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Capital Structure and Corporate Performance of Selected Firms on the Nigerian Stock Exchange

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Abstract
The capital structure of a firm is very important to the firm's successful operation. The objective of the study was to analyze the effects of Capital Structure on Corporate Performance of selected firms on the Nigerian Stock Exchange in Nigeria from 2011 to 2017. The study employed data from five multinational companies, using Micro Panel data as the estimated technique. Both the Random Effect Model and the Fixed Effect Model were estimated, and the Hausman effect was carried out to determine the appropriate model. The result shows that the effect of liquidity of the firms is negatively related to return on Asset (ROA). Hence, keeping funds in non-interest yielding form does not increase the ROA of the firms. Similarly, the short term debt financing (CLA) is negatively related to ROA. However, there is a positive relationship between long term debt financing and ROA. It noted that short term debt financing requires the payment of the debt in a short term, and this may not be convenient for the firms, and impair their performance. However, repaying long term debt may be convenient, and this may have a positive effect on the performance of the firms. Management of the quoted firms in Nigeria is strongly advised to increase the use of equity capital in financing to improve the earnings of their firms.

Keywords: Capital Structure, Firms, Nigerian Stock Exchange, Corporate Performance

JEL Classification: C23, L11, L22, G31

1. INTRODUCTION

Capital structure is one of the major decisions that have to be made by finance managers. According to Pandey (2010) defined capital structure as the so many ways of financing an organization, in order words, it is the proportionate relationship between debt and equity. Capital structure is the way in which a firm finances its operations and growth through the utilization of various sources of funds. The capacity of companies to carry out the needs of their stakeholders is closely associated with capital structure (San and Heng, 2011). The determination of the capital structure of a firm is a tough task, in the quest for optimal capital structure, a firm might have to issue so many securities in various mixes in order to have a combination that will maximize its

overall value (San and Heng, 2011). There is a close relationship between capital structure and corporate performance (Tian and Zeitun, 2007). The measurement of a firm's performance can be done through the utilization of variables which involve productivity, profitability, growth, or customer's satisfaction. These measures have some connections between them. Financial measurement has been found to be one of the tools which reveal the financial strengths, weaknesses, opportunities, and threats. According to Barbosa and Louri (2005), the financial measurements are returned on investment (ROI), residual income (RI), earning per share (EPS), return on Asset (ROA), dividend yield, price earning yield, price-earnings ratio, growth in sales, market capitalization, etc.

Capital structure is a significant managerial decision because it influences the shareholder's return and risk as to the market value. According to Pandey, in making capital structure decisions, finance managers are expected to seek answers to the following questions: how to finance the investment project; does the way in which these investments projects are financed matter; how does financing affect the shareholders' risk, return and value; is there an optimum financing mix in terms of the maximum value to the firm's shareholders; can the optimum financing mix be determined in practice for a company; and what factors in practice should a company consider in designing its financing policy? The pioneer of this debate and studies on capital structure theory is Modigiliani and Miller (1958). The general direction of the opinion of researchers is that a firm should determine and chose an optimal level of debt and equity combination based on the tradeoff between the cost and benefits of debt.

It is the general opinion among researchers that firms should plan their capital structure in a way that it will maximize its use of funds and to be able to adapt to changing situations. This study attempts to investigate the effect of capital structure and corporate finance on firms' performance in Nigeria using variables from the firms' post-consolidation published financial statement covering 2013 to 2017. Empirical studies on the relationship between firms' performance and capital structure have produced mixed results. Abor (2007) reports a positive relation between capital structure and performance over the period 1998-2002 in the Ghanaian firms. Masulis (1983), Jordan et al. (1998), Simerly and Li (2000), Frank and Goyal (2003), and Deping et al. (2011) showed that there is a positive relationship between the capital structure and performance of the firms.

Therefore, this study aims to determine the relationship between capital structure variables and corporate performances of some listed firms on the Nigerian Stock Exchange in Nigeria. Data for this study, equity, debt, and profit before tax, were from the published financial statements of the sampled firms was used for data analysis.

2. LITERATURE REVIEW

Studies on capital structure theory went back to as far as fifty decades ago when Modigliani and Miller (1958), published their work. They proved that, under certain assumptions (existence of a perfect market and the absence of taxes and transaction costs), costs of capital does not affect capital structure. Which means; debt in a firm's capital structure does not affect the firm's value. This theory is normally referred to as an irrelevant theory. Modigliani and Miller (1963) modified the irrelevant theory by presenting proof that cost of capital affect the capital structure and thus the value of the firm when the assumptions that there are no taxes or transaction cost were removed. They opined that borrowing gives a tax advantage, where the tax deducted from the interest results in tax shields, which in turn reduces the cost of borrowing and maximizes the firm performance (Miller, 1977). This requires the firm to make a trade-offf between the cost of debt and the benefits of using debt. Several studies shed light on the specific characteristics of firms and industries that determine leverage ratios. These studies agree that leverage increases with fixed assets, non-debt tax shields, growth opportunities, and firm size and decreases with volatility, advertising expenditures, research and development expenditures, bankruptcy probability, profitability and uniqueness of the product. Bauer (2004), studied the effect of size, profitability, tangibility, growth opportunities, tax, non-debt tax shields, volatility, and industry classification on capital structure. In his study, he concluded that leverage is directly related to size, while leverage is inversely related to profitability. There was also a negative relationship between tangibility and leverage. It was discovered that leverage is positively correlated with tax, and it is negatively correlated with non-debt tax shields. No

relationship was found between leverage and volatility. The capital structure of a firm may evolve as a result of a deliberate plan by the firm's managers while at other times it is as a result of the combination of the situation in which the firm had to deal with in the past. Some firms may find it difficult accessing banks loan (Kamsvag, 2001) while some have retained enough earnings to undertake their investment opportunities without leading to debt financing (Anderson, et al., 2006). Some firms, in principle, do not want to undertake any debt (Anderson and Williamson, 2001). However, there are several other factors that have been considered by scholars as determinants of a firm's capital structure. Peterson and Rajan (1994) suggested that the business size, age, and cash flow are very relevant factors. Olowe (2011) argued that "in other to maximize the wealth of the shareholders', the factors a financial manager should consider in the choice of capital structure include: nature of the firm's assets, business risk, stability of sales, profitability, growth rates of the firm, taxes, control, management attitudes, lender and rating agency attitudes, conditions in the stock market, perceived undervaluation of equity shares in the Stock market, and reserve borrowing capacity".

Pandey (2010) noted that in practice capital structure decision involve considerations of assets, growth opportunities, financial flexibility, and operating strategy, debt, and non-debt tax shields, loan covenants, financial slack, sustainability and feasibility, control, marketability and timing, issue costs and capacity of raising funds.

Harris and Ravis (1990), summarizing a good number of empirical studies suggest that 'leverage increases with fixed assets, investment opportunities non-debt tax shields, and firm size and decreases with volatility, advertising expenditure, the probability of bankruptcy, profitability, and uniqueness of the product.' However, Wald (1999) observed that leverage decreases rather than increases with non-tax shields. Researchers have identified a number of factors as determinants of firm financial performance. Abbas et al. (2013) carried a study on determinants of firm's financial performance, using the textile sector of Pakistan for their study, and found that firm's performance is greatly affected by short – term leverage, size, risk, tax and non – debt tax shield. Safarova (2010), in his study on factors that determine firm performance of New Zealand listed companies discovered that size is the most important factor determining firm performance, followed by growth and leverage, while other factors such as tangibility, corporate governance, cash on hand and risk appeared to be marginally related to firm operating performance. Mirza and Javed (2013) carried out a study on the determinants of the financial performance of firms on Pakistan stock market and concluded that firms having well-governed ownership structure, capital structure, and proper risk management tend to have a better financial performance. Valentin (2012), based on his study of determinants of corporate financial performance, is of the opinion that a company's financial performance is directly influenced by its market position. He also identified risk and growth as important factors influencing a firm's financial performance. The size of the company can also have a positive effect on financial performance because the larger firms can use this advantage to get some financial benefits in business relations. (Marthur and Kenyon, 1997). According to Kyereboah – Coleman (2007), the basic motive behind any investment, made by the corporate sector, is to earn a profit. It is the major goals of a business organization to maximize shareholders' wealth and generate enough profits to continue the business and to grow further in the future. Mirza and Jared (2013). However, the performance of the firm is affected by multiple external and internal factors. While the internal factors are specific to each firm, the eternal factors can be the same for all or most of the firms. The external factors include market preferences and perceptions, country rules and regulations, and the economy of the country (Mirza and Jared, 2013). Corporate financial performance is directly influenced by its market position. Safarova (2010) study the factors that determine firm performance in New Zealand listed companies, eight factors were examined, namely intangibles, corporate governance, and cash on hand, leverage, firm-specific risk, growth and tangibility in relation to their influence on a firm's performance. He found that size is the most important determinant of firm performance, and other factors have marginal relationships. He, however, opined that this is due to various reasons surrounding the New Zealand financial market during the sample period, 1996 – 2007. Mirza and Javed (2013) studied the determinants of the financial performance of firms listed on the Pakistani Stock Market and found that firms having proper corporate governance structures and monitoring will be more profitable for shareholders. Their conclusion is that firms having well-governed ownership structure, capital structure, and proper risk management tend to have better financial performance. In view of the nature of financial institutions, researchers have classified determinants of bank performance into two – bank-specific (internal) and macroeconomic (external) factors (Al–Tamimi and Hasan, 2010; and Aburimem 2005). Internal factors are the

characteristics of individual banks which affect performance. These are factors that are influenced by internal bank management and board decisions. The external factors are the characteristics of the economy of the country where the bank operates, which are beyond the control of the bank and affect bank performance.

Fosu (2013), studied 257 South African listed firms using panel data to investigate the relationship between capital structure and firm performance, paying attention to the degree of competition, found out that financial leverage has a significant positive effect on the performance of the firms. In his study titled "Comparison of impact from capital structure to corporate performance between Chinese and European listed firms," he found out that capital structure has a significant negative effect on firm performance in China, whereas, significant positive effect in European countries before financial crisis happened in 2008.

David and Olorunfemi (2010) used panel data analysis to analyse the capital structure and corporate performance in Nigeria petroleum industry. It was found that a positive relationship exists between earning per share and leverage ratio on the one hand and a positive relationship between dividend per share and leverage ratio, on the other hand.

However, in a similar study carried out by Khan (2012) on 36 engineering sector firms in Pakistan, he was able to establish that financial leverage has an insignificant negative relationship with firm performance. He noted that firms in the engineering sector of Pakistan are mainly dependent on short term debt. In another research, Ogebe et al. (2013) investigated the impact of capital structure on firm performance in Nigeria for a period of 10years. They used the fixed effect regression estimation model to confirm that a negative relationship exists between performance and leverage of the firms. They also affirmed that the traditional capital structure theory is valid.

Following the review of empirical studies, the optimal capital structure of a firm is very paramount to its successful operation though these decisions differ from one firm to another. Some authors are of the view that a positive relationship exists between capital structure and the firm performance while some believe that there is a negative relationship. The need to carry out a study that focuses on the petroleum companies in Nigeria is fuelled by the dearth of literature on this area.

3. RESEARCH METHODOLOGY

Model ONE (Multinational Firms)

$$ROA_{it} = \alpha + \beta_1 LTA_{it} + \beta_2 CLA_{it} + \beta_2 Size_{it} + \beta_3 Liquidity_{it} + u_{it} \ \ldots\ldots\ldots \qquad (3.1)$$

Where ROA is the return on Asset, LTA is long term debt financing, which is the ratio of the long term liability to total asset. CLA is the short term debt financing, the ratio of the short term liability to total asset, Size is the size of the firm, proxied by the log of the total asset, Liquidity is the ratio of the current asset to the current liability.

Model ONE (Indigenous Firms)

$$ROA_{it} = \alpha + \beta_1 LTA_{it} + \beta_2 CLA_{it} + \beta_2 Liquidity_{it} + u_{it} \ \ldots\ldots \qquad (3.2)$$

All the variables are as previously defined. The variable, size, was removed because the number of the cross-sections is four.

Estimation Technique
The estimation technique used is Micro Panel data. It was estimated using the Random Effect Model. Both the Random Effect Model and the Fixed Effect Model were estimated, and the Hausman effect was used to determine the appropriate model, which was Random Effect Model.

4. RESULT DISCUSSION

4.1 Descriptive Statistics

Table 4.1 and Table 4.2 show that the mean of Return on Asset (ROA) for the multinational firms is 0.192422 while it is 0.037749 for indigenous firms. This shows that shareholders of multinational companies have more return on their investments than those of the indigenous firms. Similarly, the average liquidity of multinational companies is 0.9%, while it is 0.5% for indigenous firms. This also shows that the multinational firms were more liquid than the indigenous firms. In terms of size, however, the multinational firms are bigger in size with an average of 18.2% than the indigenous firms with an average of 17.4%. However, the CLA of the multinational firms is 0.44% while it is 0.4% for the indigenous firms, the LTA for the multinational firm is 0.25%, while it is 0.21% for the indigenous firms. This shows that the multinational firms finance their capital structure through short term debt financing and long term debt financing than their indigenous counterparts

Table 4.1: Descriptive Analysis of Individual Variables OF Selected Multinational Firms

	TTA	SIZE	ROA	LTA	LIQUIDITY	CLA
Mean	0.245384	18.54162	0.192422	0.245384	0.946369	0.438875
Median	0.240278	18.49956	0.209647	0.240278	0.909946	0.420867
Maximum	0.391090	18.94887	0.237596	0.391090	1.256453	0.713700
Minimum	0.104221	18.15861	0.046731	0.104221	0.807514	0.283034
Std. Dev.	0.099339	0.256369	0.061659	0.099339	0.151362	0.148748
Skewness	0.033520	0.141082	-1.860408	0.033520	1.057394	0.614967
Kurtosis	1.599642	1.998914	4.788530	1.599642	2.928220	2.183781
Jarque-Bera	2.866349	1.577609	24.85484	2.866349	6.529654	3.177638
Probability	0.238550	0.454388	0.000004	0.238550	0.038204	0.204167
Sum	8.588428	648.9568	6.734760	8.588428	33.12293	15.36064
Sum Sq. Dev.	0.335520	2.234652	0.129263	0.335520	0.778951	0.752288
Observations	35	35	35	35	35	35

Source: Computed by Author 2019

Table 4.2: Descriptive Analysis of Individual Variables of Selected Indigenous Firms

	ROA	SIZE	TTA	LTA	LIQUIDITY	CLA
Mean	0.037749	17.90517	0.638952	0.205628	0.534693	0.433323
Median	0.051292	17.97174	0.665333	0.203438	0.434003	0.439592
Maximum	0.085539	18.54424	0.784835	0.304886	1.310793	0.581397
Minimum	-0.039763	17.18754	0.480715	0.102693	0.271658	0.232597
Std. Dev.	0.037803	0.401713	0.096447	0.059329	0.334420	0.102223
Skewness	-0.975306	-0.268566	-0.267588	-0.082419	1.753190	-0.666224
Kurtosis	3.148208	2.609355	2.136630	2.637438	4.548159	2.997750
Jarque-Bera	4.464666	0.514633	1.203792	0.185060	17.14008	2.071328
Probability	0.107278	0.773123	0.547772	0.911622	0.000190	0.354991
Sum	1.056974	501.3447	17.89064	5.757586	14.97139	12.13306
Sum Sq. Dev.	0.038586	4.357086	0.251152	0.095037	3.019589	0.282140
Observations	28	28	28	28	28	28

Source: Computed by Author 2019

4.2 Effect of Capital Structure on Corporate Performance of Selected Multinational Firms

In order to estimate the capital structure on corporate performance of selected multinational firms, both the Random Effects and Fixed Effects models were analyzed. The results are presented in Table 4.3. In order to choose the appropriate model, the Hausman test was performed. The result of the Hausman test is presented in Table 4.3

Table 4.3: Comparing the Random Effects with the Fixed Effects

Dependent Variable: ROA	Fixed Effects Regression			
Variable	Coefficient	Std. Error	t-Statistic	Prob.

SIZE	0.672962	0.265244	2.537144	0.0175
LTA	0.362977	0.506233	0.717016	0.4798
LIQUIDITY	-0.599218	0.186458	-3.213688	0.0035
CLA	-1.575852	0.260462	-6.050217	0.0000
C	-11.11578	4.760933	-2.334790	0.0275
Dependent Variable: ROA	Random Effects Regression			
SIZE	0.672962	0.265244	2.537144	0.0166
LTA	0.362977	0.506233	0.717016	0.4789
LIQUIDITY	-0.599218	0.186458	-3.213688	0.0031
CLA	-1.575852	0.260462	-6.050217	0.0000
C	-11.11578	4.760933	-2.334790	0.0264

Source: Computed by Author 2019

4.2.1 Correlated Random Effects - Hausman Test

The Hausman Test is a test of the Null hypothesis, which says that the Random Effect model is the appropriate model. If the probability value of the test is significant, the null hypothesis is rejected, and that signifies that the fixed effect model is appropriate. Otherwise, the Random effect model is appropriate. Table 4.4 shows that the null hypothesis of Random model cannot be rejected because the probability value is not significant.

Table 4.4: Correlated Random Effects - Hausman Test

Equation: Untitled			
Test cross-section random effects			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	0.000000	4	1.0000

Source: Computed by Author 2019

4.2.2 Result of the Random Model

Table 4.5 shows that variables that significantly influence Return on Asset are the size of the firms, short term debt financing, and liquidity of the firms, while long term debt financing is not significant. The result shows that the size of the firms is positively related with ROA. It shows that the bigger the firms, the bigger are the return on assets. This can be explained such that a bigger firm is about to produce on a larger scale, at a lower average cost, and sell at a cheaper price than the smaller ones can do. Hence, she will be able to make more return. However, the results on the effect of liquidity of the firms are negatively related to ROA. This is not unexpected because the firms are not banks. The firms are production firms. The more liquid they are, the less will be the level of investment, and the less will the ROA. Similarly, the short term debt financing (CLA) is negatively related to ROA. The reason for this may be because of the high-interest rate involved in debt servicing in the country.

Table 4.5: Capital Structure and Corporate Performance of Selected Multinational Firms

Variable	Coefficient	Std. Error	t-Statistic	Prob.
SIZE	0.672962**	0.265244	2.537144	0.0166
LTA	0.362977	0.506233	0.717016	0.4789
LIQUIDITY	-0.599218***	0.186458	-3.213688	0.0031
CLA	-1.575852***	0.260462	-6.050217	0.0000
C	-11.11578**	4.760933	-2.334790	0.0264
F-statistic	47.90781***	R-squared	0.864640	
Prob(F-statistic)	0.000000			

*** indicates significance at 1%, ** indicates significance at 5%

Source: Computed by Author 2019

4.3 Effect of Capital Structure on Corporate Performance of Selected Indigenous Firms

In order to estimate the capital structure on corporate performance of selected multinational firms, both the Random Effects and Fixed Effects models were analyzed. The results are presented in Table 4.6. In order to choose the appropriate model, Hausman test was performed. The result of the Hausman test is presented in Table 4.7

Table 4.6: Comparing the Random Effects with the Fixed Effects

Dependent Variable: ROA	Fixed Effects Regression			
Variable	Coefficient	Std. Error	t-Statistic	Prob.
SIZE	-0.023259	0.066312	-0.350753	0.7294
LTA	0.401544	0.188049	2.135315	0.0453
LIQUIDITY	-0.191408	0.128697	-1.487268	0.1525
CLA	-0.620433	0.280789	-2.209607	0.0390
C	0.391011	0.034060	11.47996	0.0000
Dependent Variable: ROA	Random Effects Regression			
LTA	0.390611	0.181534	2.151721	0.0417
LIQUIDITY	-0.233060	0.048560	-4.799440	0.0001
CLA	-0.713016	0.093738	-7.606469	0.0000
C	0.391011	0.036412	10.73851	0.0000

Source: Computed by Author 2019

4.3.1 Correlated Random Effects - Hausman Test

The Hausman test also shows that the appropriate model to be used in this analysis is the Random Effect model. This is because of the insignificant value of the probability value of the Hausman test.

Table 4.7: Correlated Random Effects - Hausman Test

Equation: Untitled			
Test cross-section random effects			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	0.000000	3	1.0000

Source: Computed by Author 2019

4.3.2 Result of the Random Model

Table 4.8 shows that all the variables significantly influence Return on Asset, in other words, short term debt financing, long term debt financing, and liquidity of the firms. The result shows that the result on the effect of liquidity of the firms is negatively related to ROA. This is similar to the situation with the multinational firms. The firms are production firms. Hence, keeping funds in non-interest yielding form does not increase the ROA of the firms. Similarly, the short term debt financing (CLA) is negatively related to ROA. However, there is positive relationship between long term debt financing and ROA. This is against the situation with that of the multinational firms. One explanation for this is that short term debt financing requires the payment of the debt in a short term, and this may not be convenient for the firms, and impair their performance. However, repaying long term debt may be convenient, and this may have a positive effect on the performance of the firms.

Table 4.5: Effect of Capital Structure on Corporate Performance of Selected Multinational Firms

Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
LTA	0.390611**	0.181534	2.151721	0.0417
LIQUIDITY	-0.233060***	0.048560	-4.799440	0.0001
CLA	-0.713016***	0.093738	-7.606469	0.0000

C	0.391011***	0.036412	10.73851	0.0000
F-statistic	44.25851***	R-squared	0.846915	
Prob(F-statistic)	0.000000			

*** indicates significance at 1%, ** indicates significance at 5%

Source: Computed by Author 2019

5. CONCLUSIONS AND RECOMMENDATIONS

The study empirically analyzed the effect of capital structure on corporate performance of selected firms on the Nigerian Stock Exchange. The study confirms the validity of the traditional theory of capital structure. Contrary to the traditional theory, which posits that a positive relationship exists between leverage and firm's performance, this study found that a negative relationship exists between leverage and firm performance. This study also found that a positive relationship exists between the firm's size and firm performance as well as between tax and firm performance; the lagged return on asset also had a positive relationship with firm performance. The implication is that the size, tax, and the lagged return on an asset can be considered to have a positive influence on the performance of a firm. Since leverage has a negative effect on the firm's performance, it is therefore recommended for the firms to rely more on equity financing as a way of raising funds for their business. They should reduce their borrowing operations which could make them go bankrupt. Therefore, to improve corporate performance of firms in Nigeria, the following were recommended:

1. The management of firms should consider the use of more debt in their capital structure mix as this will reduce the overall cost of capital as a result of its tax advantage. Moreover, increase firm financial performance;
2. The management of the quoted firms in Nigeria should increase the use of equity capital in financing to improve earnings of their firms; and
3. Investors of quoted firms in Nigeria should also consider the capital structure of any firm before investing in them as the strength of a firm's capital mix determines the level of returns.

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