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FIRM SIZE AS A MODERATOR TO CAPITAL STRUCTURE AND FINANCIAL PERFORMANCE OF LISTED COMSUMERS GOODS MANUFACTURING COMPANIES IN NIGERIA

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ABSTRACT

From the time when the innovative work of Modigliani and Miller (1958) on the relevance and irrelevance of capital structure, researchers in corporate financial theory have always been interested in the contributory effect of capital structure on financial performance and value of the firm. The conventional thinking from the theories propounded since then was premised on underlying relationship that capital structure choice determines or affect performance thereby impact on the value of the firm. The study examined how firms moderate between capital structure and financial performance of listed consumer goods manufacturing companies in Nigeria. The study recommended that the management of Nigerian listed Consumer Goods Manufacturing Companies should work very hard to optimize the capital structure of their listed manufacturing firms to increase the financial performance. They can do that through ensuring that their capital structure is optimal; the Management of Nigerian listed Consumer Goods Manufacturing Companies should increase their commitments into short term debt to total asset to improve financial performance from their business operation.

Keynote: Firms Size, Capital Structure, Financial Performance, Consumers Goods

INTRODUCTION

The corporate financing decision incorporates the capital structure decision a firm makes on the choice of debt to equity mix use to finance its operation with the intention to maximize the shareholder's return (Babalola, 2012). In Nigeria, the role of capital structure in determining the value of the firm cannot be underestimated, however, the deteriorating corporate liquidity, declining bank credit, outrageous increases in interest rate have an adverse effect on the capital structure of Nigerian firm listed on the Nigeria stock exchange in recent past. Many firms have collapsed due to various reasons among which finance is most prominent while the emphases of the capital structure research have always been on its effect on financial performance and value of the firm thus establishing a unidirectional relationship approach. There is an on-going debate in the capital structure literature about the effect of financial performance on the capital structure which is theoretically based on the opposite connection hypothesis (Berger and Bonaccorsi, 2006). Berger and Bonaccorsi (2006) and Margaritis and Psillaki (2010) both study the effect of leverage on firm efficiency while considering the reverse causality between efficiency and the firm capital structure. The two studies differ in the empirical approach. Berger and Bonaccorsi (2006) run a two-stage least squares regression, whereas Margaritis and Psillaki (2010), estimate the two parts of the circular relation separately by Ordinary Least Square (OLS) and use lagged values of the endogenous regressors to achieve exogeneity. Both studies find a positive relationship between leverage and efficiency. This relationship was further evident in Asian countries.

In Nigeria, capital structure and the impact on performance have been investigated for many years, but researchers have found different results in different contexts (Chandrasekharan, 2012; Modugu, 2013; Oke and Obalade, 2015; Onaolapo et al 2015). For instance, a recent study by Abata and Migiro (2016), found an insignificantly negative correlation between financial leverage and return on asset (ROA) on one hand and a significantly negative relationship between

debt/equity mix and return on equity (ROE) on the other hand. However, this study failed to consider the possibility of a reverse causal relationship between capital structure and performance of Nigerian firms. Therefore, all attempts of these previous studies are focused on a unidirectional relationship except the study carried out by Yinusa, et al. (2016), which seeks to establish a bidirectional relationship between capital structure and firm performance. As a departure from proxy efficiency as the performance measure, their study employed return on equity and found support for the franchise value hypothesis. Invariably the study failed to consider other financial performance variables to properly assess the reverse causality situation in Nigeria in the light of the two underline hypotheses the efficiency risk hypothesis and franchise value hypothesis thus, creating avenue for new research in different context for achieving a more complete understanding of the effect of financial performance and capital structure choice in Nigeria. Therefore, it is against this backdrop that this research work was conducted to address the research gap to know if there is a possibility of a reverse causality in financial performance and capital structure of the firms listed in NSE in the face of the two competing hypotheses. To the best of my knowledge, there is a lack of research regarding the relationship that may exist between capital structure and financial performance among Consumer Goods Manufacturing Companies in Nigeria**.**

Firm Size

A moderation effect is a causal model that postulates "when" or "for whom" an independent variable most strongly (or weakly) causes a dependent variable (Frazier et al., 2004). A moderator modifies the strength or direction (i.e., positive, or negative) of a causal relationship. Conceivably the moderation effect is more commonly known as the statistical term "interaction" effect where the strength or direction of an independent variable effect on the dependent variable depends on 33 the level or the value of the other independent variable. Therefore, the term "moderation effect" has continuously been reserved for models that intend to make causal hypotheses. Specifically, a moderation effect is a special case of an interaction effect, a causal interaction effect, which requires a causal theory and design behind the data. In other words, a moderation effect is certainly an interaction effect, but an interaction effect is not necessarily a moderation effect (Wu & Zumbo, 2008). The study adopted firm size to control for differences in total assets among the studied firms. This decision is informed by prior empirical literature that showed that the firm size has the potential to influence capital structure (Yinusa et al., 2016; Berger & Bonaccorsi, 2006; Margaritis & Psillaki, 2007). Fatoki, (2018), opined that the size of a firm plays a significant role in determining the form of relationship the firm enjoys within and outside its operating environment. The larger a firm is, the better the influence it has on its stakeholders. Another thing is the growing influences of conglomerates and multinational corporations in today's global and local economies where they operate portend an indication of what role size plays within the corporate environment. Buttressing the position of size in corporate discourse, Rajan et al (2001) argue that a fascinating aspect of economic growth is that much of it takes place through the growth in the size of existing organizations. Size plays an important role in capital structure (Abor & Biekpe, 2006; Abor & Biekpe, 2009; Booth, et al 2001). Its importance as moderating variable has become such a routine to employ in empirical corporate finance studies. There are several theoretical reasons why firm size is related to capital structure, these include economies of scale in lowering information asymmetry, scale in transaction costs and market access (Krasauskaite, 2011). For an instant, in the presence of non- trivially fixed costs of raising external funds large firms have cheaper access to outside financing per each amount borrowed (Leary & Roberts, 2004). Large firms are more likely to diversify their financing sources. firms because they face more examination by ever-suspicious investors (Fama & French, 2002).

Capital Structure

The term capital structure of an enterprise is a combination of equity capital, debt capital, preference share capital, etc. A cautious attention must be paid as far as the optimum capital structure is

concerned. With unplanned capital structure, companies may fail to economize the use of their funds. Consequently, it is being increasingly realized that a company should plan its capital structure to maximize the use of funds and to be able to adapt more easily to the changing conditions. (Taani, 2013). One of these definitions for Muthama et al (2013) that state the study of capital structure attempts to explain the mix of securities and financing sources used by corporations to finance real investment. The firm needs to make investments to at least remain in business, let alone display some growth. To finance these investments, the firms can use internal finance sources such as retained earnings and issuing shares for public or use external finance sources as a loans or bonds. The term capital structure refers to the relationship between the various long-term sources financing such as equity capital, preference share capital and debt capital (Nassa, 2016). Capital structure is the permanent financing of the company represented primarily by long-term debt and equity and deciding the suitable capital structure is the important decision of the financial management because it is closely related to the value of the firm. Algieri et al (2018) defined capital structure as the mix of long-term debt and equity maintained by the firm.

Although, the actual levels mix of the firm's permanent long-term financing represented by debt, preferred stock, and common stock equity may vary somewhat over time, most firms try to keep their financing mix close to a target capital structure. According to Ehrhardt and Brigham (2011), the main purpose of the capital structure is to comprise of the optimal mix of debt and equity. A firm's capital structure decision includes its choice of a target capital structure, the average maturity of its debt, and the specific types of financing it decides to use at any time. As with operating decisions, managers should make capital structure decisions that are designed to maximize the firm's intrinsic value. From the last definitions, the capital structure can be defined as the mixing of financial sources to finance the firms' operations. Financial sources can include the debt and equity that can be used by the firms.

Capital structure plays a serious part which supports an organization address the problem of whether an optimum capital structure can be attained. Abor (2005), state that a firm wishes to finance its operations and in doing so, they will need to choose a particular combination of equity and debt which forms a capital structure. Therefore, total capital of a firm is composed of both debt and equity which makes up firm's capital structure. Capital structure decisions are a vital managerial decision as it influences the shareholder risk and return. According to Bradley et al. (1984) one of the most critical issues for companies and has become one of the most contentious issues in finance is capital structure. Capital structure as the contribution of debt, equity, and other securities that a business has as its capital. Capital structure refers to the volume of business capital that is made up of debt and the amount made up of equity with the object of minimizing the cost of capital to the business (Jami & Koloukhi, 2018).

Jaffe et al (2004) also defined capital structure as the mix of different debt and equity kept in the business. Capital structure can also be referred to as the composition of different securities used by a company to finance its investment activities. The capital structure includes both short-term debts, long-term debts, and equity. Capital structure has also been called the financial structure of the business (Jaffe et al, 2004). Two types of capital exist in all businesses; they are debt capital and equity capital. Each capital type has its advantages and disadvantages to the company employing it. When a business uses debt to finance its operations, that business is described as leveraged (Pahuja & Sahi, 2012). An unlevered company is one that has no debts on its books (Pahuja & Sahi, 2012). Jami and Koloukhi (2018) provided that the decisions on capital structure involve selecting first the amount of capital required and second considering the financing combination that is available to the business. Capital structure is critical to the management of any business because both the financial risk and cost of capital of the company are affected by the capital structure. Abor (2005) described capital structure as a precise mix of debt and equity which is normally used to finance the firm's operations. Abor (2005) further added that a firm can select among several alternative sources of capital with different mix of securities. This definition provides itself for review to firms because it emphasizes on specific proportion of debt and equity used for financing

organizations. Naveed et al (2015) defined the capital structure concept as the relationship between the various forms of financing. Hence, the term signifies the proportion between equity and debt capital that some firm targets to attain as part of the firm's objectives. However, they did not propose clearly on the proportion of the capital structure concept.

Financial Performance

A firm's financial performance is of importance to investors, stakeholders and the economy at large. Investors are interested in the returns for their investment. A business that is performing well can bring better reward to their investors. Financial performance of a firm can increase the income of its staff, rendering quality product or services to its customers and creating more goodwill in the environment it operates. A company that has good performance can generate more returns which can lead to future opportunities that can in turn create employment and increase the wealth of people. Firm's performance is the ability of a firm to achieve its objectives resources. According to Mbaeri (2021) a company's performance is its ability to achieve its target objectives from its available resources.

Suleiman (2014) viewed a firm's performance as the result of a company's assessment or strategy on how well a company accomplished its goals and objectives. Financial performance provides a deductive measure of how well a company can use assets from business operations to generate revenue. Mbaeri (2021) defined financial performance as a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. This term according to Pandey (2017) is used as a general measure of the overall financial health of a business. Research on the firm's financial performance emanates from organizations theory and strategic management. The notion of financial performance is used to describe performance of an entity with the legal status of a company.

The concept of financial performance is a controversial issue in finance due to its multidimensional meaning. In analyzing a firm's financial performance, emphasis should be made in formulating an adequate description of the concept of a financial performance. Measuring of firm's financial performance is one of the management strategic functions aimed at satisfying the interest of shareholders and other stakeholders in a company. Firm's performance appraisal involves a periodic and systematic evaluation of its operations to determine the achievements of the firm's objectives. Evaluation of a firm's performance requires the use of certain principles that may be either internal or external. Internal principles are the ability of a company to achieve its stated objectives, while external principles refer to the comparison of a company with its competitors in the industry to develop a good business strategy that will enable the firm to compete favorably in the market. The existing research on the relationship between capital structure and financial performance used different methods of measuring firms' financial performance.

Most of the previous studies on firms financial performance measured firm performance from the accounting based or market-based methods of measuring company's financial performance. The most used performance measures are accounting based which include return on assets (ROA), return on equity (ROE), return on investment (ROI) and Tobin's Q. Accounting based measurement of performance is the most popularly used. Returns On Assets (ROA) was widely used as was found in the studies of Abbasali et al (2012), Babalola (2012), Osuji and Odita (2012) and Khalaf (2013)

Performance is to a large extent expressed in terms of profits and losses and this is observed by how a business performs over a given period (Kubai, 2016). According to Erasmus (2008) financial performance is considered as the best possible way of as to how a firm generates its' revenues through utilization of its assets. Performance in financial perspective involves the act of carrying out financial activity so as to realize the financial objectives within a given time period. It is not only used to determine a given period financial status but also the results of its operations and policies

through monetary terms. These measures are important since they can be used for comparison between firms which are on the same or different industry (Raewf et al., 2021).

The Trade-Off Theory

Kraus and Litzenberger (1973) first introduced the trade-off theory of capital structure, building from the works of Modigliani and Miller (1958). The theory developed from the heavy criticism of the MM theory of a perfect market. Abel (2018) formalized the financial relationship that existed in the trade-off theory. The theory provides for an optimal financing mix based on a trade-off of the mix between the benefits of debts and the cost of debts. This theory recognizes the existence of taxes on transactions. The theory provides that interest on debts, which are tax-deductible, provides the advantage of tax savings in the form of extra cash, increasing the value of the levered firm. This theory provides that where debt is permanent with a static marginal tax rate and a constant cost of debt, a firm with debt would have a higher market value than a firm without debt resulting from the present value of tax shield associated with debt. According to Margaritis and Psillaki (2010) although there are benefits associated with the leverage of a firm, the leverage increases the agency cost associated with the business emanating from the conflicting relationship between the managers, shareholders, and debt holders. The conflicting relationship may originate from the managers serving their personal interest at the expense of maximizing shareholders' wealth, with shareholders engaging in unprofitable investment because they have limited liability.

To protect themselves, debt holders may introduce debt covenants and restrictions and engage professional analysts introducing extra agency costs to the business that offsets the tax shield benefits. An impact of the agency theory is that the probability distribution of future cash flows changes as the probability of the incurrence of the bankruptcy cost changes (Gleißne 2019). The benefits from the tax shield because of debt are not infinite as debts introduce another dimension of cost in the form of bankruptcy cost (Zhang, 2013). Outside the agency cost, debt increases the bankruptcy risk through default in repayment. According to Mirza and Azfa (2010), as a firm increases its debt levels, the financial risk also increases, making shareholders unwilling to advance more equity capital to the business or demand higher dividend payments to cater for the high risk they are bearing. Debt holders also will demand higher rates of return on additional capital provided, which increases the rate of cash outflow from the business. Mirza and Azfa (2010) concluded that increases in debts result in increases in firm value 32 proportionately until a point where any further increment in debt leads to more agency costs and bankruptcy costs, reducing the value of the business. Therefore, the theory proposes an optimum debt level, exceeding the optimum level results in the potential debt defaults exceeding the advantages of the tax shield of debt.

Brounen et al. (2006) showed that the trade-off theory provides for an optimal capital structure that a firm should achieve or maintain if the company wants to increase shareholders' wealth. Several variations to the trade-off theory have been proposed in the literature. The dynamic trade-off model considers the cost of adjustment towards the target debt ratio. The dynamic trade-off model indicates that firms will only adjust their target ratio only when the benefits of adjustment exceed such an adjustment cost. The cost of adjustment places boundaries on the leverage ratio for optimal adjustment of the capital structure (Burgstaller & Wagner 2015; Mauer & Triantis, 1994). Burgstaller & Wagner (2015) also observed that restrictions in the debt covenants, managers' reputation, and opportunities of takeover also influence the capital structure. Brennan and Schwartz (1984) introduced an investment policy into the trade-off theory. With investment policy, the firms simultaneously determine the debts to be held in cash and how much of the debt to be invested. A study by Childs et al. (2005) on the trade-off theory suggested that firms can avoid the agency cost when they dynamically adjust their levels of debt and maturity of debts. Modern proponents have focused on coming up with a unified model that accommodates and accounts for several factors (Hennessy & Whited, 2005; and Strebulaev, 2007). None of these variations has been able to overcome the traditional model, as most studies still refer to the static trade-off theory in their analysis.

Empirical Review

Maina and Ishmail (2014), examined the effect of capital structure on financial performance of firms listed at the NSE. The population of interest of this study was the firms quoted at the NSE, and a census of all firms listed at the NSE from year 2002-2011 was the sample. Secondary data was collected from the financial statements of the firms listed at the NSE. The study used Causal research design and Gretl statistical software to perform the panel Regression analysis. The study concluded that debt and equity are major determinants of financial performance of firms listed at the NSE. There was evidence of a negative and significant relationship between capital structure (DE) and all measures of performance. This implies that the more debt the firms used as a source of finance they experienced low performance. The study also concluded that firms listed at NSE used more short-term debts than long term.

Akomeah et al (2018), examined the effect of firm capital structure decisions on their performance based on a sample of non-financial firms. The results of the study show that capital structure decisions thus affect firms' performance significantly. The study sampled 20 listed firms on the Ghana Stock Exchange over a 7 year period from 2010 to 2016. The study used both equity ratios and leverage ratios to measure capital structure. In all the regression results, the leverage variables were inversely related to performance. Short-term debt to equity which was expected to be positively related to performance is equally negatively related. The argument for short-term debt being positively related is due to the fact that such funds are generally cheap and easily accessible. However, the significance of such decisions on performance is mostly observed on equity holders. Thus, the return on equity as a measure of performance is significantly impacted by capital structure decisions. This is true regardless of the financial leverage variable observed, be it short-term debt, long-term debt or total debt. This, therefore, suggests that managements' decision regarding how much debt to be employed in a business is constantly made with shareholders being the revolving factor.

Johan (2020), studied the determinants of the capital structure of non-bank financial institutions. Non-bank financial institutions include finance companies such as consumer finance, leasing, and factoring. Determining the capital structure is an important challenge for finance companies. A finance company must manage the gap in funding between short-/long-term and fixed rates against the floating interest rate. Total assets of finance companies in Indonesia amount to more than IDR 500 trillion in 2018. The industry is also considered one of the fastest growing industries during the last 15 years. In this study, we have analyzed the five major financial ratios and the impact of alliance. We use the leverage ratio as the proxy of capital structure and the panel data technique. The sample consists of 90 finance companies covering the period of 2010-2016. The empirical results show that the determinants of finance companies' capital structure are the asset composition, firm size, equity size, and profitability. In contrast, support of the parent company and firm efficiency have no impact on the capital structure.

Hsu (2013), investigated the effects of leverage and ownership structure as moderating effects between R&D expenditures and firm performance. Leverage is important for a firm to complete innovation and ensure the financial resources required to launch new products. Ownership structure has the capability to diversify their investments and encourage the invested companies to pursue the projects with prospects. The results indicate leverage and ownership structure moderated R&D expenditures and financial leverage based 336 information technology firms. A noteworthy result is that ownership structure has a positive effect on R&D performance relationship. However, leverage has a negative effect on the relationship between R&D and firm performance.

CONCLUSIONS

The researcher had a major objective of establishing the relationship between capital structure and financial performance of listed consumer goods manufacturing companies in Nigeria. The following recommendations were reached

1. The management of consumer goods manufacturing companies should work very hard to optimize the capital structure of their listed manufacturing firms to increase the financial performance. They can do that through ensuring that their capital structure is optimal.
2. The Management of consumer goods manufacturing companies should increase their commitments into short term debt to total asset to improve financial performance from their business operation. This is in line with the findings of this study that the short-term debt of listed manufacturing firms in Nigeria influences their financial performance positively.
3. The Management of consumer goods manufacturing companies should be concerned about the level of their total debt to total equity, for better financial performance. This is because the findings of this study revealed a positive insignificant relationship the variables and financial performance.
4. Stakeholders of listed Manufacturing firms in Nigeria should also reduce the level of total debt to total assets and long-term debt of any firm to improve financial performance. This is in line with the findings of this study that revealed a negative significant impact of total debt and long-term debt on financial performance of listed manufacturing firms in Nigeria.
5. The researcher suggest caution should be exercised in concluding differences in industry structure and other factors not captured by this study may affect the position of each firm.
6. Furthermore, there may be other external factors which affect the profitability of the firm which is ignored by most studies such as the quality of Human Resources, environmental factors, organizational structure, and operational procedures as opined by Asian (2015).
7. Management of consumer goods manufacturing companies should do thorough research in optimum capital structure mix.

Contributions to scholarship

The essence of research is to find more knowledge and integrate to the existing body of knowledge. The new knowledge acquired in the process of closing the gap in research is the contribution to knowledge. Oates (2006) cited in Presthus and Munkvold (2016) defined contribution as answer provided to initial research question(s) framed and can equally emerge as unexpected findings. Four ways in which a researcher can contribute to the body of knowledge include the research area, the methods adopted, solving trending issues, and by developing a unique approach or model. Consequently, the research study contributed to knowledge in the following ways.

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