



## Corporate Governance, Capital Structure and Firm Value: An Empirical Evidence

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### Abstract

*The study examines the combined impact of corporate governance and the structure of corporate capital in creating organizational value. Corporate governance mechanisms such as foreign ownership, women on board and the size of the board together with the debt capital as a measure of capital structure on market value added (MVA). The combined effect of corporate governance and capital structure presupposes the optimization of both concepts to enhance firm value. Hence, to create external value for corporate firms, the composition of the structure of capital in addition to corporate governance ultimately propel the market value of Nigerian manufacturing firms. The empirical result revealed the impact of foreign ownership, women on board and board size on the measure of firm value. Capital structure has no significant impact on firm value. The satisfaction of stakeholders is derivable from the external value created by the firm for owners and other relevant stakeholders. The underpinning theories of the study in this paper highlighted the stakeholder's theory and trade-off theory.*

Keywords, Corporate Governance, Capital Structure, Stakeholder's Theory, Trade-Off Theory, Firm Value.

### 1.0 INTRODUCTION

The need to protect the interest of corporate stakeholders requires the institutionalization of good corporate governance practices within the administration framework of Nigerian manufacturing firms in order to enhance corporate value. The mechanisms of corporate governance entrenched the principles of fairness, accountability, responsibility, and transparency in the management and control of corporate entities (Van Horne and Machowicz, 2005). Through corporate governance practices, the right and the obligations of stakeholders like shareholders, debt holders, directors, management staff and employees are spelled out and guaranteed in order to enhance the market value of firms. The rules and regulations guiding the operations of corporate entities are captured under the fundamental structure which ensures the attainment of corporate goals and objectives as accentuated under corporate governance practices. The fundamental structure in corporate governance defines the process for sourcing financial capital needed to enhance the

economic and market value of corporate firms (Bayrakdaroglu, Ersoy and Citak, 2012).

Fundamentally, there are different sources of fund available to a corporate organization to finance their business activities. This different sourcing of funding available to corporate bodies comprises of short term debt, long term debt, retained earnings and equity capital (Akingunola, Olawale, and Olaniyan, 2018). Short term debt constitutes corporate liabilities that are likely to be discharged within an accounting year, they represent the short term liabilities that are current liabilities in nature. On the other hand, long term debt consists of all debt capital fund maturing for more than one year period. Retained earnings refer to undistributed profit reserved by the firms for self-financing. Equity as a source of capital represents the fund invested by owners of the firms into the firm.

The capital fund can be equity capital, debt capital or retained earnings are either provided by shareholders, bondholders or debenture holders in exchange for fair returns on their investment. Returns to capital providers come in form of dividend and interest which are determines from the value created by the firms and in the same vein, the benefits accruable to other stakeholders such as employees, host community and government agencies are determined through firm value. The enhancement of corporate valuation depends to a large extent on the optimum combination of the maximization of corporate governance and capital structure.

By definition, capital structure is the proportionate mixture of equity capital, debt capital and retained earnings to maximize corporate value. The optimization of the structure of capital minimizes the overall cost of capital which results in wealth maximization for the corporate body's value creation. According to Modigliani and Miller (1958), a strategical mixture of the composition of capital structures maximizes firm value. Additionally, firms requirement for business expansion necessitates additional injection of capital from different sources which require the optimization of the sources for maximum return on investment.



Empirically, the study on the impact of capital structure on the value of firms remained inconclusive (Mykhailo, 2013). For example, Adeyemi and Oboh (2011) established the existence of limited research in the areas of capital structure and firm value determination in Nigeria. According to Uwalomwa and Uadiale (2012) firm value is created from an optimum capital structure. This research work intends to explore the effect of corporate governance and capital structure on the corporate value in Nigerian manufacturing firms so that their impact on the value of Nigerian manufacturing firms can better be understood in a specific sector of the Nigerian economy.

Subsequent sections of the paper comprise of review of relevant literature, the underpinning theory and the methodology of the study. Lastly, the fifth section discusses the method of data analysis and the results and conclusions of the study.

## 2. 0 REVIEWS OF RELEVANT LITERATURE

In the previous literature, several variables are utilized to proxy corporate governance mechanisms in order to enhance the value of corporate entities. For instance, Bayrakdaroglu, et al., (2012) adopted managerial ownership, ownership concentration, foreign ownership, audit committees and board independence as measures of corporate governance with EVA, MVA, and CVA as measures of firm value. Tulung and Ramdani (2018) used board size and board independence as metric of corporate governance and return on assets (ROA), return on equity (ROE) and capital adequacy ratio (CAR) as a measure of firm performance. Similarly, Al-Dhamari, Ismail and Al-Gamrh (2016) used women on board as a measure of corporate governance mechanisms while Chen, Gramlich, and Houser (2017) utilized women on board as a proxy of board diversity a measure of corporate governance in relation to corporate risk strategies. However, a limited number of empirical studies that examined the relationship between corporate governance and market value added as a measure of firm value are available. This study intends to established and explain the changes expected in market value added by foreign ownership, board size and women on board as a measure of corporate governance.

Furthermore, Modigliani and Miller are in 1958 study the relationship between capital structure and the value of firms in their work titled “irrelevance theory of capital structure”. The study asserted the irrelevance of capital structure to the value of firms. However, this position was reverted in 1963 when the impact of taxation on firm value was

taken into consideration. The inclusion of debt capital as tax-shield assisted in establishing the impact of capital structure on the value of firms. Optimum capital structure enhances firm value due to cost minimization inherent in tax-shield benefit associated with debt capital (DeAngelo & Masulis 1980). There are many theories underpinning the relationship between corporate governance and capital structure with the value of the firm. The stakeholder’s theory and the Trade-off Theory of capital structure will be used for this study.

### 2.1 Stakeholder’s Theory

The stakeholder’s theory encapsulate the interest of relevant stakeholders in determining the value of a corporate entity. It is a theory that focuses on protecting the combined interest of both the shareholders, debt holders, management, host communities, and other non-investing stakeholders through ethical practices. According to Kusi, Gyeke-Dako, Agbloyor, and Darku (2018), an empirical study that examines the impact of corporate governance, capital structure and other ethical studies utilized stakeholder’s theory as the underpinning theory.

### 2.2 Trade-off Theory

This theory propounded that there exists a balance to be achieved by allowing more debt capital in the composition of capital structure which minimizes the overall cost of capital. Debt capital reduces the tax liability of a corporate entity while marginally the extra cost of debt related to the greater risks from financial distress (Akingunola, et al., 2018). According to the trade-off theory an optimum leverage firm is achieved where the marginal derivable benefits from additional debt financing equate the additional cost of debt marginally. Criticism of this theory was premised on the nonexistence of an optimal gearing level. In accordance with trade-off theory, an increase in the ratio of debt capital increases the interest tax shield of firms. However, an increase in debt capital-related costs offset the positive effect of debt ratio on firm value (Cuong and Canh, 2012). The aim of the study is to investigate the combined effect of corporate governance and capital structure in determining the market value added of Nigerian manufacturing firms.

### 2.3 Foreign Ownership

Several empirical studies documented the impact of foreign shareholding on the corporate value of business entities. Ciftci, Tatoglu, Wood, Demirbag, and Zaim (2019) found evidence that supports the influence of foreign ownership on firm value. Similarly, Aydin, Sayim, and Yalama (2007)



indicate that firms with foreign shareholding create better market value than domestically owned firms. The superiority of product differential, market strategy, governance, financial management and better economies of scale associated with foreign-owned firms supersede that of locally owned firms which makes them perform better (Barbosa & Louri, 2005). In order to generalize these empirical findings, further study is anticipated to be conducted which will enable a better understanding of the impact of foreign ownership on the value of Nigerian manufacturing firms. This study intends to provide empirical evidence to support the impact of foreign investors on the market value added of Nigerian manufacturing firms. Rathnayake, Kassi, Louembé, Sun, and Ding (2019) identified the importance of foreign ownership in determining firm value without providing an empirical finding. However, Uwuigbe and Olusanmi (2012) revealed the existence of a positive relationship between foreign ownership and firm value empirically in Nigeria. A study conducted by Xu, Zhu, and Lin (2005) attested to the positive impact of foreign ownership on the value of corporate entities. However, Tsegba and Ezi-Herbert (2011) and Malik (2015) failed to establish a positive relationship between foreign ownership and the value of firms in Nigeria and India respectively. These divergent findings necessitate further analysis in order to establish the empirical impact of Nigerian manufacturing firms on the market value added as measured of firm value. Hypothetical, foreign ownership serves as a determining factor in creating firm value.

*H1: There is a significant relationship between foreign ownership and the value of Nigerian manufacturing firms.*

## 2.4 Women on Board

Empirical evidence from extant literature affirmed to the impact of women on board of directors as a basic measure of corporate governance on the value of firms. Al-Dhamari et al., (2016) document the impact of women on board on dividend yield by establishing a positive relationship between women participation on the board and dividend pay-out. Similarly, Ararat, Aksu and Tansel Cetin (2010) evidently reinforced the positive impact of women on board on the performance of corporate entities. Luckerath-Rovers, (2013) investigate the influence of women on board on the performance of firms by using return on equity (ROE), return on sales (ROS) and return on invested capital (ROIC) as measures of performance. The outcomes indicate that women inclusion in the board composition accentuates the better performance of firms when

compared with firms with absent of women on their boards. Other studies such as Carter, Simkins, and Simpson (2003); Krishnan and Park (2005); Campbell and Minguez-Vera, (2008) and Cater, D'Souza, Simking, and Simpson, (2010) found statistical significant of women on board on the value of business entities. However, other studies indicate a negative relationship between women on board and the value of firms (Rose, 2007; Adams & Ferreira, 2009; Datmadi, 2011 and Ahern & Dittmar, 2012). The inconsistencies in the findings require further investigation of the relationship between women on board and the value of Nigerian manufacturing firms for better generalization. It is on this basis that this study formulates the hypothesis of the study as follows;

*H2: There is a significant relationship between women on board and the value of Nigerian manufacturing firms.*

## 2.5 Board Size

Several studies on the relationship between board size and the value of firms provided divergent results. For instance, the study conducted by Tulung and Ramdani (2018) examined the empirical relationship between the size of the board and the performance of a regional development bank in Indonesia. The result of the study revealed a positive significant relationship between board size and firm performance. Similarly, the result of the study carried out by Isik and Ince (2016) indicates that firm performance is positively associated with the board size. Furthermore, Mollah, Al Farooque, and Karim (2012) upheld the existence of a positive relationship between the size of the board and firm value (Qureshi, Rasli and Zaman, 2014). Uadiale (2010) established a robust positive relationship between financial performance and the size of the board. The study suggests that the greater the number of board members the higher the value of corporate firms. According to, Goodstein, Gautam, and Boeker (1994), large board structure entrenched the diversity needed for safeguarding critical organizational assets. The study of Kyereboah-Coleman, Adjasi, and Abor (2006) revealed the significant relationship between board size and the performance of firms. However, Yermack (1996) believed that communication, coordination and making a decision is hampered with an increasing number of members on the board which obstructed the value of the firm. Several studies conducted by Mak and Kusnadi (2005), Mollah (2007), Ujunwa (2012) and Kumar and Singh (2013) evidenced the negativity of the relationship between the size of the board and the financial performance of a



corporate firm. These mixed and inconclusive results necessitated the need for further empirical investigations in order to establish the relationship between board size and the corporate value of Nigerian manufacturing firms as measured by market value added (MVA). The study, therefore, formulated the subsequent hypothesis;

**H3:** *There is a significant relationship between board size and the value of Nigerian manufacturing firms.*

### 2.6 Capital Structure

This study intends to investigate the relationship between the market value added and debt capital as a measure of capital structure in Nigerian manufacturing firms in the proposed framework of the study. The basic motive of the study is to test the combined effect of incorporating corporate governance mechanisms and capital structure in an attempt to establish their empirical effect on the value of Nigerian manufacturing firms. Several studies investigated the relationship between capital structure and the value of the firm with mixed findings. The study conducted by Detthamrong, Chancharat, and Vithessonthi (2017) attested to the positive effect of leverage on firm performance whereas corporate governance failed to be associated with financial performance. The pattern of the relationship shows that an increase in debt capital enhances the value of firms. The finding of the investigation between capital structure and firm value by Ahmad and Abdullah (2013) revealed that an optimum ratio of total debt capital increases the value of firms. Uwalomwa and Uadiale (2012), Cuong and Canh (2012), Cheng, Liu and Chien (2010) and Nieh, Yau and Liu (2008) establish the positive relationship between capital structure and the value of firms. However, Khan (2012) examine capital structure decision and firm value and reported a negative insignificant result. Similarly, Ahmad Abdullah and Roslan (2012) reported a negative relationship between capital structure and the value of consumers and industrials sectors in Malaysia. Many other studies, however, provides a negative and insignificant relationship between capital structure and firm value in Nigeria (Onaolapo & Kajola 2010; Chinaemerem & Anthony 2012 and Dada &

Ghazali 2016) and in other economies of the world (Zeitun & Tian 2014; Elkelish & Marshall 2007 and Jiraporn, & Liu, 2008). It is on this premise that the study hypothesized that;

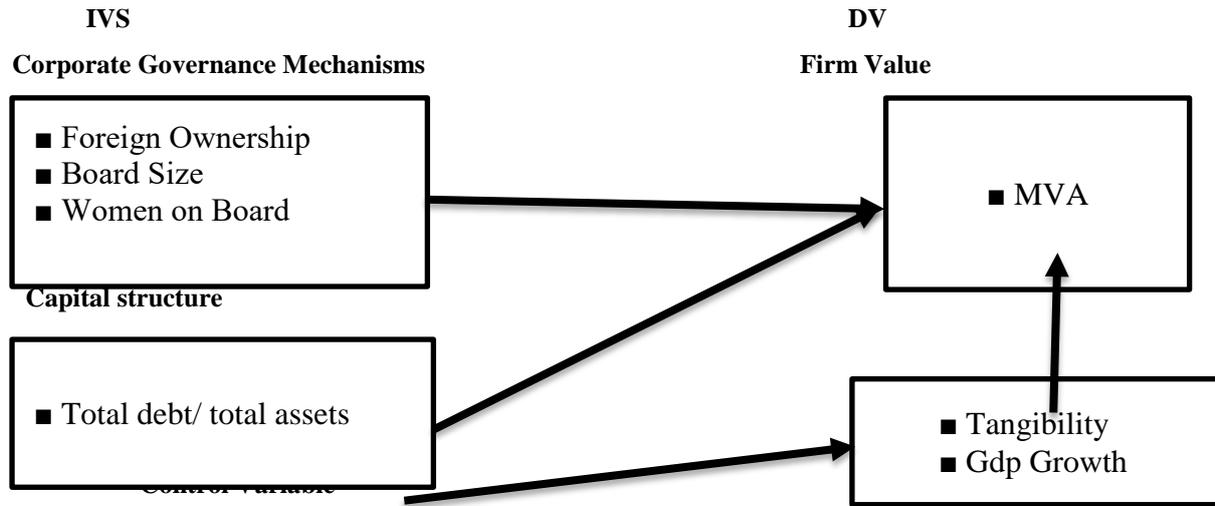
**H4:** *There is a significant relationship between capital structure and the value of Nigerian manufacturing firms.*

### 2.7 Firm Value

Tobin's q as a measurement of value has severally being used to investigate the effect of corporate governance on firm value (Ararat et al. 2017). Other studies measures firm value using return on assets (ROA), returns on equity (ROE), return on investment (ROI) and return on Sales (ROS) (Omidfar, Moradi & Bagherpour Velashani 2017; Jiraporn & Liu 2008; Nour Abu-Rub 2012; Chhibber & Majumdar 1999) Tobin's q is measured by  $\text{Book value of debt} + \text{preferred stock} + \text{market value of common stock}$  divided by  $[\text{book value of total assets}]$ . However, using Tobin's q to measure the value of firm failed to recognize the market value of corporate entities because using Tobin's q calculation in determining the value of firms depends exclusively on accounting profit despite its vulnerability to creative accounting practices (Bhasin, 2013). In the same vein, the computation of return on assets, return on investment, return on equity and that of return on sales rely on accounting data. However, this study adopted the use of market value added (MVA) to assess the confidence of the capital market on the firms as a result of the impact of corporate governance and capital structure. The market value added measures enable the assessment of the value created for the owners of the firms externally (Vijayakumar, 2008). Market value added measures the net present value of share value from the initial and current value. Using market value added in measuring the value of firms enables the maximizing of shareholders value (Lee & Kim 2009). Severally, Bhasin (2013), Lee and Kim (2009) and Bayrakdaroglu et al. (2012) used the market value added to measure the value of corporate entities. This study will utilize the measure of MVA using the market value of the firm minus invested capital (Johan 2018).



**CONCEPTUAL FRAMEWORK OF THE STUDY**



*Fig. 1. The Proposed Framework of the Study*

**3. RESEARCH METHODOLOGY**

The study made use of panel data for a period of 5 years spanning from 2012- 2016. The purposive sampling technique is adopted because of the specialized nature of the data required. The manufacturing sector of the Nigerian economy was the focus of this study. The study made use of 89 listed manufacturing firms comprising of different industries within the sector. Stata software 14 was used for data analysis by utilizing different tests such as OLS panel data regression, Hausman test, and random effect regression. The following table provides the operational definition and the measures of independent variables, control variables, and dependent variables.

**TABLE 1: MEASURES OF EXPLAINABLE VARIABLES**

Variables	Measurement	Key	Type	Justification
FIRM VALUE (MVA)	Market capitalization- minus Invested capital	FRV (MVA)	Dependent	(Johan, 2018)
FOREIGN OWNERSHIP (FOW)	1 if there is a foreigner on the board of directors and 0 if otherwise.	CGM	Independent	(Adelopo, 2011)
WOMEN ON BOARD(WOB)	The proportion of women directors on the board	CGM	Independent	Al-Dhamari, Ismail & Al-Gamrh (2016)
BOARD SIZE ( BOS)	Logarithm of the Number of Members in the Board of Directors.	CGM	Independent	(Tsagem, Aripin, & Ishak, 2015)
CAPITAL STRUCTURE (CAS)	Book value of total debt/Book value of Total assets*100%.	TDB	Indepen dent	Goh,Tai, Rasli, Tan & Zakuan (2018). Detthamrong, Chancharat and Vithessonthi (2017). Cuong and Canh (2012).
TANGIBILITY (TAN)		CONV	Control variable	Garba & Mohamed (2018)
GDP GROWTH (GDP)	Yearly Growth	GDP	Control Variabl e	Tanaka, Bloom, David and Koga (2018).



The hypotheses already formulated in this study will be tested using a multiple regression model to evaluate the perceived relationship between the independent variables and the dependent variable:

$$MVA_{it} = \beta_0 + \beta_1 FOW_{it} + \beta_2 WOB_{it} + \beta_3 BOS_{it} + \beta_4 CAS_{it} + \beta_5 TAN_{it} + \beta_6 GDP + \epsilon_{it}$$

**Where:**

MVA: Market Value Added

FOW: Foreign ownership, WON: Women on Board, BOS: Board Size, TAN: Tangibility and GDP: GDP growth.  $\beta$  indicate the intercept whereas  $it$  signified the longitudinal nature of the data which represent the firms and time.

The above equation is used to establish the empirical relationship between the dependent and the independent in a regression model which capture foreign ownership, women on board, board size as the independent variables and tangibility and Gdp growth as the control variable in determining the market value added (MVA) of Nigerian manufacturing firms.

#### 4. RESULT AND ANALYSIS

The result of the panel data analysis is captured under this heading as discussed above. The variables of the study are arranged in an excel file for easy analyzing of the corporate governance and **Table 4.2**

STAS	MVA	FOW	WOB	BOS	CAS	TAN	GDP GROWTH
Mean	3.20E+07	0.5213483	0.0875194	8.658427	57.59355	0.4773908	3.42
Max	2.44E+08	1	0.428571	18	100.292	0.880902	6.3
Min	0	0	0	4	17.7877	0.064539	-1.6
Sd	6.26E+07	0.500106	0.101066	2.521118	21.98331	0.244974	2.785505
Skewness	2.474243	-0.08547	0.973546	0.761183	0.088788	-0.01877	-0.87788
Kurtosis	8.189796	1.007305	3.346816	3.730885	2.297728	1.881327	2.403026
Observations	445	445	445	445	445	445	445

#### 4.2. Hausman test for random effect regression or fixed effect regression

The Hausman specific test proved that the fixed effect model is the most appropriate for this study but however the data has the problem of heterogeneity on fixed effect and that of autocorrelation which requires a solution. This problem was remedied using the panel corrected standard error to ameliorate the problem of heterogeneity and autocorrelation inherent in the dataset.

capital structure using the Stata 14 software and descriptive statistics.

#### 4.1 Descriptive Statistics

Descriptive analysis is used to provide an explanation of the inherent features of the data of the study in order to have a better understanding of the variables in the study. From table 4.2, the mean, max, min, standard deviation, skewness and kurtosis of the data of the study are itemized. The mean of the dependent variable (MVA) for the manufacturing firms is 32000000. Foreign ownership as an independent variable provides an average of 0.5213483 with a standard deviation of 0.500106. Women on board show 0.0875194 with a standard deviation of 0.101066. However, the average value of board size is 8.658427 with a standard deviation of 2.521118. The maximum number of members on the board of Nigerian manufacturing firms is 18 while the least of the numbers of the board members is 4. The average value of the capital structure is 57.59355 with a standard deviation of 21.98331. The percentage ratio of foreign ownership on the board is 52.14% which shows that 52.14% of the Nigerian manufacturing firms comprise of foreigners as board members. Only 8.75% of the Nigerian manufacturing firms consists of the female as board members which indicates the low presence of women on the boards.

**Table 4.3**

Correlated Fixed Effect- Hausman Test  
Equation: Untitled  
Test Panel Data Fixed Effects

Test Summary	Chi-Sq. Statistic	Chi-Sq D.F	Prob.
Panel Data Fixed Effects	59.17	59	0.0000

**4.3 Results and Discussion****Table 4.***Result of panel data regression**Dependent variable: Market Value Added**Method: Panel Corrected Standard Error (Panel Data Fixed Effects)**Sample: 2012-2016**Number of years: 5**Firms: 89 manufacturing firms**Firm Year's Observations: 445*

Variables	Coefficient	Std Error	T-Statistic	Prob.
Constant	-7.74e+07	1.13e+07	-6.84	0.000
FOW	3.60e+07	3345872	10.75	0.000
WOB	1.41e+08	2.59e+07	5.45	0.000
BOS	7009013	1026896	6.83	0.000
CAS	39731.86	64473.02	0.62	0.538
TAN	3.21e+07	5149113	6.24	0.000
GDP	-28314.32	840139.3	-0.03	0.973
<b>Weighted Statistics</b>				
R-Squared	0.2854			
Wald Chi2(7)	885.31			
Prob > Chi2	0.0000			
Estimated Covariance	4005			
Estimated Autocorrelations	0			
Estimated Coefficients	7			

**5. Conclusion**

The analysis of the empirical relationship between corporate governance, capital structure, and firm value revealed the following results. The finding of the study relates to the Nigerian manufacturing firms. The study proposed that foreign ownership, women on board, board size and capital structure impact on the value of Nigerian manufacturing firms. The study adopted market value added as the measure of the value of Nigerian manufacturing firms due to the non-vulnerability of MVA to creative accounting practices. The result of the analysis indicates that foreign ownership, women on board and board size impact positively on firm value while capital structure failed to establish the impact of capital structure on firm value. The relationship between foreign ownership and firm value revealed significant positive at 1%. The result shows that the inclusion of foreigners on the board of Nigerian manufacturing firms enhances corporate value. On the average 52.13% of Nigerian manufacturing firms consists of foreigners as members of the board and empirical evidence

attested to the impact of ownership by foreigners as the basic determinant of firm value. Women on board as a measure of the mechanism of corporate governance also reported the existence of a positive relationship with market value added at a 1% level of significance. The finding indicates a strong relationship between women on board and firm value as a result of the gender diversity existing in the composition of the board. The size of the board revealed a significant positive relationship with the value of Nigerian manufacturing firms. This shows that the average size of the board with 8 members significantly increase the market value of Nigeria manufacturing firms. Therefore, for Nigerian manufacturing firms to improve their value significantly there is a need for the board of Nigerian manufacturing firm to consist of 8 members on the average. However, capital structure failed to establish a significant relationship with the value of Nigerian manufacturing firms. The result of the finding between firm value and capital structure indicate that including the debt capital as part of corporate



finances has no impact on the value of Nigerian manufacturing firms. This finding is contrary to finding reported by Cuong & Canh (2012) which indicates that leverage below 59.27% has the capability of improving the value of manufacturing firms. From the result of the study, corporate governance mechanisms measured by foreign ownership, women on board and board size empirically enhance the market value added (MVA) of Nigerian manufacturing firm whereas capital structure empirically failed to impact on the

market value added (MVA) of Nigerian manufacturing firms. Study of this nature can be extended to other measures of corporate governance with other firm's characteristics in order to deepen a better understanding of the impact of corporate governance on value creation. Other studies can include the measures of the audit committee, family ownership, board interlocking or institutional ownership to assess their impact on the value of manufacturing firms.

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