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Effect of Corporate Governance on the Going Concern Status of Listed Non-Financial Companies in the Nigerian Stock Exchange Market

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ABSTRACT

This study examines the effect of corporate governance practices on the going concern status of listed non-financial institutions in Nigeria. The study considers the directional effects of corporate governance indicators on the continuous and foreseeable existence of institutions providing non-financial services in Nigeria but quoted in the Nigerian Stock Exchange. Ex post facto method was used and data were obtained from the studied companies. Corporate governance variables used in the study include board size, board composition, board meeting and board tenure; these were measured to examine their relationship with the going concern index. The result shows among others that corporate governance variables have no significant aggregate effect on going concern status of the studied companies. The decomposed results however indicate a relationship between two of the corporate governance indicators with going concern index of the studied companies, howbeit not significant. The study recommends that companies should carefully monitor all elements that indicate going concern issues and not merely focus on corporate governance because it does not completely isolate firms from going concern threats. Companies should equally compose their boards based on expertise, experience and qualification rather than gender.

Keywords: *Corporate governance, going concern, board size, board tenure, board meetings, board composition, board gender mix*

INTRODUCTION

The complex nature of businesses today is regulated by the ongoing technology advancement which has turned the world to a global village. As a result the success of any country is largely dependent among others on the smooth performance of the private sector. The organizations' competitive strategy, lucidity and control structure which operate within the

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nation's economy, help drive the economy of the nation. In line with International Accounting Standards (IAS 1), financial statements of a business are prepared based on the going concern convention which states that the operations of a business should be treated as if it will continue its transactions in perpetuity (Chen and Miller, 2011). The effectiveness or otherwise of the corporate structure of such an enterprise would assist investors (and other stakeholders) in determining if the going concern status of the business enterprise, as depicted by certain symptoms in the financial statements as prepared by the management of the company who are also members of the board, could be sustained (Clay, 2011).

In order to improve the lucidity and quality of financial statements of companies, the Nigerian government issued a series of rules and regulations requiring all listed companies to adhere to the requirements of the Code of Corporate Governance. In addition to this, the Securities and Exchange Commission (SEC) has outlined the duties and responsibility of members of the boards of publicly listed companies, (Iskandar, 2011). In all of these, corporate governance plays a crucial role in determining the continual existence of these enterprises. Though it has been argued by Leftwich, Watts and Zimmerman (1981), that there is no one best principle of good corporate governance, individual companies are expected to design and implement strategies in line with the regulatory framework (i .e. the code of corporate governance as it relates to different nations). As a result, there will be improved competency, higher corporate performance and transparency which will help secure shareholders interest and the economy as a whole. For instance, non-current assets (Property, Plant and Equipment etc.) of an enterprise are valued using historical cost concept, which is assumed that the business will exist in perpetuity (going concern) (Chen and Miller, 2011). This would not have been if the going concern has been impaired. Probably, the best basis of measurement of such non-current assets of PPE would have been the realization or present value measurement approach (Clay, 2011).

One of the cardinal points of corporate governance is to promote a culture in which directors will give priority to the ethical pursuit in the best interest of the shareholders (Leftwich and Watts, 2006). Good corporate governance assists corporations to prevent exploitation of investors by the managers and prevent fraudulent or sharp practices that suddenly terminate the lifespan of a business (Michael,1976).

The concept of going concern states that the operations of a business will continue to exist in perpetuity (Hair, Black, Babin, Anderson and Tatham, 2010). That is, the financial statements of the enterprise shows that the company will exist into the predictable future and this is dependent on an opinion expressed by the auditors stating that the financial statements, shows a true and fair view of the company's financial position. This is crucial because, so many parties depend on this financial information to make financial decisions. Managers and directors use this information for strategic planning, shareholders

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are interested to know how their investments are managed up and the expected returns they will receive for taking the risk, potential investors need this information to determine if they should invest in the company or not, creditors need to know if the company will be able to pay its liability in the future (Fama and Jensen, 1983). This can simply be said to mean that a business financial statements are prepared under the assumption that the company will continue to exist and carry on its operations into the predicable future without any aim of winding up. If at any point in time the business starts facing liquidity problems and decides to shut down its activities, it therefore means that the going concern concept is inapplicable in the preparation of the company's financial statements, and as such, other methods like 'break-up basis' could be applied (Demsetz and Villa, 2001).

The going concern concept means that a company will continue to exist into a foreseeable future, that is, over an annual period from the day the financial statements are published or reported. However, where the board/management doubts the ability of the company to continue as a going concern, it is duty bound to report this in the financial statements. Subsequent to different possibilities of going concern reactions, it is essential to appraise by consulting an external auditor to determine if the company will continue to exist for a period of twelve months after the date of the financial statements audit.

Signs of Going Concern Problem

The signs of going concern could be categorized into financial and non-financial. Financial symptoms are symptoms that could be discovered through the financial statements and they include the following amongst others: Adverse current ratio or trend, High gearing ratio, Overtrading and undercapitalization, Consistent operating losses over a period of time, Consistent default on loan interest and repayment, Arrears of statutory deductions like tax, dividend, and so on (Clay, 2011). Non-Financial Symptoms may not be directly linked to the financial statements but other factors like: prolonged industrial action or labour strike, loss of key management staff of the company, natural disaster, loss of franchise or patent right, government legislations or government pronouncements, legal proceedings, withdrawal/loss of key supplier or customer (Carcello and Hermanson, 2002).

Measurement of Going Concern

A common method of judgment for evaluating a company's ability is through accounting ratios. This allows the board or management to link information from the financial statements in order to establish a relationship over a period of time that will signify the solidity of its going concern or otherwise. Consequently, the following financial ratios (Current Ratio,

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Acid-Test Ratio, Return on Capital Employed and Gearing Ratio) can be calculated from the financial statements to test the going concern ability of the company or otherwise (Hair, Black, Babin, Anderson and Tatham, 2010).

Current Ratio is one of the many general tests to determine how liquid a business is and it is used by most creditors, employees and the general public to determine the company's ability to settle its short term debts using current assets. It is computed mathematically as:

$$\frac{\text{current assets}}{\text{current liabilities}}$$

This measures short term solvency and the industry standard of this ratio is 2:1. It endangers the business when it is low putting it at risk of facing a situation where the corporation will be unable to pay its short term debts signaling a lack of credit worthiness which hampers the company's continuity in business.

Acid-Test Ratio also called Quick Ratio it is a ratio that tests the company's ability of liquid resources to be able to settle its short term financial obligations; it is a measure of instant debt paying ability of a business entity. The industry standard of the ratio is 1:1 and where it is lower, it signals a symptom of going concern problem for a business entity. Hence, the board must ensure that the company generates a reasonable cash and cash equivalent that will enable her to meet short term needs without resorting to long term borrowing to settle short term obligations. It is computed as:

$$\frac{\text{current assets - inventory}}{\text{current liabilities}}$$

Return on Capital Employed is a primary ratio also called Return on Investment. It tests the company's profitability which helps to determine the essence of the company in business. Where this is low or getting lower than previous years, it is expected that the board or management should be proactive about it in order to avoid subsequent drop, otherwise, the company's going concern ability will be in danger. This ratio is expressed as:

$$\frac{\text{net profit after tax}}{\text{net total assets}} \text{ or } \frac{\text{net profit after tax}}{\text{capital employed}}$$

Gearing Ratio can also be referred to as debt ratio and it tests the relationship between long term debt and equity capital. It is a measure of long term solvency. The more debts into the capital structure of a company, the company becomes highly geared and it becomes

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unsafe for equity holders as a larger chunk of profits will be used in paying interest on loan while the balance becomes minimal for equity holders. To equity investors, it is expected that return on capital employed should be higher than interest payable on loans.

The Concept of Corporate Governance

There are many definitions of corporate governance as viewed from various perspectives. Each researcher tries to define corporate governance as it relates to the angle from which it is being looked at. Generally, corporate governance can be said to be about the ascendancy of an organization, this simply means that corporate governance has to do with hierarchy in an organization and the responsibilities expected to be implemented by these authorities (Lafond and Watts, 2006). It can also be defined as the system by which the affairs of companies are directed and controlled by those charged with the responsibility (Chen and Miller, 2011).

Corporate governance is defined as the procedure, systems and dealings through which the board of directors oversees what the executives do to achieve the objective of the company (Dayton, 1984). According to Mueller (1981), "governance is concerned with the intrinsic nature, purpose, integrity and identity of the institution, with a primary focus on the entity's relevance, continuity and judiciary aspects. Governance involves monitoring and overseeing the strategic direction, socio-economic and cultural context, externalities and constituencies of the institution".

Corporate governance is a system through which the company's executives coordinate and control the activities of the organization in a systematic manner. This is to ensure division of labour and setup an internal control system that will provide checks and balances which will assure ethical pursuit to the owners of the corporation (Clay, 2011). It should be emphasized that there is no acceptable method of determining the number of directors a company should have, though the regulations on best corporate governance according to the Securities and Exchange Commission of Nigeria recommends a minimum of five (5) directors without maximum number. The composition of the board should include diversified expertise and knowledge (Greco, 2011). It is noteworthy to mention that there are two (2) board structure types as practiced all over the world (Hair *et al,* 2010) which are the unitary board system and two-tier board systems. The unitary board system is a system where both the executive and non-executive directors serve under the same board structure. Two-tier board system is a board structure where the responsibilities of the board are shared in the category of executive (management) and non-executive (supervisory) roles. It is the supervisory board which monitors the executive board activities (Gul and Atalay, 2003).

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However, for the purpose of this work, the emphasis is on the two-tier board structure as it relates to Nigeria. Consequently, the two-tier board structure is divided into executive and non-executive boards. Executive directors are full-time employees of the company and thus, have two relationships and sets of duties, one to the board of directors and another to the company's employees (Demsetz and Villa, 2001). As such, they work for the company in a senior capacity, usually concerned with policy matters or functional business areas of major strategic importance. Most of these large companies tend to have executive directors responsible for finance, information technology, marketing and so on; they are mostly engaged under fixed term contracts, often rolling over every 12 months (Fama and Jensen, 1983). These directors are often times recruited by the board of directors and they are the highest earners in the company, with remuneration packages made up partly of basic pay and fringe benefits and partly performance-related pay (Hair *et al,* 2010). The chief executive officer (CEO) and the finance director (in the US, chief financial officer) are always classified as part of executive directors (Hair *et al,* 2010).

The Non-Executive Directors (NEDs) are not employees of the company and are not involved in its day-to-day running unlike the Executive Directors. Most at times, they have full-time jobs elsewhere, or may sometimes be prominent individuals from public life who may have (or may not have) retired from active employment. They usually receive a flat fee for their services, and are engaged under contract for service (civil contract, similar to that used to hire a consultant) (Elloumi and Gueyie, 2001). The non-executive directors are supposed to provide a balancing influence and help to minimize conflicts of interests (Hair *et al,* 2010). Most of them are expected to be independent (Hair *et al,* 2010). Furthermore, these directors are expected to have high quality of integrity, probity, accountability and ethical standards (Leftwich, Watts and Zimmerman, 1981). The responsibilities of the Board of Directors, according to Davidson and Kim (2004) are:

i. To ensure proper accountability and efficient performance of the operations of the company;
ii. To ensure proper management of the company by overseeing the effective performance of the management in order to ensure that shareholders' wealth is maximized;
iii. To ensure good corporate governance by making sure that the operations of the company are *in tandem* with relevant regulatory and legal frameworks;
iv. To define a framework by which authority and responsibility are assigned to the management team.

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Measurement of Corporate Governance

There are many ways to measure corporate governance in an organization. However, the following are key indicators of corporate governance as enumerated by Habbash (2010):

Board Size: The size of the board of directors varies from one company to another, and it is determined by a number of factors such as scope of the company, percentage level of competence required and so on. However, the board size should be relative to the dimension of the operations of the company. The code of corporate governance in Nigeria stipulates a minimum number of 5 directors as members of the board of directors without limit to its maximum. It is essential that the board has an optimum number in size, such that its oversight functions could be effectively carried out.

Board Composition: The structure of the board should reflect the quality of experience gathered over the years by members without negotiating compatibility, integrity, and independence. Hence, the board entails a mixture of executive and non-executive directors, with majority being non-executive directors but at least one independent director. It is advised that the positions of the company's Chairman and the CEO should not be conferred on a single person rather it should be split between two different individuals in order to preserve a solid internal control system and ensure checks and balances. The qualification, uprightness, core competence, knowledge on board matters, entrepreneurial skills and accountability of members of the board should play a key role in selecting individuals for these positions.

Board Tenure: It is the responsibility of the shareholders at Annual General Meetings (AGM) to elect directors and approve the terms and conditions of their directorship. As such board tenure for directors varies from one company to another. However, for the purpose of good corporate governance, every director must have a specified tenure in his condition of service for appointment while re-appointment is subject to performance.

Board Meetings: It is the responsibility of the board as headed by the Chairman to decide how often the meetings of the Board of Directors should be held. However, the Code of Corporate governance in Nigeria prescribes at least once in a quarter in order to effectively perform its oversight functions and monitor management's performance (Lafond and Watts, 2006). Every director is expected to attend at least 67% of the meetings except for a reasonable excuse which must be disclosed to the shareholders at the annual general meetings. Attendance at these meetings form part of re-nomination process for a director (Leftwich, Watt and Zimmerman, 1981).

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Board Gender structure: It is equally expected for the purpose of gender equality that a reasonable mix of male and female should comprise the membership of the board of directors.

Audit Committee: This is a key element of corporate governance as an audit committee of at least three non-executive directors with written terms of reference which deal clearly with its authority and duties must be established by the board. This committee should be made up of independent directors.

THEORIES OF CORPORATE GOVERNANCE AND GOING CONCERN

There are basically four models of corporate governance and going concern that are identified by Donaldson (1994), Hawley and Williams (1996). These are simple financial form, the stewardship model, the stakeholder model and the political model. The simple financial model states that the main hitch of corporate governance is to create regulations and incentives schemes that will successfully align the manager's or stewards of the organization's self-interest with that of the owners of the business without creating conflict of interest. These regulations are company's guidelines of what is expected as a behavioural pattern from managers. The stewardship model, according to Donaldson (1994), states that managers if left on their own will act as responsible stewards of the asset they control. Most theories of corporate governance use personal or self-interest as a starting point. However, this theory explains that as professionals, managers will act with integrity towards achieving what is expected of them. This is because managers are initially guided by their zeal to achieve the goals expected from them while exercising competence and due diligence so if left on their own, they will act to ensure that the business is a going concern.

The stakeholders' model expresses business ethics and corporations management methods that address morals and values in managing a business (Hawley and Williams, 1996). According to Mitroff (1983), traditionally, it is considered that managers of a business owe shareholders and owners a fiduciary duty of safe guarding the interest of shareholders. However, stakeholder model argues that there is a wider external framework of the economy that contributes to the legal, socio-political and economic success of the organization that is known as stakeholders. This is derived from their ability to effect changes in the firms' activities. Therefore, stakeholders are as important as the owners of the business because it is an enterprise duty to generate means, utilize them by creating value and at the same time maximize profits for the owners of the business.

The political sculpt is one of the rational choice models, which states that, the individual or group of actors in the decision-making procedure act rationally and are trying to achieve their own aims while in competition with one another. It holds that decision-making is a bargaining process. This explains the ability of shareholders and the owners of

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the business to influence the decision making process of the organization. Akintoye (2010) also identifies three essential theories of corporate governance which are: the stewardship theory, the Agency theory and the market theory. The Stewardship theory states that managers if left on their own will act as responsible stewards of the asset they control. Most theories of corporate governance use personal self-interest as a starting point. However, this theory explains that as professionals, managers will act with integrity towards achieving what is expected of them.

Agency theory on the other hand, explains the relationship between an agent and the principal. This theory states that the agent is supposed to symbolize the principal in business transactions and is expected to act in the best interest of the principal without paying attention to his personal gain or self-interest. This simply means that the managers and directors of a corporation make financial decisions on behalf of the owner and shareholders of the business with regards to the interest of these individuals. This theory assumes that managers if left on their own will act in their own self-interests at the disadvantage of shareholders (Hart, 1995).

The market theory holds that, whether directors and managers see themselves as stewards or as agents to investors, is really of no importance because these investors can simply sell their securities in the market to recover what they invested in the organization whose agents are not realizing the required returns expected by shareholders as a result of poor corporate governance structure. There exists a symbiotic relationship between the concepts of corporate governance and going concern as both are geared toward efficient corporate performance that will secure the investments of equity providers and as well ensure continuous existence of the business entity. The board of directors is to ensure the continuous existence of the business entity by making sure that corporation objectives are achieved through a number of policies and compliance with necessary frameworks. The board ensures this is done through oversight functions of the audit committee and other committees like risk management, remuneration, nomination and so on. Good corporate governance helps to maximize corporate value, enhances transparency and efficiency by ensuring that credible personalities are appointed into the board, avoids gender bias, and puts in place solid internal control system through regular board meetings and renewable performance-related tenure ensures the going concern of the organization.

METHOD

The study uses the *expost-facto* research design and data were obtained from the financial statements of companies under study from both manual and online retrieval methods. This study focused on twenty (20) non-financial institutions listed on the floor of the Nigerian Stock Exchange in year 2016. The independent variables were size of the board, composition of board, meetings and tenure on the board, while the dependent variable

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was going concern index represented by the calculated Z score.

$$Z \text{ score} = \beta o + {}_{1} BSIZ + {}_{2}BCOM + {}_{3} BMEE + {}_{4}BTNR +$$

Where:

Z score =	Firms' financial condition (strong, moderate and weak)
BSIZE =	Board size
BCOM =	Board composition
BMEE =	Board meeting
BTNR =	Board Tenure

The Z score was used to estimate the going concern of firms which is the dependent variable; the Altman's model was adopted to quantitatively measure this variable.

RESULTS AND DISCUSSION

The correlation matrix presented in Table 1 indicates that the Z score is positively correlated with Board Size, Board gender and Board Meetings. However, it has a negative correlation with Board tenure. The regression result shows the systematic relationship between the dependent variable Z score which represents the going concern of the firms and the independent variables, Board size, Board composition, Board meeting and Board Tenure. The adjusted R square was used to show the explanatory power of the model, this is because this score varies only with the addition or removal of any independent variable that has a predictive effect on the dependent variable. The adjusted R-squared value of 0.050 shows that the independent variables, Board Size, Board Composition and Board tenure; explain only about 5% of the systematic variations in the going concern of organisations sampled. This clearly indicates that going concern issues of the organisations are also affected by issues beyond the range of corporate governance. The Durbin Watson statistic of 1.424 hovers around 2 which is the conventional acceptable level for this test; this indicates the absence of autocorrelation. The F-statistic of 0.746 with a probability of 0.576 shows that the independent variables are jointly insignificant; the P-value falls in the acceptance region which is above the significance level of 5% (0.05), hence we accept the null hypothesis that says the independent variables have no predictive effects on the dependent variable. This indicates the model is not able to properly predict the relationship between the variables.

The results show a t-statistic of -0.096 and a probability of 0.925, the decision rule is to reject the null hypothesis if calculated t-statistic is greater than critical value of t-statistic. The results show that t-statistics calculated of -0.096 is greater than t-statistics critical value of -1.729, we therefore reject the null hypothesis which states that board size has no significant effect on going concern of the companies. The results on test of

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hypothesis 2 show a t-statistic of 1.341 and a probability of 0.200. The result shows that t-statistic calculated of 1.341 is lower that t-statistic critical value of 1.729, we therefore accept the null hypothesis that the board composition has no significant effect on the going concern of the companies.

The results shows a t-statistic of 1.110 with a probability of 0.284, the positive relationship between the Board meetings and going concern is found not to be significant at the 5% significance level. The results shows that t-statistic calculated of 1.110 is lower than t-statistic critical value of 1.729. Hence, the null hypothesis that Board meetings have no significant effect on the going concern of companies is accepted. The results show a t-statistic of -0.674 with a probability of 0.511, there is a negative insignificant relationship between the Board tenure and going concern which was found not to be significant at the 5% significance level.The results show that t-statistic calculated of -0.674 is greater than t-statistic critical value of -1.729. Therefore, the null hypothesis that Board tenure has no significant effect on firms' going concern of companies is rejected.

The result shows that Board size significantly affects the going concern of firms. It is generally the responsibility of the board to ensure continuous existence and smooth functioning of the organizations' activities. The size of the board becomes inconsequential where the diversity or experience of the members of the board does not yield positive returns to ensure survival. The results may be indicative of this phenomenon among the sample selected. The policies enacted and implemented by the board is more influential than mere board size. The results also show that Board composition does not significantly affect the going concern of firms. A desirable mix of expertise and experience is advised for appointment into board membership.

Policies of high quality and effective implementation of such can go a long away to ensure that the going concern of the firm is not threatened. The board composition for this study was measured by gender composition rather than qualification and experience in relevant sectors. The results also show that Board meetings have no significant effect on firms going concern. This is explained by the fact that meetings without enacting meaningful and business influencing policies may have done nothing to protect and ensure going concern for the business. Board meeting is one of the core elements of corporate governance because it gives board members the opportunity to monitor the implementation of approved policies and deliberate on issues as they emerge. The length of stay in office of the board members have not accounted for much difference in the going concern position of the studied firms.

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Table 1: Correlation Matrix

	Z SCORE	BSIZ	BCOM	BMEE	BTNR
Z SCORE	1.00	0.079	0.286	0.215	-0.038
BSIZ	0.079	1.00	0.428	-0.149	0.61
BCOM	0.286	0.428	1.00	-0.087	0.224
BMEE	0.215	-0.149	-0.087	1.00	0.156
BTNR	-0.038	0.61	0.156	0.156	1.00

Source: Computaton using SPSS 20

Table 2: Regression Results
Dependent Variable: Z score
Method: Least Squares
Sample: 20
Included observations: 20

Variables	Unstandardized Coefficient	Coefficient Std. Error	Standardized Coefficient	t-Statistic	Prob.
C	0.768	2.009		0.382	0.708
BSIZ	-0.015	0.152	-0.025	-0.096	0.925
BCOM	0.165	0.123	0.361	1.341	0.200
BMEE	0.275	0.247	0.269	1.110	0.284
BTNURE	-0.084	0.124	-0.167	-0.674	0.511
R-squared	0.166		Durbin-Watson stat		1.424
Adjusted R-squared	0.050				
F-statistic	0.746				
Prob. (F-statistic)	0.576				

Source: Computaton using SPSS 20

CONCLUSION AND RECOMMENDATIONS

Generally, corporate governance is important in guarding the interests of different stakeholders but it does not ensure survivability by completely eradicating going concern problems as evidenced by the results obtained from the samples used for this study. Based on the findings, companies should carefully monitor all elements that indicate going concern issues and not merely focus on corporate governance because it does not completely isolate firms from going concern threats. In addition, companies should compose their board based on expertise, experience and qualification rather than gender. Companies should also ensure improvement on board meeting agenda such that the resolutions of such meetings will bring forth positive policies that will grow companies' profits and assets.

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APPENDIX

DATA OBTAINED

Z score	Board size	Board Meetings	Board Gender	Audit Committee	Board Independence
3.3	11	5	10	6	4.5
1.7	10	5	0	6	9
.1	8	4	1.666667	6	1.666667
2.0	7	9	2.5	6	2.5
5.5	9	8	3.5	6	8
2.2	9	8	3.5	6	8
1.7	14	4	13	6	13
1.1	12	6	5	6	3
1.2	15	4	6.5	6	2
1.1	8	5	7	6	3
.2	8	5	0	6	7
3.1	6	4	5	6	5
.6	12	4	0	6	3
2.5	10	4	1.5	6	4
4.7	8	4	7	6	3
1.8	6	4	0	6	5
5.0	15	5	6.5	6	1.5
4.4	11	5	2.666667	6	1.2
2.3	9	4	3.5	6	2
2.0	8	4	3	6	1.666667

Source: Nigerian Stock Exchange, 2016.

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