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Board Independence, Ownership Structure and Firm Profitability: Evidence from Nigeria Exchange Group.

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Abstract

This study empirically investigated the relationship between board independence, ownership structure and firm profitability of quoted nonfinancial firms in Nigeria. The study is vital as it portrays the extent to which corporate governance structure relates to firm profitability. Therefore, two hypotheses were formulated to guide the investigation, and the statistical test of parameter estimates was conducted using panel data multiple regression model with Ex Post Facto design adopted and data for the study were obtained from the financial statements of nonfinancial firms listed on Nigerian Exchange Group (NGX) with data spanning from 2014-2023. The findings of the study generally indicate that board independence have a significant and positive influence on profitability while board ownership have negative and statistically significant impact on profitability on both models. Thus, the study concludes that board independence ensures profitability and ownership structure have no significant on profitability. The study however suggests the need for ownership structure to be increased for better performance.

Keywords: Board independence, Ownership structure, Profitability, Corporate governance, Nonfinancial Firms, Nigeria.

Introduction

Investors and other stakeholders can keep a close eye on corporate changes by using financial reports. Creditors and investors are curious about the details of decisions. The company's main objective is to maximise value over the long run (Kurznack et al., 2021). The share price represents the company's value (Fama & French, 1998). An agreement between investor supply and demand determines the stock price on the capital market, ensuring that it is a fair price that can be used as a measure of the company's worth (Tkachuk, 2019). The financial management function, which allows a financial decision to impact other financial decisions and firm value, can be used to optimise business value (Fama & French, 1998).

According to Madden (2017), the company's primary goal is to increase firm value by increasing the prosperity of owners and shareholders. Firm value is important because it reflects the company's performance, which can affect investors' perceptions of the company (Mira, 2020). The primary goal of the company's establishment is to increase the value of the company by increasing the prosperity of the owner or shareholders (Ahmad et al., 2018). When the stock price rises, it indicates that the company's value, as well as the welfare of the owners, increases. The operational actions of the business determine its profitability. The financial statements' operations are demonstrated by the realisation of net income (Arsyad et al., 2021).



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The ownership structure may have an impact on a potential agency problem (Rossi et al., 2018). According to some researchers, the control that the ownership structure has over the business's operations affects how profitable it is to achieve its objectives, which include maximising firm value. When management makes decisions that solely serve to further his own interests rather than that of the shareholders, this is known as a conflict of interest. Pure managers will undoubtedly make different decisions and act differently than managers who possess company shares. If a manager owns stock in the company, they are also shareholders. Naturally, managers who own stock in the company will align their interests with those of the shareholders. Managers who don't hold firm stock, on the other hand, might simply care about themselves. Managerial ownership refers to the ownership of firm shares by managers. The presence of a significant block shareholder suggests that the degree of dispersion of shareholders by outsiders is lower. This phenomenon can also occur in companies where large block shareholders (a large number of shareholders) are typically composed of institutional shareholders who have a high ability to control managers.

By offering the profitability variable, this study aims to reexamine how managerial and institutional ownership affect firm value. It has been demonstrated that managerial ownership affects firm value (Ogaluzor and Omesi (2019). Thus, similar conclusion was reached by (Sienatra et al., 2015; and Julianti, 2015). However, studies by Bona-Sánchez et al. (2018), Ogaluzor and Omesi (2019 and Hidayah & Subowo (2019) demonstrate that managerial ownership has no bearing on the value of the company. Institutional ownership has a distinct impact on business value as well.

Given the abundance of prior research demonstrating the disparate impacts of managerial and institutional ownership on business value, it would be worthwhile to do additional study using profitability as a mediating variable. One sort of data that investors might utilize as a signal is profitability (Abd Rahman & Ahmad, 2018). Requests to purchase company shares are one way that market reactions might be influenced by information about a firm's profitability. Prior studies have demonstrated that profitability positively affects business value with a comparatively high coefficient. Manu et al. (2019) demonstrates how profitability influences business value. Consistent with these findings, Pangestuti et al. (2022) and Jonnius & Marsudi (2021) demonstrate that business value is impacted by profitability. There is a dearth of research demonstrating that the profitability variable mediates the relationship between ownership structure and business value.

The author used company data from 2014 that was listed on the Nigeria Exchange Group to examine the effect of board independence, ownership structure and firm profitability of listed nonfinancial firms, taking into account the background of divergent operation resulting from corporate governance adoption on board composition and ownership structures of the previously mentioned.

Literature Review and Hypothesis Development

The study of corporate governance on firm profitability is anchored on the stewardship theory like the agency theory involves a relationship between the principal and the agent. Stewards according to this theory behave in a pro-social way, this behavior is aimed to build a strong relationship with the principal and to enhance the fortunes of the company (Zahra et al., 2009). This behavior is premises on the sought relationship between the shareholders and the management



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team in relation to the objectives of the organization. Stewardship theory assumes managers possess sufficient self-motivation to act in the best interest of the shareholders. This theory suggests that a manager does not exhibit pure self-serving behaviour due to factors such as moral reasoning, reputational capital, and the manager's commitment to the firm's value. Stewardship theory arises from psychology and sociology rather than the economics of agency theory. Maximization of the firms' profit and reducing overhead costs is the preferred outcome of a steward principal relationship. The theory postulates that this is achievable on the condition that the manager and the owner both choose to behave as stewards, the principal steward relationship is based on a choice when both parties place the objectives of the organization first, and it leads to a positive performance outcome (Davis et al., 2018). Therefore, the inside directors are presumed to be more efficient because of their knowledge of the firm and daily encounter with the firm activities. Therefore, advocates of stewardship theory believe that board with a more substantial number of insider director will perform better than the board with a large number of independent directors because of their reduced ability to monitor the managers.

Board Independence and Firm Profitability

The research on board composition has also focused on the relationship between board independence and firm performance. The Board of directors is classified into two categories; (1) the executive, which is personnel such as managers and directors, and (2) the non-executive directors who are also referred to as independent directors. 38 Siegel and shim (2006), defined executive directors as individuals on the board who is an employee of the firm. While independent directors are those directors do not have any other material pecuniary relationship or transaction with the company, it's a promoter, management, or its subsidiaries that can affect their independent judgment (Merendino & Melville, 2019). Arguments have been put forward as to why outside directors are more reliable and efficient than inside directors, however, the combination of both inside and outside directors is advised by most national and international corporate governance codes for competent governance.

According to Kilincarslan (2021) and Musleh Alsartawi, (2019) a higher proportion of independent directors on board indicates improved monitoring and consequently reduced agency problems. Also, Marshdeh, (2014) suggest that independent directors are more effective in monitoring the management activities and function as disciplinarians of managers, but they found no significant relationship between the proportion of independent directors in the board and firm performance. Consequently, the supporter of stewardship theory believes that independent directors are less able to monitor managers than executive directors due to their lack of specialist knowledge of firms' internal operations, the executive directors have a better chance due to their daily involvement in the organization activities. Independent directors in some board could be executive directors in other firms; therefore, this might result in their inability to monitor the management efficiently. The manager may exploit the opportunity of reduced monitoring to achieve his /her gain rather than fulfilling his/her obligations to the shareholders. Also, evidence from the study of Uribe-Bohorquez et al. (2018) shows a significant positive relationship between independent directors and firm performance measured by ROA, ROE and Tobin's Q. They argue that the higher the percentage of outside directors the better the performance of the firm. These results establish the view of agency theory and resource dependence theory, which propose that independent directors are efficient in monitoring the management and serve as a disciplining



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device. Further, Rahman & Saima (2018) also reported a positive relationship between the number of independent board members and firm performance.

Moreover, agency theory suggests that independent and non-executive directors on the board would mitigate agency conflicts and control executive management opportunism as they are free from business relations with management, which could materially interfere with the exercise of their independent judgment and direct management towards better performance (Mohd Sanusi et al., 2018). On the other hand, agency theorists link executive board members with higher agency conflicts and lower firm performance due to their ability to act opportunistically to maximize their own benefits at the expense of the shareholders rights.

Empirical evidence reports mixed results. For example, Villanueva-Villar et al. (2016) find a positive association between independent board members and firm performance. Al Farooque et al. (2020) indicates that independent and outside directors on the board positively affect firm performance. While Latif et al. (2020) document a positive relationship between non-executive directors on the board and firm performance, Amin & Nor (2019) report a negative relationship between the two variables. Moreover, Akter et al. (2020) document an insignificant impact of independent and outside board members on firm performance. Furthermore, Majeed et al. (2020) find that board composition, as measured by the proportion of non-executive directors to total board members, is significantly and negatively associated with ROA, but insignificantly related to ROE for the Pakistani banking sector. From an agency perspective, independent directors are essential for monitoring and safeguarding shareholders' interests to reduce the agency's problems and improve firm performance. Thus, formulate the following hypothesis:

H2: There is no significant association between board independence and firm performance of listed nonfinancial firms in Nigeria

Ownership Structure and Firm Profitability

Previous literature revealed that there is no link between managerial ownership characteristics and firm performance. For instance, in America, several studies believed that the ownership structure of a firm posits no effect on firm performance. They demonstrate that contradict the idea that managerial ownership might boost firm profitability. On the contrary, it reveals that it cannot increase firm profitability. Alabdullahet (2022), has illustrated in the same line the link between managerial ownership and performance. Internal control mechanisms have generated several empirical studies; such have not concentrated on the relation to the mechanisms and performance in companies and also in corporate governance of many countries around the world. In a similar vein, Alabdullah et al (2019) and Ahmed et al, (2019) tested the link between some important internal control mechanisms of manufacturing and service companies to represent the direct impact on corporate performance in a sample of 100 manufacturing and service companies. Their research revealed that Jordanian manufacturing and service companies are entrenching a culture of rigid mechanisms of internal control that have supported to curb fraud and manipulations enhancement of reliability, due process, and firm financial performance.

Ogaluzor and Omesi (2019) their study investigated the relationship between share ownership structure and financial performance of listed consumer goods companies in Nigeria, using a cross-section of secondary data for 2016 fiscal year, which was obtained from the published annual reports of the firms. Share ownership structure was viewed from the dimensions of ownership concentration and managerial share ownership, while financial performance was



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measured with return on assets. Firm size was used to control for heterogeneity in firm-specific characteristics with Generalized Least Square (GLS) regression technique used. They found that the entrenchment impact hypothesis was validated as a result of the findings that showed a substantial inverse association between high levels of ownership concentration and financial performance. On the other hand, although a positive association was shown to exist between managerial share ownership and financial success, the results that were obtained did not meet the criteria for statistical significance at the standard level. On the other hand, though a positive relationship was confirmed regarding the relationship between managerial share ownership and financial performance, results obtained fell short of statistical significance at the conventional level.

Conversely, Rong et al. (2017) investigate the effect of corporate governance quality and ownership structure on the relationship between the agency cost and firm performance. Both the fixed-effects model and a more robust dynamic panel generalized method of moment estimation are applied to Chinese A-listed firms for the years 2008 to 2016. The results show that the agency–performance relationship is positively moderated by (1) corporate governance quality, (2) ownership concentration, and (3) non-state ownership. Hence, state ownership reveals a negative effect on the performance relationship. Based on the preposition the study hypothesis thus:

H1: Board ownership has no significant relationship with firm profitability of listed nonfinancial firms in Nigeria.

Research Methodology

This study adopted correlational research design because the study examine board independence, ownership structure and profitability. The secondary data from companies listed obtained from the Nigerian Exchange Group (NXG) for ten (10) years period from 2014 – 2023, and analysed with the aid of statistical tools (STATA). Therefore, the following regression models will test the direct effect of board independence, ownership structure on the two types of firm profitability indicators (return on asset, and Tobin’s Q). The model is as follows:

$$ROA_{it} = \beta_0 + \beta_1 BIND_{it} + \beta_2 BOWN_{it} + \beta_3 FSIZ_{it} + \beta_4 FAGE_{it} + \beta_5 LEVG_{it} + \varepsilon_{it} \dots \dots \dots 1$$

$$Tobin's Q_{it} = \beta_0 + \beta_1 BIND_{it} + \beta_2 BOWN_{it} + \beta_3 FSIZ_{it} + \beta_4 FAGE_{it} + \beta_5 LEVG_{it} + \varepsilon_{it} \dots \dots \dots 2$$

Where:

ROA = Return on Asset (company measure)

Tobin’s Q = Tobin’s Q (market measure)

BIND = Board Independence

OWNC = Ownership Concentration

FSIZE = Firm size

FAGE = Firm Age

LEVG = Firm Leverage

i = Refers to the company

t = Refers to the time.



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e = Error term

Result

The results of the study of corporate governance and firm profitability of nonfinancial firms are discussed in Table 1, 2, 3, and 4 with findings respectively.

Table 1: Descriptive Statistics Results

Variable	Mean	Std. Dev.	Min	Max	Obs.
ROA	8.423	11.163	0.015	176.267	76
Tobins' Q	0.038	.01301	.0128	.0716	76
BINDP	67.294	14.897	16.667	94.444	76
OWNC	18.283	23.739	0	94.35	76
FSIZE	7.082	0.817	5.093	9.241	76
FAGE	93.221	1306.239	1	26	76
LEVG	4.041	7.006	-22.681	55.939	76

Source: Output from STATA, 2024.

Table 1 presents the descriptive statistics of all variables. The mean value of ROA is 8.423 with a range from 0.0001 to 8.4280, suggesting that the majority of firms have low performance. A Tobins' Q value from 0.038 0 to 0.038 is considered as a low performance, and it may indicate that the stock is undervalued. The range of independent directors sitting on boards with an average of 67.294 which is higher than standard deviation of 14.897 with a min of 16.667 and max of 94.444 indicate that majority of the firm under study maintain board independence which appear to be adequate. The mean value for managerial ownership is 18.283 which is less than standard deviation of 23.739 suggesting that the Nigerian nonfinancial is high which deviate from other studies classify the managerial ownership at 5% to 20% as moderate, while below 5% is classified as low and above 20% as high managerial ownership. The firm size is with an average value of 7.082 with a Std. Devi. 0.817, while min and ma value are 5.093 and 9.241. in addition, Firm age average value of 93.221 and Std. devi. of 1306.239 while min and ma value are 1 and 26 which indicates that majority of the firm's year of incorporation from year 1 to 26 respectively. The mean value of leverage is 4.041 with a standard deviation of 7.006 0.47, with a range of 0 to 4.041 suggesting that all firms have leverage close to the average leverage of companies.

Table 2: Correlational Matrix Result

Variable	ROA	Tobin's Q	BINDP	OWNC	FSIZE	FAGE	LEVG
ROA	0.000						
Tobq	0.030	1.000					
BINDP	0.019	0.023	1.000				
OWNC	-0.086	-0.095	-0.085	1.000			
FSIZE	-0.065	0.063	-0.057	-0.218	1.000		
FAGE	-0.012	-0.072	0.040	-0.040	0.039	1.000	
LEVG	0.014	0.269	-0.118	-0.032	0.087	-0.021	1.000

Source: Output from STATA, 2024.

Table 2 presents the correlation between dependent and independent variables. Apart from board independence, board ownership as an independent variable shows a negative correlation with ROA and Tobin's Q, indicating that a higher proportion of ownership effect a decrease in firm



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performance in nonfinancial firms. None of the remaining variables are correlated especially control variables of firm size and firm age except leverage. Further, a negative correlation among control variables indicates no dependency among them, thus indicating a low likelihood of multicollinearity in the multiple regressions

Table 3: Variance Inflation Factor (VIF) for Multicollinearity

Variable	VIF	1/VIF
FSIZE	1.06	0.940456
BSHOW	1.06	0.941459
BINDP	1.03	0.972316
PTBV	1.02	0.978748
FAGE	1.00	0.995541
Mean VIF	1.04	

Source: Output from STATA, 2024.

The measurement of the study's construct using collinearity is shown in Table 3. To explain the relationship between the variables and minimize multicollinearity, a collinearity diagnostic was performed. According to the collinearity diagnostic matrix, there was no significant correlation between any of the variables. The study's mean VIF of 1.04 indicates that multicollinearity is not an issue. The variables are independent of one another and can be incorporated into the model,

Multiple Regression Analysis

Table 4 present the panel regression results of the effect of ownership structure on firm profitability performance for both accounting (ROA) and market measures (Tobin’s Q). The model's control variables (FSIZE, FAGE, and LEVG) and corporate governance structure to firm profitability explain 56% of variations in ROA and Tobin’s Q, according to the model's R-squared of 0.558. The primary use of the F-statistics was to assess the degree to which the regression model fit the data. At a 5% significance level, the F-statistic value of 0.001 (ROA) and 0.000 (Tobin’s Q) indicate that the model fits well (prob>F=0.000). This indicates that the F-statistics were employed to ascertain whether the regression equation significantly amplified the impact of the corporate governance structure on firm profitability as measured by ROA and Tobin’s Q, which was not the result of chance. The Housman test to determine between fixed and random effect is not significant, hence random effect is adopted. Again, Breusch-pagan LM test (p-value = 0.000), the finding of the test suggests that the data is homoscedastic. It is highlighted that the robust standard error test takes care of outliers and thus provides a clearer picture and indicates that the data is homoscedastic. In Table 4: panel data regression between corporate governance structure and firm profitability therefore refuted the null hypothesis.

Table 4: Multiple Regression results for Panel Data (Fixed and Random Effect).

Variable	Model 1 - ROA (Random Effect)		Model 2 – Tobin’sQ (Random Effect)	
	Coeff.	P.value	Coeff.	P.value
BINDP	0.002	0.283	0.000	0.439
BOWN	0.001	0.627	-0.000	0.160
FSIZE	0.062	0.440	0.000	0.768



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FAGE	0.000	-0.92	-0.035	0.055
LEVG	0.023	0.000	0.001	0.000
Constant	6.364	0.000	0.034	0.000
Prob > F		0.001		0.000
Observation		760		760
R-squared		0.558		0.244
Number of Firms		76		76
Breusch-pagan LM test (p-value)		0.000		0.000
Hausman test (p-value)		0.191		0.076
Heteroscedasticity (p- value)		0.000		0.000

Source: Output from STATA, 2024.

Table 4 presents the regression results for ROA and Tobin's Q. For ROA, the BINDP with a coeff. of 0.002, P.value of 0.23 posits a positive and statistically significant with firm profitability, which support the agency theory that an independent and impact profitability of the nonfinancial firms, hence did not support hypothesis 1 which states that there is no significant effect of INDP and ROA. This result supports the findings of those studies done by Rashid Khan et al. (2020). In addition, board ownership with a coeff. of 0.001 with a P.value of 0.627 shows a positive and statistically significant against ROA. This result rejects the stated hypothesis that BOWN influences ROA which supports the previous findings of

The model on 2 reveals that INDP influences Tobin's Q (β 0.000, p-value >0.05) which is positive and statistically significant, therefore, providing partial support for hypothesis for hypothesis 1. This reveals that BIND on Tobin's Q enhances firm profitability. This is in line with the study of Latif et al. (2020) who attest that board independence has a positive effect on firm profitability of nonfinancial firms. Additionally, board ownership with (β = -0.000, p-value < 0.05) and Tobin's Q, this result is negative and statistically significant. Based on hypothesis 2 model 2, hence proves there is no significance in Tobin's Q which hypothesis and the result inline with the outcome of Akter et al. (2020). For firm-level control variables, we discovered that FSIZE has a positive and significant impact on Tobin's Q while FAGE has a negative and statistically significant influence on Tobin's Q. LEVG has a positive and significant impact on Tobin's Q and a significant impact on all the models.

Conclusion and Recommendation

The study examined the effects of corporate governance structure on firm profitability between 2013 and 2023 of nonfinancial firms listed on the Nigeria Exchange Group. Identifying the correlation between board independence and board ownership and profitability were the two specific objectives of the study. Based on the findings, it is concluded that the board independence of nonfinancial firms is significantly associated with profitability (ROA and Tobin's Q). In addition, board ownership is statistically insignificant with profitability (ROA and Tobin's Q).

Based on the conclusion of this study, it recommended that following the CG policy and code of ethics, as well as setting up a suitable corporate governance under the code of governance to bring in additional knowledge required by the board to operate effectively and impact company performance. Nonfinancial firms in Africa specifically Nigeria have not been fully complying to



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the CG policy, which has prevented businesses from reaping the full benefits described by OCED (2015).

Policymakers, regulators, business managers, and researchers are all impacted by these findings. In the first place, companies listed in Nigeria are not fully experiencing the impact of CG mechanisms on profitability, according to the study's findings. This is because the CG mechanisms were blatantly copied from other industrialized countries without taking into account the mechanisms that would work best for their particular environment. Hence, policymakers, particularly those in the SEC, must implement CG policy reforms that meet the needs of internal and external stakeholders. By doing this, the company will perform better and grow sustainably. Additional authorities, like CG rating agencies, could be set up to keep an eye on the governance practices of listed companies in the Nigeria Exchange Group.

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