



Capital Structure and Financial Performance of Quoted Consumer Goods Manufacturing Companies in Nigeria

¹Sani Abdulrahman Bala
(sonyaxle@gmail.com)

¹Jami'u Olanrewaju Oladele
(oladelejamiuolanrewaju@gmail.com)

¹Nurudeen Mohammed Moshud
(moshud2010@gmail.com)

¹Department of Accounting, Usmanu Danfodiyo University Sokoto, Nigeria

Abstract

This paper examined the impact of Capital structure on financial performance of quoted Consumer goods manufacturing companies in Nigeria. The data was secondary in nature data were retrieved from the annual reports of quoted consumer goods manufacturing companies whose financial statements were available for the period 2018 to 2020 on the Nigerian Stock Exchange. The population of the study is made of (20) quoted consumer goods manufacturing companies in Nigeria, out of which seventeen (17) companies were selected as the sample size for the study. The results amongst others statistically revealed that no significant relationship exist between capital structure (CS) and Net Profit Margin as shown from the P-value of 0.347 also, there is no relationship between capital structure and Gross Profit Margin with P-value of 0.196. In view of these findings, the study recommended among many others that every firm should take advantage of equity benefits by not focusing only on debt financing because of the relationship revealed by the outcome of this study

Keywords: Capital, Performance, Profit, Margin, Asset

1. Introduction

Capital structure is a sensitive aspect of company in finance company's overall assets by selecting the appropriate mixture of debt. The Global business environment has intensively become dynamic and is increasingly unpredictable in recent years. The theory of capital structure has remained an area of interest for researchers of corporate finance for a long period. In recent years the influence of financial crisis on stock markets around the globe has raised renewed concerns on excessive leverage of firms and its impact on their financial performance. Theoretically most models discussing capital structure of firms identify tax savings, bankruptcy costs, transaction costs, adverse selection and agency cost etc. as the dominant factors influencing a firm's choice of debt and equity also its impact on firm performance. Similarly, different firms may pursue different goals but the core objective of any firm is to minimize its cost. Therefore, the financial manager needs to analyse and decide on the capital structure that is suitable in financing a business enterprise.

Consequently, the financial management of companies has become more demanding to meet this demand; companies are applying different means to structure their capital in ensuring the survival of their business (Fwamba 2017). The relationship between capital structure and financial performance of companies has been the subject of many



researchers for many years and has led to many theories and models. The objectives of this study include: to determine the relationship between capital structure and Gross profit margin, Net profit Margin, Return on Asset and Return on Equity of listed consumer goods manufacturing companies in Nigeria. The research hypotheses include (i) there is no significance relationship between capital structure and Gross profit margin, (ii) there is no significance relationship between capital structure and Net profit Margin, (iii) there is no significance relationship between capital structure and Return on Assets, and (iv) there is no significance relationship between capital structure and return on Equity.

2. Literature Review

Concept of Capital Structure

According to Oladele, Omotosho, & Adeniyi, (2017), debt and equity are identified as the two core components of financing while identifying the debt owners and equity owners as the two investors in the firm. How a firm determine the amount of debt and equity for their business remains an issue of great concern. Wrongly selection between the debt and equity may pose a great threat to the survival of a firm.

Aliu (2015) defined capital structure as the mix of financial liabilities and equities. It is a process by which industries finance their assets through a combination of assets and liabilities. This definition is in line with the views of Shehu, (2011); Ishaya and Abduljeleel, (2014) who see capital structure as the combination of different kinds of securities (debt and equity) which are obtained by firms and industries to finance their operations. Capital structure is a technique employed in financing through long term capital like shares, debentures, loans, among others, and short term engagement from creditors and overdrafts (Nirajini & Priya, 2013).

Akinyomi and Olagunju, (2013) and Lambe, (2014) described the capital structure as the combination of different securities employed by firms in financing a profitable operation. The distinction in the definitions given by various scholars is the revolving of those definitions around the main sources of finance that include debt capital and equity capital which firms use in financing their operations.

Concept of Financial Performance

Financial performance refers to firm's ability to achieve its financial goals and objectives (Yahaya & Lamidi, 2015). Kajirwa (2015) deduced that a firm's financial performance is depended on firm's assets utilization in carrying out its income generating business activities. Financial performance is more attached to components of firm's financial statements. The financial performance is a crucial measure of economic success of a firm such as how the firm is achieving set financial goals and shareholders wealth maximization objective (Xu & Wanrapee, 2014). Firms shareholders and stakeholders are mainly concerned about financial performance before they can inject capital or finances in to the firm (Nyamita, 2014).

Webster (2012) defined financial performance as what is accomplished. The following major ratios were used in measuring financial performance of enterprises: return on asset (ROA), return on equity (ROE), gross profit margin (GPM), net profit margin (NPM), return on capital employed (ROCE) and return on investment (ROI) in



determining the relationship between capital structure and selected corporate performance proxies. Financial performance of a company is characterized by the company's competitiveness: firm's business potentiality, ability to pay financial obligation, social corporate responsibilities, increased sales and production, high profits, (Dufera, 2015). Increase in prices and sales are not indicators of financial performance, sales are not determinant of improved financial performance of a firm (Kalio & Maghanga, 2012).

Empirical Review

Ofoegbu and Rufus (2017) in a study on the impact of capital structure on the financial performance of construction and real estate quoted companies in Nigeria. They adopted Pooled Ordinary Least Square Regression Analysis to analyse the data collected from the financial report of construction and real estate quoted companies from 2005 to 2014. The result of their study revealed that capital structure has a significant influence on the financial performance of a firm on the basis of Earning per Share, Return on Capital Employed and Return on Equity but no significant influence return on assets. Osaretin et al., (2019) examined capital structure and the profitability-liquidity trade-off on 18 manufacturing firms listed on Nigerian Stock Exchange (NSE) from 2005 to 2017. They adopted a descriptive analysis and PVAR model to establish the relationship between capital structure, liquidity, and profitability. The findings showed the profitability and liquidity trade-off as a function of capital structure. They concluded that the debt ratio has hurt profitability and liquidity when equity share is considered while debt possesses a positive effect on profitability and liquidity when considering the asset of the company. Ajibola et al., (2018) in his study on the impact of capital structure on the financial performance of listed consumer manufacturing firms in Nigeria, sampling 10 manufacturing companies over a period of ten years (2005-2014). They employed the use of secondary data and analysed the data by using panel ordinary least square regression. Their result suggests that a positive and statistically significant relationship exists between long term debt ratio, total debt ratio and return on equity while a positive and statistically insignificant exist between return on equity and short-term debt ratio. They concluded that both short term debt and long-term debt are important in the financial decision of a firm but due to the negative insignificant relationship that exists between the proxies of capital structure and returns on asset, they opined that the return on equity is a better measure of performance. This also supported the work of some past researchers who also concluded that there is a positive relationship between total debt to total equity ratio and financial performance of firms.

Charles et.al (2018) established the effect of short-term debt to total assets ratio on the financial performance of medium-sized and large enterprises in Kenya. The study drew on secondary data consisting of audited financial statements from 60 large enterprises listed at the NSE and 30 medium-sized enterprises which are among the Top-100 medium-sized enterprises totaling to 90 enterprises for a six-year period (2011 to 2016). The main objective of the study was to establish the effect of short-term debt to total assets ratio on financial performance of medium-sized and large enterprises in Kenya. Short-term debt to total assets ratio was used as capital structure proxy while ROE and ROA were used as measures of financial performance. Descriptive statistics



(mean and standard deviation) and inferential statistics (Pearson Correlation, simple regression) were used to analyse data. The hypothesis was tested using calculated value of F and the critical value of F. The study established that SDTAR had a significant negative effect on ROE and ROA. In conclusion the study established that a decrease in financial performance was attributed to an increase in short-term debts total assets ratio. It was recommended that the enterprises reduce the usage of short-term debts in financing operations so as to improve their financial performance.

Sohail *et al.* (2014) studied the impact between capital structure and performance in which core area is financial performance of sugar companies listed in Karachi Stock Exchange Pakistan (KSE Pakistan). Secondary data was utilized from company's financial reports, annual reports and state bank of Pakistan (SBP) Financial review for the period of six years (2006-2011). The results show that there is weak positive correlation between capital structure and financial performance at 0.354. Coefficient of determination is .125. F and T values are 28.060 and -5.297 respectively which shows insignificant level of the sugar companies listed in KSE Pakistan. Osuji & Odita (2012) examined the impact of capital structure on financial performance of Nigerian firms using a sample of thirty non-financial firms listed on the Nigerian Stock Exchange during the seven years period, 2004 – 2010. Panel data for the selected firms were generated and analysed using ordinary least squares (OLS) as a method of estimation. The result shows that a firm's capital structure surrogated by Debt Ratio, Dr has a significantly negative impact on the firm's financial measures (Return on Asset, ROA, and Return on Equity, ROE). The study of these findings, indicate consistency with prior empirical studies and provide evidence in support of Agency cost theory.

Theoretical Framework

The Tradeoff theory: Contrary to Modigliani and Miller's view on bankruptcy, the trade-off theory recognizes bankruptcy cost and stipulates that the capital structure of companies involves a trade-off between tax benefits associated with debt financing and the cost of financial distress (Ofoegbu and Rufus 2017). The theory suggested that firms should strike a balance to maintain debt to equity at its optimal level as additional debt at that point may be riskier to both creditors and shareholders and in turn, may lead to financial distress. Static Trade-off theory alongside with Pecking Order theory were proposed in the same year by Myers and Majluf (1984) respectively.

The Pecking order theory: Myers and Majluf, in 1984 developed the pecking order theory (POT). This theory proposes the hierarchical order of financing that involves internally generated funds, issuing debt, and new equity accordingly (Myers, 1984). The pecking order theory indicates that investors may likely take no interest in new stocks of a firm when new shares are issued for the belief that the company may be overvalued as a result of information asymmetry that exists between the managers and the investors of the firm (Myers & Mailuf 1984). They further their claims that firms will prioritize on financing new investment with internal financing by utilizing retained earnings, then issue debt when retain earnings has been depleted, while equity comes as the last option.

Agency Theory: Berle and Means (1932) brought up the agency theory and based their view on capital structure. The theory stipulates that there is a conflict of interest

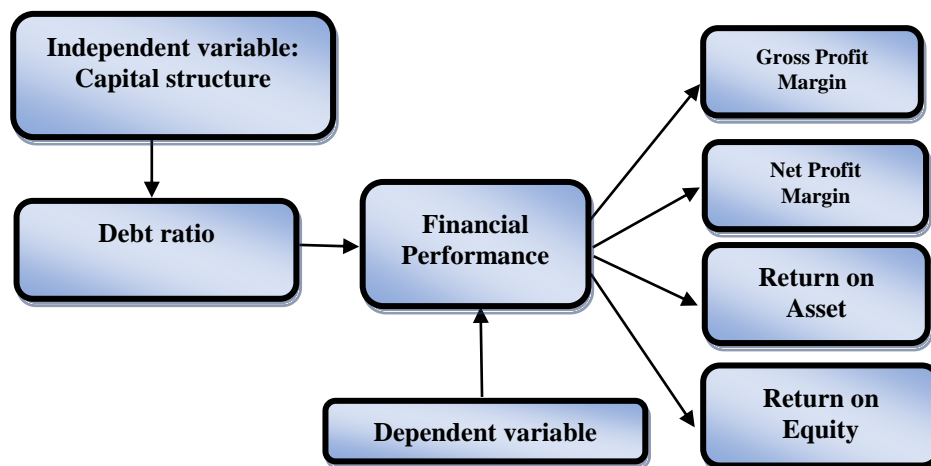


between the shareholders who are regarded as the principals and the managers (agents) of the firms when it comes to making a decision on capital structure. According to Elliot and Elliot (2002), the main responsibility of managers is to bring an increase in the return of shareholders by increasing profit margin and cash flow. However, Jensen and Meckling (1976) identified two kinds of conflicts between the debt holders and the equity holders and the one between the shareholders and the managers. This theory stipulates that an optimal capital structure can be realized by minimizing the costs associating with the conflicts between the groups involved.

3. Methodology

The data are panel in nature and as such the study is cross-sectional; this is because several firms were observed over a period of three years (2018–2020) which therefore justifies the choice of cross-sectional design. Data were gathered from secondary sources. That is the data were retrieved from the annual accounts and reports of sampled firm. The population of the study is made up of consumer goods manufacturing companies quoted on the Nigeria Stock Exchange as at 31st December, 2020 which stood at 20 companies, out of which seventeen (17) companies were selected as the sample size of the study based on the availability of data. Both descriptive and inferential statistics were used to analyse data. In order to realize the aim and objectives of the study, the proxies for dependent variables are NPM, GPM, ROA and ROE, while for independent variable is debt ratio. The study employed STATA statistical software for the purpose of data analysis.

Figure 1: Variable Specification model





Measurement of Financial Performance

The most commonly used accounting method to measure the performance of a firm include Returns on Assets (ROA), Return on Equity (ROE), and Returns on Capital Employed (ROCE) (Vakilifard, 2011). Gross Profit Margin (GPM): Gross margin, also known as "gross profit margin," is a metric that gives you a general overview of how efficiently your business is running. When you calculate gross profit margin at regular intervals and look at your numbers over time, it gives you an indication of how well your processes and systems are working. If your margin percentages remain stable, it's a sign that your business is in good health. If you can see gross profit margin wildly fluctuating or decreasing at every calculation interval then you need to examine why this is happening so you can fix any weak spots in your company operations (Weigand & Baker, 2009). Net Profit Margin (NPM): Net Profit Margin (also known as "Profit Margin" or "Net Profit Margin Ratio) is a financial ratio used to calculate the percentage of profit a company obtains per Naira of revenue gained. The net profit margin is equal to net profit (also known as net income) divided by total revenue, expressed as a percentage. Rate of Return on Equity (ROE): this belongs to the category of profitability ratio and it represents the amount of return created for investors for investing their funds. This financial ratio is calculated as a dividend on profit before tax on equity (Vakilifard, 2011). This ratio provides the profitability power of a company towards its shareholders (Weigand and Baker, 2009). Rate of Return on Assets (ROA): this accounting standard shows the extent to which the management efficiently applies its resources for profit acquisition. It is one of the profitability ratios used to investigate the source of profit and its acquisition source in connection with the financial analysis (Weigand & Baker, 2009). This rate is realized by dividing the net profit of a firm by its total assets. Rate of Return on Capital Employed (ROCE): this is a profitability ratio used in measuring how firms efficiently use their capital to realize profits (Weigand & Baker, 2009).

Model Specification

In order to determine the degree of the relationship between the independent variable (Capital structure) and dependent variable (Gross Profit Margin, Net Profit Margin, Return on Asset and Return on Equity), the study explored the model designed by Gupta & Gupta (2014).

Y_{it} = α_i + β₁X_{it} + U_{it}..... 1

Where X in the model represents the independent variable (Capital Structure) "i" in the model stands for a firm, t represents time while α_i represents the individual effect that can be decomposed to fixed individual effect. Y represents the vector of explanatory variables: gross profit margin, net profit margin, return on asset, and return on equity. β₁ stands for parameter while U represents unobserved components that may affect the performance of the firm. Thus, the regression model used to test the hypothesis is given as follow:

GPM = α_i + β₁CR + U 2

NPM = α_i + β₁CR + U 3

ROE = α_i + β₁CR + U 4



$$ROA = \alpha_i + \beta_1 CR + U \dots\dots\dots 5$$

Where CR is Debt Ratio, GPM refers to Gross Profit Margin, NPM indicates Net Profit Margin, ROE stands for Return on Equity, ROA signifies Return on Assets, U is the standard error and α is the Constant factor.

Measurement of Variables

Table 1: Variable Measurement

Capital Structure	Independent Variable
Debt Ratio (DR)	= Total Debt (long term debt + short term debt) / Total Assets
Financial Performance	Dependent Variable
Gross Profit Ratio (GPR)	= Gross Profit (GP) / Net Sales X 100
Net Profit Ratio (NPR)	= Profit Before Tax (PBT) / Net Sales X 100
Return on Asset (ROA)	= Profit after Interest and tax / Total asset
Return on Equity (RO)	= Profit after Interest and Tax / Equity Capital

Source: Author's Computation

4. Result

Descriptive Statistics

This represents an analysis of data collected

Table 2: Descriptive Statistics of Dependent and Independent variables

	Mean	Standard deviation	Variance	Skewness	Kurtosis
CS	0.9318	1.1601	1.3459	1.9734	6.6310
GPM	0.2724	0.1088	0.0118	-0.7399	4.1667
NPM	0.5118	0.0716	0.0051	-0.4511	4.6587
ROA	0.054	0.0770	0.0059	0.0368	4.2066
ROE	0.1347	0.1988	0.0395	1.6010	6.3192

Source: Author Computation

The standard deviation revealed how much variance exist from the mean which are 1.1601, 0.1088, 0.0716, 0.0770 and 0.1988 for CS, GPM, NPM, ROA, and ROE respectively. This implied that low variance exist from the mean.

Variance displayed how far the numbers are spread out, the variance shows that CS, GPM, NPM, ROA and ROE are 1.3459, 0.0118, 0.0051, 0.0059 and 0.0395 respectively. This implied that there is low spread out of number. From the results of skewness, the acceptable values of skewness fall between -3 and +3, it shows that GPM, NPM are skewed to the left because the coefficients are -0.7399 and - 0.4511 respectively likewise CS, ROA and ROE are skewed to the right with the coefficient of 1.9734, 0.0368 and 1.6010 respectively which implied that the value is normal. The appropriate range of Kurtosis is -10 to +10 (Brown, 2006). Therefore, the results of Kurtosis revealed the level of normality of data. From the table the kurtosis of CS, GPM, NPM, ROA and ROE are 6.6310, 4.1667, 4.6587, 4.2066 and 6.3192 respectively which indicate that the data is normally distributed.



Correlation Matrix

The correlation matrix was used to determine the degree of relationship between variables of the study. These associations among the variables of the study are presented in Table 3 below.

Table 3: Correlation Matrix of Dependent and Independent Variables

	CS	GPM	NPM	ROA	ROE
CS	1.0000				
GPM	0.1344	1.0000			
NPM	0.1840	0.4755	1.0000		
ROA	0.1541	0.3451	0.8486	1.0000	
ROE	0.2189	0.3746	0.7662	0.91231	1.0000

Source: Author Computation

The correlation matrix shows that CS has positive relationship with GPM, NPM, ROA and ROE, which is 0.1344, 0.1840, 0.1541 and 0.2189 respectively which means that increase in Total Capital structure, lead to increase in financial performance by the firms and vice versa. It can also be observed that the relationship between the independent variables themselves are not significant, an indication of absence of multicollinearity. This can be clearly observed from the two indicators (i.e. Tolerance value and Variance Inflation Factor (VIF) which are within less than 1 and less than 10 respectively

VIF Results

Table 4: Multicollinearity Test

Variable	VIF	1/VIF
ROA	9.25	0.108076
ROE	6.17	0.162001
NPM	4.18	0.239415
GPM	1.36	0.736520

Mean VIF | 5.24

The result of the test shows that the VIF value is below 10 which indicated absence of multicollinearity problem. The VIF of the ROA shows 9.25, ROE is 6.17, NPM is 4.18, and GPM is 1.36 which showed that all independent variables have no serious multicollinearity and likewise the tolerance value (DF) showed 0.108076, 0.162001, 0.239415, and 0.736520 for ROA, ROE, NPM and GPM respectively.

Regression Results

Hypothesis One: Capital Structure has no significant effect on Gross Profit Margin of Quoted Consumer Good Manufacturing Companies in Nigeria.

Table 5 shows that there is positive and no significant relationship between CS and GPM, on listed consumer manufacturing companies in Nigeria with p-value of 0.347 and coefficient are 1.4337, which indicate that we reject null hypotheses and accept alternative hypothesis which says Capital structure has significant effect on financial performance of listed consumer manufacturing companies in Nigeria.



Table 5: Capital Structure and Gross Profit Margin

	<i>Coefficient</i>	<i>P-value</i>
Constant (C)	0.54128	0.227
GPM	1.4337	0.347
R-Square	0.0181	
Adj. R- Square	- 0.002	
Wild Chi 2	1.1613	
P>chi 2	0.3471	

Source: Author Computation

Hypothesis Two: Capital Structure has no significant effect on Net Profit Margin of Quoted Consumer Good Manufacturing Companies in Nigeria.

Table 6: Hypothesis Two: Capital Structure and Net Profit Margin.

	<i>Coefficient</i>	<i>P-value</i>
Constant (C)	1.9896	0.000
NPM	2.9828	0.196
R-Square	0.0339	
Adj. R- Square	0.0141	
Wild Chi 2	1.1519	
P>chi 2	0.1961	

Source: Author Computation

Table 6 shows that there is positive and no significant relationship between CS and GPM, on listed consumer manufacturing companies in Nigeria with p-value of 0.196 and coefficient are 2.9829, which indicate that we reject null hypotheses and accept alternative hypothesis which says Capital structure has significant effect on financial performance of listed consumer manufacturing companies in Nigeria.

Hypothesis Three: Capital Structure has no significant effect on Return on Asset of Quoted Consumer Good Manufacturing Companies in Nigeria.

Table 7: Capital Structure and Return on Asset.

	<i>Coefficient</i>	<i>P-value</i>
Constant (C)	0.8052	0.000
ROA	2.3214	0.280
R-Square	0.0238	
Adj. R- Square	0.0038	
Wild Chi 2	1.1579	
P>chi 2	0.2802	

Source: Author Computation

Table 7 shows that there is positive and no significant relationship between CS and ROA, on listed consumer manufacturing companies in Nigeria with p-value of 0.280 and coefficient are 2.3214 which indicate that we reject null hypotheses and accept alternative hypothesis which says Capital structure has significant effect on financial performance of listed consumer manufacturing companies in Nigeria.



Hypothesis Four: Capital Structure has no significant effect on Return on Equity of Quoted Consumer Good Manufacturing Companies in Nigeria.

Table 8: Capital Structure and Return on Equity

	<i>Coefficient</i>	<i>P-value</i>
<i>Constant (C)</i>	0.7597	0.000
ROE	1.2772	0.123
R-Square	0.0479	
Adj. R- Square	0.0285	
Wild Chi 2	1.1435	
P>chi 2	0.1228	

Source: Author Computation

Table 8 shows that there is positive and no significant relationship between CS and ROE, on listed consumer manufacturing companies in Nigeria with p-value of 0.000 and coefficient are 1.2772 which indicate that we reject null hypotheses and accept alternative hypothesis which says Capital structure has significant effect on financial performance of listed consumer manufacturing companies in Nigeria.

5. Conclusion and Recommendations

In conclusion, there is positive relationship between Capital structure and financial performance of manufacturing firms in Nigeria. In addition, capital structure has no impact on financial performance of the firms in terms of Gross Profit Margin (GPM), Net Profit Margin (NPM), Return on Assets (ROA), and Return on Equity (ROE). In line with the findings of the study, the study recommends that Managements of Nigerian consumer goods manufacturing firms should strive to optimize the debt level because of their effect on their financial performance. Specifically, consumer goods manufacturing companies in Nigeria should consider other sources of financing business rather than concentrating much of debt as revealed in the findings of this study.

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