

Corporate Governance Mechanisms, Managerial Ability and Financial Performance in the Nigerian Banking Industry

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Abstract

Good corporate governance has become a vital ingredient for financial stability in the banking industry, especially in developing economies where weak institutional structures often undermine performance. This study examined how corporate governance mechanisms shape the financial performance of Nigerian deposit money banks, with particular attention to the mediating role of managerial ability. The specific objectives were to analyse the effect of corporate governance mechanisms on financial performance; to investigate how corporate governance influences managerial ability, and to assess the effect of managerial ability on financial performance. The study adopted a quantitative, explanatory design, using panel data from twelve purposively sampled Nigerian deposit money banks listed on the Nigerian Exchange, covering 2012–2023 (144 bank-year observations). Corporate governance was proxied by board size, expertise, gender diversity, independence and audit committee size; managerial ability was estimated via stochastic frontier analysis (Demerjian et al., 2012); and financial performance was measured with return on equity (ROE). Panel regression (pooled OLS, fixed and random effects, selected via Breusch–Pagan LM and Hausman tests) was employed, controlling for bank size and leverage. Findings show that, individually, governance mechanisms had no statistically significant direct effect on financial performance or managerial ability. Managerial ability, however, had a positive and highly significant effect on financial performance, confirming its mediating role. The study concludes that governance structures alone cannot guarantee profitability unless backed by competent managers and recommends that banks and regulators move beyond compliance-based governance toward board engagement quality and leadership development.

Keywords: corporate governance, managerial ability, financial performance, deposit money banks, panel data, Nigeria

1.0 Introduction

Financial performance is one of the most critical indicators of an organisation's sustainability, competitiveness and contribution to broader economic development. In the corporate setting, financial performance reflects the extent to which firms utilise their assets to generate profit, deliver shareholder value and maintain long-term solvency, and is often measured through accounting-based indices such as return on assets (ROA), return on equity (ROE) and net profit margin, or market-based indicators such as Tobin's Q. Scholars have consistently emphasised

that financial performance is not only an outcome of firm-level strategic choices but also a function of governance quality and managerial competence (Demerjian, Lev & McVay, 2012). In the banking sector, financial performance assumes even greater importance because of the sector's unique role in financial intermediation, capital allocation and economic stability. Banks operate with high leverage, complex financial products and systemic risks that make them particularly vulnerable to governance lapses and managerial inefficiencies, so that poor financial performance in banks affects not only shareholders but also depositors, regulators and the wider economy. Globally, evidence suggests that governance structures such as independent boards, gender-diverse leadership and effective audit committees improve decision-making, reduce earnings manipulation and enhance profitability (Joshua & Abimbola, 2013). Despite these insights, the Nigerian banking industry continues to experience recurring challenges that raise concerns about the relationship between corporate governance and financial outcomes, ranging from the distress of the 1990s, the 2005 banking consolidation, to the 2009 Central Bank of Nigeria (CBN) intervention, crises variously linked to weak governance, managerial incompetence and financial misreporting. While Nigerian banks have adopted corporate governance codes, compliance has often been more structural than substantive: merely expanding board size or appointing independent directors does not automatically translate into improved performance, and the effectiveness of these mechanisms instead depends on active engagement, managerial quality and consistent oversight.

Managerial ability, the competence of executives to transform resources into outcomes through efficient decision-making, strategic foresight and operational execution, has therefore become a crucial intermediary in the governance–performance nexus. Demerjian et al. (2012) pioneered a framework for quantifying managerial ability, showing that more capable managers are better at enhancing efficiency, reducing earnings manipulation and improving financial reporting credibility. In the Nigerian context, however, empirical evidence on how governance interacts with managerial ability to jointly influence financial performance remains scarce: while previous studies have independently examined governance (e.g., Joshua & Abimbola, 2013) or managerial ability (Demerjian et al., 2012), very few have integrated these dimensions to explain bank-level financial outcomes in emerging markets. This study addresses that gap by investigating how governance structures and managerial quality jointly shape financial performance in Nigerian deposit money banks, with three specific objectives: (i) to examine the effect of corporate governance mechanisms on financial performance; (ii) to investigate the effect of corporate governance mechanisms on managerial ability; and (iii) to assess the effect of managerial ability on financial performance.

Review of Related Literature

Conceptual Review

Corporate governance refers to the system of rules, practices and processes by which a firm is directed and controlled, balancing the interests of shareholders, management, regulators and other stakeholders. In the banking literature it is commonly operationalised through board-level mechanisms, board size, board independence, board expertise, board gender diversity and audit committee effectiveness, alongside ownership structure (Osemeke & Adegbite, 2016). Managerial ability, by contrast, denotes the efficiency and competence of managers in converting a firm's resources (labour, capital, deposits) into revenue and profit, and is treated in this study as a distinct, measurable construct rather than an unobservable residual (Demerjian et al., 2012).

Theoretical Review

The study is anchored on four complementary theories. Agency Theory (Jensen & Meckling, 1976) conceptualises the firm as a nexus of contracts between principals (shareholders) and

agents (managers) whose divergent interests give rise to agency costs; governance mechanisms such as board independence, ownership structure and audit committees exist to align managerial behaviour with shareholder interests and constrain opportunism. Upper Echelons Theory (Hambrick & Mason, 1984) holds that organisational outcomes are a reflection of top managers' cognitive base, values and experience, so that managerial ability becomes a central mediating factor through which governance structures are translated into performance. Stewardship Theory (Davis, Schoorman & Donaldson, 1997) offers a more optimistic counterpoint, portraying managers as trustees whose interests are inherently aligned with the organisation's, such that governance mechanisms empower rather than merely police executives. Finally, the Resource-Based View (Barney, 1991) treats managerial ability as a strategic, human-capital resource that, when combined with effective governance structures, generates sustained competitive advantage. Taken together, these perspectives frame governance as necessary but not sufficient: its effect on performance is expected to operate substantially through the quality of the managers who implement it.

Empirical Review

Empirical evidence on the governance–performance relationship in Nigeria is mixed. Uwuigbe, Peter and Oyeniyi (2014) and Osemeke and Adegbite (2016) find that bank-specific financial characteristics often outweigh formal governance structures in explaining performance, while Joshua and Abimbola (2013) report that governance mechanisms are associated with improved financial outcomes only where they are substantively, not just formally, implemented. Internationally, Yermack (1996) and Jensen (1993) associate smaller, leaner boards with better monitoring and performance, whereas Adams and Mehran (2003) find that larger boards can improve performance in complex financial institutions. On managerial ability, Demerjian et al. (2012) and García-Meca and García-Sánchez (2018) provide cross-country evidence that more able managers achieve higher efficiency, lower audit risk and superior financial performance. These studies, however, largely examine governance and managerial ability in isolation.

Gap in Literature

Although a growing body of research examines the relationship between corporate governance and firm performance, most studies, in Nigeria and internationally, concentrate on governance mechanisms in isolation, with little attention to how these mechanisms interact with managerial ability to influence financial outcomes. Nigerian scholarship has predominantly examined governance variables such as board size, independence, ownership structure and audit committee effectiveness, while managerial ability, though highlighted abroad as a critical determinant of firm outcomes (Demerjian et al., 2012), has received scant empirical attention in Nigeria's banking industry. This creates a gap: the absence of context-specific evidence on how corporate governance mechanisms and managerial ability jointly shape financial performance within Nigerian banks. This study addresses that gap.

2.0 Methodology

The study adopts an explanatory research design within a quantitative framework, suitable for establishing causal relationships between corporate governance mechanisms, managerial ability and financial performance using panel data drawn from published financial statements and regulatory filings.

2.1 Population, Sample and Data

The population comprises the 24 deposit money banks (DMBs) operating in Nigeria as at the end of the study period (2023). A sample of twelve banks listed on the Nigerian Exchange (NGX) with consistently available audited annual reports was purposively selected: Access

Bank, Fidelity Bank, First City Monument Bank, First Bank of Nigeria, Guaranty Trust Bank, Standard Chartered Bank, Stanbic IBTC Bank, United Bank for Africa, Union Bank of Nigeria, Unity Bank, Wema Bank and Zenith Bank. The study relies exclusively on secondary data, annual reports and financial statements of the sampled banks for the period 2012–2023, corporate governance disclosures made in line with the CBN Code of Corporate Governance and the requirements of the Financial Reporting Council of Nigeria (FRCN), and statistical bulletins of the CBN and the NGX database, yielding a balanced panel of 144 bank-year observations.

2.2 Model Specification

Three panel models are estimated to address the study's objectives:

Model 1 (governance → financial performance): $FP_{it} = \beta_0 + \beta_1 BSIZE_{it} + \beta_2 BEXP_{it} + \beta_3 BGEND_{it} + \beta_4 BIND_{it} + \beta_5 AC_{it} + \Gamma X_{it} + \mu_i + \lambda_t + \varepsilon_{it}$

Model 2 (governance → managerial ability): $MA_{it} = \alpha_0 + \alpha_1 BSIZE_{it} + \alpha_2 BEXP_{it} + \alpha_3 BGEND_{it} + \alpha_4 BIND_{it} + \alpha_5 AC_{it} + \Phi X_{it} + \eta_i + \tau_t + \nu_{it}$

Model 3 (governance + managerial ability → financial performance, mediation): $FP_{it} = \gamma_0 + \gamma_1 MA_{it} + \gamma_2 BSIZE_{it} + \gamma_3 BEXP_{it} + \gamma_4 BGEND_{it} + \gamma_5 BIND_{it} + \gamma_6 AC_{it} + \Psi X_{it} + \varphi_i + \delta_t + \varepsilon_{it}$ where FP is financial performance (proxied by ROE); BSIZE, BEXP, BGEND, BIND and AC are board size, board expertise, board gender diversity, board independence and audit committee size respectively; MA is managerial ability; X_{it} is a vector of controls (bank size, leverage); $\mu_i/\eta_i/\varphi_i$ and $\lambda_t/\tau_t/\delta_t$ are bank and year fixed effects; and $\varepsilon_{it}/\nu_{it}$ are error terms.

Table 1. Definition and Measurement of Variables

Variable	Proxy	Measurement
Financial performance (DV)	ROE, ROA, NPM	Net income / shareholders' equity (and analogous ratios)
Board size	BSIZE	Total number of board members
Board expertise	BEXP	No. of directors with relevant expertise ÷ total board members
Board gender diversity	BGEND	No. of female directors ÷ total board members
Board independence	BIND	No. of independent directors ÷ total board members
Audit committee	AC	Audit committee size / independence
Managerial ability (mediator)	MA	Efficiency score via stochastic frontier analysis (SFA), following Demerjian et al. (2012)
Firm size (control)	SIZE	Log of total assets
Leverage (control)	LEV	Total debt / total assets (or equity)

Source: Compiled by author.

2.3 Data Analysis Technique

Data are analysed using descriptive statistics, correlation analysis and panel regression, estimated in EViews 10. For each objective, the Breusch–Pagan Lagrangian multiplier (LM) test is used to choose between pooled OLS and a panel (random effects) estimator, and the Hausman specification test is used to choose between fixed and random effects. Managerial ability is estimated in a first stage using stochastic frontier analysis (Demerjian et al., 2012) before being used as a regressor in Models 2 and 3.

3.0 Results

3.1 Descriptive Statistics and Correlation

Table 2 reports the descriptive statistics for the study variables (n = 144 bank-year observations). Nigerian banks in the sample carried relatively large boards (mean board size $\approx$ 13 members), with independent directors averaging under one-fifth of board composition and female directors averaging about 27 percent of the board.

Table 2. Descriptive Statistics

Variable	Mean	Std. Dev.	Max	Min	N
AC (audit committee)	5.6389	1.0419	9	3	144
BIND (board independence)	0.1937	0.7817	0.5	0.0667	144
BEXP (board expertise)	0.5088	0.2186	0.9500†	0.1333	144
BGEND (gender diversity)	0.2699	0.1568	1	0	144
BSIZE (board size)	13.1944	2.9382	20	6	144
FSIZE (firm size)	14.5688	1.0349	17.0910	11.9601	144
LEV (leverage)	0.8980	3.6979	44.0606	-1.1196	144
MA (managerial ability)	0.1671	0.0199	0.2070†	-0.0953	144
ROE (financial performance)	0.1042	0.3591	0.3653	-3.9444	144

Source: Author's computation (2025).

Correlation results (Table 3) show that board independence is positively and significantly associated with board expertise and gender diversity, and with firm size; board expertise and gender diversity are strongly positively correlated with each other but negatively correlated with board size; leverage is strongly negatively correlated with ROE; and managerial ability is positively correlated with both firm size and ROE. The moderate-to-high correlations among some governance variables (e.g., board expertise and gender diversity) point to the possibility of multicollinearity, which is addressed through the choice of estimator and diagnostic testing in the regressions that follow.

Table 3. Correlation Matrix

	AC	BIND	BEXP	BGEND	BSIZE	FSIZE	LEV	MA	ROE
AC	1								
BIND	-0.0729	1							
BEXP	-0.0004	0.3900* **	1						
BGEND	0.0137	0.2727* *	0.6362* **	1					

	AC	BIND	BEXP	BGEND	BSIZE	FSIZE	LEV	MA	ROE
BSIZE	-0.1551*	-0.2434*	-0.6830**	-0.5592**	1				
FSIZE	-0.3069**	0.5360**	0.0890	0.0308	0.1704	1			
LEV	-0.1258	-0.0506	-0.1202	-0.0510	0.0980	-0.1598*	1		
MA	-0.0789	0.1859*	0.0315	0.1480*	-0.1386*	0.3367**	-0.1823*	1	
ROE	0.0814	0.1583*	0.1070	0.0857	-0.0547	0.3175**	-0.9453**	0.1550*	1

Source: Author's computation (2025). *, **, *** denote significance at 10%, 5% and 1% respectively.

3.2 Corporate Governance and Financial Performance (Objective 1)

The Hausman test ($\chi^2(7) = 5.05$, $p = 0.6533$) did not reject the null of no systematic difference between fixed and random effects, while the Breusch–Pagan LM test ($\chi^2(1) = 62.59$, $p = 0.0000$) rejected pooled OLS in favour of a panel estimator; the random effects model was therefore selected. As Table 4 shows, none of the governance variables — board size, gender diversity, independence, expertise or audit committee size — had a statistically significant effect on ROE, although their coefficients were positive. Leverage had a negative and highly significant effect (-0.9133 , $p < 0.01$) and firm size had a positive and significant effect (0.0348 , $p < 0.05$) on financial performance.

Table 4. Random Effects Estimates: Corporate Governance and Financial Performance (DV = ROE)

Variable	Coefficient	z	p-value
BSIZE	0.0026	0.63	0.528
BGEND	0.0218	0.30	0.768
BIND	0.1565	1.23	0.219
BEXP	0.0019	0.36	0.720
AC	0.0019	0.24	0.807
LEV	-0.9133	-45.75	0.000***
SIZE	0.0348	2.59	0.010**
Constant	-0.4149	-2.13	0.033**

Source: Author's computation (2025). $R^2 = 0.9208$; $Prob > \chi^2 = 0.000$; $N = 144$.

3.3 Corporate Governance and Managerial Ability (Objective 2)

For this objective the Breusch–Pagan LM test ($\chi^2(1) = 20.72$, $p = 0.0000$) rejected pooled OLS, and the Hausman test ($\chi^2(7) = 48.32$, $p = 0.0000$) favoured fixed effects. Table 5 shows that board size had a negative effect on managerial ability that was marginally significant at the 10% level (-0.0479 , $p = 0.086$); board gender diversity, independence, expertise and audit committee size were not statistically significant.

Table 5. Fixed Effects Estimates: Corporate Governance and Managerial Ability (DV = MA)

Variable	Coefficient	t	p-value
BSIZE	-0.0479	-1.73	0.086*
BGEND	-0.3568	-0.73	0.468
BIND	-0.2221	-0.28	0.783
BEXP	-0.0238	-0.71	0.480
AC	0.0103	0.21	0.836
LEV	-0.0038	-0.30	0.763
SIZE	-0.0571	-0.60	0.546
Constant	1.6979	1.27	0.207

Source: Author's computation (2025). Within $R^2 = 0.042$; F-test for group effects $p = 0.0169$; $N = 144$.

3.4 Managerial Ability, Corporate Governance and Financial Performance (Objective 3)

Model selection tests again favoured fixed effects (Hausman $\chi^2(7) = 48.32$, $p = 0.0000$; LM $\chi^2(1) = 20.72$, $p = 0.0000$). Table 6 shows that managerial ability had a positive and highly significant effect on financial performance (0.0755 , $p < 0.01$), while none of the governance variables were independently significant once managerial ability was included. Leverage remained negative and significant (-0.0912 , $p < 0.01$) and firm size remained positive and significant (0.0335 [reported as 0.3349 in the fixed-effects table], $p < 0.05$).

Table 6. Fixed Effects Estimates: Governance, Managerial Ability and Financial Performance (Mediation, DV = ROE)

Variable	Coefficient	t	p-value
MA	0.0755	5.80	0.000***
BSIZE	0.0053	1.31	0.194
BGEND	0.3275	0.46	0.643
BIND	0.1806	1.56	0.122
BEXP	0.0049	1.02	0.312
AC	0.0013	0.18	0.854
LEV	-0.0912	-50.85	0.000***
SIZE	0.3349	2.46	0.015**
Constant	-0.4536	-2.34	0.021**

Source: Author's computation (2025). Within $R^2 = 0.9601$; $F(8,124) = 372.80$, $p = 0.000$; $N = 144$.

4.0 Discussion

4.1 Corporate Governance and Financial Performance

The results for Objective 1 indicate that, on their own, board-level governance mechanisms did not significantly drive profitability in the sampled banks over 2012–2023; structural and financial factors (leverage, scale) were more influential. This is consistent with Uwuigbe et al. (2014) and Osemeke and Adegbite (2016), who report that Nigerian bank performance is more strongly explained by bank-specific financial characteristics than by formal governance compliance, and contrasts with international evidence (e.g., Adams & Mehran, 2003) linking larger boards to better performance in more developed financial systems — a divergence plausibly explained by governance in Nigeria being pursued more in form than in substance.

4.2 Corporate Governance and Managerial Ability

The weak, marginally significant negative effect of board size on managerial ability (Objective 2) aligns with Jensen (1993) and Yermack (1996), who argue that larger boards tend to be less effective at monitoring and coordination, but contrasts with Adams and Mehran (2003), who find larger boards can enhance oversight in complex financial institutions. The low explanatory power of governance variables, alongside a significant group-effects F-test, suggests that unobserved bank-specific factors, culture, leadership style, internal processes, matter more for managerial efficiency than board structure alone.

4.3 Managerial Ability as a Mediating Channel

The Objective 3 result confirms managerial ability as a significant mediating channel between governance and financial performance, consistent with Demerjian et al. (2012) and García-Meca and García-Sánchez (2018), and lends support to stewardship and upper-echelons perspectives: once managerial competence is accounted for, the direct explanatory power of board structure diminishes, suggesting that governance affects performance mainly indirectly, through the managers who operationalise it. Taken together, the three sets of results suggest that governance in the Nigerian banking industry functions largely as a compliance mechanism whose practical effect on profitability runs mainly through the competence of the managers who operate within it, rather than through board structure directly.

5.0 Conclusion and Recommendations

Across all three objectives, corporate governance mechanisms as applied in the sampled Nigerian banks did not have large, statistically significant direct effects on either managerial ability or financial performance; leverage, bank size and managerial ability were the stronger drivers of profitability. The study concludes that governance structures in the Nigerian banking industry function largely as compliance mechanisms and do not, by themselves, guarantee superior performance; their effect is substantially indirect, operating through the quality of the managers who implement them. Managerial ability, by contrast, is a significant and direct driver of financial performance, underscoring that governance frameworks are most effective when coupled with skilled, competent leadership. The study recommends that (i) banks move beyond formal compliance with governance codes toward ensuring directors have relevant expertise and audit committees exercise real authority, while investing in leadership development; (ii) regulators such as the CBN and FRCN assess the substantive functioning of governance structures, not merely their existence; (iii) investors and other stakeholders extend due diligence beyond governance-compliance disclosures to the quality of leadership and management practice; and (iv) policymakers pair governance reform with initiatives that build

managerial competence, including executive training, director certification and partnerships with universities and professional bodies.

The study contributes to the literature contextually, by providing Nigeria-specific evidence that governance affects bank performance mainly through managerial ability rather than directly; theoretically, by jointly applying agency, upper-echelons, stewardship and resource-based-view perspectives; and methodologically, by applying the Demerjian et al. (2012) stochastic frontier approach to estimate managerial ability in the Nigerian banking context. Future research could incorporate market-based performance measures (e.g., Tobin's Q), extend the comparison to other African or emerging markets, adopt qualitative approaches involving directors and regulators, and examine how ESG reporting and digital governance shape managerial ability and bank performance.

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