

Political Connection, Board Characteristics and Firm Performance in Nigeria

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Abstract

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This study examines the relationship between political connection, board characteristics and firm performance in Nigerian quoted firms. The model of the study is built based on the agency theory. It utilises a cross-sectional data of 116 firms for the year 2013, obtained from the annual reports of the firms. The robust corrected standard error regression was used in estimating the model. The study provides partial support for the proposition of the agency theory. The study finds board gender positively related to firm performance, while political connections and CEO incentives were negatively related with firm performance. The findings of this study should interest organisational stakeholders. Particularly, the negative association of political connection with firm performance has implication for auditors, shareholders and management. Furthermore, the study recommends more females to be considered into directorship positions, since they play a significant role in shaping the transparency of the board for better performance.

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1. Introduction

An important issue that has been found to highly influential in developing countries is political connection (Poon, Yap & Lee, 2013), as past studies have found political connections explaining the variation in performance (Johnson & Mitton, 2013). Politically connected firms are widely perceived to entail poor corporate governance practices and are more risky as perceived by stakeholders such as auditors and lenders (Bliss & Gul, 2012a).

Also likely to influence firm performance as has been highlighted by a number of studies, is the governance structure in place (Bhagat & Bolton, 2008). Corporate governance issues have become a worldwide problem, as is evident in the number of corporate governance reports that have been issued in a number of countries (Rossouw, 2005). The board of directors is particularly important in developing economies, characterised by relatively weak governance mechanisms and institutions such as market for control, financial markets, regulators, monitoring and legal system (Ujunwa, Salami & Umar, 2013). It has been observed that the effectiveness of the board is impaired by information asymmetry which leads to the agency problem between management and shareholders, whereby managers exploit the shareholders (Fama & Jensen, 1983). This has been adjudged to be responsible for several corporate failures in Nigeria, especially as was seen in the banking sector (Oso & Semiu, 2012).

Theoretically, despite a number of studies have investigated the nexus between political connection and financial performance (Bliss & Gul, 2012b; Johnson & Mitton, 2003; Osamwonyi & Tafamel, 2013), within the Nigerian context, the literature is still relatively scarce as only one study to the best of our knowledge has investigated the relationship between political connection and firm performance. Further, considering the governance attributes and firm performance relationships, prior studies have found the results to be mixed (Abidin, Kamal, Kamal & Jusoff, 2009; Haniffa & Cooke, 2005; Liao, Luo & Tang, 2014), hence providing justification for future studies. Also, to the best of our knowledge there are no studies that have investigated the role of CEO incentives in influencing the performance of firms within the Nigerian context.

Following the issues highlighted, the objective of this study is therefore to examine the relationship between political connection, board characteristics and firm performance in Nigerian quoted firms. This study makes several contributions to the body of literature. Firstly, the study examines the relationship between political connection and financial performance in Nigeria. Secondly the paper also adds to the literature on corporate governance, as the study investigates, the role of several governance characteristics for instance chief executive officer incentive and foreign presence on financial performance that have also not been studied previously within the Nigerian environment. Lastly, the study employs a large sample relative to the Nigerian environment, as most of the prior studies were deficient in terms of the sample size.

2. Materials and Methods

2.1. Theoretical framework: Agency theory

Issues concerning strategic planning and business policies are largely influenced by agency theory (Donaldson & Davis, 1991). The isolation of ownership from control results in the problem of information asymmetry and leads to a conflict of interest between management and shareholders (Jensen & Meckling, 1976). Agency theory argues that there is an agency loss which is the shortfall in returns available to residual owners as a result of direct control being in the hands of managers (Jensen & Meckling, 1976).

Corporate governance mechanisms can aid firm performance. For instance, agency theory predicts that better performance can be expected from companies whose corporate governance structure is such that there is intensive monitoring in the form of large board size which plays a crucial role in board

effectiveness (Raheja, 2005) and foreign directors in the board, as there is a greater push for better performance by foreign owners as a result of geographical separation (Craswell & Taylor, 1992). This intensive monitoring ensures the managers desists from embarking on any form of opportunistic behaviour and as such, the managers cannot withhold information for their benefits.

2.2. Methodology

2.2.1 Sample design and data collection

The sample comprised all 183 firms in the main stream of the Nigerian Stock Exchange market as at 2013. From this sample, companies with unavailable data as at the time of collecting data for this study are removed to arrive at a final sample of 119 companies, which is deemed appropriate based on the scientific guideline for determination of sample size as developed by (Krejcie & Morgan, 1970). The sample comprised financial and non-financial companies as both groups are expected to be profitable. The annual reports are used in the collection of data for this study, due to its degree of reliability and widespread acceptability by organisational stakeholders (Haniffa & Cooke, 2005).

2.2.2 Measurement of variables introduction

The dependent variable firm performance is operationalized in this study using profitability measured as profit after tax divided by equity (ROE). The independent variables include; political connection defined as where there exist in the company, a director who is an existing or former political appointee of the government, military or ex-military personnel. It is measured using a dummy variable “1” if political connection exists and “0” otherwise (Johnson & Mitton, 2003). Board size is measured as the total number of directors on the board (Abidin et al. 2009). Foreign presence is the percentage of directors that are foreigners to total director (Liang, Xu, & Jiraporn, 2013). CEO incentives is the total number of shares owned by the CEO divided by the total number of shares (Westphal, 1999). Board gender is the proportion of female directors to total directors (Liao et al. 2014) and lastly firm size is the log of total assets (Wan Hussin, Che-Adam, Lode & Kamardin, 2005).

2.3 Model Specification

In order to test the above hypotheses, the model is structured based on ordinary least square regression analysis. It is illustrated below:

$$\text{PROF} = \beta_0 + \beta_1 \text{PCON} + \beta_2 \text{BSIZE} + \beta_3 \text{FOREPR} + \beta_4 \text{CINCENT} + \beta_5 \text{BGEND} + \beta_6 \text{FSIZE} + \epsilon_t$$

Where, PROF=profitability; PCON= political connection; BSIZE= board size; FOREPR=foreign presence; CINCENT = CEO incentives; BGEND= board gender; FSIZE= size of the firm .

3. Results and Discussion

3.1. Descriptive analysis

It can be observed from the results that the minimum return on equity which is used as a proxy for profitability is -0.94, while the maximum is 2.29 and the average is 0.14. This reveals that while most of the firms are profitable, some firms also made losses during the period. Amongst the sampled firms,

on the average, about 54% of the firms appeared to be politically connected. Furthermore, on the average, the number of directors on the board of firms quoted in the Nigerian Stock Exchange market as at 2013 is about 9 directors. On the average about 17% of these directors are foreigners, while 11% are females. The average ratio of CEO shares to the total number of shares is 0.05, and the average log of total assets which is used as a proxy for size of the firm is 16.50.

Table 1. Descriptive statistics for disclosing and non-disclosing firms

VARIABLE	MIN	(N=119)		MEAN	STD. DEV
		MAX			
PROF	-0.94	2.29		0.14	0.30
PCON	0	1		0.54	0.50
BSIZE	5.00	17.00		9.06	2.53
FOREPR	0.00	0.75		0.17	0.21
CINCENT	0.00	0.64		0.05	0.12
BGEND	0.00	0.44		0.11	0.11
FSIZE	11.37	21.78		16.50	2.03

Notes: PROF=profitability; PCON= political connection; BSIZE= board size; FOREPR=foreign presence; CINCENT = CEO incentives; BGEND= board gender; FSIZE= size of the firm

3.2 Multiple Regression Analysis

Reporting the results of the ordinary least square regression requires that certain diagnostic tests have to be conducted to ensure that the results reported can be relied upon (Gujarati, 2003). It is important to check that there is absence of multicollinearity and there is no problem of heteroskedasticity. The results of the Breuch Pagan test for heteroskedasticity, with a p-value of 0.00, shows that the model is heteroskedastic. This is then corrected for using the robust regression analysis (Hoechle, 2007). Table 2 presents the results of the ordinary least square regression with profitability as the dependent variable. There is an obvious improvement in the significance of the variables when the robust regression is run.

The result of the robust regression shows a significant negative relationship for political connection ($\beta = -0.08$, $p < .10$) and CEO incentives ($\beta = -0.38$, $p < .05$), while a positive relationship was found for board gender on the relationship with profitability of the sampled firms. The results for board size, foreign presence and firm size were not significant.

Table 2. Regression Analysis.

Dependent Variable: profitability (ROE).

Variables	OLS Regression			Robust Regression	
	Predicted sign	coefficient t value	tstat	coefficient value	tstat
PCON	+	-0.08	-1.39*	-0.08	-1.47*
BSIZE	+	0.01	0.25	0.01	0.19
FOREPR	+	0.06	0.43	0.06	0.65
CINCENT	+	-0.38	-1.53*	-0.38	-1.86**
BGEND	+	0.31	1.15	0.31	1.39*

FSIZE	+	-0.01	-0.67	-0.01	-0.38
$R^2=0.05$	F-statistic	p-		$R^2=0.05$ F-	
	=1.05	value=0.40		statistic=2.16,	p-value=0.05

Note: *p<.10; **p<.05; ***p<.01

3.3 Discussion of Findings

The objective of the study was to examine the relationship between political connection, board characteristics and firm performance in Nigerian firms. The results show partial support for the agency theory that explains the role of the board of directors in resolving the agency problem. The positive relationship between board gender and firm performance is in tandem with studies by Carter, Simkins and Simpson (2003) that considered the nexus between board diversity and firm value. They purport that greater diversity will lead to more independence and subsequent better performance. The result also agreed with Campbell and Minguez-Vera (2007) that found gender positively related to firm value. The negative result reported between political connection and firm performance is in line with the study of Tu, Lin and Liu (2013) that investigated how privatised firms were acquired by politically connected persons and how the firms behaved after their acquisition. The study showed that such firms received preferential treatment and faced post privatization tunnelling, which lead to dwindling performance after privatization. Similarly, as is the case with Linck, Netter and Yang (2008), the negative relationship between CEO incentives and firm performance could be interpreted to mean that the CEO with increased shares, can threaten and dilute the effect of the board of directors (Boyd, 1994). As such, they could influence the appointment of outside directors and make the board a rubber stamp

4. Conclusion and recommendations

The main findings show board gender to have a positive relationship with firm performance, while negative associations were found for the relationships between political connections, CEO incentives on the firm's performance. In drawing conclusions based on the findings of this study, it should be noted that the data used is cross-sectional, as such future studies may consider extending the time frame. In addition, the study defined firm performance based on the return on equity measure of profitability. Future studies might consider other measures of performance such as tobin q, return on assets, earnings per share etc. The findings of this study should interest organisational stakeholders. Particularly, the negative association of political connection with firm performance has implication for auditors, shareholders and management. The study recommends that external auditors be made to pay particular attention to politically connected firms as political connections have tendencies to weaken the governance structure within the firms. Also, the study highlights the need for policy makers to harmonise and develop corporate governance standards and practices that takes into consideration the specific needs of the African continent. Furthermore, the study recommends more females to be considered into directorship positions, since they play a significant role in shaping the transparency of the board for better performance. Lastly, the study has implication for research as there is a dearth of

studies from the Nigerian market, considering the different regulatory structure that separates it from other developing and developed economies.

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