Capital Structure and Financial Performance of Listed Pharmaceutical Enterprises Nigerian Experience

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Abstract: This study investigated the association between capital structure and financial performance of listed pharmaceutical enterprises in Nigeria. The specific objectives of the study were, among others, to ascertain the relationship between short term debt and returns on assets of listed pharmaceutical firms in Nigeria; the relationship between short term debt and earnings per share of listed pharmaceutical firms in Nigeria. The study design was ex-post facto, with a population of five (5) listed pharmaceutical firms in Nigeria, same as the sample size for the study. Data for the study was secondary data obtained from published financial statements of firms for over the past 6 years. Descriptive statistics was used to address the research questions, while Pearson product moment correlation coefficient connected with multiple regression was employed to assess the hypotheses with the aid of SPSS, version 21. Findings revealed that these is a positive moderate association between long term debt and return on asset. This is also positive weak association between retained profits and return on assets among others. It was concluded that the firms long term debt level has favourable association with financial success.

It was however, recommended pharmaceutical firms should make use of moderate level of long-term debt obligation since it yields moderate level of returns, and firms should use long term debt over short term debt in financing their operations and asset acquisition to boost their profitability

Keywords: Capital Structure, Financial Performance, Enterprises, Return on Assets, Earnings per Share.

INTRODUCTION

Internally or externally generated funds have a variety of consequences on the organization's overall financial success. Shareholders, investors, consumers, workers, suppliers, and future investors are all stakeholders in these commercial organizations (Ball, 2013).

Adams (2014) ˮadvocates balancing the principal's and agent's risk tolerances to decrease the principal-agent disagreement. Management would, in an ideal world, promote commercial projects that maximize the wealth of the company's most significant stakeholder, its shareholders, while also being socially responsible. (Hobson, William, and Venkatachalam, 2012). Khan (2013) proposes that suitable assistance, particularly enough financial capital, is critical in this regard. The percentage of a company's profits that is kept for reinvestment or debt repayment rather than being dispersed to shareholders as dividends is referred to as retained profits (also known as retained surplus) are a type of revenue retention (Chasan, 2012). Most executives favor cash from operations as a key source of capital for reinvestment and business development. As a result, some firms prefer to maintain a larger portion of their profits and reinvest them, especially when the investment prospects are favorable (Campbell, 2012). While some shareholders may be upset if their company increases earnings retentions, Ball (2013) believes that earnings are one component of a bank's net worth, and that increasing cash available for acquisitions, repurchase of outstanding shares, or other authorized expenditures increase the supply of cash available.

Several variables that lead to company failure may be addressed by strategies and financial decisions that encourage growth and achieve organizational objectives; hence, the importance of financial decisions cannot be overstated (Salawu, 2019).

Poor funding decisions might lead to a company's collapse. For both management and investors, determining whether a proper capital structure exists, is a challenging task. All financial decisions are made with the purpose of generating wealth, and the best way to judge the quality of a financing decision is to look at how it impacts the firm's performance (Salawu, 2019). As a result, retained earnings can be used to raise shareholder value (Hobson, William, & Venkatachalam, 2012). Burgstahler and Dichev (1997), on the other hand, stated that capital mismanagement might occur when management discovers they have a lot of cash on hand and choose to destroy value instead.

Statement of The Problem

Investors in Nigeria, rarely evaluate the significance of capital structure mix and how it influences firm's performance. Financial constraints have been a major factor influencing firm success in emerging countries, notably Nigeria. The depth and growth of diverse financial markets are the foundations for defining the optimal capital structure of Nigerian economic sectors. As a result, one element that is universal and significant among businesses around the world is the financial decisions that executives must make. Capital structure has been demonstrated to be a key predictor of a company's performance in a variety of empirical investigations. Wong (2014) found that capital structure is connected to common stock returns and risk in research. Wong (2014), discovered that in construction businesses, the success of a company as evaluated by ROE is inversely related to the long-term debt ratio.

Purpose of the study

The purpose of this research was to determine the relationship between capital structure and financial performance of listed pharmaceutical companies in Nigeria. Other specific objectives addressed in the study were to;

1. Ascertain the relationship between short term debt financing and return on assets of listed pharmaceutical firms in Nigeria.
2. Evaluate the relationship between short term debt financing and earning per share of listed pharmaceutical firms in Nigeria.
3. Assess the relationship between retained earnings and returns on assets of listed pharmaceutical firms in Nigeria.

Research Questions

The study was guided by the following research questions

1. What is the relationship between short-term debt and return on assets of listed pharmaceutical firms in Nigeria ?
2. What is the relationship between short-term debt and Earnings per share of listed pharmaceutical firms in Nigeria ?

Research Hypotheses

The following null hypotheses were tested in the study;

Ho_1. There is no relationship between short-term debt and return on assets of listed pharmaceutical firms in Nigeria.

Ho_2. There is no relationship between short term debt and earnings per share of listed pharmaceutical firms in Nigeria.

Ho_3. There is no relationship between retained earnings and returns on assets of listed pharmaceutical firms in Nigeria.

Review of Related Literature

Capital Structure

The capital structure of a corporation is defined as a combination of stock and debt financing. It is one of the most important financial variables because it is related to the firm's capacity to meet the needs of all of its stakeholders, including employees, the community, and shareholders (Jensen, 2016).

The riskiest kind of financing is equity finance, which refers to funds given by the company's owners. According to the number of shares owned, shareholders are entitled to a portion of the company's earnings, which is known as a dividend. However, the corporation is not required to pay dividends on a regular basis since it can retain a portion of its income to fund future business development. Shareholders share in business risks as well, and they are the last to gain if a firm is dissolved after all debts have been paid (Brockington, 2020).

Borrowing from external sources of money, such as financial institutions, or via the issuance of bonds, are both examples of debt finance. Instead of controlling the company's activities, the financier is compensated for the use of his capital with a predetermined yearly return. Alternatively, regardless of whether the borrower (business) generates a profit or not, the borrower (firm) is legally obligated to return the principle amount plus accumulated interest. Failure to pay such financial obligations can result in the loss of the secured asset, the bankruptcy of the company, or both (Bichsel & Blum, 2015).

In terms of business growth and economic progress, debt finance provides both benefits and drawbacks. Debt financing provides benefits such as a tax shelter and the alleviation of free cash flow

difficulties through improving management conduct, whereas debt financing costs include agency costs and bankruptcy costs resulting from shareholder and debt holder conflicts (Fama & French, 2012).

Short Term Debt Financing

Any debt due within a year is classified as short-term debt, and it is included in a company's current liabilities financial statement, according to Olaniyi, Elulu, and Abdusalam (2015). Short-term bank loans, as well as other kinds of debt, are frequently included in a business's liabilities statement. Accounts receivable and inventory are two forms of short-term debt. Non-current liabilities, such as long-term debt or loans, are used to finance long-term assets such as land purchases and building or ship construction. This is calculated by dividing total assets by current debts.

Retained Earnings

After expenditures and dividends are paid, remaining earnings are reinvested in the business to fuel future development (Dinayak, 2014). The goal of retention is to improve the likelihood that profits will be retained in the business by offering additional opportunities for progress. Some of an organization's net income is held rather than dispersed as dividends to shareholders, which is known as retained profits (Chasan, 2012). The business's objective should be to reinvest profits in new ventures. It is a critical internal source of money that a company must get at the least expensive cost possible (Mohamed, 2010).

Retained earnings are eventually added to the wealth of shareholders, according to theory and literature. More earnings are generated as management reinvests retained earnings in capital projects and the acquisition of return-generating assets, resulting in improved financial performance (Baker, 2019). Return on retained earnings is a ratio that measures how successfully Profits from the preceding year were reinvested in the business (Poker, 2011). A high proportion indicates that a company would be better off reinvesting in its operations, whereas a low percentage indicates that dividend payments are in the corporation's best interests. Investors should seek for companies that have a high rate of return on retained earnings and regularly reinvest their profits when making investment selections.

Return on Assets (ROA)

The return on assets (ROA) is a metric that assesses management's overall success in creating profits from its available assets. The higher the return on investment (ROI) of the company, the better. It also compares earnings to a company's whole revenue-generating assets. It shows how much profit a firm earns in comparison to its total assets; a greater ROA indicates that the company is profitable, while a lower ROA indicates that it is not.

The simplest method for calculating ROA, according to Gitman and Zutter (2012), Ehrhardt & Brigham (2011), and Ross et al., is to divide net income by total assets during a period. On the other side, Lindow (2013), Glantz (2003), Ross et al. (2003), and Friedlob and Schleifer (2003) use EBIT and divide it by total assets to get a gross ROA (2003). This is a non-affected measure of a company's asset return efficiency. This study employed objective financial performance criteria adjusted for interest and taxes to evaluate management's performance objectively.

Earnings per Share

According to Milad et al., earnings per share (EPS) is a critical financial indicator for investors and financial analysts (2013). It is commonly used to measure the profitability and risk of earnings and

stock price evaluations. It summarizes a company's profits for an ordinary share throughout a fiscal period. (Goya, 2013; Myers,. 2014; Silva, M. (2018)), and has been used as a performance proxy in several studies. For example, Myers,. 2014; used profits per share (EPS) and other accounting variables to investigate the impact of capital structure on enterprises' financial performance and shareholder wealth in Nigeria.

Theory of Pecking Order

In accordance with the rule of the least effort or resistance, organizations should prioritize their sources of finance from internal to external, with stock being the final choice. According to the theories, managers and investors have asymmetric information. Investors desire to discount a company's newly issued shares in order for management to anticipate a price reduction ahead of time. (1984, Myers and Majluf). Asymmetric information theories lead to the conclusion that there is a hierarchy of company preferences for funding their investments. If there is no asymmetry, firms will borrow money to meet further capital needs and will issue stock to meet remaining capital requirements, according to the Pecking order theory. The relative expenses of various financing solutions are reflected in the preference order. When the market overvalues equity, according to the Pecking order theory, corporations are eager to sell it. (Myers, 2014) This is based on the assumption that managers act in current shareholders' best interests. According to Myers and Majluf (2014), enterprises will prefer internal sources of financing over costly external financing. As a result, the Perking order theory predicts that organizations that are lucrative and hence generate large earnings would utilize less loan capital than those that do not.

Empirical Review

Thuranira (2014) analyzed the correlation between retained earnings and NSE listed companies' financial performance. The data was collected from 2009 to 2013 using descriptive research methods. To determine the tendency of association between variables, Regression and correlation analyses were used in this investigation. The data indicates that the association between retained profits and financial success is weak and inconsequential.

Chepkemoi, (2013), The influence of retained and dispersed earnings, as well as capital invested, on financial performance was researched using data from 99 publicly traded Pakistani firms from 2006 to 2011. To investigate the link between variables, the researchers analyzed data using both descriptive and panel regression techniques. The research discovered a significant positive correlation between dividends and earnings and financial success, but no such relationship existed between capital employed and retained earnings.

Tariq et al (2014), wanted to know how important dividends and retained earnings were in comparison. The research was based on data from 66 non-financial firms that were listed on the Korean Stock Exchange between 2007 and 2010. To determine the tendency of association between variables, the study employed regression and correlation analysis. Dividends had a bigger influence on financial performance on the KSE than retained profits, according to the study's results.

Essays et al (2013), The effect of retained earnings on NSE listed firms' financial performance was explored. Data on 40 NSE-listed firms was collected between 2005 and 2008. To discover the association between variables, researchers employed basic linear regression analysis. There is a link between dividend yield and ROA, according to the evidence. Retained profits and price to book value have a favorable and considerable influence on DMBs' ROA, according to Silva (2008). This indicates that if DMBs finance their operations with retained earnings, there may be little pressure on DMB management (Silva, 2008). This also implies that DMBs' financial performance is increasingly

reliant on retained profits funding. A data collection of 290 banks from 61 countries is used in the study.

Hassan M. et al (2014), The following has been examined on the effect of capital structure on firm performance In a study of 36 Bangladeshi firms listed on the Dhaka Stock Exchange between 2007 and 2012, four performance measures were used as dependent variables earnings per share (EPS), return on equity (ROE), return on asset (ROA), and Tobin's Q. Three capital structure ratios were used as independent variables short-term debt, long-term debt, and total debt ratio. According to the pooling panel regression technique, EPS is strongly correlated with short-term debt despite being significantly correlated with long-term debt.

Research Method

A retrospective research was done to determine the relationship between the predictor (capital structure) and the criterion (financial performance) of listed pharmaceutical firms in Nigeria .

The study target population was all NSE-listed pharmaceutical companies, while the study's accessible population was five (5) listed pharmaceutical companies in Nigeria. The study covered the period between 2015 and 2020.

The study sample was the five (5) selected listed pharmaceutical companies in Nigeria. The research gathered data from secondary sources. The Nigerian Stock Exchange's (NSE) group fact book was compiled using data from the annual reports of five (5) pharmaceutical businesses.

The descriptive statistics, Pearson product moment correlation, and OLS multiple regression techniques were employed in this study. Descriptive statistics were employed to determine each variable's central tendency.

Other tests of significance which were used in the study included

Determination of the independent variable's explanatory power, the R^2 – coefficient of determination.

The T-test was performed to determine the significance of each variable's coefficient;

F-Ratio was used to test for the significance of the overall models;

Durbin-Watson (DW) test was used to test whether auto-correction exist or not in error term (U);

Model Returns on Equity (ROA) model

ROA $=f$ (LTD, STD,RE)………………………………………………..3.1

This can be written in ordinary least square (OLS) form as

ROA_1 $a_o + a_1 LTD_1 + a_2 STD_1 + a_3 RE_1 + U_1$……………………………………….3.2

.$a_1 > 0 a_2 > 0 a_3$

Model 2 Earnings per share (EPS) Model

EPS $= f$ (LTD, STD,RE)……………………………………………….3.3

This can be written in ordinary Least Square (OLS) form as

$ROI_1 + a_0 +_{a1} LTD_1 + a_2 STD_1 + a_3 RE_1 + U_1$……………………………………3.4

Where ROA = Returns on Asset, as proxy for financial performance

EPS =Earnings per share, as proxy for financial performance

LTD = Long-term debt, as a proxy capital structure

STD = Short-term debt, as proxy for capital structure

RE = Retained Earnings, as proxy for capital structure

T = Time period under study

a_o = constant

a_1+a_2 = parameter or co-efficient of explainable variables

U = Error term

Decision Rule

Accept H_o if the p-value of the independent variable is greater than 0.05

If the independent variable has a p-value less than 0.05, reject Ho.

If the independent variable's p-value is less than 0.05, it indicates that the variable has a significant effect on the dependent variable's fluctuations and vice versa.

DATA PRESENTATION, ANALYSIS, RESULTS AND DISCUSSION

This chapter summarizes the study findings and data analysis. NSE Handbooks and corporate website for a six-year period commencing in 2015. On the Nigerian Stock Exchange, there are 17 pharmaceutical companies listed.

A regression analysis was done out using the predictor variables. In each case, the t-test was performed to determine significance.

An association with the dependent variable is significant if the p-value is more than 0.05.

Descriptive Statistics

This section provides the study project's descriptive statistics. Descriptive statistics included mean and standard deviation. These descriptive data cover five (5) listed pharmaceutical companies from 2015 through 2020.

Table 1. Descriptive Statistics of independent and Dependent variables

	N	Minimum	Maximum	Sum	Mean	Std. Deviation	Variance	Kurtosis	
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error
LTD	30	0	9	170	3.68	1.640	2.688	5.166	.833
STD	30	5.08	8.64	190.15	2.6384	1.73660	.543	2.210	.833
RTE	30	.00	8.51	168.20	2.6067	1.76557	3.117	5.751	.833
ROA	30	.00	5.77	25.10	2.8367	1.50839	2.275	4.990	.833
EPS	30	.60	2.70	46.26	2.5418	.52578	.276	.064	.833
Valid N (listwise)	30								

Source NSE and SPSS output (21)

Table above contains the descriptive statistics for all of the study's variables. 1. Long-term debt was on average 3.68 and standard deviation was 1.640; short-term debt was on average 2.6384 and standard deviation was 1.73660; retained earnings were on average 2.6067 and standard deviation was 1.76557; return on asset was on average 2.8367 and standard deviation was 2.50839; and earnings per share were on average 2.5418 and standard deviation was 0.52578. The study's mean value exceeded 2.5. As a consequence, the researcher established that the variables were prevalent.

Test of Hypotheses

Decision Rule

If the significant/Probability Value (PV) is less than 0.05 (level of Significance), the null hypothesis is rejected and a Significant Relationship is inferred. If the Significant Probability Value (PV) is more than 0.05, accept the null and assume an insignificant connection (level of Significance).

Test of Hypothesis 1

H0$_1$ There is no relationship between short-term debt and return on asset of listed Pharmaceutical firms in Nigeria.

Based on Table 1, probability/significant value of 0.906, the researcher accepts the null hypothesis and concludes that short-term debt and return on asset have a positive relationship.

Table 2: Correlation Table on the strength of relationship between short-term debt and earnings per share

Correlations

		STD	EPS
STD	Pearson Correlation	1	.274
	Sig. (2-tailed)		.142
	N	30	30
EPS	Pearson Correlation	.274	1
	Sig. (2-tailed)	.142	
	N	30	30

Source SPSS output (21)

The relationship between short-term debt and earnings per share (EPS) is seen in Table 2. R = 0.274**, significant/probability ratio = 0.142, significance level less than 0.05. According to table 2, there is a weak relationship between short-term debt and earnings per share of the listed pharmaceutical firms in Nigeria. Short-term debt accumulation is associated with a fall in the profits per share of listed pharmaceutical companies. "

Test of Hypothesis 2

H0$_2$ There is no relationship between short-term debt and earnings per share of listed Pharmaceutical firms in Nigeria.

in Table 2 a probability/significant value of 0.142, the researcher accepts the null hypothesis and discovers a weak association between short-term debt and profits per share.

Table 3 Correlation Table on the strength of relationship between retained earnings and return on asset

Correlations

		RTE	ROA
RTE	Pearson Correlation	1	.032
	Sig. (2-tailed)		84
	N	30	30
ROA	Pearson Correlation	.032	1
	Sig. (2-tailed)	.084	
	N	30	30

**. Correlation is significant at the 0.01 level (2-tailed).

Source SPSS output (21)

Table 3 illustrates the amount and direction of the relationship between retained earnings and return on assets. Indeed, it exceeded 0.05 significantly, with a correlation coefficient of -0.032** and a significance/probability ratio of 0.84.. The value of the retained profits and return on asset of the listed pharmaceutical enterprises in Nigeria is weak, according to the categorization in table 3, implying a weak link between retained earnings and return on asset. Furthermore, the correlation coefficient is positive, indicating that a rise in short-term debt is linked to an increase in the return on assets of listed pharmaceutical companies.

Test of Hypothesis 3

$H0_3$ There is no relationship between retained earnings and return on asset of listed Pharmaceutical firms in Nigeria.

The probability/significant value in Table 3 is 0.02, with a 0.05 level of significance, indicating that the researcher rejects the null hypothesis and concludes that retained profits and return on asset have a moderate and positive association.

Discussion of Findings

According to the test of H_{01}, At pv = 0.00 0.05, the correlation coefficient value of r = 0.023** is significant indicating a weak relationship between short-term debt and return on asset, as shown in table. Table also revealed that short-term debt has a statistical impact on asset return. The estimated t-value for short-term debt was 0.142>t-tab (0.05, 227), with a PV of 0.00 0.05 as a significant probability value. Raluca (2014) looked at the Between 2010 and 2015, the capital structure and profitability of publicly traded Romanian firms were examined. Multiple Regression was used as the model. The data indicate that the degree of capital structure has a significant effect on business performance as assessed by ROA, ROE, RCA, and MBR.

On the H_{02} test, As indicated in table 2, There is a little upward trend in the link between retained profits and return on assets with a correlation value of 0.032** and pv = 0.000.05. Table 4.5 further revealed that retained earnings had a statistically significant impact on return on investment. The estimated t-value for retained earnings was 0.84 >t-tab (0.05, 227), with a PV of 0.00 0.05 as a significant probability value. Thuranira (2014) looked on the correlation between retained earnings and NSE-listed firms' financial performance. From 2009 to 2013, data was collected using descriptive research methods and to ascertain the degree of relationship between variables, regression

and correlation analyses were conducted. The findings indicate a tenuous and insignificant relationship between retained earnings and financial performance.

On the H_{03} test, there is a substantial positive link between retained earnings and earnings per share, as shown in table 3, with a correlation coefficient of 0.60** significant at pv = 0.000.05.

Conclusions

From the result Of the various analysis, there is a moderate relationship between long-term debt and return on asset of listed pharmaceutical companies on the Nigeria Stock Exchange,.

The financial performance of Long-term debt, short-term debt, and retained earnings are all important factors for pharmaceutical businesses listed on the Nigerian Stock Exchange. The negative/positive correlation between the predictor and dependent variables denotes this. The research study also concluded that a firm's long-term debt level has a positive impact on financial performance, while short-term debt has a negative impact, implying that as a firm takes long-term loans to acquire fixed assets that will be used to increase the firm's liquidity level in meeting its short- and long-term debt obligations, the more profitable it becomes. Finally, the analysis discovered a negative correlation between short-term debt and the financial performance of pharmaceutical firms listed on the Nigerian Stock Exchange.

Recommendations

The following recommendations were put forward;

1. Proper regulation of banks by government so as to lower the cost of short-term debt and enhance business performances, as many businesses rely on debt financing to satisfy their financial obligations.

2. Pharmaceutical companies should not rely solely on retained earnings in financing their operations but, rather combine it with other capital structure mix to ensure high rate of returns.

3. Maximum use of retained earnings in increasing earnings of shareholders of the companies and other interest parties should be enhanced for the expansion of firms in the pharmaceutical business.

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