

Full Length Research

# Capital Structure and Corporate Performance of Non-Financial Firms in Nigeria

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This study examined the relationship between capital structure and corporate performance of listed non-financial firms in Nigeria. The study employs the panel data analysis technique using correlation research design. Four capital structure proxies (long term debt to equity, total debt to equity, total debt to total assets and long term debt to total assets) were tested against return on assets (ROA) of 27 listed non-financial firms in Nigeria for a period of eight (10) years (2011-2020). The results from the empirical analysis, based on the fixed effect strategy showed that, long term debt-to-equity, total debt-to-equity and total debt to total assets have significant positive relationship with corporate performance; while long term debt-to-total assets has a significant negative relationship with corporate performance. The study recommends among others that, since long term debt to equity is a significant determinant of corporate performance in Nigeria, management should sustain their current policies and should also be very sensitive in determining the appropriate amount of long term debt to equity that should be included in their capital structure build up. Also, total debt to equity which represents the firms' leverage levels in Nigeria is significant and positively related to firms' performance, it therefore follows that, policies that would encourage firms to employ more leverage (due to the tax shield benefits) while reducing equity financing in the operations of the firms activities should be vigorously pursued by management in this regard.

**Key Words:** Capital structure, Corporate performance, Debt, Equity, Assets, Non-financial firms.

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## INTRODUCTION

The primary objective of every business organization is to make profit and to enhance shareholders' worth. To achieve these objectives, firms' management usually engage in several decisions making activities with the aim of enhancing organizational performance. However, the principal decision is the financing decisions that dictate how firms are being financed, otherwise known as capital structure decision (Abata, Migiro, Akande & Layton, 2017).

Capital structure refers to the ways by which management raises the resources needed to carry out the financial commitments of the firm. The capital composition of a firm often takes different forms. However, the combination of debt and equity ratio is the most common to maximize the value of the firm (Olokoyo, 2012). Relying on the theories of both finance and economic scholars like Modigliani and Miller (1958; 1963), Walter (1963), points out the advantages and supportive roles of capital structure in enhancing firm performance.

Firm performance is the ability of an organization to acquire and manage the resources in different ways to develop competitive advantage (Olaniyi, Elelu & Abdulsalam, 2015). Company's performance is evaluated in three dimensions;

the first dimension is the company's productivity which relates to its ability to process inputs into outputs efficiently. The second dimension is profitability, which deals with the level to which company's earnings are higher than the costs. The third dimension is market premium, which concerned with how the company's market value is exceeding its book value (Nishanthini & Mimalathan, 2013).

Although several studies have examined the relationship between capital structure and firm performance in both developed and developing nations, how these studies produced mixed submissions towards the subject matter. For instance, Idode, Ogunlowore, Adeleke, and, Ashogbon (2014), Dahiru (2016), Mathanika, Virginia and Paviththira (2015) conclude that capital structure relates positively with firm performance. However, Mykhailo (2013), Appah, Okofo and Bariweni (2013), Oino and Ukaegbu (2016) and, Ajayi and Zahiruddin (2016) report otherwise. Also, some studies such as San and Heng (2011), and Ibrahim (2009) could not find any substantial correlation between capital structure and corporate performance.

Following from the above, it became imperative for more studies just like this one to be conducted on the subject matter in order to ascertain the preferred source of finance in the listed non-financial firms in Nigeria. Therefore the primary objective of this study is to evaluate the impact of capital structure on the financial performance of non-financial firms in Nigeria. The specific objectives of the study are:

- i. To examine the effect of long term debt to equity on the performance of listed non-financial firms in Nigeria.
- ii. To investigate the influence of total debt to equity on the performance of listed non-financial firms in Nigeria.
- iii. To evaluate the effect of total debt to total assets on the performance of listed non-financial firms in Nigeria.
- iv. To explore the effect of long term debt to total assets on the performance of listed non-financial firms in Nigeria.

### **Hypotheses of the Study**

The hypotheses of the study are stated in line with objectives as follows:

**H<sub>01</sub>:** Long term debt to equity has no significant effect on the performance of listed non-financial firms in Nigeria.

**H<sub>02</sub>:** Total debt to equity has no significant effect on the performance of listed non-financial firms in Nigeria.

**H<sub>03</sub>:** Total debt to total assets has no significant effect on the performance of listed non-financial firms in Nigeria.

**H<sub>04</sub>:** Long term debt to total assets has no significant effect on the performance of listed non-financial firms in Nigeria.

### **Review of Literature**

#### **Concept of Capital structure**

The mixture of long-term fund like term loans, long-term debt, debenture, bond, preference share capital and, stock share capital and undistributed profit/dividend /retained earnings form capital structure. The company's capital structure shows all the ways a company obtains the finances employed in running its operations, that is, how firm raise its operational funds, which usually comprises preference share capital, debt capital, ordinary share capital, and so on. It is constant when a company maintains the size of this source of finance. A capital structure decision refers to the financial framework that involves debt and equity kept by a firm; every financial manager owes this decision with high esteem in financing.

#### **Concept of Performance**

Generally, firm's performance is adjudged by profit or value-creation from its transactions. Corporate performance is based on the efficiency and effectiveness with which a firm uses its available resources to generate revenues (Olaniyi, Elelu & Abdulsalam, 2015). It is an indication of how efficient and effective the management of a corporate entity is rewarding the handling of funds. The terms performance and profitability are often used interchangeably; as every organization need to earn profit to survive and grow, otherwise the organization's capital will deteriorate and lose value.

There are different parameters by which firms' performance are evaluated, among which are: Return on Assets (ROA), Return on Equity (ROE), Return on Capital Employed (ROCE), Return on investment (ROI), Net Profit Margin (NPM), Earnings per Share (EPS) and TOBIN'S Q (Basit&Irwan,2017;Lawal., Monica, Edwin & Adisa, 2014;Hasan, Rahaman, Ahsan & Alam, 2014; and Mahmoud, 2017).

## Theoretical Review

The study was underpinned by the traditional or relevance theory postulated by Walter (1958) and Gordon (1959) theoretical framework. The Relevance Theory argues that the firm's total value at any given period is strongly influenced by its capital structure. That is, the combination of debt, equity and other forms of financing determine how the firm will perform financially.

## Empirical Review

Tedy, Azam and Lukytawati (2015) investigate how capital structure affected the way firms performed, with the financial sector of the Indonesian Financial Stock Exchange (IDX) as case study. The data was drawn from the period 2009 - 2013. Panel data analysis was used to measure how capital structure correlates with how firms perform. Results revealed that capital structure does not relate a positive firm's performance as x-rayed by ROA, which is in assonance with the Pecking Order Theory. Each financial subsector was differently affected by capital structure. While it adversely affects funding companies, securities companies, and other financial subsectors, it positively affects others like the insurance and banking subsectors. Further analysis of the results obtained revealed that financial sectors employ high leverage with the banking sector having the leverage with the highest value of 89% overall debt to overall assets.

Mukaria, Mugenda and Akenga (2015) examine how leverage affects the performance of listed non-financial firms of the securities exchange of Nairobi. OLS technique was used to show if the variables are correlated. 38 non-financial companies obtained through a purposive sampling were employed from 2008-2013. Findings revealed no notable differences in financing performance between the highly-levered and the lowly-levered firms; therefore, it correlates negatively with the leverage and firm performance. Also, firm growth has no noteworthy relationship with financial leverage. Similarly, Ahmed, Anis and Imam (2015) explored how corporate governance driven capital structure affects companies listed in the Johannesburg Stock Exchange in 2010. 71 listed firms were considered. Findings pointed out that independent Audit committee, institutional ownership, and external Auditor size, influences the capital structure in South Africa in a significantly negative way.

Mathewos (2016) studies how capital structure affects the way commercial banks selected in Ethiopia performed financially for a period of five years: 2011 – 2015. Secondary data derived from the financial statements of these banks were used and multiple regression models were applied to analyze the data. The study employed two accounting-based indices for financial performance, the Return on assets (ROA), and the Return on equity (ROE) as the dependent variables and also five capital structure measures - debt to equity ratio, debt ratio, loan to deposit, asset tangibility, and bank's size as independent variables. Findings revealed that financial performance relates adversely with proxies, capital structure, while DR's impact is negative. Findings revealed too, that proxies of capital structure like DER and DR correlate positively and significantly with ROE, but TANG and SIZE correlates negatively with financial performance determined by ROE.

Oino and Ukaegbu (2016), researched on how capital structure affects the output of Nigerian listed non-financial firms, and their adaptability to targeted capital structure. They tested the Pecking order theory and the Trade-off theory with respect to the level of their importance to Nigerian firms. Using the pool OLS and GMM in ensuring the robustness of results, empirical findings showed profitability and asset structure correlate negatively with leverage, while the firm's magnitude and non-debt tax shield correlate positively with leverage. The very high adjustment speed (47%), of Nigerian firms compare favorably with similar researches done in most developed countries.

Ajayi and Zahiruddin (2016) studied the correlation capital structure has with performance of firms in Nigeria. 100 non-financial firms taken from listed Nigerian companies in the Nigerian Stock Exchange (NSE) from 2010 to 2014 was the sample size for the research. Employing the panel data econometric method, results revealed the positive significant correlation which exists between assets turnover and tangibles on one hand, and how the firms perform. Again, risk has significant negative correlation with performance. Furthermore, a firm's age has significantly negative impact with ROA. With ROA too, sales growth has a positive and significant impact.

Paseda (2016) examine the determinant of capital structure of quoted Nigerian along five dimensions, namely firm-specific and industry factors; taxes, non-financial stakeholders, supply-side factors and the maturity structure of corporate liabilities. The study comprises of all non-financial corporation quoted on (NSE) for the period of 1999 – 2014, and 50 companies were utilized. It was revealed that firm age, asset tangibility and expected inflation correlates positively to capital structure, while the volatility of earnings factors, profitability, liquidity, dividend-paying status, and asset tangibly, growth size, related negatively with capital structure. Therefore, the outcomes favour the Pecking order theory, the target adjustment as well as and market condition model.

El-maude, Abdul and Ahmad (2016) examine how capital structure affects the way firms perform in the Nigeria cement

industry. From seven companies, four companies were selected among the listed companies, ranging from 2010-2014. The work shows that long and short term debt correlates significantly with Return on Equity (ROE), and Return on Assets (ROA). But due to the inability of the cement companies to utilize debt in their capital structures, their performance is not optimized. They then recommended cement companies make ample use of long-term debt in their capital structure as it impacts positively on how they perform financially.

Mahmoud (2017) studied the way capital structure affects listed Nigerian manufacturing companies. An empirical inquiry employed Tobin's Q model from 2012 to 2016. Eight (8) explanatory variables were utilized to evaluate how the affect firm value (Tobin's Q), wherein it came to limelight that seven of the eight variables were significantly related to firm value while only one was not; it was also discovered that the profitability, firm's magnitude, leverage and liquidity negatively and significantly related to the value of the firms, while on the other hand, age of firm, tendency and tangibility positively and significantly related to the value of the firm, which validated the prediction of Pecking order theory in case of profitability.

In a related study by Daniel (2017) in Kenya focused on 36 listed companies for the period 2011 to 2015. Results indicate the value of non-financial firms is statistically and significantly correlated with capital structure; long term debt impacts positively on firm values. It was recommended before concluding on using it in financing their operations firms should always compare the marginal cost and benefit of employing long-term debt

Isiaka, Diki and Okpanashi (2018) examined the determinant of firms' profitability using five (5) listed Agriculture companies in Nigeria from 2008 to 2016. The independent variables were liquidity, operating expenses efficiency, leverage, and sales growth, while the dependent variable was ROE. Findings showed that sales growth and liquidity positively and significantly affects profitability and ROE respectively. And leverage was negatively and significantly related to profitability. It was recommended that the agriculture companies should increase their liquidity asset and turnover as it influences the profitability of firms and reduces the debt, especially at the high-interest rate.

## METHODOLOGY

The study makes use of a causal research design. The population of the study comprises of 185 non-financial firms listed on the Nigeria stock exchange. Sample size for the study was 40 firms randomly selected based on the availability of data, coupled with the fact that each company must have fulfilled its obligation of publishing their annual reports for the year ended 2011 to 2018. The convenient sampling technique was employed to arrive at this final sample size for the study. Needed information was gathered from the selected firms' annual reports for the period of 2011 to 2018.

### Model Specification

The study adapts Mathewos (2016) model as follows:

$$CPER = \beta_0 + \beta_1LTDQ_{it} + \beta_2TDQ_{it} + \beta_3TDTA_{it} + \beta_4LDTA_{it} + \beta_5FAGE_{it} + \mu_{it}$$

Where:

|                       |   |                                                           |
|-----------------------|---|-----------------------------------------------------------|
| CPER                  | = | Corporate performance (proxied by Return on Assets (ROA)) |
| LTDQ <sub>it</sub>    | = | Long term debt to equity for firm i at period t           |
| TDQ <sub>it</sub>     | = | Total debt to equity for firm i at period t               |
| TDTA <sub>it</sub>    | = | Total debt to asset for firm i at period t                |
| LDTA <sub>it</sub>    | = | Long term to debt to total asset for firm i at period t   |
| FAGE <sub>it</sub>    | = | Firm Age for firm i at period t                           |
| $\beta_0$             | = | Intercept                                                 |
| $\beta_1$ - $\beta_5$ | = | Parameter Estimate                                        |
| $\mu_{it}$            | = | Error term                                                |

## Data Analysis and Discussion of Results

**Descriptive Statistics:** The descriptive statistics of the data of the study is presented thus:

**Table 1. Descriptive Statistics**

|              | Mean    | Median  | Max     | Min     | Std. Dev. | Skew     | J-B.    | Prob.   |
|--------------|---------|---------|---------|---------|-----------|----------|---------|---------|
| <b>CPER</b>  | 17.5939 | 17.8307 | 21.2336 | 14.7994 | 1.76886   | 0.15098  | 3.14798 | 0.20721 |
| <b>LTDQ</b>  | 16.7361 | 16.8269 | 20.4968 | 9.91195 | 1.88667   | -0.20491 | 2.73839 | 0.25431 |
| <b>TDQ</b>   | 16.9326 | 17.4040 | 20.6005 | 13.0997 | 1.84117   | -0.0384  | 2.96786 | 0.22674 |
| <b>TDTA</b>  | 1.01419 | 1.00845 | 1.53599 | 0.87912 | 0.06699   | 5.39125  | 6401.72 | 0.00000 |
| <b>LDTA</b>  | 0.96171 | 0.96586 | 0.99968 | 0.86266 | 0.01943   | -1.72634 | 181.247 | 0.00000 |
| <b>LFAGE</b> | 2.90329 | 3.17805 | 3.97029 | 0.69314 | 0.86436   | -0.64778 | 8.71727 | 0.01279 |

**Source: Author's computation (2022)**

The descriptive statistics indicates that the mean value of corporate performance (CPER) is 17.5939. The median value of 17.8307 is higher than the mean value and suggests that the pattern of corporate performance is not similar across the sampled firms indicating the presence of heterogeneity. Long term debt to equity (LTDQ) and total debt (TDQ) presents almost similar results. Indeed, the mean value for both variables stood at 16.7361 and 16.9326, with a slight difference in their median values (16.8269, 17.4040); but they are almost of the same range in terms of maximum value scores of 20.4968 and 20.6005 respectively. On the hand, TDTA has a mean of 1.01419 and median value of 1.00845 while LDTA has a mean value of 0.96171 and median value of 0.96586 respectively.

**Table 4.2: Regression Results**

### Panel Least Squares Result

Dependent Variable: CPER  
 Method: Panel Least Squares  
 Date: 08/08/21 Time: 15:32  
 Sample (adjusted): 2011 2020  
 Periods included: 10  
 Cross-sections included: 27  
 Total panel (unbalanced) observations: 263  
 Convergence achieved after 8 iterations

| Variable           | Coefficient | Std. Error            | t-Statistic | Prob.  |
|--------------------|-------------|-----------------------|-------------|--------|
| C                  | 11.23029    | 0.201870              | 55.63135    | 0.0000 |
| LTDQ               | 0.230601    | 0.009405              | 24.51903    | 0.0000 |
| TDQ                | 0.810191    | 0.009738              | 83.19543    | 0.0000 |
| TDTA               | 2.131908    | 0.085045              | 25.06803    | 0.0000 |
| LDTA               | -13.94532   | 0.149727              | -93.13830   | 0.0000 |
| LFAGE              | 0.010608    | 0.003953              | 2.683589    | 0.0080 |
| AR(1)              | 0.907026    | 0.039042              | 23.23203    | 0.0000 |
| R-squared          | 0.859967    | Mean dependent var    | 16.85577    |        |
| Adjusted R-squared | 0.809966    | S.D. dependent var    | 1.667259    |        |
| S.E. of regression | 0.009753    | Akaike info criterion | -6.385019   |        |
| Sum squared resid  | 0.016741    | Schwarz criterion     | -6.262252   |        |
| Log likelihood     | 591.2292    | Hannan-Quinn criter.  | -6.335255   |        |
| F-statistic        | 58.864436   | Durbin-Watson stat    | 2.043844    |        |
| Prob(F-statistic)  | 0.000000    |                       |             |        |
| Inverted AR Roots  |             | .91                   |             |        |

**Source: Author's computation (2022)**

An examination of the empirical results revealed that the R-square and its adjusted counterpart stood at 0.85 and 0.80 respectively. This means that about 80% (adjusted  $R^2$ ) of the systematic variations in the performance of listed non-financial firms in Nigeria is explained by capital structure and other relevant variables in the model. The F- value of 58.86 which is significant at 1% level indicates the fitness of the model. The DW statistics value of 2.04 confirms the absence of autocorrelation in the model. The implication of this is that the estimated model is reliable for structural analysis and policy decisions.

### Test of Hypotheses

Table 2 shows that long term debt to equity (LTDQ) has a positive and significant relationship with corporate performance (CPER) from coefficient of 0.2306 and a p-value of 0.0000. Based on this, the study rejects hypothesis I. Similarly, total debt to equity (TDQ) has a positive and significant relationship with corporate performance (CPER) from coefficient of 0.8101 and a p-value of 0.0000. Consequently, the study rejects hypothesis II. Also, total debt to total assets (TDTA) has a positive and significant relationship with corporate performance (CPER) from coefficient of 2.1319 and a p-value of 0.0000. The study therefore rejects hypothesis III. Finally, Table 2 shows that long term debt to total assets (LTDA) has a negative and significant relationship with corporate performance (CPER) from coefficient of -13.9453 and a p-value of 0.0000. Hence, the study rejects hypothesis IV.

### Discussion of Results

Table 2 reveals that all the explanatory variables have positive signs except that of LDTA with a negative sign. The empirical results indicate that the coefficient of LTDQ, TDQ, TDTA to performance are significant at 1% level. This statistical significance implies that a unit change in each will lead to 0.23, 0.81, and 2.13 changes respectively in the performance of the firms except LDTA that is inversely related to performance with 13.2 coefficients; this is in tandem with Ofosu (2013), Goya (2013), and Babalola (2014).

### Conclusion and Recommendations

This study investigated the relationship between capital structure and performance of non-financial firms in Nigeria. Secondary data were collected from the annual accounts of 27 firms randomly selected using the convenient sampling technique. Corporate performance was represented by ROA while four capital structure variables were used, long term debt to equity (LTDQ), total debt to equity (TDQ), total debt to total assets (TDTA) and long term debt to total assets (LDTA). The study covered a period of eight (8) years (2011 to 2018). The results from the empirical analysis showed that long term debt-to-equity, total debt-to-equity and total debt to total assets have significant positive relationship with corporate performance; while long term debt-to-total assets has a significant negative relationship with corporate performance. The study therefore concludes that capital structure has significant impact on corporate performance of listed non-financial firms in Nigeria.

In line with the findings above, the study hereby recommends that since long term debt to equity is a significant determinant of corporate performance in Nigeria, management should sustain their current policies and should also be very sensitive in determining the appropriate amount of long term debt to equity that should be included in their capital structure build up.

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