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CEO Tenure and Financing Decisions of Nigerian Non-Financial Listed Firms: A Dynamic Panel Approach

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Abstract

Access to long-term debt has been a persistent problem facing Nigerian non-financial listed firms. The existing literature suggests that CEO tenure has a bearing on the ability of firms to secure a considerable amount of borrowings to finance their investment opportunities. However, Nigeria's corporate governance framework does not contain a specific recommendation on the CEO tenure, which in turn results in an unstable tenure of CEOs in the Nigerian corporate environment. Thus, this paper examines how CEO tenure influences the financing pattern of the companies operating in the country. The study analysed the balanced panel data set of 63 Nigerian listed firms for seven years (2012- 2018) using the two-step system GMM. In particular, the research found that CEO tenure is significantly and positively associated with the firms' leverage ratio. This evidence underscores the relevance of the CEO tenure on the borrowing decisions of the Nigerian non-financial listed firms. The findings of this research have some policy implications on the firms' capital structure choices. First of all, the Nigerian firms should attach more value to the longer serving CEOs, because longer tenure enhances CEOs' strategic decisions, including the choice of optimum leverage. Also, regulatory authorities in Nigeria should specify the number of years CEOs should serve. By doing so, CEOs will have a stable term in office and thereby empowering them in collaboration with their board members to design an effective debt policy to boost the firms' value.

Keywords:
CEO tenure
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1. Introduction

A chief executive officer (CEO) is the head of the management team charged with the responsibility of managing a firm's daily activities. Also, a CEO and other executive directors are responsible for designing firms' financial policies and presenting the same to the board of directors for ratification (Abor, 2007). Moreover, among the vital decisions that top-level managers may undertake is the financing decisions. The firms' financing decisions is otherwise known as a capital structure choice, and it refers to the mixture of debt and equity that a company used to fund its investment opportunities (Myers, 2001). The ultimate goal of capital structure is for firms to select a portfolio of financing sources that will minimise the cost of capital, enhanced profitability and ensure sustainability (Ardalan, 2017).

One of the important corporate governance mechanisms that the literature identified is CEO tenure. A CEO tenure refers to the number of years a CEO remains in his position. In this regard, the existing literature shows different views regarding how the CEO tenure influences firms' financing choice. According to the agency theory, firm managers should have a moderate office tenure, because a higher tenure promotes managerial entrenchment. Hence, the agency literature concluded that entrenched managers adopt capital

structure with a lower proportion of debt (Berger, Ofek, & Yermack, 1997; Ndaki, Atle Beisland, & Mersland, 2018). Perhaps due to the performance pressure of high debt level. On the other hand, the upper-echelons framework considers CEO tenure as an avenue for acquiring cognate experience. In this context, Hambrick (2007) explains that CEO tenure is positively associated with managerial skills and firms' strategic decisions. Given these contradictory views, one may argue that the effect of CEO tenure on firms' capital structure may differ across firms operating in different countries. Hence, our focus in this study is on the Nigerian corporate sector.

Accordingly, this article focuses on the Nigerian corporate environment for several reasons. First of all, prior studies pay less attention to modelling the relationship between CEO tenure and capital structure. Most of these Nigerian studies concentrated on the effect of board size, board composition and CEO duality on the debt-equity choice of the Nigerian firms (Adegbile, 2015; Ganiyu & Abiodun, 2012; Ranti, 2013). Secondly, the codes of corporate governance (CCG, 2011) that guides the conduct of the non-financial companies operating in the country do not contain a specific recommendation on CEO tenure. Besides, the Nigerian listed firms face difficulty in accessing a considerable amount of leverage to finance their investment opportunities due to the undeveloped nature of Nigerian debt market (Ahmad & Etudaiye-Muhtar, 2017). In this context, both agency and upper-echelons theories argue that CEO tenure has a strong bearing on how firm managers design their capital structure composition. Therefore, this paper seeks to determine the impact of CEO tenure on the borrowing decisions of the Nigerian listed firms.

More specifically, this paper looks at the relationship between CEO tenure and capital structure from the perspective of the agency theory, upper echelons and trade-off theories. Thus, providing new insight into the Nigerian corporate governance literature. Unlike previous studies, this research employs a generalised method of moments (GMM) which has been considered to be a more robust estimation method. The GMM procedure can mitigate endogeneity and reverse causality effect and thereby producing more consistent and efficient results (Arellano & Bover, 1995). Contrary to the prediction of the agency theory, the empirical evidence from this paper suggests CEO tenure is positively related to capital structure. Thus, the result implies that experienced CEOs aimed at an optimum leverage level to enhance firms' value.

The rest part of the paper proceeds as follows: the second section presents an overview of the literature. Part three explains the methodological approach of the study. Also, part four discusses the empirical results, while the last segment carry's closing remarks.

2. Literature Review

This research views the nexus between CEO tenure firms' financing decisions using the lenses of the agency framework, upper-echelons and trade-off theories. In particular, the agency theory focused on how the separation between ownership and control in an organisation may lead to an agency conflict. Given that the management of firms' resources is vested in the hands of managers, this perspective believed that these mangers might likely to engage in maximising their utility at the expenses of the shareholders' wealth (Fama & Jensen, 1983; Jensen & Meckling, 1976). In this way, the theory suggested that firms should constitute a board of directors to monitor the actions of the CEO and his management team. Accordingly, the agency literature identified several mechanisms by which a corporate board can exploit to exercise its oversight functions. One of such mechanisms that determine the monitoring capacity of a board of directors includes CEO tenure. According to the agency framework, longer CEO tenure promotes managerial entrenchment, which in turn, hinders effective corporate governance (Berger et al., 1997; Hermalin & Weisbach, 1998). Therefore, this theory concluded that longer CEO tenure weakens board monitoring.

On the other hand, the upper-echelons theory considered CEO tenure as an avenue for acquiring cognate working experience. According to this viewpoint, the managers' cognate experience is directly related to the firms' decision-making capacity (Barney, 1991). Also, some studies argued that longer CEO tenure is associated with increased confidence in decision making and risk-taking behaviour of top-level managers. Thus, suggesting that a CEO's ability to take more challenging decisions increases as his tenure lengthens (Güner, Malmendier, & Tate, 2008; Orens & Reheul, 2013). Moreover, the upper-echelons theory argued that managers' experience broadens as their tenure increases and that experienced CEOs rebalance their capital structures with more debt to raise firms' value. In this regard, empirical evidence reported a significant positive relationship between CEO tenure and total debt as a proxy for firms' capital structure (Matemilola, Bany-Ariffin, Azman-Saini, & Nassir, 2018; Ndaki et al., 2018; Ting, Azizan, & Kweh, 2015).

Additionally, the trade-off theory suggested that firms have optimum leverage ratio that maximises their value. The optimum point is where the benefits and costs of debt are equal (Kraus & Litzenberger, 1973; Shyam-Sunder & Myers, 1999). According to this framework, the interest on borrowings is an allowable expense in the determination of companies' income tax. Therefore, debt financing enables firms to shield a considerable proportion of their profits from income tax (Sani, 2020). This paper believed that financing decision is among the strategic decisions that a CEO and his management team will undertake to enhance firm value. In this way, top -managers' cognitive capacity broaden as their tenure rises which in turn leads to the usage of more debt to derive the advantage of the interest tax shield. In sum, the integration of the upper-echelons and trade-off theory perspectives may permit one to predict that the determination of optimum

leverage is a function of CEO cognate experience. Hence, this study hypothesised that CEO tenure exerts a significant positive influence on the firms' capital structure.

Furthermore, the agency literature argued that board size is also an essential attribute that determines board monitoring. In this context, Jensen (1993) and Pillai and Al-Malkawi (2018) emphasised that larger boards are less effective in discharging its monitoring role. Similarly, as shown by Yermack (1996), investors have the perception that companies with smaller board size are associated with robust governance system. In addition, there is strong evidence from the literature that creditors attached more value to the firms with sound corporate governance, and thus board size is negatively related to the supply of debt (Abobakr & Elgiziry, 2016; Dimitropoulos, 2014; Kyriazopoulos, 2017; Sewpersadh, 2019). The agency theory also pointed out that the presence of independent directors on corporate boards may enhance the effectiveness of firms' decisions (Zahra & Pearce, 1989). Perhaps due to the technical knowledge and skills that such directors possessed. In this regard, empirical evidence reported that the stock market reacts positively to the appointment of outside directors. Hence, empirical studies found that firms' leverage decreases as the proportion of independent directors on boards increases (Kyriazopoulos, 2017; Purang, Abdullah, & Bujang, 2016; Wen, Rwegasira, & Bilderbeek, 2002).

Nevertheless, existing studies also showed that firm-level attributes might also explain the variation of capital structure across firms. For instance, findings reported that larger companies are relatively more diversified; they generate substantial cash flows and have a lesser probability of bankruptcy. Thus, bigger firms are associated with a considerable debt ratio in their capital structure compositions (Chipeta & Deressa, 2016; Fitzgerald & Ryan, 2019; Titman & Wessels, 1988; Wald, 1999). Also, some studies emphasised that profitable firms rely more on internally generated funds because of the information asymmetry between companies and potential investors (Myers, 1984). Therefore, due to this disparity of information, potential investors may undervalue the new equity or debt instruments issued by firms. In this situation, profitable firms may prefer internal funding against external financing sources. This instance leads to the conclusion that firms' leverage ratio decreases as companies' profitability level grows (Alipour & Derakhshan, 2015; Lemma & Negash, 2013).

In the same vein, existing literature showed that firms with high liquid assets might also give less attention to debt financing. In this way, firms with a considerable percentage of a liquid asset have a greater ability to meet up their financial commitments as at when due. Thus, resulting in the prediction that highly liquid firms issue fewer debt instruments when rebalancing their capital structure (Abdulla, 2017; Al-Najjar, 2011; Rokhayati, Pramuka, & Sudarto, 2019).

3. Research Methodology

3.1 Sample Size and the Study Variables

This article analysed the balanced panel data set of 63 Nigerian non-financial listed firms for seven years (2012-2018). The paper exploited a purposive sampling technique and constructed its sample size in the following manner. In the first instance, this research considered only the firms that revealed financial and corporate governance information in their annual reports. Moreover, the study focused on non-financial firms because financial firms are subjected to regulations such as minimum capital requirement. Hence, the capital structure compositions of the financial firms appear to be unique (Rajan & Zingales, 1995). More precisely, the study variables are as follows: the capital structure (TD) stands as the dependent variable. The main explanatory variable is CEO tenure, while the control variables include board size (BS), board independence (BI), firm size (FS), return on assets (ROA) and liquidity (LIQ). This study included these control variables to minimise specification bias and likewise to empower our regression model.

3.2. Econometric Model

This study employed a generalised method of moments estimator (GMM) to investigate the dynamic relationship between CEO tenure and capital structure. If one applies static estimation methods to determine a dynamic relationship, the parameter estimates may be biased due to the possible correlation between the lagged dependent variable and error term (Arellano & Bond, 1991; Roodman, 2009). Thus, as shown by Ozkan (2001), GMM is the most suitable approach in estimating dynamic relationship among variables. The GMM is of two variants: the difference and system GMM. In particular, the system GMM framework is relatively more robust because the technique introduces more instruments to dramatically enhance the efficiency of the econometric estimates (Arellano & Bover, 1995). Also, the two-step system GMM is more efficient in dealing with heteroscedasticity and autocorrelation because the estimator utilises the first-step errors to construct heteroscedastic-consistent standard errors (Roodman, 2009). Therefore, this paper used the two-step system GMM framework in determining the impact of CEO tenure on the capital structure of Nigerian non-financial listed firms.

Accordingly, the specification tests available to ascertain the validity of GMM estimates include the Hansen test of over-identifying restrictions and the Arellano and Bond test of no second-order serial correlation (Arellano & Bond, 1991). The null hypothesis of the Hansen statistic is that the instruments are robust and uncorrelated with the error term. Therefore, one may fail to reject the null hypothesis of the

Hansen test when its P-value is insignificant. On the other hand, the null hypothesis of the Arellano and Bond test suggests that there is no second-order serial correlation in the first differenced error-term. Thus, when the p-value of the Arellano and Bond test is significant, the GMM estimates in question suffer from the second-order serial correlation.

This paper adopted the partial adjustment model used by Ozkan (2001) with some modification to suits the nature of this research. The model is given as:

$$y_{it} = (\delta - 1)y_{it-1} + \beta X_{it} + \mu_i + \mu_t + \varepsilon_{it} \quad (1)$$

Where y_{it} represents the dependent variable in the model for firm i in t time, y_{it-1} is the lagged dependent variable, δ is the adjustment parameter, which is a coefficient value that lies between 0 and 1, the speed of adjustment is given as (1-δ), X_{it} is the vector of independent variables in the model, μ_i is the firm-specific effect, μ_t is the time effects and the error term is denoted as ε_{it}. Therefore, by substituting the study variables into the Equation 1, this research specifies the model in equation two below:

$$TD_{it} = (\delta - 1)TD_{it-1} + \beta_1 BS_{it} + \beta_2 BI_{it} + \beta_3 CEOT_{it} + \beta_4 FS_{it} + \beta_5 ROA_{it} + \beta_6 LIQ_{it} + \mu_i + \mu_t + \varepsilon_{it} \quad (2)$$

Where:
TD = book value of total debt/book value of total assets for a firm i in time t.
BS = the total number of board members for firm i in time t.
BI = number of independent directors divided by the board size for firm i in time t.
CEOT = the number of years a CEO has been holding his position for firms i in time t.
FS = is the firm size, determined as the logarithms of total assets for firm i in time t.
ROA = Net profit before interest and taxes over the total assets for firm i in time t.
LIQ = liquidity, determined as the current assets over current liabilities for firm i in time t.

4. Empirical Results and Discussion

Table-1. Descriptive Statistics.

Variable	Mean	Std. Div.	Min.	Max.	Observations
TD	0.2302	0.1908	0.0000	0.8490	441
BS	8.7990	2.3603	4.0000	17.000	441
BI	0.0801	0.1146	0.0000	0.5560	441
CEOT	5.4852	5.2256	1.0000	29.0000	441
SIZE	10.1903	0.7904	8.4190	11.9170	441
ROA	0.0751	0.1250	-0.3100	0.5290	441
LIQ	1.1929	0.6602	0.0650	3.8490	441

Note: TD = total debt / total assets, SIZE = firm size, ROA = return on assets, LIQ = liquidity, BS = board size, BI = board Independence, CEOT = CEO tenure.

Table 1 exhibits a descriptive statistic of the study variables. The variable (TD) represents the ratio of total debt over total assets, and its average value is 0.2302. This evidence suggests that the firms' total debt stands at 23.02% of their total capital employed. Thus, the result signifies that the Nigerian non-financial listed firms rely heavily on equity in financing their operations. Perhaps, because of the difficulty in securing a substantial amount of leverage from the Nigerian capital market. The board size (BS) of the sampled companies indicates an average of nine members approximately, but with a large deviation across the companies. Also, board independence (BI) shows that 8% of the firms' board members are independent directors.

According to the statistics, CEO tenure (CEOT) ranges from one year to twenty-nine years and thereby showing that CEOs' tenure across the firms differs substantially. The variable firm size (FS), which is measured as the logarithms of the firms' total assets reveals a minimum and maximum ratio of 8.4190 and 11.9170, respectively. The return on assets (ROA) suggests that on average, the firms recorded a profitability ratio of 7.5%. This research attributes this low profitability level to the inability of the firms to obtain a substantial amount of borrowings and thus, leading to the lower return on assets. The liquidity position of the companies (LIQ) exhibits a minimum and maximum ratio of 0.650 and 3.8490, respectively.

On the other side, Table 2 contains the correlation results among our study variables. The evidence suggests that there is no significant association across our explanatory variables. Hence, the result reveals that our model specification is free of the multicollinearity problem.

Table-2. Correlation Matrix.

Variable	TDTA	SIZE	ROA	LIQ	BS	BI	CEOT	VIF
TD	1.000							
SIZE	0.031	1.000						1.20
ROA	-0.279***	0.164***	1.000					1.09
LIQ	-0.388***	-0.047	0.176***	1.000				1.07
BS	-0.104**	0.344***	0.005	-0.032	1.000			1.17
BI	-0.0289	0.1722***	0.026	0.105	0.142***	1.000		1.05
CEOT	0.239***	-0.095	-0.104	-0.087*	-0.187***	0.079	1.000	1.08

Note: TD = total debt / total assets, SIZE = firm size, ROA = return on assets, LIQ = liquidity, BS = board size, BI = board Independence, CEOT = CEO tenure
***, ** & * indicate significance at 1%, 5% and 10%.

Table-3. Regression Results: Two-step System GMM.

Dependent variable	Independent Variable	Coefficient	Z-statistics	P-value
Total debt ratio (TD /TA)	TD_{it-1}	0.7694***	33.09	0.000
	Firm size	0.0086***	3.21	0.001
	Return on assets	-0.1027	-0.94	0.346
	Liquidity	-0.0290***	-8.02	0.000
	Board size	-0.0022**	-2.45	0.014
	Board independence	-0.0581***	-4.27	0.000
	CEO tenure	0.0013**	2.10	0.036
	Hansen statistics			0.111
	AR1			0.001
	AR2			0.162
	Wald statistics			0.000
	Year dummies			yes
	Industry dummies			yes

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

Table 3 shows the two-step system GMM regression results of the relationship between CEO tenure and the financing decisions of the Nigerian listed firms. According to the results, this study satisfies the underlying assumptions of the GMM diagnostic tests. The Hansen statistic shows an insignificant P-value. Therefore, this paper fails to reject the null hypothesis of instruments validity. Thus, the evidence indicates that our GMM estimate at hand is valid and robust. As expected, the P-value of the AR2 also appears insignificant, which implies that in our model specification, the second-order serial correlation is absent. The Wald statistics exhibit the joint significance of the explanatory variables in predicting the leverage ratio of the Nigerian listed firms. Also, the lagged total debt ratio ($TDit_{-1}$) is positive, and significant at the 1% level. The adjustment coefficient predicts that the firms make a partial adjustment speed at the rate of (1-0.7694) = 23.06% annually. This adjustment process appears to be slowly and thus, signifying the presence of high floatation costs in the Nigerian capital market.

Moreover, the regression results show that the CEO tenure, which is our primary explanatory variable, is positively related to leverage at the 5% significance level. This result reveals that CEO tenure exerts a strong positive influence on the total debt ratio of the Nigerian listed firms. The evidence is associated with the argument of the upper-echelons theory that CEO experience broadens as his tenure increases. Again, the result aligns with the finding that there is a positive relationship between CEO experience and capital structure (Matemilola et al., 2018; Ndaki et al., 2018; Ting et al., 2015). More importantly, this empirical result emphasises that longer tenure enhances the strategic decisions of the CEOs of Nigerian non-financial listed firms.

Additionally, some of the control variables that this paper employed show signs consistent with the existing literature. For instance, the variable board size displays a negative coefficient and thereby revealing that as the Nigerian non-financial listed firms' board size grows, their leverage ratio decreases. This finding provides support to the studies by Dimitropoulos (2014); Kyriazopoulos (2017); Sewpersadh (2019). These empirical works argue that firms with larger board members are associated with lower debt in their capital structure. One possible explanation for this finding is that a larger board size weakens corporate governance and thereby sending a wrong signal to creditors. Hence, this circumstance may give rise to the negative between board size and the firms' leverage. Also, the regression results of this research indicate that board independence exerts a negative effect on the total debt ratio at the 1% level of significance. This evidence is consistent with the findings by Wen et al. (2002) and Purang et al. (2016). These studies showed that firms' stock prices rise due to the appointment of independent directors. In this way, Nigerian non-financial listed firms with a higher proportion of independent directors on their boards may design their capital structures with more equity than debt. Thus, resulting in an adverse effect of board independence on the firms' leverage ratio.

Furthermore, the study also included firm size, return on assets and liquidity as control variables. With regard to firm size, the results show significantly that larger companies carry a higher leverage ratio. This finding reinforces the underlying assumptions of the trade-off theory that bigger firms are relatively more diversified; they generate substantial cash flows and have a lesser probability of bankruptcy. Therefore, this positive impact of firm size is in tandem with the studies that found that larger companies issue a sizeable number of debt securities (Chipeta & Deressa, 2016; Fitzgerald & Ryan, 2019; Titman & Wessels, 1988; Wald, 1999). However, according to the findings, profitability measured by the return on assets (ROA) documents an insignificant effect on leverage. This study attributes this weak association between profitability and debt to the inability of the Nigerian listed to employ substantial leverage in their capital structure. Therefore, using a lower debt level may prevent the firms from deriving the full benefits of the interest tax shield. This instance may result in an insignificant relationship between ROA and the companies' total debt ratio. Also, evidence in this research strongly suggests that liquidity and debt financing are negatively related. This finding is consistent with the prediction that highly liquid firms issue fewer debt instruments when setting their capital structures (Abdulla, 2017; Al-Najjar, 2011; Rokhayati et al., 2019).

5. Conclusion

This article looked at how CEO tenure determines the capital structure of the Nigerian non-financial listed firms. The research analysed the panel data of the 63 companies from the year 2012-2018 using the two-step system GMM. The study viewed the nexus between CEO tenure and firms' financing decisions within the context of the agency theory, upper-echelons and trade-off perspectives. The research found that CEO tenure is significantly and positively associated with the firms' leverage ratio. Thus, the evidence underscores the relevance of the CEO tenure on the borrowing decisions of the Nigerian non-financial listed firms. In addition, the evidence from this paper also showed that board size, board independence, firm size, profitability and liquidity might also explain the variation of debt ratio across the Nigerian firms.

Furthermore, the findings of this research have some policy implications on the firms' capital structure choices. First of all, the Nigerian firms should attach more value to the longer serving CEOs, because longer tenure enhances CEOs strategic decisions, including the choice of optimum leverage. Also, higher CEO tenure may pave the way for firms to access a considerable amount of leverage from the external environment to boost firms' value. Secondly, shareholders should allow CEOs to serve for a longer term in office. This opportunity will empower a CEO in consultation with board members to design an effective debt policy that may enable the firms to derive the benefits of debt financing. However, the paper has some limitations because the study measured capital structure using the book value of debt. Also, we do not control for other board attributes like board gender and CEO skill. Therefore, future studies should explore such directions with the view to providing more evidence on the determinants of firms' capital structure.

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