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MEDIATING ROLE OF CAPITAL STRUCTURE BETWEEN CORPORATE GOVERNANCE AND CORPORATE PERFORMANCE IN NIGERIA

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Abstract

Insurance companies are a vital part of the financial sector. This study examines the impact of corporate governance and capital structure on the financial performance of Nigerian insurance companies using secondary data from 2016-2020. The sample includes 21 out of 29 insurance companies listed on the Nigerian Exchange Group (NEG). Various statistical tests and models were employed to analyze the data. Findings show that while corporate governance practices positively impact financial performance, the relationship is not statistically significant. Conversely, capital structure significantly enhances financial performance. The study recommends strategies for implementing effective corporate governance and capital structure practices, emphasizing the importance of adhering to updated codes of corporate governance and fostering employee understanding of these practices to improve the financial performance of Nigerian insurance companies.

INTRODUCTION

Corporate governance involves directing, administering, and controlling an organization, focusing on the interactions between internal and external stakeholders and the governance procedures designed to achieve organizational objectives. It also addresses the processes and controls to mitigate principal-agent issues (Aldamen, 2017). Corporate governance enhances a bank's financial performance and the interests of stakeholders such as the board of directors, shareholders, employees, and executive management (Ashenafi & Kelifa, 2018).

Capital structure, which is how a company uses a combination of stock and debt to finance its assets, is crucial for corporate governance. It links managerial and institutional ownership and influences corporate debt policy (Santosa, 2020). Studies indicate that corporate governance, especially ownership arrangements and audit quality, affects the capital structure of companies (Kyriazopoulos, 2019; Buvanendra, 2020). Ownership structure and board size significantly impact debt ratio levels, with these effects varying during financial crises (Hoang & Phung, 2019). Foreign ownership can increase debt security, while growth prospects like sales growth and profitability negatively affect leverage during constraints (Kyriazopoulos, 2017; Chow, 2019). Financial performance, evaluated through metrics such as return on assets (ROA), return on equity (ROE), and earnings per share (EPS), is used to assess managerial performance (Jr, 2016; Myers, 2016; Joeveer, 2017). It involves analyzing a firm's financial strengths and weaknesses by establishing relationships between components of financial statements and identifying significant connections (Metcalf & Titard, 1976).

Research on corporate governance's impact on financial performance varies across different sectors and methods, with mixed results—positive, neutral, and negative (Nawaz & Ahmad, 2017; Rivelles & Sapena, 2018; Budiharjo, 2019; Nuryana & Surjandari, 2019; Ullah et al., 2019; Fauzan et al., 2020; Paniagu et al., 2020; Mathur & Khandelwal, 2020; Tiwari & Chebolu, 2020; Wang et al., 2019; Bayu & Hunde, 2020; Indiastuti et al., 2020). Some studies have considered capital structure as a mediator, while others have looked at corporate governance as a mediator between variables (Nuryana & Surjandari, 2019; Robert et al., 2020; Tran & Doan, 2020). However, the combined effect of corporate governance and capital structure on financial performance is often overlooked (Mathur; Khandelwal; Tiwari; Chebolu, 2020; Al-Tamimia, 2020).

Stakeholder and agency theories underpin this study, emphasizing the importance of stakeholders in achieving a firm's long-term strategic goals and addressing the relationship between corporate governance, capital structure, and financial performance (Al-Gamrh et al., 2020). This approach helps guide strategic decision-making to address business and societal challenges (Clarkson, 1995; Harrison, 2015; Waheed et al., 2020). Agency theory examines issues like the varying incentives for boards to oversee management and protect shareholders' interests, and how corporate governance impacts agency problems and firm performance (Fama & Jensen, 1983; Jensen & Meckling, 1976; Brunninge, 2007; Zahra, 2000; Eisenberg, 1998; Daily & Dalton, 1992).

So, the present study intends to check the effect of corporate governance and capital structure on financial performance in which corporate governance and capital structure have been considered as an independent variable and financial performance is considered as a dependent variable by selecting insurance company of financial sector listed on NEG from 2016-2020. Because insurance companies play a vital role in order to promote the socio-economic development of modern economy. It is a policy where an insurance company promises to pay benefit on the death of the person whose life is insured (Okiro, 2015). Previous researches have been done using these variables as mediating or moderating role in different sectors particularly on banking sector. But here corporate governance and capital structure are used as an independent variables and financial performance as a dependent variable which would definitely be helpful in insurance sector and could be used practically as well.

LITERATURE REVIEW

The relationship between corporate governance and financial success in many economic sectors has been studied extensively. In Nigeria, the banking and financial services, insurance, and non-financial industries, as well as the textile industry (Ashraf, 2017), all have a significant impact on corporate governance and firm performance (Jizi, 2017; Mansur and Tangl, 2018; Okoye et al., 2016) Corporate governance has both little and major effects on various industries and countries around the world (Palaniappan & Rao, 2018). Numerous studies have examined the effect of corporate governance on firm performance using a group of publicly traded companies from different stock markets in various countries (Bauer, 2017; Klapper & Love, 2017; Durnev & Kim, 2017).

In a corporation, increased managerial ownership can result in good corporate governance. Managerial ownership is crucial because it serves as an incentive mechanism for directors, who are opportunistic unless they have the right incentives (Abdallah & Ismail, 2017; Kumar & Zattoni, 2020), in accordance with agency theory. While institutional ownership refers to the ownership of stock in a company by an institution, such as a bank, insurance company, investment firm, or another institutional owner. Institutional investors have the resources to effectively monitor and examine management's operations, which deters managers from making excessive investments and has an impact on how well a company performs (Alipour, 2016; Elmagrhi, 2016; Parrino, 2019). Recently, it has been discovered that institutional investors are more inclined to use their ownership rights to influence management to undertake shareholder-friendly initiatives (Aggarwal, 2016; Jong, 2017; Cornett, 2018; Chaganti and Damanpour, 2018; Parrino, 2019).

The phrase "capital structure" refers to a long-term financing structure made up of long-term debts, owners' capital, and preferred shares. Financial structure and capital structure were frequently used interchangeably in several researches. But they represent quite different ideas. The firm's financial structure illustrates the relationship between all of its liabilities and all of its assets (Suto, 2003; Myers, 2015; Gitman, 2016; Watson & Head, 2017; Ferrarini, Hinojales, & Scaramozzino, 2017; Khan, Qu, Shah, Bah, & Khan, 2020). The debt to equity ratio, short-term and long-term debt ratios, and debt to equity ratio are the primary parameters used in this study to assess the influence of capital structure. One of the most crucial decisions that a company must make is whether to work with equity or debt, which is one of the capital structure's two primary components. The key choice that will ultimately influence profit maximisation and the ability to compete in the market is choosing the appropriate ratio of equity to debt (Garcia-Terul and Martinez -Solano, 2016; Pelham 2016; Driffield, Mahambare, & Pal, 2016; Teruel and Solane 2016; Kraus & Litzenberger, 2016; Peavler, 2017; Ullah, 2017; Agyei, & Owusu, 2018; Prasetyo, 2019; Weinraub and Visscher 2020).

A measure of a company's capacity to produce a profit and financial health is called financial performance. Financial performance, according to Freeman (2015) and Ristriawati (2015), a gauge of how successfully and efficiently a manager or business accomplishes appropriate goals. According to Febryani and Aulfadin (2016), a firm's performance is a key objective that must be met by any organization, regardless of location, as performance is an indicator of the firm's capacity for resource management and allocation. In order to get the conclusion that a company's performance is an accomplishment made by the company over a predetermined period of time that illustrates the organization's financial position in accordance with accepted standards The performance evaluation can be used to determine the performance that has been made (Edwards, & Nibler, 2000; Cahyani, 2017; Chugh, Meador & Kumar, 2017; Cheema & Din, 2017; Bhagat, & Bolton, 2018; Danso, Adomak et al., 2019).

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

CG & FP

Many organizations have expressed interest in the influence and application of corporate governance (CG), as it has a significant impact on institutions' financial stability. We did not follow the conventional format when we reviewed empirical studies, which clarify the authors' methodological approach, the time span they covered, etc. Instead, we focused on the authors' key conclusions. Empirical investigations on the link between CG and FP produced contentious findings (Abobakr, 2017; Ahmed et al., 2017; Dzingai and Fakoya, 2017; Ahmed. 2017), in some of studies documented a positive relationship between of CG and FP of firms including banks (Filip, Vesna and Kiril, 2014; Bebeji et al., 2015; Bussoli et al., 2015; Ashfaq and Saeed, 2017; Alam and Akhter, 2017). Similarly, limited studies reported negative linked between variables of CG and FP (Kusuma and Ayumardani, 2016; Okoye et al., 2016; Aldalayeen, 2017) and found that CG has significant effect on banks' FP. On the other hand, few studies revealed that there is no significant effect of CG on banks performance (Esan, Ananwude, & Okeke, 2020).

H_1: There is a significant effect of CG on FP

CS & FP

As per literature knowledge, large enterprises tend to look for capital from stock sources rather than loan sources, according to Fama and Jensen (2003). Increased transaction costs and information asymmetry, which are more prominent in small companies than large ones, are to blame for this. Additionally, acquiring outside capital is challenging for small enterprises. This highlights how firm size influences the connection between the financial performance and capital structure of non-financial organizations. Firm managers may find it challenging to choose capital structures due to the difficulties in finding the optimal (Noreen, 2013). The relationship between the listed companies' financial performance and capital structure is moderated by their size (Peavler, 2017; Ullah, 2017; Chugh, Meador & Kumar, 2017; Agyei, & Owusu, 2018; Prasetyo, 2019; Danso, et al., 2019; Weinraub and Visscher, 2020; Meshack et al., 2020).

H_2: There is a significant effect of CS on FP

CONCEPTUAL FRAMEWORK

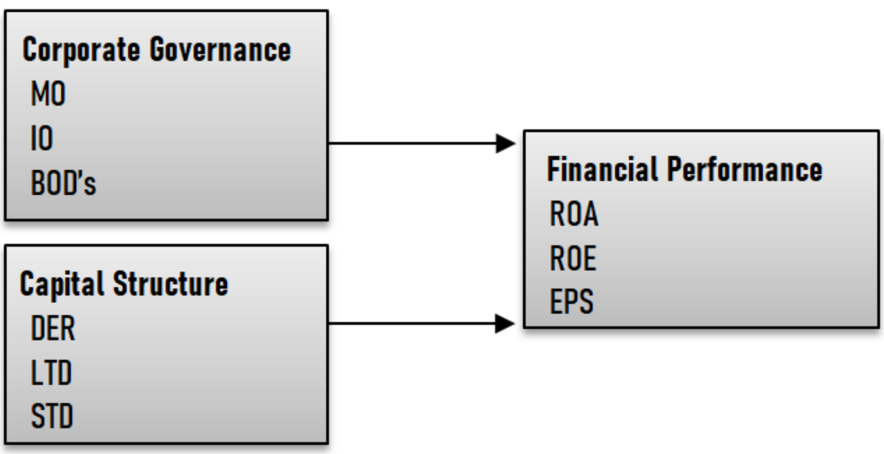

Figure 1: Conceptual Framework

RESEARCH METHODOLOGY

The type of this study based on descriptive and quantitative in nature. Data for this study collected from secondary source like Nigeria Stock Exchange (NEG). The population has been considered from the listed companies on NEG in which the financial sectors have been taken as a target population in out of 544 companies and 35 sectors. Insurance companies have been considered as sample by using purposive sampling technique based on data availability because data is collected from 21 companies out of 29 insurance companies and also based on the efficient performance level. In this study the secondary data has been used. The STATA tool is used to calculate the results of this study by applying different tests such as descriptive statistics, shapiro-wilk test, VIF (Variance Inflation Factor) test, breusch-pagan test, fixed effect regression test, hausman test and regression test to check the impact of variables.

MODEL:

$Y = \beta_0 + \beta_1 (X_i) + \beta_1 (X_i) + e$

$FP = \beta_0 + \beta_1 (CG) + \beta_1 (CS) + e$

Table 1: *Measurement of Variables*

Variables	*Formulas*	*Source*
Independent Variable Corporate Governance		
MO	Number of shares held by directors and members of the board/total outstanding shares	Gul, Ullah, Gul, Rasheed, (2020)
IO	Number of shares owned by institution/number of shares outstanding year-end	Wafiyuddin, Pratama, Fitriani, Rachmavati, (2020)
BOD's	Number of meetings	Naciti, (2019)
Capital Structure		
Debt to Equity Ratio	Long term debts/Owner's equity	Ali & Faisal, (2020)
Short Term Ratio	Short term debt / (Short term debt + Equity)	Nawaz, Ahmad, (2017)
Long Term Ratio	Long term debt / (Long term debt + Equity)	Nawaz, Ahmad, (2017)
Dependent Variable Financial Performance		
ROA	Net Income / Total Assets	Gul, Ullah, Gul, Rasheed, (2020)
ROE	Net Income / Total Equity	
EPS	Company's net income/total number of outstanding shares	Nawaz, Ahmad, (2017)

RESULTS OF THE STUDY

The data analysis results are as follows.

Table 2: *Descriptive Statistics*

Variables	Obs	Mean	Std. Dev.	Min	Max
MO	105	7.809524	.464825	5	8.5
IO	105	7.42	1.040285	4.7	8.5
BOD	105	-6670476	.130884	.3	1.1
DER	105	1.071238	2.276313	-.95	9.07
STR	105	-.4254286	.3516391	-1.3	.7
LTR	105	-.3239048	.4731594	-2.5	.03
ROA	105	.6371429	1.319707	-1.09	6.2
ROE	105	.9684762	1.217218	-1.3	5.94

The above table shows the descriptive statistics of all variables in this study in which the mean value of MO is 7.809 with SD value of .4648 having the minimum value of 5 and maximum value of 8.5 in out of 105 observations. Similarly, under the 105 observation the mean value of IO is 7.42 and SD value is 1.040 with 4.7 minimum value and 8.5 max value. Moreover, the rest of variables values are mentioned below.

Table 3: *Shapiro-Wilk Test*

Variable	Obs	W	V	Z	Prob>z
Uhat	105	0.78	18.619	6.504	0.00000

The null hypothesis Ho: The error terms are normally distributed. The P-Value is more than 0.05 (5%) that's why the null hypothesis cannot be rejected.

Table 4: *VIF*

Variable	VIF	1/VIF
CG	1.01	0.990325
CS	1.01	0.990325
Mean VIF	1.01	

The value of vif for individual co-efficient is more than 10 (thumb rule) then there is a chance of multicollinearity and vice versa.

Table 5: *Breusch-Pagan Test*

chi2(1)	= 73.54
Prob>chi2	= 0.0000

If the value of pair wise correlation for individual co-efficient is more than 0.80 (80) then as a thumb rule, there is a chance of multicollinearity and vice versa.

Table 6: *Hausman Test*

	(b) Fixed	(B) Random	(b-B) Difference	Sqrt(diag(V_b-V_B)) S.E.
CG	.1897555	.1138301	.0759254	.1122791
CS	.0133074	.3444638	-.33115564	.1144297

chi2 (2) = 8.55 Prob>chi2 = 0.0139

The hausman test is used to determine the appropriate model between fixed effect and random effect model that which one would be selected as per the critical value. Here, the p-value is 0.0139, so the fixed effect model is appropriate in this study.

Number of observations = 105
Group variable: Company Code Number of groups = 21
R-square: Observation per group:
Within = 0.0095, Minimum =5
Between = 0.0193, Average = 5.0
Overall = 0.0186, Maximum = 5
Corr (u_i. Xb) = 0.0358,F(2,82)=0.39,
P> F = 0.6755

Table 7: *Fixed Effects Model*

Fixed-effects (within) regression

FP	Coef.	Std. Err.	t	P>(t)	(95%Conf.Interval)
CG	.1987555	.2171244	0.87	0.385	-.2421742
CS	.0133074	.1679943	0.08	0.937	-.3208868
cons	-.3685914	1.149289	-0.32	0.749	-.2.654893

F test that all u_i=0: F (20, 82)=31.98
Prob > F = 0.0000

In a fixed effects model, any form of link between the unknown factors and the observed variables is allowed. The effects of time-invariant effects on time-invariant variables are either totally or partially eliminated by fixed effects models. This holds true whether or not the variable is explicitly measured. The fixed effects regression model is widely used to lessen selection bias in the estimation of causal effects in observational data because it excludes significant portions of variance that are thought to contain confounding factors.

Table 8: *Regression Model*

Source	***SS***	***df***	***MS***
Model	30.558253	2	15.2791268
Residual	40.038990	102	.392538263
Total	70.59715	104	.678818813

FP	***Coef.***	***Std. Err.***	***t***	***P>(t)***	***95% Conf. Interval)***	***FP***
CG	-	.1424	-	0.8	-	.2589
CS	.02362	86	0.	69	.3062	92
Co	83	.0757	17	0.0	485	.8168
ns	.66652	83	8.	00	.5162	355
	033	.7567	80	0.3	051	2.192
	.69200	306	0.	63	-	98
	79		91		.8089	
					637	

Number of Observation = 105 Prob>F = 0.0000
F(2, 102) =38.92 R-squared= 0.4329
Root MSE = .62653, Adj R-squared = 0.4217

The table 8 indicates that there is a significant association among variables because the p-value is less than the critic vale 0.05, means that alternate hypothesis accepted and null hypothesis can be rejected having observations. The f- value is 0.90. The R^2 value is 0.4329 which explain the variation of dependent variable by independent variables. It is also called coefficient of variation to check the fitness of regression model.

Discussion and Conclusion

The current study intend to focus the impact of CG and CS of insurance sector of Nigeria in which three dimensions of each variable were taken in which CG includes managerial ownership, institutional ownership and board of directors, CS includes debt to equity ratio, short-term debt ratio and long-term debt ratio and lastly the financial performance includes ROA, ROE and EPS. This research was conducted to investigate whether is there any influence of CG and CS on the financial performance of insurance companies of Nigeria and are they practicing any of these dimensions in their work activities. Secondary source was used t collect the data from the annual reports of all insurance companies by using purposive sampling technique listed on NEG.

According to the current findings, there is a positive and significant impact of CG and CS on FP (Machmud et al., 2020). Sound CG is anticipated to improve FP and raise company value, according to several academics who have suggested that CG has a positive impact on a FP (Rahman, & Ibrahim, 2020). Other findings indicate that CS and CG have an impact on the firm's value. Additionally, using institutional ownership ratios and CS will raise the firm's worth. The outcome also demonstrates that FP acts as a mediator between CG, CS and firm value. It implies that if a company can become a useful monitoring tool, its value may rise (Nurazi, Zoraya, &Wiardi, 2020).According to the academics cited above, CG and CS have a conscious and considerable impact on the financial success of insurance businesses. The overall results of this research are fit and showing significant relationship but on the basis of first hypothesis which was to check the impact of CG and FP is rejected because there is no relationship between CG and FP is accepted showing alternate relationship, supported by [Ashfaq and Saeed, 2017; Alam and Akhter, 2017; Meshack, Nyamute, Okiro, & Duncan, 2020].

According to the consequences, it is finalized that corporate governance and capital structure plays a significant role in the financial performance of insurance companies of Nigeria. Correspondingly, the results shows that the dimensions of corporate governance (managerial ownership, institutional ownership, board of directors) and capital structure (debt to equity ratio, short-term debt ratio and long-term debt ratio) affect the financial performance of insurance sector. Hence the study revealed that dimensions of corporate governance and capital structure have positive significance on financial performance, as obtained by the secondary data collected through the annual reports of 21 insurance companies out of 29 companies based on the availability of data from the listed insurance companies on Nigeria Stock Exchange (NEG). The application of corporate governance and capital structure is the most crucial element in the financial performance of insurance sector. Each dimension of corporate governance and capital structure needs primary concentration in order to enhance the financial performance and to extend the insurance sector of Nigeria. Valid statistical analysis on collected authentic data by using secondary data collection method declared desired results concerning financial performance of insurance companies.

LIMITATIONS, FUTURE DIRECTION AND IMPLICATIONS OF THE STUDY

This study consists of some limitations due to lack of time and other resources. There were many financial sectors but due to time limitations only insurance companies in all over Nigeria were taken as a population. There are other dimensions of CG and CS with respect to research questions and research problems that have not been explored.

The report of the current researcher advocates that the aspects of CG and CS are to be given main attention including other areas specifically to improve the insurance companies FP of Nigeria. In order to enhance the FP of insurance companies the managers and employees must have a good understanding about the corporate governance policies either through training or by applying other methods to ensure the successful implementation of these practices in all the areas of insurance company's financial activities including the best way of controlling financial transactions.

Since the current study has some limitations regarding the facets of corporate governance and capital structure as the study investigated their impact on one of the financial institutions and ignored other institutions. The role of corporate governance and capital structure in non-financial institutions may also need to be investigated. There are many other practices and events that affect the financial performance that can be taken as a gap for the study. Moreover, the study skipped some of the dimensions of corporate governance, capital structure and financial performance that can be used.

The current study also supports the idea that, in order to improve financial performance, managers and employees must support capital structure and CG legislation. Additionally, given their strong and positive correlation, it is advised that corporate governance and capital structure be given adequate attention As long as the researcher has preferred to generally consider corporate governance and capital structure along with three dimensions to check their impact on financial performance. The present study advised some future prospects for the analyst i.e., each dimension of corporate governance and capital structure can be used separately to investigate their impact on FP. Additionally, the future investigation can be performed on other financial institutions like investment companies along with non-financial institutions.

Additionally, the subsequent analysis can be carried out by concentrating on the additional research that is advised to use samples or various company sectors as a comparison, such as the financial sector, trade, service, and investment sectors, as well as the agricultural, mining, property, and real estate sectors. Additionally, a variety of other variables, such as mediating and moderating variables, as well as a variety of various dimensions, can be taken into account while studying the financial sectors.

The study is applicable with regards to all financial sectors of Nigeria like banking sector, insurance sector, mudaraba, musharakah, conventional or commercial sector, Islamic banking and many more as financial sectors are always deemed to be one of the most vital sectors for the economy to be able to function. The variables selected for the study are the most critical and major concerns regarding the growth and stability of financial sector. Yet there are many financial sectors that need awareness about the effect of the three aspects of CG and CS on their financial performance. The current study specifies the acknowledgement and grasp about the implementation of CG and CS and the appropriate attentions towards the application of all their three dimensions which will result in boosting FP of the insurance sector in Nigeria.

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