Corporate Governance Mechanisms in Minimising Agency Problems through Dividend Policy: Case Study of Listed Industrial Goods Companies in Nigeria

Lukman Bello[1], Sabo Ahmed[2] and Alfred Anthony Kwanti[3]

Department of Accountancy, Taraba State University, Jalingo Taraba State – Nigeria
E-mail: lukmansoul5@gmail.com

Abstract

Dividend payment is an effective instrument that minimizes agency problems between managers and shareholders as it increases potential default risk of the firm and thereby reduces the available funds to managers. This study examines the impact of corporate governance mechanisms on the dividend policy of the Nigerian industrial goods firms. The study employed the ordinary least square regression in analyzing the data gathered from the annual report of sample ten firms covering 2014 to 2018. The result shows that board composition and CEO dual have a positive effect on dividend policy while audit committee composition has a negative effect on the dividend policy. The study recommends that the positions of board chairmanship and CEO should be separated, and also more independent competent board members should be incorporated in the board, in order to enhance managerial capability thereby increasing the level of Corporate Governance mechanisms on dividend policy of the Nigerian industrial goods firms.

Keyword: Corporate Governance Mechanisms, Dividend Policy, Industrial Goods Companies and Minimising Agency Problems.

Introduction

The issue of corporate governance has drawn the attention of researchers and corporations globally. This is owing to the fact that governance mechanisms demand a set of the relationship among various stakeholders such as the organization's management, its board; its shareholders, its audit committee and other stakeholders that provide structure in which organizations are set, and monitor their performance. Meanwhile, there should be proper incentives for the board and management to pursue objectives in the best interests of the company and its shareholders and enhance effective monitoring. The presence of an effective corporate governance system helps to offer a degree of confidence that is required for the proper functioning of a market economy (OECD Principles, 2007).

Corporate governance is a system based on which companies are directed and managed for optimum level of performance, be it financial and non-financial (Fatimoh, 2012). It can also be seen as the sum of processes, structures and information used for directing and overseeing the affairs of an organization (Sanda, Mikailu & Garba, 2005). Therefore, the main idea of corporate governance is to safeguard the stakeholder interest, which is to ensure that the directors/ managers have to comply with the stakeholder's interest arising from the separation of owners and managers. This separation gave rise to the formation of a number of mechanisms globally for ensuring the going concern assumption of corporate entities that affect business sustainability and survival which eventually enhances companies' ability to pay a dividend. This dividend is a means by which shareholders are rewarded, without any dividend payout, shares would not have any value (Morad & Adel, 2013).

The dividend payment is considered an effective corporate governance mechanism that aligns the interest of stakeholders and minimizes agency problems between managers and shareholders by increasing potential default risk of firms and thereby reducing the available funds to managers. The agency cost theory refers to the cost borne by shareholders for monitoring behaviour and these costs are considered as an implicit cost due to the potential conflict of interest among shareholders and corporate managers (Husam, Nizar & Rekhap, 2012).

Meanwhile, dividend policy is one of the most important policies in finance as it is directly related to shareholders. This remains a subject of debate among academics and practitioners. A previous empirical study shows that investors are better protected with greater dividend payout ratios (Shliefer & Wolfenzon, 2002: Badariyya, Rabi'u, Awaisu & Tijjani, 2015).

Therefore, the importance of corporate governance mechanism in paying out dividend cannot be overemphasized. Available literature on the relationship between corporate governance mechanisms and dividend policy especially in non-financial firms in Nigeria is limited as such the main objective of the study is to examine the relationship between corporate governance mechanism and dividend policy of the Nigerian industrial goods firms.

Review of Related Empirical Literature

Badariyya, Rabi'u, Awaisu and Tijjani (2015) investigate the impact of corporate governance mechanisms on dividend policy of Nigerian foods product firms. The result reviled that board size, board composition, audit committee composition and CEO dual have a positive effect on dividend policy.

Kurawa (2013) investigates the effect of corporate governance on corporate social responsibility of petroleum marketing firms listed on the Nigerian stock exchange. The results indicate that corporate social responsibility activities in the Nigerian petroleum marketing industry are positively driven mainly by management equity holding and to some extent by other attributes of composition and chief executive officer duality.

Similarly, the study conducted by Maniagi, Musiega, Mutrithia, Alala, Damianus and Douglas (2013) investigates the relationship between corporate governance, dividend policy and performance of banks listed on Nairobi security exchange, covering five years period (2007-2011). The study discovered that dividend yield for banks, as a proxy for dividend policy is significant and positively correlated to business risk and growth opportunities, also positively correlated to CEO duality but negative and significant to board independence as corporate governance proxy.

According to a study conducted by Tornyeva and Wereko (2012) which investigate the relationship between corporate governance and financial performance of insurance companies in Ghana. The findings revealed that large board size, board skills, management skill, larger serving CEO'S, size of the audit committee, audit committee independence, foreign ownership, institutional ownership, dividend policy and annual general meeting as independent variables are positively associated with the financial performance of insurance companies in Ghana.

Similarly, in a study by Amarjit and John (2012) which examine the relationship between corporate governance, institutional ownership and decision to pay dividends in American service firms. A sample of 296 American firms was selected for a period of 3 years from 2009-2011. The result revealed that the decision to pay dividend has a positive function to board size, CEO duality and internationalization of the firms has a negative function to institutional ownership.

Odia and Osikhena (2012) investigate payout policy, agency conflict and corporate governance, using a sample of 30 listed companies randomly selected in the Nigerian stock exchange covering the period 2006-2010. Panel OLS regression result indicates that a firm's investment opportunities and leverage have a significant impact on dividend payout.

Moreover, Chen, Lin and Yong-Cheol (2011) found a positive relationship between the size of the board of directors and the propensity of companies to pay cash dividends and a negative relationship between CEO duality and propensity to pay cash dividends. In a study conducted on 1056 listed companies in the Shanghai and Shenzen stock market covering years 2001-2007.

Oskar, Ivan and Oleksandr (2007) investigate the relationship between corporate governance and dividend policy in Poland. The study revealed that transparency disclosure index TDI and each individual TDI sub-index are statistically significant at the 1%, 5% or 10% level. The strongest results are for the TDI sub-indices board, disclosure and shareholders. The coefficient of 0.86 unsub-index concerning disclosure in the years 1998-2004 by 1 point predicts a 0.86point increase in dividend-to-cash flow ratio.

Mohammed and Joshua (2006) in a study that examine the factors that affect dividend payout ratios of listed companies in Ghana, showed that payout ratios were positively related to probability, cashflow and tax but are negatively related to risk and growth.

However, Norazlan, Ruzita, Fauzias and Mohd (2012) in a study that examine the effect of board structure, capital structure on dividend per share. The results reveal that increases in debts ratio, larger board size and the presence of duality role have significant negative effects on dividend payment while a larger number of independent directors has a significant positive effect on dividend payment. Meanwhile, the interaction between board structures reveals that duality existence has weakened the negative effect of debt ratio on dividend payment.

Morad and Adel (2013) the study examines the relationship between dividend policy and corporate governance mechanisms proxied as firm’s structure of non-financial corporations listed from 2004-2008 on Amman stock exchange. Their result revealed that there is significant negative relationship between firm’s dividend payout ratio and capital owned by stakeholders and negative relationship exist between dividend payout ratio and sales growth. In summary, it can be said that corporate governance mechanisms have a very strong positive association with dividend policy while leverage has a negative association.

Materials and Methods

For the purpose of this study, ten (10) out of the fourteen (14) industrial goods companies listed on the Nigeria stock exchange market as at 31st December 2018 are selected. The criteria used for choosing the sample size is the availability of complete data under the period of study that is; 2014-2018. For this study, data was extracted from annual reports and accounts of the ten (10) sampled industrial goods companies from their websites and that of the Nigerian stock exchange. For analysis purposes, Stata version 12 was used to run descriptive statistics, correlation and regression.

Table 1: Variables Measurement

S/no	Class of Variable	Variables	Measurements	Source
1	**Dependent Variable**	Dividend Policy	This is measured as the dividend payout ratio i.e DPS/EPS	Bohren et al (2012), Morad and Adel (2013)
2		Board Composition	This is measured as the proportion of outside directors sitting on board with the executive directors	Kurawa (2013)
3		CEO Duality	This is measured as a dummy variable that is equal to one if the CEO is also the chairman of the board of directors and zero otherwise	Larcker et al (2011), Masulis et al (2007)
4	**Independent Variables**	Audit Committee Composition	This is measured as the proportion of independent directors in the audit committee.	Panchasara (2012)
5		Firm Size	This is measured as the log of the book value of total assets	Bohren et al. (2012)
6	**Control Variables**	Leverage	Leverage is determined by This is measured as the firm's book value of long term debt and short term debt (total debt) divided by its book value of the total asset	Masulis, et al. (2007), Bohren et al. (2012)

Model Specification

$$DPOR= \beta_0 + \beta_1 BC + \beta_2\ CEOD + \beta_3\ ACC + \beta_4\ SIZE + \beta_5\ LEV + \mathcal{E} \qquad (1)$$

Where: DPOR – Dividend Payout ratio, BC – Board Composition, CEOD – Leadership Structure, ACC – Audit committee Composition, SIZE – Firm Size, LEV – Firm leverage and Ɛ – error term.

Result of the Findings

In this section, the results are presented and major findings are discussed. The section covers the descriptive statistics, correlation matrix, variance inflation factor and regression.

Table 2: Descriptive Statistics

Var.	Minimum	Maximum	Mean	Std. Dev
DPOR	0	1.3636	.3389	.3942
BC	.6667	.9	0.7803	.0758
CEOD	0	1	0.6	.4949
ACC	.1111	.25	.1659	.0386
LEV	0	.8323	.1843	.2121
SIZE	12.5630	21.1138	15.6364	2.1375

Source: researcher's analysis of 2020.

The above Table 2 shows the descriptive statistics of dependent and independent variables used in the study, containing minimum, maximum, mean and standard deviation. The dependent variable that is dividend payout ratio (DPOR) has a mean and standard deviation of 0.3389 and 0.3942 respectively, indicating the absence of substantial variation. The independent variables show some level of variability. To sum up, board composition (BC) has the highest mean of 0.7803 with a standard deviation of 0.0758. Audit committee composition (ACC) records the lowest mean of 0.1659, while the leadership structure (CEOD) records the standard deviation of 0.4949.

Table 3: Correlation Matrix (Pearson) of the variables of the Study

VAR	DPOR	BC	CEOD	ACC	LEV	SIZE
DPOR	1.0000					
BC	0.1145	1.0000				
CEOD	0.4241	-0.7276	1.0000			
ACC	-0.6099	-0.2103	-0.1179	1.0000		
LEV	-0.4272	0.0043	-0.4887	0.1810	1.0000	
SIZE	0.2438	-0.4372	0.4833	-0.3757	-0.2106	1.0000

Source: researcher's analysis 2020.

The above Table 3 is on the correlation matrix between all pairs of variables used in the regression model. The value of 1.0000 on the diagonal indicates that the dividend payout ratio has a perfect positive relation with itself. It also shows that the independent variables have a positive correlation with the dependent variables except for audit committee composition and leverage which has a negative effect. The positive correlation indicates that as the proportion of independent director increase and as CEO continues to serve as chairman of the board, the dividend payout ratio increases.

Table 4: Regression Results of the Model

DPOR	Coef.	t	P>|t|	VIF	Tolerance Value
BC	3.9358	4.07	0.000	4.69	0.2134
CEOD	0.7967	5.18	0.000	5.05	0.1980
ACC	-3.6925	-3.23	0.002	1.70	0.5876
LEV	0.2225	0.96	0.342	2.11	0.4750
SIZE	-0.0035	-0.17	0.868	1.78	0.5629
Cons	-2.5834	-2.26	0.029		
R-square = 0.6756					
Prob > f = 0.000					
F- value = 18.33					

Source: researcher's analysis 2020.

Table 4 presents a summary of the regression result obtained from the study model ($DPOR_{it} = \beta_o + \beta_1 BC_{it} + \beta_2 COED_{it} + \beta_3 ACC_{it} + \beta_4 LEV_{it} + \beta_5 SIZE_{it} + \mu_{it}$). The regression result reveals that the cumulative R^2 (0.6756) which is the multiple coefficients of determination gives the proportion or percentage of the total variation in the dependent variable explained by the independent variables jointly. Hence it signifies about 68% of the total variation on dividend policy of Nigerian industrial goods companies is caused by their board composition, CEO duality, audit committee composition, leverage and firm size. Similarly, the result of the F- statistic (18.33) shows that the model is well fitted and the firm characteristics in this study are well selected and utilized as confirmed by the P-value (0.000). From the result the coefficient of board composition is 3.9358 while the P-value is 0.000, this indicates a positive and significant relationship between DPOR and board composition at a 1 percent level of significance. The positive relationship between board composition (i.e the proportion of independent directors on the board) and dividend payout ratio indicates that the higher the proportion of independent directors sitting on the board the higher the dividend payout ratio.

The coefficients of CEO Duality 0.7967 with P-value 0.000; this indicates a positive and significant relationship between DPOR and CEO Duality at a 1 percent level of significance. The positive relationship between CEO Duality and DPOR indicates that if the office of CEO is separated from that of the chairman of the board the higher the DPOR.

On the other hand, the coefficients of audit committee composition -3.6925 with P-value 0.002; this indicates a negative and significant relationship between DPOR and audit committee composition at a 1 percent level of significance. The negative relationship between audit committee composition and DPOR indicates that the higher the proportion of independent directors sitting on the audit committee the lower the DPOR. However, the coefficient of leverage and firm size are 0.2225 and -0.0035 respectively with their respective p- values of 0.342 and 0.868, this indicates a positive but insignificant relationship between DPOR and leverage, while it shows a negative but insignificant relationship between DPOR and firm size.

Major findings, from the result of the analysis, P-values are 0.000which is significant at a 1 percent level of significance. Therefore, the study concludes that there is a significant relationship between the independent variables (board composition, CEO Duality and Audit Committee composition) and the dependent variable (DPOR) of listed Industrial Goods Companies in Nigeria.

Multicollinearity test is to check whether there is a correlation between the independent variables which will mislead the result of the study. Table 3 presents the matrix of the linear relationship among the continue independent variables. From observation, none of the correlation between the independent variables is up to 0.50. The highest is the firm size and CEO Duality (0.4833) then, CEO Duality and DPOR (0.4241). In addition, the low magnitude of the correlations amongst the exogenous variables indicates that multicollinearity should not be a problem for the sample of the study. To formally substantiate the lack of multicollinearity between the independent variables, collinearity diagnostics are observed and that the variance inflation factor (VIF) and tolerance values indicate absences of multicollinearity as both reveals less than 10 and 1 concurrently (Table 4).

Conclusion

The study examined the relationship between corporate governance mechanisms: Board composition, Audit committee composition and CEO duality on dividend policy of ten listed industrial goods companies in Nigeria. The study concludes that board composition and CEO duality have a significant positive effect on dividend policy, while audit committee composition has a significant negative effect on dividend policy.

Recommendation

Based on the findings obtained from the regression result, the study recommends as follows;

i. The positions of board chairmanship and CEO should be separated, and also independent competent board members should be incorporated in the board composition, these actions would enhance managerial capability and therefore increase the level of Corporate Governance mechanisms on dividend policy of the Nigerian industrial goods firms.

ii. Also ensuring full compliance with the code of corporate governance (2006) and the provision of relevant accounting standards such as (IAS, IFRS, etc.) are ways that would make corporate governance have an impact on firms' dividend policy.

References

Amarjit, S. G. and John, D. O. (2012). Corporate Governance, Institutional Ownership and the Decision to pay the amount of Dividends Evidence from the U.S.A: *International Research Journal of Finance and Economics.*17; 60-71.

Badariyya A., Rabi'u, S. J., Awaisu A. S. and Tijjani H.A. (2015). Corporate Governance Mechanism and Dividend Policy: Evidence from Nigeria: *Journal of Accounting.* 3(2); 1-11

Bohren, O., Josefsen, M.G. and Steen, P.E. (2012). Stakeholder Conflicts and Dividend Policy: *Journal of Banking and Finance*. 36(10); 2852-2864

Chen, L., Lin, C. and Yong-Cheol, K. (2011). Financial Characteristics of Corporate Governance and the Propensity to Pay Cash Dividends of Chinese Listed Companies: *International business and management.* 3(1); 176-188.

Fatimoh, M. (2012). Impact of Corporate Governance on Banks Performance in Nigeria: *Journal of Emerging Trends in Economics and Management Sciences (JETEMS* 3(3): 257-260.

Husam, A., Nizar, A. and Rekha, P. (2012). Internal Mechanism of Corporate Governance and Firm Performance; A review of Theory and Empirical Evidence.

Kurawa, J.M., (2013). Effects of Corporate Governance on Corporate Social Responsibility of listed firms in the Nigerian petroleum marketing industry; A paper presented at 5th international conference on corporate governance: governance of the private and public sector.

Larker, D.F., Ormazabal, G. and Taylor, D.J. (2011). The Market Reaction to Corporate Governance Regulation: *Journal of Financial Economics*, 101: 431-448.

Maniagi, G. M., Denco, M. J., Alala, O. B., Damianus, O. and Douglas, M. (2013). Corporate Governance, Dividend Policy, and Performance: special reference to banks listed on Nairobi security exchange, Kenya: *International Journal of Innovative Research and Development*. 2(5): 1744-1764.

Masulis, R.W., Wang, and Xie, F. (2007). Corporate Governance and Acquirer Returns: *Journal of Finance.* 62(4): 1851-1889.

Mohammed, A. and Joshua, A. (2006). Determinants of Dividend Payout Ratios in Ghana*: The Journal of Risk Finance*, 7(2): 136-145.

Morad, A. and Adel, B. (2013). Corporate Governance and Dividend Policy when investor protection is weak; A paper presented at the first conference on understanding Global Business Environment: its Economic, Financial, Accounting, Marketing, and IT Dimensions /by the university of Jordan – Faculty of Business WTO chair program: retrieved from https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2416432

Norazlan, A., Ruzita, A., Fauzias, M. and Mohd, H. (2012). Board Structure, Capital Structure and Dividend per Share: Do they interact. University Kebangsa on Malaysia DOI: 10.7763/IPEDR. 57(28): 41-55

OECD (2007). CEOD Principles of Corporate Governance, www.oecd.org/daf/corporate-affairs.

Odia, J.O. and Osikhena, K.O. (2012). Corporate Governance and Dividend payout policy in Nigeria: *International Journal of Research in Commerce and Management* 3(4): 19-24.

Oskar, K., Ivan, S. and Oleksandr, T. (2007). Corporate Governance and Dividend Policy in Poland: *DIW Discussion paper, No. 702* http://hdi. Handle. Net/10419/27227

Panchasara, B.M. (2012). An Empirical Study on Corporate Governance in Indian Banking Sector Thesis Ph.D., Saurashtra University.

Sanda, A. U., Mikailu, A. S. and Garba, T. (2005). Corporate Governance Mechanism and Firm Performance in Nigeria: *African Economic Research Consortium (AERC) Research paper 149.*

Shleifer, A. and Wolfenzon, D. (2002). Investor protection and equity market: *Journal of Financial Economics.*6 (2): 3-27.

Tornyeva, K. and Wereko, T. (2012). Corporate governance and firm Performance: Evidence from the Insurance sector of Ghana: *European journal of business management.* 4(13): 95-112