CORPORATE GOVERNANCE ATTRIBUTES AND CAPITAL STRUCTURE OF LISTED FIRMS IN THE NIGERIAN FOOD AND BEVERAGES INDUSTRY

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Abstract

This paper assesses the impact of corporate governance attributes on capital structure of listed firms in the Nigerian food and beverages industry from 2003 to 2012. The study uses leverage (LEV) as dependent variable while board size (BSZ), board composition (BCO), managerial shareholding (MSH), tangibility of assets (TAN) and growth (GRW) are the explanatory variables. Nine firms that had been quoted before the year of the study (2003) are considered in this paper. The sample size of the study is derived using sample selection formula, from the calculation six out of nine firms emerged as the sample size after giving all the firms the equal chance of being picked through random sampling technique. The data generated from annual reports of the sample firms are analyzed using Pearson correlation coefficient and multivariate regression analysis. The results reveal that tangibility of assets and growth have positive relationship with leverage while board size, board composition and managerial shareholding have negative relationship with leverage. Similarly, the researcher recommends that firms should embrace a well established corporate governance structures that will assist them to gain easier access to credit at lower cost.

Key words: Corporate governance attributes and capital structure.

1.0   Introduction

Corporate governance has received greater attention both in practice and in academic research (Blue Ribbon Committee, 1999; Bebchuk and Cohen, 2004). This emphasis is due, in part, to the prevalence of highly publicized and flagrant financial reporting frauds such as the one that happened in Enron, WorldCom, Aldelphia, and Parmalat (Larcker & Richardson, 2004). Corporate governance entails the processes and structures by which the corporation and its affairs are directed and managed, in order to improve long term shareholders' value by enhancing corporate performance and accountability, while taking into account the interest of other stakeholders (Jenkinson and Mayer, 1992). Capital structure, on the other hand, refers to the different options used by a firm in financing its assets (Bhaduri, 2002).

Prior research suggests that there are two important aspects of the interaction between governance and leverage. Firstly, corporate leverage can act as a self-disciplining internal governance mechanism to mitigate the costs of the manager–shareholder agency conflict (Jensen and Meckling, 1976; Jensen, 1986). Secondly, better governance is associated with lower costs of debt financing (Cremers, Nair and Wei, 2004; Klock, Mansi and Maxwell, 2005) and, therefore, plays an important role in determining a firm's choice of capital structure.

In developing economies like Nigeria, improvement of corporate governance mechanism is essential because better governance structure provides better financial standing and status. Hence, it also helps companies in obtaining higher rating from rating agencies that allow easy generation of funds.

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Consequently, firms with strong corporate governance are expected to have easier access to capital markets and, in general, are subject to lower expected agency costs of debt, and can thus afford greater leverage.

A number of studies on the impact of ownership structure and corporate governance on capital structure are well documented in Accounting, Finance and Management literature (Arshad and Safdar, 2009; Ahmad, Ahmad and Hamze, 2012; Albert and Appiah, 2014). This study is different as it aims at assessing the impact of corporate governance attributes on capital structure in the Nigerian foods and beverages industry from 2003 to 2012. The paper is divided into five sections, covering introduction, literature review, methodology, results and discussions, conclusion and recommendation.

2.0   The Concept of Corporate Governance and Capital Structure

Scholars from different part of the world have different perspectives of what corporate governance is or should be. Shleifer and Vishny (1997) define corporate governance as referring to the way in which suppliers of finance assure themselves a return on their investment. Also, Abdullah and Valentine (2009) and Mulbert (2010) see corporate governance as being concerned with the intrinsic nature, purpose, integrity and identity of the institution with a primary focus on the entity's relevance continuity and judiciary aspect.

Besides, capital structure decision is the vital one since the profitability of an enterprise is directly affected by such decision. The successful selection and use of capital is one of the key elements of the firms' financial strategy (Vehnampy & Aloy-Niresh, 2012). Suitable capital structure is not only imperative for maximization of interest of every stakeholder of an organization, but is also crucial for the organization to compete effectively and efficiently in its operating environment (Simerly & Li, 1999). Fallacious choice of capital structure would not only lead to its financial distress, but also ultimately drag the organization into insolvency (Eriotis et al 2007). Therefore, capital structure refers to the different options used by a firm in financing its assets (Bhaduri, 2002).

2.1   Regulatory Framework of Corporate Governance

The regulatory framework of corporate governance is a global phenomenon. Researches show that while there are universal codes for regulating the practice of corporate governance, there exist other national codes based on local needs and the unique characteristics of each country. Importantly, regardless whether it is global or national, the regulatory framework of corporate governance can be viewed from two broad perspectives viz: voluntary and mandatory. Stressing this point, Wilson (2006) observes: In Nigeria, as in most developed countries, observance of the principles of corporate governance has been secured through a combination of voluntary and mandatory mechanisms. In 2003, the Atedo Peterside Committee set up by the Security and Exchange Commission (SEC), developed a Code of Best Practice of Public Companies in Nigeria. The code is voluntary and is designed to entrench good business practices and standards for boards of director, auditors, CEOs etc of listed companies. He goes further to say that: Mandatory corporate governance provisions relating to banks and other firms are contained in the Companies and Allied Matters Acts (CAMA) 1990, the Banks and other Institutions Acts (BOFIA) 1991, the Investment and Securities Acts (ISA) 1999 and the Security and Exchange Commission Acts (SECA).

Globally however, there are three identified codes of corporate governance that are often cited and explicitly referred to in the development of national codes for corporate governance. These are: Principles of Corporate Governance (1999) by the Organization for Economic Cooperative and Development (OECD), Principles of Corporate Governance by the Commonwealth Association for Corporate Governance (CACG) and either the first or second King Report on Corporate Governance for South Africa by Institute of Directors of South Africa (Rossouw 2005).

Drawing from the trio of OECD, CACG and IoD's Codes, a number of countries in Africa have developed and published their national codes for the practice of good corporate governance. Rossouw (2005) highlights the countries as follow: Ghana: (Manual on Corporate Governance in Ghana 2000), Kenya: (Private Sector Corporate Governance Trust 1999), Malawi: (Corporate governance Task Force 2001), Mauritius: (Report on Corporate Governance in Mauritius 2003), Nigeria: (Code of Corporate Governance in Nigeria 2003), South Africa: (Institute of Directors of South Africa, IoD, 1994, 2004), Tanzania: (Steering Committee on Corporate Governance in Tanzania, 2000).

With special preference to Nigeria, all the existing codes and laws which entrust the Corporate Affairs Commission (CAC), Security and Exchange Commission (SEC) and Central Bank of Nigeria (CBN) with the responsibility of regulating corporate governance reflect some of the key elements OECD and other global codes.

2.2 Corporate Governance Attributes and Capital Structure

Corporate governance attributes of firms are the principal determinants of capital structure. Firm's factors such as board size, board composition, CEO/Chair Duality and managerial shareholding may have significant impact on capital structure.

2.2.1 Board Size and Capital Structure

The Board of Directors is an apex body of a company that is accountable for managing the firm and its operation. It plays a vital role in strategic decisions regarding financial mix. Pfeffer and Salancick (1978) suggest a significant relationship between capital structure and board size. The evidence regarding direction of relationship between board size and capital structure is mixed. Berger et al (1997), state that firms with larger board of directors generally have low gearing levels. Also, they found that larger boards exert pressure on managers to follow lower gearing levels and enhance firm performance. Abor and Biekpe (2008) investigate the relationship between corporate governance and capital structure decisions of Ghanaian Small and Medium Enterprises by using multivariate regression analysis. The results provide negative relationship between board size and leverage ratios and SMEs with larger boards generally have low level of gearing. On the other hand, Wen, Rwegasira and Bilderbeek (2002) found positive relationship between board size and capital structure. They stated 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 suggested that larger board may find difficulty in arriving at a consensus in decision which can ultimately affect the quality of corporate governance and translate into higher financial leverage levels. Jensen (1986) suggests that companies with high gearing level rather have larger boards. Hence, Anderson, Mansi and Reeb (2004) stated that the cost of debt is generally lower for larger boards because lenders think that these companies are being monitored more effectively by a diversified portfolio of experts. So debt financing becomes a cost effective choice.

2.2.2 Board Composition and Capital Structure

The board could consist of three types of directors, namely, insiders, outsiders and affiliated directors. The directors represent various stakeholders. Insiders are employees of the firm, who could be managers themselves, or employees naturally in the control of managers. Insiders usually have more information and incentives to dampen monitoring efficiency (Dechow, Sloan, & Sweeney, 1996). Insiders are in the key role of giving special resources and advice to the management (Agrawal & Knoeber, 1996). Although outsiders have no direct relationship with the firm, they are in the key role of monitoring (Dechow et al, 1996), and they are assumed to represent the shareholders, especially large shareholders (Harris & Raviv, 2008). The affiliated directors represent other stakeholders who could be suppliers, distributors, audit firms or labour unions. Affiliated directors are believed to be less interested in monitoring and to a certain extent

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are in the rapport of managers. Powerful management is able to influence the board composition. Literature has shown many evidences that managers could bring in affiliated directors, increase the insider directors numbers, or reduce the number of outside directors (Shivdasani, 1993). Jensen (1986) and Berger et al, (1997) indicate that companies with higher gearing levels rather have relatively more non executive directors whereas companies with lower representation of non executive directors experience lower leverage.

2.2.3   CEO/Chair Duality and Capital Structure

Another important criterion of the board is the separation of the role of the CEO and the role of the chairperson of the board. Statistics shows that majority of U.S. companies have the same person who performs the role of CEO and the role of the chairperson of the board (Brickley, Coles and Jarrell, 1997; Cornett, McNutt and Tehranian, 2009). If a CEO also acts as the chairman, the power of the CEO increases, and consequently, the CEO influences the other board members and controls the board. This situation has direct impact on the financing decision of the company.

In addition, Fama and Jesen (1983) opine that firm decision management and decision control functions should be separated. Decision management function encompasses the right to initiate and execute new proposals for the disbursement of the firm's resources while decision control function comprises of the right to approve and monitor those proposals. This separation is ensured through a set of internal checks and internal controls. This system facilitates the judicious utilization of a firm's resources. Therefore, the same system should be implemented at the premier level. However, the role of chief decision management authority (CEO) should also be separated from role of chief decision control authority (chairman). Presence of CEO/Chair duality signals the absence of separation of decision management and decision control and it ultimately leads to agency problems.

Further, Fosberg (2004) suggests that firms with separate chairman and CEO employ the optimal amount of debt in their capital structures. Also, he opines that firms with separate CEO and chairman generally have higher financial leverage. However it is worth mentioning that this relationship is statistically insignificant. Abor and Biekpe (2008) also show evidence about the presence of positive relationship between gearing levels and CEO duality.

3.0   Methodology

The study uses ex-post facto research design and documentary data are extracted from the Annual Reports and Accounts of the sampled companies from the fact books published by the Nigerian Stock Exchange. The population of the study comprises of all the fourteen (14) firms in the Nigerian foods and beverages industry that are quoted in the Nigerian Stock Exchange. The firms are listed on table 3.1.

Table 3.1: Population of the Study

S/N	Firms	Year of Listing
1	Seven-up Bottling Company PLC	1986
2	Cadbury Nigeria PLC	1976
3	Flourmills of Nigeria PLC	1979
4	Northern Nigeria Flourmills PLC	1978
5	Nestle Nigeria PLC	1979
6	Big Treat PLC	2007
7	Dangote Flourmills PLC	2008
8	Dangote Sugar Refinery PLC	2007
9	Honeywell Flourmills PLC	2009

10	Multi-trex Integrated Foods PLC	2010
11	National Salt Company Nigeria PLC	1992
12	P.S Mandrides and Company PLC	1979
13	Union Dicon Salt PLC	1993
14	UTC Nigeria PLC	1972

Source: Generated from the Fact Book of the Nigerian Stock Exchange, 2011/2012

Table 3.1 shows the firms that are within the scope of the study. Hence, the firms that had been quoted before the year of study (2003) are considered. This is because the researcher could only have access to the data for the stated period. The firms that emerged are nine firms namely Seven up Bottling Company PLC, Cadbury Nigeria PLC, Flourmills of Nigeria PLC, Northern Nigeria Flourmills PLC, Nestle Nigeria PLC, UTC Nigeria PLC, P.S Mandrides and Company PLC, National Salt Company Nigeria PLC and Union Dicon Salt PLC.

3.1   Sample Size and Sampling Technique of the Study

The sample size of the study is derived using the sample selection formula used by (Collins and Schultz, 1995 and Barde, 2009).

$$n = \frac{N}{1 + Ne^2}$$

Where:

N = the population size

n = the sample size

e = the marginal error at 25%

By substitution, the sample of the study will be determined as follows:

N = 9 and e = 25%

$n = 9/1 + 9(0.25)^2$

$n = 9/1 + 9(0.0625)$

$n = 9/1 + 0.5625$

$n = 9/1.5625$

$n = 5.76$ (that is, approximated to 6).

From the above result, the sample of the study is six (6) out of nine firms quoted in the Nigerian foods and beverages industry. Therefore, in employing random sampling technique, the researcher picked the following firms in table 3.2 as sample size of the study

Table 3.2 The Sample Size of the Study

S/N	Firms
1	Seven Up Bottling Company PLC
2	Cadbury Nigeria PLC
3	Flourmills of Nigeria PLC
4	Northern Nigeria Flourmills PLC
5	UTC Nigeria PLC
6	National Salt Company Nigeria PLC

Source: Generated by the author from table 3.1

Table 3.2 shows the six (6) firms that emerged as the sample of the study, using random sampling technique.

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3.2   Model Specification

The model below expresses the relationship between capital structure and corporate governance attributes.
$$LEV = \beta_0 + \beta_1 BSZ + \beta_2 BCO + \beta_3 MSH + \beta_4 TAN + \beta_5 GRW + \varepsilon.$$

3.3   Variables and their Measurements

Below is the presentation of dependent variable, independent variables and their measurements:
Dependent Variable
LEV: Leverage is quantified by using total debt to equity ratio.
Independent Variables
BSZ: Board size is total number of board of directors.
BCO: Board composition is calculated as the number of non-executive directors divided by total number of directors.
MSH: Managerial shareholding is measured as percentage of shares held by members of board disclosed in annual financial reports.
TAN: Tangibility of assets is measured as fixed assets divided by net total assets.
GRW: Growth is measured as change in total asset divided by net total asset.

4.0   Statistical Results and Discussion

This section presents the results of the analysis performed on the data collected. The analysis was carried out using Statistical Package for Social Sciences (SPSS 20 Version)

Table 4.1: Correlation Analysis of Leverage and Corporate Governance Attributes

	LEV	TAN	GRW	BSZ	BCO	MSH
LEV	1.000					
TAN	0.881	1.000				
GRW	-0.142	-0.375	1.000			
BSZ	-0.063	-0.070	0.314	1.000		
BCO	0.003	-0.066	0.382	0.447	1.000	
MSH	-0.121	-0.081	0.125	0.269	0.064	1.000

Source: Generated by the researcher from the Annual Reports and Accounts of the sampled companies, using SPSS (Version 20).

The result presented on Table 4.1 shows tangibility of assets is positively and significantly correlated at 1% significance level with leverage. This implies that an increase in the tangibility of assets of firms in Nigerian food and beverages industry will increase the rate of leverage by 88%. Therefore, the relationship between tangibility of assets with leverage is positive. On the other hand, board composition is positively and insignificantly correlated with leverage. However, growth, board size and managerial shareholding show insignificant correlation with leverage.

Based on the correlation result reported in Table 4.1, the Pearson correlation coefficient of tangibility of assets, growth, board size, board composition and managerial shareholding are 88%, -14%, -6%, 0.3% and -12% respectively. From this it can be deduced that only tangibility of assets has a strong association with leverage.

Below is the result of multivariate regression of leverage and independent variables (tangibility of assets, growth, board size, board composition and managerial shareholding) respectively.

Research Centre for Management and Social Studies (RCMSS)

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.908[a]	.825	.809	2.845559

a. Predictor: (Constant), Board Size, Board Composition, Managerial Shareholding, Tangibility of Assets and Growth
Source: Developed by the researcher using SPSS 20

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.417	2.277		1.501	.139
	Board Size	-.129	.147	-.059	-.874	.386
	Board Composition	.141	3.336	.003	.042	.966
	Managerial Shareholding	-.077	.080	-.058	-.970	.336
	Tangibility of Assets	.117	.008	.964	15.611	.000
	Growth	.062	.017	.245	3.618	.001

a. Dependent Variable: Leverage
Source: Generated by the researcher from the Annual Reports and Accounts of the sampled companies, using SPSS (Version 20).

Based on the regression result above, the intercept has the value of 3.417 indicating the average effect of all the explanatory variables on the leverage (dependent variable). The result shows that out of the entire independent variables in this study, tangibility of assets and growth are significant going by the 5% significance level that is adopted in the social science research, while other independent variables are insignificant. This implies that tangibility of assets and growth have a positive significant relationship with leverage.

The R-square (R^2) for the model is 82.5%, which means that 82.5% of the variation in leverage is explained by the independent variables used in this study while the remaining 17.5% of the change is as a result of other variables not addressed by this model. The R^2 results indicate the overall goodness-of-fit of the model. After modification, the explanatory power of the model adjusted R^2 value is 80.9%. This indicates that 80.9% of the variation of firms in the Nigerian food and beverages industry leverage is explained by the explanatory variables in the model. The model equation can be written as thus:
$LEV = 3.417 - 0.129\beta_1 + 0.141\beta_2 - 0.077\beta_3 + 0.117\beta_4 + 0.062\beta_5 + \varepsilon$.

5.1 Conclusion

The essence of this paper is to assess the impact of corporate governance attributes on capital structure of listed firms in the Nigerian food and beverages industry for the period of 2003 to 2012. Hence, the paper has empirically established that some key variable components such as tangibility of assets and growth have a positive significant relationship with capital structure (that is, leverage). In addition, board size, board composition and managerial shareholding have a negative relationship with leverage.

5.2 Recommendations

Good corporate governance system when adopted by companies can assist in infusing better management practices, effective control, good accounting system, stringent monitoring, effective regulatory mechanism and efficient utilization of firms' resources resulting in better performance. Also, firms should embrace a well established corporate governance structures that will assist them to gain easier access to credit at lower cost.

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