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Impact of Capital Structure on The Financial Performance of Listed Financial Institutions in Nigeria

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ABSTRACT: The influence of capital structure on deposit money bank financial performance was explored in this study. The secondary data was gathered from the annual reports and accounts of the 14 sampled Deposit Money Banks from 2014 to 2018, and generalized least square multiple regression was used to evaluate the secondary data. According to the findings, total debt to total assets, total debt to total equity, and long-term debt to total assets have little bearing on the financial performance of Nigerian banks. The study also discovered that the ratio of short-term debt to total assets has a considerable influence on a bank's financial success. In light of the findings, it is suggested that bank management strive diligently to reduce the short-term debt to total assets component of their capital structure, since this has a detrimental impact on their financial performance. They also have a tendency to enhance the ratio of total debt to total assets since it improves their financial performance. Long-term debt to total assets ratios should be reduced in capital structure components since they have a negative impact on financial performance

KEY WORDS: Financial performance, Long-term debt, Short-term debt, Total assets, Total equity.

1.1 INTRODUCTION

Financial performance constitutes the fundamental objective of every financial sectors, it is a catalyst for transmitting monetary policy impulses to the banking sector and the entire economy. The presence of a smooth banking system is a pathway to growing economy. The fulcrum of an economic development is the sound functioning of the financial sector via its laudable roles in coordinating funds or capital. Capital structures are particularly imperative to the banking industry because, cases of failures in business practices had negatively affected investors' and public confidence.

A solid capital structure combination is the cure for a successful business, since it arises from the drive to maximise shareholder value, and as such, it has a significant impact on a company's capacity to compete. The choice of debt and equity to achieve a strong capital structure with low operating costs and great financial profitability is one of the most pressing concerns managers confront today. The choice of a good balance of debt and equity, the debt maturity schedule, and the precise forms of capital to utilise at a given moment are all factors to consider when deciding on capital structure. Managers must make capital structure decisions to optimise shareholder wealth and a company's intrinsic value, according to (Brigham & Ehrhardt, 2017).

Practically, there are recent cases of failure in the banking sector in Nigeria has been attributed to low performance; this is recognized as one of the key factor responsible for the failure of banks in the country. These failures may be attributed to the inability of banks to meet the optimum capital structure. For instance, the collapse of Skype Bank Plc. has raised concerns on capital structure financing mix. It is glaring that failures do not happen within a blink of eye. The build-up process is mostly over a long period of time resulting from the inability to meet up with corporate financing issues. It is noteworthy that Skype Bank fate was determined by how its capital structure was managed. With regards to that, the regulatory bank in Nigeria which is the Central Bank of Nigeria (CBN) together the Nigeria Deposit Insurance Corporation (NDIC), announced the formation of a bridge bank. Since then, Polaris Bank has taken over the assets and liabilities of Skype Bank Plc. An overwhelming numbers of financial institutions have been faced with glaring failure due to improper management of capital structure.Several authors have

absorbed different opinions on the relationship between capital structure and financial performance. For example, Abor (2005), Nimalathason and ValeriuBrabete (2010), San and Heng (2011) and Saaedi & Mahmoodi (2011) carried out research and the results showed that capital structure and financial performance has a strong positively relationship. Some authors found that there are a no or a weak relationship between capital structure and financial performance, Ibrahim (2009) and Khalaf Al- Taani (2013) have confirmed this assumption. From the above contributions, it is clear that researches on the relationship between financial performance and capital structure are indecisive and requires further investigation which is the major drive to this current research.

In Nigeria for instance, vast number of the studies have fail to employ other mechanisms on capital structure in relation to financial performance. The studies which include Babalola (2012), Yinosa and Babaloola (2012), Olokoyo (2012), Sabastian and Rapuluchuckwu (2012) and Idode, Adeeleke, Ogunlowo and Ashogbon (2014) left out some gaps that requires to be filled. For instance, Salawo (2007), conducted a research on the effect of capital structures on profitability of some selected companies in Nigeria, it focused on short term debt while other forms of financing were left out, hence the result could only be used in the context of short term debt financing rather than the overall. In the actual sense, a study on capital structure is presumed to cut across different forms of debt financing. Also, Babalola (2012), conducted as research on the effect of capital structure on financial performance in Nigeria, using sample of ten firms, focused on total debt to total assets. The study did not include the aspect of total debt to equity, short term debt to total equity and long term debt to total equity even when all the types of debt financing are used by the sampled firms. More so, The study of Babalola (2012) and that of Olokoyo (2012) made use of Chi-square technique to analyse the data. Chi-square is seen as a tool which lacks the reflecting of the concept of time variant.

Theoretically, studies on capital structure and financial performance of enterprises should use approaches that evaluate both time variation and particular characteristics. Sebastian and Rapuluchukwu (2012) also contracted short term debt, long term debt, and total debt in an attempt to analyse the link between capital structure and liquidity on corporate returns of enterprises from 2002 to 2006. Total debt to total equity was not included as one of the debt financing variables in the analysis. From 2008 to 2012, Idode, Adeleke, Ogunlowore, and Ashogbon (2014) performed research on the influence of capital structure on bank performance in Nigeria, which included both equity and debt financing.

However, the analysis overlooked short-term and long-term loans, both of which are critical forms of funding for Nigeria's banking system. In order to fill the gaps described above, a study should be conducted that examines various kinds of finance in order to address the concerns that remain unanswered. What impact does the short debt to equity ratio, long term debt to total equity ratio, and total debt to equity ratio have on a bank's financial performance? The goal of this research is to find answers to these fundamental problems. As a result, the following hypotheses are proposed in order to attain the aforementioned goals.
$H0_I$: Total debt to total assets ratio has no significant impact on financial performance of Deposit Money Banks in Nigeria.
$H0_{II}$: Total debt to total equity ratio has no significant impact on financial performance of Deposit Money Banks in Nigeria.
$H0_{III}$: Short term debt to total asset ratio has no significant impact on financial performance of Deposit Money Banks in Nigeria.
$H0_{IV}$: Long term debt to total asset ratio has no significant impact on financial performance of Deposit Money Banks in Nigeria.

2.1 LITERATURE REVIEW

2.1.1 Concept of Financial Performance (Profitability)

Financial performance, often known as profitability, refers to the extent to which shareholder wealth and earnings rise at the conclusion of a period compared to when the period began. Profitability may be calculated using ratios from financial statements, namely the statement of financial position and the income statement, or by utilising stock market indexes (Aboh, 2012).

The ratios provide a path for determining whether or not a company is maximising shareholder wealth, as well as a way to assess industry average performance over time. According to Saeed (2013), a good performance metric should take into consideration all of the effects of investments on shareholders' wealth maximisation. The primary goal of shareholders is to increase their profits. As a result, while calculating profitability, the company must indicate how much wealthier the shareholder is as a result of previous investments made over a period of time.

2.1.2 Concept of Capital Structure

The capital structure of a company may be defined as the combination of its financial liabilities. The basic kinds of a firm's obligations are equity and debt, and equity and debt holders are the two main types of investors in businesses. Each investor is connected with varying degrees of advantages, risk, and control. As a result, it is regarded as the method through which businesses finance their assets using a mix of equity, debt, and hybrid securities. A company's capital structure is made up of its

obligations. It is a combination of a company's short-term debt, long-term debt, common stock, and preferred equity. The capital structure decision refers to how a company finances its whole operation and expansion by combining several sources of funding.

The debt-to-equity ratio measures how well a company uses borrowed capital. Total debt (short- and long-term debt) + current liabilities is divided by Total Equity Contribution to arrive at this figure. Lenders of money (creditors) want this ratio to be lower, because the lower the debt ratio (firms leverage), the higher the percentage of the firm funded by shareholders. The total debt to total equity ratio indicates how much of a company's entire equity is compared to its total liabilities. This shows how much the outside world, such as obligors, lenders, and raw material suppliers, have invested in the firm in comparison to what the owners (shareholders) have invested.

According to various studies done in Nigeria and across the world, the total debt to total equity ratio is projected to have a significant influence on a company's financial success. Bonds and long-term notes payable are examples of debts, whereas retained earnings, preferred stock, and common stock are examples of equity. Financial leverage increases with business size, investment opportunities, fixed assets, and decreases proportionally with profitability, the risk of bankruptcy, volatility, and advertising spend, according to Raviv (2014). According to the theories of capital structure, non-debt tax shielding, asset structure, and earnings volatility are the elements that may strain leverage.

2.2 Empirical Review

Mathanika (2015) investigated the link between capital structure and financial performance of industrial firms listed on the Nigerian Stock Exchange's floor (NSE). Its findings reveal that the total debt to equity ratio has no impact on a company's financial success. From 2004 to 2009, Rasa and Jurgita (2012) evaluated the influence of corporate governance decisions on capital structure in Nigerian food and beverage industries. There was a substantial negative link between total debt to total asset and business financial performance, according to the findings. Furthermore,

Abor (2005) investigated the influence of capital structure on the financial performance of firms listed on the Ghanaian Stock Exchange's floor. Short-term depreciation and Return on Equity were shown to have a substantial positive association in the study. To put it another way, short-term debt is an essential source of funding for Ghanaian businesses. From 2007 to 2011, Saeed (2013) investigated the impact of capital structure on bank financial performance in Pakistan. Short-term debt to total assets shows a substantial positive link with a bank's financial success, according to the study.

Umar (2012) investigated the influence of capital structure on the financial performance of the Pakistan Stock Exchange's listed firms. Short-term debt, long-term debt, and overall debt all have a negative influence on profit before interest and taxes, return on assets, earnings per share, and gross/net profit margin, according to the findings. Return on equity has a positive link with long-term debt, according to the findings. Goyal (2013) investigated the impact of capital structure on public sector financial performance in the Republic of India. The association between earnings per share, return on assets, and return on equity with capital structure was launched using regression analysis. The findings reveal that short-term debt to total assets has a positive association with financial success as evaluated by Return of equity, Return on assets, and Earnings per share.

Pouraghajan and Malekian (2012) investigated the influence of capital structure on the financial performance of enterprises in Tehran. As a result, the findings reveal a substantial negative association between bank debt ratios and financial performance, as well as a positive relationship between asset turnover and financial performance. Furthermore, the study reveals that when debt rates decline, profitability rises, resulting in an increase in the number of financial performance indicators reported by banks, maximising shareholder value. In Nigeria, Abiodun (2014) looked at the link between capital structure and business success. The findings revealed a link between return on assets and the debt-equity ratio.

2.3 Theoretical Review

The trade-off theory, which was initially utilised by Modigliani and Miller (1963) to explain the most advantageous level of capital structure that may be used to assess the advantages and costs associated with debt financing, is the foundation theory. This might be thought of as a trade-off between the tax benefits of deferring interest payments and the costs of financial difficulties. This capital structure theory contends that enterprises with higher profits should be encouraged to employ debt financing rather than stock financing in order to benefit from the tax break.

According to Myers (2001), tradeoff theory aids enterprises in determining debt levels that balance the tax benefits of more debt financing with the costs of potential financial crisis. This idea aids tax-paying businesses in making reasonable borrowing projections. The trade-off hypothesis compares the firm's risk of bankruptcy and agency costs versus the tax advantages associated with debt utilization. According to Myers and Majluf (1984), corporations employ the pecking order hypothesis to

pick capitals in the following sequence: internal finance, debt, and equity. However, due to the lack of other options, businesses prefer to fund their operations using retained earnings wherever possible. When retained earnings are insufficient, they use borrowed financing. Only as a last resort is equity financing used.

This theory also claims that using retained earnings to fund investments first closes a gap generated by knowledge asymmetry. Due to knowledge gaps between the company and its stakeholders, the company will choose retained earnings over debt, short-term debt over long-term debt, and debt over equity.

3.1 METHODOLOGY

The study adopted correlational research design as it links the relationship between capital structure and financial performance. The population of the study consist of 14 Deposit Money Banks (DMBs) listed on Nigerian Stock Exchange as at 31st December, 2018. Census sampling technique was adopted for the study. Secondary data from annual reports and accounts of DMBs for five (2014-2018) was used to analyzed the panel data using multiple regression technique with the help of stata13 statistical tool. Financial performance (ROA) is the dependent variable, while total debt to total assets (TDTA), total debt to total equity (TDTE), short term debt to total assets (SDTA) and long term debt to total assets (LDTA) represents the independent variables. This relationship is captured in the model:

$$ROA = \beta_0 + ß_1 TDTA_{it} + ß_2 TDTE_{it} + ß_3 LDTA_{it} + ß_4 SDTA + \Sigma_{it}$$

Where: B_0 = Constant term, B_1-β_3 = Parameters to be estimated, TDTA=Total debt to Total asset, TDTE=Total debt to Total equity , LDTA= Long term debt to total asset, SDTA=Short term debt to total asset Σ =Error Term, i= ith Bank, t=tth Period. Financial Performance (ROA): Profit After Tax by Total Asset (Abor, 2008), Total Debt to Total asset: Total debt by Total Asset (Akinyomi, 2013); Total debt to Total equity: Total debt by Total Equity (Salawu, 2007); Short-term debt to Total Assets: Short-term debt divided by Total Asset (Amara & Bilal, 2014) and Long-term Debt to Total asset Long-term debt by Total Asset (Khalaf, 2013)

4.1 RESULTS AND DISCUSSIONS

The result of the data analysis and test of hypotheses are presented in this section. The descriptive statistics, correlation matrix and summary of regression result are presented and analyzed.

Table 1. Descriptive Statistics

Variables	Mean	Std Deviation	Minimum	Maximum
ROA	.0254254	.0435028	-.0953183	.2584365
TDTA	.8051026	1.065605	.0060247	8.804617
TDTE	5.516938	8.896063	-1.968358	73.6552
LDTA	.124621	.151554	0	.9516289
SDTA	.6236332	.311177	.0060247	1.758078

Sources: Generated by Researchers (Stata output) 2021)

Table 1 shows that Deposit Money Banks (DMBs) in Nigeria has a return on assets (ROA) with a mean value of 0.0254254 (3%) which indicates that the DMBs made an average of 3% profit approximately compared with total assets employed. The standard deviation of 0.0435028 (4%), shows that the dispersion between the banks is not much because the value of the standard deviation is very much closer to the mean value. The result showed minimum and maximum values of -0.0953183 and 0.2584365 respectively. TDTA has a mean value of 0.8051026 (81%) which shows that DMBs in Nigeria has an average total debt of 81% that constitute their capital. The standard deviation value of 1.065605 (107%) indicates that the dispersion is high as the value of the standard deviation is greater than the mean value. The range is between the minimum and maximum values 0.0060247 and 8.804617 respectively.

TDTE has a mean value of 5.516938 which indicates that on the average, the total debt DMBs in Nigeria is 552% more than the total equity. The standard deviation of 8.896063 reveals that the deviation between the banks in terms of TDTE is very high this is because the value of the standard deviation is greater than the mean value. The range is between -1.968358 and 73.6552. LDTA has a mean value of 0.124621 which reveals that on the average the long-term debt of the DMBs is 12%. The standard deviation is 0.151554 (15%) which indicates that the dispersion is not very much from the mean value. The minimum and maximum values range between 0 and 0.9516289 respectively. SDTA reveals a mean value of 0.6236332 which indicates that

DMBs have 62% short-term debt during the period under review. The standard deviation stood at 0.311177 (31) which shows that the deviation is very small among the banks.

Correlation Matrix

Table 2 below presents the correlation matrix which shows the relationship between the dependent variable and the independent variables and equally the association between the independent variables themselves.

Table 4.2. Correlation table

VARIABLES	ROA	TDTA	TDTE	LDTA	SDTA
ROA	1.0000				
TDTA	-0.2442* (0.0416)	1.0000			
TDTE	-0.1423 (0.2399)	0.9147* (0.0000)	1.0000		
LDTA	-0.3875* (0.0009)	0.3137* (0.0082)	-0.0043 (0.9715)	1.0000	
SDTA	-0.5429* (0.0000)	0.3260* (0.0059)	0.1552 (0.1996)	0.5179* (0.0000)	1.0000

Sources: Generated by Researchers (Stata output) 2021.

Table 2 above indicates that TDTA is negatively associated with ROA as revealed by the coefficient value (-0.2442) (0.0416) significant at 5% and TDTE with a coefficient of (-01423) (0.2399) significant at 5% is negatively related to ROA. Also, LDTA is negatively associated with ROA revealed by the coefficient (-0.3875) (0.0009) significant at 1%. SDTA showed a negative correlation with ROA (-05428) (0.0000) and significant at 1%.This negative association of TDTA, TDTE, LDTA and SDTA with ROA indicates that profitability may decrease when banks increase their debt ratio. LDTA reveals a negative relationship with TDTE (-0.0043) (0.9715) significant at 10%, which shows that further increase in long-term debt may decrease total equity. The correlation coefficient can only show the degree of association between the explained and the explanatory variables but cannot be used to make statistical inferences.

REGRESSION RESULTS

Table 3 below reveals that the mean variance inflation factor value is 8.74 which is below 10 and suggests the absence of multicollinearity. This is consistent with Neter, Wasserman and Kutner (1989), only VIF more than 10 is indicative of multicollinearity. The Breusch-Pagan/Cook- Weisberg test for heteroscedasticity test reveals a Chi2 value of 71.19 which is significant at 1%. This indicates the presence of heteroscedasticity in the data of the study hence the conduct of fixed and random effect regression technique to avoid wrong statistical inference. The choice of the most appropriate model is based on the outcome of the Hausman specification test which reveals a Chi2 value of 0.17 and an insignificant p-value of 0.9968 suggesting that the random effect model is the most appropriate technique for the study. The Breusch and Pagan Lagrangian multiplier test for random effects reveals a chi2 value of 34.21 and a significant p-value of 0.0000 informs the choice of the random effect model to ordinary least square model as the most appropriate. Rsq value of 0.3173 signifies that the repressors' explained 32% of variation in financial performance; the remaining 68% are determine by factors not captured by the model. Wald Chi2 value of 19.94 and a p-value of 0.0005 indicate a significant linear relationship between the variables.

Table 3. Summary of Random Effect Regression Result

Variables	Coefficient	z-value	p-value
TDTA	0.0111442	0.62	0.537
TDTE	-0.0013796	-0.63	0.530
SDTA	-0.0722086	-3.00	0.003
LDTA	-0.0542569	-1.05	0.292
Constant	0.0758576	4.51	0.000
R2 (overall)	**0.3173**		
Wald Chi2	**19.94**		**0.0005**
Hausman test	**0.17**		**0.9968**
Heteroskedasticity	**71.19**		**0.0000**
Mean VIF	**8.74**		

Source: STATA$_{13}$ Output

The model is estimated as:

$$ROA = 0.0758576 + 0.0111442(TDTA_{it}) - 0.0013796(TDTE_{it}) - 0.0542569(SDTA_{it}) - 0.0722086(LDTA_{it})$$

Testing of Hypothesis

Hypothesis I

Table 3 above reveals TDTA with a z-value of 0.62, p-value of 0.537 (significant at 10%) and an associated coefficient value of 0.0111442 signifies that for any 1% increase in TDTA ratio, the profitability of DMBs in Nigeria will increase by 1.11%. The findings provide sufficient evidence not to reject null hypotheses I and therefore concludes that TDTA has an insignificant positive effect on financial performance of DMBs in Nigeria. Therefore, the result suggests that DMBs may increase TDTA. This finding agrees with the study of Saeed (2013). However, this finding contradicts the work of Mathanika (2015) who found a negative relationship between LDTA and financial performance.

Hypothesis II

TDTE indicates a z-value of -0.63, p-value of 0.530 (significant at 10%) with a coefficient of -0.0013796. This signifies that for any 1% increase in TDTE ratio, financial performance of DMBs in Nigeria may decrease by 0.14%. This result provides evidence not to reject null hypotheses II and therefore conclude that TDTE has an insignificant influence on financial performance of DMBs. Therefore, the result suggests that DMBs may decrease TDTE ratio. This findings is in line with the study of Mathanika (2015) and in contrast with Rasa and Jurgita (2012) who found significant but negative association between debt to equity and financial performance.

Hypothesis III

SDTA reported a z-value of -3.00, p-value of 0.003 (significant at 1%) and a corresponding coefficient value of -0.0722086. This implies that for any 1% increase in SDTA ratio, financial performance may decrease by 7.22%. This result provides sufficient evidence to reject null hypotheses III and therefore conclude that SDTA has a significant influence on financial performance of DMBs in Nigeria. This suggests that DMBs may decrease SDTA ratio. This findings aligns with the study of Umar (2012) but contradict Saeed (2013) and Goyal (2013) who found strong positive relationship.

Hypothesis IV

LDTA showed a z-value of -1.05, p-value of 0.292 (significant at 5%) with an associated coefficient value of -0.0542569. This means that for any 1% increase in LDTA ratio, financial performance may decrease by 5.43%. The result provides evidence not to reject null hypotheses IV and further concludes that LDTA has an insignificant effect on financial performance of DMBs in Nigeria. This suggests that DMBs may decrease the LDTA ratio. The findings is in line with the study of Umar (2012).

5.1 CONCLUSIONS

This study examines the impact of capital structure on the financial performance of listed deposit money banks (DMBs) in Nigeria. TDTA, TDTE, SDTA and LDTA constitute the independent variables used to determine the influence on financial performance, while the financial performance (ROA) is the dependent variable of the study. It was found that TDTA has a positive and insignificant influence on the financial performance of DMBs at 10% level of significant. TDTE has an insignificant negative effect on financial performance of DMBs at 10% significant level. However, SDTA has a negative and significant effect on the financial performance of listed DMBs in Nigeria at 1% significant level. While LDTA has an insignificant negative influence on the financial performance of DMBs at 5% level of significance. Therefore the result implies that of all the independent variables only SDTA significantly impacted on the profitability of listed DMBs in Nigeria.

6.1 RECOMMENDATIONS

Based on the findings and conclusions, it is recommended that:

i. The management of DMBs should increase the ratio of TDTA because it may improve their financial performance
ii. The management of DMBs should decrease the ratio of TDTE this because it decreases the financial performance
iii. The management of DMBs should monitor SDTA ratio by reducing it because it has a significant declining effect on their financial performance.
iv. The management of the DMBs in Nigeria should reduce the ratio of LDTA as long term debt exerts a declining insignificant influence on their financial performance.

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