Capital Structure and Financial Performance of Commercial Banks in Nigeria

Aliyu Ahmed Alhaji

Abstract

Capital Structure is an important concept in business which have accounted for financial performance of businesses in literature. Thus, this study was conducted to examine the relationship between capital structure and financial performance of commercial banks in Nigeria for the period of (2010 to 2019). Five (5) commercial banks were selected using Judgmental sampling technique. Data were collected from financial statements of selected banks. The data was analyzed using E-View 2010. Unit root test, Granger causality test and panel regression Analysis was conducted in this study. We concluded that, capital structure variables used are good predictor and significant with financial performance of commercial banks in Nigeria. In addition, we concluded that, Debt to Equity Ratio, Total Debts and Total Equity over the period under study, do not contributed to the financial performance (Return on Assets) of commercial banks in Nigeria. Furthermore, Equity to Capital Ratio and Debts to Capital Ratios improves the financial performance(Return on Assets) of commercial banks over the years. We therefore, recommended that, the bank managers should ensure that, capitals are spent on productive assets in other to improve financial performance of the banks, among others.

Index terms—

1 Capital Structure and Financial Performance of Commercial Banks in Nigeria

Aliyu Ahmed Alhaji usinesses are brought into existence with aid of finance. As such, finance, can be said to be the money used to established businesses. Businesses require money to acquire assets which are used to provide relevant goods and services conceived in the business. Finances are sourced either as equity (contributions made by the owners of the business) or debts (contributions accrued from the creditors). Therefore, business finance ideally, is the combination of equity and debts, which is referred to as capital structure.

Firm's combination of debt and equity results in a given capital structure Brealey, Myers & Allen, (2011); Nirajini & Priya, (2013).Capital structure represents the proportion of funds attributed to the firm through different sources, which may comprise of internal and external financers, Martis, (2013).Capital structure explains the owners' rights and interests of creditors' proportional relationship; it indicates the ratio between the corporate structure and the various sources of financing, and their mutual combinations Bauer (2004). The capital structure theory is an essential theory in finance as it addresses sources of finance available to Author: B.Sc, Accounting, M.Sc in Financein View. e-mail: Aliyuahmed458@gmail.com.

available to business organizations wishing to raise funds to finance their operations. Myers (2001) explains capital structure as an attempt to explain the mix of securities and financing sources used by corporations to finance real investment. Capital structure is a combination of the ratio of debt and equity for the firm to finance it assets. Pandey (2010) posits that capital structure decision is significant managerial decisions that represent the proportionate relationship between debt and equity. Debt comprises of long term debt such as debenture while equity is made up of ordinary share capital, share premium, reserves and retained earnings.

The impact of capital structure on either financial or productive business performance cannot overlook simply because, it is essential to assets accumulations, production of either goods or services that enhances wealth maximization and profit realization by the business organization. The goal of capital structure is to minimize the cost of capital and maximize the firm's value. This suggests that an optimal capital structure decision is essential for firm's survival Ganiyu, (2015).

Banks as a financial sector deals with services of collecting money as deposits and giving out money in form of loans to the people in the society. The banking institutions are financial institutions that play the intermediation role between the surplus and deficit sectors in any economy. Banking sector enhances the flow of funds for productive purposes. It is possible that the amount given as loan is less than the total sum paid by the deficit sector and in that case, the banking institution is supposed to payback the surplus sector from the equity of the banks Al-Mutairi&Naser, (2015).

From the forgoing, the bank managements are tasks to make use efficiently the business funds because, the shareholders as well as the creditors are expecting returns on their respective investment in banks. The decision of the banks management in Nigeria concerning optimal capital structure level in other to achieved organizational goals is a crucial factor on the banks financial performance. Financial performance expresses the optimum utilization of resources and the ability to make a profit Aymen, (2013). The roles of banks in the Nigerian economy are enormous, as such; banks financial performance is an essential factor that should be recon with from the bank's management. The successes achieved on financial performance increases shareholders, creditors

2   Introduction

Abstract-Capital Structure is an important concept in business which have accounted for financial performance of businesses in literature. Thus, this study was conducted to examine the relationship between capital structure and financial performance of commercial banks in Nigeria for the period of (2010 to 2019). Five (5) commercial banks were selected using Judgmental sampling technique. Data were collected from financial statements of selected banks. The data was analyzed using E-View 2010. Unit root test, Granger causality test and panel regression Analysis was conducted in this study. We concluded that, capital structure variables used are good predictor and significant with financial performance of commercial banks in Nigeria. In addition, we concluded that, Debt to Equity Ratio, Total Debts and Total Equity over the period under study, do not contributed to the financial performance (Return on Assets) of commercial banks in Nigeria. Furthermore, Equity to Capital Ratio and Debts to Capital Ratios improves the financial performance(Return on Assets) of commercial banks over the years. We therefore, recommended that, the bank managers should ensure that, capitals are spent on productive assets in other to improve financial performance of the banks, among others. and potential investors' confidence on banks. Hence, financial performance brings about stakeholders' confidence in banks. A favorable bank financial performance engenders creditors' confidence in terms of the ability of the banks to meet their obligations, gives assurance to depositors about the safety of their deposits, rewards shareholders with return for their invested funds, to managers it is an assurance of their jobs security and to the state it shows bank's ability to pay tax Aymen, (2013).

However, the Central Bank of Nigeria (CBN) capitalization policy regulations that mandated banks to have capital structure of tune of 25Billion Naira makes it a demanding task for banks management to determine optimal capital structure. Aremuet al. (2013), opines that, banks needed to mix both debt and equity strategically to attain capital structure at an optimal level. Thus, banks are left with decisions on what optimal capital structure mix between debts and equity accounted to success in financial performance? What mix of equity and debts will ensures lower cost of capital and subsequently improves the financial performance? From the forgoing, many researches had been carried out on capital structure and financial performances of banks in Nigeria. This study aim to examine the capital structure and financial performances of commercial banks in Nigeria for the period of ten (10) years, that is, from 2010-2019. This period was chosen because, it best examine the capital structure mix of commercial banks in Nigeria after the 2010 capital structure regulation by Central Bank of Nigeria (CBN). Many studies do not make use of this period for their studies, thus, making this research a step ahead of other researches. In addition, the study shall focus on five (5) commercials banks. These banks were selected randomly from listed commercial banks in the Nigerian Stock Exchange (2020)

3   a) Financial Performance

Financial performance simply refers to the potential returns made from the transactions of goods and services rendered by the business organization. Financial performance is a yardstick to measure the used of equity finance and debts finance, as well as general wellbeing of the business organization. Bhunia et al. (2011), defined financial performance as firm's overall financial health over a given period of time. They added that analysis of financial performance is aimed at assessing the feasibility, solidity and fertility of a business. Similarly, Nyor and Yunusa (2016) see financial performance as the level of performance of a firm over a specified period of times, expressed in terms of overall profit or losses during that time. It is measuring the results of a firm's policies and operation in monetary terms.

Financial managers use ratios from company financial statement to assess its financial performance Watson & Head, (2007), Bhunia et al., (2011). One of the key factors used in measuring financial performance of an entity is

its profitability. (K.D Mihajlov 2014) said, profitability is the unique measure of corporate success and essential indicator of financial performance. Profits are generators of retained earnings within a firm. Moreover, they are often used ascomponents of the businesses overall income and competitiveness appraisal. Business Organization profitability affects the decision of shareholders and creditors, its ability to invest and provide sustainable growth rates as well as its capability to boost returns on equity and debts. Even though profitability is a sufficient indicator of the current competitiveness of a company, it is better if it is measured over an extended period of time.

4 b) Theories of Capital Structure

For the purpose of this study, Tradeoff theory, Agency Cost theory and Pecking Order theory will be discussed.

i. Pecking Order Theory This theory explains the decision hierarchy to be follow by the banks managers when determining the sources of additional finances to the business. This theory was postulated by Myers and Majluf in 1984. The theory stated that, asymmetric information increases the cost of financing. Because of information asymmetries between the firm and potential investors, the firm will prefer retained earnings to debt, short-term debt over long-term debt and debt over equity. Myers and Majluf (1984) suggest that the problem of information asymmetric can be solved if firms did not issue new security but rather use only its retained earnings to support the investment opportunities at its disposal. This presupposes that issuing equity becomes more expensive as asymmetric information insiders and outsiders increases. Priority is then given to the internal fund because it is the easiest fund to obtain. Thus, the theory concluded that, it is less costly when sourcing for additional finances when retain earnings are used, then follow by debts and lastly equity.

5 ii. Tradeoffs Theory

This theory propounded from the works of **??**itzenberger (1973), Miller (1977), Scott (1977) and Kim (1978) among others. This theory of capital structure gives an assumption that the management of a company will always choose how much debt and equity to use in financing the operations of the entity and that this is obtained by balancing off the cost and benefits associated with each source of finance. According to the theory, firms should select an optimum capital structure that balances the benefits and risks of both debt and equity.

6 Review of Literatures iii. Agency Cost Theory

This theory assumed that, the manager as an agent many not act in the best interest of the shareholders and he determines the best optimal capital structure for the organization. This theory was postulated by Jensen and Meckling (1976). They define the agency relationship inside the firm as: "A contract under which one or more person (the principal) engages another person (the agent) to perform some service on their behalf which involves delegating some decisionmaking authority to the agent". According to this theory, the agent manager may pursue his personal objective or deliberately act in such a way that portrays lack of commitment, self-centeredness which may lead to firm losing its value significantly in contrast with the overall firm's objectives that will maximizes its value. Consequently, conflict of interest may arise between the manager and the firms' owners. Taking up more debt financing may reduce agency cost problems, apart from meeting up the expectation of shareholders, managers must strive hard to redeem the fixed obligation of debt. Therefore, managers are motivated to act in such a way that will protect their interest in terms of job security and welfare.

7 c) Empirical Reviews

The following are researches that establish the impact or relationship between capital structure and financial performance of banks in Nigeria.

Ningi S. I. and Usman H. A. (2017) examined the effect of capital structure on financial performance of deposit money banks in Nigeria. It was observed that capital structure has direct impact on financial performance of Deposit Money Banks (DMBs). It is one of the important financing decisions of banks that is closely related to its survival. Taken into consideration the advantages of using debts, such as monitoring the conducts of managers as well as tax shielding ability, it is imperative for banks managers to explore less costly debtfinancing opportunities to finance their operations. DMBs should ensure optimum mix of debt and equity in their capital structures to maximize financial performance.

Adeniyi, A. J., Marsidi, A., Babatunji, A. S. (2020) study capital Structure and Commercial Banks Performance in Nigeria. This study used profit after tax and earnings per share as a measure of performance and employed panel regression technique to analyze data collected from a sample of fourteen quoted commercial banks between 2009 and 2016. The result shows a significant relationship between debt and profitability of commercial banks in Nigeria. The study concludes that debt can be significantly influenced by liquidity and shareholders' wealth. Consequently, the study recommend that commercial bank managers should not depend on debt capital as a source of financing the organization capital structure but rather use retained earnings of the business and consider debt as the least alternatives.

Adeoye and Olojede (2019) examined the effect of capital structure on the performance of some selected banks in Nigeria. The objectives were to examine the relationship that exists between capital structure and financial

performance and to investigate the effect of capital structure on the financial performance of quoted deposit money banks in Nigeria.

To achieve these, a cross sectional time series secondary data covering the period of seven years (2012-2018) was extracted from the audited financial statement of ten (10) banks listed on the floor of stock exchange. The descriptive statistics, Pearson moment correlation and multiple linear regressions were used. The correlation results showed that capital structure is negatively correlated with financial performance (ROA and ROE). Result from panel regression revealed that debt to equity though significant, impacted negatively on return on assets and return on equity, asset tangibility significantly impacted return on asset but insignificantly impacted return on shareholder's assets. Also Age have a significant impact on return on asset and insignificant effect on return on equity. They therefore concluded that capital structure have a negative effect on the financial performance of deposit money banks in Nigeria and recommended that appropriate proportion of capital should be tailored towards viable investment opportunities for maximum return of shareholders wealth and increase in value of the firm. More so, while finance manager is alert to the movement in the stock market, banks should take precautionary measures for mitigating credit risk associated with lending and borrowing.

E Chuke Nwude and Kenneth Chikezie Anyalechi, (2018), examine Impact of Capital Structure on Performance of Commercial Banks in Nigeria. The study evaluated the influence of financing mix on the performance of commercial banks, and the causal link between debt-equity ratios. Data collated were analyzed using correlation analysis, pooled OLS regression analysis, fixed effect panel analysis, random effect panel analysis, granger causality analysis, as well as post estimation test such as restricted f-test of heterogeneity and Hausmantest. The findings show that while debt finance exert negative and significant impact on return on asset, the debt-equity ratio has positive and significant influence on return on equity. There was neither unidirectional nor bidirectional relationship between capital structure and performance of commercial banks in Nigeria.

Hafiz U. A, (2018), studied capital structure and performance of deposit money banks in Nigeria. Accordingly, the general objective of this study is to assess the impact of capital structure on the financial performance of Bank in Nigeria with specific reference to how debt ratio and equity ratio affect return on equity The study recommends that more incentives need to be given to STD suppliers to effectively adjust the maturity structure of STDs. Similarly, debt should be used with caution in order to explore its tax shield and managerial efficiency benefits.

8 III.

9 Methodology a) Research Design and Sources of Data

The study adopted a descriptive research design. A descriptive approach in data collection is able to collect accurate data on and provide a clear picture of the phenomenon under study. In addition, the principal method common to this kind of research is empirical method. This method entails the use of quantitative, statistical or regression techniques in evaluating the research issues or problems.

The judgmental sampling design was used to select five banks from the Nigerian Stock Exchange to carry out the empirical analysis. These banks are First Bank plc, First City Monument Bank; Guarantee Trust Bank (GTB), Union Bank, and Zenith Bank. Ten years, between 2010 and 2019 were used for the empirical analysis. Data were sourced from the Nigeria stock exchange and annual report of the respective banks.

10 b) Regression Model and Variables

The financial performance that is the dependent was proxy by Return on Equity (ROA), which simply means the returns accrued from the use of business assets. Thus, this was used in proxy of financial performance because, both equity and debt finances are used to purchase assets of the business. On the other hand, independent variable, which is capital structure, is proxy by: Debt to Equity Ratio (DTER), the leverage ratio showing how the business uses its debt and equity to finances its assets, Debt to Total Capital Ratio (DTCR), which shows the quantum of debts in total capital of the business, Equity to Total Capital Ratio (EQCR), the ratio of equity in total capital structure of the business, Total Equity (TEQ), the total amount of equity contributed by shareholders and lastly, Total Debts (TDBT), the total liabilities or debts finance in the business i. Model I ROA it = ? 0 + ? 1 DTER it + ? 2 DTCR it + ? 3 EQCR it + ? 4 TEQ it +? 5 TDBT it +? it + ? it + ? it Where; a = intercept ROA = Return on Equity DTER = Debt to Equity Ratio DTCR = Debt to Total Capital Ratio EQCR = Equity to Total Capital Ratio TEQ = Total Equity TDBT = Total Debts

In the equation, i is the individual dimension and t is the time dimension. The ? i and ? i parameters represent the overall constant in the respective model.

ii. Model II In other to achieve the first objective of the study, the study employs the granger causality test so as to see the direction of causality between capital structure and financial performance of banks. The model takes the form as specified below:ROA it = ? 0 + ? k i=1 ? 1 DTER it-1 + ? k i=1 ? 2 DTCR it-1 + ? k i=1 ? 3 EQCR it-1 ? k i=1 ? 4 TEQ it-1 + ? k i=1 ? 5 TDBT it-1

It is assumed that the error terms are uncorrelated. Model II is used to determine the causality between ROA and other independent variables used for the capital structure. The null hypothesis is that ROA does not granger cause independent variables. The Fstatistics is compared. If the F-statistics is significant for any of the coefficient then the null hypothesis is rejected.

11 c) Method of Data Analysis

Unit root test was conducted to establish if there is stationarity in the data used for this research. Since time series data are proneto spurious regression thus, a way out of this is to test for stationarity of all variables using the Augumented Dickey Fuller Unit Root Test. The null hypothesis is that, the data has unit test root. If the P-value is less or (0.05 or 5%), the null hypothesis will be rejected and vice versa.

In addition, in other to check if there is muticollinearity, that is if there is correlated relationship between the dependent and independent variables, correlation Matrix table will be used to examine the relationship between the variables.

12 Where;

IV. The Granger Causality Test carried out to examine if there is a causal relationship between the dependent variable and independent variables. The Table 4.2 above show that, Return on Asset (ROA) don not have a causal relationship with Debt to Equity Ratio (TDER). This was in line with the study of Adeoye and Olojede (2019). In the same vein, Return on Assets (ROA) does not have causal relationship with Total Equity (TEQ), Total Debts (TDBT), and Total Debts to Capital Ratio (DTCR) and Equity to Capital Ratio (EQCR). The p-values of all the variables as shown in the table 4.2 are less than (0.05), thus, there is unidirectional or bidirectional relationship between capital structure and financial performance of commercial banks in Nigeria. This was in line with the study of E Chuke Nwude and Kenneth Chikezie Anyalechi, (2018). Therefore, we reject the null hypothesis which says the dependent variable Granger caused the independent variables. 4.4 which show the result f unit root test carried out to examine if the data used for the variables are stationarity over the period of the study. This test was carried out using E-View 10, thus, revealed that, the P-value (0.0149< 0.05), there is no unit root in the data, thus, at the first difference; the Return on Assets (ROA) is stationary. Therefore, we reject the null hypothesis which says there is unit root in the data over the years.T his result is line with the study of **??**deoye and Olojede (2019). (ROA). Debt to Equity Ratio (DTER) with coefficient of (0.07), shows negative insignificant relationship with Return on Assets (ROA). And lastly, Equity to Capital Ratio (EQCR) with coefficient of (-0.55) also revealed a negative insignificant with Return on Assets (ROA). Form the forgoing; we can conclude that, there is no multicolinearity between the variables, because independent variables are insignificant with the Return on Assets (ROA).

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14 a) Panel Regression Results

From the above table, R-squared (0.915) means that, the independent variables together explained 91.5% of the Return on Assets (ROA), thus, the remaining (8.5%) are other factors not captured in this study.

In addition, the Prob (F-statistics, 0.028< 0.05), shows that, there is a significance relationship between capital Structure and financial performance of commercial banks in Nigeria. This result is line with the study of Adeoye and Olojede (2019), Ningi S. I. and Usman H. A. (2017) and Hafiz et al (2018).

The regression result also shows the coefficient relationship between the independent variables and Return on Assets (ROA). Debts to Equity Ratio (DTER), was statistically insignificant (coefficient -0.6345, p-value 0.3036) and have a negative relationship with the Return on Assets (ROA). This implies that, the Debt to Equity Ratio over the years do not improve the financial performance of commercial banks in Nigeria over the years. This was in line with the study of E. ChukeNwude and Kenneth Chikezie Anyalechi, (2018),. Equity to Capital Ratio (EQCR) and Debts to Capital Ratio(DTCR)shows a negative but statistical significant relationship (coefficient -4.7365, p-value 0.0110 and (coefficient -18.6211, p-value 0.05 respectively) with the Return on Assets (ROA). This mean Equity to Capital Ratio (EQCR) and Debts to Capital Ratio (DTCR) has positive influence on the financial performance. The negative coefficient may be as result of Equity and debts capital incurred on non-performing Assets. This was in line with researches conducted by Ronoh and Ntoiti (2015) and Ramadan and Ramadan (2015). Total Debts (TDBT) is positively insignificant (coefficient 1.1137, p-value 0.3748) with the Return on Assets (ROA). This implies that, the Total Debts (TDBT) is irrelevant to the financial performance of commercial banks in Nigeria. Total Equity (TEQ) shows negative insignificant relationship (coefficient -1.0833, p-value 0.3027) with Return on Assets (ROA). Therefore, it is immaterial and do not improves financial performance of commercial banks in Nigeria.

15 V. Conclusions and Recommendations

This study carried out to examine the relationship between capital structure and financial performance of banks in Nigeria. The study used five (5) commercial banks and financial statements of the 10 years period form (2010-2019). From the study, we concluded that, capital structure variables used are good predictor of financial performance of commercial banks in Nigeria. In addition, we concluded that, Debt to Equity Ratio, Total Debts and Total Equity over the period under study, do not contributed to the financial performance of commercial banks in Nigeria. From the forgoing, we recommended that:

1. The statistical insignificant of Debts to Equity Ratio to Financial performance: thus, we recommended that, the bank managers should ensures adequate and robust capital structure mix between equity and debts

279 finances in other to yield favorable outcome in the future. 2. We also, recommend that, the commercial banks
280 should not depend highly on the debts finances, thus, they should make use of their retain earnings to boost their
281 capitalization, as this is in line with pecking order theory. 3. The bank managers should ensure that, capitals are
282 spent on productive assets in other to improve financial performance of the banks. 4. Finally, the government
283 should put in place relevant policies that will improve performance of capital markets where finances are source
284 from, and also, put in place polices that will make commercial banks find retain earnings more attractive than
  debts. [1]

4

		1: Descriptive Statistics			
	N	Minimum	Maximum	Mean	Std. Deviation
ROA	10	.07	.22	.1480	.04517
DTER	10	23.21	33.60	28.1980	3.59973
DTCR	10	4.00	4.31	4.1880	.09414
EQCR	10	.69	.96	.8170	.08015
TEQ	10	1122336	2443981	1750909.30	484129.744
TDBT	10	5294135	15531117	9845646.60	3221889.668
Valid N (listwise)	10				

Author's Computations, 2020.

Null Hypothesis:	Obs	F-Statistic	Prob.
DTCR does not Granger Cause ROA	8	0.65444	0.5809
ROA does not Granger Cause DTCR		2.74412	0.2101
DTER does not Granger Cause ROA	8	1.19583	0.4150
ROA does not Granger Cause DTER		3.02217	0.1910
EQCR does not Granger Cause ROA	8	1.65610	0.3276
ROA does not Granger Cause EQCR		5.10023	0.1083
TDBT does not Granger Cause ROA	8	0.97585	0.4716
ROA does not Granger Cause TDBT		0.18175	0.8424
TEQ does not Granger Cause ROA	8	0.29607	0.7632
ROA does not Granger Cause TEQ		0.32148	0.7473

Author's Computations 2020.

Figure 1: Table 4 .

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Figure 2: Table 4 . 2 :

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	ROA	TDBT	TEQ	DTCR	DT
		3: Multicolinearity Test. Correlation Matrix			
ROA	0.001836				
	1.000000				
TDBT	0.169337	9.34E+12			
		1.000000			
TEQ	-0.017695	1.28E+12	2.11E+11		
		0.915220	1.000000		
DTCR	0.051219	213823.4	21900.20	0.0007976	
		0.783305	0.533915	1.000000	
DTER	-0.073287	5472200.	456362.08	201246	11.
		0.524250	0.290962	2659847	1.0
EQCR	-0.554345	-173441.0	-16665.19	-005556	-0.1
	-0.746309	-0.477228	-818216		0.4

Author's Computations 2020.

Table 4.3 above show the results of correlation relationship between the viable which is used to examine if there is multicolinearity among the variables used in the study. Total Debts (TDBT) with coefficient of (0.169) exhibits positively insignificant relationship with Return on Assets (ROA). Total Equity (TEQ) with coefficient of (-0.017) shows negative significant relationship with Return on Assets (ROA). Debt to Capital Ratio (DTCR) with coefficient of (0.05) shows positive significant relationship with Return on Assets

Table 4.4: Unit Root Test

		t-Statistic
Augmented Dickey-Fuller test statistic		-4.125697
Test critical values:	1% level	-4.420595
	5% level	-3.259808
	10% level	-2.771129

*MacKinnon (1996) one-sided p-values.

Warning: Probabilities and critical values calculated for 20 observations and may not be accurate for a sample size of 9

Figure 3: Table 4 .

45

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	23.50160	6.081689	3.864321	0.0181
LOG(EQCR)	-4.726575	1.055664	-4.477350	0.0110
LOG(DTCR)	-18.62110	6.940146	-2.683100	0.0551
LOG(DTER)	-0.634583	0.538052	-1.179409	0.3036
LOG(TDBT)	1.113754	1.116107	0.997891	0.3748
LOG(TEQ)	-1.083294	0.916618	-1.181839	0.3027
R-squared	0.915320	Mean dependent var		-1.957468
Adjusted R-squared	0.809470	S.D. dependent var		0.334952
S.E. of regression	0.146206	Akaike info criterion		-0.723897
Sum squared resid	0.085504	Schwarz criterion		-0.542346
Log likelihood	9.619487	Hannan-Quinn criter.		-0.923058
F-statistic	8.647338	Durbin-Watson stat		1.433486
Prob(F-statistic)	0.028758			

Author's Computations, 2020.

Figure 4: Table 4 . 5 :

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