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INFLUENCE OF CAPITAL STRUCTURE ON FINANCIAL PERFORMANCE OF QUOTED CONSTRUCTIONS AND REAL ESTATE COMPANIES IN NIGERIA

[1]ALABI TAOFEEQ OLANIYIAMIN; [2]YAHAYA HASSANAT IDRIS; & [3]UMAR USMAN

[1]Kadpoly Trust cooperative society LTD [2 & 3]Department of accounting, College of Business and Management Studies, School of Business and Financial Studies, Kaduna, Polytechnic.

Abstract

This study investigates the influence of capital structure on financial performance of quoted constructions and real estate companies in Nigeria; the capital structure has caused a lot of discussion in the financial fortress. The deteriorating involvement of Nigerian financial system highlights the importance of effects bankrolling mix procedures of the survival of firms. The dependent variables for the study is financial performance proxies by Return on Capital Employed , Return on Equity and Return on Asset , while the capital structure is independent variable which is proxies by debt-to-equity ratio. Descriptive statistics, correlation and regression analysis used to analyze the data using STATA. An ex-post facto design was adopted in examining the influence of capital structure on financial performance. The Study covers all the construction and Real Estate firms that are listed on the Nigerian Stock Exchange for the period of 2014-2018. The study shows that the panel regression result is not statistically significant because it is greater than 5%. The coefficients of gearing showed that one unit change in gearing will cause a negative -0.001002 unit changes in ROCE of sampled companies. This indicates that gearing has a negative effect on ROCE of Nigerian Construction and Real Estate companies sampled. Thus, the study recommends that corporations should concentration on efficient and effective use of their resources to generate more profits because success may result from upgraded performance in the use of assets.

Keyword: capital structure, financial performance, return, Construction and Real Estate

Introduction

The possessions of capital structure on financial performance of enterprises have been of precise research concentration in the prose of corporate finance. Though, there are impulsive theories on the affiliation between capital structure and worth of a firm. The Lamb alleged that capital structure distresses the firm value while under the expectations of perfect markets and no taxes, argue that capital structure decision is inappropriate (Pandey, 2011). Modigliani and Miller contrary their situation when they contemplate corporate taxes. Tax savings consequential from interest paid on debt create value for the firm. Though, the tax benefit of debt

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is concentrated by personal taxes and financial distress. Hence, the trade-off between cost and benefit of debt can turn capital structure into a relevant decision. Therefore, at their preliminary take off, Corporations are normally financed through equity financing. Then, they plough back part of their returns into their professional to give chance for development and evolution, as well as to accompaniment evenhandedness finance. Notwithstanding these, establishments at times find it challenging to take up numerous occasions in the marketplace. This is because, the bondholder's equity which forms the wholesale of their capital calm with all the income reserves produced from undistributed profits in the historical, may be inadequate to finance growth or expansion sequencers. To hostage this shortage, the firms go for additional foundations of capital, usually from concentration comportment and period grounded loan accommodations in the form of issuance of predilection shares, debentures, promises, where the instances are promising and the jeopardy involved can fruitfully be resolute or assessed.

Capital structure is the grouping of the numerous foundations of funds made by a firm for financing its actions and capital investments in simple relationships; therefore, the comparative connection among debt and equity. (Khan, 2012)..

The Building segment is very critical in any country's social and economic advance. There are numerous influences accountable for this. Apart from the sector's probable with respect to service generation, the various actions presumed in the sector are very connected to promotion effective sectorial associations and enhancing, as well as substantial financial development. For instance, efforts to ensuring sound and justifiable national and economic development cannot discount the importance of infrastructural development such as carriage,rail road, air, sea modes), industrial development (construction of industrial parks and factories), construction of organized buildings, and establishment of lodging with respect to construction of various types of buildings, among others. These are areas where the construction and structure sector is indispensable. The subdivision warrants to given more consideration because Nigeria is knowledgeable for real estate development due to her rising population, rapid urbanization, and for the fact that the sector contributes up to 7.7% to the Gross Domestic Product of Nigeria (Adugbo, 2018). Apart from equity source debt financing is required. Two major loans required to finance construction and real estate projects in Nigeria are short-term loan for financing the construction stage, and long-term loan loan which is lasting in nature for financing the project completed its normal operating life. Excessive debt financing would definitely wear away the effectiveness performance of the segment. In reality; capital structure of a firm is difficult to determine (Ong & Teh, 2011). A firm has to issue various securities in an uncountable combination to come across particular combinations that can maximize its overall value which means optimal capital structure Therefore, the issue of how an organization is financed is of supreme importance to both managers and providers of funds. This is because if a wrong mix of finance is employed, the performance and survival of the business enterprise may be seriously affected (Ong & Teh, 2011,Osuji & Odita, 2012).

Therefore, an appropriate capital structure decision is a key for any organization not only in terms of cumulative its value and maximizing returns, but also due to the effect such a decision has on its ability to compete favorably. Warokka et tl (2011) experimental 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. Prose revealed that numerous exercises have been supported out to investigate the relationship that exists between capital structure and performance (Onaolapo & Kajola, 2010; Warokka et al., 2011). However, the results of these

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previous studies have been inconsistent. While some researchers reported positive relationship between capital structure and performance (Akintoye, 2008; Dare & Sola, 2010), others reported negative relationship (Iorpev & Kwanum, 2012). Yet still, some researchers reported that no relationship exists between capital structure and performance (Prahalathan & Ranjan, 2011). Consequently, the connection that happens among capital structure and performance sustained contentious and unlocked for further research until another research was showed in other sector of the Nigerian economy on the Consolidation Banks which to have found that capital structure has impact on firm performance.

To the greatest information of the researchers' knowledge, nobody of those studies were conducted in the Construction sector of the Nigerian economy and most of the preceding researches were conducted retaining short term debts as part of the capital structure while in real intelligence only long terms debts forms part of the capital structure. That is why capital is different as the combination of varieties of long term sources of funds and equity shares including reserves and surpluses of an enterprise (Olowe, 2011). This research was therefore stimulated by these gaps and was envisioned to cover these understandable experiential research gaps in the capital structure unbiased literature in Nigeria by examining the influence of capital structure firms' performance.

Conceptual Framework

Concept of Capital Structure

Capital structure has been views by different researcher's (Khan 2012) view Capital structure as the assortment of the numerous bases of funds initiated by a firm for financing its procedures and capital reserves. Agro and Ema (2012) seen capital structure as the percentage of capital at work in a business by nature, it is a mix of a company's long term debt, specific short term debt, mutual equity and preferred equity and it simple describes how a firm finances its overall operations and growth by using different sources of funds, broadly speaking, there are two forms of capital equity capital and debt capital. Nirajini and Priya (2013) express he view on capital structure as the technique in which a society is financed a mixture of long term capital which encompassed ordinary shares and reserves, bank loans, exchangeable loan. And short term liabilities such as a bank overdraft and trade creditors. Wolde and mariam Birru (2016) mentioned capital structure of a firm as the configuration or assembly of its liabilities. In his wok he further defined and identified the classes of capital to include both long term and short term sources of capital and equity. This view is also shared by Akinsulire (2011) where he defined the capital structure of the company to be how the company finances its operations. According to him, the means a finance are usually made up of three sources which include the ordinary share capital, the preference share and the debt capital.

Concept of Financial Performance

The countenance "performance" is a concept of dual tiers, specifically efficiency and effectiveness. While efficiency is the ratio between out–put and input, effectiveness is the degree of goal achievement for an organization. According to the incentive philosophy in management science, performance is understood as a worth of work accomplished by an operative. Ling & Hong (2010) argued that organizational performance is the sum of triumph achieved by all businesses involved with an organizational goal during a strong-minded period of time, with the goals either meant for

a specific stage or on the overall extent. According to Xu (2007), operating performance is the notch of a company realizing its strategic goals, as well as pointer for the inspection of the company's overall competiveness that showed properly the assessment of organizational performance will give an organizations manager an idea of current condition of his/her organization. The assessor indicators used the most often are an organization's income, production capacity and profitability. There are massive amount of previous studies addressing measurement dimensions of organizational performance. Since the benefits of organizational performance will eventually be fed back to the financial dimension most scholars in this field adopt financial performance as one of the indicators. In an environment characterized by convenient ways of information delivery and rapid changing markets, nevertheless, a company nowadays shall never solely rely on financial performance to achieve survival and competitiveness. That is to say, it is impossible to sufficiently gauge organizational performance using financial performance as the sole indicator (Ling & Hong, 2010).

Review of Empirical Studies

Salteh, et al (2012) scrutinized the impression of capital structure on firm performance, using five performance measures which including earning per share, return on assets, return on equity, market value of equity to the manuscript value of equity and Tobin's Q as dependent variable and four capital structure measures which including short-term debt, long- term debt and total debt to total assets, and total debt to total equity as independent variable. They chose 28 Iranian corporations listed in Tehran Stock Exchange as a sample. The study privileged 2005 - 2009. The consequences designate that firm performance, which is measured by (Returned On Equity, MBVR & Tobin's Q is purposely and positively associated with capital structure, while there is a negative relation between capital structure and (ROA, EPS). They concluded that firm performance is positively or even negatively related to capital structure.

Fosu (2013) careful take 257 South African listed firms using panel data to explore the liaison between capital structure and firm performance, paying particular devotion to the degree of industry competition, found that financial leverage has a significant positive effect on firm performance. in his study, titled "Comparison of impact from capital structure to corporate performance between Chinese and European listed firms" using data from more than 1200 listed companies in Germany and Sweden and more than 100 listed companies in China covering the period 2003- 2012, originate that capital structure has a significant negative effect on firm performance in China, whereas, significant positive effect in 2 European countries before financial crisis happened in 2008.

Chakraborty (2010) active two performance measures, including ratio of profit before interest, tax and depreciation to total assets and ratio of cash flows to total assets and two leverage measures, including ratio of total borrowing to assets and ratio of liability and equity, and reported a negative relation between these ones.

However, in the view of F.D, Dare and O. Sola. (2010), on capital structure and corporate performance discovered that firm's performance is positively related to equity financing and dept.-equity ratio, while a negative relationship exists between companies' performance and debt financing. At debt equity trade-off, there will be a positive correlation between firm performance and debt-equity ratio. The writers accredited the negative correlation existing between corporations' performance and debt financing to the high cost of borrowing in Nigeria.

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Salim and Yadar (2012) observed capital structure and firm performance from Malaysia listed companies, using four accounting based measure of firm performance, ROE, EPS, ROA and Tobin Q), found out that capital structure (especially TD and STD) impacts negatively, measured by ROE, and they found this consistent with who documented the same result. However, capital structure (LTD and TD) had negative significant impact on firm's performance, measured by ROA.

Khan (2012) studied the relationship of capital structure decisions with the firm's performance using 36 engineering firms in Pakistan listed on the KSE as sample for the period 2003 -2009 using the panel econometric technique, Pooled Ordinary Least Square regression. His findings show that financial leverage unhurried by short term debt to total assets (STDTA) and total debt to total assets has a significant negative relationship with the firm's performance measured by Return on Assets , Gross profit margin and Tobin's Q.

Theoretical Framework

Trade-Off Theory

The trade-off theory rises to the idea that a corporation indicates how abundant debt finance and how much equity funding to use by balancing the cost and benefits (Muritala, T.A 2012). In the trade-off the theory of capital structure, the insolvency cost is allowed to exist. Thus, trade-off theory suggests that establishment's capital structure decision involves a trade-off between the tax benefits of debt financing and the costs of financial distress. When firms regulate their capital structure, they tend to change toward a target debt ratio that is consistent with theories based on tradeoffs between the costs and benefits of debt. The decision of a firm about the use of debt finance or equity finance depends on the costs and benefits devoted to each source of funds. For example, in determining the best capital structure, the firm must reflect the trade-off between costs and benefits of each source of finance as each has some costs and assistances. For example, the use of debt attracts some tax saving benefits as well as bankruptcy costs. The firm should strike a equilibrium at that point where any extra debt becomes riskier and hence more exclusive to both creditors and shareholders' so as to avoid financial distress (Khan 2012). When the gradation of leverage upsurges, stockholders position becomes unwarrantable, the risk of creditors increases and they demand a higher interest rate and do not grant a loan to the company.

RESEARCH METHODOLOGY

This study adopts *an ex-post facto* design in examining the influence of capital structure on financial performance of listed construction and real estate companies in Nigeria. This is most widely used design by previous researchers as the statistics will be gotten from published documents and which in this case refers to the annual reports and accounts of the sampled Construction and Real Estate companies which are historical in nature, thereby rendering this research an ex post facto. The population of the study is all the Construction and Real Estate companies which remained listed on the Nigerian Stock Exchange for the period of five years 2014-2018.

DATA PRESENTATION, ANALYSIS AND INTERPRETATION

Descriptive Statistics

The summary of the descriptive statistics of the variables are presented in table below

Table 4.1 Descriptive Statistics

Variables	Min.	Max.	Mean	Std. Dev.
ROCE	-.12837	2.377	.2005	.4807
ROE	-.27814	5.069	.5010	1.214

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ROA	-.05676	1.566	.1055	.3089
LEVERAGE	-10.680	32.32	4.489	9.283

SOURCE: Extract from STATA Output.

In the table above 4.1 offerings the descriptive statistics for the dependents and explanatory variable. From the table, Return on Capital Employed has minimum and maximum values of -0.1284 and 2.3773 respectively and the mean value of 0.2005 as well as the standard deviation value of 0.4807. The standard deviation of 0.4807 signifies that the data deviate from the mean value from both sides by 0.4807 implying that there is not much wide dispersion of the data from the mean even thou the standard deviation is higher than the mean value.

The table also shows that the mean of Return on Equity of the sampled firms is 0.509 with standard deviation of 1.214, and minimum and maximum values of -0.2781 and 5.0686 respectively. This implies that the performance of the firms in terms of Return on Equity is on average 0.508998, and the standard deviation value indicates that ROE of the sampled firms deviates from the mean value from both sides by 1.214, implying that there is significant dispersion of the data from the mean because the standard deviation is higher.

Moreover, the table shows that the mean of the Return on Asset of the firms is 0.1055434 with standard deviation of 0.309. The minimum and maximum values are -.0567 and 1.566 respectively. This implies that Return on Asset of the sampled firms is on average 0.1055434, and the standard deviation value indicates that the value deviates from the mean from both sides by 0.3089, implying that there is no significant dispersion of the data from the mean because the standard deviation is lower.

Finally, the table portrays that the mean of the debt-to-equity ratio (Gearing) of the firms is 4.489 with standard deviation of 9.283. The minimum and maximum values are of -10.680 and 32.317 respectively. This implies that long term debt to total assets of the firms is on average 0.8527. The standard deviation indicates that the value of the firms` Gearing ratio deviates from the mean value from both sides by 9.283. This implies that there is significant dispersion of the data from the mean because the standard deviation is higher.

Correlation Matrix

The correlation matrix explains the degree of relationship between the dependents and independent variables of the study as well as the dependent variables among themselves. The summary of the associations among the variables of the study is presented in table 4.2, while the full result is attached as appendix (IIB)

Table 4.2 Correlation Matrix

Variables	ROCE	ROE	ROA	GEARING
ROCE	1.0000			
ROE	0.7222	1.0000		
ROA	0.0048	-0.0227	1.0000	
LEVERAGE	-0.0194	0.2110	0.1225	1.0000

SOURCE: STATA Output.

Table 4.2 reveals Return on equity and Return on Asset of the firms are positively correlated with Debt-to-equity ratio. The values of 0.2110 and 0.1225 of the variables indicated that an increase in

gearing ratio will lead to increase in Return on Equity and Return on Asset. In contrast, Return on Capital Employed have negative relationship with Gearing ratio, meaning increase in gearing ratio will lead to decrease in Return on Capital Employed of the sampled firms for the period under study.

The relationship of the dependent variables among themselves indicates that Return on Capital Employed is positively correlated with Return on equity and Return on Asset. On the other hand, Return on equity and Return on Asset are negatively correlated among themselves.

FINDING

These study demonstrations that the panel regression result is not statistically significant because it is greater than 5%. The coefficients of gearing presented that one unit change in gearing will cause a negative -0.001002 unit changes in ROCE of sampled companies. This indicates that gearing has a negative effect on ROCE of Nigerian Construction/Real Estate companies sampled. These effects are however not statistically significant for the period of the study. The study also reveals that the panel regression result shows a positive relationship between gearing and Return on Equity of Construction/Real Estate companies for the period of study. The coefficients of gearing presented that one unit change in gearing will cause a positive -0.0099022 unit changes in ROE of the companies, Although, gearing has a positive effect on ROE, this effect is however not statistically significant for the period studied and also the study shows that the panel regression result for gearing and return on Asset is not statistically significant because it is greater than 5%. The coefficients showed that one unit change in gearing will cause a negative -0.0040754 unit changes in ROA of the companies.

CONCLUSION AND RECOMMENDATIONS

The study inspected the influence of capital structure on financial performance of Construction and Real Estate companies in Nigeria. The study observed dependent variables like ROCE, ROE, and ROA as against the independent variable, which is gearing. The study established that capital structure has negative effect on Return on Capital Employed, also on Return on Assets but positive effect on Return on Equity. Findings of this study therefore provide understanding into the consequence of capital structure as it influences ROCE, ROE and ROA. The study settles that on the overall, capital structure does not affect ROA, ROE and ROCE significantly; however, firm specific factors may cause some mutual capital structure effect to significantly affect ROA, ROE and ROCE. Base on the above conclusion, the following recommendations are extracted:

i. The researchers strongly recommends that firms both extremely and ordinary geared should take into awareness the amount of leverage incurred because it is an even though it is insignificant determinant of firm's performance. Also whatever source of finance that construction and real estate companies choose to adopt in funding their commercial activities, their managers should deliberate those sources of fund that can enhance returns and also increase the performance of the organization. The firms should invest in assets that will generate positive returns so as to improve their return on assets.

ii. The study recommends that corporations should foot more emphasis on efficient and effective use of their resources to produce more profits because achievement may result from upgraded performance in the use of assets.

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iii. The study recommends that capital structure and its impacts should move from theoretical level to practical level. In doing this the top industries as well as stock exchange operators should be fully elaborate in the issue of optimal capital structure and how it affects firms.

iv. The medication to the firms that desire to continue and succeed should pay consideration to variables of profitability because most of these are strategic variables that are within management and the board of directors' control. It could be argued that the more profitable firm could be able to offer more new products that could generate more profit and sustain the company liquidity.

v. The study recommends that companies should focus on well-organized to use of their resources to generate more profits because success may result from improved performance in the use of assets.

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