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Impact of Capital Structure on Financial Performance of Listed Building Materials Companies in Nigeria

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Abstract: This study examined the impact of capital structure on firm's performance in Nigerian Building Material Industry. Sample of five (5) firms in Nigerian Building Material Industry listed on the Nigerian Stock Exchange were used as a sample over a ten (10) year period (2009-2018). Data was generated from financial statement of the firms within that period. Regression analysis was run to determine the level of impact of capital structure surrogated by short term debt, long term debt and equity on performance epitomized by Return on Asset. The analysis revealed that short term debt has a significant impact on firm performance; long term debt has a significant negative impact on firm performance. The result also revealed that equity has an impact on firm performance and a weak negative relationship between equity and Return on Asset. The study recommends that the management of the listed firms in the industry should ensure a proper trade-off between debt and equity to reduce the risk of overburdened external financing so as to improved financial performance to the benefit of equity holders.

Keywords: Equity, Short term debt, Long term debt, Financial Performance, Firm

I. INTRODUCTION

Every firm, whether new or old, needs sufficient funds to finance its operations. Capital of a company has for long been established as a significant factor that determines the health of a firm. In fact, the difference between sound and strong firm and unsound and weak firm is the sufficiency of capital. Capital of a company, according to [1] refers to the means of funding business. However, [2] sees capital as a stock of money possessed by a person or firm which may be invested from time to time in order to earn income but which is intended not to be diminished. From the above, it can be deduced that capital is an important factor that does not only enhance firms operation but also determine the corporate survival. [3] posited that financing decisions result in a given capital structure and suboptimal financing decisions can lead to corporate failure.

Capital structure theory is seen as ansinequanon to the administration of firm wishing to raise fund for finance. It addresses the means of finance available to an enterprise likewise the best mix of such resource that can reduce the overall cost of capital and minimizes returns on acquisition. The success of any business, therefore, lies in its management's effort to identify optimum capital for smoothness, sustainability and prosperity in line with her overall goals and objectives [1].

Impact of capital structure on financial performance of companies remained a matter of concern among scholars, corporate finance managers and other stakeholders since the work of Modigliani and Miller in 1958. Over the years, researchers have examined the impact of capital structure on firms' financial performance.

Statement of the Research Problem

Capital structure has become a topic of public interest since the work of [4]. Since then, it attracts attention of researchers and professionals. Building materials industry plays an important role in promoting and supporting economic growth and development. When building industry is however not adequately financed, firms in the industry may not perform effectively in today's competitive environment; neither will they meet up the productivity standard. Building materials industry, the world over occupies a strategic and leading position in the production of goods and services.

Several studies have been conducted on capital structure and firm's financial performance in Nigeria. Such researches notably the work of [5] conducted their research on capital structure and firms performance in Nigerian Manufacturing sector and the result shows that firm's capital structure surrogated by Debt ratio has a negative impact on firm's financial performance. [6]

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equally examined the impact of capital structure on financial performance of Nigerian firms and the result also shows that capital structure has a negative impact on firm's financial performance. [7] on the other hand focused his research on the impact of capital structure on firm's profitability in Nigeria. However none of the above researches was conducted on Nigeria building materials industry.

Therefore, it is in line with the aforementioned problem that the research work intends to highlight the impact of capital structure on firm's financial performance of Nigerian building materials industry.

Objectives of the Study

The main objective of this study is to investigate the impact of capital structure on financial performance of listed building materials companies in Nigeria. The specific objectives of the study are to:

i. Examine the impact of short term debts on financial performance of listed Building Materials Companies in Nigeria.

ii. Examine the impact of long term debt on financial performance of listed Building Materials Companies in Nigeria.

iii. Examine the impact of equity financing on firms' financial performance of listed Building Materials Companies in Nigeria.

Research Hypotheses

With reference to the aforementioned specific objectives and statement of research problem, the following hypotheses are formulated in null form to guide the study:

H1: Short term debts have no significant impact on financial performance of listed building materials companies in Nigeria.

H2: Long term debts have no significant impact on financial performance of listed building materials companies in Nigeria.

H3: Equity financing has no significant impact on financial performance of listed building materials companies in Nigeria.

II. LITERATURE REVIEW

Concept of Capital Structure

Capital structure otherwise known as financial structure has been defined by numerous knowledgeable individuals. According to [5], it is the means by which an organization is financed. It is the combination of equity and debt capital maintained by a company. [8] define capital structure as the mix (or proportion) of a firms" permanent long term financing represented by debt, preferred stock and common stock equity, he considers debt and equity financing as major components of capital structure.

[9] defines the capital structure of a company as the relationship that exists between the different classes of capital in the company. In his wok he further defined and identified the classes of capital to include both long term and short term sources of capital and equity. This view is also shared by [2] where he defined the capital structure of the company to be how the company finances its operations. According to him, the means a finance are usually made up of three sources which include the ordinary share capital, the preference share and the debt capital. [10] define capital structure as the percentage of capital (money) at work in a business by type. It is a mix of a company's long term debt, specific short term debt, common equity and preferred equity and it simply describes how a firm finances its overall operations and growth by using different sources of funds. Broadly speaking, there are two forms of capital equity capital and debt capital. Each has its own benefits and drawbacks and a substantial part of wise corporate management is attempting to find the optimal capital structure in terms of risk/reward pay off for shareholders.

A firm's capital structure is then the composition or structures of its total assets are total debt. For example, a firm that sells N40billion in equity and N60billion in debts is said to be 40% equity financed and 60% debt financed. The firms ratio of debt to total financing 60% is thus referred to as the firms leverage which can also be describe as it is gearing ratio or the proportion of the capital employed of the firm which comes from outside business.

According to [11], Knowledge about capital structure has mostly been derived from data in developed economies that have many institutional similarities. Since different countries have different institutional arrangements mainly with respect to tax and bankruptcy codes existing market for corporate control, and the roles of banks and securities market, it might prove inadequate to infer what occurs in the developed economies or what determines their capital structure can be used to explain what is obtainable in the developing countries like Nigeria. In addition there are differences in the social and cultural issues and in levels of economics development; thus, the need to examine differently the determines of capital structure for firm developing economies. [12] posits that the critical stage of a company's financing. Is its capital structure which involves maintenance of various combinations of capital stock that could maximize shareholders' wealth.

The capital structure decision is significant as it affects the cost of the capital and market value of the firm. According to [13], under favorable economic conditions, increase in debt capital that is referred as leverage also increase earning per-share to the equity holders. That is, even though leverage cannot change the total expected earnings of the firms, it can affect the residue earnings to the shareholders.

Debt financing: debt financing is a kind of finance that becomes a commitment for the company to repay back interest and principal at the end of a particular period. These interests are tax deductible and the tax authorities make an allowance for these expenses. The inability of the

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company to repay this commitment and the interest accruable to this commitment would attract distress for the company and this would ultimately lead to bankruptcy.

Equity financing: This entails the ability of the firms to raise its external finance from the public and at the same time issue out a part of the firms ownership right evidenced by share certificate. The equity holders are part owners of the company. At the end of the financial period, the firms reward the equity holders with dividend from the profit made by the company [14].

Capital Structure Decision

Capital structure decision is very important because it affects the balance sheet, shareholder's return and the share price of the firm [15]. That decision becomes even more difficult, in times when the economic environment in which the company operates presents a high degree of instability. Thus, the choice among the ideal proportion of debt and equity can affect the value of the company as much as return rates can [16]. The capital structure decision will involve decision on adopting the right combination of debt and equity for the firms' operations. A demand for raising additional funds according to [17], generates a new capital structure since a decision has to be made to quantity and forms of financing to adopt. This decision will involve an analysis of the existing capital structure and the factors which will govern the decision at present. Examples of these factors are the dividend decisions and the company's policy to retain or distribute earning also affects the owner's claims.

Measures of Performance

Performance of a company could be measured through many ways; some of these measures are:

Return on Asset (ROA): Return on Assets, commonly referred to as ROA, is a good internal management ratio because it measures profit against all of the assets a division uses to make those earnings. Hence, it is a way to evaluate the division's profitability, performance, and effectiveness. ROA provides good information about a firm's financial performance in terms of using asset to create income. ROA, is generally seen as a stable financial performance ratio, an increasing ROA indicates that a firm generate more profitability while decreasing ROA indicates that a firm generates less profitability [18].

Return on Investment (ROI): Return on investment compares income with operational asset that produces the income. It shows the relationship between the firm's net profit (output) and the long-term invested capital (Inputs). Consequently, it shows the effectiveness of management in terms of utilizing firm assets and its power to create shareholder value ([19]. Additionally, this measure is considered more accurate than others that depend only on the balance sheet. ROI relies on two financial statements balance sheet (financing) and income statement (Profit).

Return on Equity (ROE): Return on equity ratio shows the effectiveness of management to create extra earnings for shareholders [20]. In other words, ROE measures profitability of a firm by exposing how much profit it generates with the money shareholders have invested ROE is often used by traders to detect the firms that have faster growth of total shareholder equity.

III. METHODOLOGY

This study utilized the ex-post facto design as it attempts to utilize published documents and which in this case refers to the use of annual reports and accounts on the impact of capital structure on firms' financial performance of quoted Building Material Industry in Nigeria. The population of this study consists of 10 Nigerian Building Material companies that enjoy first-tier listing on the Nigerian Stock Exchange (NSE) as at December 31, 2018. There are many types of sampling methods. But, for the purpose of this study, stratified sampling technique is used. The basis for the stratification of the sample is due to the grouping of companies in the industry (Building Materials Industry) into cement producing companies, Aluminum producing companies and paint producing company.

IV. RESULT AND DISCUSSION

In testing the hypotheses the researcher employ 5% as level of significance as is commonly used in social sciences research. This is in line with the work of [21], [22], [23] and [24].

To determine if we can accept or reject hypotheses at 5% level of significance, an acceptance or rejection point is to be used. (Where t_{cal} is the computed statistic and t_α is the critical value of t.) Note that, if the $t_{cal} > t_\alpha$ the researcher reject the null hypothesis but where the $t_{cal} < t_\alpha$ the researcher accept the null hypothesis. This shows that, there is no sufficient statistical evidence to reject the null hypothesis, which leads to its acceptance. The researcher use degree of freedom as indicated below;

Degree of Freedom= n-k, where

n=number of population

k =number of sample firms.

10-5=5 at 5% level significance will give the $t_{\alpha\ 0.025\ value}$ of 2.571 (2-tail test).

The hypotheses are stated below in their null form.

Hypothesis I

H_{01}: Short Term Debt does not have significant impact on the financial performance of listed firms in the Nigeria consumer goods industry.

Based on the above analysis, there is weak positive relationship between Short term debt and return on asset because the R-square and adjusted R-square are less than 50% level of significance as shown in the above analysis which is 25%(0.25) and 17%(0.17) respectively, with positive p-value of 0.0708 which is greater than 5% level of significance, so the null hypothesis is thereby accepted.

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It is therefore concluded that Short term debts have no significant impact on the financial performance of listed firms in the Nigeria consumer goods industry.

Hypothesis II

H_{02}: Long term debt does not have significant impact on financial performance of listed firms in the Nigeria consumer goods industry.

Based on the above analysis, there is weak positive relationship between Long term debt and return on asset because the R-square and adjusted R-square are greater than 50% level of significance as shown in the above analysis which is 25%(0.70) and 17%(0.17), with positive p-value of 0.8810 which is greater than 5% level of significance, so the null hypothesis is thereby accepted. It is therefore concluded that Long term debts have no significant impact on the financial performance of listed firms in the Nigeria consumer goods industry.

Hypothesis III

H_{03}: Equity does not have significant impact on financial performance of listed firms in the Nigeria consumer goods industry.

Based on the above analysis, there is positive relationship between Equity and return on asset because the R-square and adjusted R-square are greater than 50% level of significance as shown in the above analysis which is 25%(0.25) and 17%(0.17), with positive p-value of 0.9778 which is greater than 5% level of significance, so the null hypothesis is thereby accepted. It is therefore concluded that Equity has no significant impact on the financial performance of listed firms in the Nigerian building materials industry.

V. CONCLUSION

This research seeks to examine the impact of capital structure on financial performance of listed firm in the Nigeria building materials industry. This subject has been widely researched over time and different results have been discovered in different locations. This study looked strictly at the building materials industries quoted on the Nigerian Stock Exchange (NSE) as at 31 December, 2016 and with sample size of five (5) listed companies from 2009 to 2018. The study also seeks to fill the gap in other works done by researchers in this field who have used Nigeria as a case study. Based on this finding;

a. Short term debt (STD) has a positive relationship with Return on Asset (ROA) as measure of firm performance, the finding indicates an adverse relationship in the sense that profit of the company and short term debt of the company flow in the opposite direction. That is, when short term debt increases, return on assets decreases.
b. Long term debt (LTD) has a positive relationship with Return on Asset (ROA) as measure of firm performance, the finding indicates an adverse relationship in the sense that profit of the company and long term debt of the company flow in the opposite direction. That is, when long term debt increases, return on assets decreases.
c. Equity (EQTY) has a positive relationship with Return on Asset (ROA) as measure of firm performance, the finding indicates an adverse relationship in the sense that profit of the company and equity of the company flow in the opposite direction. That is, when equity increases, return on assets decreases.

VI. RECOMMENDATIONS

The following recommendations are made in the light of the conclusions of the study:

a. Government should encourage short term debt providers so that listed firms in this industry can have access to finance their activities. And the studied firms should boost their level of investment in assets so as to enjoy credit at lower cost which can stimulate capital accumulation and more profitability.
b. Managers should lessen their substantial attention on long term debt and make critical analysis on their sources of fund, because long-term debt seems to be expensive and employing more of it could lead to a decrease in firm financial performance.
c. Management of the studied firms are advice to issue additional shares and have more investors so as to defray the risk of external control and tendency of liquidation due to over burden external finance in the company’s capital structure.

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