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Corporate Governance and Capital Structure of Listed Manufacturing Firms in Nigeria

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ABSTRACT*: The study examines the impact of corporate governance on capital structure of the quoted manufacturing firms in Nigeria. This study used secondary data methodology to obtained annual report and sample of 28 out of 68 listed manufacturing firms on the Nigeria stock exchange over a period of ten years 2013-2022. The findings revealed significant and positive relationship between corporate governance and financial leverage of listed manufacturing firms in Nigeria. Specifically, the board size coefficient is positive and statistically significant at the 0.01 level and shows a significant positive relationship between board size and financial leverage. The results further indicate a significantly positive relationship between CEO duality and leverage. The coefficient of dual in the model is positive (coef=0.402) and is significant (t=2.640) at the 0.01 level. However, board composition revealed a negative but significant relationship with financial leverage of the listed manufacturing firms in Nigeria. It is recommended that management of manufacturing companies in Nigeria should always display creativity that will ensure good corporate governance so as to significantly drive down the gearing level of their companies.*

KEY WORDS: Corporate Governance**,** Capital Structure**,** Manufacturing**,** Firms**,** Nigeria

INTRODUCTION

The concept of corporate governance is a broad term that tends to describe the manner in which right and responsibility are shared amongst shareholders, managers and other stakeholders of a given institution. The question of adjusting the capital structure of a company arising from the corporate governance characteristics has been in the front burner of many researchers some decades back. the is

the process and structure used to direct and manage the business and affairs of a company towards enhancing business prosperity and corporate accountability with the ultimate objective of maximizing long-term shareholder value. Corporate governance can further be described as the rules and practices that govern the relationship among the managers and shareholders of corporations, which contribute to the growth and financial stability by underpinning market confidence, financial market integrity and economic efficiency (OECD 2004).

Corporate governance is a philosophy and mechanism that entails processes and structure which facilitate the creation of shareholder value through management of the corporate affairs of the firm in such a way that ensures the protection of the individual and collective interest of all the stakeholders. It is generally associated with the existence of agency problem and its roots can be traced back to the separation of ownership and control concept of the firm. Agency problems arise as a result of the relationships between shareholders and managers and are based on conflicts of interest within the firm. Similarly conflict of interests between controlling shareholders and minority shareholders is also at the heart of the corporate governance literature. Good corporate governance practices usually have significant influence on the strategic decisions of a company, e.g. external financing, that are taken at board level. Therefore, it is a new consensus in the literature that corporate governance variables like size of board, composition of board, skill set at board and CEO/Chair duality may have direct impact on capital structure decisions (Pfeffer & Salancick, 1978; Berger 1997).

Capital structure is perceived as an important management decision as it greatly influences the owner's equity return, the owners' risks as well as the market value of the shares. Both theoretical and empirical capital structure literature have attempted to explain the determinants of capital structure. Hence, some broad categories of capital structure determinants have been documented in the literature.

Today capital structure has economic implication for policy intervention. At the macro level, they have implications for capital market development, interest rate and security price determination, and regulation. Decisions on these factors, affect capital structure, corporate governance and company development (Green, Kimuyu, Manos & Murinde, 2002). It is therefore mandatory for management of a company to determine an appropriate capital structure that will ensure their business continues as a going concern. Achieving a sustainable capital structure require good corporate governance to ensure effective and efficient financing decision.

In both the developed and developing economies corporate governance has become a global issue due to financial crisis that has taken centre stage in the globe. Most empirical research has focused on the impact of corporate governance on firms' performance (Brown & Caylor, 2006; Obafemi, Araoye & Ajayi 2021; Araoye & Olatunji, 2019). It was noticed from the extensive review of literature that only few researches were done for firms in developing market suggesting the failure of many authors in exploring the impact of corporate governance on capital structure unlike authors in developed nations (Abor & Biekpe, 2007; Uwuigbe, 2014). In Nigeria most studies on corporate governance and capital

structure focused on non-financial firms, food and beverages or all listed firms on the Nigeria stock exchange market (Damina, Muritala & Umar, 2022; Yinusa & Babalola, 2012; Ehikioya, Omankhanlen, Omodero & Isibor, 2021; Aminu & Muritala, 2018). Therefore, this study intends to fill the gap not covered in previous studies by specifically looking in the direction of manufacturing firms listed on the Nigeria stock exchange market.

Hence, the objective of this research is to determine the effect of corporate governance on capital structure of listed manufacturing companies in Nigeria using leverage as a proxy for capital structure.

LITERATURE REVIEW

Conceptual Review

Corporate governance and capital structure has succeeded in attracting a good deal of public interest because it is a tool for socio-economic development. Also when there is good corporate governance and capital structure, there will be proper and efficient practice in the administration of business entities. This will ultimately lead to reduction in the incidence of corporate failures, poor internal control system, poor corporate structure, indiscipline both on the part of management and workers. Poorly governed corporations do not only pose a risk to themselves, they do to others and could indeed pull down capital market. For instance, the poor governance of a systematically important firm would pose a threat to the economy. Irrespective of how sound macro-economic policies are, if entities are not well governed, the macro-economic objectives may not be attained.

Corporate governance is thus a philosophy and mechanism that entails processes and structure which facilitate the creation of shareholder value through management of the corporate affairs in such a way that ensures the protection of the individual and collective interest of all the stakeholders. Sound corporate governance principles are the foundation upon which the trust of investors and lenders is built. Good corporate governance practices may have significant influence on the strategic decisions of a company, e.g. external financing, that are taken at board level. Therefore, corporate governance variables like size of board, composition of board, skill set at board and CEO/Chair duality may have direct impact on capital structure decisions.

It is clear that capital structure is an important management decision as it greatly influences the owner's equity return, the owners' risks as well as the market value of the shares. In other words, how a firm is financed is very important not just to the managers of a firm but also to fund providers. This is because if a wrong mix of finance is employed, the performance and survival of the business enterprise may be seriously affected. However, firms financing decisions involve a wide range of policy issues which may be outside the direct control of a firm's management.

Theoretical Review

Financial Distress and Bankruptcy Costs Theory

According to this theory, financial distress is generated by the presence of debt in the capital structure which could lead to bankruptcy. It states that the larger the fixed interest charges created by the use of leverage, the greater the probability of decline in earnings and greater the probability of incurrence of costs of financial distress (Harris & Raviv, 1988). It is believed that there is an appropriate capital structure beyond which increases in bankruptcy costs are higher than the marginal tax-sheltering benefits associated with additional substitution of debt for equity.

The Pecking Order Theory (Asymmetric Information Model)

This model considers the possibility of asymmetric information whereby firm managers are assumed to know more about the characteristics of the firm's return stream or investment opportunities (Harris & Raviv, 1988). The choice of capital structure by management therefore signals to outside investors some insider information. This asymmetry of information influences the choice between internal and external financing and between new issues of debt and equity securities. This choice is based on the „pecking order" hypothesis (Baskin, 1989). The pecking order theory of capital structure was first presented by Myers and Majluf (1984), and relied heavily on information cost to explain corporate behaviour.

Agency Costs (Free Cashflow) Theory

Under this model, an optimal capital structure can be obtained by trading off the agency cost of debt against the benefit of debt (Riahi-Belkaoni, 1999). Agency costs are costs due to conflicts of interest. Two types of conflicts are identified by Jensen and Meckling (1976): first is the conflicts between shareholders and managers arising from the situation of managers holding less than 100% of the residual claim and second is the conflict between debt holders and equity holders arising from the debt contract that make equity holders invest sub-optimally.

Empirical Analysis

Some researches has been previously conducted as regards the association and linkages that exist between the corporate governance and capital structure of firms in both the developed and developing economies with different result and implications. Javid, Nazir and Kanem (2021) investigate the effect of corporate governance on capital structure of non financial listed on the Pakistani stock exchange during the period 2004-2016. The study used pooled OLS to analyze the data obtained. The findings shows that there is a significant direct relationship between board size, board composition, CEO/Chair duality, managerial ownership and firms finance decisions

In Nigeria some of the work carried out in relation to corporate governance and capital structure of firms could be seen in the study of Ehikioya et al., (2021) that investigate the effect of corporate board characteristics on capital structure of firm listed on the Nigeria stock exchange from 2015-2019. The study applied OLS regression to evaluate the data of 93 selected firms obtained during the period. The

findings discovered positive connection between board size, CEO/Chair duality and capital structure of the listed firms on the Nigeria stock exchange during the period under study.

Forsberg (2004) finds that firms with separate chairman and CEO employ the optimal amount of debt in their capital structures. He discovers that firms with separate CEO and chairman generally have higher financial leverage. Given that board of directors is the seat of premier level of decision control mechanism in the corporate structure, it must not be controlled by CEO. Presence of CEO/Chair duality signals the absence of separation of decision management and decision control and it may ultimately leads to agency problems.

Short, Keasey and Duxbury (2002) examine the influence of ownership structure on the financial structure of UK firms. Results reveal that there exist positive relationship between management ownership and leverage ratio whereas negative relationship is observed between large external equity holder's ownership and financial leverage. However, relationship between management ownership and leverage ratio is not significant in the presence of a large outside equity holders. These findings suggest that outside equity holders affect the agency costs of equity financing and debt financing. Furthermore, the study of Uwuigbe (2014) in examining the relationship that exist between corporate governance variables and capital structure decisions of listed firms in Nigeria using OLS regression data analysis method, noticed that corporate governance attributes of board size, board composition and managerial ownership are negatively connected with the capital structure of the listed firms.

Okiro, Aduda and Omoro, (2015) establish the effect of corporate governance and capital structure on performance of firms listed at the East African community securities exchange. A census survey was carried out on all the 98 listed companies between 2009 and 2013 in Nairobi Securities Exchange, Uganda Securities Exchange Dar es Salaam Stock Exchange and Rwanda Stock Exchange. The result of study revealed a positive but significant relationship between corporate governance and firm performance.

The board of directors is the highest body of a company that is responsible for managing the firm and its operation. Abor and Biekpe, (2007) examine the relationship between corporate governance and capital structure decisions of Ghanaian Small and Medium Enterprises by using multivariate regression analysis. The results provide evidence about negative relationship between board size and leverage ratios and SMEs with larger boards generally have low level of gearing. On the other hand, Wen, (2002) finds positive relationship between board size and capital structure. He argues that large boards follow a policy of higher levels of gearing to enhance firm value especially when these are entrenched due to greater monitoring by regulatory authorities. It is also argued that larger board may find difficulty in arriving at a consensus in decision which can ultimately affect the quality of corporate governance and will translate into higher financial leverage levels.

Damina et al., (2022) through a qualitative technique, examine the impact of corporate governance on the capital structure of non-financial firms in developing countries from 2011 to 2022. The study reviewed thematically evidence from 50 previous studies that examined the effect of board size on leverage and discovered mixed result with conclusion that adopting a single theory is insufficient to explain the rationale of the relationships between corporate governance and capital structure.

Javaid et al., (2021) investigates the relationship that exist between corporate governance and capital structure by analyzing the mediating role of cost of capital in the non-financial firms listed on the Pakistan Stock Exchange (PSX) for the period of 2004–2016. The study applied three approaches of panel data analysis of Pooled OLS, fixed and random effect panel regression and Hausman test to determine the relationship between corporate governance and capital structure of non financial firms in Pakistan. The findings discovered significant relationship between corporate governance variables and financing decision of the listed non financial firms in Pakistan,

Hromei, (2021) examine the effect of corporate governance of listed firms Italy France and Germany over the period of 2010 to 2019 using financial and non financial data of the listed firms in these countries. The result revealed positive relationship between the corporate governance variables (board size and CEO duality) and debt financing decision of the firms.

The relationship between presence of non-executive directors and capital structure has been explored by few researchers but evidence in this regard is mixed.

METHODOLOGY

Area of Study

This study examined the effect of corporate governance on capital structure of manufacturing companies listed on the Nigerian stock Exchange (NSE).The study adopted a descriptive research method. The target population for the research is all manufacturing firms listed on Nigeria stock market. There were about 68 manufacturing firms listed on the Nigeria capital market as at 31st December 2022 with sample of 28 firms.

The study used Secondary data. Data on components of corporate governance and capital structure were sourced from the annual reports of the selected companies, Nigerian Stock Exchange (NSE) websites and relevant Nigerian Stock Exchange publication. The study utilized a panel data analysis of 28 sampled firms listed on the Nigeria stock exchange market over the 10 years period from year 2013-2022. A hierarchical regression analysis was used to test the hypotheses and the data were analyzed using the multiple regression estimation techniques.

Model Specifications

This study employs multiple regression analysis in a panel data framework to measure the dependence of capital structure on corporate governance variables. This model is consistent with some previous similar works (Abor, 2007; Olatunji & Araoye, 2019).

The general form of model is:

$LEV = f(Bz, Dua, Bcomp, age, Size, roa)$ ..... *(i)*

$LEV = \alpha + \boldsymbol{\beta_1} lBz_{it} + \beta_2 Dua_{it} + \beta_3 Bcomp_{it} + \beta_4 age_{it} + \beta_5 Size_{it} + \beta_6 roa_{it} + \varepsilon_{it}$ ..... *(ii)*

Where:

Bz = board size,

Dua_i = CEO duality;

$Bcomp$ = board composition,

age_i = age of firms,

$Size$ = size of assets

roa_{it} = return on assets

α = Intercept

ε_{it} = Error term

$\boldsymbol{\beta_1}$.....$\boldsymbol{\beta_6}$ = coefficients of independent variables Measurement of Variables

The selection of variables was primarily guided by the result of previous empirical studies such as Berger, (1997) and Wen, (2002). The study measured capital structure using leverage and this is consistent with the literature as most studies used leverage to proxy capital structure. This study measured firms' capital structure and corporate governance variables as follows:

Leverage = Ratio of total debt to total assets.,

lBz_{it} = number of board members,

Dua_{it} = 1 if the CEO is also chairman of the board, 0 otherwise.

$Bcomp_{it}$ = percentage of outside directors of board,

$lage_{it}$ = number of years in business,

$Size_{it}$ = log of total assets

roa_{it} = income before tax and interest to total assets,

RESULT AND INTERPRETATION

Descriptive Analysis

Table 4.1 Descriptive Analysis of Variable

Descriptive analysis Variable	Minimum	maximum	mean	Median	Std deviation	skewness	Kurtosis
Lev	0.00	7.86	.32	0.12	0.63	6.94	73.12
% *Bcomp*	00	1.00	.64	0.68	0.21	-0.57	2.97

logB-size	0.60	0.78	.71	0.69	0.06	-0.439177	2.59
Dual	00	1.0	.93	1.00	0.25	-3.44	12.81
Size	7.55	11.52	9.4	9.37	0.75	0.08	2.76
Age$_i$	.00	1.71	1.34	1.45	0.28	-1.83	7.19
ROA	-6.05	3.40	0.22	0.14	0.65	-1.25	40.54

Source: Authors Computation (2023)

Table 4.1 shows that corporate governance variables board size has a mean of 71% which shows that most firms has a mean of 11directors and most firms (93%) have the CEO doubling up as director. The mean figure for non executive (outside) is 64% with a median of 40%. This reveals that most public listed companies in Nigeria have already been compliant with the Nigerian rule of corporate governance that states that 30% or more of the board size must be Non executive directors.

A Test of Relationship between Corporate Governance and Capital Structure

Correlation Analysis

Table 4.2 Correlation Matrix of the Main Variable

Correlation							
t-Statistic							
Probability	AGE	lev	lbod	dual	outdir	lnas	ROA
AGE	1.000000						

LEV	0.008440	1.000000					
	0.234349	-----					
	0.8148	-----					
Lbod		0.062747	1.000000				
		4.247719	----				
		0.1813	------				
Dual	0.052698	0.062747	0.261848	1.000000			
	1.465302	3.745719	7.533566	-----			
	0.1432	0.0813	0.0000	-----			
Outdir	-0.047268	-0.044500	0.141848	0.015890	1.000000		
	-1.313957	-3.236844	4.042566	0.441259	-----		
	0.1893	0.0065	0.0000	0.6591	-----		
Lnas	-0.023896	0.051942	0.24378	-0.060862	0.949563	1.000000	
	-0.663708	1.444209	3.26751	-1.693075	84.08299	-----	
	0.5071	0.1491	0.0000	0.0908	0.0000	-----	
ROA	-0.057591	0.000784	0.35421	0.125170	0.090298	0.047904	1.000000
	-1.601777	0.021769	1.92756	3.503134	2.517573	1.331685	-----
	0.1096	0.9826	0.0000	0.0005	0.0120	0.1834	-----

Source: ***Author's computation (2023)***

The study follows the approach used in similar studies (Gompers, Ishii, & Metrick, 2003; Klapper & Love, 2004) to try and disentangle the corporate governance effect on capital structure measured by controlling for various firm characteristics likely to be associated with capital structure. Table 4.2 shows pair-wise correlation between the corporate governance components, capital structure and firms' characteristics for the cross-section of 28 firms in the sample across ten (10) years. The sample size varies from 278 to 280 observations due to missing values for some variables. The correlation results show individual relationship among different variables. All the variables are positively correlated with capital structure except the ratio of non executive director (outdr) which shows that if there would be one unit change in the ratio then the capital structure would be adversely affected by 3%. The rest of the variables are positively related with capital structure. It means that if the variable increases/decreases then capital structure would also increase/decrease in same direction.

Regression Results

Relationship between Corporate Governance and Financial Leverage

Table 4.3: Corporate Governance Score Regression on Leverage

	OLS	**Fixed effects**	**Random effects**	***F-statistic***	***4.807402***
	Lev	***Lev***	***Lev***	***Prob(F-statistic)***	***0.000000***
Constant	**15.926 (7.043)**	**2.903 (2.936) ****	**11.138 (6.597)***	***Durbin-Watson stat***	***1.478211***
Lbod	**0.206 (2.120)****	**0.550 (4.939)***	**0.208 (2.779)****		
Dual$_i$	**3.710 (-2.306)***	**0.402 (2.640)***	**-1.220 (-2.127)***		
Outdir	**-2.082 (-1.988) ***	**-0.495 (-2.143)***	**-1.511 (-2.167)****		
Age$_i$	**0.026 (-0.688)**	**-0.361 -(0.907)**	**-0.004 (-0.027)**		
ROA	**-0.388 (-3.754)**	**-0.127 - (2.230)****	**- 0.400 (-3.918)****		
Size	**0.206 (2.120)***	**0.343 (2.769) ***	**1.220 (2.127)***		
Obs no	**280**	**280**	**280**		
Adj R^2	**0.24**	**0.32**	**0.30**		

Source: Author's computation (2023)- Eview 7.1

Note: *, **.and *** indicate significance at 1%, 5%, and 10% levels

Table 4.3 indicates that capital structures measured by leverage are related to the corporate governance measures, that is the board size, CEO duality and board composition. A unit increase in board size results in positive increase in leverage (0.206, 0.550, 0.208) while a unit increase in board composition leads

to decrease in financial leverage (-2.082, -0.495, -1.511) with Pool OLS, fixed effect and random effect respectively. Pool OLS, fixed effect and random effect models indicate that corporate governance measures have significant effect at 1% and 5%.level- both positive on firm capital structure. Though, the co-efficient of corporate governance are weak, many of the control variables are significant also in predicting leverage (significant at p = 0.01, 0.05).

The result shows that there is a significant association between board size (measured by log of number of board members) and capital structure. The board size coefficient is positive and statistically significant at the 0.01 level which indicates a significant positive relationship between board size and financial leverage. This result is consistent with earlier studies (Rajendran, 2012;, Wen, 2002; Noriza, 2010). Board size has positive relationship with leverage suggesting that large board size adopts high leverage policy. This result shows a positive and statistically significant (t = 4.939) relationship between board size and financial leverage. The finding suggests that large boards, which are more entrenched due to superior monitoring by theses bodies, pursue higher leverage to raise company value.

Furthermore, the results indicate a significantly positive relationship between CEO duality and leverage. The coefficient of dual in the model is positive (0.402) and is significant (2.640) at the 0.01 level. This result is not surprising because, most manufacturing firms (93%) on the NSE has the CEO as the director and this concentrates decision making authority on an individual leading to high financial leverage policy for firms on NSE. The result suggests that the number of non executive director on the board has a negative estimated association with leverage in three estimations and it is significant. This result is consistent with the hypothesis that outside directors tend to monitor managers more actively, causing these managers to adopt lower leverage for getting good performance results.

The firm size (measured by log of asset) is positive, suggesting that larger firms have higher leverage relative to their assets. The results offer strong support that larger listed firms have a greater capacity for debt and gearing. The positive relationship between size and leverage is understandable in the context of the Nigerian economy because firms' greater diversification reduces their exposure to bankruptcy risk. This result is consistent with empirical studies in developed economies which have found leverage to be positively related to company size (Rajan & Zingales, 1995).The firm's size results are statistically significant at the 1% in every regression. The co-efficient in each regression are positive and significant at 1% level. Surprisingly, the study finds that age is insignificantly related to leverage (and even negative in some cases). In the regressions, the profitability instrument that is applied is EBIT return on assets (E_ROA). A negative and significant relationship is found between leverage and profitability. This is in line with a number of empirical studies including the study conducted by Okiro, et al., (2015). The overall result as measured by adjusted R^2 which indicates the impact of the independent variable on the dependent variable by which the independent variable explain over 32% of the variance in the capital structure of firms in all the regressions show the fitness of the model.

CONCLUSION

This study has followed the approach used in the literature and empirically analyzed the effects of corporate governance measures on capital structure of firms. A firm financing decision is one of the most fundamental issues managers have to face. According to new theories of capital structure, such decisions can be affected by various factors, among which corporate governance is one. The assumption of the empirical work is that the contribution of good corporate governance practices in Nigeria is positive and this was tested by looking at the relationship between some component of corporate governance and capital structure measured as financial leverage. Hypotheses were used to examine the relationship between corporate governance practices and firms' capital structure. The study investigates the impact of corporate governance on capital structure of Nigerian manufacturing firms and found significant and positive relationship between corporate governance and financial leverage of listed manufacturing firms in Nigeria. The implication of these findings indicate that the management artistry displayed by the board will significantly drive down the gearing position of the manufacturing sector while the more number of board size base, the higher the gearing position.

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