regressed with the aid of EVIEWS 7.0 econometric software package. The study revealed that board size, board independence and audit committee composition have negative effect on financial performance while board gender diversity positively influences financial performance. However, none of the corporate governance variables (BZS, BDI, BGD and AUD) significantly influence financial performance (ROE). The study therefore recommends that steps should be taken for mandatory compliance with the code of corporate governance by management of insurance companies in Nigeria.
Keywords: Corporate Governance, Financial Performance and Insurance Company.

INTRODUCTION

Recently, the issue of corporate governance has been a source of interest to investors, policy makers, and corporations especially after recent corporate scandals. Investors have asked what must be done to get corporations to maximize shareholders value and improve its performance. Consequently, researchers, corporate managers, and shareholders are interested in the nexus between corporate governance and firm performance.

Numerous events are accountable for the keen interest in corporate governance especially in both industrialized and emerging nations. The subject of corporate governance leapt to global business limelight from relative obscurity after a string of collapses of high profile companies. Enron, the Houston, Texas based energy giant and WorldCom the telecom behemoth, shocked the business world with both the scale and age of their unethical and illegal operations. These organizations seemed to indicate only the tip of a dangerous iceberg. While corporate practices in the US companies came under attack, it appeared that the problem was far more widespread. Large and trusted companies from Parmalat in Italy to the multinational newspaper group Hollinger Inc., Adephia Communications Company, Global Crossing Limited and Tyco International Limited, revealed significant and deep-rooted problems in their corporate governance. Even the prestigious New York Stock Exchange had to remove its director (Dick Grasso) amidst public outcry over excessive compensation (La-Porta, Lopez and Shleifer, 1999).

Corporate governance tools assure shareholders of adequate returns on investments. Daily and Dalton (1992) and Eisenberg, Sundgren, and Well (1998) agreed that when these tools are not exiting or did not function properly, outside investors would neither invest in company equity securities nor lend to company. And this may cause company not to have access to long term debts and therefore the overall economic performance would suffer because many good business opportunities would be missed and financial distress at individual firms would spread quickly to other firms, employees, and consumers. In the case of Nigeria, tribalism, inexperience directors, unqualified staff, poor management, lack of standard practice, inadequate polices and weak internal control systems account for some of the lapses in the operation of some corporate organizations. And that is why many organizations in Nigeria were distressed especially most public corporations and private companies, such as NITEL, NEPA, NRC,

Machine Tools, Steel Rolling, Nigerian Tobacco Company, Exide Battery, Leventis, National Banks, the Alpha Merchant Bank Limited, Savannah Bank Plc, SocieteGenerale Bank Limited, Forum Finance Limited, Global Bank, etc. It is on this note that this study wishes to examine the impact of corporate governance mechanism andfinancial performance of quoted insurance companies in Nigeria.

LITERATURE REVIEW

Concept of Corporate Governance

Conceptually corporate governance has been defined by specialists from different perspectives. Coleman and Nicholas-Biekpe (2006) defined corporate governance as the relationship of the enterprise to shareholders or in the wider sense as the relationship of the enterprise to society as a whole. However, Mayer (1999**)** offers a definition with a wider outlook and contends that it means the sum of the processes, structures and information used for directing and overseeing the management of an organization. It is upon this system that specifications are given for the division of competencies and responsibilities between the parties included (board of directors, the supervisory board, the management and shareholders) and formulate rules and procedures for adopting decisions on corporate matters. Adams and Ferreira (2003) defined Corporate Governance as both the promise to repay a fair return on capital invested and the commitment to operate a firm efficiently. Similarly, Attiya and Robina (2007) consider the codes of good governance as "a set of 'best practice' recommendations regarding the behaviour and structure of the board of directors of a firm designed to address deficiencies in the corporate governance system by recommending a comprehensive set of norms of the role and composition of the board of directors, relationship with shareholders and top management, auditing and information disclosure, and selection, remuneration, and dismissal of directors and top managers".

Corporate Governance is divided into external and internal corporate governance. Internal corporate governance is covering public's interest, employees' interest, and owners' interest. While external corporate governance is defined as a mechanism through which governments' responsibility to control the operations of banks are exercised based on the prevailing bank regulations (Daily and Dalton, 1992).

Concept of Financial Performance

There are different views on what performance is, one view is concerned with record of outcomes achieved, that is, performance is regarded as accomplishments. Another view is that performance is about doing the work which is behavioral in nature. Fadun, (2013) opined that performance is a multi-dimensional construct, the measurement of which varies depending on whether the measurement objective is to assess performance outcomes or behavior. Mallin, (2004) sees performance as individual efforts that will lead to a specific outcome that will be matched with expected reward by managers. Armstrong (2004) in Fadun, (2013) defined performance as the outcomes of work because they provide the strongest linkage to the strategic goals of the organization, customer satisfaction, and economic contributions. Performance could be regarded as behavior i.e. the way in which organizations, teams, and individuals get work done. Hillman, Cannela, and Pactzola (2000), see performance as the act or process of performing a task, an action that involves a lot of effort, or how well or badly you do something or something works. Brumbach (1988) in Fadun, (2013) has a comprehensive view of performance:

Performance means both behaviors and results. Behaviors emanate from the performer and transform performance from abstraction to action. Not just the instruments for results, behaviors are also out-comes in their own right – the product of mental and physical effort applied to tasks – and can be judged from the results.

This definition embraces both the behavior and outcomes and indicates that when managing the performance of teams and individuals both inputs (behaviors) and outputs (results) need to be considered. That is, there is need for performance evaluation, assessment or appraisal which assists management to plan, control activities and to make viable economic financial decisions which is the objectives of the organization as a whole to be met (Albert, 2014).

Akeem, Terer, Temitope, and Feyitimi (2014), emphasized that management, and other stakeholders measure or evaluate the overall financial performance of a firm through its audited financial statements which shows the results of the firm's business operating cycle within a year and to identify firm's strengths and weaknesses in order to proffer remedial solution. Furthermore, Agrawal, and Chadha, (2005) suggested that firm's future plan should be in line with the firm's financial strengths and

weaknesses; consequently, financial analysis is the starting point for making plans, before adopting any advanced forecasting and planning techniques.

Understanding the past is a prerequisite for anticipating the future. The management of the firm would be interested in all areas of the financial analysis; it is their duties to make the effective and efficient use of the firm's resources in their quest for optimization attainment. Shareholders (investors), who have invested their resources in the company, are most concerned about the organization's profitability. They have assurance in those companies that indicate stable growths in earnings seeing that, they focus on the analysis of the firm's current and potential earnings. While supplier of long-term debt concentrated on the long-term and short-term solvency. They evaluate the firm's profitability over time, its ability to generate cash to be able to pay interest and repay principal and the relationship between various sources of funds (capital structure relationships).

In Nigeria, Central Bank provides prudential financial guideline to evaluate banks' financial health; it comprises some financial soundness indicators-FSIs. They are: Capital Adequacy Ratio (CAR), Loan to Deposit Ratio (LDR), Liquidity Ratio (LR), Cash Reserve Ratio (CRR), and Non Performing Loan Ratio (NPL) as proxies for effective and efficient corporate governance while return on assets (ROA) as banks' performance.

Measures of Firm Performance

There are numerous measures for measuring the performance of a firm. Previous studies have employed return on assets (ROA), return on equity (ROE) and Tobin's Q as measures of firm performance. For example, Healey, (2003) and both used ROA and Tobin's Q as measures of firm performance. Deegen (2004) used sales, investment opportunities and ROA as parameters for company performance while Klapper and Love (2002) used Tobin's Q, ROA and ROE as measures of firm performance. However, there has been a great controversy as to whether or not these measures are the best proxies for firm performance. Some have argued that accounting rates of returns such ROA and ROE only convey little information about economic rate of return. There is also a serious contention that market based measures are superior to accounting based performance measures because the latter is subject to executives' manipulation, making the measures more attractive. This practice is known as window dressing. Some critics believe that the use

of Tobin's Q as a measure of firm performance rests on the argument that Tobin's Q is a better proxy for the firm's future growth opportunities, and not firm performance. Others argue that Tobin's Q is sensitive to external events, and is therefore beyond the control of the executives.

Return on Assets (ROA): This is measured by the ratio of net income to total assets.Net income is defined as net profit after tax.

$$ROA = \frac{Net\ Income}{Total\ Assets}$$

However, according to Baysinger and Hoskinsson (1990), using this method to calculate ROA has some drawbacks. One of the reasons given is that total assets are recorded at historical cost while net income is recorded at current values. The replacement cost of the company assets optimally ought to form the denominator. Adopting this measure for the denominator is however difficult to find as companies assets are sometimes very unique. Another reason is that ROA contains information that has to do with two key drivers of company value creation which are profit margins and asset turnover because ROA shows how much income has generated for one naira of assets. There can also be a great variation of ROA across companies and across industries. Companies such as manufacturing companies might be characterized as being highly asset intensive and thus might require a higher net income to obtain an equal level of ROA compared to non-asset intensive companies. Therefore, caution must be exercised in drawing conclusions from comparing ROA across different types of companies,

Return on Equity (ROE): This is a measure of firm performance which is proxied as the ratio of net income to total equity.

$$ROE = \frac{Net\ Income}{Total\ Equity}$$

Return on equity is very important because it contains information about profit margins, asset turnover and financial leverage. ROE measures the return earned on shareholders' funds and thus a measure of the value generated by the investors invested capital.

Tobin's Q: This is a measure of whether or not the market value of the company is equal to its replacement cost. Therefore, the formula for calculating Tobin's Q is the ratio of the market value of share capital to the book value of total assets. Where these two variables are equal Tobin's Q would be equal to 1. If the ratio is smaller than 1, this shows that the cost to replace the company's assets is greater than the stock value of the company,

which implies that the stock is undervalued. Similarly, the reverse would be the case where the ratio is greater than one. However, the problems found with the calculation of ROA also exist for the calculation of Tobin's Q. In other words, it is difficult to correctly estimate the replacement cost of company assets since there might be differences between the book value of total assets and the market value of asset. Therefore, in the calculation below the book value of total assets shall be applied as the replacement cost, knowing that this might not result in exact values of a company Tobin's Q.

$$\text{Tobin's Q} = \frac{\text{Market Value of Share Capital}}{\text{Book Value of Total Assets}}$$

Hypotheses of the Study

The null hypotheses are indicated as follows:

H_{O1}: Board size has no significant relationship with financial performance of quoted insurance companies Nigeria.

H_{O2}: Board independence does not have a significant relationship with financial performance of quoted insurance companies Nigeria.

H_{O3}: Audit committee has no significant influence on financial performance of quoted insurance companies in Nigeria.

H_{O4}: Board gender diversity does not have no significant impact on financial performance of quoted insurance companies in Nigeria.

METHODOLOGY

In this study, the ex-post facto time series cross-sectional research design is adopted in order to evaluate relationships among variables across a set of population overtime that may exhibit quite differing characteristics. This also involves analytical method that involves the application of secondary data. Thus, data for this study will be collected about the same phenomenon at different points in time devoid of any attempt on the part of the researcher to influence or manipulate the data. The data obtained would expose changes in the variables of concern.

The population for this study consists of all (19) nineteen Nigerian quoted insurance companies and is still operating as at 2017. Using the judgmental sampling technique, this study selected 19 listed insurance firms and the listed insurance firms selected are African Alliance Insurance, Aiico, Axa Mansard, Consolidated Hallmark, Continental Reinsurance, Cornerstone Insurance, Custodian & Allied Insurance, Equity Assurance, Lasaco Assurance, Linkage Assurance, Mutual Benefit Assurance, Nem Insurance, Niger Insurance, Regency Alliance Insurance, Royal Exchange, Staco

Insurance, Standard Alliance Insurance, Unity Kapital Assurance, Wapic Insurance. These insurance firms were considered because they are listed in the Nigerian stock market which therefore enabled us to have easy accessibility to their annual reports which is the major source of our secondary data.

The data used for this study was generated from secondary sources consisting of the annual audited financial statements of the sampled insurance firms listed on the Nigerian Stock Exchange (NSE) between the eight (8) years period of 2008 and 2015.

Model Specification

The model for this study is a slight modification of the model used previously by Fadun (2013). The Econometric model of Fadun (2013) is therefore seen below as;

$ROE_{it} = \beta_o + \beta_1 BZE_{it} + \beta_2 CEO_{it} + \beta_3 INS_{it} ++ \beta_4 AUD_{it} + \beta_5 DIV_{it} + + \beta_6 BLH_{it} + \beta_7 AGM_{it} + e_t$..(equ 3.1)

Where:

ROE_{it} represents firm performance variables which is return on equity for listed insurance firms at time t.

BZE_{it} is Board Size; CEO_{it} is CEO's tenure of office; INS_{it} is institutional ownership; $AUD_{it}$is audit committee composition; INS_{it} is Institutional ownership; AUD_{it} audit committee composition; DIV_{it} dividend policy; BLH_{it} block-holders and AGM_{it} is annual general meeting.

e_t, the error term which account for other possible factors that could influence Y_{it} that are not captured in the model.

Based on the fact that we employ different governance and performance proxies, the above model is therefore modified to determine the relationship between corporate governance and performance of quoted insurance companies in Nigeria. In doing this we therefore developed the simple definitional model below to guide our analyses. This model is as follows;

$ROA_{it} = f(BDZ_{it}, BDI_{it}, AUD_{it}, BG_{it})$…………………………………..(equ 3.2)

The model is specified in econometric form as follows:

$ROA_{it} = \beta_0 + \beta_1 BZE_{it} + \beta_2 BDI_{it}, + \beta_3 AUD_{it} + \beta_4 BGD_{it} + \varepsilon_i$……………...(equ3.3)

Where:

- ROA_{it}= Return on Asset
- BDZ = Board Size
- BDI= Board Independence

AUD = Audit Committee Composition

BGD = Board Gender Diversity

β_0 = Constant or intercept.

β_{1-4} = Coefficients of explanatory variables.

ε_{it}= Error term representing other explanatory variables that were not captured.

The *aprori* expectations with respect to sign:

$\beta_1>0: \beta_2>0: \beta_3>0: \beta_4>0$

Data Analysis Method

In analyzing the relationship between corporate governance and financial performance of listed insurance firms in Nigeria, the panel data methodology was adopted. This is because the study combined time series and cross sectional data. The study employs OLS econometric technique to analyze the resulting panel data model. Thus, a panel data regression methodology is used in the data analysis. A panel data is a combination of time series data and cross sectional data. Panel data regression technique is an important tool for analyzing time series cross-sectional data. In order to have a robust empirical investigation, two basic analytical methods would be used before the econometric analysis of the panel regression, namely, Descriptive Statistics and Correlation Analysis. Descriptive statistics was used to examine the initial characterization of the variables, while the correlation analysis will be used to investigate the nature and degree of correlation (relationship) between the variables, both of which falls under the statistical analysis. The statistical method thus, involves the use of Descriptive Statistics and Correlation Analysis. The econometric analysis which involves the use of OLS panel regression methodology will finally be used to estimate the panel data model in order to evaluate the individual effect of each of the independent variables(corporate governance mechanism) on the dependent variable (performance of insurance companies).

DATA ANALYSIS AND PRESENTATION OF RESULT

Descriptive Statistics

The table: 1 gives a descriptive summary of corporate governance Board Size (BZS), board independence (BDI), board gender independence (BGI), audit

committee composition (AUD and Performance (ROE) of listed Insurance firms from 40 observations covering 8 years period.

Discussion on Findings

From hypothesis I - IV listed insurance companies corporate governance is predicted/ ex have any significant influence on its nonperforming loans. However, from the regression results in Table 3 and Table 5, as expected the coefficients of the corporate governance measures (BZS, BDI, BGD and AUD) were not significant. The insignificant coefficient of corporate governance variables (BZS, BDI, BGD and AUD) supports Beiner*et al.*, (2003); Agrawal and Chadha (2005) and Akeem, *et al.,* (2014) findings, that corporate governance has no significant impact on performance of insurance companies. The likely explanation for this finding could however be due to the way things are been done in Nigeria. For instance, the way committees of the insurance companies are been constituted. Members of audit committee in Nigeria insurance companies are seldom mixed, that is both finance and none finance members constitute the committee. This can affect the way the committee discharges its functions. Another justification for this result could be the poor implementation of corporate governance code by board members who allocate funds to themselves. The insignificant relationship further reflects that corporate governance in the Nigerian economy is weak. Based on this discussion therefore, we come to these conclusions:

i. We accept the null hypothesis that listed insurance companies corporate governance (board size, board independence and audit committee composition) has no significant influence on its performance.
ii. We reject the alternative hypothesis that listed insurance companies corporate governance (board size, board independence and audit committee composition) has a significant influence on its performance.

This result provides weak support that corporate governance influence performance of insurance companies in Nigeria. The null hypothesis is therefore accepted and we conclude that corporate governance has no significance influence on the performance of Nigerian quoted insurance companies.

SUMMARY

This study examines the impact of corporate governance on the performance of Nigerian listed insurance companies. The study employed descriptive econometric analytical tools in studying 14 Nigerian quoted insurance companies with 133observations for the period 2008 to 2015. The analyses were performed using panel data. This study tries to fill the gap left by other studies in this field by investigating the effect of corporate governance on the performance of Nigerian quoted insurance companies by extending the corporate governance measures that has been hitherto employed by other studies. The study employed different measures of corporate governance such as Board Size (BZS), Board Independence (BDI), Board Gender Diversity and Composition of Audit Committee (AUD) in order to investigate the varying effects of these corporate governance variables on performance.

A balanced panel of 14 quoted Nigerian insurance companies was studied in this research work. Only listed insurance companies were studied. Listed insurance companies corporate governance was found not to have a significant impact on their performance. An interesting finding is that three of the measures of corporate governance (board size, board independence and audit committee composition) have a negative relationship with performance while board gender diversity was positively related to performance. The results of this study further confirm some prior findings by other scholars and earlier researchers and the research work has been able to find answers to the research questions earlier raised.

CONCLUSION AND RECOMMENDATION

A notable difference between the corporate governance of Nigerian insurance companies and insurance companies in developed economies is that insurance companies in Nigeria presumably have weak corporate governance. This difference to an extent, might limit the explanatory power of the corporate governance theories in Nigeria. It suggests that the theoretical underpinnings of the observed correlations are still largely unresolved.

The results of this empirical study suggest that some of the insights from modern corporate governance theories are not portable to Nigeria in, that certain firm-specific factors that are relevant for explaining corporate governance and performance in the Western countries seems not to be relevant in Nigeria. This is true despite profound institutional differences

that exist between Nigeria and the Western countries. Overall, the empirical result from this study does not support the fact that corporate governance significantly influences the performance of listed insurance companies in Nigeria. This simply means, they have no significant impact on performance of Nigerian quoted insurance companies. The findings of this study suggest that Corporate Governance has not helped in providing solution to the problem of poor performance of insurance companies, a phenomenon that has been militating against the expansion of listed insurance companies in Nigeria.

In line with the findings of this study, the following recommendations are made:

i. Management of insurance companies and the relevant authorities should improve on the poor corporate governance practices, not paying claims on time.
ii. Management of insurance companies should improve on the way audit committees of the insurance companies are been constituted. Members of audit committee in Nigerian insurance companies should include only those with finance background. A situation were the audit committee are mixed, that is both finance and none finance members constitute the committee should not be encouraged as this can affect the way the committee discharges its functions.
iii. Emphasis should be shifted from these measures of corporate governance to other Corporate Governance variables, such as; insider abuse, transparency, disclosure and accountability. Also the oversight and monitoring functions of the Nigeria Insurance Commission should be strengthened to ensure adherence to rules and principles guiding the approval of claims.
iv. Improper credit risk management reduce the insurance companies' performance affects the quality of its assets and increases the rate of improper valuation of which may eventually lead to financial distress. Hence, oversight and monitoring functions of Nigeria insurance commission should be strengthened to ensure adherence to rules and principles guiding the approval of claims.

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Table 1: Descriptive Statistics

	ROE	BZE	BDI	BGD	AUD
Mean	0.818045	9.556391	0.625940	0.129023	5.879699
Median	3.150000	9.000000	0.630000	0.100000	6.000000
Maximum	15.18000	17.00000	0.870000	0.430000	6.000000
Minimum	-78.32000	6.000000	0.360000	0.000000	4.000000
Std. Dev.	10.68595	2.240852	0.106023	0.106251	0.477328
Skewness	-3.922880	0.827679	-0.276034	0.574385	-3.699865
Kurtosis	25.59682	3.697633	2.385159	2.414299	14.68900
Jarque-Bera	3170.789	17.88240	3.783899	9.214222	1060.612
Probability	0.000000	0.000131	0.150778	0.009981	0.000000
Sum	108.8000	1271.000	83.25000	17.16000	782.0000
Sum Sq. Dev.	15073.01	662.8271	1.483808	1.490173	30.07519
Observations	133	133	133	133	133

Source: Results extracted from E-views 7.0 Output, 2016.

Table 2: Pearson Correlation Statistics

	ROE	BZE	BDI	BGD	AUD
ROE	1.000000	-0.017814	-0.075884	0.147237	-0.062842
BZE	-0.017814	1.000000	0.034771	-0.287248	-0.007775
BDI	-0.075884	0.034771	1.000000	-0.199281	0.110031
BGD	0.147237	-0.287248	-0.199281	1.000000	0.281476
AUD	-0.062842	-0.007775	0.110031	0.281476	1.000000

Source: Results extracted from E-views 7.0 Output, 2017.

Table 3: Pooled OLS Result
Dependent Variable: ROE

Variable	Coefficient	T-Ratio	Prob.
Constant	14.97126	0.794620	0.4286
BZE	-0.462155	-0.822051	0.4129
BDI	-2.453621	-0.240597	0.8103
BGD	13.10856	1.020438	0.3098
AUD	-1.716542	-0.579262	0.5636
	Adjusted R^2 = 0.125705 F = 4.25(0.001447) D.W = 2.26		

Source: Results extracted from E-views 7.0 Output, 2017.

Table 4: Summary of Hausman Test for Cross-Section Random Effects

Test cross-section random effects			
Model	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Return on Equity	4.768	4	0.3119

Source: Results extracted from E-views 7.0 Output, 2017.

Table 5: Random Effects Results
Dependent Variable: ROE

Variable	Coefficient	T-Ratio	Prob.
Constant	20.67874	1.414954	0.1595
BZE	-0.405867	-0.900939	0.3693
BDI	-15.00100	-1.714690	0.0888
BGD	17.65663	1.697644	0.0920
AUD	-1.508656	-0.677191	0.4995
	ADJUSTED R^2 = 0.038 F = 2.311 (0.06) D.W = 2.04		

Source: Results extracted from E-views 7.0 Output, 2017.

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