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Moderating Role of Corporate Governance on the Relationship between Financial Leverage and Financial Performance: A Conceptual Review

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Abstract
Organisations face new hurdles in the form of competitive advantage in the unstable environment of today. Leverage in finances and corporate governance are key factors in improving the performance of the company. The study's conclusion is that the data regarding the correlation between financial leverage and firm performance are inconsistent. Comprehending the implicit relationship between financial leverage and company success empowers managers to devise strategies that will yield superior operational outcomes. It also aids in improving performance and achieving higher objectives for the organisation. The idea that financial leverage is a significant source of competitive advantage was emphasised by this study. When it comes to any kind of organisation, corporate governance is thought to be the most significant factor and a key factor in determining the organization's success. It is a crucial component of the organization's ability to survive in the marketplace since corporate governance determines an organization's performance, which is a definite sign of its ability to stay in business. The relationship between financial leverage and firm performance was then effectively moderated by corporate governance. Corporate governance, financial leverage, and organisational performance are defined for this purpose. Examples from academic academics are taken into consideration to illustrate how corporate governance and financial leverage affect the performance of organisations. The conclusion is that an organization's success and accomplishments are significantly correlated with how it maintains and manages its financial leverage and corporate governance.
Keywords: Financial Performance, Corporate Governance, Financial Leverage.

1.1 Introduction

The significance of a firm's performance cannot be overstated, particularly from the viewpoint of the shareholders. After all, a company’s financial performance directly interprets the efficacy of managerial strategies in generating returns from investments (Ismaila & Tanko, 2023). However, the extent to which a firm's performance impacts the returns of shareholders' investments is a subject of ongoing debate. Maintaining a clear distinction between business operation and investment growth, shareholders primarily gravitate towards the measure of returns their investments can yield (Abolo, 2023). Henry and Zheng (2017) assert that an organization's financial performance will typically have a significant long-term impact on the various stock returns of the company. The primary goal of shareholders, according to Ironkwe and Emefe (2019), is to maximise their wealth, which is reflected in the share price. Furthermore, within the framework of macroeconomics, financial performance represents the effectiveness of companies in managing their limited resources (Ironkwe & Emefe, 2019). Investor trust in these companies may therefore be increased by their strong performance, which demonstrates the viability of the economy. Investors' concerns have been aroused by the collapse of a few respectable American corporations, like WorldCom and Enron. Numerous businesses worldwide, including those in Nigeria, have experienced performance issues.

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For instance, the success of the oil and gas sector influences the economies of the oil-producing nations of the world, making it a significant contributor to global economic development (Asikhia et al., 2023). Despite the recent search and development of non-fossil energy sources, the cost of meeting a significant portion of the world's non-oil producing countries' energy needs through the Oil and Gas sector still has an impact on their finances (Asikhia et al., 2023). Many nations that produce oil and gas rely on the performance of this sector as their primary source of financial resources. Performance issues in the oil and gas industry have affected profitability, earnings per share, return on assets (ROA), and return on equity (ROE). Similar difficulties have been noted in the financial performance of oil and gas companies listed on the Nigerian Stock Exchange (NSE), indicating that Nigeria is not exempt from this phenomena. The financial performance of oil and gas companies listed on the NSE has been declining in respect to their ROA and ROE, claim Okonkwo, Adigwe, Ezu, and Oko (2020). Similar to this, Bashiru and Bukar (2021) and Oyakhire (2019) demonstrated how capital structure has an impact on the ROA and ROE of listed oil and gas companies in Nigeria.

We can draw the conclusion that no entity can endure in the absence of strong financial or nonfinancial performance. According to Nangih (2021), managers should always improve financial performance to draw in investors and uphold positive relationships with other stakeholders. It also serves as the best indicator of a company's sustainability and the degree to which its objectives have been met. Investigating the causes of the aforementioned organisations' poor performance is therefore necessary. Additionally, it is imperative that variables like financial leverage that may have an impact on a company's performance be routinely reviewed. In addition, there are few studies that have examined the impact of leverage on firm performance with a moderating variable. Instead, most prior research has focused on the direct relationship between the independent and dependent variables, with little attention paid to the possibility that a third variable could affect how the two variables interact.

Aniobi C. S. et al (2021) observed that governance crisis in Nigeria is an institutional problem that would require structural and reorientational approaches to diagnose in other to enable every sector to work efficiently. Financial leverage, on the other hand, refers to businesses borrowing funds to fund their ongoing operations. Numerous advantages of debt financing for business operations include tax deductions, more financial flexibility, and a predictable interest rate (Santos et al., 2023). A company's financial success is greatly impacted by the proper amount of debt it uses to create an ideal capital structure (Akhtar et al., 2021). Additionally, while using debt improves business performance, the existing capital structure encourages companies to use it up to a certain point. Furthermore, employing debt exposes a business to a great deal of danger since defaulting on debt transfers ownership from shareholders to bondholders or creditors (Sahminan, 2021). In order to help different stakeholders understand how debt affects financial performance, it is now crucial to research how debt affects a company's financial performance.

The ideal mix of debt and equity ratios results in the optimal capital structure. Because interest is a tax-deductible expense, a company should choose the optimal combination of debt in its capital structure (Santos et al., 2023). In contrast, businesses that take on excessive leverage may find themselves in financial trouble. Decisions on corporate funding are very important in an organization's corporate structure. Financial leverage policy can be impacted by any actions made by a business board (Kijkasiwat, et al., 2022). A company's rules and processes must be clearly stated and specified in order to operate successfully. In turn, growing business complexity and company failures have made it possible to strengthen corporate governance regulations.

Nations lacking corporate governance would meet catastrophic consequences. A corporation may have a financial crisis if its debt load climbs above the ideal level and it disregards proper corporate governance (Kijkasiwat, et al., 2022). The emphasis on the significance of robust corporate governance practices to mitigate the risks associated with major company scandals, financial crises, and unexpected firm failure has increased (Puni & Anlesinya 2020). Corporate governance can function as a method to align the interests

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of stakeholders and management, since the interests of owners and representatives may differ. According to Bhagat and Bolton (2019), companies that adhere to clear corporate governance principles are more capable of managing efficient procedures, exercising control over supervision, providing more chances for growth, and having improved access to resources. As a result, they enhance overall performance and lower risks.

Previous research indicates that corporate governance influences capital structure decisions made by businesses, and that these effects can vary depending on whether a country is developed or developing (Kijkasiwat, et al., 2022; Pham & Nguyen 2019; Zhou et al. 2021; Khan et al. 2019). A larger board benefits shareholders in emerging nations, but in industrialised financial systems, the opposite is true, according to Rashid (2018). Financial leverage in developing nations is also impacted by board independence (Abobakr & Elgiziry 2019). A board's judgement about capital allocation is influenced by the number of non-executive directors. Businesses have easier access to resources since they are more knowledgeable about the jobs that the organisation performs (Kijkasiwat, et al., 2022). According to Pillai and Al-Malkawi (2018), because of information asymmetry in financial markets, board independence is ineffective as a tool for overseeing owner managers in some developing nations. In contrast, leverage policies are supported in developed nations by corporations that have superior rules and protection of the interests of minority shareholders (Awasthi 2017). The questions of whether corporate governance (CG) moderates the relationship between financial leverage (FL) and firm performance (FP) emerge in light of the contradictory findings from previous research. In the context of developed and emerging economies, this specific subject has not been addressed in the literature (Kijkasiwat, et al., 2022).

The body of research in this area focuses on the following relationships: (1) leverage and corporate governance; (2) leverage and corporate governance; (3) firm performance and leverage (Dalci 2018; Guo et al. 2021; Kijkasiwat, et al., 2022); and (4) leverage and corporate performance (Hajawiyah et al. 2020; Vijayakumaran & Vijayakumaran 2019). The empirical evidence about these effects in a single nation strengthens the case for state-owned nations, in particular, to adopt their own robust corporate governance code (Bhatt & Bhatt 2017). (Zhou et al. 2021). Finding the impact of financial leverage on company performance is necessary, nevertheless, especially in light of the variations in corporate governance frameworks across developed and developing nations. It is crucial to address the issue of whether corporate governance influences the way in which financial leverage and business performance interact. First, the literature on the connection between financial leverage and company performance is inconsistent. The moderating influence between these variables may be significant if the relationship between financial leverage and company performance is not consistent. Secondly, it is important to determine the effects of any changes in corporate governance as a moderator on financial leverage and business performance.

1.2 Objectives of the Study

The objectives of this research paper are as follows:

i. To explain the concept of firm performance and its advantages for an economy of the country.
ii. To explain the concept of financial leverage and its advantages for an organization.
iii. To examine the relationship between financial leverage and organizational performance.
iv. To explain the concept of corporate governance and its advantages for an organization.
v. To examine the relationship between corporate governance and organizational performance.
vi. To examine if corporate governance can moderate the relationship between financial leverage and organizational performance.

2.0 Methodology

To obtain the above objectives, the study applied a systematic review of literature review from various research articles. Hence this study is a desk research rather than a survey researching.

3.0 Literature Review

3.1 Concept Financial Performance

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Many academics held that organisation theory and strategic management were the starting points for research on financial performance (Samuel & Abdulatef, 2016). Because of this, the focus of an analysis of a firm's financial performance should be on defining the idea of financial performance, which encompasses the various dimensions from which a firm's financial performance originated. The process by which a business allocates its resources in accordance with its operational strategy and goals in order to gain a competitive edge is known as firm financial performance. Ibrahim and Abdullahi (2019) describe financial performance as a company's capacity to optimise its operating costs, make the best use of its resources, and increase shareholder value. It demonstrates the management's efficacy and efficiency in using company resources. It can also mean a company's effort to reach predetermined targets or maximise efficiency. Additionally, it is a gauge of the company's profitability, earnings, and value growth, which is revealed by the increase in share market value (Ibrahim & Abdullahi, 2019).

Nonetheless, a measure of a company's financial performance is its ability to turn a profit from its main line of business (Gofwan, 2022). A company's overall financial health can be inferred from its financial performance during a given time period. Stakeholders in the firm include trade creditors, bondholders, investors, employees, and management. These parties are all monitoring the company's financial performance. According to Man and Wong (2013), a company's financial performance demonstrates how successfully it generates revenue and allocates its resources to satisfy the demands of its stakeholders and investors. A business's financial health can be evaluated using a variety of metrics. You can use operational income, cash flow from operations, and other comparable indicators. Another option would be to use the quantity of units sold (Gryphon & Mahajan, 2019). In order to uncover information that contributes to increased earnings or decreasing debt, the analyst or investor also wants to go deeper into the financial statement.

Corporate performance metrics come in a variety of forms, so picking the right ones to further your research goals is crucial. Performance evaluations provide information on the right metrics to use while addressing research issues. But there isn't always consensus on which performance metrics should be applied (Haniffa & Hudaib, 2006). The performance of the company has been measured using a variety of metrics in previous research (e.g., value ratio, labour productivity, net present value, market-to-book value, and earnings per share). For the sake of this proposal, the performance metrics might be categorised into two main groups: accounting metrics, namely ROA, and ROE, and Tobin's Q is a market metrics. In conclusion, among the most popular accounting metrics for assessing financial success are without a doubt ROA and ROE. A firm's assets make up its total worth, while its equity is the total amount of investors' investments in the organisation. In order to determine the rate of return on the equity and asset, (Nana & Baiden, 2020; Armstrong & Gyimah, 2019; Ashari & Krismiaji, 2019; Oroud, 2019; and Siddik, 2017) employ both ROA and ROE as the primary metrics.

3.2 Financial Leverage

To finance their assets and grow their operations, businesses require money. To finance their assets, a variety of funding sources are available. Basically, there are two types of financing that can be used: long-term loans, bonds, ordinary and preferred stock issues, and reserves and retained earnings, which are examples of internal financing sources. According to Khalid et al. (2017), financial leverage is the use of borrowed funds, or debt, as capital through the utilisation of various funding sources. These sources can be short- or long-term debt, such as bonds or debentures. Financial leverage, according to Horne (2009), is the use of a fund or asset for which the company pays a fixed cost in exchange for a fixed return. One strategy used by owners and managers to finance their capital is leverage. A company's entire interest-bearing debt is compared to its total assets, or capital, as appropriate, to get a basic picture of how much debt it is using. A greater proportion suggests a riskier endeavour and a greater reliance on debt. It has the ability to ascertain the whole amount of financial risk (Khalid et al., 2017).

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Leverage is defined as the ratio of debt to equity in a company's capital structure. It describes the degree to which a business boosts performance by utilising both equity and borrowings. Given that it affects market value, risk, and shareholder return, the financing choice is solely a managerial one (Nwanna & Ivie, 2017). Businesses that took on a substantial amount of debt during a recession may be viewed as having a high degree of leverage, which could be extremely risky. Financial leverage is the process of financing the purchase of assets with borrowed funds (debts) in the hopes that the capital gain from the sale of the acquired assets would outweigh the cost of borrowing. It is also known as the measure of how much a company uses equity and debt to finance its assets in order to raise operating profits.

Generally speaking, businesses can raise capital from both internal and external sources. By returning a portion of their profits—which would have otherwise been paid out as dividends to shareholders—to their shareholders, the corporations are able to raise money internally. It is also possible to raise money from outside sources by issuing debt or stock. The choice about the firm's leverage is based on how much debt and equity to use to finance the business (Sagin & Eragbhe, 2014). Financial leverage, as defined by Adetunji et al. (2016), is the percentage of fixed income securities (like debt) that are used in a company's capital structure. Debt, equity, and hybrid securities are possible financing choices that will represent the performance and worth of the company. Elevated debt funding could lead to default and bankruptcy expenses, whilst equity financing would send a negative message about the company's performance to the public. Managers that make wise capital structure decisions will optimise investment utilisation and ensure the long-term viability of the business (Ibrahimy & Aidi, 2021). As a result, it will guarantee that the goal of the company—maximizing shareholder wealth or the firm's value—is achieved.

3.3 Concept of Corporate Governance

Corporate governance is a framework for directing and controlling enterprises, according to the OECD (2004). The corporate governance structure delineates the allocation of rights and obligations among various stakeholders, including the board, management, shareholders, and other relevant parties, and delineates the protocols and guidelines for reaching decisions concerning corporate matters. The OECD Principles are the first attempt at developing the fundamentals of a sound corporate governance framework by an intergovernmental body. Governments can use it as a reference point to assess and enhance their laws and regulations, and firms can use it as a guide when creating corporate governance frameworks and best practices (OECD, 2004). It is an internal control and procedural system used in the management of specific businesses. Within an organisation, it offers a framework that outlines the rights, obligations, and functions of various groups, including the management, the board, controlling shareholders, and minority or non-controlling shareholders. Corporate governance is designed to keep one group from seizing the assets and financial flows of another organisation or groups (Anonymous, 2018).

Jensen and Meckling (1976), Shleifer and Vishny (1997), John and Senbet (1998), Tirole (2001), Imhoff (2003), OECD (2004), Keasey et al. (2005), and CBN Codes (2003, 2006) are a few additional academics and organisations that have defined corporate governance differently; their definitions did, however, agree on one important point: corporate governance includes all policies and practices designed to guarantee that management makes decisions that maximise the firm's value while also acting in the best interests of all stakeholders. It also includes the entire spectrum of institutional, cultural, and legal frameworks that define the power and authority of publicly listed companies, as well as who controls them, how that power is used, and how the risks and rewards associated with their operations are distributed.

Mueller (2006) distinguishes between two types of corporate governance institutions: those that vary from company to company within a country, like the proportion of outsiders on the board and the number of members on the board, and those that are common to all companies in a country, like law and legal institutions. Four categories of power are proposed by Tricker (1984) for corporate governance: ownership power, corporate director's power, management power, and institutional power. According to Luo (2005), corporate governance is implemented through three mechanisms: corporate integrity and governance

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culture; discipline-based mechanisms (executive penalty, internal auditing, conduct codes, and ethics programmes); and market-based mechanisms (board composition, board size, market discipline, board chairmanship, executive compensation, and interlocking directorate).

However, according to Garko (2014), a thorough examination of the aforementioned definitions reveals that corporate governance is a system used by the business to guarantee the honesty and competence of the management and board in making strategic choices and running the company's operations. Undoubtedly, corporate governance may be understood as a collection of procedures that companies use to function when ownership and management are kept apart. It covers the systems that offer a certain level of investment protection to corporate shareholders. The explanation above makes clear that there are numerous approaches to define corporate governance. A structure for internal control offered by corporate governance lessens agency issues. The framework of corporate governance delineates the respective entitlements and obligations of various business stakeholders and delineates the protocols and guidelines for formulating choices pertaining to corporate matters. Furthermore, corporate governance pushes managers to optimise firm value rather than individual goals and guarantees that all stakeholders have access to accurate information about the organisation's worth. The foundation of every governance system is the means of enabling management control and maximising the value of the company. In light of these factors and the complex nature of CG, the ownership structure, audit committee, and board makeup are conceptualised and modified in this study as essential components of CG.

3.4 Financial Leverage and Performance

Various studies have focused on the direct relationship between leverage and performance for example Kijkasiwat, Hussai, and Mumtaz, (2023); Adamu, Kauji, and Mamuda, (2023); Ermalina, Kusumawati, Maryama, Utami, and Subandi, (2023); Daruwala, (2023); Okunev, (2022); Christie et al., (2021); Ogachi et al., (2020); Gamlath (2019); Ramlan and Nodin (2018), Jeleelá and Olayiwola (2017) and Ramli and Nartea (2017) found a positive significant relationship between leverage and performance. Alessi et al. (2022); Berrada, (2022); Okunev, (2022); Ofulue et al., (2022); Delele, (2021); Firouzi and Meshkani, (2021); Yenni et al., (2021); Botta (2020); Dirman, (2020); Palomino et al., (2019); Izevbekhai and Odion (2018); Mishra and Deb (2018); Abdul Jeleel and Olayiwola (2017) and that of Matar and Eneizan (2018) found a negative significant relationship between leverage and performance. While, Witkowska et al., (2019); Hamouri et al. (2018); Gohar, et al., (2015); Yasemiaet al., (2014) found a no significant relationship between leverage and performance. Therefore, throughout literature, there was difficulty observing consistency in the outcomes of the empirical studies that have often shown contradictory results regarding the effect of leverage on firm performance. This inconsistency in the results shows that there is a need of the inclusion of a variable that can moderate the relationship.

3.5 Moderating Role of Corporate Governance

Studies on the effect corporate governance on performance shows a strong and significant effect, for example: Bui, and Krajcsak, (2023); Ermalina, et al., (2023); Ibrahim, et al., (2023); Ronoowah, and Seetanah, (2023); Sarwar, et al., (2022); Mansour et al. (2022); Singh and Tabassum, (2018); Padachi et al. (2017); Bhatt and Bhatt (2017); Sheaba et al., (2017) found a positive significant relationship. While, Adamu, et al., (2023); Rajput and Joshi (2014) and Adegboye et al. (2019) found a negative significant relationship. This indicated that corporate governance can moderate the relationship between financial leverage and performance.

To this end, prior research has found mixed evidence or inconsistency regarding the relationships between financial leverage and firm performance. Moreover, there is a lack of evidence on the moderating variable that can weaker or strength the relationship; hence, this study tackles this issue. The study aim to propose a conceptual framework on the moderating role of corporate governance on the relationship between financial leverage and firm performance.

3.6 Theoretical Review

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3.6.1 Agency Theory

The literatures in the fields of accounting, economics, finance, marketing, political science, organisational behaviour, and sociology have all employed agency theory to support their discussions of financial leverage and corporate governance (Amedu, 2016; Farhat, 2014; Garko, 2014; Haniffa & Hudaib, 2006). Based on the notion of the separation between ownership and control that is present in contemporary corporate culture, it is frequently regarded as the most popular theoretical approach to the study of corporate governance. It all began with Berle and Means' (1932) work, which emphasised the division between the company's ownership and management. The primary emphasis lies in ensuring that the interests of the principals and the agents are aligned (Jensen & Meckling, 1976; Fama, 1980). The agency hypothesis describes the relationship between the two parties: the managers are the owners or shareholders of the company, and the principals are their agents or stewards in managing and controlling the company. However, the managers may not always act in the best interests of the shareholders, preferring to further their own interests. Adam Smith recorded this circumstance in his analysis of joint stock firms during the eighteenth century (Cadbury, 1992).

To sum up, agency theory focuses on recognising and resolving conflicts that may occur between an organization's managers and owners while they carry out their respective responsibilities. Thus, the agency theory, which provides the best explanation for the study's difficulty, serves as the basis for this study's theoretical review. This is a result of the Nigerian companies' shareholders being spread out throughout the nation and abroad. Because of this, it is challenging for them to convene on a regular basis and make judgements that could temper the excesses of the management.

3.7 Propose Conceptual Framework

This study's conceptual framework diagrammatically illustrates how corporate governance influences the correlation between financial leverage and firm performance. The schematic representation of the suggested framework is shown in Figure 1 below.

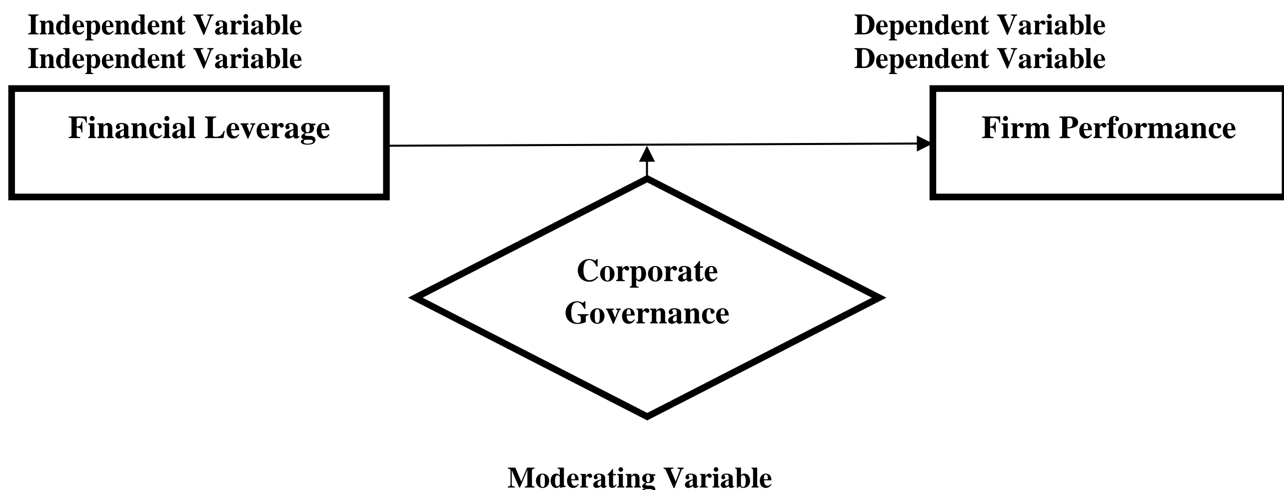

Figure 1: Conceptual Framework of the Study

Source: Developed by Researchers from the Literature Reviewed as a Road Map, 2024

4.0 Conclusions and Recommendations

As a conclusion, it should be highlighted that there is a wealth of evidence in the literature indicating that the conclusions on the relationship between financial leverage and company performance are inconsistent. The debt-to-equity ratio, assets coverage ratio, cash coverage ratio, interest coverage ratio, and debt services coverage ratio—all of which are deemed relevant inside the organization—all serve to elucidate financial leverage. Additionally, research shows that corporate governance can mitigate the relationship between

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financial leverage and business performance and has a strong, meaningful impact on organisational performance. It is suggested that future studies to apply the proposed conceptual framework so as to find an empirical evidences.

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