

MODERATING EFFECT OF MANAGERIAL OWNERSHIP ON CAPITAL STRUCTURE AND FINANCIAL PERFORMANCE OF LISTED CONGLOMERATE FIRMS IN NIGERIA

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Abstract

Most of the previous studies on capital structure and financial performance of firms examined the direct relationship between long term and short-term debts without examining their indirect relationship with financial performance of firms. This paper examined the moderating effect of managerial ownership on capital structure and financial performance of listed conglomerate firms in Nigeria for the period 2004 to 2018, the period of the study coincided with financial crisis periods, which eroded the financial performance of conglomerate firms in Nigeria. Secondary data was obtained from a population of six firms through their annual reports and accounts. Capital structure as an independent variable was proxied by long-term debt and short-term debt, managerial ownership is a moderating variable while return on assets was used to represent financial performance as the dependent variable of the study. The study adopted generalised least square fixed effect multiple regression technique in analysing the data. The findings revealed that short-term debt have negative significant impact on financial performance, while long-term debt and moderating variables of the study shows insignificant impact on financial performance. It is recommended that the firms should reduce the percentage of debt in their capital structure and focused more attention on equity financing or debt with a cheaper cost attached to it, since the result provides evidence that short-term debt have negative significant effect on financial performance of the firms.

Keywords: Long-term debt, Short-term debt, Managerial ownership, Financial performance

Introduction

Financial performance provides a deductive measure of how well a company can use assets from business operations to generate revenue. Mirza and Javed (2013) viewed firms' performance as the ability of a company to achieve

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its objectives using its available resources. Firm's financial performance is the measurement of the results of a company's strategies, policies and operations in monetary terms. Capital structure is the combination of debt and equity financing of a firm, debt financing can be in form of long term and short-term debt financing. Long-term debt is the most common types of debt provided by financial institutions to the business entities, which can be used for business expansion, acquisitions of assets, refinancing and working capital in the long-run period. Short-term debt is one of the types of debt that financial institutions provided to the business entities in order to improve the company's financial performance for growth and development, and short-term debt has maturity period of not more than a year. Managerial ownership is the proportion of firms' shares owned by the company's management

The existing empirical studies on capital structure and financial performance of companies in developed nations and emerging economies abounds. For example, the work of Ojo (2012), Abbas, Bashir, Manzoor and Akram (2013), Birundu (2014); and Mule and Mukras (2015) among others provide mix results, this creates a gap for further research by introducing a third variable known as moderating variable in order to examine the indirect relationship between capital structure and financial performance of listed conglomerate firms in Nigeria. Nowadays, conglomerate firms in Nigeria are finding it difficult to raise capital through equity financing in the capital market, this necessitate them to increase the level of leverage in their capital structure for them to survive in the business. Most of the previous studies on capital structure and financial performance of firms in Nigeria seemed to have focused more attention on financial sector and some subsectors of the manufacturing sector in exclusion of conglomerate subsector despite its strategic importance to the Nigerian economy. The significant contribution of conglomerate to the Nigerian economy has made conglomerate firms an important sector to be study in the country. Therefore, this study seeks to examine the relationship between moderating effect of managerial ownership on capital structure and financial performance of listed conglomerate firms in Nigeria.

Literature Review

Empirical Studies

Empirical literatures were reviewed from the previous studies on the relationship between leverage and financial performance of firms such as the work of Getahun (2016) who studied the effect of capital structure on financial performance of insurance companies in Ethiopia using the sample size of 9 insurance companies out of the population of 17 firms for the period of 2004 to 2013 and found negative significant relationship between leverage and financial performance of the companies. Another study was conducted by Mule and Mukras (2015) on the relationship between financial leverage and financial performance of listed firms in Kenya for the period of 2007 to 2011 using the sample size of 47 firms. The finding of the study reveals an evidence of positive

significant association between leverage and financial performance of the firms. Nassar (2016) examine the impact of capital structure on financial performance of listed companies in Turkey using the population of 136 companies listed on Istanbul Stock Exchange for the period of 2005-2012. A multivariate regression analysis is applied to test the relationship between capital structure and firm performance, the results shows a negative significant relationship between capital structure and firm performance.

Similarly, Abbas, Bashir, Manzoor and Akram (2013) examined the impact of determinants of financial performance of listed firms in Pakistan for the period of 2005 to 2010 using sample size of 139 firms out of the population of 164 firms and the result shows evidence of negative insignificant correlation between leverage and financial performance of the selected firms. Birundu (2014) explored the effect of capital structure on financial performance of small and medium enterprises in Kenya using the sample size of 40 firms for the period of 2009 to 2013 and found negative insignificant relationship between leverage and financial performance of the firms. Bhattarai (2016) examined the impact of capital structure on financial performance of manufacturing firms in Nepalese using the sample size of 8 companies for the period of 2004 to 2014. The result of the analysis reveals an evidence of negative significant relationship between leverage and financial performance of the companies.

In addition, Birru (2016) studied the effect of capital structure on financial performance of commercial banks in Ethiopia for the period of 2011 to 2015 using the sample size of 9 banks which was arrived at using purposive sampling technique and the result reveals evidence of negative significant association between leverage and financial performance of the banks. Adamassu (2016) investigated the influence of capital structure on financial performance of manufacturing companies in Ethiopia using the sample size of 15 firms for the period of 2006 to 2012. The finding of the study shows a positive insignificant association between leverage and financial performance of the firms. Pouraghajan, Malekian, Milad, Vida and Bagheri (2012) explored the effect of capital structure on financial performance of listed companies in Tehran Stock Exchange for the period of 2006 to 2010 using the sample size of 400 firms and found evidence of positive significant correlation between leverage and financial performance of the firms.

More so, Mwangi and Birundu (2015) studied the effect of capital structure on financial performance of 40 small and medium scale enterprises in Kenya for the period of 2009 to 2013. The result from the analysis reveals a positive insignificant association between leverage and financial performance of the firms. Bongoye, Banafa and Kingi (2016) examined the effect of firm specific factors on financial performance of non-financial companies listed in Nairobi Securities Exchange for the period of 2011 to 2015. The result exhibited an evidence of negative insignificant correlation between leverage and financial performance of the firms.

Sudiyatno, Elen and Kartika (2012), investigated company policy, firm performance and firm value using a sample size of listed manufacturing firm in the Indonesian Stock Exchange for the period of 2008 to 2010, and found a negative significant effect of leverage on firm's financial performance. Their findings is in line with the findings of Salehi (2009) who conducted a research on leverage and financial performance of some selected Iranian companies and found that leverage has a negative significant impact on firm performance. Earlier, Rayan (2008) documented that financial leverage has a negative significant effects on firm's financial performance. Firms with low financial leverage tend to perform better than the firm with high financial leverage (Tan, 2009). Damouri, Khanagha and Kaffash (2013) studied the relationship between changes in the financial leverages and the values of the listed firms in the Tehran Stock Exchange, using a sample of 98 firms for the period of 2001 to 2010. Their results showed that there is no significant relationship between changes in the financial leverages and the financial performance of the selected firms.

Similarly, Fosu (2013) on the relationship between capital structure and firm performance using panel data consisting of 257 South African companies for the period of 1998 to 2009 and found that financial leverage has a positive and significant effect on a firm's performance. Low level of leverage can lead to an increased in profit, efficiency as well as firm performance, while high level of leverage can lead to a decrease in profit efficiency as well as a decrease in firm performance (Skopljak & Luo, 2012). Similarly, Hsu (2013) reported that leverage has a negative effect on the performance of 336 Information Technology companies in Taiwan. Onimisi (2010) examined the effect of capital structure on the performance of listed manufacturing firms in Nigeria, and found a positive relationship between leverages and financial performance of Nigerian listed manufacturing firms. Likewise, Pachori and Totala (2012) examined the influence of financial leverages on shareholders returns and market capitalisation in India, and found that, there is no significant influence of financial leverage on shareholders' returns and market capitalisation.

Another study was carried out by Rehman (2013) investigated the relationship between financial leverage and financial performance of listed sugar companies in Pakistan, and found a positive significant relationship between leverage and firms financial performance. Akhtar, Javed, Maryam and Sadia (2012) too reported a positive significant relationship between leverage and the financial performance of listed fuel and energy companies in Pakistan. Ojo (2012) studied the effect of financial leverage on corporate performance of some selected companies in Nigeria and reported a significant effect between leverage and financial performance. However, Magpayo (2011) conducted a study on the relationship between leverage and financial performance, using a sample of 1000 companies in Philippine for the period of one year (2009), and found a negative significant impact between leverage and the financial performance of the sampled firms.

Theoretical Framework

Pecking order theory

Pecking order theory was developed by Myers (1984), according to this theory firm prefer internal funding over external funding. In case firms required external funding, they would prefer debt to equity and equity is considered as last resort. So the firm don not have predetermined or optimum debt to equity ratio due to information asymmetry. The firms adopt conservative approach when it comes to dividends and use of debt financing to maximise the value of firm. One of the aspects of pecking order theory implies that when it comes to profitable firms, they would always prefer internal financing rather than taking up new debts or equity. Even though, debt is considered cheaper than equity within certain proportions.

Myers (1984) suggests that it is because the value of firm and wealth of shareholders associated with firm is distributed by asymmetry of information. This argument is supported by Famma and Fench (2000) who found that profitable firms were less levered as compared to non-profitable firms. Murray and Goyal (2003) held that large firms tend to accumulate debts in order to support and keep up with the payments of dividends while small firms tend to behave in opposite behaviour. Firms with higher potentials for growth prefer using less long term debt as well as debt with fewer restrictive arrangements in order to become more financial flexible. Firms with sufficient fixed assets can generate external finance more easily and at lower cost by using their assets as collateral, which support the trade-off theory. Therefore, pecking order theory is adopted to underpin this study.

Methodology

Correlation research design was adopted because the study measured the relationship between moderating effect of managerial ownership on capital structure and financial performance of listed conglomerate firms in Nigeria for the period of 2004 to 2018. The population of the study consists of all the 6 listed conglomerate firms on Nigerian Stock Exchange. In view of the availability of data for all the 6 firms, the study adopted census sampling approach by studying all the 6 firms as a sample size. The study used secondary data, which was obtained from the annual reports and accounts of the 6 listed conglomerate firms in Nigeria for the period of the study. Generalised least square multiple regression was adopted for the panel data analysis in order to establish the relationship among the variables of the study. Multiple regression was considered appropriate in view of the fact that it helps in not only establishing relationship between dependent and independent variables, but also cause and effect of their relationship.

Table 1: Variables Definition and Measurement

| Variables Acronym | Variables Name | Variables Measurement and Source |
|-------------------|--|---|
| ROA | DV Return on Assets | Measured as the profit before interest and tax divided by the firm's total assets (Mwangi & Birundu, 2015). |
| LD | IV Long Term Debt | Measured as the ratio of long term debt to firm's total assets (Fosu, 2013). |
| SD | Short Term Debt | Measured as the short term debt divided by the firm's total assets (Rehman, 2013). |
| MS | Moderator Managerial Ownership | Measured as the proportion of company's shares owned by the firm's management (Saidu & Gidado, 2018). |

Sources: Compiled by the Author, 2020

Model Specification

The models used to empirically test the hypothesis formulated is as follows:
 $ROA_{it} = \beta_{0it} + \beta_1 LD_{it} + \beta_2 SD_{it} + \varepsilon_{it}$ (1)

$ROA_{it} = \beta_{0it} + \beta_1 LD_{it} + \beta_2 SD_{it} + \beta_3 MS_{it} + \beta_4 LD * MS_{it} + \beta_5 SD * MS_{it} + \varepsilon_{it}$ (2)

Regression Results and Discussion of Findings

Some robustness tests like multicollinearity and hetroskedasticity tests were conducted in order to see their existence or otherwise. The multicollinearity test revealed a variance inflation factor and tolerance values of less than 10 and 1 respectively, meaning that the data used in the study does not have any multicollinearity problems. The hetroskedasticity test revealed a Chi² value of 35.55 with a p-value of 0.000, which is significant at 1% level of significance. This means there is hetroskedasticity problem associated with the data of the study. As a result of the existence of hetroskedasticity problem associated with the data of the study, the study conducted fixed and random effect models tests and then hausman test was used to decide which model to be adopted for the study between fixed and random effect models. The result of hausman test reveals a Chi² value of 10.07 with p-value of 0.073, which is significant at 10% level of significance, this means fixed effect model should be selected. Therefore, the study adopted fixed effect regression for model 2, which has R² of 0.177 and Wald Chi² value of 9.40, which is greater than the R² of 0.162, and Wald Chi² value of 8.09 robust OLS regression for model 1 of the study.

The summary of the regression results obtained from the analysis of data is presented in Table 2. It reveals that long-term debt is positive and insignificantly correlated with financial performance of listed conglomerate firms in Nigeria. The beta coefficient of the variable is 0.080 with p-value of 0.486, which is statistically insignificant at any level of significance. This means long term debt is increasing the financial performance of listed conglomerate firms in Nigeria, but not at a significant level of the study for both model one and two.

Table 2: Regression Results

| VARIABLES | MODEL(1) OLS | MODEL(2) FE |
|---------------------|-------------------------|------------------------|
| LD | 0.063 (0.173) | 0.080 (0.486) |
| SD | -0.241*** (0.002) | -0.188** (0.034) |
| MS | | -0.247 (0.811) |
| LD*MS | | 1.557 (0.319) |
| SD*MS | | -1.023 (0.639) |
| Constant | 0.112*** (0.005) | 0.085 (0.197) |
| Observations | 90 | 90 |
| F-statistics | 8.09 | 9.40 |
| R-squared | 0.162 | 0.177 |
| Number of id | 6 | 6 |

Denotes Significant at 1%, 5% & 10%

*** p<0.01, ** p<0.05, * p<0.1

The finding is in consistent with the study of Abbas *et al* (2013) but contradicted the findings of Hsu (2013). The table 1 shows that short-term debt has significant negative impact on financial performance of conglomerate firms in Nigeria. This can be observed from the computed value of beta coefficient of -0.188 with p-value of 0.034, which is statistically significant at 5% level of significance. This implies that short-term debt is reducing the financial performance of the firms. This finding is in line with that of Akhtar *et al* (2012) but inconsistent with Birru (2016).

In addition, managerial shareholding as a moderating variable of the study is negative and insignificantly influencing the financial performance of listed conglomerate firms in Nigeria. This is shown based on the computed value of beta coefficient of -0.247 with the corresponding p-value of 0.811. Furthermore, the interaction of long-term debt and managerial shareholding is positively and insignificantly affecting financial performance of listed conglomerate firms in Nigeria, this can be proved by the beta coefficient of 1.55 with p-value of 0.319. Finally, the result provides evidence of an insignificant negative association between the interaction of short-term debt and managerial shareholding as moderating variable and financial performance of listed conglomerate firms in Nigeria. The result shows a beta coefficient of -1.023 with p-value of 0.639, which is insignificant at any level of significance.

The Wald Chi² value of 9.40 with p-value of 0.007, which is significant at 1%, level of significant shows that the model is well fitted with the variables of the study. Moreover, the coefficient of determination of R², which stands at 18%, indicates the proportion of the total variations in dependent variable that is explained by the independent variables. This signifies that 18% of the total variation in financial performance of listed conglomerate firms in Nigeria is

caused by the combined effect of long-term debt, short-term debt and managerial shareholding as moderating variable; while the remaining 82% is caused by other factors outside the model of this study.

Conclusion and Recommendations

The study investigates the moderating effect of managerial ownership on capital structure and financial performance of listed conglomerate companies in Nigeria. It was concluded that long term debt is positively influencing financial performance of conglomerate firms in Nigeria, short term debt are negatively influencing the financial performance of listed conglomerate firms in Nigeria, while moderating variable of the study is found to have insignificant influence on financial performance of listed conglomerate firms in Nigeria. It is recommended that the listed conglomerate firms in Nigeria should reduce the level of debt components of their capital structure and focused more attention on equity financing, since it was found that short term debt have negative relationship with the firms' financial performance and also to look for a debt with cheaper cost of capital attached to it.

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