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Corporate Governance and Organizational Financial Performance: A case of Listed Companies on Dar es Salaam Stock Exchange

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Abstract

The study looked at the effects of corporate governance on financial performance of companies listed on Dar es Salaam stock exchange. The study chose to investigate the association between corporate governance characteristics; such as board size, board, and audit committee composition, and business financial success, measured by return on assets (ROA) and return on equity (ROE). Thirteen (13) listed firms made up study population, and companies' financial reports for the years 2010 to 2021 were the source of the quantitative secondary data. E-Views 9 software was used to analyze the data using a linear regression model with dynamic panel data and the Generalized Method of Moments. The results indicated a high correlation between financial performance and the audit committee (ROA & ROE). Similar to this, board size had a beneficial impact on ROA but a negligible impact on ROE. Both financial performance metrics are severely impacted by the composition of the board (ROA & ROE). According to the study findings, both positive and negative effects on financial performance are caused by corporate governance traits (return on assets and return on equity). As a result, the study proposed increased size and composition of the directors in accordance with the level of complexity and operational nature of each of the listed firms.

Keywords: *Audit Committee, Board size, Board composition, Firm Financial performance, listed companies in Dar es Salaam Stock Exchange (DSE)*

Background of the Study

Corporate governance is one of the important category of any business that build the courage of stakeholders and helps in protection of their interest (Bui, and Krajcsák, 2024). Good Corporate Governance ensures that companies operate efficiently and effectively and maximize shareholder value (Alodat *et al.,* 2022). Corporate governance is the new business trend in contemporary world since it's observed as a moral activity (Khan, and Mahmood, (2023). Corporate Governance comprise enforcing compliance of law and demonstrating ethical conduct through board size, board composition and Audit Committee involvement (Danilov, 2024). The relationship between corporate governance and financial performance has caught wide attention of researchers in the last decade (Al-ahdal et al., 2023: Ali, and Frynas, 2021; Disli, et al., 2022; Shakri et, al, 2024: Farooq, and Ali, 2022; Basyith et al.,2022; Dauda and Shafii, 2021; Ghulam et al., 2021; Lu and Batten, 2023; Rinalldi and Vigano, 2021). According to Farooq *et al.* (2022), companies can achieve better financial performance and can reduce risk by aligning incentives between managers and shareholders and by providing reliable and transparent financial reporting. Akaso, Adusei & Shahzad

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(2021) revealed that investors are more confident in firms that are more effective in their performance to maximize shareholders wealth. A lot of research done in some countries show that many investors believe in companies with effective corporate governance (Napitupulu,etal 2023; Nyakurukwa, and Seetharam,2023). Investors tend to be more attracted in countries with comprehensive, continually updated legal frameworks and business regulations (Gold and Taib, 2023; Ben & Chouaibi, 2023). Audit committee, board Size and board Composition play an important role in ensuring and monitoring all operations and accounting process so that management can provide information that is relevant and credible to all stakeholders (Bui, and Krajcsák, 2024).

Corporate governance in developed countries has a huge positive impact to the firm's financial performance through board size, board composition and audit committee and boost their economies and social responsibilities (Zheng et al., 2023). Despite the clear benefits associated with good CG, there are still challenges in implementing effective governance practices. These challenges include issues such as the concentration of ownership, conflicts of interest and the difficulty of measuring and monitoring governance practices (Hunjra *et al.*, 2021).

In African countries, research showed that corporate governance influence organizational performance both in positive and negative way (Abebe *et al*, 2022). Corporate governance is vital for economic development of Tanzania as it plays an important role in strengthening economy of the country (Temba, et al, 2023). The Capital Markets and Securities Authority(CMSA) has generated guidelines for good corporate governance practices by public listed companies in Tanzania in response to the growing significance of governance issues both in emerging and developing economies and for promoting domestic and regional capital markets growth (KO Mrabure, 2020).

The Dar es Salaam stock Exchange (DSE) market is a stock market which is based in Dar es Salaam, Tanzania. It was established in 1996 as a company limited by guarantee without share capital. DSE as a non-profit making body came into action in 1998 to facilitate the government implementation of the reform to encourage wider ownership of privatized firms and all companies in Tanzania. DSE later changed to a public limited company when it re-registered in 2016, in which its activities are monitored and supervised by the Capital Markets and Securities Authority (CMSA). It is also a member of the African Stock

Exchanges Association (ASEA). Therefore, up to December 2022, there were twenty nine (29) listed companies (DSE, 2022).

Public listed companies are required to comply with DSE listing rules requirements in which the companies should disclose all information on annual basis (i.e. audited financial statements and non-financial information) as prescribed under the Capital Markets Regulations Act. In Tanzania corporate governance in listed companies is still ineffective as there are a lot of shortfalls in practicing and provide an expected outcome.

The reviewed studies were based on specific companies or sector of the economy. While other studies focused on identification of determinants or quality of corporate governance practices. There are limited studies on the impact of Corporate Governance for the firms that are listed on Dar es Salaam Stock Exchange market (DSE). This current study examined the influence of corporate governance on firm's financial performance in Tanzania based on thirteen (13) selected companies listed on the Dar es Salaam Stock Exchange market (DSE).

The Agency theory

Jensen, (1986) defined the agency relationship as a contract under which one party (the principal) engages another party (the agent) to perform some services on their behalf. This study focused on Agency theory. The theory is concerned with conflicting interests between principals and agents and holds a central role in the governance of every organization. Agency Theory hypothesizes that separation between the owners and managers of a company creates a variance of interests which eventually increase the agency costs. These costs refer to the collection of agent enticement costs and monitoring costs incurred by the principals in limiting the variance of interests; bonding costs incurred by principals to discourage the agents from having interest in deviating actions; and the welfare residual loss or reduction incurred by the principal as a result of the deviation between the agents' decisions and welfare maximizing decisions expected by the principals. Managers in Agency theory often deploy organization assets for their own interests rather than the interest of the owners. These problems are usually intensified by differences in risk preference between the agents and the principals.

Agency theory is relevant to this study as it helps in explaining the behavior of executives as well as recommending the performance outcomes of managerial actions. The theory advises on the way the county governance mechanisms should be geared towards controlling executive behavior to improve performance. Based on the agency theory, the study hypothesizes that governance is beneficial to the performance of regional governments by checking on management excesses. Performance in the public sector has some general features which are accomplished in a performance measurement system that involves a relationship between inputs, process, outputs and outcomes which are then guided by two objectives that answers two questions:

(a) Are we doing things right?
(b) Are we doing the right things?

Empirical Literature Review

Bui and Krajcsák (2024) investigate the relationship between corporate governance (CG) and financial performance in the case of publicly listed companies in Vietnam for the period from 2019 to 2021. The study found a positive relationship between transparency, disclosure and financial performance and a positive correlation between Corporate Governance and company size.

Affes, and Jarboui (2023) studied the impact of the implementation of effective corporate governance on the financial performance of 160 companies in the UK between 2005 and 2018 while taking into account the specificity of the business sectors. The study found that implementation of good corporate governance leads to the improvement of the financial performance of companies measured by the return on equity.

Nawaz, and Ohlrogge (2023) empirically examines the nexus between corporate governance, intangible resources, CEO traits, and financial performance. In contrast to prior research, this study examines these relationships in a longitudinal manner focusing on Deutsche Bank for the 1957–2019 period. Results suggest that human capital efficiency drive the financial performance of Deutsche Bank at all times especially, during the economic malaise periods, suggesting that human capital is the main source of profitability for the Deutsche Bank. Additional results suggest that larger board size diminishes the impact of intangible resources on financial performance when the former CEO assumes board's chairmanship.

Singh and Rastogi (2023) examines how corporate governance influences the financial performance of listed SMEs in the context of developing economies like India. The results demonstrate that ownership concentration is not significantly related to financial performance. Further, information disclosures are inversely significant for financial performance. The results show that agency problems and information asymmetry plague the sampled firms. Further, the results of the study are indicative of inefficiencies in the governance structures of SMEs. Thus, it is evident that listed SMEs fail to reap the benefits of corporate governance.

In Tanzania, Temba et al (2023) assess corporate governance's influence on financial performance regarding asset quality, efficiency use of equity, earning ability, capital adequacy, and liquidity in commercial bank. The findings revealed that corporate governance (board aspects of governance, board members over-boarding) positively influences the financial performance of commercial banks in terms of their earning ability, asset quality, and capital adequacy. Corporate governance also negatively influences the efficient use of equity and liquidity through board gender diversity, board aspects of governance, and board control.

Martín and Herrero, (2018) analyses the structure of boards of directors and its impact on business performance, which is approximated by economic profitability and the Tobin's Q ratio. The results confirm a high degree of compliance with the recommendations of the Good Governance Code, and suggest that performance of the advisory and monitoring functions are factors that determine the composition of boards.

Methodology

The study was guided by the positivism research philosophy and quantitative research approach. The target population for the study was twenty nine (29) companies listed at the Dar es Salaam Stock Exchange. The study selected thirteen (13) companies listed with the data set spanning from 2010 to 2021 covering a total of eleven years. The population selected based on companies which are incorporated at DSE from year 2010 as well as the availability of information obtained from the selected companies including economic impact of global pandemic COVID-19. The research used secondary data sources available on the companies' annual financial statements published at DSE as required by the law or respective company's websites. The research study used multiple linear regression (generalized method of moments/ dynamic panel data) to estimate the model using E-Views software package with return on assets (ROA) and return

on equity (ROE) as dependent variables and corporate governance attributes (Board size, Board composition and audit committee composition) form the independent variables.

The linear regression model (Generalized Method of Moments/ Dynamic Panel Data) that was used for this study is represented by the equation:

$$\mathbf{Y_{it} = \rho_j Y_{it-j} + X_{it}'\beta + \varepsilon_{it}}$$

Where, Y_{it} is the dependent variable, $\rho_j Y_{it-j}$ is the lagged dependent variable, $X_{it}'\beta$ is the coefficient of the explanatory variable (corporate governance attributes), and ε_{it} is the error term assumed to have zero mean and independent across time period. From the economic model in the equation above, equation below is evolved:

$ROA = dROA(-1) + \beta_1 BS + \beta_2 BC + \beta_3 AC + \varepsilon_{it}$……..Equation # 1

$ROE = dROE(-1) + \beta_1 BS + \beta_2 BC + \beta_3 AC + \varepsilon_{it}$……Equation # 2

Where, ROA, ROE are the dependent variables, dROA(-1) and dROE(-1) are lagged dependent variable, $\beta_{1,2,3}$ is the coefficient of the explanatory variable (corporate governance attributes), and ε_{it} is the error term assumed to have zero mean and independent across time period.

Board Size (BS) – This variable captures the size of the board. It is expressed in terms of number of members serving on the board of a particular firm. Therefore the effect of the board size may not be determined as a priority.

Board Composition (BC) – this variable captures the board composition in terms of the ratio of Non-executive directors to the total number of directors. It is calculated as the number of Non-executive directors divided by the total number of directors in the board as we can determine executive director composed.

Audit Committee (AC) – this is the number of independent directors on audit committee divided by the total number of directors in the audit committee.

Return on Assets (ROA) - An indicator of how profitable a company is, in relation to its total assets composed. ROA provides an idea as to how efficient the management is at utilizing its assets to generate earnings for economic benefit flow. It is calculated by dividing a company's annual earnings by its total assets. ROA is expressed in natural logarithm (ln).

Return on Equity (ROE) – an indicator of how profitable a company is, in relation to the equity injected include no of shares and advance toward share capital, ROE gives an idea as to how efficient the

management is at using its investment to generate earnings growth. It is calculated by dividing a company's annual earnings by its total equity and also it is expressed in natural logarithm (ln).

dROA(-1) – it is a lagged return on asset, that shows how previous years return on asset affect the current return on asset trend analysis.

dROE(-1) – it is a lagged return on equity, that shows how previous years return on equity affect the current return on equity trend analysis.

Results and Discussions

Testing for Serial Correlation

Serial correlation is the relationship between a given variable and a lagged version of itself over a various time interval. The presence of correlation between residuals and their lagged values violates the standard assumption of regression theory which requires uncorrelated regression disturbances. Therefore before estimating an equation for statistical inference, test for serial correlation should be conducted.

Table 1: Correlation analysis ROA

	DROA	**BS1**	**BC1**	**DAC**
DROA	1.000000	0.197332	0.064334	0.302403
BS1	0.197332	1.000000	-0.249147	0.032585
BC1	0.064334	-0.249147	1.000000	0.112366
DAC	0.302403	0.032585	0.112366	1.000000
ROE				
	DROE	**BS1**	**BC1**	**DAC**
DROE	1.000000	0.174793	0.037028	0.334402
BS1	0.174793	1.000000	-0.249147	0.032585
BC1	0.037028	-0.249147	1.000000	0.112366
DAC	0.334402	0.032585	0.112366	1.000000

Source: Author (2023)

From the table 1, correlation analysis was performed on the stationary data right after taking their first differences. The correlation analysis confirmed that there is a positive relationship between board size and ROA with a positive coefficient of 0.197 and ROE of 0.174. Board composition was positively related to financial performance (ROA and ROE) with correlation coefficient of 0.064 and 0.037 respectively. Audit committee composition is positively related with ROA with a correlation coefficient of 0.302, while it is positively related with ROE with correlation coefficient of 0.334.

Test for Arellano-Bond Serial Correlation

Arellano-Bond is one of the methods of testing serial correlation where it is only applicable for equations estimated by Generalized Method of Moments (GMM). The test is actually two separate statistics, one for first order correlation and one for second, where the AR (2) is widely employed in empirical application to check for serial correlation where the null hypothesis should not be rejected.

Table 2: Arellano-Bond Serial Correlation Test for Model 1

Test order	m-Statistic	rho	SE(rho)	Prob.
AR(1)	0.417430	-521.6965	1249.783	0.6764
AR(2)	0.324613	121.196257	373.356122	0.7455

Table 3: Arellano-Bond Serial Correlation Test for Model 2

Test order	m-Statistic	rho	SE(rho)	Prob.
AR(2)	0.097401	77.807618	798.838416	0.9224

From the results of the table 2 and table 3, the focus was on test order AR (2) of both models with probability values of 0.7455 and 0.9224 respectively, which are greater than critical value of 0.05; this implies that the null hypothesis of no serial correlations in the model 1 and model 2 cannot be rejected.

Stationarity Tests

The study applied Augmented Dickey-Fuller (ADF) accompanied with Phillips Peron (PP) to test the stationarity of the observation.

Table 4: Stationarity Test

	Test and results	
	Stationarity test on independent and dependent variables	
	T-statistic & Probabilities in parenthesis	
Variables	**ADF – Fisher Chi-square**	**PP – Fisher Chi-square**
Ln ROA	20.5825 *(0.7632)*	41.5457 *(0.027*
Ln ROE	17.6365 *(0.8886)*	25.6632 *(0.4817)*
BS	9.37408 *(0.9504)*	11.9339 *(0.8506)*
BC	7.83943 *(0.9535)*	7.90135 *(0.9517)*
AC	8.68365 *(0.3697)*	6.29342 *(0.6144)*
	Test and results	
	Stationarity test after differentiating independent and dependent variables	
	T-statistic & Probabilities in parenthesis	
Variables	**ADF – Fisher Chi-square**	**PP – Fisher Chi-square**
dROA	58.5822 *(0.0003)*	154.767 *(0.0000)*
dROE	49.5785 *(0.0035)*	114.729 *(0.0000)*
dBS	25.7375 *(0.0279)*	82.7520 *(0.0000)*
dBC	22.3763 *(0.0712)*	58.1962 *(0.0000)*
dAC	8.58143 *(0.1985)*	21.6494 *(0.0014)*

Table 4 above shows the results of the tests for stationarity on independent and dependent variables where the upper part of the table contains results conducted on independent and dependent variables which evidence that the series have a unit root hence not stationary because the T-statistics and corresponding probabilities are not statistically significant. However, test results performed on independent and dependent variables resulted to the rejection of null hypothesis of ADF & PP, therefore the series have no unit root i.e. stationary.

Regression Results

Model 1: Return on Asset

Table 5: Model 1 summary

Model	Std. Error of Regression	Instrument rank	J–statistic	Prob. (J – statistic)
1	3.257456	13	10.90652	*0.282171*

Mean dependent var	0.208205		S.D. dependent var	**3.982384**
S.E. of regression	3.257456		Sum squared resid	**1199.045**
J-statistic	10.90652		Instrument rank	**13**
Prob(J-statistic)	0.282171			

From the findings in the above table 5, the value of J-statistic was 10.90652 at a 5% level of significance with a *p-value* of *0.282171* which is greater than 0.05 implying that the null hypothesis of the validity of the model is accepted i.e. the data comes close at meeting the restrictions.

Table 5: Regression results model 1

	Coefficients	Standard error	T-value	*P-value*
dROA(-1)	-0.315754	0.006315	-50.00344	0.0000
Board size (BS)	-1.219358	2.026108	-0.601823	0.5485
Board Composition (BC)	0.655755	0.072122	9.092298	0.0000
Audit committee (AC)	2.290537	0.751834	3.046599	0.0029

From the above table 9, the established regression equation was:

ROA = -0.315754 dROA (-1) -1.219358BS+0.655755+2.290537AC.

The results in table 5 shows that board size has a positive influence on return on asset with a statistically insignificant *p-value* of *0.5485*, implying that a unit increase in board size will cause return on assets to decrease by 0.307628. This is similar to Musallam (2024) who found a significant positive relationship of CEO duality and board size with financial performance through the existence of risk management.

The board composition has a positive coefficient of 0.655755 with a *p-value* of *0.0000* which is significant and shows that board composition positively influence return on assets. The findings disagree with Martín and Herrero (2018) who noted that there is a negative and significant relationship with the independence of boards.

Audit committee composition has a coefficient of 2.290537 with a significant *p-value* of *0.00294*, which is interpreted that a unit increase in the composition of audit committee leads the return on asset to increase. This concurred with Hassan (2022) who found that, audit committee size and meetings negatively influence firms' performance.

Model 2: Return on Equity

Table 6: Model 2 summary

Model	**Std. Error of Regression**	**Instrument rank**	**J – statistic**	**Prob. (J – statistic)**
2	5.291201	13	8.267216	*0.507458*

Mean dependent var	0.427179		S.D. dependent var	5.949265
S.E. of regression	5.291201		Sum squared resid	3163.640
J-statistic	8.267216		Instrument rank	13
Prob(J-statistic)	0.507458			

From the findings in the above table 6, the value of J-statistic was 8.267216 with a *p-value* of *0.507458* which is greater than 0.05 implying that there is an acceptance of null hypothesis of the validity of the model, that the data comes close at meeting the restrictions.

Table 7: Regression results model 2

	Coefficients	**Standard error**	**T-value**	**P- value**
dROE(-1)	-0.279807	0.006728	-41.59109	0.0000
Board size (BS)	-0.310736	4.305826	-0.072166	0.9426
Board Composition (BC)	-0.152456	0.060874	-2.504455	0.0137

Audit committee (AC)	10.85135	0.743541	14.59415	0.0000

From the table 7, the established regression equation was:

ROE = -0.279807 dROE(-1) -0.310736BS-0.152456BC+10.85135AC.

Under this model, board size as a corporate governance attribute has a negative coefficient of -0.310736 with a *p-value* of 0.9426 which is statistically insignificant implying that the board size does not contribute much on return on equity. Affes, and Jarboui (2023) found that the implementation of good corporate governance leads to the improvement of the financial performance of companies measured by the return on equity.

Board composition has a negative influence on return on equity which means that an increase of a unit of board composition will decrease return on equity by -0.152456. The results of this study differ with Temba et al (2023) who revealed that corporate governance (board aspects of governance, board members over-boarding) positively influences the financial performance of commercial banks in terms of their earning ability, asset quality, and capital adequacy.

Audit committee has positive coefficient of 10.85135 with a *p-value* of *0.0000* that is statistically significant, meaning that audit committee composition has positive impact on return on equity i.e. a unit increase in the audit committee will cause ROE to increase. This findings disagreed with Abu (2024) who found that audit committee have a positive significant effect on asset (ROA) and a positive insignificant effect on return on equity (ROE).

Conclusions

Overall, the Audit Committee as one of the corporate governance attributes, proved to be a strong contributing factor to both return on asset and return on equity as a measure of firm, this imply that a higher number of non-executive directors in the board with variety of skills, experience, exposure and knowledge are likely to bring higher return on assets and favorable return on equity.

The findings showed that, board size have a negative significant relationship with return on equity with a *p-value* of 0.0137 and as well, a positive significant relationship with return on assets with a *p-value* of 0.000, this means large board size helps in effectively monitoring managerial action and increasing voluntary disclosures on ROA then on ROE it depends.

Also audit committee composition has a positive influence on both return on assets and return on equity, this can be due to high professional fees asked from independent non-executive members of the board which has a positive impact on the financial performance, also it can be as a result the fact that when the audit committee meets frequently, it leads to efficiency and accountability that's positively impact financial performance.

The empirical results of the study generally indicate that corporate governance attributes have positive and negative influence on financial performance (return on assets and return on equity).

Recommendation

The study recommends the Audit committee and board size to be considered by the management of listed firms at DSE since they affect the financial performance of the organization. Therefore, an increase in Audit committee and board size for listed companies should be done in line with the complexity and nature of operation of the individual companies listed.

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