

# [The concept of corporate governance has drawn the](https://assignbuster.com/the-concept-of-corporate-governance-has-drawn-the/)

The concept of corporategovernance has drawn the focus of attention in recent years, because of itspromising importance on the economic health of business organizations andsociety in general. This is in affirmation with Claessens & Fan (2002) whoexpressed an opinion that corporate governance has received much attention inrecent years. Several empirical studies have provided the link between corporategovernance and firm performance. Bebchuk, Cohen and Ferrell (2004) assertedthat “ firms directed and controlled efficiently has higher firm performance”; Gompers, Ishii &Metrick (2003) demonstrated through their study that firmswith lower level of corporate governance quality leads to higher risk and lowerstock returns than those with a higher level of governance quality. The corporate scandalsof the early 2000s, including Enron, Worldcom, Tyco, those of USA, South EastAsia, Europe and others, were directly linked to corporate governance failures(Hussin& Othman 2012; Abdul-Qadir&Kwambo, 2012).

Nigeria is notexcluded of this occurrences as similar financial and accounting scandal hasbeen concealed this include the banking sector with 26 banks liquidated in 1997and the falsification of the company’s financial statement in Cadbury NigeriaPlc. in2006 and more recent events in 2009 post consolidation banking criseswhen ten banks were declared bankrupt and eight (8) executive management teamsof the banks were removed by the Central Bank of Nigeria (CBN 2010).   However, corporategovernance is considered to involve a set of complex indicators, which facesubstantial measurement due to the complex nature of the interaction betweengovernance variables (such as board composition, ownership structure, executivecompensation, transparency and disclosure of information.) and firm performanceindicators. Corporate governance ensures that corporations are managed in thebest interests of their owners (shareholders). For instance, Magdi and Nedareh(2002) emphasized the need for organization managers to act in the interest ofthe firm, particularly minority shareholders or investors by ensuring that onlyaction that facilitate delivery of optimum returns and other favorable outcomeare taken at all times.

According toOgbulu (2012), effective corporate governance apportion powers anddevelop room for checks and balances which most times ensures that managers infusein positive net present value projects thus helping the relationship betweenmanagement and shareholders to be characterized by transparency andfairness. Corporate governance is therefore, about building credibility, ensuring transparency and accountability as well as maintaining an effectivechannel of information disclosure that will foster good corporate performance. This has led to a wave of regulation aimed at preventing similar problems inthe future. Corporate governance is not only necessary at the individualcompany level but it is also a critical element in maintaining a soundfinancial system and a robust economy. Executive compensationis often used as an instrument to align both the managerial interests (agents)and the shareholders (principals). The basic idea is to reward executives accordingto their performance. It is another important component of corporate governancethat connotes the compensation package provided to firm management in ordertoencourage firm performance.

While good quality corporate governance leads tobetter firm performance (Klapper and Love, 2004; Nelson 2005), it also has aneffect on the level of executive compensation of the firm through improvingfirm performance and accordingly rewarding executives (Ryan and Wiggins Iii, 2004; Bratten et al., 2011). This indicated that there remains simultaneousrelationship between executive compensation and firm performance. Firm performance is aconcept that supports the effective and efficient use of financial resources toachieve overall company objectives which include both shareholders wealthmaximization and profit maximization objectives. According to Richard et al(2009), organization performance encompasses three specific areas of firmoutcomes. First is the financial performance such as profits, return on assets, return on investments etc. Secondly is the product market performance (sales, market shares etc.) and lastly shareholder return (total shareholder return, economic value added etc.

). In general terms threelevels of determinants of firms’ performance can be identified. Firstly itrelates to external factors which firms do not have charge of and areeconomywide. Second factors are internal and under the direct purview of the firms. Thesefactors, which include managerial efficiency, governance structure andownership structure, affect the ability of the firms to manage externalfactors.

Finally, there are other factors such as size, leverage, and nature ofthe industry. Performance therefore is directly influenced by the concept ofprofitability; this is because profit is the rallying point of allstakeholders. This study examinesthree accounting performance indicators which are Return on Equity, Return onAssets and Earnings per Share Market to Book Ratio as a market based indicatorand Economic Value Added.

This studywill further empirically explore this subject matter by finding therelationship between corporate governance mechanisms and financial performanceof some selected companies listed on the Nigeria Stock Exchange (NSE).