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EFFECT OF CAPITAL STRUCTURE AND FINANCIAL PERFORMANCE ONQUOTED CONSUMER GOODS FIRMS IN NIGERIA

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Abstract

This paper empirically investigated the effect of capital structure and financial performance on consumer goods firms listed on the floor of the Nigerian stock exchange from the period of 2016 - 2020. The study is quantitative in nature, and the tool of analysis employed is the multiple linear regression technique. Results indicate strong relationship between all the capital structure components and return on assets. The t-test hypothesis discovered that capital structure variables have significant effect on financial performance measured by return on assets. This study recommends that listed consumer goods companies in Nigeria should research a suitable mix of capital structure components in line with the agency theory postulations. Managers should further critically analyse the appropriate debt-equity mix suitable for their entities in order to gain the benefits of debt-equity mix in line with the pecking order theory so as to ensure adequate shareholder returns on assets.

Keywords: Capital Structure, Financial Performance, Nigeria Stock Exchange, Return on Assets.

1. Introduction

The capital structure of a company has for long been established as a significant factor that determines the health of the firm. It is a well-known fact that the difference between sound and strong firm and unsound and weak firm is the sufficiency of its working capital. Capital structure refers to the way in which a firm is financed through a mix of debt and equity. It is the proportion of capital attributed to the firm through different sources, which include both internal and external finances (Oladele, Omotosho & Adeniyi, 2017).The means through which managers finance their company's operation to achieve positive net present value has important implications on shareholders wealth maximisation objectives. Thus, the cumulative effect of these discrete financing options marks the capital structure decision of the firm which has long been the focus of research in the corporate finance. Riahi-Belkaonui (1999) argue that capital structure represents the major claims to a firm's assets including bothshareholders' funds andother liabilities. According to Ogbada,Jones, Nmesirionye and Ibiam (2021), the debt/equity mix takes any of three forms: 100% equity and 0% debt or 0% equity: and 100% debt or X% equity and Y% debt. From the three alternatives quoted above, option one refers to the unlevered firm, which means the firm shuns the advantage of leverage (if any). Option two on the other hand is that firm that has no equity capital. This option may actually not be realistic in the real life economic situation. This is because no rational borrower will put in his money in a business enterprise that has no equity capital. This partly explains the term "trading on equity", which means that, it is the equity element that is present in the firm's capital structure that encourages the debt providers to give their scarce resources into the business. Option three is the most realistic. This option combines a mix of a certain percentage of both debt and equity in the capital structure and thus, exploiting the benefit of debts or leverage (if any).

A number of theories have been advanced by financial management scholars to explain the capital structure of the

firms. However, there is lack of consensus among researchers about the optimal capital structure (Ogbada et al., 2021). The lack of consensus in the various theories makes further studies on capital structure crucial. Thus, capital structure decision is very critical, particularly on effect of capital structure on financial performance of listed consumer goods companies listed on the Nigerian StockExchange. The consumer goods firms are those companies whose production is tied to the individual needs of every community such as toiletries, Maggi cubes, and sugar and so on. Since consumer goods are everyday items of consumption, it is expected that with very high population such as is the case of Nigeria, the stock price and the market value of consumer goods will be high. Thus, according to Ogbada et al (2021), the stock price of the consumer goods industry stood at 150 million USD and the market value of the selected consumer goods companies was valued at 25, 977 million, USD as at the time of their research. This translates to 56.65%. Murtaldlo, *et al* (2014) posit that, capital structure and asset turnover have a significant effect on financial performance but asset structure has no effect on financial performance. In their own study Lia quart, *et al* (2017), found significant negative effect of capital structure on return on asset (ROA) on the oil and energy sector in Nigeria. Furthermore, the empirical works of Mwangi and Birundu (2015) found no significant relationship between capital structure and return on asset (ROA) in the small and medium enterprises (SMEs) in Nigeria. But the research work of Gladys and Omagwa (2017), posited that asset structure has a significant statistical effect on financial performance. Based of the above empirical findings and the scholarly arguments therefore, this study is set to empirically test the effect of capital structure on the financial performance of consumer goods companies listed on the Nigeria Stock Exchange in 2016 to 2020.

2. Review of Related Literature

2.1 Capital Structure on Financial Performance (*H*1)

A number of studies by corporate finance researchers such as Ogbada et al (2021); Olaoye et al, (2020); Liaqat, et al (2017), Oladele et al., 2017 and Igbal (2016), argues in favour of capital structure as an influencer of financial performance. To corroborate their findings this study further found a consensus in other studies on capital structure that refers to how firm investment is financed using either equity or debt or proportionate mix of both (Ghasemi & Ab-Razak, 2016; 2017; Vy & Nguyet, 2017; Olusuyi & Felix, 2017; Burksaitiene & Draugele, 2018). Previous studies employ the regressions analysis to measure financial performance by using variables such as ROA (Zulkafli & Samad 2007) and (Lawan et al., 2021). The results of the various studies indicates that capital structure depends on the position of the economic business cycle. Hence, financial managers are advised to keep abreast of economic trends in their decision to adopt debt financing mix in Nigeria (Osaretin, et al, 2019). Elsewhere in Norway however, capital structure has been found to have a positive impact on financial performance and also improve industrial performance (Obilikwu, 2018). The study by Vy and Ngyet, (2017) found positive relationship between capital structure and company performance in Vietnam. This study, the first hypothesis is to examine or test the effect of capital structure on financial performance using Return on Assets: (*H*1);

H_1: It is hypothesized that capital structure influences the financial performance of listed consumer goods companies on the Nigerian Stock Exchange.

2.2 Liquidity on Financial Performance (*H*2)

Previous studies on capital structure used different proxies to measure capital structure (Lawan, Sirajo, Haruna & Sani, 2021).The measures commonly used in the literature in the form of ratios include total debt to total assets, total debt to total equity, short-term debt to total assets and long-term debt to total assets. Total debt to total assets is the amount of debt used to finance firms' assets and other capital expenditures that can improve a firm's performance. Thus, it is expected that increasing leverage components of a firm's capital structure may increase the level of efficiency and increasing their financial performance. Firm managers who are able to identify the level of leverage as components of firms‟ capital structure are rewarded by reducing the firm's cost of finance thereby maximizing the firm's revenue (Zeitun & Tian, 2007).

On his part Demirgunes argues that liquidity affects profitability. This is based on his research results on the effect of liquidity on financial performance from Turkish retail industry which indicates that liquidity affects

profitability (Demirgunes, 2016). Based on these findings Endah and Wahyudin (2017) further defines liquidity ratio as the company's ability to pay short-term financial obligations on time. To corroborate these findings Iqbal (2016), also has the same results in his research which states that liquidity has a positive correlation with financial performance. The research study from Norway show positive relationship between capital structure and financial performance (Cheriyan & Daniel, 2019). These comparative study found that higher volatility in the Indian market was associated with greater liquidity in that market even after adjusting for the impact of trading activities. Based on the above proposition, the hypothesis to test the effect of liquidity on financial performance using Return on Asset is the study's hypothesis two ($H2$):

H2: It is hypothesized that liquidity influences the financial performance of listed consumer goods companies on the Nigerian Stock Exchange.

2.3 Asset Turnover on Financial Performance ($H3$)

Asset turnover is defined as that ratio which measures how all assets owned by a company that supports a company's sales (Pramesti, et al., 2016). Furthermore, Sitanggang (2013) argues that asset turnover has significant effect on profitability. Moreover, results of the feasibility analysis between return on assets and profitability depicts positive and significant effect (Murtaadlo, et al., 2014). A further study by Al-Ani (2014) suggests that the effect of asset turnover significantly impact on financial performance of the studied sample size. Based on the above proposition, the hypothesis to test the effect of asset turnover on the financial performance using Return on Asset is the study's hypothesis three ($H3$):

H3: It is hypothesized that asset turnover influences the financial performance of listed consumer goods companies on the Nigerian Stock Exchange.

Operational definition of variables

This study adopts the operational definition of variable as given by Brigham & Houston, (2006) in their book basic financial management translator as follows**:**

Table 1: Operational definition of variables

S/N	Variables	Definition of Terms	Indicators
1	Financial Performance (FP)	Describes every economic outcome that a firm achieve within a certain period of via company activities to generate income	ROA = $Netprofit/Totalassets$
2	Capital Structure (CS)	Capital Structure defined as permanent finance consisting of share capital, long-term debt and preference shares	CS = $Totaldebt/TotalEquitie$
3	Liquidity (LQ)	Liquidity is a ratio that measures a firm's ability to meet its short-term obligations on time	LQ = $Currentassets/$ □□□□.□□□□□□□□□□□
4	Asset Turnover (AT)	Asset turnover describes asset rotation measured by sales volume	AT = □□□□□/ □□□□□□□□□□

Source: Adopted from Brigham& Houston, (2006).

2.4 Theoretical Underpinnings

Capital structure can always be explained by the M-M theory by Modigliani and Miller (1958). The MM theory illustrates that under certain key assumptions, firm's value is unaffected by its capital structure. Capital market is assumed to be perfect in Modigliani and Miller's world, where insiders and outsiders have free access to information without transaction cost, bankruptcy cost and no taxes. Thus according to these authors, equity and debt choice become irrelevant while internal and external funds can be perfectly substituted. These researchers argue that the value of a firm should not be contingent upon its capital structure. The theory argued further that a firm should have the same market valuation and Weighted Average Cost of Capital (WACC) at all capital structure

levels. They argue further that the value of a company should be determined by the return and risks of its operation not on the way it finances those operations. It was not until 1977 that Miller fine tune their theory to bring in the new version of theory known as irrelevance theory of capital structure. He opined that capital structure decisions of firms that have a mix of both corporate and personal tax circumstances are irrelevant (Miller 1977). The MM theory was criticized by modern researchers on the ground that perfect market does not exist anywhere the world in real life. Attempts to relax these assumptions particularly the no bankruptcy cost and no taxation led to other theoretical postulations.

This current study is underpinned by the agency and pecking order theories. The agency theory is a theory concerning the relationship between shareholders and the managers (Akeem et al., 2014). Agency theory initially developed by Berle and Means (1932) suggest that, firms can be viewed as a link of contracts between resource holders. Agency relationship arises whenever the principal(s), hire one or more individuals called manager, to perform certain tasks with delegated decision- making authority (Akeem et al., 2014). It was not until 1976 when Jensen and Meckling defines agency relationship as a contract under which the principal(s) engage an agent to perform certain tasks on their behalf involving delegating authority to the agent. These scholars observed that, the agent will not always act in the best interests of the principal. Accordingly, Eisenhardt (1989) came up with an improved version of the theory for resolving two problems that can occur in agency relationships i.e. desires of the principal and agent and the verification of what the agent is actually doing by the principal. The problem here is that the principal cannot verify that the agent has behaved appropriately. The second is the problem of risk sharing that arises when the principal and agent have different attitudes toward risk. The problem here is that the principal and the agent may prefer different actions because of their different risk preferences (Eisenhardt, 1989). The principal can limit divergences from his interest by establishing appropriate incentives for the agent and by incurring monitoring costs designed to limit the abnormal actions of the manager. Chechet and Olayiwola (2014) in trying to find a solution to agency problem observed that, the only control mechanism to checkmate the managers' excesses to pursue shareholders interest is to introduce more leverage in financing the firm. If more of leverage is employed. Debt servicing and fear of liquidation eventually leading to loss of jobs by the managers may result in cost reduction thereby leading to efficiency and improved performance.

The pecking order theory gain much prominence through the work of Myers and Majluf (1984) and Myers (1984), which state that firms that have high profits tend to attain low debt profile. This is because when firms are more profitable their first priority is to generate financing through retained earnings in order to maximize the value of the existing shareholders. However, in case the retained earnings are not sufficient, the firms can then go for debt and if further financing is required they issue fresh equity. According to Myers (1984), retained earnings is preferred because it almost has no cost, but if the external resources are used for financing like in the case of issuance of new shares it may have very high costs. The pecking order theory came as a result of information asymmetries existing between insiders of the firm and outsiders (Cyril, 2016). These theory is adopted by managers as their financing policy to minimize associated costs by preferring internal financing to external financing and favoring equity to high risk debts.

3. Methodology

The populations of this study are all the listed consumer goods firms on the floor of the Nigeria Stock Exchange for five years from 2016 - 2020. This sample size is determined using the criteria used in previous studies (Ogbada et al., 2021). Consumable industrial sector firms listed on the Nigeria Stock Exchange with financial reporting periods from 1/1/ 2016 to 31/12/2020, have positive net earnings during the stated periods. Thus applying the above criteria, this study will have a total of 15 consumer goods firms that met the conditions hence this study will have a total of 84 data set. The adopted or proxied independent variable of this study is capital structure (CS), while the dependent variable is financial performance proxied by (ROA). This study also conducts specification tests which include Multicollinearity, Autocoleration, Heteroscedasticity, and Normality tests to

ensure that the model employed in this study passed the basic checks for testing the hypotheses. A hypothesis testing is done by means of multiple linear regression analysis using SPSS version 24.

4. Results and Discussions

In line with prior studies, descriptive statistics was employed to provide a qualitative report of the selected variables of the study (Ogbada et al., 2021; Ghozali, 2017). Descriptive statistics is avery powerful tool of analysis that provide an over view of statistical data regarding minimum, maximum, mean and standard deviations of an empirical research. The results of the statistical analysis are presented in Table 2 below. The result in these Table shows that financial performance measured by ROA has the lowest value of 0.02 and the highest value of 0.430, the average value is 0.103 >0.105 standard deviation. This means that the distribution of the ROA value is good. Capital Structure as measured by the CS has the lowest value of 0.071 and the highest value of 3.026, the average value is 0.793, and the standard deviation value is 0.582. The mean value of 0.793 >0.582 standard deviation meaning that the distribution of CS values is satisfactory. Liquidity measured by the LQ has the lowest value of 0.511 and the highest value of 10.251, the average value is 2.787, and the standard deviation value is 1.918. Asset turnover as measured by total asset turnover (AT) has the lowest value of 0.201 and the highest value of 2.891, the average value is 1.276, and the standard deviation value is 0.553. The mean value is 1.2796>0.553 standard deviation which means that the distribution of AT values is excellent.

Table 2: Descriptive Statistics

Narration	Data Volume	Minimum	Maximum	Mean	Std. Deviation
ROA	84	0.020	0.430	0.103	0.105
CS	84	0.071	3.026	0.793	0.582
LQ	84	0.511	10.251	2.787	1.918
AT	84	0.201	2.891	1.276	0.553

Source: Researchers computations using SPSS version 24.

4.1 Regression Assumption Tests

The various tests conducted in this study is meant to produce a good regression model. To avoid errors in testing classical assumptions, the number of samples used must be free from the classical assumption test and the number of samples used must be free from biases (Ghozali, 2014). The classic assumption test results in this study are as based on Table 3 below. It is known that the results of Multicollinearity tests indicating that the whole independent variables has a tolerance value > 0.10 and VIF value of < 10. Thus, it can be stated that the regression model in this study is free from the symptoms of Multicollinearity.

Table 3: Regression Assumption Tests

Narration	Coefficients						Collinearity
	β	Std. dev.	beta	1	Sig. lev	Tolerance	VIF
Constant	-0.100	0.052	-	-1.866	0.650	-	-
CS	0.071	0.025	0.410	2.775	0.005	0.415	2.405
LQ	0.027	0.006	0.520	3.855	0.000	0.495	2.015
AT	0.070	0.020	0.376	3.550	0.001	0.805	1.240
R	0.525						
R2	0.276						
Adj. R2	0.236						
Std. Error	0.934						
D. Watson	2.225						
F. Stat	0,952						

Source: Researchers computations using SPSS version 24.

4.2 Hypotheses Testing

This study test the hypotheses formulated using the multiple linear regression technique as follows:

ROA = -1.01+ 0.071CS + 0.027LQ + 0.070AT + e …….. (1)

The feasibility results of the model (F-Test), multiple regression coefficient Test (t-Test), and Coefficient of determination (R^2) results are also shown in Table3. The results as depicted in Table 3 summarily indicates that the Capital Structure (CS), Liquidity (LQ), and Asset Turnover (AT) concurrently influence financial performance proxied by return on assets (ROA). Furthermore, the model regression coefficient results of hypothesis (H1) i.e. capital structure against financial performance is also shown in Table 3. The results of the analysis (H1) Capital Structure (CS) have a value of (cal)> from $(Table)$ which is 2.775 with a significant value of 0.005. This significance value is smaller than the confidence level of 0.005 < 0.050. This means that the capital structure (CS) has a significant effect on financial performance proxied by (ROA). This means that Hypothesis (H1) is accepted. This study's result support that of Ogbada et al., (2021), Nainggolan and Pratiwi (2017) and Liaqat, et al., (2017), whose research found that capital structure strongly influences financial performance. Furthermore, results of hypothesis (H2) i.e. the relations between liquidity and financial performance shows that, (H2) Liquidity (LQ) has a value of $(cal) > (Table)$, which is 3.855 with a significance value of 0.000 < 0.050. This result shows that liquidity (LQ) has a significant effect on financial performance proxied by (ROA). Hypothesis (H2) is therefore accepted. Nainggolan and Pratiwi (2017) defined liquidity as firm's ability to fund the company's operations and achieve its short-term requirements. The result in this study showed that liquidity has an influence on the size of ROA. The result of this study supports those of Ogbada et al., (2021) and Iqbal (2016), which confirms that liquidity, has an effect on financial performance. The result of hypothesis (H3), that deals with effect of Asset Turnover on financial performance however, has a value of 3.550 with the value of sig. 0.001 < 0.05. This shows that asset turnover (AT) has a significant effect on financial performance proxied by (ROA). Therefore, this study's hypothesis results (H3) are accepted. This also shows that if asset turnover measured by total asset turnover (AT) is higher, the level of financial performance of the company will also be higher because the company in utilizing its assets efficiently. This is expected to higher operational activities of the company, resulting in an increase in the level of profitability of the company.

The results of this study supports the results of research conducted by Ogbada et al., (2021) and Pramesti, et al., (2016), which found that asset turnover measured by total asset turnover (AT) influences financial performance. Finally, the coefficients of determination test results (H2) in Table3 above shows that the adjusted R square value is 0.236. This means that 23.6% of the dependent variable in this study can be explained by independent variables namely profitability (ROA), liquidity (LQ), and capital structure (CS), and asset turnover (AT), while the remaining 76.4% is explained by other variables outside the study's model.

5. Conclusion, Recommendations and Suggestion for Further Study

The study investigates the effect of Capital Structure (CS), Liquidity (LQ), and Asset Turnover (AT) on financial performance in the consumer goods firms listed on the floor of the Nigerian Stock Exchange from 2016 to 2020. The results of the study's analysis concludes that Capital Structure (CS), Liquidity (LQ), and asset Turnover (AT) instantaneously influence the financial performance for all the hypothesis tested. This study therefore recommend that management of listed consumer goods firms in Nigeria should involve an appropriate mix of capital structure mechanisms to ensure adequate returns on assets in line with the agency theory postulation. Furthermore, the management of the quoted consumer goods firms in Nigeria should critically analyse the appropriate debt-equity mix suitable for their entities in order to gain the benefits of debt-equity mix in line with the pecking order theory. This study has some limitations. Firstly, the

consumer goods companies listed on the Nigerian Stock Exchange are scanty. Future research should explore the policy of all companies listed on the Nigeria Stock Exchange. This study employ only three independent variables namely capital structure (CS), Liquidity (LQ), and asset turnover (AT). Future studies should add more variables such as return on equity (ROE), Tobin's Q, as other measures of financial performance.

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