

# Corporate Governance and Firms' Performance: Evidence from Quoted Firms on the Nigerian Stock Exchange

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## Abstract

The aim of this paper is to examine the relationship between corporate governance and firms' performance of listed firm in the Nigerian stock exchange between 2012 and 2017. Consequently, data were extracted from 40 companies out of 169 companies, which are listed on the Nigerian Stock Exchange as at 2018 169. Dynamic ordinary least square was adopted to analyze the objective of study. The principal findings that originate from this study are that board independence, gender diversity and managerial ownership have a positive relationship with firms' performance. These variables improved the return on asset and the return on equity of the selected firms. Therefore, it could be concluded from this study that corporate governance improves the performance of the listed firms on the Nigerian stock exchange. However, due to the findings that emerged in this study, this paper makes the following vital policy recommendations for the policy makers, corporate firms, institution regulators and future researchers. The board independence of the listed firms in the Nigerian stock exchange should be encouraged by increasing the percentage of independent directors in these firms. Similarly, there should be a balance in the inclusion of males and female with effective managerial ownership among the board of directors in the listed firms in the Nigerian stock exchange.

**Keywords:** Corporate Governance, Firms' Performance, Nigerian Stock Exchange

## Introduction

Corporate governance has become an issue of public interest in the recent time. The critical need for proper and efficient practice in the administration of business entities in an economy has been identified as a reason behind the advocacy for good corporate governance in organizations.

Deficiencies in corporate governance have caused serious problems for companies in terms of scandals and fraud in both internationally and locally managed firms; for instance, scandals that ravaged the Volkswagen in 2015, which resulted into a \$4.6 billion loss in the company that very year. In the same vein, the case of the Gupta family of South Africa in 2017, which made KPMG to lay off 400 employees in South Africa, cannot be overemphasized. In Nigeria, poor corporate governance practices have caused several issues in companies such as Mega Bank Nigeria and Cadbury Nigeria Plc in the time past. It is important to stress that the perpetual failures in organization performance have orchestrated the compelling need for a deeper understanding of the issues diffusing the spillovers of corporate governance into the company's performance.

Generally, corporate governance is regarded as the systems of rules, practices and processes, which guide the direction and control of a company (Cadbury, 1992). This involves reconciliation of the interest of a company's stakeholders, which are composed of shareholders, management, customers, suppliers, financier, government and the community at large.

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Meanwhile, it is expected that a good corporate governance will generate more profits for the firms and thereby raise their valuation and increase sales growth. It also has the capacity to reduce the capital expenditure of the firms. However, despite the fact that supervisory agencies elucidate the aftermath effect of corporate governance on organization performance, the empirical arguments regarding this subject matter are limited in Nigeria (Dabor et al., 2015). It is worth noting that financial scandals, which bewildered some reputable corporations such as Panasonic, Volkswagen, Toshiba and KPMG, South Africa, sparked off the studies about the impact of corporate governance on firms' performance in the literature. Consequently, the bulk of these studies focused on firms operating in developed economies, which its policy implications may yield different results in the Nigerian context. Similarly, majority of past studies in Nigeria are small sample oriented, which could limit the generalizations of their results in the country. In view of the above, this study will move the frontiers of knowledge by examining the relationship between corporate governance and firms' performance while employing a larger sample, which comprised all the firms listed at the Nigerian stock market. The uniqueness of this study also lies in the utilization of econometric technique in which several studies in Nigeria failed to adopt.

## Literature Review

The section critically reviewed past studies on nexus between corporate governance and firm performance.

### Corporate Governance

Corporate governance could be conceptualized as the system, which dictates the control and direction of companies (Siromi & Chandrapala, 2017: 20). According to Pass (2004), corporate governance has to do with the responsibilities and duties of the board of directors of a firm in connection with the control of the firm and their relations vis-à-vis all the stakeholders of the firm. Raut (2011) denotes corporate governance as a set of customs, institutions, laws, policies and processes that influence the ways in which a firm is controlled, administered and directed. However, firms that are saddled with the responsibility of applying the corporate governance

processes and principles have high tendency of improving the level of confidence and reassurance of shareholders with respect to their investments. This assertion is justified by the submission of Qureshi and Mahmood (2018) who submitted that the aim of developing principles that dictate the control and direction of a firm is to increase the awareness of the potential risk that may confront the company. The board of directors and executive management should possess adequate awareness to be able to predict accurately the potential risk that could affect the firm's performance, and increase the ability of the company to minimize or mitigate such risk.

In another perspective, (OECD, 2004) argues that corporate governance should, as a matter of necessity, revolve around the powers, duties and roles of the firm management, shareholders and the board of directors in one hand, and transparency and the place corporation occupies in the society at large. In another words, corporate governance stresses the control and the management of a firm with a view to maximizing the utility of both the firm and its stakeholders as well. It has been established that some parameters, both internal and external of the firm, are deployed in evaluating the extent of corporate governance among firms. The influences the firm possesses outside the company is measured by the external mechanisms. Whereas, the existing structures within the firm assess its internal governance mechanisms. Consequently, Thomson and Bereau (2009) submitted that some level of confidence is given to a firm that practices good corporate governance. For instance, an active group of nonexecutive directors ensures the confidence of an organization in the market. Therefore, this variable serves as one of the major criteria that influences foreign institutional investors when making investment decisions. Corporate governance also influences the share price of the company because it has been argued to have a positive influence on it. This implies that a clear image of corporate governance of a firm can help it obtain a better capital at a more reasonable cost. It could be concluded that good corporate governance is not pertinent to only the stakeholders of the firm, but also the economy at large because it attracts both rational distribution and optimum management of a firm's human and material resources. This invariably leads to a better corporate performance which would largely facilitate rise in the firm's share price, thus raising a shareholder holdings' value in the long run.

## **Emergence of Corporate Governance in Nigeria**

In Nigeria, corporate governance could be traced to the era of the British colonial masters before independence from the British in 1960. Before the country got her independence, an Anglo-Saxon-based system of corporate law and regulation was imposed on the country by the British colonial government (Adigbite, 2011). Consequently, the Nigerian government introduced the 1968 companies Act after independence to replace the existing company's ordinance of 1922. It is worth of note that the 1968 companies act was fashioned after the United Kingdom Companies Act of 1948. This implies that all the reforms in law and legal system offshoots of the Anglo-Saxon model. The implication is that Nigeria's legal operating framework for corporations is yet to factor in the nation's business environment (Adegbite, 2011). Little wonder, despite the availability of these laws in the country, there are still catalogues of corporation failures in both financial and non-financial sectors of the economy. Evidence abound in Nigeria that banking industry and manufacturing firms are collapsing on daily basis rewarding their investors, shareholders, suppliers, depositors, employees and other stakeholders with a series of losses. This has metamorphosed into continuous loss of aggregate output and rising level of unemployment among the teeming population of the country. It is not a gainsay to report that the unprecedented corporate scandals and failures that characterized majority of Nigerian firms in the late 1990s and the early 2000s were the products of dishonesty in management decisions and outright cover-ups of nefarious activities of people at the companies' helm of affairs. These activities led to the crippling of many companies and the resources of millions of innocent stakeholders.

## **Board Composition and Financial Performance**

The relationship between the board composition and financial decision of firms cannot be undermined in any corporate organization. Firm's performance is usually a reflection of the quality or otherwise of its directors and board composition. In corroborating the above assertion, Nicholson and Kiel (2004) submitted that outstanding and positive performance of a firm is linked with an effective management team and a board of the firm. Meanwhile,

poor board and inefficient management effectiveness lead to poor corporate success. Because the responsibilities of the board of directors range from overseeing the firm's operations to the examination of the performance of top management with a view to protecting shareholders' interests. However, an attempt was made in the literature to enunciate the service role of the board of directors, vis-à-vis resource dependence perspective. In view of the above, Mintzberg (1983) beam light on at least four different service roles of the board of directors as follows; chief adviser and counsellor to the organization, co-opting external influencers, enhancing corporate reputation and generating funds and establishing contacts for the firm. It is instructive to stress that the effectiveness of the service roles and supports a firm gets from its board is largely a function of the cumulative configuration of human capital of the board such as board demography characteristics such as professional diversity, gender diversity, etc., of the board members. The configuration of a board of directors with different backgrounds has the capacity to be more effective in terms of accessibility to critical technical skills, crucial expertise and wealth of experience to catalyze relevant advice and counsel that will serve as an impetus for the achievement of the founding goals of the firm.

Another strategic role of the board is the development of corporate strategy and creation of corporate vision that propel strategic changes in an organization. However, there are some other parameters such as conflict resolution, debate norms and cohesiveness that can be used to determine the effectiveness or otherwise of board of directors in producing effective outcomes in cooperative decision-making between executive and non-executive directors. This implies that the board of directors must be good team players with some level of cohesiveness. Objective debates and some accompanying conflict in the course of the debates cannot be totally eroded among the board as a decision-making group of the organization. Therefore, the intensity of the debates is a direct function of cycle of group and interpersonal network that exists between executive and non-executive directors. The terms non-executive directors are synonymous to independent directors who are outside of the firm. They are regarded as outsider directors because their relationships with the firm is neither business nor personal (Ogbechie & Koufopoulos, 2010). In another words, this set of directors does not have a business relationship with the company

for the past three years or more. The more reason for the inclusion of independent directors is usually linked with the possession of appropriate skills, caliber, wealth of experience, goodwill and personal qualities of some set of people in the society that might help in providing the board of directors with quality insights or critical ideas in some related sectors that could contribute to the improvement of the overall firm's financial performance. Succinctly put, independent directors bring quite a degree of objectivity to the board's deliberations because they are independent of the management of the firm and any of its interested parties. This plays an indispensable role in checkmating and monitoring executive management of the firm. Therefore, non or low representation of outside directors in boards could result into the lack of objective decision-making and failure to monitor activities of the firm's management objectively.

Furthermore, Aduda and Musyoka (2011) assessed the nexus between executive compensation and firm performance in bank industry in Kenya. It was discovered in the study that an inverse relationship exists between executive compensation and the size of bank. The reason for this result was arrogated to the fact that the influence of principal owners of the bank diminishes as the size of the bank grows in the country. In another related study by Dehaene, De-Vuyst and Ooghe (2001), it was discovered that the percentage of independent directors is directly related to the financial performance of firms in Belgium. Also, the correlation between number of external directors and return on equity of the firm was positive and significant. This study provided an empirical evidence to corroborate the assertion that independent directors bring more benefits to the firm because of their independence from the firm's management. In contrast, Priya and Nimalathan (2013) argued that independent directors reduced firm performance and this negative effect was more pronounced during the recent financial crisis.

### **Gender Diversity and Financial Performance**

Over time, there have different speculations that women are more endowed with some innate qualities and characteristics with make them to more specialized in different activities that can guarantee good governance. While juxtaposing the above proposition, Azmi and

Barrett (2013) opined that women are risk averse, meticulous, good decision-makers and possess some special skills in finance and accounting. This argument has sparked off debate in the literature that female executives and directors could have potentials that drive better financial performance of a firm. Consequently, Campbell and Mingues-Vera (2008) and Adams and Ferreira (2009) in different studies concluded that the presence of female directors could exert a positive impact on both performance of firms and their market value. Similarly, Krishnan and Park (2005) reported a positive correlation between the presence of women in management teams and financial performance while examining the linkage between female directors and return on total assets of 679 companies from the Fortune 1,000 database. But, Rose (2007) discovered no significant relationship between firm performance and female composition of board with Danish. Furthermore, Carter, Simkins and Simpson (2003) asserted that there was a significant and positive association between Tobin's Q and the inclusiveness of women on the boards of the Fortune 1,000 companies. In summary, it could be pinpointed that the results from various studies indicate that the inclusiveness of women on the boards or women participation in management teams might facilitate the team performance in such a way of bringing in different insights, which might eventually metamorphosed into higher business value and financial performance of organizations.

### **Methodology**

This study makes use of secondary data from 2012 to 2017. Data of various variables used for the analysis of this work were extracted from the annual financial reports of companies listed in the Nigeria stock and E-Views software was employed for the running of the data. It is important to state that the target population of this work is 169 companies, which are listed on the Nigerian Stock Exchange as at 2018. However, a total of 40 listed firms operating in high-profile industries in the Nigerian Stock Exchange were purposively selected for this study. This implies that about 23.7% of the total population was adopted for the analysis. The selected sample size is large enough to make empirical generalization. This is justified by the proposition of Uwuigbe (2014), where a minimum of 5% of a defined population is considered as an appropriate sample size in making generalization. The

purposive sampling technique in the study was motivated by size of companies, based on their sectors, and the availability of the annual reports of the companies. The following is the list of the selected firms for the study: Abbey Mortgage Bank, Access Bank, AG Leventis, AXA Mansard, Berger Paint, C and I Leasing, Cap Plc, Caverton, Champion Breweries, Consolidated Hallmark Insurance, Consolidated Reinsurance Plc, Dangote Cement, Diamond Bank, Ecobank, FCMB, Fidelity Bank Plc, First Bank, Forte Oil, GTBank, Guinness, Honeywell, International Breweries Plc, Jaiz Bank Plc, Julius berger, Lafarge Africa Plc, Nascon, Nestle, Nigerian Brew. Plc, Oando Plc, Portland Paint & Products Nig., PZ, Royal Exchange Plc, StanbicIBTC Bank Plc, Sterling Bank Plc, Transcorp, UBA, Unilever Nigeria Plc, Union Bank Plc, Unity Kapital Assurance Plc and WAPIC Insurance Plc.

## Model Specification

$$Y_t = F(BOC_t, BIN_t, MAO_t, GED_t) \quad (1)$$

## Results and Discussion

Where:

$Y_{it}$  represents firm performance variables, which are: return on capital employed and return on assets for firms at time t. Meanwhile, model 1 could be explicitly transformed to models 2 and 3, respectively.

$$ROE = \beta_0 + \beta_1 BOC_t + \beta_2 BIN + \beta_7 MAO + \beta_3 GED + e_t \quad (2)$$

$$ROA_{it} = \beta_0 + \beta_1 BOC_t + \beta_2 BIN + \beta_7 MAO + \beta_3 GED + e_t \quad (3)$$

Where:

ROE and ROA represent firm performance variables which are: return on assets and return on equity for the firms at time t. Meanwhile, BOC and BIN, represent the board composition and board independence, respectively. MAO represents managerial ownership and GED represents gender diversity. However,  $e_t$  the error term which accounts for other possible factors that could influence ROEt and ROA<sub>t</sub> that are not captured in the model.

The a priori expectation is such that  $\beta_1, \beta_2$  and  $\beta_3 > 0$ .

**Table 1: Descriptive Statistics of Annual Data Series**

| Descriptive Statistics | GED      | ROA      | ROE      | BOC      | BIN      | MAO      |
|------------------------|----------|----------|----------|----------|----------|----------|
| Mean                   | 0.137897 | 0.011726 | 0.023315 | 0.666667 | 1.72E+08 | 3.00E+08 |
| Median                 | 0.133929 | 0.014119 | 0.028247 | 0.700000 | 2.370071 | 1.594664 |
| Maximum                | 0.166667 | 0.021300 | 0.042274 | 0.800000 | 6.00E+09 | 4.56E+09 |
| Minimum                | 0.125000 | 0.034838 | 0.070387 | 0.400000 | 0.000000 | 825.2900 |
| Std. Deviation         | 0.015175 | 0.016739 | 0.033475 | 0.149383 | 8.76E+08 | 6.85E+08 |
| Skewness               | 0.845754 | 0.837637 | 0.788116 | 0.626099 | 6.053147 | 2.986945 |
| Kurtosis               | 2.438229 | 3.160302 | 3.136309 | 2.040000 | 3.926540 | 1.79750  |
| Jargue-Bera            | 31.76785 | 28.32241 | 25.03089 | 24.89600 | 13664.26 | 1316.787 |
| Probability            | 0.000000 | 0.000001 | 0.000004 | 0.000004 | 0.000000 | 0.000000 |
| Sum                    | 33.09524 | 2.814292 | 5.595683 | 160.0000 | 4.12E+10 | 7.20E+10 |
| Sum. Sq. Deviation     | 0.055036 | 0.066969 | 0.267816 | 5.333333 | 1.83E+20 | 1.12E+20 |
| Observation            | 240      | 240      | 240      | 240      | 240      | 240      |

Source: Authors' Computation (2019)

Table 1 presents descriptive statistics of the data used to capture corporate governance and firm performance. This is very crucial because it provides a useful information about the distribution of the data series. It could be observed from Table 1 that the values of mean and median of the variables return on asset, return equity, gender diversity, board independence, managerial ownership and

board composition are almost identical. This implies that the distribution of the data series is nearly symmetrical. A distribution of data series is perfectly symmetrical when the values of mean, mode and median of such data are (Karmel & Polasek, 1980). Also, the normal distribution of the data series could be confirmed from the value of Kurtosis which is not significantly different from 3.

**Table 2: Correlation between Corporate Governance and Capital Structure in Nigeria**

| Variables | BIN   | MAO    | GED    | BOC    |
|-----------|-------|--------|--------|--------|
| BIN       | 1.000 | 0.055  | 0.025  | 0.125  |
| MAO       | 0.055 | 1.000  | -0.054 | 0.183  |
| GED       | 0.025 | -0.054 | 1.000  | -0.141 |
| BOC       | 0.125 | 0.183  | -0.141 | 1.000  |

Source: Author's Computation (2019)

Board composition has a weak positive correlation with board independence and managerial ownership, but a weak negative correlation with gender diversity. Whereas, the correlation between gender diversity and board independence is positively weak, but has a weak negative correlation with managerial ownership. In the same vein, a weak positive correlation exists between managerial ownership and board independence. Consequently, the presence of weak correlation among the regressors is good because it has the capacity to eliminate the problem of potential multicollinearity in the model estimation.

**Table 3: Impact of Corporate Governance on Return on Asset**

| Variable           | Coefficient | t-Statistics | P-Value |
|--------------------|-------------|--------------|---------|
| BOC                | -0.018105   | 0.72         | 0.4714  |
| GED                | 0.215602**  | 2.03         | 0.0435  |
| BIN                | 0.009844    | 0.57         | 0.5691  |
| MAO                | 0.032721**  | 2.63         | 0.0091  |
| C                  | 0.027817*** | 1.06         | 0.2877  |
| R-Squared          | 72.1        |              |         |
| Adjusted R-Squared | 69.3        |              |         |

Source: Author's Computation (2019) \*\*\*Significant at 10%, \*\*Significant at 5%.

Dependent Variable: ROA

Method: Dynamic Ordinary Least Square (DOLS)

The estimated results of the regression analysis were shown in Table 3. All the explanatory variables possessed expected sign except board composition. However, the explanatory variables in the model jointly explained about 72% of the systematic variations in the dependent variable, return on asset leaving 28% unexplained as result of random chance. This connotes that this model is comparatively good for the analysis. Meanwhile, when the loss in the degree of freedom was adjusted, the explanatory power reduces to 69.3%.

Furthermore, the relationship between board composition and return on asset is negative though the relationship is not significant at 10% level of significance. This implies that the size of board as a variable has not led to the improvement of performance, in term of return on asset of listed firms in the Nigerian stock exchange. However, board independence, gender diversity and managerial ownership have a positive relationship with return on asset of the selected firms. It is important to emphasize here that the impact of managerial ownership and gender diversity is significant at 5% level of significant. This implies that managerial ownership and the diversity of gender among the board of directors are significant factors that promote the performance of the listed firms in the Nigerian stock exchange. Though the proportion of independent directors also facilitates a positive performance of the listed firms in Nigeria, the influence is not significant in the country.

**Table 4: Impact of Corporate Governance on Return on Equity**

| Variable           | Coefficient | t-Statistics | P-Value |
|--------------------|-------------|--------------|---------|
| BOC                | -0.018697   | 0.25         | 0.7994  |
| GED                | 0.627398**  | 2.01         | 0.0448  |
| BIN                | 0.007742    | 0.57         | 0.5691  |
| MAO                | 0.012884**  | 3.72         | 0.0002  |
| C                  | 0.037450    | 0.49         | 0.6248  |
| R-Squared          | 74.2        |              |         |
| Adjusted R-Squared | 64.5        |              |         |

Source: Author's Computation (2019) \*\*\*Significant at 10%, \*\*Significant at 5%.

Dependent Variable: ROE

Method: Dynamic Ordinary Least Square (DOLS)

The estimated results of the regression analysis showing the nexus between corporate governance and return on equity were shown in Table 4. All the explanatory variables possessed expected sign except board composition. However, the explanatory variables in the model jointly explained about 74% of the systematic variations in the dependent variable, return on asset leaving 26% unexplained as result of random chance. This connotes that this model is comparatively good for the analysis. Meanwhile, when the loss in the degree of freedom was adjusted, the explanatory power reduced to 65%.

In addition, the relationship between board composition and return on equity is negative though the relationship is

not significant at 10% level of significance. This implies that the size of board as a variable has not led to the improvement of performance, in term of return on equity of listed firms in the Nigerian stock exchange. However, board independence, gender diversity and managerial ownership have a positive relationship with return on asset of the selected firms. It is important to emphasize here that the impact of managerial ownership and gender diversity is significant at 5% level of significant. This implies that managerial ownership and the diversity of gender among the board of directors are significant factors that promote the performance of the listed firms in the Nigerian stock exchange. Though the proportion of independent directors also facilitates a positive performance of the listed firms in Nigeria, but the influence is not significant.

In summary, the impact of corporate governance on the return on asset and the return on equity of the listed firms in the Nigerian stock exchange is almost the same. Therefore, these variables could be used to measure the performance of the firms. It instructive to state that the findings in this work regarding board independence is in line with Dehaene, De-Vuyst and Ooghe (2001) who opined that the percentage of independent directors has a positive impact on the financial performance of firms in Belgium. But on the contrary, the submission of Priya and Nimalathan (2013) in a related study in Sri Lanka. Similarly, the results from the impact of board composition and gender diversity are justified by Nicholson and Kiel (2004), who submitted that outstanding and positive performance of a firm is linked with an effective management team and a board of the firm. Also, Azmi and Barrett (2013) argued that women are risk averse, meticulous, good decision makers and possess some special skills in finance and accounting and female executives and directors could have potentials that drive better financial performance of a firm.

## Conclusion and Recommendation

This paper has empirically examined the relationship between corporate governance and firms' performance of 40 listed firm in the Nigerian stock exchange between 2012 and 2017. The results. However, board independence, gender diversity and managerial ownership have a positive relationship with firms' performance. These variables improved the return on asset and the return on equity

of the selected firms. Therefore, it could be concluded from this study that corporate governance improves the performance of the listed firms on the Nigerian stock exchange.

Consequently, due to the findings that emerged in this study, this paper makes the following vital policy recommendations for the policy makers, corporate firms, institution regulators and future researchers. The board independence of the listed firms in the Nigerian stock exchange should be encouraged by increasing the percentage of independent directors in these firms. Similarly, in the composition of the board of directors, gender diversity and managerial ownership should be factored in. There should be a balance in the inclusion of male and female with effective managerial ownership among the board of directors in the listed firms in the Nigerian stock exchange.

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