CAPITAL STRUCTURE AND AGENCY COST DETERMINANTS ON VALUE OF NON-FINANCIAL FIRMS NIGERIA

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Abstract

This study examined the impact of capital structure, agency cost on firms' value of non-financial listed firms in Nigeria over the period of 2011 to 2020. Panel regression techniques was adopted. The study revealed that debt ratio (long term debt to assets) has a positive (negative) and significant effect on the value of firm. The study also revealed that there is a positive and significant effect of asset tangibility and operating expenses to sales on the value of the non-Financial firms in Nigeria. Based on the interactive effect, it was revealed that the negative effect of long term debt ratio on Tobin's Q ratio (TQ) is increased for firm with high agency problem. Also, the study discovered that positive effect of debt to assets on Tobin's Q ratio (TQ) is reduced for the firm with high agency problem. Thus, this increase will only come when there optimality. The study therefore recommends that since capital structure matters, non-financial firms should use debt optimally so as to increase market value.

Keywords: Capital Structure, Agency Cost and Firms' Value

1.0 Introduction

The choice of the capital structure is one of several tactics used by corporate finance managers to raise the firm's market value and lower its total cost of capital. Corporate executives are curious about the best ways to combine these money in order to maximize the wealth of the shareholders because finance is a crucial component for growth in every firm. Ongeri (2015) claims that the pressure of the current global business environment has made corporate financial managers more wary of the combination of long-term debt that minimizes agency

costs resulting from the conflict of interest between the shareholders and the management. Furthermore, Uremadu and Onyekachi (2018) asserted after the work of Modigliani and Miller (1958), that capital structure is meaningless and exposes the firm to high risk, and worsens the firm's agency problem except otherwise the utilization of capital structure is optimal in such a way that reduces the cost of debt such as bankruptcy and agency cost. As stated by Kalash, (2019), an optimal capital structure will be necessary in accomplishing the firm's value objective of any organization.

It was also proposed that the ratio of a combination of long term debt to assets moderates the cost of the agency (Jensen and Meckling, 1976). In the Study of Lawal (2014), capital structure is the composition of debt and equity instruments to meet the corporate aim, including reducing all associated loan costs and boosting shareholder value. The choice of a company's financial mix is crucial since it gives the company the resources it needs to finance its investment alternatives. Specifically, the usage of capital structure will allow business owners to reduce managers' opportunistic conduct and other agency-related issues. Excess debt financing, according to the study of Rakesh and Lakshni (2013) study, lowers agency costs by allowing directors (managers) to carry out their duties with greater care and awareness of maximizing shareholders' wealth by efficiently allocating free cash flow to be able to pay their debt holders' obligations. As a result, agency problem arises from the conflict of interest between owners and managers and can be mitigated by the capital structure option made by a company.

Ongeri (2015) asserts that the agency problem is typically caused by a difference of opinion between the owners (shareholders) and the managers of the company. These agency-related costs are related to the agency's responsibility for policing management for excesses while working toward the shareholders' goal. In accordance with Zakaria et al. (2016), avoiding agency cost involves the distribution of free cash flow to shareholders of the investment of such cashflows on wealth maximizing investment alternative. According to the agency theory, using debt instead of stock will boost a company's value since it will save money on interest taxes and be better able to allocate free cash flow. The agency theory also supports the idea that the firm's capital structure will aid in resolving agency costs and the prospect of bankruptcy, both of which can have an impact on managers personally. In order to do this, this study looked at how Nigerian manufacturing businesses' capital structures and agency expenses affected their company values.

There are many problems with the paucity of empirical research on the impact of company value, agency cost, and capital structure, particularly in developing and emerging economies. The capital structure and agency cost in industrialized nations have been evaluated in a number of studies (Doorasamy, 2021; Wu, 2019; Pandey and Sahu, 2017), where the types of frictions and market imperfections vary. The understanding of how certain market frictions, such as transaction costs, information asymmetries, agency conflict, taxation, and bankruptcy costs, can influence Modigliani & Miller's (1958), forecast has been significantly lacking in the literature.

Thus, researchers looking into capital structure that takes the influence of market frictions into account are presented with a research gap due to the variation of these frictions in an emerging economy. In order to fill a significant gap in the corporate finance of previous empirical regarding the variations in market imperfections in the Nigerian stock market, in a developing economy (Nigeria), the current study was conducted to ascertain the impact of capital structure on the firm's market value according to the agency cost theoretical model. Some attempts to connect this emerging market line of study, and specifically studies in Nigeria was conducted by several authors including (Ibrahim and Isiaka, 2020; Ateibueri, 2020; Foyeke, Olusola, and Aderemi, 2016; Nuhu, et al, 2020). However, by integrating one of the frictions (agency cost) from a developing market to corroborate, this study expands on previous investigations into the capital structure and agency cost on firm's value.

This study was set to examine capital structure and agency cost determinants on value of quoted non-financial firms in Nigeria. Specifically, the objectives of the Study are to:

I. assess long-term debt to asset ratio impact on the value of firms in Nigeria
II. examine the impact of total debt to asset ratio on the value firms in Nigeria
III. analyze the influence of assets tangibility ratio on the value firms in Nigeria
IV. ascertain the effect of operating expenses to sales on the value of firms in Nigeria

2.0 Review of Literature

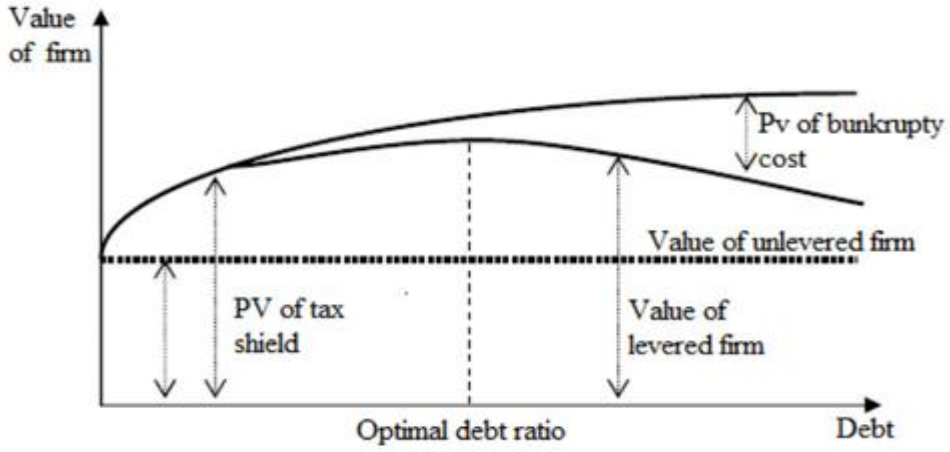
This study is underpinned by the trade-off theory which was initiated in the earlier work of Modigliani and Miller (1963) when the tax assumption was relaxed. The theory was founded by Kraus and Litzenberger (1973) and was further advanced by Myers (1984) and Frank and Goyal (2005); the theory believes that corporate finance managers must balance or trade off the cost of the use of leverage with the benefits. The theory supports that managers must

ascertain the capital structure that maximizes the benefits from the tax shield and minimizes the associated cost, such as bankruptcy or any other cost that will make the firm shareholders worse off (Agency Cost). The trade-off theory was based on various predictions, which includes the debt or leverage ratio of each firm differs since all firms have their debt thresholds; that firm with safe tangible assets are usually less exposed to financial distress risk, which can make them increase their debt financing. The reverse is the case for less profitable firms with risky intangible assets. In the Study of Qiu and La (2010), it was revealed in Australia that this prediction was accurate that firms with risky intangible assets are likely to be more exposed to risk. The trade-off theory also stated that firms with high tax marginal rates would borrow more since they are likely to benefit more from the tax shield. In the documentation of MacKie-Mason (1990), a firm with a high tax margin tends to borrow more (High leverage), and those with low margin are less levered (that is, they should finance using equity than debt). Finally, the theory predicted that firms with high profit before tax but have low non-debt tax shields (Depreciation and investment tax) will be motivated to borrow more since the incentives are high, unlike firms with high non-debt tax shields. The trade-off theory was further classified as the static and dynamic trade-off theories.

This model was anchored on the trade-off theory, which stated that firm value is a function of their target debt ratio subject to the cost of bankruptcy and agency. Thus, the firm will want to balance the benefits from the tax shield with the bankruptcy and agency cost demerits. Thus, in this case, the problem of agency which is associated between the agent and principal is due to the extent of debt financing or the misuse of free cash flow arising from the operating decision of the managers (Jensen and Meckling, 1976).

The graph below shows the optimal point of a firm as the use of debt financing increases.

Figure 2.3. Optimal Capital Structure



Source: Myers, (1984)

From the empirical perspective, the study conducted by Doorasamy (2021) on the impact of capital structure, firm value, and managerial ownership in East African Countries was motivated by the growth in East Africa, which has motivated investment from outside investors in the firm's equity and loans. The Study considered sixty-five (65) listed firms on the stock exchange in East Africa. The Generalized Method of Moment (GMM) test was adopted to test the hypothesis. Findings revealed a relationship that is negative and significant between leverage and the value of the firm. The study further suggests that the value of the firm will decrease as the firm uses more debt. Importantly, the cost of agency, which has long-term repercussions for management ownership and firm value, was not taken into consideration in this study, which explained the relationship between capital structure and managerial ownership. The current study will completely explain the reasons for the short-term decline, which are mostly due to friction between owners and agents, which lowers the firm's value.

Wu (2019) conducted a study on the effect of capital structure and ownership concentration on internationalization performance and utilizes sample of 217 Chinese multinational companies (CMNEs) from 2009 to 2016. To evaluate the hypotheses, the study used dynamic threshold analysis and fixed effect regression. The study discovered that ownership concentration among Chinese multinational enterprises (CMNEs) has an impact on risk preferences, which in turn has an impact on the performance of the firm. Also, the short-term debts and the performance of Chinese multinational enterprises (CMNEs) was discovered to be positive and significantly correlated. According to the study's findings, debt financing and ownership concentration are appropriate and will help the company increase its value.

However, this study was conducted in China where the stock market demonstrates some degree of efficiency and transparency. Thus, these findings cannot be used to make generalization in a less developing country like Nigeria, where the market is less efficient, thus, this study will fill the gap in literature in countries where the stock market are less developed.

Hoang, et al (2019) studied the agency problem's influence on the firm's performance in the Vietnamese market. A sample of seven hundred and thirty-six (736) companies in Vietnam from 2010 to 2015 was considered. The robustness test and the Generalized System Method of Moments (SGMM) technique were adopted to test the hypotheses. The result revealed that agency costs exert a negative impact on firm performance. In addition, we show that a debt instrument can be a valuable tool to reduce the negative impact of agency costs on firm performance. This study focuses on agency costs without taking into account how capital structure may help enterprises reduce their agency costs. This current research will fill the gap by providing evidence on the role capital structure in reducing conflict between business owners and employees.

Faisal and Sakir (2020) studied agency conflicts, firm value, and monitoring mechanisms in Indonesia using a non-monotonic model and a combination of agency conflict control mechanisms. The study collected data on the performance of 580 Indonesian firms from 2009 to 2018. To test the hypotheses, panel piecewise and moderated regression models were conducted. The results of this study demonstrated that both the monitoring and expropriation hypotheses exist for non-financial enterprises in Indonesia by showing that the link between ownership concentration and company performance had followed a non-monotonic pattern. Additionally, it was discovered that agency conflict control mechanisms like shareholders, dividends, and the forms of foreign ownership affect the performance of the chosen enterprises in Indonesia. This study offered insight into the company's performance based on agency conflict, but it neglected to consider how the debt structure may help to reduce the conflict and create a profitable business model.

3.0Methodology

In Nigeria's non-financial listed enterprises, the study investigates the effect of capital structure, agency costs, and firm value. The study employed panel multiple regression to determine the relationship between the dependent and independent variables. The Hausman test is used to determine which of the two principal results fixed and random effect regression is preferred in order to evaluate the probable hypotheses.

To investigate the determinants of firm's value using capital structure and agency costs, a general multi-factor model was created. In order to obtain this causality without bias, a preliminary model was generated in order to identify mutual causality and rectify its implications for the structural equation. These models were supported by the Agency theory of Jensen and Meckling (1976) and the trade-off theory (Static) of Myers (1984).

Firm's Value Model

The equation below shows the functional relationship:

$$Tobin's\ Q\ it = f\ (LTDAit, DAit, ATANit, OPEXit, EMZSCOREit, SIZEit, ASSGWTit, LADOPEXit, DAOPEXit) \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots (1)$$

Where

Symbols of Variables	Meaning
DA_{it}	Total debt to assets ratio of firm i at time t
LTDA	Long-term debt to assets ratio of firm i at time t
$ATAN_{it}$	Assets Tangibility ratio of firm i at time t
OPEX	Operating Expenses to sale firm i at time t
$EMZSCORE_{it}$	Emerging Market Altman Z-Score of firm i at time t
$SIZE_{it}$	Firm size of firm i at time t
ASSGWTit	Asset growth of firm i at time t
LAOPEX	Long term debt and operating expenses firm i at time t
DAOPEX	Debt to asset and operating expenses of firm i at time t
Tobin's Qit	Firm value firm i at time t

Source: Authors' Design, (2023)

The econometrics model for the Study is as follows;

$$TobinsQit = \beta 0 + \beta 1\mathrm{DA}it + \beta 2LTDAit + \beta 3ATANit + \beta 4\ OPEXit + \beta 5EMZSCOREit$$

$$+ \beta 6SIZEit + \beta 7\mathrm{ASSGWRTit} + \beta 8\mathrm{LAOPEXit} + \beta 9\mathrm{DAOPEXi}$$

$$+ \varepsilon it \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots (2)$$

Where

$$\beta o, \beta 1, \beta 2, \beta 3, \beta 4, \beta 5, \beta 6, \beta 7, \beta 8\ and\ \beta 9 = Parameters\ estimated$$

$$\mathcal{E}it = the\ error\ term\ firm\ i\ at\ time\ t$$

4.0 Results and Discussion

Among listed companies on the Nigerian stock exchange, this study will look at the relationship between capital structure, agency cost, and firm value. Data was gathered from Nigerian non-

financial companies between 2011 and 2020 that routinely published their audited financial statements. The analysis was conducted using a sample of 75 non-financial companies that have reliable data for the studied time period.

4.1 Pool Tobins'Q Model

The results of the Tobin's Q panel regression model was presented below.

Table 4.1: Tobins'Q Result Interpretation (Dependent Variable = TOBINS'Q)

Variables	Pool OLS	Robust OLS
C	-88.10112(0.000)*	-62.04324(0.000)*
DA	0.4450241(0.000)*	0.2523373(0.000)*
LTDA	0.299947 (0.000)*	-0.1451089(0.000)*
ATAN	0.2598264 (0.000)*	0.1611562 (0.000)*
OPEX	0.0357624 (0.000)*	0.577491 (0.000)*
LDAOPEX	-0.0003702 (0.005)*	-0.0000994 (0.226)
DAOPEX	-0.0003753 (0.000)*	-0.0006374 (0.000)*
EMZSCORE	5.746789 (0.000)*	4.087349 (0.000)*
SIZE	3.865617 (0.000)*	3.259755 (0.000)*
ASSGWT	0.0361084 (0.001)*	0.0464373 (0.0000)*
R-Squared	0.6792	
Adj R-squeal	0.6753	
F-statistic	172.67 (0.000)*	351.82 (0.0000) *
VIF test	5.78	
Heteroskedasticity	107.06 (0.00)*	
Observation	744	744

Source: Author's Computation, 2023

Note: *1% level of sig., **5% level of sig. () are the P Values

The modified R-Squared value of 0.6753 in the aforementioned table, which comes from the OLS pooled regression, shows that 67.53% of the variation in the dependent variable is explained by the independent variables in the pooled companies over the time period taken into account. However, the error term or the excluded factors were able to explain the remaining variation of 32.082%. Since the P-values are smaller than the significance thresholds at 5%, the F statistic value of 172.67 and its related P-value of 0.00 show that the pooled OLS regression model has an overall statistical significance. As a result, the pooled OLS regression is appropriate for statistical analysis. In addition, the following table shows that the mean VIF value is 5.78, which is lower than the benchmark value of 10, indicating that the model is not multicollinear and that no independent variable needs to be omitted because the estimates will be useful for statistical analysis. The Breusch Pagan was also used to perform the heteroscedasticity test, and it was found that the model has a heteroscedasticity issue since the result

was 107.06 (0.00), which was statistically significant at 5% because the presence of heteroscedasticity was accepted as the alternative hypothesis. The robust regression was used to fix this issue

4.2 Panel Regression Results

This section examines the causality between the independent variables capital structure and agency cost and other control variables, and how they affected the firm value of non-financial enterprises listed on the Nigerian stock market. Additionally, we incorporate interaction terms to investigate potential interactions between capital structure and agency cost. The resulting panel data regression results were deconstructed, and the outcomes are shown and described below.

4.2.1 Tobins'Q Model

Using the Tobin's Q (TQ) panel data regression findings, the value of non-financial companies in Nigeria is investigated in connection to the capital structure and agency costs factors. The results obtained are presented in table 4.2

Table 4.2: Tobins'Q Result Interpretation (Dependent Variable = TOBINS'Q)

Variables	Fixed Effect (FE)	Random Effect
C	10.37273(0.000)*	3.318352 (0.0001)*
DA	*0.014633* (0.000)*	*0.016741* (0.000)*
LTDA	*-0.002740* (*0.1231*)	*-0.003679* (*0.0352*)**
ATAN	*0.012160* (0.000)*	*0.012231* (0.000)*
OPEX	*-0.000509* (*0.4404*)	*-0.000624* (*0.3393*)
LDAOPEX	*-0.00000784*(*0.4823*)	*-0.0000109* (*0.3229*)
DAOPEX	*0.00000748*(*0.3168*)	*0.0000086*(*0.2424*)
EMZSCORE	0.074982(0.000)*	0.086290 (0.000)*
SIZE	-1.498619(0.0000)*	-0.532334 (0.000)*
ASSGWT	-0.000284 (0.0007)*	-0.001082 (0.1803)
R-Squared	0.761108	0.180479
Adj R-Squared	0.731066	0.170430
F-statistic	25.33441 (0.000)*	17.96058 (0.0000) *
Hausman test	64.929513 (0.000)*	
Observation	744	744

Source: Author's Computation, (2023)

Note: *1% level of sig., **5% level of sig. () are the P Values

In order to determine a causal relationship the variable used in the study, fixed and random effect regression was performed. The results demonstrate differences in the coefficient

magnitude, signs, and significance. Based on the null hypothesis that the random effect model is preferable to the fixed effect model, the Hausman test, was used to choose the best technique between the two effects. The Hausman test result from Table 4.2 was statistically significant at 5% which suggests that the null hypothesis should not be accepted. As a result, the finding suggests that fixed effect should be considered while doing hypothesis testing. The corrected R-Squared value (Fixed effect) from Table 4.2 above is 0.73. This indicates that the sum of all the independent variables may account for 73% of the changes or variations in the dependent variable (TQ). While additional factors that are outside the purview of this study's investigation can account for the remaining 27%. The total statistical significance of the TQ model at the 5% level is indicated by the F-statistic value of 25.33441 and its p-value of 0.000. Thus, we can draw the conclusion that this model can be generalized with confidence.

Test of Hypothesis

The Effect of Capital Structure

The hypothesis predicts the impact of capital structure factors on the firm's value, including debt to total assets and long-term debt to assets. In Table 4.2 the fixed effect results showed that debt to assets, which was regressed against Tobin's Q with the control variables, has a positive impact on the firm's value because the estimated coefficient is 0.014633 and is statistically significant at 5% since the probability value of 0.0000 is below the significant level. We may thus draw the conclusion that capital structure affect the value of the companies in Nigeria. Additionally, the result of the long-term debt-to-assets ratio based on the slope coefficient was (-0.002740), reflecting a detrimental influence on the firm's worth. However, even at 5%, this result was statistically insignificant since the probability value of 12.31% was higher than the significant threshold. Therefore, we may draw the conclusion that long-term debt to assets has a small but negative impact on the Tobin's Q measure of the value of non-financial enterprises in Nigeria.

The Effect of Agency Cost

The asset tangibility ratio and operational expenditures to sales ratio were used to estimate the agency cost theories. Asset tangibility appeared to have a positive influence (0.012160) on the firm's value (Tobin's Q) from the panel regression table, and this effect was statistically significant at the 5% level of significance since the probability value of 0.0000% is less than this threshold. Therefore, we may draw the conclusion that asset tangibility has a favorable and considerable impact on the value of non-financial enterprises in Nigeria. In the case of

operating expenses to sale ratio the slope coefficient was (-0.000509) which appeared to have a positive influence on firms' value. The result obtained was statistically insignificant at 5% since the probability value of 44.04% was greater than the significant level. We can conclude that there is a negative and insignificant impact of operating expenses to sales on the value of non-financial firms in Nigeria.

The Joint Effect Relationship

The above analysis examines the joint relationship between the independent variables and firms' value separately. However, the section discussed the interaction variables LDAOPE and DAOPE to analyze the possible interaction effect capital structure and agency cost have on the value of the firm. From the fixed panel regression model, the coefficient on LDAOPE is negative (-7.84E-06) and statistically insignificant at 5% level of significance since the probability value of 48.23% is greater than the significant level, while the coefficient of long term debt to assets ratio was negative (*-0.002740*). This suggest that negative effect of long term debt ratio on firms' value is increased by 0.00000784 for firm with high agency problem. Also, the result of the model shows that that debt to assets has a positive coefficient (*0.014633)* and statistically significant, while the interactive term DAOPE is positive (7.48E-06) and insignificant at 5% since the probability value of 31.68% is greater than the significant level. This suggest that the positive effect of debt to assets on Tobin's Q ratio (TQ) is increased by 0.00000748 for the firm with high agency problem.

5.0 Conclusion and Recommendations

This study focused specifically on the non-financial enterprises listed on the Nigeria Stock Exchange between 2011 and 2020 to assess the effects of capital structure and agency cost on firms' value. However, in order to ascertain the capital structure and agency cost effect on the value of firms, the researchers adopted a Panel multiple regression techniques to estimate whether there is a causality running from capital structure and agency cost indicators on the value of firm performance measure. For the purpose of measuring firms' value, Tobin's Q ratio (TQ) was used, while the measurements of independent variables are long term debt ratio, total debt ratio as a proxy of capital structure while asset tangibility and operating expenses are proxy to agency costs and the control variables include bankruptcy cost, firm size and asset growth.

To further investigate into the relationship, we examine the interaction between capital structure and agency cost using both long term debt and debt ratio on operating expenses to sale. The study revealed that the capital structure proxy debt ratio reveals and effect that is

positive and significant on the value of firm while long term debt to assets has a negative and insignificant effect on the value of firm in Nigeria. These results back up the theories of Modigliani and Miller (1962) and Myers (1984), who concluded that capital structure is important in determining a company's value as long as the costs and benefits of debt are balanced. If they are not, the effect becomes negative as is evident in the use of long-term debt. According to Jahanzeb, et al (2014), the optimal capital structure is achieved when a firm cancels out the cost of debt against the benefits. This indicates that non-financial firms in Nigeria are yet to achieve optimality in the use of long term debt since it creates burden on the value of the firm. The study also revealed that there is a positive and significant effect of asset tangibility being a proxy of agency cost firms value in Nigeria. Also, this same relationship was investigated with using operating expenses to sales which provided a mixed result indicating that there is a negative and insignificant effect with Tobin's Q ratio (TQ), this indicates that agency cost issue will only arise and affect the firm when they misuse revenue for their personal interest (Jensen and Meckling, 1976). In conclusion, agency problem will be eliminated when management invest excess cash flow on tangible assets and efficiently manage operating expense and also eliminate information asymmetry. Based on the interactive effect, it was revealed that the negative effect of long term debt ratio on Tobin's Q ratio (TQ) is increased for firm with high agency problem. Also, the study discovered that positive effect of debt to assets on Tobin's Q ratio (TQ) is reduced for the firm with high agency problem. Thus, this increase will only come when there optimality. In conclusion, we can say there is interaction between the capital structure and agency cost of non-financial firms in Nigeria, which is beneficial only under the condition of a reduced or minimal agency issue. Conclusively, debt financing increases agency cost where there is no proper control and monitoring. The study therefore recommend based on the findings that since debt is relevant based on the Modigliani and Miller theory (1962), managers should be optimal in the using debt as a source of finance since a negative relationship exists between the long term debt and value of the firm variables used in this work this was supported by Myers (1984).

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