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Effects of Corporate Governance Practices on Profitability of firms Listed on the Zimbabwe Stock Exchange

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Abstract

The study assessed the effects of corporate governance practices on the profitability of companies listed on Zimbabwe Stock Exchange (ZSE) during the period 2014 to 2019. Literature shows that entities with good corporate governance are more likely to have proper control mechanisms as well as proper allocation of resources which ultimately contribute to their improved economic and financial stability. The study employed the quantitative methodology. Panel data was collected from the ZSE listed firms' annual financial reports for the period 2014 to 2019. Corporate governance variables data used in the study included: board composition, board meetings, ownership, gender diversity and demographical characteristics of board members. Data was analysed using the Panel Corrected Standard Error (PCSE) regression analysis model. The results show that firm size, firm experience, board executive diversity and ownership structure have significant influence on profitability. Board gender diversity and post graduate qualification have no significant influence on firm's profitability. The study recommends that entities should pay attention to good corporate governance practices as they have significant influence on firm profitability.

Key Words: Corporate governance, financial performance, Profitability

Introduction

Corporate governance is concerned with the alignment of the interest of individuals involved in the management of business and those of shareholders (Clark 2014). Corporate governance principles are meant not only to safeguard and increase shareholders' economic value but also to ensure that the interests of all the stakeholders are considered and addressed appropriately. The general perception on corporate governance amongst businessmen and investors is that corporate governance has significant influences on the firm's performance and safeguards the interest of shareholders. Hence, corporate governance has become a hot topic and widely discussed in both developed and developing countries.

Since year 2000, Zimbabwe has been experiencing a harsh economic environment which was characterized by hyperinflation, shortages of foreign currency, high unemployment rate, liquidity problems among other macro-economic challenges. The government implemented a raft of measures to turn around the economy but in vain. Hyperinflation caused the collapse of the Zimbabwean dollar in 2009 and informal dollarisation of the economy. Dollarisation of the economy and the formation of Government of National Unity eased the economic woes. However, soon after the general elections held in 2013, the economy started backsliding again.

In 2016, the government through the Reserve Bank of Zimbabwe (RBZ) reintroduced the Zimbabwean dollar in the form of Bond notes. The reintroduction of the Bond notes resulted in the slow disappearance of the US$ in the market and the emergence of foreign exchange parallel market. Several entities were involved in underhand dealings as well as participating in buying foreign currency on the black market to sustain their businesses. Despite the general believe that listed companies are better governed and can perform better than unlisted companies, some ZSE listed companies seemed to have been outperformed by unlisted companies in the same sectors. The question that remains unanswered is whether good corporate governance has significant influence on financial performance especially in a turbulent economy. It is against this background that necessitated this study.

Methodology

Positivism paradigm was adopted for this study. Panel data totalling 223 observations was collected from 48 companies listed on the ZSE during the period 2014 to 2019. Corporate governance variables that were analysed included: board composition, board meetings, ownership, gender diversity and demographical characteristics of board members. Corporate governance was measured using the Blau (1977) model whilst firm profitability was measured using the gross profit margin. Data were analysed using the PCSE regression analysis model shown in the table below.

Table 1: PCSE Regression Analysis Model

Independent Corporate Governance Variables		
Independent variables	**Description**	**Hypothesis**
BC	Board Composition	+
EQ	Education Qualification	+
BM	Board Meetings	+
GD	Gender diversity	+
OWN	Ownership	+
Regulating corporate governance variables		
FSIZE	Firm size	+
SERV	Sector Services	+
MANF	Sector Industrial Manufacturing	+
YEARL	Years Listed	+

Results and Discussion

Descriptive statistics

Firms in the service sector constituted 46% of the population whilst the manufacturing sector was 31% and primary sector was 23%. The sectors were further sub-divided into 16 sub-sections in accordance to type and nature of their business. The primary sector consisted of agriculture 55%, mining 27% and tourism 18%. The manufacturing sector comprised of engineering 20%, industrial 20%, beverages 13%, paper & packaging 7%, industrial holdings

20%, and Agri-industrial 20%. The service sector was made up of retail 27%, banking & financial 23%, building & associates 18%, insurance 14%, properties 9%, transport 5% and technology 5%. Overall, agriculture and retail had the highest number of participating firms with 13% each, followed by banking & financial services 10%, building & associate 8%, insurance, engineering, industrial manufacturing, mining, industrial holding and Agri-industrial had 6% each, tourism & beverages had 4% each while the paper & packaging and technology were the least with 2% each.

The results show that common business in Zimbabwe is retailing, agricultural activities as well as the financial sector. Table 2 below presents the descriptive statistics of the variables used in the regression equation. The mean gross profit margin for the firms is 16.824 whilst the standard deviation is 1.565.

Table 2: Descriptive Statistics of the variables

Variable	Mean	Standard deviation
Primary Sector	16.478	1.389
Manufacturing	17.166	1.484
Service Sector	16.744	1.666
Total (All Sectors)	16.824	1.565

Impact of corporate governance on firm profitability

The average number of the non-executive directors and executive directors on the ZSE for the period 2014 to 2019 was 9. 92% of the companies that were listed on the stock exchange had two executive directors, the managing director and finance director, in the board whilst 8% of the companies had more than two executive directors. The maximum number of executive directors that served on the board was 5. The corporate governance reports do not specify the maximum number of board members that should constitute the board. The King IV report simply recommends that the number of NED should exceed the number of ED. Researchers (Fauzi & Locke 2012; Hardjo & Alireza 2012) found a positive and significant relationship between the board size and firm performance when measured using different performance measures.

Firm size significantly and positively influences firm profitability, and the variable is significant at 5 percent level of significance. This means that as the firm's size increases, the Gross profit also increases. The positive relationships may be caused by the economies of scales as the firm grows (Guo & Kga 2012). This result confirms the findings of (Sritharan 2018; Kajola 2010) who also examined the influence of firm size on profitability of Sri Lankan diversified holdings companies listed in Colombo Stock Exchange

Results of regression equation assessing the impact of corporate governance on firm profitability are presented in Table 3 below. Results show that being a service sector firm and having directors with postgraduate qualifications does not significantly influence firm profitable.

Table 3: Results of Regression Equation

Variable	Coef.	Std. Err.	z	P>|z|
Firm Size	0.026	0.011	2.30	0.022
Firm Experience	-0.055	0.026	-2.06	0.039
Ownership – Government	-0.121	0.033	-3.72	0.000
Ownership – Employees	0.122	0.036	3.41	0.001
Board Gender diversity	0.099	0.151	0.65	0.515
Board Executive diversity	-1.250	0.355	-3.52	0.000
Post graduate Qualifications	0.003	0.040	0.07	0.945
Manufacturing sector	-0.101	0.049	-2.08	0.038
Service Sector	-0.076	0.051	-1.50	0.133
Cons	0.578	0.292	1.98	0.048
R^2	0.217			
Wald chi2(13)	87.30			
Prob > chi2	0.000			

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The firm's number of years in the industry has a negative significant influence on the firm's profitability and the variable is significant at 5 percent level of significance. The results portray the phenomenon of a business whose products and services approach the maturity stage with the passage of time. Businesses have the potential of making substantial profits margins at their early stages and the profit margin declines as new players enter the industry, market gets saturated, and substitutes are developed (Pathirawasam 2013). The result agrees with Akben-Selcuk (2016) who found similar results.

Shareholding and ownership structure of an entity has significant influence on the profitability of the entity. Government ownership is significant and has a negative relationship with firm profitability and result is significant at 1 percent level of confidence. On the other hand, employee ownership is significant and positively influence the profitability of an entity. The variable is significant at 1 percent level of confidence. Researchers (Balagobei & Velnampy 2017; Jiang and Jian 2015; Kota & Tomar2010; Sarkar & Sarkar 2000) also got similar findings where they established that the ownership structure has a huge impact on company financial performance on the companies listed on stock exchange in China. Becht, Bolton & Roell, (2002) emphasized that large block holdings give rise to a second agency problem between block holders and minority investors. This conflict between block holders and minority investors is considered being at least as relevant as the owner manager conflict (Maury and Pajuste 2005).

Board executive diversity significantly and negatively influence firm's profitability. The variable is significant at 1 percent level of confidence. The result agrees with the findings of (Kilic 2015; Rashid 2011), who established a negative relationship between board diversity and financial performance. The results from this study do not support the economic case for board diversity which implies that diverse directors are likely to increase the financial performance of the companies. Possibly, the diversity in the board may result in divergence of culture, preferences, stages in life, preferences and that may cause destructive friction within the board, which negatively impacts on firm's profitability.

The results show that board gender diversity has no influence on firm profitability. At 5 percent level of confidence, the variable is insignificant. The results agree with the findings of Steven, Bourmpoula & Silberman (2014) and McKinsey (2015). However, researchers (Kilic & Kuzey 2016; Rashid 2010) believe that representation from diverse groups provides a balanced board so that no individual or small group of individuals can dominate the decision- making of the board. Further, diversity also provides a representation for different stakeholders of the firm for equity and fairness (McGregor 2017). The Resources theory also perceived board members as the resources of the entity which are expected to contribute to the enhance firm performance.

The results show that at 5 percent confidence level, post graduate qualifications do not have significant influence on firm's profitability. The results agree with the findings of Kahveci & Wolfs (2019), Van der Walt & Ingley (2003) and Singh & Vinnicombe (2004). It was observed that 83% of the boards were dominated by Chartered Accountants who were occupying the executive positions. 93% of board members had at least a post graduate qualification. The King IV report and the ZIMCODE recommend that the governing board should consists of appropriate skills, knowledge, experience, diversity and have independence to effectively discharge its roles and responsibility.

Conclusion

This study examined the effect of corporate governance practices on firm financial performance of listed companies on ZSE, from 2014 to 2019. At 5 percent level of confidence, firm size, firm experience, Ownership structure and Board executive diversity significantly influence firm profitability whilst Board gender diversity and post graduate qualifications do not significantly influence firm profitability. Firm size, employees' ownership structure variables are significant and positively influence firm profitability. Firm experience, government ownership and board executive diversity significantly and negatively influence firm profitability. Board gender diversity does not influence firm profitability. Firms are recommended to pay attention to corporate governance variables as they have an impact on profitability.

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