Effects of Corporate Governance Practices on Efficiency of Firms Listed on the Zimbabwe Stock Exchange

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Abstract

The study assessed the effects of corporate governance practices on the efficiency of companies listed on the Zimbabwe Stock Exchange from 2014 to 2019. Literature suggests 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 were 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 were analysed using the Panel Corrected Standard Error (PCSE) regression analysis model. The results showed that firm size and postgraduate qualifications have significant influence on efficiency. The results showed that board gender diversity, firm experience, board executive diversity and ownership structure have no significance influence on firm's efficiency. The study recommends that entities should pay attention when constituting their boards and on appointment of senior managers as relevant qualifications have significant influence on firm efficiencies.

Key words: Corporate governance, financial performance, Efficiency

Introduction

Corporate governance is concerned about strategies, accountability, control, distribution of power and mechanisms by which entities ensure and maintain balanced relationships amongst stakeholders. Due to the importance of corporate governance in the business fraternity, corporate governance has become a tropical topic and widely discussed in the business world. Generally, corporate governance is perceived to have a significant influence on the firm's financial performance and safeguards the interest of shareholders.

Since 2000, Zimbabwe has been experiencing a harsh economic environment which was characterised by hyperinflation, shortages of foreign currency, high unemployment rate, liquidity problems among other macro-economic challenges. The government implemented a raft of measure 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 a Government of National Unity eased the economic woes. However, soon after the general elections held in 2013, the economy started backsliding again and that could have eroded corporate governance morals.

In 2016, the government through the Reserved Bank of Zimbabwe (RBZ) reintroduced the Zimbabwe dollar in the form of Bond notes. The reintroduction of the Bond notes resulted in the slow disappearance of the United States dollars 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 belief that listed companies are better governed and can perform better than unlisted companies, some ZSE listed companies were 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.

Research Methodology

Positivism paradigm was adopted for this study. Panel data totalling 223 observations were collected from 48 companies listed on the ZSE during the period 2014 to 2019. Corporate governance variables that were analysed included board composition, educational qualification, board meetings, ownership, gender diversity and demographical characteristics of board members. Corporate governance was measured using the Blau (1977) model while firm efficiency was assessed using Return on Assets. The dependent variable of the study, Return on Assets (ROA), is calculated with logarithm [(net profit (loss) + interest expense / total assets at the beginning of the year) + 1]. Data was 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

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 and packaging 7%, industrial holdings 20%, and Agri-industrial 20%. The service sector was made up of retail 27%, banking and financial 23%, building and 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 and financial services 10%, building and associate 8%, insurance, engineering, industrial manufacturing, mining, industrial

holding and Agri-industrial had 6% each, tourism & beverages had 4% each while the paper and 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 for the Return on asset for the firms is 0.055 whilst the standard deviation is 0.163.

Table 2 – Mean and Standard deviations of Variables

Variable	Mean	Standard deviation
Primary Sector	0.066	0.233
Manufacturing	0.053	0.132
Service Sector	0.051	0.142
All Sectors	0.055	0.163

Impact of corporate governance on firm efficiency

The results from the study show that 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, its efficiency also improves. The positive relationships may be caused by the economies of scales as the firm grows (Guo & Kga 2012). The greater the total assets or sales, the easier it becomes to automate business processes or bargain better prices respectively. This result confirms the findings of Meiryani & Olivia (2020).

The results shows that the firm's number of years in the industry has no significant influence on the firm's efficiencies. At 5 percent level of confidence, the variable is not significant. Though a considerable literature exists on the firm profitability, most of them have not included ROA as a variable in their study. More so, the few studies in Nigeria like Kolawole (2013), Aliu (2010), Owolabi and Obida (2012) have not captured the effect of operating expenses on firm profitability even though other factors like firm size, firm age and leverage have been considered in the literature. However, the findings of Alex, Augustine and Mercedes (2006), counter this assertion with their view that firms improve with age, that is, ageing firms experience rising level of productivity since they are able to understand their strengths over time.

Results of regression equation assessing the impact of corporate governance on firm Return on Asset are presented in Table 3 below.

Table 3 – Regression Equation Results

Variable	**Coef.**	**Std. Err.**	**z**	**P>|z|**
Firm Size	0.016	0.008	2.05	0.041
Firm Experience	-0.013	0.013	-0.97	0.331
Ownership – Government	0.001	0.027	0.04	0.964
Ownership – Employees	0.017	0.019	0.93	0.350
Board Gender diversity	-0.005	0.083	-0.06	0.951
Board Executive diversity	-0.220	0.207	-1.06	0.288
Post graduate Qualifications	0.061	0.027	2.25	0.024
Manufacturing sector	0.009	0.040	0.23	0.816
Service Sector	-0.027	0.040	-0.69	0.490

Cons	-0.149	0.202	-0.74	0.461
R^2	0.0656			
Wald chi2(13)	20.44			
Prob > chi2	0.0154			

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.

The study revealed that board executive diversity has no significant influence on firm's efficiencies. At 5 percent level of confidence, the variable is not significant. The results agree with findings from Staikouras et al (2007) and Adusei (2012). 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 (Adusei 2012). However, Bonn, Yoshikawa, & Phan (2004) found a positive relationship between board diversity and firm performance on India firms.

The study also established that board gender diversity had no influence on firm efficiency. At 5 percent level of confidence, the variable is not significant. The results from the study agree with the finding of Reguera-Alvarado, Ruiz & Laffarga (2017) who established that while social performance is positively associated with both gender and cultural diversity, the relationship was insignificant. However, Kilic and Kuzey (2016) 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 (Keasey 1997).

The study also shows that board size has no effect on the firm efficiency. The results agree with findings of Bennedsen, Kongsted & Nielsen (2004), Beiner (2003) and Bhagat & Black (2002). Vafeas (2000) and Mak & Yuanto (2003) found negative relationship between board and return on asset. The argument is that small boards are more informed and performs better than large boards. However, researchers (Fauzi & Locke 2012; Hardjo & Alireza 2012; Bonn et al 2004) found a positive and significant relationship between the board size and firm performance when measured using different performance measures.

The shareholding and ownership structure of an entity has no significant influence on the firm efficiency. At 5 percent level of confidence, the variable is not significant. The results agree with the findings of Mousavi, Moridipoor & Jari (2010) who established no significant relationship between the concentration of ownership and return on assets. However, Becht, Bolton & Roell, (2002) found a negative relationship between firm structure and performance and 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 members with post graduate qualifications significantly and positively influence the firm's efficiencies and the variable is significant at 5 percent level of confidence. The results agree with the findings of (Boyatzis, 1982; Ljungquist, 2007) who established that members with higher educational qualifications, like PhDs in particular, generally provide a rich source of innovative ideas to develop policy initiatives with analytical depth and rigour that will provide for unique perspective on strategies issues.

Conclusion and recommendations

At 5% level of confidence firm size and the number of board members with post graduate qualifications have significant influence on firm efficiency. A firm's experience, ownership structure and board executive diversity and board gender diversity do not significantly influence firm efficiencies. Nevertheless, firms are recommended to pay attention to corporate governance variables to enhance their profitability.

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