



CORPORATE GOVERNANCE ATTRIBUTES AND FINANCIAL PERFORMANCE: EVIDENCE FROM ELECTRICITY DISTRIBUTION COMPANIES (DISCOS) IN NIGERIA

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Abstract

The unsatisfactory performance and revenue shortfall of Electricity Distribution Companies (DisCos) in Nigeria have generated a lot of concern among stakeholders. Therefore, the study examines effect of corporate governance attributes on the financial performance of Electricity Distribution Companies (DisCos) in Nigeria. The study utilized a sample of eleven (11) electricity distribution companies covering a 10-year period, starting from 2013 to 2022 with 110 observations using Ordinary Least Square (OLS). Secondary data were extracted from annual reports of the companies. The regression results showed that board independence has a statistically significant positive relationship with Return on Equity (ROE), while board size and political connection have statistically significant negative relationship with ROE. Based on the findings, the study recommended that the board of DisCos emphasize the skillset and expertise of outside directors, as this can make significantly contribute to companies' performance.

Keywords: board independence, board size, corporate governance, financial performance, political connection

1. Introduction

The Nigerian power sector has undergone significant reforms in recent years, driven by the need to improve efficiency, increase electricity generation and distribution and also to enhance overall performance (Adeniran et al., 2020; Oyedepo et al., 2018). Despite these efforts, the sector continues to face numerous challenges that hinder its ability to meet the country's electricity demands. One critical area of concern is corporate governance which play a vital role in ensuring the effective management and oversight of electricity distribution companies (Adelegan, 2022).

The sector's reform began with the Electric Power Sector Reform Act of 2005, which aimed to attract private investment (Oluwalana, 2020). The privatization in 2013, which established 11 electricity distribution companies (DisCos), has been plagued by systemic financial and operational inefficiencies, leading to persistent financial losses (Oyedepo et al., 2020). The DisCos inherited dilapidated infrastructure, with over 60% of transmission lines and substations operating beyond their lifespan at the time of privatization (NERC, 2013).

By 2023, only 44% of customers had metered connections, exacerbating revenue losses from estimated billing and electricity theft, which accounted for 35% of total power generated (NBS, 2023; World Bank, 2022). DisCos operate with non-cost-reflective tariffs, creating a liquidity crisis. For instance, in 2022, DisCos collected only 68% of billed revenue (₦782 billion

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out of ₦1.14 trillion), with commercial losses exceeding ₦250 billion annually (NERC, 2023). The sector's aggregate technical, commercial, and collection (ATC&C) losses averaged 45% in 2023, far above the global benchmark of 10% (AFDB, 2023).

Moreover, the companies' debt and foreign exchange pressures, (e.g., \$1.5 billion borrowed in 2013) became unsustainable due to naira depreciation and debt-to-equity ratio exceeded 80%, with servicing costs consuming 40% of operational revenue (CBN, 2023). Government agencies also owed DisCos over ₦98 billion in unpaid electricity bills (NERC, 2022). Despite privatization, grid generation stagnated at 4,000–5,000 MW, far below Nigeria's 30,000 MW demand (NERC, 2023). Gas shortages, transmission failures, and aging infrastructure caused 206 grid collapses between 2013 and 2023, costing the economy an estimated ₦4.3 trillion annually (IMF, 2023). Regulatory frameworks failed to enforce performance standards (BPE, 2023). This implies that the distribution companies have been operating at a loss, thereby have effect on their financial performance. However, an efficient and vibrant corporate governance must be put together to confront these challenges.

Corporate governance has been a pressing issue since the late 1990s and early 2000s, following the spectacular financial failures of large organizations such as Enron (2001) and WorldCom (2002) in the USA. These collapses, which shocked the business world with their scale and severity of illegal operations, revealed underlying issues that posed significant risks (Dalton, 2013). Despite increased awareness among large companies about the importance of addressing corporate governance issues, some companies still struggle with unethical behaviours perpetrated by individuals within or on behalf of the organization (Cole et al., 2020).

The recent banking industry collapses in Germany and the United States can be attributed to corporate governance failures, as evident in the cases of Wirecard (Germany, 2020), Silicon Valley Bank (United States, 2023), Signature Bank (United States, 2023), First Republic Bank (United States, 2023) (BBC News, 2023 and AP News, 2023). These failures highlight the crucial role of effective corporate governance in preventing bank collapses.

The board size as a corporate governance attribute has received a considerable attention in recent years from academics, regulators and market participants. This continuous attention could be as a result of its empirical evidence on company performance (Johl *et al.*, 2015). Some authors like Wu (2012) argued in favour of large boards that they offer numerous benefits, including the diversity of perspectives and ideas, which can provide insights that more informed decisions.

According to Ciftcia *et al.*, (2019), large board is more likely to be watchful with regard to general problems because they would immediately review any management decision and take appropriate actions. Conversely, researchers such as Jordi *et al.*, (2018) and Zeren (2021) advocate for smaller board sizes, arguing that they foster enhanced productivity, greater team work and collaboration, improved monitoring of firm activities leading to increased efficiency and effectiveness. Proponents of smaller boards like Rashid and Islam (2013) and Kalim Ullah et al., (2018) also argue that large boards are prone to increased costs and complexities associated with coordination and monitoring, ultimately hindering their effectiveness.

The composition of the board, particularly regarding independence, has been widely studied as a key component of corporate governance mechanisms (Dalton & Dalton, 2020; Kang & Kim, 2020). The independence of the board of directors provides valuable insights into the quality of a firm's management and the effectiveness of check and balances on the managerial

decisions (Boubakri et al., 2020; Lee & Lee, 2020).

Furthermore, the Companies and Allied Matter Act (CAMA, 2020), provides that a public company shall have at least 3 independent directors but silent on the maximum. However, the best international practice is having more non-executive directors than executive directors for ensuring independence of the board (Achim et al., 2017; Mohammad, 2020). Consistent with the findings of Renu and Kuldip, (2020), independent directors bring valuable independence and diverse skills and expertise to the board. Contrary to the Conclusion of Yi-Hui, (2020) that independent directors are good monitors but cannot put in economic value to the firms. Supporting the study by Hassan *et al.*, (2019), independent outside board members are more likely to be ineffective in monitoring complex institutions having high potential growth.

Political connections of the directors on the board have received a widely academic and public concern. Previous studies have extensively examined the effects of political connections on firms' financial performance. However, accordingly, literatures find mixed evidences concerning the relationships between political connections and financial performance.

Past literatures like that of Redhwan, *et al* (2020) and Aldhamari *et al.*, (2020) have suggested that political connection is a valuable asset that a firm uses to minimize its external risk, especially in the emerging economies. Firms with political connections gain more government contracts and regulatory liberation (Shin *et al.*, 2017), access to more loans from bank and also likely to receive government subsidies (Wu *et al.*, 2018).

Evidence has revealed that politically connected board enjoys advantages, including favorable government policies that hinder competitors from entering the market (Wang *et al.*, 2019), lower tax rates (Wang, 2019; Chancharat *et al.*, 2019; Li, 2021) a greater likelihood of being out in term of economic distress (Joni *et al.*, 2020) and favorable bank lending (Hung *et al.*, 2017; Wu *et al.*, 2018). On the other hand, political connections have a negative effect and considered grabbing hands when government officials and bureaucrats engage in rent-seeking behavior (Joni *et al.*, 2020). Moreso, politically connected board may also suffer many drawbacks such as higher debt, lower productivity and low performance. (Ullah & Kamal, 2019))

Does good corporate governance necessarily enhance firm performance? Extensive research has been conducted on the relationship between corporate governance and financial performance, resulting to mixed conclusions. Despite the growing body of literature, the empirical evidence remains inconclusive, highlighting the complexity of this relationship and the need for further research (Anis *et. al.*, 2017).

The study, therefore examines the effect of corporate governance attributes on firm performance using data from Nigerian Electricity Distribution Companies. This study advances the ongoing discussion on the relationship between corporate governance attributes and financial performance, providing a foundation for future research in the power sector. Evidence from Electricity Distribution Companies (DisCos) in Nigeria. Specifically, the study seeks to;

- i. assess the effect of board size on the financial performance of Electricity Distribution Companies in Nigeria
- ii. assess the effect of board independence on the financial performance of Electricity Distribution Companies in Nigeria
- iii. assess the effect of political connection on the financial performance of Electricity Distribution Companies in Nigeria

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On the basis of research objectives, the following null hypotheses were formulated and tested at 0.05 significant level in the study

H₀₁ Board size has no significant effect on the financial performance of the Electricity Distribution Companies in Nigeria.

H₀₂ Board independence has no significant effect on the financial performance of the Electricity Distribution Companies in Nigeria

H₀₃ Political connection has no significant effect on the financial performance of the Electricity Distribution Companies in Nigeria.

The study encompassed all Electricity Distribution Companies (DisCos) in Nigeria, covering the period 2013 to 2022, thereby constituting a 100% representation of the DisCos which are sufficient for regression analysis. The study provides the first in-depth examination of the relationship between corporate governance attributes and financial performance, specifically focusing on Electricity Distribution Companies (DisCos) in Nigeria.

2. Literature Review

Empirical Review

A study conducted by Aliyu *et al.*, (2021), examined the effect of board size on financial performance of firms in Nigeria for a period of 11 years. The study utilized a sample of the top 14 Nigerian banking industries in Nigeria. Data from secondary source was used and the total firm observation was 154. The outcome showed a significant positive relationship. Erika *et al.*, (2018) conducted a study that empirically examined the effect of board size on financial performance. The sample size consisted of 237 companies with 1,422 firm years observation that had been listed on the Standard and Poor (S & P) 500 index during the period between 2004-2009. The result showed a positive and significant association between board size and financial performance. Arora and Sharma (2016) research on Indian firms (2001- 2010) found a significant positive relationship between board size and financial performance, based on an analysis of 1992 listed firms.

In Contrast, Guest (2019) found no significant relationship between board size and financial performance in a large sample of 2746 UK listed companies (1981-2002), with results even indicating a negative relationship. Similarly, Lee-Lee *et al.*, (2018) reported a negative but insignificant correlation between board size and financial performance, measured by Return on Asset (ROA), in a study of 290 Malaysian firms listed on the Bursa Malaysia stock exchange for the period (2010- 2014).

Onyekwere and Babangida, (2022), examined the relationship between board independent and financial performance of listed banking industry in Nigeria. Using the sample size of 12 banks listed on the Nigerian Exchange Group beginning from 2015-2019. The results indicated that board independence has direct positive impact on Return on Assets (ROA) and Return on Equity (ROE). Sarim (2021), studied the firm financial performance and board independent index effectiveness of listed firms in the India for the period of one year starting from 2018 to 2019. The study utilized secondary data of 100 listed firms on the Bombay Stock Exchange. The correlation matrix result showed a positive and significant.

Lestari (2021) found a positive and significant relationship between board independent and financial performance in a study of 40 Indonesian firms listed on the Indonesia Stock Exchange

(2014- 2018). Similarly, Dinh *et al.*, (2021) reported a positive and significant association between board independent and Return on Assets (ROA) in a 10-year study of 200 firms listed on the Ho Hanoi Stock Exchange (HNX) and Ho Chi Minh Stock Exchange (HoSE) from 2009-2018 with 1947 firm year observations.

Aliyu *et al.*, (2021) found a negative relationship between board independent and financial performance in Nigerian banks, using Return on Assets (ROA) and Tobin's Q. On the other hand, Naciti (2019) reported a negative and significant correlation between board independence and financial performance, measured by Return on Assets (ROA) and Return on Equity (ROE) in the Malaysian market.

Eissa and Eliwa (2021) found that political connections had a significant positive impact on financial in a study of Egyptian non-financial firms for the period of 2014-2017 with the 284 firm year observations. Sabeeh *et al.*, (2021) reported that politically connected family-owned firms in Pakistan outperformed non-family-owned connected firms, with a positive effect on firm performance measured by Return on Assets (ROA). Similarly, studies in various contexts have found a positive and significant relationship between political connections and firm performance. Tawiah *et al.*, (2021) reported this finding in Nigerian firms (2011-2018), Ika *et al.*, (2021) in Indonesian (2013-2017) and Sabeeh *et al.*, (2021) in Pakistani family-owned firms (2013-2018), where politically connected family firms perform better than non-family connected firms.

In contrast, some studies have found a negative and insignificant relationship between political connectedness and firm performance. Faisal *et al.*, (2021) reported this finding in Pakistani firms for a period, 2007 -2014, measured by Return on Asset (ROA) and Tobin's Q. Wu *et al.*, (2018) found similar results in Chinese private firms, a study between 2005 and 2012 with the sample observation of 5036 using Return on Asset (ROA). The political connections of top executives had no significant impact on financial performance.

Theoretical Review

Agency theory is the predominant theoretical approach which explains the association between corporate governance and financial performance (Nguyen *et al.*, 2014). It stipulates that when ownership and control are separated, conflicts of interest often arise between principal and agent (Chieh & Hou, 2018)). As noted by Gbalam and Enwongo (2020), managers may prioritize their own self-interest over the interests of shareholders, highlighting the potential for conflicting priorities.

Consistent with existing literature, Jensen and Meckling (1976) argue that managers may not always act in the best interest of shareholders and corporate governance mechanisms such as the independent of the board can help mitigate agency problems. Agency theory suggests a positive causal link between corporate governance and financial performance, but empirical evidence is mixed, fueling ongoing debate in the literature.

3. Methodology

The study used a panel regression model to analyse the effect of corporate governance attributes on financial performance of the electricity distribution companies in Nigeria from 2013 to 2022, consistent with prior studies (Khan et al., 2020; Nguyen et al., 2022).

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Financial performance was measured by Return on Equity (ROE) in similar studies (Al-Matari et al., 2020; Hassan et al., 2022).

Model Specification

The panel data model was concisely captured below:

$$ROE_{it} = \beta_0 + \beta_1 BSZ_{it} + \beta_2 BIND_{it} + \beta_3 PCON_{it} + \mu_{it} \text{ --- (1)}$$

Where: ROE_{it} is Return on Equity; net profit divided by total equity of shareholder; β_0 is Intercept; β_1 is Coefficients of the explanatory variables; BSZ_{it} is Board Size (total number of directors on the board); $BIND_{it}$ is Board Independent; number of non-executive directors on the board; $PCON_{it}$ is Political Connection; number of directors who are currently or formerly held a political position; and IT is firm i at time t .

4. Results and Discussion

Descriptive Statistics

Table 1

Descriptive Statistics

Variables	Obs	Mean	Std. Dev	Min	Max
ROE	110	0.156	1.605	-6.570	2.720
BSZ	110	7.558	0.975	2	10
BIND	110	0.777	0.870	0.000	0.860
PCON	110	0.182	0.735	0.130	0.330

Source: STATA 14

Table 1 presents the descriptive statistics, showing that Return on Equity (ROE) ranges from –6.570 to 2.720. The minimum value of –6.570 likely reflects persistent revenue shortfalls experienced by the electricity distribution companies (DisCos). Though certain distribution companies achieved reasonable profits, such as Abuja Electricity, Benin Electric, Enugu Electricity, Eko Electric, Ibadan Electricity and Ikeja Electric in different years, potentially due to effective corporate governance.

The mean ROE was 0.156 with standard deviation of 1.605. Board size varied from 2 to 10 members, with a mean of 7 and standard deviation of 0.975, indicating relatively moderate board size. Board independence showed significant variation, with independent ranging from 0% to 86% and a means of 78% and standard deviation of 87%, suggesting average independence. Additionally, political connections among board members ranged from 13% to 33%, with a means of 18%, and standard deviation of 0.735 implying potential policy influence.

Table 2
Correlation Matrix

Variables	ROE	BSZ	BIND	PCON
ROE	1.0000			
BSZ	-0.0883	1.0000		
BIND	0.1137	0.0277	1.0000	
PCON	-0.2120	-0.1340	0.0436	1.0000

Source: STATA 14

Table 2, shows that Return on Equity (ROE) is negatively correlated with board size (-0.0883), indicating that increasing board size may not enhance performance. In contrast, ROE is positively correlated with board independence (R of 0.1137), suggesting that greater board independence is associated with improved performance. Additionally, political connection is negatively correlated with ROE (-0.2120), implying that adding politically connected members to the board may not significantly affect performance.

Table 3
Summary of Regression Result

Variables	Coefficients	Std Error	Z-value	P- value
Constant	-2.548	3.222	-0.79	0.431
BSZ	-0.498	0.172	-2.90	0.002
BIND	3.609	2.390	1.91	0.009
PCON	-6.281	2.247	-2.80	0.006
R²				0.573
Adjusted R²				0.4962
F Statistics				8.250
Mean VIF				1.350

Source: STATA 14

The adjusted R² of 0.4962 explains that, variables under study explain approximately 50%, of the variation in the outcome. While the remaining 50.38% is attributed to other variables not included in the model. The regression results show that board size has a significant negative coefficient (-0.498) at 1% level, while board independence has a statistically significant positive coefficient (3.609) at level. In contrast has a statistically negative coefficient (6.281) at 1%. Furthermore, the Variance Inflation Factor (VIF) values are below the threshold of 10, with a mean VIF of 1.350, indicating no issue of multicollinearity.

Discussion of Findings

The study investigated the corporate governance attributes on the financial performance of electricity distribution companies in Nigeria, focusing on board size, board independence and political connection. The results showed that all three variables were statistically significant. The

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board size has a negative co-efficient of 0.498 with a probability of 0.002, significant at 1%, indicating that increasing board size by one member would lead to a 0.50% decrease in financial performance. This suggests that large boards may hinder effectiveness. This finding is consistent with Jensen & Meckling (1976) agency theory and previous studies by Zabria *et al.* (2016), Lee-Lee *et al.*, (2018) and Guest (2019) but contradicts others like Arora and Sharma (2016), Erika *et al.*, (2018) and Aliyu *et al.*, (2021).

In contrast, board independence has a positive co-efficient of 3.609 with a probability value 0.0009; significant at 1%, indicating that adding one non-executive director would increase financial performance by 3.61 equivalents to 4%, supporting agency theory and aligning with studies by Sarim (2021), Lestari (2021), Dinh *et al.*, (2021), Onyekwere and Babangida, (2022) and others but contradicts Yasser *et al.*, (2017) and Naciti (2019).

The political connection had a negative co-efficient (-6.282) and a probability of 0.006, significant at 1%. This means that, an increase in politically connected board members would decrease performance of electricity distribution companies by 6.28%, implying the presence of politically connected members on the board has no any effect on the financial performance. This is supported by the studies of Wu *et al.*, (2018), Chong *et al.*, (2018), Faisal *et al.*, (2021), but differing from studies of Muhammad, (2020), Eissa and Eliwa (2021), Sabeeh *et al.*, (2021), Tawiah *et al.*, (2021), Ika *et al.*, (2021), Dinh *et al.*, (2021) that found positive relationship.

5. Conclusion and Recommendations

On the basis of the reviewed extant literature and the findings of this study, empirical evidence has been provided that the corporate governance attributes have a statistically significant effect on the financial performance of electricity distribution companies in Nigeria. The outcome is in consistent with the agency's theory which documented that, there is a need for an improved quality financial reporting in the corporate setting because of the consistent failure and collapse being witnessed by many organizations.

In line with the study conclusion, the following recommendations were proffered:

- (i) Rather than focusing solely on the size of the board, emphasize should be placed on the skillset and expertise of their members.
- (ii) The board should appoint a majority of non-executive directors to ensure a balance of expertise, independence and executive oversight, facilitating effective governance and decision making.
- (iii) Again, the focus should be on hiring professionals with proven track records in the power sector, rather than those with political connection who might skew towards political agendas instead of financial prudence which can ultimately hinder reliable financial performance.

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