Effects of corporate governance disclosure on profitability of public listed firms in Tanzania

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DOI: 10.22437/ppd.v10i5.20628	Received: 18.09.2022	Revised: 26.09.2022	Accepted: 27.10.2022	Published: 31.12.2022

Abstract

This study investigated the effect of corporate governance information (CGI) disclosure on firms' profitability in the Dar es Salaam Stock Exchange (DSE). Twenty-one listed companies were studied for a period ranging from 2006 to 2021 using a mixed research method with an explanatory sequential design. Return on equity (ROE) and Return on Assets (ROA) was employed as dependent variables in the panel data analysis. CGI disclosure was an independent variable. The control variables were geographical diversification, firm age, size, and sales growth. Secondary data was obtained from DSE. Qualitative data was gathered via semi-structured interviews. Thematic analysis and a random effect model with two estimates (1 and 2) were used to analyze qualitative and quantitative data. The findings suggested a positive and significant effect of CGI disclosure on firm profitability. The findings add to the body of knowledge by signifying stakeholder theory. The study concluded that Disclosure of CGI might undeniably result in increased profitability. We recommended that firm managers look closely at CGI disclosure, enhance their disclosure practices, and invest in disclosure strategies that benefit stakeholders.

Keywords: *Corporate governance, Information disclosure, Firm profitability, ROA, ROE*

JEL Classification: G39, O16, M10

INTRODUCTION

The accumulation of invaluable lessons from a string of business failures that occurred in different parts of the world gave rise to the continued relevance of corporate governance in various countries and regions around the globe (UNCTAD, 2007). Due to the worldwide importance of corporate governance, listed companies have been subjected to great pressure in recent decades to disclose Corporate Governance Information(CGI) (Nobanee & Ellili, 2022). CGI disclosure offers additional information to stakeholders and eliminates the information gap between insiders and investors caused by managers' dominance of information access and control (Nurfitriana & Yadiati, 2018). The annual report is regarded as one of the primary sources of information through which management may disclose CGI (Esther & Henry, 2018).

Stakeholders' theory was put forth by Edward Freeman (1984); it states that the firm's effectiveness is measured by its ability to satisfy its stakeholders. The firm's stakeholders are all the parties impacted by its operations, and its existence, in the long run, is based on their satisfaction (Muis et al., 2022). Stakeholders include customers, workers, suppliers, political action organizations, environmental groups, local communities, the media, financial institutions, governmental bodies, and more (Rintamäki, 2018). This concept portrays the firm's environment as a biosphere of connected groups that must be satisfied to maintain the firm's health and profitability (Simon, 2016). This demonstrates that stakeholders are vested in ensuring that the resources are exploited to the fullest extent of their potential, which should ultimately benefit society as a whole (Mottis, 2019). Effective corporate governance is one of the key ingredients in satisfying the stakeholders' vested interests, as the management overlooks the optimal exploitation of firms' resources for the benefit of all the concerned parties. From that point of view, this study will test the stakeholders' theory by determining if the disclosure of CGI affects firm profitability.

Even though annual financial reports might present a brighter financial future for the firm, there exist Nonfinancial factors drive large firms to collapse (Ooghe & De Prijcker, 2008). Such failures spurred governments all around the world to seriously probe alternative methods to improve their particular countries' corporate governance frameworks (Roszaini & Mohammad, 2006). Different countries have distinct national traits as well as social and economic priorities (Joshi, 2021). What is acceptable in one nation may not be desirable in another (Ibiam & Nwogo, 2017). Similarly, each firm has its own history, culture, and commercial objectives (Vieira, 2015). As a result, corporate governance cannot be static; there is a chance for it to vary unpredictably among countries and enterprises as it is driven by internal and external environmental dynamism (Joseph & Tranos, 2018). Ultimately any effect on corporate governance might end up affecting firm profitability.

Profitability is the ability of a firm to generate more money than it spends. The majority of a firm's earnings come from its operational activities. There will be no profit if the company is not operating efficiently (Oluwaseyi et al., 2021). Profit and profitability are distinct concepts. Profit is an absolute monetary unit, but profitability is a relative measure of how efficiently and effectively a company uses its resources to generate such profit. ROA and ROE are two of the most often used metrics of profitability, and they assess profit relative to the resources used to achieve that profit (Francis, 2020). Since profitability largely depends on a firm's operational efficiency and effectiveness, it is more likely to be influenced by corporate governance (Hakimah et al., 2019). This mainly stems from the fact that individuals charged with governance have the right and duty to control and direct the entire firm's operations (Iqbal & Kakakhel, 2016). Bestowing of rights and duty to control firm's resources gave rise to the need for CGI disclosure.

The disclosure of CGI is guided by the global reporting initiative standard no 102 – governance disclosure. GRI standards offer firms a flexible and future-proof reporting framework as processes and themes of CGI are always up to-date and relevant when a firm employs the GRI standards (Strozzilaan, 2020). However, the presence of standards doesn't negate the fact they might be interpreted and implemented differently based on cultural, economic, and business variations across nations (Ghasarma et al., 2017). Due to variations in interpretations and implementation of standards, we argue that the effect of corporate governance disclosure on the profitability of businesses can vary across the globe.

Researchers across the globe have probed to establish the effect of corporate governance on firm profitability. Harisa et al. (2019) concluded that the quality of CGI disclosure does not affect the profitability of Indonesian and Malaysian Islamic banks.

They further narrated that companies found it difficult to grasp the benefits of CGI disclosure, felt that it is an activity that puts an undue demand on the firm's resources, and believed that CGI transparency is not lucrative. Buallay (2017) revealed that there was no direct effect of corporate governance on firm profitability in Saudi Arabia, as firms with low implementation of corporate governance had higher operational performance measures (ROA and ROE). Panchasara & Bharadia's (2013) results showed that the financial and nonfinancial disclosures of Corporate Governance greatly impacted the profitability of Indian banks proxied by ROA. Kaur & Vij (2017) established that the Return on Assets and Return on Equity of Nairobi Securities Exchange (NSE) Companies were positively affected by CGI disclosure.

In the African context, Lishenga & Mbaka (2008) concluded that better corporate governance disclosure does not significantly affect the profitability of Kenyan firms, as there was an inability to establish a significant relationship between compliance with CGI disclosure and ROA and ROE. A study done by Adefemi et al. 2018) also failed to establish any significant effect of CGI disclosure on the profitability of Nigerian firms. Herbert & Agwor (2021) determined that Nigerian banks' corporate governance disclosure of the board of directors had a considerable positive effect on ROA. Still, it had no meaningful effect on ROE.

Studies in Tanzania have examined the relationship between corporate governance and firm profitability. Masasi (2020) found that corporate governance positively affected banks' ROA and ROE. Assenga et al. (2018) determined that the ROA and ROE of Tanzanian-listed firms were negatively affected by CEO dualism but were positively affected by board size and gender diversity. Matemu (2020) found that corporate governance positively impacted the ROA and ROE of financial institutions registered in DSE. The results indicate a contradiction in the different aspects of corporate governance effects on firms' profitability. Apart from the contradiction, the researchers considered only certain aspects of corporate governance and not in its all entirety as is required to be disclosed by the standards. Masasi (2020) focused on controls, and board independence and composition, Assenga et al. (2018) focused on board's characteristics, and Matemu (2020) focused on board size, composition, and characteristics. A glimpse view offered by other researchers in Tanzania necessitates further studying the effect of corporate governance disclosure on firm profitability by considering all the aspects of CGI disclosure.

Harbaugh & To (2020) argue that disclosing information might sometimes backfire on the issuer. Thus nondisclosure might bring an equilibrium if information standards are low or if previous expectations were positive. They further argued that full disclosure of the information is viable if standards of information are high or expectations are low enough. Sticking to the same vantage point, we argue that CGI disclosure might positively or negatively affect firms' profitability. Some firms might be reluctant to fully disclose CGI due to the information being of low standards and detrimental. In that light, we sought to establish the effect of CGI disclosure on the profitability of listed firms in Tanzania.

The presence of a conclusion dilemma among researchers, variations in interpretations, and implementation of GRI standards resulting from cultural, economic, and business environment differences coupled with the focus of Tanzanian researchers on board compositions and characteristics when assessing the effect of corporate governance on firm's profitability creates a gap in the literature. Thus, the primary objective of this research is to fill that gap by investigating whether CGI disclosure affects the profitability of Tanzania's publicly listed firms. Our study looked at firms that were traded on the Dar es Salaam Stock Exchange between 2006 and 2021. The novelty of this study stems from its research design and the substantive results on the details of the effect of CGI disclosure on the enhancement of a firm's profitability. It offers relevant information to investors and regulators, which they can use while making various decisions regarding the listed firms. To the best of our knowledge, the research approach used in this paper and the outcomes of this research have been largely underexplored in the Tanzanian context.

METHODS

The study used a mixed explanatory sequential research design to give a larger and more comprehensive view of the paper and to explain initial quantitative findings (Almeida, 2018). With this approach, it is easy to draw powerful and meaningful conclusions due to the collaboration of the design's strong numeric emphasis and relevant qualitative explanations (Almeida, 2018). While in pursuit of the research result, we formulated the following hypothesis

$H_{1:}$ Corporate governance disclosure has a positive effect on firms' profitability

Sample and data

Twenty-one firms in the Dar es Salaam stock exchange (DSE) made up the Sampling Population. The study used the census approach as all the firms in the DSE were studied financial years 2006 to 2021 were included in the study's time frame. Panel data on the dependent variable firm profitability (ROA, ROE), independent variables CGID, and control variables (firm size, firm age, geographical diversification, and sales growth) were obtained from audited annual reports of firms listed on the DSE. The research used panel data for the period extending from 2006 to 2021. The choice to use panel data was based on its capability to offer reduced collinearity while providing greater information (Barthelemy, 2017). 2006 is also the year data became available in electrical format from the DSE. The Tanzania Company Ordinance 2002 also went into effect in 2006, and most of the listed companies began complying with the ordinance's criteria and IFRSs in compiling their financial reports in the same year after it was institutionalized in 2004. As a result, this research opted to begin its investigation in 2006.

Interviews with a semi-structured format were conducted so quantitative research results could be supported. Twelve key informants were interviewed for the study. One broker, four regulators from CMSA and DSE, and Seven senior executives from various firms were chosen as key informants. Respondents were selected based on their understanding of DSE enterprises' internal transactions, governance, and tenure in office. Interviews were employed to offer better insights from many who understand the internal affairs, processes, and relationships of the organizations investigated in this study (Maia, 2021).

Analytical model

A regression model was employed to establish the effect of CGI disclosure on firms' profitability. Other researchers, such as (Kaur & Vij, 2017; Panchasara & Bharadia, 2013), have also used a similar model to determine the effect of CGI disclosure on firms' profitability. The regression model's appropriateness stemmed from the dependent variable's continuous nature. Equation (i) and (ii) presents the models

$$ROA_{it} = \beta_0 + \beta_1 CGID_{it} + \beta_2 FS_{it} + \beta_3 FA_{it} + \beta_4\, Geog\ diver_{it} + \beta_5\, Salgrowth_{it} + FD_i + TD_t + e_{it} \ldots (1)$$

$$ROE_{it} = \beta_0 + \beta_1 CGID_{it} + \beta_2 FS_{it} + \beta_3 FA_{it} + \beta_4\, Georg\ diver_{it} + \beta_5\, Salgrowth_{it}\, FD_i + TD_t + e_{it} \ldots (2)$$

Where: ROA and ROE are dependent variables, β_0 is constant, β_1 to β_5 were the estimates which included independent variables Corporate Governance Information Disclosure (CGID), Firms size (FS), Firm Age (FA), Geographical diversification (Geog diver) and Sales growth (Sal growth) while vectors FD (Firm Dummy) represented firms time invariant specific effect and TD (Time Dummy) represented time variant specific effect, e is the error term, and i and t are firm and time elements respectively

ROA was chosen because of its ability as a tool to relate profits against operational efficiency. It measures a firm's long-term financial viability by considering its use of existing assets to generate profits (Strouhal et al., 2018). Under corporate governance, ROA is a good measure of the agents' utilization of available assets to generate profits for the principal. The value of ROA was determined using the formula presented in equation (3)

$$ROA = \frac{Profit\ before\ tax}{Total\ assets} \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (3)$$

ROE was used due to its ability to measure profit by focusing on profitability for shareholders (Albuja et al. 2011). In this study, shareholders are a group of interest since they are among the stakeholder as presented by the stakeholder's theory. ROE was determined using the formula presented in equations (4)

$$ROE = \frac{Profit\ after\ tax}{shareholders'\ equity} \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (4)$$

Lishenga & Mbaka (2008) and Buallay (2017), among others, are examples of researchers who employed ROA and ROE as performance measurement tools when assessing the effects of CGID on firms' profitability.

Before beginning the data analysis process, the researcher made sure that the data satisfied all of the requirements for regression assumptions and then moved on to the next step. After conducting a Hausman specification, it was determined that random effects were likely to be more consistent and efficient.

Computation of Corporate Governance information disclosure (CGID) Index

In order to construct the corporate governance disclosure index, we used information extracted from the annual reports of the firms whose corporate governance disclosures were under scrutiny. The index was constructed based on a dichotomous scale in which an item that was disclosed was marked as 1, and the undisclosed item was marked as 0. As the regulations require the disclosure of 40 items related to corporate governance, then the disclosure index was calculated as

$$CGID = \frac{Total\ score\ of\ the\ company}{Maximum\ \ score\ obtainable\ by\ the\ company\ as\ per\ regulations\ (40)} \times 100 \ldots\ldots\ldots (5)$$

The CGID value varied from 0 to 100, with 0 being the worst disclosure and 100 representing the greatest possible disclosure by a firm. Kaur & Vij (2017) and Wendy et al., 2020) adopted a similar approach to measuring CGI information disclosure. Variables measurement are presented in Table 1

Table 1. Variables measurement

Variables	Measurement	Expected Sign
Dependent Variable		
Return on Asset	Net profit before tax divided by total assets.	+/-
Return on Equity	Net profit after tax divided by shareholders' equity	+/-
Independent variable		
CGI disclosure	It is dichotomous, i.e., 1 for disclosure and 0 if otherwise	+
Control variables		
Firm size	Natural logarithm of the total assets	+/-
Geographical diversification	Dichotomous, i.e., 1 for diversification and 0 for otherwise	+
Firm age	Number of years since incorporation till the period of study	+/-
Sales growth	Current year's sales minus the previous year's sales over the results of the previous year's sales	+/-

Note that: + = positive and – = negative

RESULTS AND DISCUSSION

Descriptive statistics linking CGI disclosure and firm profitability

The effects of CGI disclosure on firm profitability were examined in this research. Descriptive statistics are presented in Table 2 to give an overview of the mean, minimum, maximum, and standard deviations of ROA, ROE, firm size, firm age, sales growth, and geographical diversification.

Table 2. Descriptive results for dependent and independent variables

Variable	Obs	Mean	Std. Dev.	Min	Max	Skewness	Kurtosis
ROA	265	12.377	25.214	-163.772	69.260	-0.739	2.603
ROE	265	14.237	24.304	-143.832	62.460	-0.238	1.401
CGI	265	0.680	0.107	0.475	0.875	0.497	2.406
FA	265	23.568	17.160	0	69	0.990	2.224
Geog diver	265	0.619	0.385	0	1	-0.660	2.657
FS	265	7.696	1.105	4.674	10.138	-0.219	2.284
Sal growth	265	0.826	8.848	-0.899	97.525	0.439	2.310

Table 2 shows that the average ROA was 12.38%, with a minimum loss of 163.7% and a maximum profit of 69.26%. ROA's standard deviation was 25.21, indicating volatility in returns. On average, ROE was 14.2% with a minimum loss of 143.80% and a maximum return of 62.460%; ROE standard deviation was 24.3, indicating volatility in returns. CGI Disclosure averaged 68%, ranging from 47.5% to 87.5%. DSE-listed enterprises satisfied 68% of CGI disclosure requirements on average. Such findings imply that stakeholders didn't obtain the whole CGI information they wanted, according to CMSA (2002). Inadequate CGI disclosure may exacerbate agency problems and affect stakeholders' assessments of governance quality and capacity to drive the firm toward profitability (Kemei, 2017)

The average company age since incorporation was 23 years, and the average business size was 7.6 out of 10. Data also showed that 61.9% of firms were geographically diverse. Average sales growth of 82.6% shows that firms were stretching their selling and distribution over time. All variables have skewness values between 0 and 0.9 and kurtosis values between 1.4 and 2.6, suggesting normally distributed data with light tails (Jaume et al., 2020).

Regression analysis for CGI disclosure and firm profitability.

In order to assess the nature of the connection that exists between the dependent and independent variables, a random effect model was used. The regression was performed using two different estimates to assess whether the findings were consistent. The outcomes of the regression analysis are shown in Tables 3 and 4, respectively.

Table 3. Corporate governance disclosure and firm profitability (ROA)

Variables	ROA	ROA
Corporate governance disclosure	161.8623***	179.7050***
	(58.611)	(58.844)
Firm size	3.3019**	
	(1.383)	
Firm age		1.4024***
		(0.393)
Geographical diversification	13.7440**	
	(6.344)	
Sales growth	1.0549***	1.0554***
	(0.125)	(0.124)
Firm dummy	Yes	Yes
Time dummy	Yes	Yes
Constant	-130.9321***	-119.2496***
	(40.938)	(41.144)
Observations	265	265

*Standard errors in parentheses: * Significant at 10%, ** significant at 5%, *** significant at 1%*

CGI disclosure had a positive and statistically significant effect on ROA in all two estimations, as seen in Table 3. These findings are similar to those of (Panchasara & Bharadia, 2013) and (Herbert & Agwor, 2021), who also concluded that corporate governance disclosure positively affected the ROA of the firms they studied. The results contradict those of (Harisa *et al*., 2019) and (Lishenga & Mbaka, 2008), who failed to establish any significant effect of CGI disclosure on ROA. CGI disclosure proved to have a significant positive effect on ROA in all two models, even when specific control variables were removed, indicating that the results are robust. These results support the stakeholders' theory which proposes that a firm's effective existence is linked to its ability to satisfy the interest of stakeholders; by doing an activity that enhances the firm's ROA, that notion is reinforced as profitability is the main interest of investors and lenders (Lado-Sestayo & Vivel-Búa, 2019).

Interviews with some key informants (KIs) were conducted in order to gain a more in-depth and crystal-clear image of the connection between CGI disclosure and ROA. The perceptions gathered from their point of view suggested that CGI disclosure makes stakeholders more likely to have faith in the corporation's governance practices, enhancing ROA. Through the disclosure of CGI, all parties concerned have the impression that those in charge of governance are acting appropriately and making sound judgments concerning the appropriate use of available resources. During the interviews, one of the managers of the company mentioned that;

"*CGI disclosure Inspires confidence among stakeholders as it portrays a glimpse of the atmosphere of the system of rules and standards that govern our company's operations and align the interests of our stakeholders. The disclosure also indicates good corporate governance procedures and ethical business practices contributing to financial viability. I remember receiving a phone call from a non-investor who was impressed by the fact that our top 10 disclosed shareholders were 75 percent Tanzanians. He said he would continue to buy our products to support his fellow countrymen. You can only imagine the number of people who feel the same way. In the end, I am certain that CGI disclosure will have a positive impact on the firm's ROA" (firm manager)*

Table 4. Corporate governance disclosure and firm profitability (ROE)

Variables	**ROE**	**ROE**
Corporate governance disclosure	50.3829**	47.1304**
	(21.801)	(21.765)
Firm size	6.1361***	
	(1.564)	
Firm age		1.8139***
		(0.456)
Geographical diversification	14.1474***	
	(5.492)	
Sales growth	1.1506***	1.1460***
	(0.213)	(0.213)
Constant	-45.5764**	-42.0979**
	(18.705)	(18.728)
Observations	265	265

*Standard errors in parentheses: * Significant at 10%, ** significant at 5%, *** significant at 1%*

CGI disclosure had a positive and statistically significant effect on ROE in all two estimations, as seen in Table 3. These findings are similar to those of (Kaur & Vij, 2017; Assenga et al., 2018), who also concluded that corporate governance disclosure positively affected the ROE of the firms they studied. The results contradict Buallay (2017) and Khanifah et al. (2020), who failed to establish any significant effect of CGI disclosure on ROE. CGI disclosure proved to have a significant positive effect on ROE in all two models, even when specific control variables were removed, indicating that the results are robust. These results support the stakeholders' theory which proposes that firm's effective existence is linked to its ability to satisfy the interest of stakeholders. When CGI disclosure is linked to positive ROE enhancement, it indicates that the firm has effectively used the monies that shareholders have invested and can offer investors considerable profits at present. By engaging in activities that improve the ROE of the company, investors' primary interest in profitability is reinforced. (Lado-Sestayo & Vivel-Búa, 2019).

Interviews with key informants (KIs) were also conducted to obtain their perspectives on the effects of CGI disclosure on ROE. According to the opinions obtained from their perspective, CGI disclosure makes shareholders more to believe in the governance procedures of the firm and consider their investments to be in safe hands. By disclosing CGI, all parties concerned assume that the management is behaving appropriately and making sound judgments regarding the appropriate use of the invested equity. This gives the impression that those in charge of governance appropriately use available resources, which ultimately enhances the firm's ROE. In the process of conducting the interviews, one of the employees from the Capital Market Regulatory authority stated that

"Our primary goal as a regulatory body is to safeguard the interests of the firm's shareholders. Every firm that wants to go public on the stock market must comply with the disclosure requirements, which is an absolute must. Shareholders may better understand a company's operational structure when the CGI is disclosed in the financial reports. Shareholder satisfaction increases when they know which individuals can operate the organization on their behalf and which individuals are responsible for how an organization's personnel act and perform. In essence, a strong CGI framework provides for Effective and efficient operations which contribute towards firm's ROE; thus a disclosure is paramount" (CMSA representative)

CONCLUSION AND RECOMMENDATIONS

Conclusion

According to the findings of this research, a significant portion of companies who are listed on the DSE makes public disclosures of CGI information. Disclosures of this kind are probably made to ensure compliance with regulatory obligations and boost the trust of the firm's many different stakeholders. Results also revealed that CGI disclosures had a positive and significant effect on the profitability of publicly listed firms. Since the disclosures affect profitability, there is a need to develop necessary measures that will mandate that good corporate governance procedures and disclosures be implemented in accordance with the GRI standards and local legal requirements.

Recommendation

We recommend that firm managers investigate the positive effects of CGI disclosure, improve their disclosure procedures, and invest in disclosure strategies that will bring even more value to stakeholders. The Tanzanian government needs to devise an efficient and effective method for rewarding those who disclose CGI and penalizing those who don't disclose CGI. Better Systems for CGI disclosure are to be created and strengthened, and regulatory authorities like CMSA should work toward this goal.

We propose that the area of potential future study may be narrowed by focusing on the disclosure practices of CGI across different sectors in Tanzania. In addition, the importance of each of the disclosure elements was treated the same throughout this investigation. Even though this helps to reduce biases, stakeholders may assign higher relevance to certain aspects of governance and less relevance to others. One facet of governance may be seen as a fundamental component and, as such, ought to be given greater weightage. Future studies might consider developing a weighted CGI disclosure index.

Similarly, we considered the lack of a weighted index as a limitation of this study. Perhaps the result would have been different if the items in the constructed CGI index were assigned weights in accordance with their relevance amongst stakeholders.

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