

CHIEF EXECUTIVE OFFICER DUALITY AND FINANCIAL PERFORMANCE OF FIRMS IN NIGERIA

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ABSTRACT

The work is centred on CEO Duality and Financial Performance of Firms in Nigeria. The objective of the study is to find out the relationship between CEO Duality and the Financial Performance of Firm. We adopted the use of secondary data from the Nigerian Stock Exchange Fact book drawn from various industries during the period 2001 – 2010 and the regression analysis with its Best Linear Unbiased Estimate (BLUES) was employed to test our hypothesis. The findings of the study revealed that CEO Duality is harmful to the Financial Performance of a firm. The study proffered useful recommendations, which when implemented will help improve financial performance of firms in Nigeria.

Keyword: CEO Duality, Financial Performance, Board Size, Corporate Governance.

INTRODUCTION

Corporate governance has important implications on the micro economic as well as the macro-economic level, where poor corporate governance can result in the failure of corporations, as in the case of the two big giants, Enron and Worldcom. The role of different instruments in implementing corporate governance is important as highlighted by Bhagat and Black (1999, 2002). These instruments include board of directors, independent directors, board size, CEO, managers, efficient market, political regime, government, regulatory authority and judiciary. The independent directors, CEO, board of directors and managers can improve the value of a firm by performance of their fiduciaries. The role of the regulatory authority, government and judiciary is important to improve the value of a firm as these authorities can protect the rights of the shareholders and implement corporate governance in developing as well as developed financial markets. Corporate governance has significant impact in disciplining a powerful and independent CEO, bringing improvement to the value of a firm in developing and developed markets. Similarly, the board and CEO can also safeguard the interest of the shareholders by creating more value for them as argued by Bhagat and Jefferis (2002) and Gompers, Ishii and Metric (2003).

The Chief Executive Officer (CEO) of an organisation can play an important role in creating the value for shareholders. The CEO can follow and incorporate governance provisions in a firm to improve its value (Brian, 1997; Defond and Hung, 2004). In addition, the shareholders invest heavily in the firms having higher corporate governance provisions as these firms create value for them (Morin and Jarrell, 2001). The decisions of the board about hiring and firing a CEO and their proper remuneration have an important bearing on the value of a firm as argued by Holmstrom and Milgrom (1994). The board usually terminates the services of an underperforming CEO who fails to create value for shareholders. The turnover of CEO is negatively associated with firm performance especially in developed markets because the shareholders lose confidence in these firms and stop making more investments.

It is the responsibility of the board to determine the salary of the CEO and give him proper remuneration for his efforts (Monks and Minow, 2001). The board can also align the interests of the CEO and the firm by linking the salary of a CEO with the performance of a firm. This action will motivate the CEO to perform well because his own financial interest is attached to the performance of the firm as suggested by Yermack (1996). The tenure of a CEO is also an important determinant of the firm's performance. CEOs are hired on short-term contracts and are more concerned about the performance of the firm during their own tenure causing them to lay emphasis on short and medium-term goals. This tendency of the CEO limits the usefulness of stock price as a proxy for corporate performance (Bhagat and Jefferis, 2002). The management of a firm can overcome this problem by linking some incentives for the CEO with the long-term performance of the firm (Heinrich, 2002). The legislation that is responsible for regulating the Nigerian capital market has been reformed recently to partially reflect corporate governance principles. A key controversy in the corporate governance literature is the impact of CEO duality (used as a proxy for board leadership structure) on corporate performance. The duality of CEO refers to the situation where the executive manager also serves as the chairman of the board of directors. Studying the relationship between the duality of the CEO and corporate performance is an important issue for several different reasons. The CEO duality "has been blamed for poor performance and slow response to change in firms. A final motivating factor for the approach taken in this paper is the fact that, although CEO duality is the common leadership structure among Nigerian firms, there is very little empirical evidence regarding its impact on corporate performance in Nigeria. Thus, the aim of this paper is to empirically provide robust evidence regarding the relationship between CEO duality and corporate performance using rigorous econometric methods of analysis.

STATEMENT OF THE RESEARCH PROBLEM

The question of whether the chief executive officer's duality affects financial performance has been the subject of much debate and research. The chief executive officer duality is an essential feature of an efficient capital market that must be given a due attention. It is on the basis of this that informed our decision of the following hypothesis.

Hypothesis of the Study

Ho: Chief Executive Officer Duality is not harmful to the financial performance of a firm.

Hi: Chief Executive Officer Duality is harmful to the financial performance of a firm.

The remaining part of the article is divided into a Review of Related Literature, Model Specification, Data Analysis, Conclusion and Recommendations.

LITERATURE REVIEW

Separation of ownership and management in modern corporations has led to different arguments regarding the relationship between the principal and the agent. According to agency theory, the agent, in this relationship, will be a self-interest optimizer. In other words, executive managers will take decisions with the aim of optimising their wealth and/or minimizing their risk at the expense of the shareholders' value. Therefore, it has been argued that internal and external monitoring mechanisms need to be implemented to lessen divergence in interests between shareholders and the management (Jensen and Meckling, 1976; Fama and Jensen, 1983).

However, some other researchers argue against the hypothesis of agency theory and propose stewardship theory. For example, Donaldson and Davis (1991) claim that, "The executive manager, under this theory, far from being an opportunistic shirker, essentially wants to do a good job, to be a good steward of the corporate assets".

i. Role of Board Size in Firms Performance

Board size plays an important role in affecting the value of a firm. The role of a board of directors is to discipline the CEO and the management of a firm so that the value of a firm can be improved. A larger board has a range of expertise to make better decisions for a firm as the CEO cannot dominate a bigger board because the collective strength of its members is higher and can resist the irrational decisions of a CEO as suggested by Pfeffer (1972), Zahra and Pearce (1989). On the other hand, large boards affect the value of a firm in a negative fashion as there is an agency cost among the members of a bigger board. Similarly, small boards are more efficient in decision-making because there is less agency cost among the board members as highlighted by Yermack (1996).

ii. Role of CEO Duality in Firms Performance

Similar to the other corporate governance instruments, CEO duality plays an important role in affecting the value of a firm. A single person holding both the Chairman and CEO role improves the value of a firm as the agency cost between the two is eliminated (Alexander, Fennell and Halpern, 1993). However, CEO duality can lead to worse performance as the board cannot remove an underperforming CEO and can create an agency cost if the CEO pursues his own interest at the cost of the shareholders (White and Ingrassia, 1992).

iii. Role of the Manager in Firms Performance

Managers can play an important role in improving the value of a firm. They can reduce the agency cost in a firm by decreasing the information asymmetry, which results in improving the value of a firm (Monks and Minow, 2001). Managers in the developed market create agency cost by under and over investment of the free cash flow. Shareholders are disadvantaged in this case as they pay more residual, bonding and monitoring costs in these firms. Managers in developing financial markets generally play a negative role in the value creation of investors. The rights of the minority shareholders are suppressed and the firms in these markets cannot produce real value for shareholders as actions of the managers mostly favour the majority of shareholders. The management and the shareholders in a developing market do not use the tools of hostile takeover and incentives to control the actions of managers. In the case of a hostile takeover, the managers are forced to perform well to be able to hold their jobs.

Similarly, appreciation and bonuses can motivate managers to produce value for shareholders (Bhagat and Jefferis, 2002). The ownership of the management in a firm has an important bearing on its value (Morck, Shleifer and Vishny, 1988). Also, firms can improve their value in developing markets by streamlining the interests of managers with those of the shareholders. This results in the convergence of the goals of shareholders and managers ultimately improving the value of the

shareholders as suggested by Mehran (1995).

iv. Role of Efficiency and Liquidity in the Market

An efficient market can improve the value of a firm by incorporating available information in the share prices. The efficiency in the market enables the firms to raise credit easily because it reduces the problem of asymmetric information and moral hazard from the market, making it more stable (free from financial disaster) as mentioned by Asian Development Bank and World Bank (1998), Thillainathan (1998) and Colombo and Stanca (2006). Markets normally observe different kinds of efficiencies. These efficiencies include allocation, dynamic and informational efficiency. Allocation efficiency in the market can be achieved by using the most productive resources for production. Dynamic efficiency can be achieved by decreasing the cost and improving the productivity of a firm. Finally, informational efficiency can be achieved by incorporating public and private information in the share prices as suggested by Colombo and Stanca (2006).

The salary of management can be linked to performance of a firm in a developed market to improve the value of a firm, as these markets are efficient and financial information is transparent. On the contrary, it is not beneficial to link the salaries and incentives of management with the share prices as majority shareholders manipulate the financials of firms in developing markets (Heinrich, 2002). The share prices are not correctly priced in these markets due to the market inefficiency (markets do not incorporate true information in the share prices) (Nam and Nam, 2004). The liquidity in a market and existence of a market for corporate control are an important determinant of corporate governance and the value of a firm in financial markets. Liquidity makes the market informational efficient ultimately improving the value of a firm (Holmstrom and Tirole, 1993). Similarly, the market for corporate control improves the value of a firm by enabling the regulatory authorities to protect the rights of the shareholders. The managers are also disciplined and it results in reduction of the agency cost from the market as highlighted by Vives (2000).

Finally, the illiquidity and non-existence of the market for corporate control in the developing market makes the regulatory authorities unable to perform their function of monitoring the firm and cannot improve its value. Also, the majority shareholders, being a powerful monitor in these markets, do not improve the value of a firm (Heinrich, 2002).

v. Financial Disclosure and Infrastructure in the Market

The transparent and timely disclosure of financial policy (dividend and investment policy) is important for the value creation of shareholders. The management of a firm is responsible for spreading the information between majority and minority shareholders on an equal basis (Peirson et al., 2000; Damodaran, 2006). Furthermore, the infrastructure in a market plays an important role in affecting the efficiency of a market. The shareholders in the developing economies are disadvantaged, as they do not enjoy the availability of financial information on a timely basis because of the underdeveloped infrastructure. The advancement in communication systems can play an important role in decreasing the informational asymmetry and improving the value of a firm in a developing market (Pereiro, 2002; Ahunwan, 2003).

vi. Corporate Social Responsibility of a Firm

Corporate social responsibility is defined as the responsibility of a firm towards all the stakeholders such as achieving sustainable development by protecting the environment and reducing poverty in addition to creating monetary value for shareholders. Corporate social responsibility can improve the value of firms in developing markets to a higher degree compared to the firms in developed market by providing social justice, as there is social, economic and cultural chaos in these markets. Reducing these problems in the developing market will benefit society as a whole and ultimately improve the value of a firm as suggested by Crowther and Rayman - Bacchus (2004) and Banks (2004).

In addition, the role of corporate social responsibility can be broadened by adding extra duties under the jurisdictions of corporate social responsibilities. As argued by Tunzelmann (1996) and Francis (2000), these additional responsibilities include a wide range of issues such as the use of reliable data for research, improving the packaging of goods, reducing noise, conserving water, managing risk in a system, creating more job opportunities and controlling waste emission in an environment. Based on this new definition, corporate social responsibility in the market results in enhancing the social value of a firm as it improves the standard of living of the people and provide them with more choices of goods and services. In addition, it gives employees a cleaner and healthier environment to operate in and improves their family relationship and productivity in workplace. Finally, the market value of a firm is also improved by corporate socially responsible acts as the agency cost among the different players of the market is decreased (Batten and Fetherston, 2003; Tomasic, Pentony and Bottomley, 2003). Corporate social responsibility is usually measured by an index, which is constructed by incorporating those aspects of the organisation that improve the social value of a firm such as ethical investment made by a firm and improving relations with the suppliers and customers of the firm (Venanzi and Fidanza, 2006).

MODEL SPECIFICATION

Regression was used as a tool for hypothesis testing and to reveal the relationship between CEO Duality and the Financial Performance of a Firm. The regression specifies the relationship among the dependent variable, independent variable. The general representation of the model is given in the equation below. The general representation of the model is as follows:

$$Y_t = C + \beta_1 \log X_{1t} + U_t$$

Where:

Y_t (regressand)	=	Net Profit;
C	=	intercept;
β_1 ($\beta_1 - \beta_5$)	=	slope of the independent variable;
X_t (regressor)	=	independent variables;
t	=	periods;
U_t	=	error term;
β_1	=	CEO Duality

DATA ANALYSIS

NPAT	=	6.334 _{NPAT} + (-1.341) _{CEODUAL}
		(0.000) (0.186)
R ²	=	0.36
R ² Adjusted	=	0.16
F-statistic	=	1.798
f-critical	=	4.04
t-statistic	=	-1.341
t-critical	=	2.021
Prob(F-statistic)	=	0.000000
DW	=	1.442
df	=	1 – Numerator and 48 Denominator
Level of Sign.	=	0.05%

R²/R² Adjusted

The R^2 represents the coefficient of determination and goodness of fit test. The R^2 suggests that 36% of the total variation in the dependent variable (NPAT) has been explained by CEODUALITY and this is not a good fit since the unexplained variation is 54% ($1 - 0.36$). The R^2 which is the adjusted R^2 for degrees of freedom suggests that 16% of the changes in the dependent variable (NPAT) have been explained by MCAP and this is not a good fit.

f-test

The f-test is used to test the overall significance of the model and the hypotheses. The decision rule of the f-test is that if $f\text{-calculated} > f\text{-critical}$, we reject the null hypothesis and accept the alternative hypothesis. The opposite is the case if the $f\text{-calculated} < f\text{-critical}$. The result revealed that f-statistic with value 1.798 is $< f\text{-critical}$ with value 4.04 and this suggest that we reject the alternative hypothesis and accept the null hypothesis which states that Chief Executive Officer Duality is harmful to the financial performance of a firm

t-test

The t-test is used to test the statistical significance of each independent variable in explaining the changes in the dependent variable. The t-test shows the predictive power of each independent variable. The decision rule of the t-test is that if $t\text{-calculated} > t\text{-critical}$, it suggests that the particular independent variable is statistically significant in explaining the changes in the dependent variables. The t-test suggests that the t-calculated with value -1.341 is $< t\text{-critical}$ with value 2.021 and this mean that CEODUAL is not statistically significant in explaining the changes in NPAT.

Dw

The Durbin Watson test is used to test for the presence or absence of first order serial correlation in the model. The Durbin Watson test with value 1.442 suggests that the model shows support for the existence of first order serial correlation.

Signs/Magnitude

The Signs and Magnitude is used to show the linear relationship that exists between the dependent and independent variable whether there are positive or negative relationships. The result shows that CEODUAL have a negative linear relationship with the NPAT. That is, a decrease in the CEODUAL by -1.341units will increase the NPAT by 6.334units.

CONCLUSION

The purpose of this study is aimed at examining CEO Duality and Financial Performance of Firms in Nigeria. The study was carried out with firms quoted on the Nigerian Stock Exchange during a period of 10years (i.e. 2001 – 2010). The study concludes that the Chief Executive Officer duality is harmful to the financial performance of a firm. Similar to the other corporate governance instruments, CEO duality plays an important role in affecting the financial performance of a firm. A single person holding both the Chairman and CEO role improves the financial performance of a firm as the agency cost between the two is eliminated. However, CEO duality have been seen as something that lead to worse performance as the board cannot remove an underperforming CEO and this to a great extent can create an agency cost if the CEO pursues his own interest at the cost of the shareholders.

RECOMMENDATIONS

Based on the findings of the study, firms are enjoined to place a remarkable degree of emphasis on the area of corporate governance and to some extent embark on eliminating CEO duality. It is also recommended that a larger data set may result in a different model of the relationship between CEO Duality and Financial Performance of firms in Nigeria. The inclusion of new corporate governance

instruments could result in additional Edgeworth combinations of the internal corporate governance mechanism. Similarly, corporate governance instruments such as capital structure, shareholding by the management, CEO tenure, banking efficiency, political regime and executive remuneration can be used to test the relationship with the financial performance of firms.

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Appendix

Regression Result on CEODUAL

Descriptive Statistics

	Mean	Std. Deviation	N
NPAT	4.31E5	231499.200	50
CEODUAL	88.2000	37.04052	50

Correlations

		NPAT	CEODUAL
Pearson Correlation	NPAT	1.000	-.190
	CEODUAL	-.190	1.000
Sig. (1-tailed)	NPAT	.	.093
	CEODUAL	.093	.
N	NPAT	50	50
	CEODUAL	50	50

Variables Entered/Removed^b

Model	Variables Entered	Variables Removed	Method
1	CEODUAL ^a	.	Enter

a. All requested variables entered.

b. Dependent Variable: NPAT

Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.190 ^a	.036	.016	229637.781	.036	1.798	1	48	.186	1.442

a. Predictors: (Constant), CEODUAL

b. Dependent Variable: NPAT

ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	9.479E10	1	9.479E10	1.798	.186 ^a
	Residual	2.531E12	48	5.273E10		
	Total	2.626E12	49			

a. Predictors: (Constant), CEODUAL

b. Dependent Variable: NPAT

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	535801.071	84597.226		6.334	.000
	CEODUAL	-1187.448	885.662	-.190	-1.341	.186

a. Dependent Variable: NPAT

Residuals Statistics^a

	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	3.61E5	4.78E5	4.31E5	43983.672	50
Residual	-3.353E5	3.827E5	.000	227282.460	50
Std. Predicted Value	-1.587	1.058	.000	1.000	50
Std. Residual	-1.460	1.666	.000	.990	50

a. Dependent Variable: NPAT

Histogram

