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AGENCY COST AND BUSINESS FAILURES IN NIGERIA; A CASE STUDY OF OGUNSTATE AUDIT PROFESSIONALS

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Abstract

Agency cost is a continuous phenomenon in today's business world, is considered an essential and significant part of business sustainability and survival. This study examined how the agency cost has contributed to the business failures and its sustainability. The business failure is measured using business collapse and sustainability of firms in Ogun State. For this study, agency cost and corporate governance are the proxies for agency cost.This study employed a survey research design. Population and sample size comprised the entire audit professionals in Ogun state. Data for the study were gathered from sixty-five audit professionals randomly selected. The data were analyzed using descriptive and Ordinary Least Square regression methods.The findings of the regression result indicate that agency cost proxies have a significant effect on business failure in Nigeria. For instance, corporate governance has significant positive effects on sustainability in Nigeria, while agency cost has a positive and significant effect on the level of business failures in Nigeria. In conclusion, agency costs are favourable and significant to drive business failure in Nigeria. The study recommended that for corporate sustainability to be guaranteed, best practices in corporate governance should be in place, and external auditors should not be too hasty in giving their opinion of the state of affairs of audited firms so as not to be liable for future collapse of the firms.

Introduction

Agency cost is a type of internal expense of a company, which forms a manager acting on behalf of shareholders. Agency costs arise as a result of core inefficiencies, dissatisfactions, and disruptions, such as conflicts of interest between shareholders and management. The payment of the agency cost is to the acting agent (Kindness, 2021). Agency conflicts commonly arise when there is a separation of interests between people who own the company and those who control the company. Agency conflicts based on agency theory can occur because management, who remains the company's manager, tends to focus on increasing personal income against company goals. A manager who has a high-performance contribution to the company also wants high wages or salaries. Aside from this, company owners often only want high-profit value income to increase their wealth. This difference in objectives certainly causes agency conflicts that agency costs are needed.

Agency costs exist to supervise management's actions to continue to carry out their duties to achieve company goals by a predetermined contract between shareholders and company managers (Ayunitha, Sulastri, Fauzi, Sakti, Nugraha, 2020). The recent increase in business shutdowns emphasizes the importance of predicting failures in advance. At the same time, arguments are on the lapses of financial indicators in the failure prediction (Jayasinghe & Kumara, 2020).

A corporate failure relates to significant events in firms' lives where its survival ends by creating losses to stakeholders. (Jenkins & McKelvie, 2016). The recent increase in business shutdowns stresses the importance of predicting failures in advance. At the same time, arguments are on the lapses of financial indicators in the failure prediction (Jayasinghe & Kumara, 2020).

Literature Review

Songsong, Daquan, & Xiaofeng. (2016) examine corporate governance, agency costs, and sustainable corporate development: a mediating effect analysis for a panel sample of 690 state- owned firms in China during 2015–2019. It shows that agency costs mediate the relationship between board size, management compensation, debt ratio, dividend policy, and sustainable corporate development. Specifically, decreasing the board size can reduce agency costs and enhance the company's sustainable development capabilities. The existing compensation system is to the disadvantage of the sustainable development of the company. Increasing the salaries of managers will increase agency costs and reduce the company's ability to develop sustainably.

Although increasing liabilities can reduce agency costs, increasing liabilities will increase financial risks. The bankruptcy costs caused by increasing liabilities are more significant than agency costs, which leads to a decline in the company's ability to develop sustainably. The implementation of cash dividend policies will help reduce agency costs, thereby increasing their sustainable development capabilities. This policy also provides new ideas for the Modigliani– Miller (MM) and agency cost theories.Nguyen, Doan, & Nguyen (2020) ascertain corporate governance and agency cost: empirical evidence from Vietnam reflecting a broad spectrum of board characteristics and ownership structure on agency costs in 281 listed companies on Ho

Chi Minh Stock Exchange (HOSE) in Vietnam in the period 2013–2018. For this purpose, three board characteristics selected are: (1) the size of the board of directors, (2) equilibrium between non-executive and executive members of the board of directors, (3) the CEO chair duality and three types of ownership structures were chosen: (1) management ownership, (2) government ownership, (3) foreign ownership. In addition, an inverse proxy of agency costs used and asset utilization ratio (asset turnover) reflects the managerial efficiency. The research methodology includes three statistical approaches: Ordinary least squares (OLS), fixed effects model (FEM) and random effects model (REM) were employed to address econometric issues and to improve the accuracy of the regression coefficients. The results can create effective corporate governance mechanisms in controlling the opportunistic managerial behaviour to lower agency conflicts and hence lower agency costs.

Ayunitha et al. (2020) examined Does the Good Corporate Governance Approach Affect Agency Costs to the consumer goods industry listed on the Indonesia Stock Exchange 2015-2019 period. The independent variable used in this study is corporate governance consisting of institutional ownership, managerial ownership, the board of commissioners, the board of directors, and the audit committee. At the same time, the dependent variable used in this study is agency cost. The data used in this study are secondary data by taking a population of 36 companies and a sample of 17 companies in the consumer goods industry. This research uses the data analysis method, the classical assumption test, and multiple linear regression. The results of this study indicate thatmanagerial ownership and the board of commissioners have a positive influence on agency costs.However, institutional ownership, the board of directors, and audit committee variables do not affect agency costs.

Jayasinghe & Kumara (2020) assessed firm failures in Sri Lanka: a substance of corporate governance. The corporate governance characteristics are proxied by CEO duality, CEO tenure, directors' independence, average director remuneration, director ownership, ownership concentration, and board size. Besides, some control variables such as interest coverage ratio, liquidity, and capital structure, which can potentially influence the failure possibilities, are added. Finally, it creates a balanced panel of 660 firm-year observations. The result was through panel logistic and panel linear regressions with standard errors adjusted for heteroscedasticity.

The results portray that the variables CEO tenure, average director remuneration, ownership concentration, and board size negatively and significantly influence the corporate failure, while CEO Duality positively and significantly influences the likelihood of corporate failure. Thus, this study provides new insights into the existing literature, especially in the context of a developing country, and the findings can be beneficial for stakeholders, practitioners, and regulators in their decision-making practices and policy implications.

Research Problem/Gap

The global importance of corporate governance became apparent in 2002 following several governance failures arising

from fraud and other unethical and criminal conduct that led to a loss of shareholder wealth and investment loss, job losses and pain to employees and family, tedious criminal investigation and legal proceedings, and imprisonment of culprits or perpetrators leading to increased legislation and control at the expense of self-regulation. Therefore, it is evident that the need for the legal imposition of accountability and external regulation of business due to corporate scandals and governance failures has reached alarming levels indeveloped countries and globally.

This failure is undesirable to investors who prefer self- regulation instead of imposed or external controls (Kabeyi, 2020). Corporate failure refers to its inability to conform to its set standards of expectations and plans, financial obligations, and ethical expectations and targets set. A corporate failure is highly undesirable because it destabilizes the economic, social and financial setups and should be avoided or averted in different ways. Because of these consequences, corporate governance should put measures to avoid failure (Abid & Ahmed 2014).The magnitude of corporate failures recorded in the last ten years has increased the concerns about audit quality. The cases of corporate scandals in Nigeria extend to the banking sector.

The failure of Afrikbank Plc., Intercontinental Bank Plc, Bank PHB and Oceanic Bank Plc., with clean audited reports, has raised several questions about the influence and value of external audits on the quality of accounting reports. Several studies have assessed the impact of audit quality on firms" financial reports using different measures such as Auditor size, Audit fees, Auditor tenure, audit committee, ownership structure and board independence (Ikpantan & Daferighe, 2019).Auditor independence which determines audit quality was one of the fundamental causes of corporate failures that led to the collapse of hitherto strong firms, whose fallout caused the global economic meltdown of the middle of 2000.

This meltdown led to users' apathy and confusion about the role auditors ought to play safeguarding their profession and restore investors" confidence to reduce the audit expectancy gap that existed after collapsing these firms. Investigations into their collapse revealed that their failures were not unconnected with auditors" inability to exhibit their professional competence and independence.

The collapse of these firms caused the erosion of shareholders" funds and further widened the gap between shareholders and management. In the same vein, creditors and other fund providers lost their fate in what would be their compensation for their lost investments. The questions raised by various users of financial statements are whether auditors have compromised with the management of firms or are grossly incompetent to perform their statutory duties? (Zayol, Kukeng, & Iortule Mdoom, 2017). Hence, this study examines agency costs and business failures in Ogun State.

Objective

The main aim of the study is to examine the effect of agency costs and corporate governance on business failures in Ogun State, Nigeria.

Hypothesis

The hypothesis was tested in line

with the stated objectives:

Ho_1: Corporate governance does not affect the sustainability of business organizations in Nigeria.

Ho_2: Agency cost does not affect the collapse of businesses in Nigeria.

Theoretical Consideration

This research considered the following theories: Stakeholders TheoryStakeholder theory was first described by Dr F. Edward Freeman, a professor at the University ofVirginia, in his landmark book, "Strategic Management: A Stakeholder Approach." It suggests that shareholders are merely one of many stakeholders in a company. The stakeholder ecosystem, this theory says, involves anyone invested and involved in, or affected by, the company: employees, environmentalists near the company's plants, vendors, governmental agencies, and more. Freeman's theory suggests that a company's real success lies in satisfying all its stakeholders, not just those who might profit from its stock. Edward Freeman's stakeholder theory holds that a company's stakeholders include just about anyone affected by the company and its workings.

That view opposes the long-held shareholder theory proposed by economist Milton Friedman that in capitalism, the only stakeholders a company should care about are its shareholders - and thus, its bottom line. Friedman's view is that companies must make a profit to satisfy their shareholders and continue positive growth. Professor Craig McDonald says his view is simple. "If you value life in the future, you should preserve the environment by addressing pollution, using sustainable extraction from the biosphere. Presumably, you act in a way that you hope will express your values and produce an outcome that makes you happy." In other words, he says, corporate responsibility and business ethics do not need their particular focus inside the company, as long as the company practices true stakeholder theory for all its stakeholders, from suppliers and employees to factory workers and environmentalists (Simon, 2021).

Agency Theorypropounded by Jensen and Meckling (1976) suggested a theory of how a company's governance is creating conflicts of interest between the company's owners (shareholders), its managers, and significant providers of debt finance. Each of these groups has different interests and objectives. Jensen and Meckling defined the agency relationship as a form of contract between a company's owners and its managers, where the owners (as principal) appoint an agent (the managers) to manage the company on their behalf.

As a part of this arrangement, the owners must delegate decision-making authority to the management. The owners expect the agents to act in the best interests of the owners. Ideally, the 'contract' between the owners and the managers should ensure that the managers always act in the owners' best interests. However, it is impossible to arrange the 'perfect contract' because decisions by the managers (agents) affect their welfare and the owners' interests (Gavarro, 2020).

The agency theory with the assignment of work from the principal to the agent (Slyke, 2006 uploaded by Hans Voordijk (www.researchgate.net)

Critics of agency theory and its applications to corporate governance issues focus on such problems as unrealistic premises concerning managers' motivations

and actions, ineffective recommendations inferred from the theory and dubious legal interpretations of corporate governance made on its basis. In addition, critics of agency theory have noticed that control mechanisms suggested are expensive and economically ineffective.

Mechanisms protecting shareholders' interests may interfere with the realization of strategic decisions, may restrict collective actions, distort investment plans and ignore the interests of other stakeholders, which may lead to decreasing their commitment to the creation of economic value (Segrestin & Hatchuel, 2011, pp. 487-488 in Kultys, 2016).

Methodology

A descriptive survey design comprising all audit professionals in Ogun State was chosen, out of which sixty-five auditors were selected randomly for this study. The techniques adopted involve simple random and purposive sampling technique. The source of data for the study was through the administration of a questionnaire.

The source of data is primary. The essential instrumentation that would be adopted to collect data is a questionnaire. The questions were in a closed-form using the Rensis Likert scales of agreed, strongly agreed, disagreed and strongly disagreed.

Regression analysis: The data were analyzed using descriptive statistics and regression analysis. Tables, charts were presented to show the trend and attributes of the data for the study through the aid of an econometric package (E-views).

Model Specification: The mathematical equation below, therefore, represents the relationship between dependent and independent variables in a linear form. The functional form of a simple linear regression model adopted in this study is given by

$Y = \beta_0 + \beta_1 X$

The explicit form of the model above is adoptedModel I

$SUS=\beta0+\beta1CG+ +\varepsilon t$… i

Model II

$BF=\beta0+\beta1AC+\varepsilon t$ ii

Where

Y = Dependent Variable (Agency cost),X= Independent Variable (Business Failures) SUS= Sustainability of Business Organization,C.G = Corporate Governance
BF = Business Collapse,AC= Agency Cost
β0= Constant. β1= Coefficient of explanatory Variable, εt= Error Term

Data Presentation and Analysis

The issue of data presentation, analysis and interpretation, and discussion of the study's findings form the basis of this chapter. This chapter on data analysis involves three sections; the first presents a descriptive analysis of the data indicating the variables' mean, minimum, maximum and standard deviation. The second part deals with the regression analysis with its interpretation. Finally, the third part focused on the testing of hypotheses and the discussion of findings.

Demographics

From the demographics table, most of the respondents are male, aged between 30 and 39 years, who has MSc/MBA, Christian, who had worked between 6-10 years and 11-15 years respectively. Information gathered from the respondents has contributed to the result generated from the analysis of questionnaires and

testing of the hypotheses from regression analysis.

Analysis of Questionnaires

From the questionnaires, most of the items on the question agreed that agency cost relates to business failure. All the items were accepted because the mean values were above the 2.50 cut- off mark. This result means that most of the problems found showed that agency cost is the primary cause of business failure. The items' standard deviations varied from 0.45 to 1.26. This result means that the responses of the respondents were unanimous.

Table 4.3 Descriptive Statistics

	Sustainability	Corporate Governance	Business Collapse	Agency Cost
Mean	21.73846	25.67692	16.53846	16.10769
Median	22.00000	28.00000	16.00000	18.00000
Maximum	28.00000	32.00000	20.00000	20.00000
Minimum	9.000000	13.00000	10.00000	9.000000
Std. Dev.	5.831694	6.376489	2.888971	3.913610
Skewness	-0.571663	-0.840254	-0.308255	-0.598363
Kurtosis	2.308622	2.359592	2.383605	1.905861
Jarque-Bera	4.834906	8.759362	2.058407	7.121008
Probability	0.089148	0.012529	0.357292	0.028424
Sum	1413.000	1669.000	1075.000	1047.000
Sum Sq. Dev.	2176.554	2602.215	534.1538	980.2462
Observations	65	65	65	65

Source: Author's computation, 2021 using Eviews 9

Table 4.3 shows the natural value of sustainability ranges from 9.000000 to 28.00000 with a mean of 21.73846 and a standard deviation of 5.831694. Corporate governance has a minimum of 13.00000 and a maximum of 32.00000 with a mean of 25.67692 and a standard deviation of 6.376489. Business collapse is averaged 16.53846 and ranges from 10.00000 to 20.00000 with a standard deviation of 2.888971. Finally, the natural value of agency cost ranges from 9.000000 to 20.00000 with a mean of 16.10769 and a standard deviation of 3.913610.

Test of Hypothesis one H_{01}

Research Hypothesis H_01: Corporate governance does not affect the sustainability ofbusiness organizations in Nigeria.

Variable	Model Coefficient	Std Error	t-stat.	Prob
C	-0.98	0.77	-1.27	0.20
CG	0.88	0.029	30.36	0.00
R^2	0.94			
Adj. R^2	0.94			
S.E of Reg.	1.49			
F-Statistic	921.83			

Prob. (F-Stat)	0.00
Post Estimation Tests	
Durbin-Watson	0.35

Table 4.4 Regression table Source: Researcher's Study, 2021

Table 4.4 shows that corporate governance (C.G.) has a significant positive coefficient onsustainability. The R-Square of 0.936029 implies that almost 94% variation in the dependent variable (sustainability) is accounted for by corporate governance. The remaining 6% is accounted for by other variables not captured in the model. The probability of the F-statistics of 0.000000 indicates the overall fitness of the model.

Also, the R-square and Adjusted R-square show that their model is stable as the figures are not significantly different. This result meansthat the estimation of the dynamic model is appropriate. From the equation:

SUS = -0.981146 + 0.884826 (CG) + e

Test of Hypothesis one H_{01}

Research Hypothesis H_02: Agency cost does not affect the collapse of businesses in Nigeria.

Variable	Model Coefficient	Std Error	t-stat.	Prob
C	-0.98	0.77	-1.27	0.20
CG	0.88	0.029	30.36	0.00
R^2	0.94			
Adj. R^2	0.94			
S.E of Reg.	1.49			
F-Statistic	921.83			
Prob. (F-Stat)	0.00			
Post Estimation Tests				
Durbin-Watson	0.35			

Table 4.5 Regression table Source: Researcher's Study, 2021

Table 4.5 shows that agency cost has a significant positive coefficient on business collapse. The R-Square of 0.797579 implies that almost 80% variation in the dependent variable (business failure) is accounted for by agency cost. The remaining 20% is accounted for by other variables not captured in the model. The probability of the F-statistics of 0.000000 indicates the overall fitness of the model. Also, the R-square and Adjusted R-square show that their model is stable as the figures are not significantly different. This result means that the estimation of the dynamic model is appropriate. From the equation:

BC = 5.919408 + 0.659254 (AC) + e

Discussion of Findings

The null hypothesis is now rejected based on the P-value of 0.0000, which is less than 0.05 significant level. The regression result indicates that agency cost

proxies have a significant effect on business failure in Nigeria. For instance, corporate governance has significant positive effects on sustainability in Nigeria, while agency cost has a positive and significant effect on the level ofbusiness failures in Nigeria.

According to the above significance, there is sufficient evidence to conclude that agency cost has contributed majorly to the collapse of businesses in Nigeria, and this is in line with the result of Songsong, Daquan, & Xiaofeng. (2016) established that increasing managers' salaries would increase agency costs and reduce the company's ability to develop sustainably. Although increasing liabilities can reduce agency costs, increasing liabilities will increase financial risks.

Conclusion

This study started with a brief introduction, statement of the problem, research questions, objectives, hypotheses, significance, and scope. It reviews the literature of past research works of other peoples and theories that are applicable and relevant to the study. The study adopted a survey research design.

An examination of agency cost and business failure. The data collected were analyzed using descriptive and regression. The hypotheses tested determines the acceptance or the rejection of the null hypotheses. The study concludes that agency costs are favourable and significant to drive business failure in Nigeria.

Recommendation

For corporate sustainability to be guaranteed, best practices in corporate governance should be inplace.

External auditors should not be too hasty in giving their opinion of the state of affairs of audited firms so as not to be liable for future collapse of the firms.

Regulatory bodies like ICAN and other professional bodies should work with the government to safeguard the further collapse of businesses in Nigeria and its environment.

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Appendix

Table 4.1 Demographics

DEMOGRAPHICS	OPTIONS	FREQUENCY	PERCENT
GENDER	*MALE*	*29*	*44.6*
	FEMALE	*36*	*55.4*
AGE	*BELOW 20 YEARS*	*8*	*12.3*
	20-29 YEARS	*8*	*12.3*
	30-39 YEARS	*27*	*41.5*

	40-49 YEARS	*17*	*26.2*
	50 YEARS AND ABOVE	*5*	*7.7*
ACADEMIC QUALIFICATION	*OND/DIPLOMA*	*12*	*18.5*
	HND/BSc	*21*	*32.3*
	MSc/MBA	*25*	*38.5*
	PhD	*7*	*10.8*
RELIGION	*CHRISTIANITY*	*43*	*66.2*
	ISLAM	*18*	*27.7*
	OTHERS	*4*	*6.2*
WORK EXPERIENCE	*1-5 YEARS*	*12*	*18.5*
	6-10 YEARS	*21*	*32.3*
	11-15 YEARS	*21*	*32.3*
	16-20 YEARS	*11*	*16.9*

Source: Author's computation, 2021

Table 4.2 ANALYSIS OF QUESTIONNAIRE

QUESTIONS	***SA (4)***	***A (3)***	***D (2)***	***SD (1)***	***Total***	***Mean***	***Standard deviation***	***Decision***
Majority of business collapse were due to poor management	28	21	7	9	65	3.0462	1.05224	Agree
Innovating items that are confusing or fail to add value led to major business collapse	33	28	0	4	65	3.3846	.78446	Agree
Lack of values lead to one of the biggest bankruptcies and business collapse in modern history	46	19	0	0	65	3.7077	.45836	Agree
Over-dependence on auditors opinion has contributed tobusiness collapse	21	19	3	22	65	2.6000	1.25996	Agree
Lack of transparent reporting on governance, risk management and corporate responsibility matters, especially qualitative aspects is a major determinant to business collapse	52	13	0	0	65	3.8000	.40311	Agree
Sustainability is a way to improve profits and wincustomer loyalty	29	19	12	5	65	3.1077	.97023	Agree
Ensuring appropriate actions and decisions at all levelsof the organization is a major determinant of sustainability	26	13	22	4	65	2.9385	.99808	Agree
A comprehensive sustainability strategy must have a solid framework that ensures its execution is consistentwith corporate governance and culture	24	14	17	10	65	2.8000	1.10680	Agree
Sustainability focuses on measuring and mitigating future forces that could affect a company's strategy, portfolio and operations	42	16	0	7	65	3.4308	.95147	Agree
Sustainability is measured in terms of costs, revenuesand reputation.	16	11	28	10	65	2.5077	1.03264	Agree

Sustainable development is development that meets theneeds of the present without compromising the ability of future generations to meet their own needs	43	22	0	0	65	3.6615	.47687	Agree
Successful innovative companies, cultivates creativeideas that add value	27	34	0	4	65	3.2923	.76492	Agree
Corporate governance has a direct bearing on businessperformance and thereby Return on Investment	11	16	38	0	65	2.5846	.76836	Agree
On average, businesses with superior governance practices generate 20 percent greater profits than other companies.	20	26	9	10	65	2.8615	1.02891	Agree
A good governance structure treats all stakeholders fairly	34	23	8	0	65	3.4000	.70267	Agree
Governance alone cannot ensure performance	46	0	19	0	65	3.4154	.91672	Agree
Governance is a luxury that can be afforded only by theperforming companies	31	13	15	6	65	3.0615	1.04398	Agree
Good governance allows decision making based on dataand reduces risk	40	15	10	0	65	3.4615	.75160	Agree
Good governance helps in creating a brand and creates comfort for all stakeholders and society	**56**	**0**	**9**	**0**	65	**3.7231**	**.69614**	Agree
Good governance leads to good performance	**39**	**7**	**10**	**9**	65	**3.1692**	**1.13975**	Agree
Core inefficiencies, dissatisfactions, and disruptions contribute to agency costs.	**29**	**20**	**16**	**0**	65	**3.2000**	**.81394**	Agree
Agency costs can occur when the interests of the executive management of a corporation conflict with its shareholders	**18**	**21**	**17**	**9**	65	**2.7385**	**1.01976**	Agree
Agency cost has contributed greatly to business failures	**33**	**26**	**6**	**0**	65	**3.4154**	**.65889**	Agree
Agency cost of debt is a problem arising from the conflict of interest created between shareholders and debt holders	**35**	**16**	**0**	**14**	65	**3.1077**	**1.18747**	Agree
Firm’s sustainability depends on agency cost and corporate governance	**42**	**23**	**0**	**0**	65	**3.6462**	**.48188**	Agree

Source: Author's computation, 2021