Effect of Capital Structure on Performance of Listed Consumer Goods Companies in Nigeria

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Abstract

Managers of corporate entities are mostly in confrontation with the problem of; what combination of capital structure (equity and debt) will maximize returns and value of their firms? The study, therefore, aims at assessing the effect of capital structure on the financial performance of listed Consumer goods companies in Nigerian. All consumer goods companies quoted on the Nigerian Stock Exchange are considered the population for this study while seven (7) out of these firms whose accounting year-ends 31 December are considered as the sample. Secondary data was utilized from the annual financial reports of the sampled firms from the year 2008 – 2013, which was obtained from African Financial website and official website of Nigerian Stock Exchange. The study used ex-post facto research design to examine the relationship between independent and dependent variables while controlling for other variables. Descriptive statistics, correlation, and hierarchical multiple regression analyzes were carried out to test the hypotheses developed in the study. The study found that there is a positive and significant relationship between firm's capital structure and corporate financial performance. The study specifically found that short-term debt (STD) has no significance positive effect on return on equity (ROE) while Long-term debt (LTD) has positive relation and significant effect on ROE. The study recommends that firms should consider the mixture of equity and debt since they are major determinants of corporate performance. Authorities concerned should create an enabling business environment for companies (especially those with low capital) so as to have access to long-term debts to finance their operations and improve performance in the short-run, instead of using high short-term debts to cushions for financing and profitability problems.
Keywords: Capital Structure, Firm Performance, Short-term debt, Long-term debt, Return on Equity

1. Introduction

It is presumed that an organization with a strong capital base may have better returns and value. Some commonly believe that a better mixture of an organization's capital is the oil that lubricates its performance and growth. The very significant question that managers of corporate entities provide an imprecise answer to is; "What will be our best mixture of debt and equity to attain optimality?" in trying to provide an answer to this question, various studies have been conducted by different scholars. The recent discussions evolving on the topic 'Capital structure' originated from the works of Modigliani and Miller in 1958. Modigliani and Miller (1958) came up with irrelevance theory that assumes that a firm's a value is independent of its capital structure, but this presumption is in a world with no taxes, bankruptcy and transaction costs. However, the recent empirical evidence clearly points out that capital structure does matter (Myers & Majluf, 1984).

Capital structure is the combination or mixture of company's equity and debt, which ensures financial stability, profit generation, growth, and expansion. Abor (2005) view the capital structure of a company as the precise mixture of debt and equity use in financing the firm's operations. Capital structure means the approach a firm use in financing their assets through the mixture of debt, equity or hybrid securities (Saad, 2010). Hybrid securities in this context mean a group of securities that combine the elements of both debt and equity, which have fixed or floating rate of return, and the holder has the option of converting it into the underlying company's share. Capital structure is a mixture of a company's debts (long-term and short-term), common equity and preferred equity (San & Heng, 2011).

However today, apart from investment decision, capital structure decision has become one of the important financial decisions of business organizations. This is because it has a long-term financial impact on its operations specifically on return maximization and value of the firm. A firm can issue a large amount of debt or a large amount of equity; hence, it is important for a firm to deploy the appropriate mix of debt and equity that can maximize its overall market value. One of the strategies used by corporate managers to improve their financial

performance is through utilization of debt and equity levels (Maina & Ishmail, 2014). This, therefore, requires much attention by corporate entities on their capital structure contents to achieve a reasonable financial performance and firm's value.

Conversely, performance is a key to determine the perpetuity of a business set up. It is regarded as the foremost objective of profit-oriented organizations. A well-performing business is often one that is effective and efficient in securing it a long-term success (i.e. one that reasonably follow it standards and judiciously utilized it resources towards achieving high performance). Managers of corporate entities are much concerned on how to achieve high financial performance as it has a long-term effect on their corporate set-ups which ranges from management efficiency (utilization of limited resources at their disposal); investors goal (wealth maximization) and lenders-driven (repayment of debt and interest charge thereon).

Berger and Patti (2002) opines that performance measurement will depict how better off a shareholder has become on the investment in an entity over a given period. Therefore, all profit-oriented organizations (Banks, insurance, consultancy, manufacturing concerns etc) are striving towards achieving greater financial performance that will maximize shareholders' wealth and value of the firm in which consumer goods companies are not an exception.

In Nigeria, consumer goods sector is in its growing phase and as well performing significantly in contributing to the economic growth of the country. This is evidence by the report published by News Agency of Nigeria (NAN) through business day online (press), which states that:

"The McKinsey Global Institute (MGI), reports that the Nigeria's consumer market is worth more than $400 billion. In the report is entitled, "Nigeria's renewal: Delivering Inclusive Growth in Africa's Largest Economy''. The MGI estimated that the value of Nigeria's consumer market could reach $1.4 trillion by 2030 with food and non-food consumer goods accounting for one trillion of the total"

Although the aforementioned report came after Osagie (2014) reported that "operatives in the consumer goods sector in Nigeria have to be watchful, as the sector has been forecast to evidence scarcely marginal development in 2014. This is because of a report by Renaissance Capital, which points out that after challenging years like 2012 and 2013, consumer companies are not likely to proceed into full recovery in the year 2014, with just a minimal improvement possible in the year ahead. Therefore, this report is an indication that consumer goods companies in Nigeria need a shield for financial survival and their managers also need to understand the best combination of debt and equity that will maximize their financial performance. In this regard, this study will examine the impact of capital structure on the performance of listed consumer goods companies in Nigeria.

Moreover, results from previous studies (e.g., Myers, 2001; Baker & Wurgler, 2002; Saad, 2010, San & Heng, 2011, Ahmad, Abdullah & Roslan, 2012; Maina & Ishmail, 2014) are conflicting and fragmented. Hence, necessitates the need to carry out a further study to justify their stance and to annex where necessary. In addition, most studies on the impact of capital structure on firm performance carried out in Nigeria (e.g., Aremu, Ekpo, Mustapha & Adedoyin, 2013; Sunday, 2015) gave less attention to consumer goods sector which is at its growing stage. Therefore, the conduct of this study is going to fill a vacuum area left by researchers.

In essence, the conduct of this study will provide the treasured information needed by corporate managers to make appropriate decisions regarding the best mixture of their capital structure, as the highly geared company is on the verge of going bankrupt. The study will provide Information to relevant authorities to analyze the performance, capital structure and capital requirements of listed consumer goods companies in Nigeria. Furthermore, this study will add value to existing literature and serve as reference and basis for future research especially on capital structure and firm performance.

2. Prior studies and Hypotheses development

In an attempt to know the best mixture of equity and debt, which optimally maximizes firm's performance and value, a stream of empirical studies have been a track on the relationship between capital structure and performance of firms. Abor (2005) who conduct a study on the influence of capital structure on profitability of listed companies on the Ghana Stock Exchange finds that short-term debt and return on equity (ROE) are

significantly positively related. The result also indicates that firms that earn a lot use more short-term debt to finance their business than firms that earn less. In other words, short-term debt is a vital source of financing operations of Ghanaian firms, because it represents 85% of total debt financing.

Moreover, Abor's result also indicates an adverse relation exist between long-term debt and ROE. This signifies that firms, which earn a lot, are more dependent on debt as their basic financing means. This is in consensus with the findings of Hadlock and James (2002) where most beneficial firms utilize more debts than their opposite counterparts are. Additionally, there is a significant positive relationship between leverage (debt ratio) and firm's performance (Holz, 2002). Warokka, Herrera and Abdullah (2011) that carried out a study on East Asia firms found a positive relationship between leverage and corporation's performance. Other studies also found a significant positive relationship between leverage and firm's performance (for instance, Roden & Lewellen, 1995; Ghosh, Nag & Sirmans, 2000; Margaritis & Psillaki, 2010).

A study by Akintoye (2008) finds that performance measures (for instance, Dividend per share, Earnings per share and Earnings before interest and tax) are significantly responsive to leverage (Degrees of financial leverage and operating leverage). The study aims to investigate the sensitivity of capital structure to the performance of selected food and beverage companies in Nigeria.

Ahmad, Abdullah, and Roslan (2012) examine the effect of capital structure on the firm performance of public listed companies in Malaysia covering two major sectors (Consumers and industrials sector). Fifty-eight (58) firms are used as the sample covering year 2005 through 2010, having 358 observations. Their result indicates that there is significant relationship capital structure variables (Short-term debt and Total debt) and performance measure (return on assets, ROA). They found that Short-term debt and total debt is negatively significant related to ROA. In the same vein, leverage (debt ratio) and firm performance are significant negatively related (Arowoshegbe & Idialu, 2013).

In a study by Soumadi and Hayajneh (2012) who examined the effect of capital structure on the performance of listed Jordanian firms found that capital structure is statistically and negatively in association with performance. Their study also found that high financial leverage and low financial leverage firms have no significant difference in their performance. Their study utilizes ordinary least square (OLS) analyzing the data obtained from 76 firms for the period of 2001 to 2006. Rao, Al-Yahyee and Syed (2007) opine that capital structure is inversely related to firm's financial performance in Oman. The relationship indicates a high borrowing cost resulting from weaknesses of debt market activities in Oman economy. They also stress that tax savings from debt usage are not enough to recover the cost of borrowing and that cost of debt would be higher than the rate of return.

Additionally, Cheng (2009) examines the impact of equity and debt financing on operating performance. The study finds that both methods of financing (debt and equity) have significant negative effect on operating performance. Consequently, the study suggests that it is hazardous for firms to rely wholly on either equity or debt when raising capital. In this effect, it is better and safer to use both sources finance in financing a firm's operations. This finding is consistent with the study by Ebaid (2009) that finds short-term debt and total debt to be negatively impacting firm's performance in terms of ROA. While short-term debt, long-term debt and total debt has no significant impact on firm's performance as measured by ROE.

On another view, the study by San and Heng (2011) on construction companies found that ROA and ROE have no relationship with large, medium and small constructions companies. The result for ROE is same with Saeedi and Mahmoodi (2011) but not for ROA which is positively associated with short-term debt, long-term debt and total debt. To Maina and Ishmail (2014), capital structure (long-term debt, short-term debt and total debt) has no significant effect on performance (Tobin's Q) of listed firms in Kenya, while controlling for capital structure determinants such as firm size, asset tangibility, opportunity growth and sales growth. Whereas, Sunday (2015) reports that long-term debt contributes significantly and positively in boosting returns to equity owners. The study further reveals that leverage significantly affects ROE. Therefore, base on the related literature review, this study hypothesized that:

Ho_a: Capital Structure (long-term debt/equity) has no significant influence on performance of listed consumer goods companies in Nigeria

Ho_b: Capital Structure (short-term debt/equity) has no significant influence on performance of listed consumer goods companies in Nigeria

Therefore, based on the related literature and hypotheses statement in this study, the underpinning theory to be used is the Pecking Order Theory. Because the theory assumes that companies prefer an internal source of financing their operations than external financing. Myers and Majluf (1984) assert that where internal funds are limited to finance the operations of firms, it moves for debt financing. Consequently, firms that are more profitable have a lower demand for external financing and should, therefore, have lower leverage. Therefore, this theory explains the hypotheses of this study, which state that capital structure has no effect on the performance of listed consumer goods companies in Nigeria.

2.1. Equity and Debt Financing

Equity is ordinary share capital or shareholders' fund that is regard as capital (ordinary) plus other reserves. Equity instrument as defined by International Accounting Standard (IAS) 32 is *"a contract that evidences a residual interest in the assets of an entity that remains after deducting its liabilities"* (Elliot & Elliot, 2012). This means that equity instrument is the amount of resources left to the providers of funds (shareholders) after full settlement of debts (long-term and short-term) in the event of liquidation. Arnold (2008) asserts that ordinary shareholders are entitled to receive returns after the claims of preference shareholders and debentures are settled. Shareholders have full rights of information access, direct, and control the company via their votes. Dreye (2010) opines that shareholders (equity holders) are owners of a company and mostly bear the associated risk with the business as they receive residual claims to the resources of the firm.

Conversely, debt is the capital that a firm raise through taking a loan that paid at a future period. Debt holders are not owners of the business, rather creditors that receive a fixed percentage as return on their loan to the company. Interest on debt capital is paid in full before payment of any dividend to equity holders because the cost of debt (Interest) forms part of the operational cost of a business. Debt financing means borrowing money from third parties and not giving up ownership. That is the financing of business operations through external sources which attracts additional cost known as 'coupon rate' (cost of borrowing). Default to meet this coupon rate may lead to negative consequences to the borrowing firm. The holders of debt capital have an initial claim on firm's assets who bear less risk than shareholders (Gitman, 2003) do.

3. Methodology

For the purpose of this study, seven (7) out of the nineteen (19) consumer goods companies listed on the Nigerian Stock Exchange (NGSE) whose accounting year ends 31 December is used as a sample. This is because, within the population, some of the companies have not filed their accounting reports within the period covered by the study and there is inconsistency in their accounting year-end. This is based on the limitation stated by San and Heng (2011) in their study that, *"different accounting policies and period for an annual account for comparison will influence the accuracy of result"*. For this study, data was utilized from annual reports and accounts of the seven (7) sampled consumer goods companies on their websites, African financials website and some publications on the website of Nigerian Stock Exchange (NGSE). The use of listed consumer goods entities is due primarily to data availability. Data for this study covered the period between 2008 and 2013. For analysis purpose, SPSS version 22 was used to run descriptive statistics, correlation, and regression.

3.1 Variables

The study tests two hypotheses using a hierarchical regression model, with the dependent variable as return on equity (ROE) measured as Earnings before interest and tax divided by owner's equity. The hypothesized variables used in this study are long-term debt/equity and short-term debt/equity. Long-term debt to equity is measured as long-term debt divided by total equity capital, while short-term debt to equity is measured as short-term debt divided by total equity capital (Zeitun & Tian, 2007; Onaolapo & Kajola, 2010; Khan; 2012; Maina &Ishmail, 2014; Sunday, 2015). Total equity capital is the summation of ordinary share capital and reserves. Long-term debt is in terms of debentures and long-term loan while short-term debt is in terms of creditors, bank loan, and overdraft.

The study also incorporates some control variables reported by related literature that may influence a firm's performance. The control variables used in this study include Asset tangibility, Firm Size, Growth in sales and

Efficiency. Following Maina and Ishmail (2014) and Sunday (2015), Asset tangibility is measured as fixed assets divided by total assets. Following Sunday (2015), size is measured by the natural log of total assets. This measure is also similar to that used by Ahmad *et al*, (2012). For growth measurement, based on a study by Abor (2005), growth is measured by sales growth rate (i.e. sales in period 1 divided by sales in period 2 minus 1). While efficiency, according to Mathur, Manohar, and Gleason (2001) is measured by total asset turnover (sales divided by total assets).

3.2 Model Specification

The following regression model is used to examine the relationship between capital structure and firm performance and control variables.

$$ROE_{it} = \beta_0 + \beta_1 STD_{it} + \beta_2 LTD_{it} + \beta_3 SIZE_{it} + \beta_4 SG_{it} + \beta_5 ASTAN_{it} + \beta_6 EFF_{it} + \varepsilon_{it}$$

Where;
$ROE_{i,t}$ = Return on equity of firm i in year t
$STD_{i,t}$ = Short-term ratio of firm i in year t
$LTD_{i,t}$ = Long-term debt ratio of firm i in year t
$SG_{i,t}$ = Sales Growth rate of firm i in year t
$SIZE_{i,t}$ = Size of firm i in year t
$ASTAN_{i,t}$ = Asset tangibility of firm i in year t
$EFF_{i,t}$ = Efficiency of firm i in year t
$\varepsilon_{i,t}$ = The error terms.

The dependent, independent and control variables are described in Table 1 as thus:

Table 1 Description of Study Variables

Variables	Description
Return on Equity (ROE)	Earnings before interest and tax divided by owners' equity
Long-term Debt/Equity	Long-term debt divided by total equity
Short-term Debt/Equity	Short-term debt divided by total equity
Firm Size	Natural log of the total assets
Sales Growth	Sales in period 1 divided by sales in period 2 minus 1
Asset Tangibility	Total fixed assets divided by total assets
Efficiency	Sales divided by total assets

4. Results

4.1 Descriptive Statistics

Table 2 provides descriptive statistics for the variables used in the model. Base on the descriptive statistics in Table 2, the mean value for ROE is 0.60105 (60.11%) with a maximum value of 1.492 and a minimum of 0.102., this also shows a better result on the performance of the sampled firms. The standard deviation stood at 0.338, which means that the proportion of return on equity (ROE) related to the companies in the sample, is not much varied. However, the findings from descriptive statistics in relation ROE is consistent with that of Maina and Ishmail (2014). Concerning the predictor variables (i.e. Short-term debt and long-term debt ratio), the mean values show -0.01916 (-1.92%) and 0.13436 (13.44%) respectively. This is an indication that some of the sampled companies use more of short-term than long-term debts which might be due to; (1) high cost of borrowing a long-term loan and/or (2) limited access to the financial market. Moreover, it may also result from the use of more equity capital than long term debt for a reason of higher return expectation at no expense to cost

of capital. The result is also a sign that while some of the sampled firms prefer internal financing in line with pecking order theory, some have to reach the extent of been highly leveraged which resulted to a negative STD of -1.92% (i.e. external debt is higher than internal financing).

Coherently, the standard deviations for both short-term debt (STD) and long-term debt (LTD) are 1.2197 (1.22) and 0.7264 (0.73). This means that the proportions of STD and LTD in relation to the sampled companies are widely varied. This is a confirmation of the aforementioned statement where some companies prefer the use of the short-term loan, others prefer long-term loan in financing their operations. In relation to the control variables (ASTAN, EFFI, SGRT, and F_SIZE), their mean values are 0.669, 1.686, 0.1238 and 7.370 respectively. While their standard deviations are chronologically as; 0.26062, 0.9488, 0.1563 and 0.4970 as shown in table 2.

Table 2 Descriptive Statistics

	Minimum	Maximum	Mean	Std. Deviation
Return on Equity	.102	1.492	.60105	.337969
Short-term debt	-3.646	1.803	-.01916	1.219732
Long-term debt	-2.750	1.394	.13436	.726433
Asset tangibility	.332	1.000	.66890	.260621
Efficiency	.275	3.987	1.68600	.948794
Sales growth	-.192	.528	.12379	.156305
Firm size	6.32	8.32	7.3696	.49675

Source: Authors' Analysis (2015)

4.2 Correlation

Table 3 provides correlations of the variables. The result from Table 3 indicates that there is a moderate correlation between return on equity (ROE) and STD ($r = .30$, $p = .065$). Meanwhile, ROE and long-term debt (LTD) are significantly positive related ($r = .50$, $p = .001$). Regarding control variables, ROE is insignificantly positively related with Asset Tangibility ($r = .22$, $p = .156$), Sales Growth ($r = .18$, $p = .244$), Firm size ($r = .14$, $p = .386$), while moderately correlated with efficiency ($r = .30$, $p = .054$). note that these figures are approximated to two-decimal places from Table 3.

However, the result from Table 3 shows that the correlation coefficients of the independent variables are relatively low; hence, no problem of multicollinearity that will cause a problem since the correlation between the explanatory variables is not up to .9 and above (Tabachnick & Fidell, 2001; Pallant, 2005).

Table 3 Pearson's Correlation Matrix

Variables	1	2	3	4	5	6	7
1 ROE	1	.223	.299	.184	.137	.288	.487[**]
2 ASTAN		1	.265	.033	-.164	-.382[*]	-.137
3 EFFI			1	.111	.217	.411[**]	.400[**]
4 SGRT				1	.125	.272	.190
5 F_SIZE					1	.634[**]	.388[*]
6 STD						1	.719[**]
7 LTD							1

(*and ** indicates significance at the 0.01 and 0.05 level (two-tailed)): ROE, Return on Equity; ASTAN, Assets Tangibility; EFFI, Efficiency; SGRT, Sales Growth; F_SIZE, Firm Size; STD, Short-term debt; LTD, Long-term debt.

Source: Authors' Analysis (2015)

4.3 Regression Analysis

Table 4 reports that hierarchical regression result. From Table 4, the hierarchical multiple regression reveals that at stage one, after the variables in block 1 (asset tangibility, efficiency, sales growth and firm size) have been entered; the overall model explains 14.4% of the variance in return on equity (.144 x 100). In addition, after block 2 variables (short-term and long-term debts) have been entered, the model as a whole explains 33% (.33 x 100). However, the overall variance explained by the predictor variables (short-term and long-term debts) after the effect of asset tangibility, efficiency, sales growth and firm size have been removed, is .186. This means that short-term and long-term debts explain an additional 18.6% (.186 x 100) of the variance in return on equity, even when the effect of asset tangibility, efficiency, sales growth and firm size have been statistically controlled for. This is moderately a statistically significant contribution, as indicated by the Sig. F change value for this line (.014). In the same vein, the model as a whole (which include both blocks of variables) is significant [$F_{(6, 35)} = 2.877$, $p < .05$] as indicated in the ANOVA result.

On the other hand, to find out the statistical contribution of each of the variables to the model, the standardized beta (β) coefficient values in are considered. Scanning the significance column (p-values), there is only one variable that make a statistically significant contribution, that is LTD ($t = 2.354$, $\beta = .487$, $p < .05$). Whereas STD ($t = .236$, $\beta = .070$, $p > .05$), Asset Tangibility ($t = 1.684$, $\beta = .306$, $p > .05$), Efficiency ($t = -.009$, $\beta = -.002$, $p > .05$), Sales Growth ($t = .470$, $\beta = .069$, $p > .05$) and Firm size ($t = -.294$, $\beta = -.054$, $p > .05$) were not statistically significant.

Besides, the overall result indicates that short-term debt has no significant effect on the financial performance (ROE) of listed consumer goods companies in Nigeria. While long-term debt has a significant effect on the financial performance (ROE) of listed consumer goods companies in Nigeria.

Table 4   Hierarchical Multiple Regression results

Variables	Standardized coefficients Beta (β)	Standard Error	t	p
Step 1				
Constant		.826	-.284	.778
ASTAN	.178	.211	1.099	.279
EFF	.214	.059	1.301	.201
SGRT	.141	.333	.918	.365
F_SIZE	.103	.110	.636	.529
Step 2				
Constant		.926	.605	.549
ASTAN	.306	.235	1.684	.101
EFF	-.002	.063	-.009	.993
SGRT	.069	.318	.470	.641
F_SIZE	-.054	.125	-.294	.770
STD	.070	.082	.236	.815
LTD	.487	.096	2.354	.024

Source: Authors' Analysis, (2015)

Notes: Step 1: $F_{(4, 37)} = 1.554$, $p > .01$, $R^2 = .144$; Step 2: Change in F, $\Delta F_{(2, 35)} = 4.872$, $p = .014$ (i.e. $p < .05$) and $\Delta R^2 = .186$: ANOVA, $F_{(6, 35)} = 2.877$, $p < .05$

5.0 Conclusion

This study provides an attempt to examine the relationship between capital structure and performance of listed consumer goods companies in Nigeria. Hypotheses are developed based on the basis that capital structure has no significant impact on firm performance. The study finds that short-term debt has no significant effect on capital structure, whereas, long-term debt has significant positive effect on the financial performance of listed consumer goods companies in Nigeria. Specifically, the results show that capital structure has a significant impact on firm's performance. This is consistent with the studies by Sunday (2015) and Ahmad *et al* (2012) that found a positive relation between long-term debt and ROE. It is also in consensus with Myers and Majluf's (1984)

theory, which states there is a positive relationship between long-term debt levels and profitability of a firm. The study recommends that firms should consider the mixture of equity and debt since they are major determinants of corporate performance. And authorities concerned should create an enabling business environment for companies (especially those with low capital) so as to have access to long-term debt to finance their operations and improve performance in the short-run, instead of using high short-term debts, to cushions for financing and profitability problems.

Despite the important contributions of this study to capital structure and performance debate, there are a number of setbacks inherent in the study. First, the study observes only consumer goods sector out of 11 sectors operating in the Nigerian stock exchange. In addition, only seven out of the available listed consumer goods companies in Nigeria are selected. This sample is relatively small and may temper with the results of this study. Future researchers may wish to replicate this study by increasing the sample of consumer goods companies or even considering other sectors as part of the sample, which may lead to arriving at a more robust model and generalization can be made with high level of precision. Second, the study utilizes on ROE as a performance measure. There are other performance measures (for instance, return on assets, net profit margin, gross profit margin, earnings per share, dividend per share, Tobin's Q e.t.c.), which can be used by future studies.

Moreover, future researchers can also examine the indirect effect of capital structure on firm performance by introducing a mediating or moderating variables like; effective management, the board of directors' independence, ownership structure, board strategic role and so on. Lastly, researchers can make positive contributions by clarifying other concepts and modifying the method of data collection. In this sense, questionnaire or interview can be used separately or combined with data from annual reports to get more understanding of the effect of capital structure on firm performance. This is because; other factors may be among the determinants of capital structure that are not captured in this study or prior studies.

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