BOARD ETHNIC DIVERSITY: DOES IT AFFECT CAPITAL STRUCTURE?

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Abstract

Objectives: *The study examined the effect of board ethnic diversity on capital structure of listed agricultural companies in Nigeria. The study focused on the three major ethnic groups in Nigeria which included Igbo, Yoruba and Hausa-fulani.*

Methodology: *The expost facto research design was adopted and panel data used. The data was sourced from the published financial statements from NSE of the listed agricultural companies in Nigeria from 2015-2019. The data was subjected to diagnostic test for multicollinearity, normality and heteroscedasticity using VIF and Breach Godfrey test. OLS was used in testing the formulated hypotheses using SPSS 25.*

Indicators: *Ethnic diversity was measured as the ratio of Igbo, Yoruba and Hausa-fulani groups on the total board of directors while capital structure was measured as debt to equity.*

Findings: *The study holds that board ethnic diversity does not have a significant influence on the capital structure of firms.*

Keywords: BOD, ethnicity, capital structure, equity, debt.

Introduction

Demographic diversity at top management is a growing concern in the social, political and cultural perspective of corporate board members. Global concern has been drawn to corporate governance issues due to high profile corporate scandals experienced globally.

The Nigerian economy is a fast developing economy like other African economies, known for her multi-ethnic and multi lingual nature, the Nigerian business environment is not free from the criticisms of governance as it concerns fair ethnic representation in corporate organizations. The question is, does the representation of the majority ethnic groups (Igbo, Hausa-fulani, Yoruba) and others matter in enhancing fair value? Ethnic diversity to firm value has not been well addressed in the Nigerian context, this has given this study a unique standpoint.

In a business environment like Nigeria with diverse ethnic groups, the question of if ethnic composition in company's board of directors becomes inescapable. Business approach and perception to the ordinary Nigerian seem different between the major ethnic groups (Igbo, Yoruba and Hausa-fulani). The Igbos are viewed as very industrious and business oriented people with the business view of expanding and penetrating every possible business territory both home and abroad. With this perception, the option of loan as against equity is accredited to the Igbos as the option for expansion and the best capital composition decision. Whereas, the Yorubas and the Hausa-fulani are seen as more reserved though seeking expansion in business but not at the pace of the Igbos. This has informed the study to empirically examine the effect of ethnic differences in the capital composition of listed agricultural firms in Nigeria.

H₀₁: Hausa-fulani ethnic group on BOD does not have any significant effect on capital structure.

H₀₂: Yoruba ethnic group on BOD does not have any significant effect on capital structure.

H₀₃: Igbo ethnic group on BOD does not have any significant effect on capital structure.

Ethnic Diversity

Board ethnic diversity is viewed as the level of ethnic diversity measured as a variation in the ethnic composition of the Board of Directors, whereas the ethnicity of the Board of Directors is determined by the largest proportion of directors that belong to a particular race. According to Zainal et al. (2013), ethnicity and firm performance has a positive and significant relationship in the Malaysian context. Some researchers have found that there is no relationship between ethnic diversity and firm financial performance in Malaysia (Monks, 2005). Hence, results are inconsistent regarding ethnic diversity. Hassan, Marimuth, Tariq and Aqeel (2017) researched effect of ethnic diversity in top management teams (TMTs). It was found that there is no effect on the firm performance if the company goes for the ethnic diversity.

Hambrick, Cho and Chen (1996) discussed advantages of having ethnic diversity in board. Ethnic diversity broadens knowledge, idea and experience through the range of information resources of different cultural background among the board members. An organization with high level of cultural heterogeneity in management is able to share ideas and reach ultimate

decision based on the various thinking and thus, will improve management performance through a common consensus among the multiracial group of the boards. Thus, large ethnic diversity may improve firm performance by sharing and reaching ultimate decision (Shukeri, Shin & Shaari, 2012).

Awaworyi and Valenzuela (2019) posit an unfavorable performance of firms with high levels of ethnic associations on the board. Hassan, Marimuthu and Johl (2015) Malaysian study showed that ethnic diversity is negatively associated with market value of firms.

An early study by Marimuthu (2009) showed ethnic diversity enhances firm financial performance in the Malaysian context. Cheong and Sinnakkannu (2014) study found a significant positive relationship between ethnic diversity and firm financial performance and that financial performance of companies differ between ethnicities.

Capital Structure

The pioneer of this debate and studies on capital structure theory is Modigliani and Miller (1958). Capital structure decisions are among the most important and crucial decisions for any business because of their effect on the firm. The question of the appropriate capital mix for the decision of survival and growth is core to maintaining the going concern of the firm. Capital structure is one of the most important areas in financial decision. This is because of the relationship it has with other financial decisions variables. Capital structure is seen as the overall configuration of long term funds at the disposal of an enterprise for the pursuit of its objectives (Ekwueme & Atu, 2018). A study by Ong and Teh (2011) opined that capital structure is a mixture of a company's debts (long-term and short-term), common equity and preferred equity. The theory of corporate debt capacity & capital structure suggests that any given combination of debt instrument in equity capital employed by a business at any given point in time has significant implications for various managerial actions especially those concerning future solvency & profitability (Osazie, 1985). Pandey (2010) defined capital structure as the various means of financing a firm, that is, the proportionate relationship between debt and equity. Pandey (2010) further stated that capital structure is a significant managerial decision because it influences the shareholder's return and risk as the market value of the share may be affected by the capital structure decisions.

If a company has higher debt rather than equity that the company doesn't make higher income because for the higher debt company need to pay higher interest which creates lower profit, on the contrary for the equity company, no need to pay interest but it provides dividend to the shareholder, if the company can make a good profit it can pay high dividend. So, a company needs to fix a balance between debt and equity (Weston and Brigham, 1979; Hossain, Khan & Khalid, 2019).

Social Impact Theory

The social impact theory (Latane, 1981) explains that the amount of influences exercised in a group is anchored on strength (power or social status) of the group, immediacy (physical or psychological distance) of the group and the number of people in the group exerting the social influence (number of sources). This can depict that a set that have more members, a close proximity, high power should exert a considerable influence on decisions.

Minority influence is said to occur when a minority subgroup attempts to change the majority (Rashotte, 2007). Researchers have often defined the process of social influence as the majority outmuscling the minority.

The major ethnic groups in Nigeria are the Igbo, Yoruba and the Hausa-fulani, in tackling capital structure optimization, the question is do the three major ethnic groups exercise influence on capital decisions on the board? Considering social impact assumptions, the three major ethnic groups are supposed to possess greater amount of influence in corporate boards due to their number and position as ethnic majority.

Methodology

The study classifies the ethnic groups in Nigeria into three (3) keeping in mind the above 250 ethnic groups in the country. All board members from the North Central, North East and North West are classified under Hausa-Fulani, all board members from South-south and South East are classified under Igbos while all board members from South West are classified as Yoruba. Foreign representation is held constant. The expost facto design was adopted and data was sourced from NSE published financial reports of the five (5) listed agricultural companies in Nigeria. The panel data covered the period of 5 years (2015-2019). The agricultural sector over the past one decade has received a considerable though not satisfactory economic focus in the mission for economic diversification in Nigeria with diverse expansion avenues created by both public (government) and private institutions.

The study was guided by a regression model:

$$CS = \alpha_0 + \alpha_1 Eth + \epsilon$$

The model is enlarged thus:

$$Dte = \beta_0 + \beta_1 Hf + \beta_2 Yrb + \beta_3 Ig$$

Where β_1 , β_2 and β_3 represents α_1

Figure 1: Conceptual model of influence of board ethnic diversity and capital structure

Source: Authors Model (Adanco)

Variable	Proxy	Measurement
Capital structure	Debt to equity	Long-term debt/long-term debt + total equity
Board Ethnicity	Igbo (Ig) Yoruba (Yrb) Hausa-fulani (Hf)	Ratio of Igbo to total directors Ratio of Yoruba to total directors Ratio of Hausa-fulani to total directors

Data analysis

The data was subjected to diagnostic test for multicollinearity, normality and heteroscedasticity using VIF and Breach Godfrey test. The standardized coefficient was explained for comparison purpose. Fixed and random effect was carried out, and the random effect was best considered.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.594 ^a	.352	.260	.2730736

a. Predictors: (Constant), Ig, Hf, Yrb

The adjusted R^2 indicates that 26% of the dependent variable (capital structure) measured as debt to equity is explained by the predictive variables captured in the study. The variables not included in the model have 74% influence on the dependent variable.

ANOVA^a

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	.852	3	.284	3.810	.025 ^b
	Residual	1.566	21	.075		
	Total	2.418	24			

a. Dependent Variable: Debt to equity

b. Predictors: (Constant), Ig, Hf, Yrb

The p-value (0.025) shows that the predictors jointly have a significant effect on capital structure of listed agricultural companies at 5% stochastic error term.

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	.896	.193		4.641	.000		
	Hf	.217	.479	.094	.452	.656	.718	1.392
	Yrb	-.373	.248	-.347	-1.503	.148	.578	1.730
	Ig	-.798	.238	-.686	-3.352	.003	.735	1.360

a. Dependent Variable: debt to equity

The standardized coefficients show the Beta value for comparative analysis of the individual predictors. The coefficient value for Hf .094 and a p-value .656 indicates a positive but insignificant effect of Hausa-fulani ethnic group on capital structure. This implies that a unit change in Hf ethnic director on BOD will shift capital composition decision by 9.4% though insignificant to the board final decision. Yoruba ethnic group coefficient value -.347 and p-value .148 implies a negative and insignificant effect on capital structure. The Igbo ethnic group coefficient value shows -.686 with a p-value .003 indicating a negative but significant effect on capital structure.

Study implication

The study considered ethnic difference among the board of directors in the Nigerian context. Agricultural companies listed with Nigerian Stock Exchange were sampled. The findings of the study are relevant in the industry as it will aid policy formulation and implementation on corporate governance with regards to the demographic characteristics of board of directors. Corporate agencies like CBN, FIRS, SEC, NSE will find the study result important in decision making and strategic planning. The agricultural sector will appreciate the result of the study in appraising the how board ethnic diversity influences capital composition of firms.

Conclusion

Board ethnic diversity is a contemporary issue in corporate governance. The increased attention of stakeholders on the state of corporate entities has broadened the search light of practitioners and researchers. Ethnic differences of board of directors have an influence on the capital mix decision of corporate entities in Nigeria. The capital mix is not tied up to a particular ethnic group, the findings revealed that the presence of Igbo, Yoruba and Hausa-fulani on the BOD foster loans and equity as a mix of capital composition while the absence of any of the ethnic groups does not engineer significant changes in the capital structure of agricultural firms. The study holds that board ethnic diversity does not have a significant influence on the capital structure of firms.

Recommendations

The study recommends base on the findings that firms should not be ethnic bias in the composition of Board of Directors. An even representation of the ethnic group will create room for diverse ideas towards the achievement of firm's objectives.

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