

## **LONG TERM DEBT AND FINANCIAL PERFORMANCE OF LISTED OIL AND GAS FIRMS IN NIGERIA**

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### **ABSTRACT**

*The study unveiled some salient relationship between long term debt structure and financial performance of listed oil and gas firms in Nigeria for the period 2008-2107. The aim of this study is to empirically ascertain the effect of debt structure on profitability of listed oil and gas firms in Nigeria. The study has contributed to the empirical body of literature on debt structure and financial performance of listed oil and gas firms in Nigeria. It aids to understanding the relationship between institutional factor on Nigerian firms debt structure and the proportionate effect on financial performance. More so, short term debt (STD) was found to have negative significant effect on financial performance on ROCE, with a positive relationship on NPM of listed oil and gas firms in Nigeria. The study therefore, concluded that short term debt is one of the strong determinants of the financial performance of listed oil and gas firms in Nigeria. The study recommends that further work is necessarily required in other sectors in Nigerian economy along with developing new hypothesis and also to design new variables to reflect the institutional influences. In addition, another work is needed urgently to lay a solid foundation on the resultant relationship between the use of equity and financial performance of list firms (oil & gas) in Nigeria using the same period of study along with different proxies as measures of financial performance.*

**Keywords: Long Term Debt, Debt Structure, Financial Performance, Oil and Gas**

### **INTRODUCTION**

An adequate asset structure is an important decision for any company. The decision is important not only for the need to maximize the returns of the various components of the organization, but also for the impact of this decision on the ability of organizations to face their competitive environment. The real impact of the capital structure on the company's performance in Nigeria was a serious problem among academics that has not yet been resolved. However, there is still conclusive empirical evidence from the literature on how capital structure influences company performance. The capital structure of the company refers to the combination of financial liabilities. Debt and equity are the two main components or types of liabilities with debt holders and capital holders were the two investors in the company with the associated level of benefits, risk and control. Debt holders exercise less control with a fixed rate of return and are protected by contractual liability in relation to their investment, while capital holders exercise greater control over the decision and take most of the risks associated with the company

Debt is a resource borrowed with the expectation of payment after a certain period of time. If the specified time period is extended for a period of one year, it becomes long-term debt and if the expected payment period is less than or equal to one year, it becomes a short-term debt. The use of debt in a company's capital structure has its share of advantages. The company benefits from the effect of the tax shield of debt and leverage. Companies pay interest to creditors of costs, exemption from corporate income tax, while dividends paid to shareholders are deducted from net profits after corporate income tax, so if interest rates are appropriate, and profits before interest and taxes rather than commercial interests, then improving the company's debt ratio would increase tax-free income, improve the market value of the company. The use of debt in the capital structure has its disadvantages:

The first is financial risk because after the need for regular commercial loans to pay interest on cash flow, a single capital payment, which requires companies with a high cash flow, will put a lot of pressure on the maturity of the debt. Once the company is poor or does not collect the necessary money, it would find itself in financial difficulties or even cause bankruptcy. Second, creditors' moral hazard is more damaging to shareholders than to the creditor. Moral risk manifests itself in the income of companies to repay the loan no more than the choice of not paying the loan when the cost of the conduct, which will result in a great loss of creditors. Debt financing affects the reasons for a company's performance, as companies generally accept fixed payments for a specific period with less control or external influence. These reimbursements take place regardless of the company's performance. However, capital financing avoids repayment and guarantees the ownership of the company to the capital holders. Therefore, the choice of capital structure is basically a financial decision problem, which has become more difficult at a time when there is a high degree of economic instability.

### **Long Term Debt**

Long-term debt measures the relative weight of long-term debt in the debt structure (long-term financing) of a company's long-term debt. Long-term debt is the financial position of the company's ability to meet its long-term financial requirements. According to Kurfi, "the decline in the long-term value of 2003 indicates that the company is doing well and depends less on debts for its commercial needs". The higher the level of long-term debt, the more important it is for a company to have a positive income and a stable cash flow. "It is very useful for management to verify the structure of the debt and determine the capacity of the debt" (Akinsulire, 2014). The relationship between long-term debt and total assets is a measure of a company's financial leverage. "Long-term debt is a debt that must be paid in more than 12 months and is not included in the value of current liabilities in the balance sheet. Includes mortgages and long-term leases, but not general commercial obligations" (Akinyomi, 2013). A high ratio generally indicates a higher level of commercial risk as the company must comply with capital and interest obligations. Potential creditors are reluctant to lend to a company with a high debt position. However, the amount of debt depends on the type of activity. For example, a company may have a high debt-to-GDP ratio, but its assets are generally liquid. A service company can afford a higher relationship than a producer because its profits are more stable (Khalaf, 2013). Once again, there have been serious discussions about capital structure and company performance. The literature has revealed that "some academics have strongly argued that the capital structure has a significant impact on the company's performance, while others show no impact. Some agree that there is a link between capital structure and company performance" (Hung, et al 2002). However, some show a positive and negative correlation between the combination of capital and the performance of companies (Tsangaao, et al 2009; Saeed and Mahmoodi, 2011; Abor, 2005; Oke and Afolabi, 2008), while others have supported a complete correlation negative. (Shoaibi, 2007; Shah et al, 2011; Narender, et al 2007, Olokoyo, 2012). Therefore, long-term debt is expected to have a significant impact on the company's profitability.

Firm performance measurement is a diverse subject matter that can be measured with different measurement tools or ratios. The measurement of performance (financial) in an organization has basically two distinct categories viz. accounting performance and investor performance. But viewing corporate performance in a holistic point of view encompasses both financial and market price. Firm performance is measured differently with different ratios such as return on asset (ROA), return on equity (ROE) return on capital employed (ROCE), return on investment (ROI), Earnings before interest and tax (EBIT), and net income (Degryse *et al*, 2010; Zahra & Peace, 1989), stock market returns and stock volatility (O'Brien, 2013; Muzir, 2011) but also Tobins Q ratio that links together market values and accounting values (O'Brien, 2003). Looking at the concept of firm performance, many researchers had in different

attempt considered the performance (profitability) of firms and its relationship with regard to their capital structure. Capital structure refers to the choice of debt and equity in a firm's capital. It also refers to the type of debt used by firms (long term debt and short-term debt) (Margaritis & Psillaki, 2010; La Rocca & La Rocca, 2007). It is argued to be crucial for business to find the best fit (balance) debt and equity to maximize their value and future growth and expansion. Considering performance to both accounting and marketing basis as two major areas of assessing performance, researchers had vehemently argued that "firm's size plays a significant role positively with a reason that bankruptcy cost decrease with firm's size. It was also opined that firm size is positively related to borrowing capacity. Again economic of scale in transaction cost is associated with long term debts that are not available to smaller firms" (Krishnan & Moyer, 1997). Nonetheless, research shows that firm size has a positive and significant effect on firms performance (Tian & Zeitun, 2007; Gleason *et al* 2009, Olokoye, 2012) while other studies found an insignificant relationship between firms size on firm's performance (Durand & Coeuderoy, 2001; Mudambi & Nicosia, 1998; Lauterbach & Vaninsky, 1999).

### **Empirical Review**

Krishnan and Moyer (1997) conducted an empirical study on "the corporate performance and capital structure of large companies in four (4) emerging market economies in Asia (Hong Kong, Malaysia, Singapore and Korea)" The study also included in its research its influence on the country of origin both in financial performance and in the capital structure of the companies studied. The analysis of variance was used to evaluate the variables based on the country of origin and the regression models of the factor model estimated to show the relationship between the expressed variables and the performance. The use of four (4) performance measure was adopted such as; return on equity (ROE), return on invested capital (ROIC), pretax operating profit margin (PTM) and market return on stock (MRS) and two measures of leverage like, total debt on equity (TD/E) and long- term debt on equity (LTD/E). The study reveals a negative and significant impact of debt to total equity (TD/TE) on return on equity (ROE) of Asian firms comprising 81 companies. It was also observed that both profitability performance and capital structure were influenced by the country of origin. It was said again that the Kong Kong corporations have significantly higher returns on equity and invested capital while performance difference among firms from the other countries were not statistically significant. Furthermore it was revealed that "the stock market return model was insignificantly which suggested that the expected variances in accounting performance across the countries were rapidly incorporated in their stock prices. In general sense, the evidence from the study only give limited support to the extent capital structure theories and the emerging market economies"

De Jong, Kabir and Nguyen (2008), analyzed "the importance of firm-specific and country-specific factors in the capital structure choice of firms from 42 countries round the world. They engage the use of data from compustat Global database and World Bank data-base for the period 1997-2007. The data were analyzed using the firm level ordinary least square (OLS) regression model with leverage as the dependent variable and the simple pooled OLS regression model" The study went further to adopt the use of unrestricted regression model and seven restricted models that are related to the joint test of significance of regression coefficient to test the null hypothesis formulated for the study. The result shows "the firm's specific determinants of leverage differ across countries and reveals an indirect impact of country-specific factors of the firm's capital structure. In conclusion, the empirical results indicates that the conventional theories on capital structure developed using listed firms in the united states as a role model, work well in similar countries with developed legal environment and high level of economic development"

Waqas, Imran, Hafiz, Jawad and Zahid (2013) examined "the determinants of financial performance of textile and food sector in Pakistan. The result revealed that total debt to total assets has strongly negative relationship with financial performance at 5% level of significance"

Innocent, Ikechukwu and Nnagbogu (2014) conducted a study on "the relationship between financial leverage on financial performance of listed pharmaceutical companies in Nigeria for the period 2001- 2012" The study utilized secondary data sourced from financial statements of three pharmaceutical companies. Descriptive statistics, Pearson correlation and multiple regressions were employed in order to determine the relationship between financial leverage variables and performance. The results showed that "total debt to total assets has negative relationship with financial performance"

Ibrahim (2013) studied "the impact of the capital structure on the financial performance of the listed manufacturing companies in Nigeria. The study formulated four hypotheses and used a generalized least squares regression to analyze the secondary data extracted from the annual reports and the accounts of the 31 companies included in the sample for the period 2009 to 2014" The study found that the total debt, long-term debt and short-term debt The term debt has a significant impact on the financial performance of the listed manufacturing companies in Nigeria. The study also found that "total debt to total capital does not have a significant effect on the financial performance of companies, and in light of the results, it is recommended, among other things, that the management of publicly traded manufacturing companies should work very hard for increase short-term debt for their total capital component asset structure, as it has a positive impact on Your financial performance In addition, companies should reduce the level of total debt to total assets and long-term debt to total assets in their capital structure components, as they negatively affect the their financial performance"

Philip (2017) made an empirical discovery on "the relationship between capital structure and organizational performance" The study used secondary data analysis; Models were developed from which estimation results were obtained using the generalized least squares regression technique. The empirical results based on the accounting data from 2009 to 2015 for 5 manufacturing companies listed in Nigeria offer some support to the organizational theory of capital structure. It was found that the leverage of a company had a direct relationship with the measurement of the company's accounting performance (profitability) due to its advantage of tax deductibility. It was also established that "the tax generally has an indirect relationship with the capital structure of the companies since the tax reduces the profits available for financing, although the profits may have been advantageously guaranteed by the company-oriented capital structure. It was also noted that the market value improves the capital structure thanks to the stimulus provided to investors. Therefore, it is suggested to Nigerian companies to try to improve their accounting performance with the advantage of deductibility" Furthermore, the combination of debt and capital for financing by Nigerian companies must be made in order to improve their accounting performance.

Hlupeko, (2013) conducted a survey to "investigate the impact of debt financing on SME operations in Masvingo. Both qualitative and quantitative research projects were used in the study. The study used a sample of 80 SMEs. Primary data was collected through a survey. Secondary data from SME registers were used in the study" Data were analyzed using SPSS 19. The results of the study showed that "debt financing had a positive impact on SME productivity". The study also established that "companies that received adequate funding from banks improved their productivity". Another result of the study was that "the cost of loans was too high to allow companies to obtain an adequate amount of the required financial investment". The study concluded that "a reasonable level of debt in the SME capital structure helped improve their productivity. The study recommends that financial institutions offer long-term debts to SMEs so that they can invest in equity instruments to increase productivity in

the future. The study also recommends reducing interest rates to motivate SMEs to acquire sufficient funds to invest in capital equipment”

Harwood (2010) studied to find out if the use of debt in a company's debt structure affects the company's performance. “A survey of commercial banks listed on the Nairobi Stock Exchange in Kenya. The specific objective was to determine the effects of the debt on the company's performance. The study used a longitudinal research project in data collection. The study considered a target population of 11 commercial banks. Data were analyzed using the statistical package of social studies version 16.0” The data were analyzed using inferential statistics; Correlation and regression model. The study found that the debt negatively affects the company's performance, although it is not statistically significant as measured by the ROA ( $\beta = -.442$ , value  $p = 0.242$ , which is higher than  $\alpha = 0.05$ ). The conclusion of the study was that the use of debt in a company's capital structure negatively affects the performance of commercial banks in Kenya, although it is not statistically significant. The administration of sugar companies must identify alternative sources of low-risk financing for debt financing.

### CONCLUSION

The study found a negative but significant relationship between Equity and financial performance proxies by NPM, ROCE of listed oil and gas firms in Nigeria. Thus, the study concluded that Equity is amongst the determinants of the financial performance of listed oil and gas firms in Nigeria. Finally, the study again found a negative/significant relationship between Tax and ROCE, but shows a positive significant relationship between Tax and NPM. The study therefore concludes that tax is not regarded as one of the major determinant of financial performance considering the debt structure of a firm.

### RECOMMENDATIONS

In line with the findings of the study, the following recommendations are made:

- i. More so, the empirical result shows that, listed oil and gas firms in Nigeria do not use much of long term debt (LTD) in their debts structure. This could be likened to the overall behavioural participation of both public and private sectors in the capital market. To encourage fund providers as well as attractive participation, NSE should strive to formulate policy's in a more flexible manner free from hindering the effective participation of companies. Economic policies that could aid to further develop the capital market to absorb increase in demand for fund should also be formulated.
- ii. Finally, financial institution, government and individuals who are fund providers to formulate policy's liberal enough to arouse the interest and zeal of users of funds to appropriately participate and government to create or provide a very conducive environment for active participation.

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