EFFECT OF CAPITAL STRUCTURE ON FINANCIAL PERFORMANCE OF SOME SELECTED SERVICE FIRMS IN NIGERIA: THE AGENCY COST PERSPECTIVE

BY

DANIEL BONNY ANCHE
SPS/13/MMN/00003

BEING A RESEARCH DISSERTATION SUBMITTED TO THE SCHOOL OF POST GRADUATE STUDIES, FACULTY OF SOCIAL AND MANAGEMENT SCIENCES, DEPARTMENT OF BUSINESS ADMINISTRATION AND ENTREPRENEURSHIP, BAYERO UNIVERSITY KANO, IN PARTIAL FULFILLMENT FOR THE AWARD OF MASTER OF SCIENCE DEGREE IN MANAGEMENT (M.SC. MANAGEMENT)

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DECLARATION

I declare that this research work is my original piece of work and is submitted in partial fulfillment of the requirement for the award of Master's Degree in Management (M.Sc. Management) and that all other materials that have been used for this work were properly acknowledged by means of standard university referencing system (APA).

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Daniel Bonny Anche

SPS/13/MMN/00003

CERTIFICATION

This is to certify that this dissertation titled "the effect of capital structure on the "financial performance of some selected service firms (non-financial) in Nigeria." By Daniel Bonny Anche (SPS/13/MMN/00003) was carried out under my supervision.

…… …….

Dr. Bala Ado Kofarmata Date

Supervisor

APPROVAL

This is to certify that this dissertation having meets the requirements for the award of master degree in Management (M.Sc. Management), is hereby approved for its contribution to knowledge.

……. ……

Prof. Bello Sabo Date

(External Examiner)

…… ……

Prof. GarbaBala Bello Date

(Internal Examiner)

……... ……

Dr. Bala Ado Kofarmata Date

(Supervisor)

……... ……

Dr. A.A Maiyaki Date

(MS.cCoordinator)

…… ……

Dr. Talatu Mohammed Barwa Date

(Head of Department)

……. ……

Dr. Shukurat M. Bello Date

(SPSS Board representative)

DEDICATION

I dedicate this work to my late Brother, Isaac Daniel Anche. May his gentle soul continue to rest in the bosom of our Lord Jesus ChristAmen. This work is also dedicated to Bestie, Ben and Bernice.

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Abstract

This work examines the effect of capital structure on the financial performance of some selected non- financial service firms in Nigeria from the agency cost perspective with a sample of four (4) out of the population of twenty three (23) firms listed on the Nigerian Stock Exchange (NSE) for the period of ten (10) years; 2004- 2013. Panel data which consist of time series and cross sectional data for the firms were generated and analyzed using panel regression. The dependent variable which served as a surrogate for financial performance was used in the study as return on assets (ROA), while the independent variables which served as surrogates for capital structure are; long term debt to capital (LDC), debt to capital (DC), debt to common equity (DCE) and short term debt to total debt (SDTD). The result shows that there is a positive and significant effect between capital structure and financial performance of service firms, and those firms experiencing agency conflicts and need to raise funds for operations and expansion should give priority to higher debt ratio, also high interest rate is a hindrance for borrowing in Nigeria. It is recommended that government needs to regulate the financial sector through monetary and fiscal policies in order to reduce the cost of borrowing and appropriate mix of capital structure should be adopted by management but priority should be given to borrowing.

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

Capital structure is the total amount of funds needed to start a business, in other words, it is the act of financing an organization. How an organization is financed is of paramount importance to both the firm's managers and providers of funds (Akintoye, 2008). This is because if a wrong mix of finance is employed, the performance and survival of the business enterprise may be seriously and negatively affected. Capital structure in finance terms means the way firms finance their assets through the mixture of equity, debt, or hybrid securities (Saad, 2010). Capital structure is a mixture of a company's debt (long - term and short - term), common equity and preferred equity (Akintoye, 2008). Capital structure is fundamentally how a firm finances its overall operations and growth by using diverse sources of funds (Tsuji, 2011).

The importance of financing decision cannot be over emphasized since many of the factors that contribute to business failure could be associated to capital structure problems (Salazar, Soto &Mosqueda, 2012). The financial factor is the main cause of financial distress. Financing decision results in a given capital structure and suboptimal financing decisions can lead to corporate failure. A great dilemma for management and investors alike is whether there exists an optimal capital structure. The objective of all financing decision is wealth maximization and the immediate way of measuring the quality of any financing decision is to examine the effect of such a decision on the firm's performance. (Lucy, Muathe& George, 2014).

The government and private sector have invested heavily in creating an enabling environment for doing business. Indeed, some companies have performed exceedingly well as a result. Several companies however are experiencing declining performance and some have even been delisted

from Stock Exchanges in the last decade (Ishaya&Abduljeleel, 2014)

The performance of a firm has to do with how effective and efficient it is able to achieve the set goals which may be financial or operational. Capital structure of a company is such a vital factor that enhances its operations. Many studies have previously been undertaken to determine and possibly develop theories that will enhance the capital mix (i.e. the appropriate capital structure) suitable for corporate organizations to apply in order to maximize shareholders value (Efobi, 2008).

Capital structure has always been one of the main topics among the students of finance. Its importance derives from the fact that capital structure is related to the ability of firms to fulfill the needs of various stakeholders. The last century has witnessed a continuous development of new theories on the optimal debt to equity ratio. The first milestone was set up by Modigliani and Miller (1958) whose model argued on the irrelevance of capital structure in determining firm's value and performance.

However, many authors have successfully proved that the relationship between capital structure and firms performance actually exists e.g. (Lubakian&Chatterjee, 1994). The same Modigliani and Miller (1963) asserted that their model was not effective anymore if tax was taken into consideration.

More recent literature, however, tends to be less interested with how the capital structure of company affects its governance structure. (Hitt, Hoskisson& Harrison, 1999) and its overall performance (Jensen, 1986). Today, the major concern for capital structure is how to resolve the conflict between owners and managers over control of corporate resources (Jensen, 1989).

One of the most important issues in shareholders and creditors decision making and economic analysis is firm's performance. Firm's performance could help shareholders to make better

decision regarding risk and return.

Moreover, according to Barbosa and Louri (2005) various measures of performance have been identified in the literature; productivity, profitability, customers' satisfaction, these are interrelated in one way or the other. Meanwhile, financial measures are indicators of financial strength, weaknesses, opportunities and threats of any firm. The proxies of financial performance includes: return on assets, return on equity, residual income, dividend per share, among others.

Many empirical and theoretical studies have shown that capital structure really influences firms' value, but the major concern in contemporary modern corporate finance is how to resolve the conflicts between the managers and the owners in the control of resources and how will that control mechanism speak on the firm performance (Jensen,1989). Going by the agency cost theory, the only control mechanism to checkmate the managers excesses to pursue the firm's overall goals is the introduction of more leverage in financing the firm. If more of debt is employed, the threat of liquidation and debt servicing which may eventually result to loss of jobs to the manager will result to the cost reduction thereby leading to efficiency and subsequently improved performance. On this basis, this study considers the effect of capital structure on the financial performance of some selected service firms from the Agency Cost Theory perspective that higher leverage results in the reduction of agency cost, improves efficiency and thereby making the firm more profitable.

1.2 Statement of the Problem

Warokka, Herrera and Abdullah (2011) observed that the subject of optimal capital structure has been the focus of several studies. Capital structure of a firm is a blend of debt and equity employed in financing its operations. The capital structure decision is critical for the continued existence of any business organization as to the maximization of returns to stakeholders

(Akintoye, 2008). Literature revealed that several studies have been carried out to investigate the relationship that exists between capital structure and performance (Onaolapo&Kajola, 2010, Warokka et al., 2011). However, the results of these previous studies have been conflicting. While some studies such as Akintoye, (2008) Dare and Shola, (2010) established a positive relationship between capital structure and firms financial performance. Others reported negative relationshipe.g (Lorpev&Kwanum, 2012). However, Prahalathan and Ranjan, (2011) established that there is no relationship between capital structure and financial performance of firms. Thus, the relationship that exists between capital structure and financial performance of firms remain controversial and open to further research (Akinyomi, 2013).

However, this study is going to venture into a new area that has received a very minimal attention as far as capital structure is concern.

A great dilemma for management and investors alike is whether there exist an optimal capital structure and how various capital structure decisions, both short term and long term influence business performance. The objective of all financing decisions is wealth maximization and the immediate way of measuring the quality of any financing decision is to examine the effect of such a decision on the firm's performance. (Lucy, Muathe& George, 2014).

The Government and private sector have invested heavily in creating an enabling environment for doing business, and indeed, some companies have performed exceedingly well as a result. Several companies however are experiencing declining performance and some have even been delisted from Stock Exchanges in the last decades. Momentous efforts to revive the ailing and liquidating companies have focused on financial restructuring and financial re - engineering. However, Managers and practitioners still lack adequate guidance for attaining optimal financing

decisions (Kibet, Tenie&Mutwol, 2011). Yet many of the problems experienced by the companies put under statutory management were largely attributed to financing Chebii, Kipchumba&Wasike, (2011). This situation has led to loss of investor's wealth and confidence in the stock Market.

However, what is discovered with the majority of these studies is that, they are sectorial in nature, like the studies of Pratomo and Ismail (2006) focusing on the Islamic Banks of Malaysia, Berger and Wharton (2002) on the banking industry of US, Ong and Teh (2011) studies on the Bangladesh construction companies. Dare and Sola (2010) concentrated on the Nigerian petroleum industry, (Onimisi 2011) concentrated on the Nigerian manufacturing firms only, Akintoye (2008) focused on the Nigerian food and beverages industry and Ishaya and Abduljeleel (2014) studied the entire Nigerian economy (financial and non - financial). These different studies from different sectors of the economy cannot be applied to this study because of differences in variables, time and industry factors, as such, this study also follow suits by focusing only on non-financial service firms in Nigeria.

This study is important because its concerns an area where a research of this nature has not been done before. Previous researches explore financial service sector when it comes to the topic of capital structure, but this work studied the non – financial service sectoras it relates to the subject of capital structure. Therefore the clear gap that this research seeks to fill is to study the non – financial service sector of the Nigerian economy using capital structure as an independent variable.

In practical terms, this study intends to find solution to the following problems;

1. To determine which source of finds gives the organization maximum financial performance.
2. To know whether there exist an appropriate capital structure or not.

3. To also know how to solve the problem that exist between managers and owners in the control of the resources of an organization (agency problem).

It is against this background that this research seeks to determine empirically the effects of capital structure on the financial performance of some selected non – financial service companies in Nigeria.

1.3 Research Questions

In order to pursue the objectives, the following research questions have been raised:

- **i.** To what extent does long term debt to capitalization affect the financial performance of service firms?
- **ii.** To what extent does debt to capital ratio affect the financial performance of service firms?
- **iii.** To what extent does debt to common equity ratio affect the financial performance of service firms?
- **iv.** To what extent does short term debt to total debt affects financial performance of service firms?

1.4 Objective of the Study:

The broad objective of this study is to determine the effect of capital structure on the financial performance of some selected service firms in Nigeria. However, this work seeks to pursue the following specific objectives:

i. To ascertain the effect of long term debt to capital ratio on financial performance of service firms.

ii. To determine the extent to which debt to capital ratio influence financial performance of service firms.

iii. To ascertain the effect of debt to common equity ratio on financial performance of service firms.

iv. To examine the effect of short term debt to total debt ratio on financial performance of service firms.

1.5 Hypotheses of the Study

The hypotheses of this study are stated in the null form which are the following:

Ho1 -: Long term debt to capital ratio has no significant effect on financial performance of service firms.

Ho2 -: Debt to capital ratio has no significant effect on financial performance of service firms.

Ho3 -: Debt to common equity ratio has no significant effect on financial performance of service firms.

Ho4 -: Short term debt to total debt ratio has no significant effect on financial performance of service firms.

1.6 Significance of the Study

This research will examine the relationship that exists between capital structure and firms financial performance. Therefore, this study will help companies (Service Firms) in Nigeria to know the appropriate decision to take in order to improve financial performance of firms. Secondly, the study is going to add to existing literature on the study area.

1.7 Scope of the Study

The study attempts to investigate the perceived effect of capital structure on the financial performance of some selected service firms (non-financial) listed on the Nigerian Stock Exchange. It covers the period between 2004 and 2013.

1.8 Limitations of the Study

The study is not free from limitations, some of the limitations were anticipated even before the research commenced, and others emerged during the research period. Resources available to the researcher were not sufficient enough to access some relevant materials to make this work extra relevant. For instance, some articles cannot be accessed until payment is made. Moreover, the sample of the study was entirely drawn from non-financial service firms only, therefore other sectors of the economy were not included in the sample and this could limit the generalization of the research findings**.**

1.9 Definition of Key Terms

Thefollowing relevant terms are hereby defined for clarity purpose.

1. **Capital Structure:**

It is how a firm finances its overall operations and growth by using different sources of funds.

2. **Financial Performance:**

It is the process of measuring the result of a firm's policies and operations in monetary terms. It also refers to the degree to which financial objectives have been accomplished.

3. **Debt:**

Debt is in the form of bond issues or long term noted payables**.**

4. **Common Equity**:

Common Equity is classified as common stock, preferred stock or retain earnings.

5. **Long Term Debt:**

Is any amount of outstanding debt that a company holds that has a maturity of 12 months or longer? It is classified as a non-current liability on the company's balance sheet.

6. **Short Term Debt:**

It is the amount of a loan that is payable to the lender within one year. In the balance sheet, this amount is classified as a short term liability.

7. **Service Firms**:

A business that makes its facilities available to others for a fee.

8. **Total Debt:**

It means total liabilities.

CHAPTER TWO

LITERATURE REVIEW AND THEORETICAL FRAMEWORK

2.1 Introduction:

This chapter is a review of relevant literature and theoretical framework. This chapter is divided into four sections including this introduction, section two deals with conceptual issues, section three present the theoretical framework and the last section discusses the empirical studies.

2.2 The Concept of Firms Financial Performance

Performance of a firm has to do with how effectively and efficiently it is able to achieve the set goals which may be financial or operational. The financial performance of a firm relates to its motive to maximize profit both to shareholders and on assets (Chakravarthy, 1986) while the operational performance concerns with growth and expansions in relations to sales and market value. Since capital is employed by firms to achieve the firms set goals, and performance is said to be the goals so set, both capital structure and firm performance are therefore expected to be proportionally related and influenced one another.

One of the most important issues which play an important role in shareholders and creditor's decision making and economic analysis is firms' performance. Firms' performance could help shareholders to make better decision regarding risk and return rates. Due to this fact that financial performance of companies is one of the criteria for assessing firms success and firms value, thus, investigating different aspects of firms performance measurement and influencing factors is very important which providesuseful information for users of financial statements.

Moreover, according to Barbosa and Louri (2005) various measures of performance have been identified in the literature, these include: productivity, profitability, customers' satisfaction etc., these are interrelated in one way or the other. Meanwhile, financial measures are indicators of

financial strength, weaknesses, opportunities and threats of any firm. The proxies for financial performance include: return on assets, return on equity, residual income, and dividend per share, among others. However, this paper will specifically use Return on assets (ROA) as a measure of financial performance. The different performance measures are; financial and non – financial measures, accounting and market measures of financial performance, under accounting measures we have, Return on Equity and Return on Asset, under market measures we have Tobin's Q and Economic value added. This work used Return on Asset as a measure of financial performance because ROA is the efficiency of assets in producing income for the organization as such, it is going to perfectly suit this work as a measure of financial performance.

Financial performance is a subjective way of how well a firm can use assets from its primary mode of business and generate revenue. The term is used as a general measure of a firm's financial health over a given period. There are many ways to measure financial performance, but all measures should be taken in aggregate. Line items such as revenue from operating income, or cash flow from operations can be used as well as total units sales. Furthermore, the analyst, or investors may wish to look deeper into financial statements and seek out margin growth rates or any declining debt. Six sigma method focuses on this aspect. There are many stakeholders in a company, including trade creditors, bondholders, investors, employees and management. Each group has its own interest in tracking financial performance of a company. Analysts learn about financial performance from data published by the company in their annual report. The purpose of the report is to provide stakeholders with accurate and reliable financial statement that provide an overview of the company's financial performance.

Financial performance identifies how well a company generates revenues and manages its assets, liabilities and financial interest of its shareholders. The balance sheet is a snapshot of the

financial balance of an organization. It provide an overview of how well the company manages its assets and liabilities. The income statement provides a summary of operations for the entire year. The income statement starts with sales or revenue and ends with net income. The cash flow statement is the combination of both the income statement and the balance sheet.

2.3 Non – Financial Measures of Performance

Business owners and advisors understand the critical role financial reporting and analysis plays in driving the successful performance of all businesses that said; financial metrics will never address the performance question in totality and it would be unwise to neglect non – financial considerations that influence any business. Non – financial performance measures can provide deep insights into inner workings of your business and serve as a leading indicator of future financial performance. Having a complete understanding of these factors can add another layer of financial metrics and help frame financial results. With this, let's look at some non – financial factors that influence performance and potential valuations; management team, corporate governance, employee satisfaction and engagement, competitive advantage, Technology, understanding your customers and current and future legislation (Crowe Irelandl, 2018).

2.4 **Accounting Measures of Financial Performance**

Return on Equity (ROE) is a measure of financial performance calculated by dividing net income by shareholders equity, shareholders equity is equal to a company's assets minus its debt. Return on Equity could be thought of as the return on net assets. It is considered a measure of how effectively management is using a company's assets to create profit (Marshal Hargrave, 2019).

$$ROE = \frac{\text{Net Income}}{\text{Average shareholders' equity}}$$

Return on Assets (ROA) it is an indicator of how profitable a company is relative to its total assets. Return on assets gives an idea to how effective management is at using its assets to generate earnings. It is calculated by dividing a company's annual earnings by its total assets. It is best used when comparing similar companies or comparing a company to its previous performance. In other words, it shows how well a company utilizes its assets by determining how profitable a company is relative to its total assets.

$$ROA = \frac{\text{Net Income}}{\text{Total Assets}}$$

2.5 Market Measures of Financial Performance

TOBINS Q

Tobin's q is an economic theory which measures a company's market value in relation to its total assets value. Tobin's Qwas named after Nobel laureate US economist James Tobin's who put forward the theory that the value of the company's outstanding shares should be equal to the total value of its assets for it to be considered a good value**.** It is the ratio between a physical assets market value and its replacement value (Mukulika Mukherjee, 2019)

ECONOMIC VALUE ADDED (EVA)

Economic Value added is a financial measurement of the returned earned by a firm that is in excess of the amount that the company needs to earn to appease shareholders. In other words, it is a measure of an organizations economic profit that takes into account the opportunity cost of invested capital and ultimately measures whether organizational value was created or lost. EVA compares the rate of return on invested capital with the opportunity cost of investing somewhere.

This is important for business to keep track of, particularly those businesses that are capital intensive. When calculating economic value added, a positive outcome means that the company is creating value with its capital investments (www. Investopedia.com)

2.6 Concept of Capital Structure

Capital structure represents a firm's financial framework which consists of the debt and equity used to finance the firm. Firm's ability to carry out their stakeholders' requirement is closely related to capital structure. Therefore, this foundation is an Imperative piece of information that should not be disregarded. Capital structure in financial terms means the way firms finance their assets through the mixture of a company's debts(long term and short term), common equity and preferred equity (Akintoye, 2008). Capital structure is fundamentally on how a firm finances its overall operations and growth by using divers' sources of funds (Tsuji, 2011).

Capital structure is the means by which an organization is financed. It is the mix of debt and equity capital maintained by a firm. Capital structure is one of the major topics among scholars in finance. Capital structure in finance term means the way a firm finances its assets across the blend of debt, equity or hybrid securities (Saad, 2010). The concept is generally described as the combination of debt and equity that make the total capital of the firm. The proportion of debt to equity is a strategic choice of corporate managers. Capital structure decision is a vital one since the profitability of an enterprise is directly affected by such decisions. Hence, proper care and attention need to be given while determining capital structure decision.

In a statement of affaires of an enterprise, the overall position of the enterprise regarding all kinds of assets and liabilities are shown. Capital is a vital part of that statement. The term "capital structure" of an enterprise is actually a combination of equity shares, preference shares

and long - term debts. A continuous attention has to be paid as the optimum capital structure is concerned with unplanned capital structure, Companies may fail to economize the use of their funds. Consequently, it is long 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. (Pandey, 2009).

Planning capital structure involves, to a great extent, the consideration of shareholders interest and other groups. Initially, at the time of its promotion, a company will have to plan its capital structure and subsequently, wherever funds have to be raised to finance investment, a capital structure is a significant management decision as it greatly involves the owners' equity return, his risk as well as the market value of the shares. It is therefore incumbent on management of a company to develop an appropriate capital structure which is most suitable to the company's operations (Ishaya&Abduljeleel, 2014).

Capital structure represents a firm's financial framework which consists of the debt and equity used to finance the firm. Therefore, this foundation is an imperative piece of information that should not be disregarded. In a nutshell, capital structure is a mixture of company's debts (long - term and short - term), common equity and preferred equity (Akintoye, 2008). Capital structure is fundamentally on how a firm finances its overall operations and growth by using diverse sources of funds (Tsuji, 2011). The capital structure of a company is such a vital factor that enhances its operations, as a result, the relevance of capital to the company's operations and performance. Many studies have presently been undertaken to determine and possibly develop theories that will enhance the capital mix (i.e. appropriate capital structure) suitable for corporate organizations to apply in order to maximize shareholders value (Czarni, Tzki& Kraft, 2004).

The capital of a company, according to Akinsulire, (2002), is a "stock of money possessed by a

person or a business firm that could be invested from time to time in order to earn income, but for which it is intended not to diminish''Uremadu, (2004), sees the capital of an organization as "those pool of funds that the company commits to its fixed assets, to inventories, to account receivables, and to cash or marketable securities" to lead to corporate growth. An economist views capital as any material or item which can be consumed in the production process to create wealth. These materials or items are said to be factors of production which are usually grouped into man, machines and money (including information as the fourth category) (Efobi, 2008).

Whether a business is newly born or it is an ongoing one, it requires funds to carry out its activities as no success is achievable in the absence of funds. The needed funds may be for daily running or business expansions. This tells how important or essential fund is in the life of a business. This fund is referred to as capital. Capital therefore refers to a means of funding business. Capital of firms when sourced, it becomes a burden on enterprises simply because it is other persons resources which they are to compensate as they deriving maximum benefits from it. It is therefore a symbol of a company's financial liability (Ishaya&Abduljeleel, 2014).

According to Dare and Sola (2010), capital structure is the debt - equity mix of business finance. It is used to represent the proportionate relationship between debt and equity in corporate firm's finances. Therefore, in this context, the composition of equity and debt in a firm's capital is what we mean by capital structure. An optimal capital structure is the best debt/ equity ratio of a firm, which minimizes the cost of financing and maximizes the value of the firm.

The capital structure of a firm as Dare and Sola (2010) opined, can take any of the following three alternatives: 100% equity and 0% debt or X% equity Y% debt. From the above, option one is that of a purely equity financed firm. That is a firm that ignores leverage and its benefits in financing its activities. Option two is that of a firm that finances its affairs solely on debt which

may not be realistic in the real world situation because hardly will any provider of funds invest in a business without owners. This is what is referred to as “trading on equity”. That is, it is the equity element that present in capital structure that motivates the debt providers to give their scarce resources to the business. Option three is that of a firm that combines certain proportion of both equity and debt in its capital structure. It will therefore reap the benefits of combined debt and equity (Ishaya&Abduljeleel, 2014).

For purely equity financed firm, the whole of it’s after - tax cash flows (profit) is a benefit to the shareholders in form of dividends and retained earnings. However, firms with certain percentage of debt in their capital structure shall devote a portion of the profit after tax to servicing such debt. Capital structure decision is therefore very critical and fundamental in the life of a business. This is not only to maximize profit to the shareholders but also due to the impact such a decision has both on sustainability and its ability to satisfy external objectives. The capital structure theory is seen as a sinequanon to the administration of a firm wishing to raise funds for finance. It addresses the means of finance available to an enterprise likewise the best mix of such sources that can reduce the overall cost of capital and maximize returns on acquisition. The success of any business lies in its management’s effort to identify this optimum capital for smoothness, sustainability and prosperity in line with her overall goals and objective of the business.

2.7 Long Term Debt to Capital

Long term debt is an interest - bearing obligation owed for over 12 months from the date it was recorded on the balance sheet. This debt can be in the form of Banknote, mortgage, debenture or other financial obligation. The debt is recorded on the balance sheet along with its interest rate and date of maturity. Total capitalization is the sum of long term debt and all other types of equity such as common stock and preferred stock. Total capitalization forms a company’s capital

structure and is sometimes computed as total assets minus total liabilities.The long term debt to total capitalization ratio shows the extent to which long term interest bearing debt (such as bonds and mortgages) are used for the firms permanent financing or the financial leverage of the company. On the flip side, it shows how much of the firm is financed by investor funds or equity. Thus, it allows investors to identify the amount of control utilized by a company and compare it to other companies to analyze the total risk experience of a particular company (Rosemary Peavler, 2019).

Companies that fund a great portion of capital through debt are considered to be riskier than those with lower finance ratio. The debt to asset ratio and the long term debt to total capitalization ratio both measure the extent of a firms financing with debt. The more the ratio increases, the more debt is being used for the permanent financing of the firm as opposed to investor funds from the sale of stock – equity financing (http://www.investopedia.com)

2.8 Debt to capital Ratio

The debt to capital ratio is a measurement of a company's financial leverage. The debt to capital ratio is calculated by taking the company's interest – bearing debt, both short and long term liabilities and dividing it by the total capital. Total capital is all interest – bearing debt plus shareholders equity, which may include items such as common stock, preferred stock and minority interest. The debt to capital ratio gives analysts and investors a better idea of a company's financial structure and whether or not the company is a suitable investment. All things being equal, the higher the debt to capital ratio, the riskier the company. While most companies finance their operations through a mixture of debt and equity, looking at total debt or net debt of a company may not provide the best information. Interest - bearing debt includes accrued expenses and trade payables (Marshal Hargrave, 2019)

2.9 Debt to common Equity

Debt to equity ratio is financial, liquidity ratio that compares a company's total debt to total equity. The debt to equity ratio shows the percentage of company financing that comes from creditors and investors. A higher debt to equity ratio indicates that more creditor financing (bank loans) is used than investor financing (shareholders). The debt to equity ratio is calculated by dividing total liabilities by total equity. A debt to equity ratio of 1 would mean that investors and creditors have an equal stake in the business assets. A lower debt to equity ratio usually implies a more financially stable business. Companies with higher debt to equity ratio are considered more risky to creditors and investors than companies with lower ratio. Unlike equity financing, debt must be repaid to the lender. Since debt financing also requires debt servicing or regular interest payments, debt can be a far more expensive form of financing than equity financing (Will Kent & Adam Hayes, 2019).

2.10 Short Term Debt to Total Debt

Short term debt also called current liabilities is a firms financial obligations that are expected to be paid off within a year. It is listed under the current liabilities portion of the total liabilities section of a company's balance sheet. There are usually two types of debt of liabilities that company accrues; financing and operating. The former is the result of actions undertaken to raise funding to grow the business while the latter is the byproduct of obligations arising from normal business obligations. Financing debt is normally considered to be long term debt in that it has a maturity date that is longer than 12 months and is usually listed after the current liabilities portion in the total liabilities section of the balance sheet. Operating debt arises from the primary activities that are required to run a business, such as accounts payables and is expected to be resolved within 12 months, or within the current operating cycle, or its accrual. This is known as

short term debt and is usually made up short term bank loans taken out, or commercial paper issued by a company (www.investopedia.com)

The value of the short term debt is very important when determining a company's performance. Simply put, the higher the debt to equity ratio, the greater the concern about company liquidity. If the account is larger than the company's cash and cash equivalent, this suggest that the company may be in poor financial health and does not have enough cash to pay off its impending obligations(AkhileshGanti, 2019)

2.9 Review of Empirical Studies:

This section discusses some empirical studies which examined the impact of capital structure on firm's performance and the effects between capital structure and firms financial performance. This section will be divided into three parts; first part presents some studies that indicate a positive effects between capital structure and firm performance, the second part shows a negative correlation between capital structure and firm's performance. The third part displays mixed results.

Many empirical and theoretical studies have proven that capital structure really influences firm's value but the major concern contemporarily in modern corporate finance is how to resolve the conflicts between the managers and the owners in the control of resources and how will that control mechanism speak on the firm performance (Jensen, 1986;1989). Going by the Agency cost theory, the only control mechanism to checkmate the manager's excesses to pursue the firm's overall goals is the introduction of more leverage in financing the firm. If more of debt is employed, the threat of liquidation, debt servicing which may eventually result loss of jobs to the managers will result to cost reduction thereby leading to efficiency and subsequently improved performance.

Empirical studies have been conducted on the determinants of capital structure on firms. Many of these studies have identified some specific firm level characteristics that affect the capital structure of firms. Of these characteristics are age of the firm, asset structure, size of the firm, profitability, growth, firm risk, tax and ownership structure (Joshua, 2008). According to Harris and Raviv (1991),there are several firms' specific characteristics and industrial factors that determine the choice of leverage ratio as conducted in many empirical studies. Most of these studies agreed that leverage increases with fixed assets, non -debt tax shields, growth opportunities, firm size and decrease with volatility, advertising expenditures, research and development costs, bankruptcy probability, profitability and uniqueness of the product.

Javed and Akhtar (2012) exploit the relationship between capital structure and financial performance. They concluded that there is a positive relationship between financial leverage, financial performance and growth and size of the companies. Saeedi and Mahmoodi (2011) examined the relationship between capital structure and performance of listed firms in Tehran Stock Exchange. According to the study, market measures of performance are positively related to capital structure and whereas ROA is positively related to capital structure, no significant relationship exists between ROE and capital structure. The findings by Saeedi and Mahmoodi (2011) indicate that financial leverage may affect different measures of financial performance in different ways. Hadlock and James (2002) and Ghosh et al. (2000) revealed a positive relationship between financial leverage and choice of capital structure.

Abdul (2012) conducted a similar study to determine the relationship between capital structure decision and the performance of firms in Pakistan. The study concluded that financial leverage has a significant negative relationship with firm performance as measured by ROA, GM. The relationship between financial leverage and firm performance is measured by ROE was negative

but not statistically significant. Berger and Bonaccarsi di Patti (2006), Gleason et al. (2002) and similarly and Li (2002) carried out similar research, the findings shows negative relationship between capital structure and firm performance.

Zeitun and Tian (2007), using 167 Jordanian companies over fifteen years period (1989- 2013), find that a firm capital structure has a significant negative impact on the firm's performance indicators, in both the accounting and market measures. Mojunder and Chaber (2004) and Rao, and Syed (2007) also confirm the negative relationship between financial leverage and performance.

The study indicated that capital structure has little to no impact on a firm's performance. The literature on the relationship between firm performance and capital structure has produced mixed results. Ebaid (2009) examined the capital structure and performance of firms. Basically the aim was to check the relationship between debt level and financial performance of companies (listed at Egyptian stock exchange during the period of 1997 to 2005).

Bodaghi and Ahmadpour (2010) collected data from 50 Iranian firms listed at Tehran stock exchange to examine the relationship between corporate governance and capital structure. They concluded a negative relationship between board size and debt to equity ratio. Authors also found that CEO duality does not significantly influence corporate financing behavior. Saad (2010) carried out a sample of 126 Malaysian publicly listed companies from 4 industries; consumer product, industry products, trading/services and plantation from 1998 - 2006. Through multiple regression analysis, Saad find a negative relationship between CEO duality and capital structure, and a positive relationship between board size and capital structure. Coles et al. (2005) find a positive relationship between board size and debt ratio in the US context. Gil, Mand, Sharma, and Mathur (2012) sampled small business owners from India and found that small business

growth and family positively influence capita structure and small business firms.

On a general note, many studies have been conducted locally and internationally in this area of study with the view of helping both growing and grown firms structuring their finances efficiently. This section of the study is therefore concerned with looking at some of those studies as follows;

Onaolapo and Kajola (2010) conducted a study on the impact of capital structure and performance of Nigerian firms focusing only on the non-financial firms for a period of seven years (2001-2007) from agency cost theory point of view. The study revealed that capital structure surrogated by debt ratio (DR) has a significantly negative impact on firm's financial measures, return on assets (ROA), and return on equity (ROE). This result provides evidence in support of agency cost theory. Pratomo and Ismail (2006) studied on the capital structure and the performance of Islamic Banks of Malaysia. Profit efficiency of a Bank was set as an indicator of reducing agency cost and the ratio equity of a Bank as an indicator leverage. Their findings are in agreement with the agency hypothesis i.e. higher leverage or a lower equity capital ratio is associated with higher profit efficiency. Berger and Wharton (2002) in the same vein, studied on the capital structure and firm performance testing agency cost theory hypothesis with a complete attention on the banking sector. Findings here are as well consistent with the agency cost hypothesis - higher leverage or lower equity capital ratio is associated with higher profit efficiency.

Oke and Afolabi (2011) also investigated the impact of capital structure on industrial performance in Nigeria taking five quoted firms into consideration with debt financing, equity financing and debt/equity financing as proxies for capital structure, while profit efficiency a surrogate for performance. For equity and debt equity finances, a positive relationship existed,

but a negative relationship exists between debt financing and performance. Basies, Anup and Suman (2010) find out the impact of capital structure on the value of firm on the industrial sector of Bangladesh economy by gathering secondary data of public listed companies traded in Dhaka stock exchange (DSE) and Chittagong Stock Exchange (CSE) using share price as a proxy for firm's value and different ratios for capital structure decision. It was found that maximizing wealth for the shareholders require perfect combination of debt and equity and that cost of capital is negatively correlated and therefore to be reduced to minimum level.

Furthermore, Ong and Teh (2011) investigated on the capital structure and firm performance of construction companies for a period of four years (2005-2008) in Malaysia. Long term debt to capital, debt to capital, debt to asset, debt to equity market value, debt to common equity, long term debt to common equity were used as proxies for capital structure (independent variable) while return on capital, return on equity, earnings per share, operating margin, net margin were used as proxies for corporate performance. The result shows that there is relationship between capital structure and corporate performance.

In Jordan, Zeitun and Tian (2007) conducted a study on capital structure and corporate performance on 167 Jordanian firm's between1989-2003. They found a significantly negative relationship between capital structure and corporate performance. Many variables such as ROA, ROE, PROF, Tobin's Q, MVBR, MBVE, and PIE were used to measure performance. While leverage, growth, Size, tangibility, STDVCF were proxies for capital structure. Dare and Sola (2010) studied on the actual impact of capital structure on firm performance on Nigerian petroleum industrial sector. Earnings per share and dividend per share surrogated performance while leverage ratio proxy capital structure. The study reported a positive relationship between the variables employed.

Pratheepkanth (2011) carried out an investigation on capital structure and financial performance of some selected companies in Colombo stock exchange between 2005-2009. Capital structure was surrogated by debt while performance was proxy by gross profit, net profit, ROI/ROCE, ROA. The result shows the relationship between capital structure and financial performance is negative. On the US banking industry, using the ratio of equity to gross total assets (ECAP) to proxy capital structure and profit efficiency (EFF) for firm performance, Berger and Wharton (2002) concluded that higher leverage is associated with higher profit efficiency which confirms agency cost hypothesis. Bodhoo (2009) investigated on capital structure and performance of Mauritius listed firms and found that below a certain range of leverage, firm's performance tends to be negatively related with the debt ratio. Onimisi, (2011) on his effect of capital structure on the Nigerian manufacturing firm's performance found that capital structure really affects firm's performance. Lastly, Ishaya and Abduljaleel (2014) investigated the impact of capital structure on the profitability of Nigerian quoted firms from the agency cost perspective, the result shows that debt ratio (DR) is negatively related with profit, the only dependent variable but Equity is directly related with profit. The study by these findings, indicate consistency with prior empirical studies and provide evidence against the agency cost theory. Finally, all the literature reviewed studied financial service firms in relation to capital structure. Therefore this work tends toward studying non – financial service firms.

Financial performance plays a vital role in measuring the success of business firms. Evaluating the firm's performance has three (3) dimensions: the firm's productivity, profitability, and market premium (Omondi&Muturi, 2013). To this end, there are a plethora of measures of financial performance, such as Return on Assets (ROA), Return on Equity (ROE), and Operation Profit Margin (OPM). But this work has focused only on return on assets as a measure of financial

performance because return on assets measures the efficiency of assets in producing income.

Therefore, the variables of this study consists of dependent variable which is return on assets (ROA) as a measure of financial performance, and the independent variables which include long -term debt to total capital (LDC), debt to total capital (DC), debt to common equity (DCE), and short term debt to total equity (SDTD), as measures of capital structure. See the table below:

2.10 Theoretical Framework

This study is built on the theoretical framework that corporate capital structure affects a firm's profitability, and that the extent or degree of that effect depends on the capital structure policy adopted by a company. The major capital structure policy adopted by a firm includes debt, total equity, mix of debt and equity, reserves, and most firms donot fully rely on internal finances like retained earnings (Efobi, 2008).

Sequel to the pioneering works of Modigliani and Miller (1958) on capital structure which opined that the choice of capital is irrelevant of firm's value given some assumptions: neutral taxes, no transaction cost, asymmetric access to credit markets i.e. firms and investors can borrow or lend at the same rate, firm financial policy reveals no information, three different theoretical explanations on the subject have been developed.

2.10.1 Modigliani -Miller Theory

The MM theory of Franco Modigliani and Merton Miller (1958) forms the bases for modern thinking on capital structure. The basic theory states that under a certain market process, in the absence of taxes, bankruptcy costs, and asymmetric information, and in efficient market, that value of the firm is unaffected by how that firm is financed. It does not matter if the firm's capital is raised by issuing stocks or selling debt. It does not equally matter what the firm's dividend policy is. Therefore, the Modigliani - Miller theory is also often called the capital

structure irrelevancy principle.

Sequel to the pioneering works of Modigliani and Miller (1958) on capital structure which opined that the choice of capital is irrelevant of firm's value given some assumptions: neutral taxes, no transaction cost, asymmetric access to credit markets i.e. firms and investors can borrow or lend at the same rate, firm financial policy reveals no information, three different theoretical explanations on the subject have been developed: the Static trade - off, the pecking order and the agency cost theories (Buferna, Bangassa&Hodgkinson, 2005).

2.10.2 The Trade -off Theory of Capital Structure

The trade -off theory of capital structure discusses the various corporate finance choices that a corporation experiences. The theory is an important one while studying the financial economics concepts. The theory describes that companies or firms are generally financed by both equities and debts. The theory generally deals with the two concepts. The purpose of the trade -off theory of capital structure is to explain the strategy of the firms to finance their investments sometimes by debt. The theory also studies the corresponding advantages and disadvantages of the financing either by debt or equity. The trade - off theory actually allows the cost of bankruptcy to exist.

More so, the static Trade - off theory opined that an optimum capital structure is obtainable where the tax benefit of debt financing equates leverage associated cost which may include financial distress and bankruptcy while investment decision and firm assets are held constant (Buferna et al.,2005).

2.10.3 Pecking Order Theory

The pecking order theory of Myers and Majluf (1984), states that firms prefer to finance new investment, first internally with retained earnings, then with debt, and finally with an issue of new equity. The firm that has not enough available internal finance would either use equity or debt to finance future positive NPV investments. According to Myers and Majluf, issuing external equity gives a bad signal to the market that supporting equity is overrated. Nevertheless, issuing debt sends a signal supporting stock is underrated. This conflicts leads to an interaction between investment and financing decision (Gajurel, 2005, p.19).The pecking order theory developed by Myers (1984) has asymmetric information as the base of its choice of financing. According to Frank and Goyal (2003), the main conclusion drawn from the pecking order theory is that there is a hierarchy of firm's preference with respect to the financing of their investment. That is, issuing new shares may harm existing shareholders through value transfer from old to new shareholders. So, Managers will prefer financing new investments by internal sources (i.e. retained earnings) first, if this source is not sufficient then managers seek for external sources from debt as second and equity as last. Thus, according to pecking order theory, firms that are profitable and, therefore, generate high earnings to be retained are expected to use less debt in their capital structure than those that do not generate high earnings, since they are able to finance their investment opportunities with retained earnings.

The pecking order theory concludes that optimum capital is difficult to determine because firms make use of first equity capital then debt and lastly equity in financing new investments. Equity capital appears both at the start and end of the pecking order (Buferna et al., 2005).

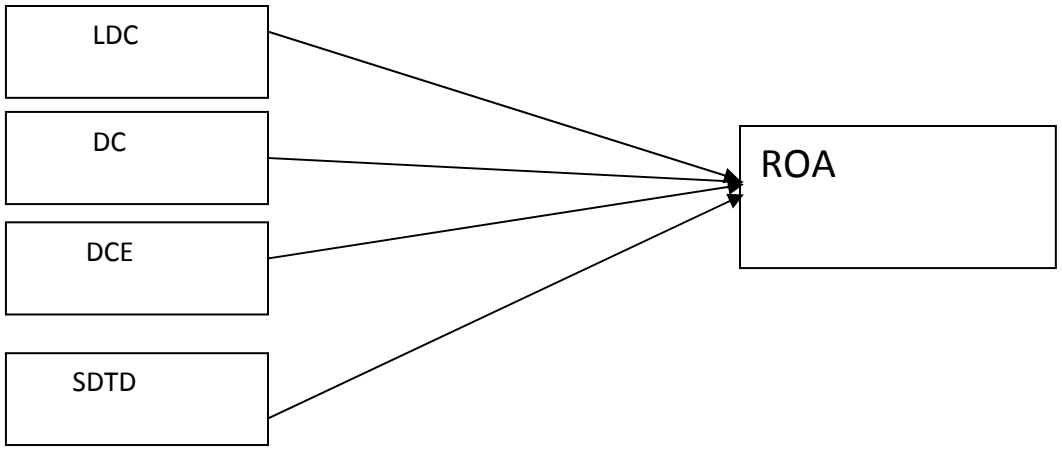
2.10.4 Agency Cost Theory

Jensen &Meckling (1976), defined agency cost as examining conflicts and relationships between agents (Managers) and principals (shareholders). The opposed interest of principals and agents and separation of management and ownership in a firm cause these conflicts. For instance, managers may be interested in taking negative NPV projects or making unnecessary acquisitions by paying too much to increase size and reputation of the firm instead of maximizing the wealth of shareholders, this is because managers get highly paid from the big companies. Managers try to operate the firm in their interest rather than taking into consideration of increasing the shareholders wealth and value of the firm. This is the theory to which this work is underpinned to the agency cost theory lastly states that an optimal capital structure is attainable by reducing the cost resulting from the conflicts between the managers and the owners. Jensen and Meckling (1976) argued that leverage level can be used to monitor the managers to pursue the overall firms' objectives and not theirs. By so doing, cost is reduced leading to efficiency which shall eventually enhance firm performance (Buferna et al., 2005).

CONCEPTUAL FRAMEWORK OF THE STUDY

Capital Structure **Financial Performance**

IV **DV**



KEY

LDC Long term debt to capital

DC = Debt to capital

DCE = Debt to common equity

SDTD = Short term debt to total debt

Figure 2.1: Conceptual Framework of the Study.

Source: The Researcher

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter contained a description of the research design, population of the study and the selection of the sample size and sampling technique. The chapter concludes with the discussion of the method of data collection and the method of statistical analysis of the data collected.

3.2 Research Design:

Research design has been viewed as a blue – print or road-map indicating the methods and procedures for collecting data and analyzing information (Zikmund, Babin, Carr and Griffi, 2010). The study used panel data which consists of time series and cross - sectional data. Multiple regression analysis was carried out to ascertain the effect of capital structure on the financial performance of service (non-financial) companies listed on the Nigerian Stock Exchange. The data for all the variables in the study were gotten from published annual reports and financial statements of the service companies listed on the Nigerian Stock exchange for the period 2004 – 2013.

3.3 Population of the Study:

The population of this study consists of 23 non-financial service companies listed on Nigerian stock exchange which have been sampled using Filtersampling method. Four (4) companies out of the 23 listed non- financial service firms were selected to represent the entire population as they have the complete data required for the period under review.

3.4 Sampling and Sampling Technique:

There are two sampling techniques: Probability and non-probability methods (Rabson, 2007). The researcher chooses to go for non – probability sampling method i.e. filter sampling. Filter sampling is the non-random sampling technique wherein the choice of sample items depends exclusively on the investigators knowledge and professionality, observation and diagnostic studies. The investigator chooses only those sample items which have complete date to be the best representation of the population to the attributes or characteristics under investigation. The filter sampling is not scientific method as the sample items are selected on observation basis. Four (4) companies were selected to represent the entire population of 23 non-financial service firms listed on Nigerian stock exchange as they have the complete data required for the period under review.

3.5 Method of Data Collection

Data were gathered from published financial statements of 4 companies sampled to represent the entire population of 23 non – financial service firms listed on the Nigerian stock exchange because they are the only ones that have complete data for the period under review, non-financial service firms listed on the Nigerian Stock Exchange (NSE) spanning the period 2004-2013.

3.6 Method of Data Analysis

In research, the nature of data dictates the tool of its analysis in most cases. Given this study therefore, a multiple regression was used for the data analysis. This is because of the multiple variables the study is made up of. It needs to be stressed that panel data was also used for this study. This combines simultaneously cross -sectional data and time series.

Hausman specification test of 1978 which test whether correlated random effect model suffers from mis – specification. If the null hypothesis is not rejected, we can conclude that the

correlation is not relevant and therefore a panel model of random effects is the correct way of carrying out the analysis of the relationship between capital structure and financial performance of service firms in Nigeria.

Generalized method of moment (GMM) was also used to analyze the data. This is because the generalized method of moment according to Gujarati (2007) is a more dynamic methodology or is a method of analysis that takes care of any change in the data.

3.7 Model Specification

Fp=f(LDC, DC, DE, SDTD)……...1

Where fp would be measured by ROA. Thus, the model to be estimated would be written as:

$ROAit = B_0 + B_1LDC_{it} + B_2DC_{it} + B_3DE_{it}\ B_4SDTD_{it} + E_{it}$……...2

Where: ROA_{it} = return on assets for firm 1 at time t (in years) used as a proxy for performance,

LDC_{it} = Long - term debt to total capital

DC_{it} = Debt to total capital

DCE_{it} = Debt to total equity

$SDTD_{it}$= Short term debt to total debt.

AGEit = Age of the firm (control variable)

E_{it} = Stochastic or disturbance term

B_0 = Constant or intercept

B_1-B_5 = Coefficient of the estimated Parameters

Apriore expectations $B_0>0$, $B_1>0$,$B_2>0$,$B_3>0$,$B_4>0$,$B_5>0$.

3.8 Measurement of Variables

Table 3.1; Variable Measurement

Variable	Measurement
Return on Assets	it is measured as a ratio of profit after tax to total assets. This is in line with the work of Osuji,C.C, and Odita,A. 2012
Long Term Debt to Capital	it is measured as the ratio of long term debt to capital Adapted from the work of Akinyomi, O. J 2013.
Debt to Capital	it is measured as the ratio debt to total capital Adapted from the work of Akinyomi, O. J. 2013.
Debt to Common Equity	it is measured as the ratio of total debt to total equity Adapted from the work of Akinyomi, O. J. 2013
Short Term Debt to Total Debt	it is measured as the ratio of short term debt to total debt Adapted from the work of Akinyomi, O. J. 2013

Source: Osuji,C.C, and Odita, A. (2012), Akinyomi, O .J. (2013)

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND DISCUSSIONS

4.1 Introduction

This chapter presents the results and discussions of findings of the study. The chapter is divided into four sections, this introduction is the first. Section two presents the descriptive analysis which is followed by the report of the inferential statistics. Finally, section four contains discussions of findings with a view to making comparison with findings of related studies reviewed in chapter two.

4.2 Descriptive Analysis

The table 4.1 presents the summary statistics of the variable used for this study. This statistics include the number of observations, mean, standard deviation, skewness and kurtosis.

Table 4.1 Descriptive Statistics of the Variables Sampled.

STATISTICS	VARIABLES			
	LDC	DC	DCE	STDTD
N	40	40	40	40
Mean	50.33437	143.0793	270.5126	247.1491
Std Dev.	76.29797	252.5861	768.3699	784.6283
Skewness	2.756676	3.65751	4.097748	4.066608
Kurtosis	11.70466	15.54942	18.3595	18.22041

Source: Computed Using Stata 10.0

The table 4.1 above presents the descriptive analysis of the sampled data from the non-financial service firms; these statistics include the number of observations, mean deviation, standard deviation, skewness and kurtosis. From the table, Long Term Debt to Capital like all the other variables has 40 observations, with a mean of 50.33437, standard Deviation of 76.29. The skewness and kurtosis of the sample stood at 2.75 and 11.70 respectively which mean the data is normally distributed. Debt to Capital has a mean of 143.029, 252.58i the standard deviation, skewness and kurtosis stood at 3.65 and 15.54942 respectively. Again with 40 observations Debt to Equity and Short Term Debt to Total Debt, have means of 270.5126 and 247.1491, standard Deviation of 768.3699 and 784.628, skewness and kurtosis of 4.09 and 4.06, 18.39 and 18.22 respectively. The Table 4.1 clearly showed that the data being sampled is strongly balanced and normally distributed.

4.3 Inferential Statistics

This section presents the results of the inferential statistics that has been carried out in the study. And this has been divided into five (5), starting with the results of Fixed Effect (FE) and Random Effect (RE), and then the result of the Hausman test of 1978, the last section presents the result of the Generalized Method of Moment (GMM).

4.2. Regression Results for the Whole Sample

Table 4.3 shows the regression results for both Fixed Effect (FE) and Random Effect (RE) models.

Table 4.2 Regression Results for the whole Sample (Fixed and Random Effect)

Dependent Variable: Return onAssets (ROA)		
Independent variables Coefficient estimates and t - ratios		
	Fixed Effect Regression	Random Effect Regression
Long Term Debt to capital	12.65171(1.19) *	8.70068(11.30) ***
Debt to Capital	2.77726(2.75) ***	1.28802(0.37) *
Debt to Common Equity	2.88078(1.02) *	1.05686(0.14) *
Short Term Debt to Total Debt	1.58534(0.18) *	0.6460572 (0.99) *
Constant	116.938(1.55) ***	1158.091 (1.78) ***
R2	0.0475	0.0422
F	539.25 ***	180 ***

Significant at 1% (***), 5% (**) & 10% (*)

Source: Computed using Stata 10.0

Table 4.2 the fixed effect and random effect results. The fixed effect regression posit results with all parameter estimate of Long term debt to capital, Debt to capital, Debt to equity and Short term debt to total debt. Having either positive or negative relationship with Return on Asset (ROA). From the table, variables such as long term debt to capital, and short term debt to total

debt, have positive effect with only long term debt to total debt having positive and significant effect with the dependent variable ROA even at 10% and 1% level respectively. From the results, the coefficient estimates for debt to equity, debt to capital and short term debt to total debt stood at 8.70068, 1.28802 and 0.6460572 respectively. Long term debt to capital is positive and significant but at 1% level. The constant term coefficient estimate is 1158.091 and also significant at 1% level. The R^2 value is 0.0475 which means 48% of the variation in the dependent variable ROA can be explained jointly by the four variables against the value of the value of the F-statistics is 539.25 and also significant at 1% level. This indicates that the model is adequate. On a general note, the independent variables are positive and significant either at 1% or at 10% and the model proof to be adequate, from the result of the F-statistic and the R^2 is also high.

From the same table 4.2, the result of the Random effect is presented, and from the table, the coefficient estimates for all the variables are positive at 10% level with only debt to capital is positive and significance even at 1% level. Again debt to capital, short term debt to total debt, long term debt to capital are significant at 10% level. The coefficient estimates for the independent variables, long term debt to capital, debt to capital, debt to equity and short term debt to equity stood at 12.65171, 2.77726, 2.88078 and 1.58534.The R^2 value is 0.0422 which means 42% of the variation in the dependent variable ROA can be explained jointly by the independent variables. The F-statistic stood at 180 and significant at 1% level, meaning that the model is adequate and can be used for projection.

On a general note, both FE and RE models are adequate and both the variables in the FE model and RE model are positive and significant. However, for us to decide on the model to base our

analysis, we need to carryout Hausman specification Test of 1978 in other to choose the model that our analysis will be based on.

Table 4.3 below presents the results of Hausman (1978) specification test in order to choose which model is appropriate between fixed effect and Random effect.

Table 4.3: Result of the Hausman Specification Test

Variables	Coefficients		
	Fixed Effect(b)	Random effect(B)	Difference (b-B)
Long Term Debt to capital	12.65171	8.70068	3.951025
Debt to capital	2.7726	1.288302	1.48894
Debt to Equity	2.880978	1.05606	0.48894
Short Term Debt to Total Debt	1.58535	0.6460572	0.9392765
Chi2 (4) = 26.24			
Prob>Chi2 = 0.0010			

Source: Computed using stata 10.0

Table 4.3 above presents the results of the Hausman test for fixed effect and random effect models. Following the diagnostic test, the Hausman specification selected the fixed effect model as more appropriate than the Random effect model. This is because the p-value indicates the significance of the test at 1% level leading to the rejection of the null hypothesis and the acceptance of the alternative hypothesis that fixed effect model is more appropriate than Random effect model.

Table 4.4: Results of Generalized Method of Moment (GMM)

Variables	Coefficients		
	Coefficients (b)	T – ratios (B)	Differences (b – B)
ROA _ L1	0.3772039	(2.29) ***	
Long Term Debt to Capital	0.274075	(0.56) ***	3.951025
Debt to Capital	1.37785	(0.38) ***	1.48894
Debt to Total Equity	2.793316	(0.27) ***	0.48894
Short Term Debt to Total Debt	2.533798	(0.26) ***	0.9392765
Cons	811.1546	(1.11) ***	
Chi2 (5) = 6.24			
Prob>Chi2 = 0.03245			
	Significant at 1% (***), 5% (**) & 10% (*)		

Source: Computed using Stata 10.0

Table 4.4, presents the results of the generalized method of moment (GMM). And from the result, the Lag value of ROA is regressed against the independent variables. From the table, all the independent variables (long term debt to capital, debt to capital, debt to equity and short term debt to total debt) are positive and significant even at 1% level this shows that the variation in the dependent variable ROA can be explain jointly by the independent variables. The chi^2 results stood at 6.24 and significant at 5% level. `

4.5 Diagnostic Test

To ensure the robustness of the estimates, several diagnostic tests on the chosen estimations are performed. Since the panel multiple regression assumes that the dependent is a linear combination of the explanatory variables; that no unimportant variable was included in the model and that all relevant variables were incorporated in the model, it happens that if the model is incorrectly or improperly specified , then no additional predictor should be statistically significant except by chance. In this study, the selected multiple regression passes the standard diagnostic test of serial correlation, normality test, heteroscedasticity test, joint test, specification error test and omitted variable test as presented in the table below;

Table 4.5

LM Test Statistics……

Serial Correlation CHSQ (2) =0.8888 (0.8961)

Normality CHSQ (2) = 1.620 (0.16807)

Heteroscedasticity CHISQ (1) = 0.15 (0.6939)

Joint Test F(3, 13) = 134.72 (0.0000)

Test for Specification Error (hat square) t =2.15 (0.049))

Source: Researchers computation using EVIEWS 9 software

4.5.1 Interpretation of Results of Selected Panel Multiple Regression Diagnostic Test

(a) **Serial correlation Test**

A further diagnostic test for serial correlation in panel data has been reported at the table using the test developed by Wooldridge (2002). For serial correlation, the probability value 0.8961 = 89.61% is greater than 0.05 = 5%, meaning that we can't accept null hypothesis rather we reject null hypothesis that the model has serial correlation.

(b**) Normality Test**

Normality test, test the hypothesis that the distribution is normal, in this case the null hypothesis (Ho) is that the distribution is normal. The chi-square (x2) of the panel level variance component is reported at the table with probability. The overall significance of the model was tested. We conclude that the data is normally distributed with the caveat that they are not at 90%.

(c) Heteroscedasticity Test

Due to the nature of the data i.e. panel data, there is no tendency for the error term to be correlated with the explanatory variables giving birth to homoscedasticity in the model. A non – graphical way to detect heteroscedasticity in the fixed effect model is also reported. This study also utilizes the White (1980) heteroscedasticity consistent standard errors to calculate statistics. The null hypothesis in that residuals are not homoscedastic (constant variance), we reject the Ho sine P <0.05 (5%) and conclude that there is heteroscedasticity in the error term. We therefore reject the null hypothesis and concludes that all the variables have significant effect on firm's financial performance**.**

(d) Joint Test

To test whether the coefficient are jointly different from zero, we conducted a joint test also known as F – Test to test the null hypothesis that both coefficients do not have any effect on firms value, the probability value (P- value =0.0000), we therefore reject the null hypothesis and conclude that all the variables have significant effect on firms value.

(e) Misspecification Test

The Breusch Pagan Lagrange Multiplier test (1980) for random effect is reported in the table of results. The Breusch Pagan Lagrange Muliplier test is used to examine the suitability of the random effect model over the Pooled Ordinary Least Square (OLS) estimation. The Housman test of 1978 is used to test for differences in coefficients between the random effect model and the fixed effect model. This test is also used to asses' problems of misspecification in the models, and answer the question of whether fixed model or random model should be used. This study used the link test to find out if there is any specification error in the model. The null hypothesis is that there is no specification error, if the P - value of hatsq is not significant then we fail to reject the null (we accept the null Ho) and conclude that our model is correctly specified.

4.6 Test of Hypotheses

An empirical study of the effect of capital structure on firm's financial performance was carried out using a panel data analysis. And data were drawn from some non-financial service firms in Nigeria that are listed on the Nigerian stock exchange. Some of the components of capital structure examined include long term debt to capital, debt to capital, debt to common equity and short term debt to total debt. All the variables have positive relationship with the dependent variable ROA in both the fixed and random effect models. However the Hausman specification

test chose the fixed effect model as the most appropriate model. Again the results of the GMM also show the same positive relationship between the dependent and independent variables.

Four hypothesis were formulated for this study based on the independent variables used. All the hypothesis were formulated in the null form. Therefore, the information bellow presents the test of the hypothesis and the discussions of major findings. Random effect and fixed effect regression analysis were used to test all the hypothesis raised in chapter one of this work. The result shows that the four predicting variables have an R2 value of 0.8232 and 0.8702 for random effect and fixed effect respectively and F statistics value of 539.25 and 180 for random effect and fixed effect respectively.

4.6.1 Null Hypothesis 1: This hypothesis states that long term debt to capital has no significant effect on the financial performance of service firms. It is therefore rejected because long term debt to capital affect financial performance of service firms significantly and positively. The t value of 11.30 for fixed effect regression shows that there is a positive and significant relationship between long term debt to capital and financial performance even at 1% level of significance. This finding support the agency cost theory which says that higher leverage result in the reduction of agency cost, improves efficiency and thereby making the firm more profitable. This finding is in line with the findings of javed andAkhtar (2012) who stated that there is a positive relationship between long term debt to capital and financial performance of firms. However, it differs from the findings of Zeitun and Tian (2007), who found that a negative relationship exist between long term debt and financial performance of firms.

4.6.2 Null Hypothesis 2: Which says debt to capital has no significant effect on financial performance of service firms. This hypothesis is rejected because it has made a significant contribution in explaining the dependent variable. The t values of 0.37 for fixed effect regression

shows a positive and significant effect between debt to capital and financial performance even at 1% level of significance. Therefore, the null hypothesis is rejected. This finding contradicts the findings of Gleason et al. (2012) which says that there is a negative relationship between capital structure and financial performance. Similarly, the finding confirmed the study of Saeedi and Mahmoodi (2011) who found a positive relationship between capital structure and financial performance. This finding also concur with agency cost perspective which says higher leverage results in the reduction of agency cost, improves efficiency and higher profitability of the firm.

4.6.3 Null Hypothesis 3: Which says debt to common equity has no significant effect on financial performance of service firms. This hypothesis is also rejected because there is a positive relationship between debt to common equity and financial performance even at 10% level of significance. The t value of 0.14 for fixed effect regression shows that the relationship between the dependent and independent variables is positive but not significant. This finding contradicts the findings of Onaolapo and Kajola (2010) which says there is asignificant negative relationship between capital structure and financial performance. More so, the finding conform to the findings of Dare and Shola (2010) whose study found a positive relationship between capital structure and financial performance of firms. It also confirm the position of agency cost theory which states that higher leverage results in the reduction of agency cost, improves efficiency and thereby making the firm more profitable.

4.6.6 Null Hypothesis 4: Which says short term debt to total debt has negative effect on financial performance of service firms. This hypothesis is also rejected because short term debt to total debt has made a positive but not significant contribution in explaining the dependent variable. Short term debt to total debt is significant even at 10% level showing a weak form of relationship. The t value of 0.99 for fixed effect regression shows a positive relationship even at

10% level of significance. We therefore reject the null hypothesis. This finding contradicts the findings of Oke and Afolabi (2011) which says there is a negative relationship between capital structure and financial performance of firms. Similarly, it concur with the work of Onimisi (2011) who found a positive relationship between capital structure and financial performance of firms. The finding in this work also concur with the perspective of agency cost theory which is the theory this work is underpinned to.

4.7 Discussion of Findings

As stated in the preceding chapters, this study investigates the effect of capital structure on financial performance of some selected non – financial service firms in Nigeria. The study employed the use of Housman specification test to select either Fixed or Random Effect models. From the Housman test, the fixed effect model was selected for the whole sample results. The findings of this work are;

1. Long Term Debt to Capital

Our findings shows that debt to capital affect the financial performance of service firm positively. The positive t – value of 11.30 for fixed effect regression shows that there is a positive and significant relationship between long term debt to capital and financial performance even at 10% level of significance. This finding is in line with the findings of Javed and Akhtar (2012) who stated that there is a positive relationship between long term debt and financial performance of firms. However, it differs from the findings of Zeitun and Tian (2007), who found that a negative relationship exist between long term debt and financial performance.

2. Debt to Capital

Debt to capital has made a significant contribution in explaining the dependent variable. The t – value of 2.75 shows a positive and significant effect between debt to capital and financial performance of service firms even at 1% level of significance. This finding contradicts the findings of Gleason et al. (2012) which says there is a negative effect between debt to capital and financial performance. Similarly, the finding conform to the findings of Saeedi and Mahmoodi (2011) who found a positive effect between debts to capital and financial performance. It also conforms to Agency cost perspective which says higher leverage result in the reduction of agency cost, improves efficiency and higher profitability of the firm.

3. Debt to Common Equity

The findings of this work shows that there is a positive relationship between debt to common equity and financial performance. It has made a positive contribution in explaining the dependent variable. The t – value of 1.02 for fixed effect regression shows that the relationship between the dependent and independent variable is positive but not significant. This finding contradicts the findings of Onaolapo and Kajola (2010) which says there is a significant negative relationship between debt to common equity and financial performance. More so, the finding conforms to the work of Dare and Shola (2010) whose study found a positive relationship between common equity and financial performance. It also conforms to the position of agency cost theory.

4. Short Term Debt to Total Debt

Short term debt to total debt has made a positive but not significant contribution in explaining the dependent variable, it is significant even at 10% level, showing a weak, positive relationship. This contradicts the findings of Oke and Afolabi (2011) which says there is a negative relationship between capital structure and financial performance. Similarly, it concur to the work of Onimisi (2011) who found a positive relationship between capital structure and financial performance. It also concurs with the position of the agency cost theory which states that higher leverage reduce agency cost, improves efficiency and increase profitability.

All the four hypotheses of this study were rejected because the result of the study showsweak positive relationship betweenlong term debt to capital, short term debt to capital and debt to common equity even at 1% level of significance, and strong, positive relationship between debt to capital and financial performance even at 1% level of significance. The dependent and the independent variables except for Debt to common equity that has a positive relationship but with a weak form of significance. This is not surprising because majority of businesses in Nigeria rely on borrowing as a source of financing. Going by the findings of this study, service firms should be given more access to credit facilities and are advised to go for higher leverage in order to enhance their performance and mitigate against agency conflict but even at that, Government need to regulate the financial sector through monetary and fiscal policies in order to reduce the cost of borrowing since high interest rate posed a major challenge to borrowing in Nigeria.

A general look at this result seems to conform to agency cost theory which says higher leverage result in the reduction of agency cost, improves efficiency and profitability. This finding is in line with the study of Javed and Akhtar (2012), Dare and Shola (2010), Saeedi and

Mahmoodi(2011), Hadlock and James (2012) and Ghosh et al. (2000), Coles et al. (2005) and Gil, Mand, Sharma, and Mathur (2012) who stated that there is a positive and significant relationship between debt to capital and financial performance of non-service firms. However, it differs from the findings of Zeitun and Tian (2017), Onaolapo and Kajola (2010), Gleason et al. (2012) who found that there is a negative relationship between debt to capital and financial performance.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1Summary of Findings.

The purpose of this study is to examine the effect of capital structure on the financial performance of some selected non-financial service firms in Nigeria. This chapter will summarize the main research findings with the aim of given recommendations to firms and government. Therefore, the main research findings which are connected to the research questions and hypothesis are as follows.

The study revealed four important findings. First, the result of the findings shows that there is a positive but weak form of significant relationship between long term debt (LDC) and financial performance of non – financial service firms in Nigeria. What this means is that any increase in long term debt will result to increase in the financial performance of service firms. Secondly, it was found that there is a strong, positive and significant relationship between debt to capital and financial performance of non-financial service firms. It means firms should go for higher leverage at a given percentage of interest rate in order to mitigate the conflict of interest that exist between Managers (agents) and investors (owners).

Thirdly, it was found that there is a positive but weak form of significant relationship between debt to common equity and financial performance of service firms. What this means is that firms that needs funds for operations and expansion could do so either through equity or debt financing, but it is advisable for firms to give priority to debt financing than equity financing. This is because equity financing has a weak significant level of relationship even at 10%. Lastly, it was found that there is a positive but weak significant relationship between short term debt to total debt and financial performance of service firms. What this means is that increase in short

term debt will result to an increase in the financial performance of service firms. The results provided positive but weak empirical support for the three hypotheses and a strong and positive empirical support for one.

5.2 Conclusions

Based on the findings of this study, the following conclusions were drawn; it was found that there is a positive but not significant relationship between long term debt to capital, debt to common equity and short term debt to total debt and financial performance of non-financial service firms in Nigeria even at 10% level. This means that an increase in any of the above variables will result to an increase in the financial performance of non-financial service firms. Therefore, government should regulate the financial sector through monetary and fiscal policies in order to reduce the cost of borrowing i.e. interest rate in Nigeria, given that the performance of non-financial service firms will be enhanced if given access to borrowing at a low cost (low interest rate). This is very important not only in terms of enhancing the performance of the firms, but also on employment and economic growth. Thus, the outcome provide evidence in support of agency cost theory which postulates that financial leverage mitigate against agency problems; that higher leverage result in the reduction of agency cost, improves efficiency and making the firm more profitable. Therefore, firms experiencing agency conflicts and needs to raise funds for operations and expansion should make debt financing a priority.

It was also discovered that there is a strong, positive and significant relationship between debt to capital and financial performance of non-financial service firms even at 1% level. In other words, a strong form of significance between debt to capital and financial performance of service firms. This means that appropriate mix of debt and equity should be considered when financing non-financial service firms, but debt must be given more priority over equity. Finally, management

needs to make prudent financial decisions and also try to improve on the firms leverage ratio as it will go a long way in determining their survival since debt has become so important in solving agency conflicts.

5.3 Recommendations

In line with the findings, the following recommendations are hereby made:

I. The study recommend that non – financial service firms should raise more debt to finance their operation as this will reduce conflict of agency, increase profit and make the organization have focus to achieve its goals and objectives.

II. Appropriate mix of capital structure should be adopted by management of non-financial service firms in order to increase their performance. It means that managers of non-financial service firms should concentrate more on long term debt in order to finance their assets. This is because this study provide evidence in support of agency cost theory that the use of debt enhances performance, reduces agency cost and improves profitability.

III. Firms experiencing conflicts and needs to raise funds for operations and expansions, higher debt ratio should be given priority. Appropriate mix of equity and debt must be ensured with debt given priority over equity. This is evidence from the result of our findings, when debt financing is positively and significantly related to firm performance, equity financing is positively but not significantly related to financial performance of service firms.

IV. Management needs to make prudent financial decisions and also try to improve on the firms leverage ratio as this will go a long way in determining their survival since debt has become so important in solving agency conflict. It should come to the knowledge of policy makers and

economic agents' i.e. individual investors and firms that the financial performance of non-financial service firms in Nigeria depends largely on proper management and composition of their capital structure.

5.4 Suggestions for Further Research

Future researchers could carry out similar studies in small and medium enterprises in Nigeria. Also, the effect of capital structure and non – financial measures of performance. They can also venture into researching how interest rates affect debt financing of non-financial service firms. Since the study of capital structure is sectorial in nature, research needs to be taken to sectors that have not been torched by this kind of research.

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