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EFFECT OF CAPITAL STRUCTURE ON THE LIQUIDITY OF QUOTED CONSUMER GOODS FIRMS IN NIGERIA

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Abstract

The study investigated the effect of capital structure on the liquidity position of quoted consumer goods firms in Nigeria. Data was collected from audited annual report of quoted consumer goods firm in Nigeria Stock Exchange and the data was analyzed using both descriptive and inferential statistics. The result of this study revealed a negative relationship between total debt to equity ratio and current ratio of selected consumer goods companies but statistically significant at 5%. Long term debt ratio also has negative and statistical significant relationship with the liquidity position of quoted consumer goods firms in Nigeria while debts to equity ratio was found to be negatively and significantly related with the liquidity position of quoted consumer goods firms in Nigeria. The study recommends that consumer goods firms quoted on NSE should adopt a better and more profitable capital structure and implement better strategy to source for the firm and reduce the rate at which the fund comes from external source especially creditors and bank or any financial institution.

Keywords: Capital Structure, Liquidity Position, Consumer Goods Firm, Equity Capital Ratio and Long Term Debts Ratio

Introduction

Liquidity refers to the ability of the business to meet its cash obligations within a specific time Period. Profitability and liquidity are related concepts, but by no means are they equivalent. According to Chandra (2011), normally a high liquidity is considered to be a sign of financial strength, however according to some authors as noted by Neto (2013), a high liquidity can be as undesirable as a low. Liquidity position of quoted manufacturing company in Nigeria can be attributed to many factors. Capital structure refers to a mixture of a variety of long term sources of funds and equity shares including reserves and surpluses of an enterprise. It is a combination of a company's long-term debt, specific short-term debt, common equity and preferred equity. The capital structure is how a firm finances its overall operations and growth by using different sources of funds. Debt comes in the form of bond issues or long-term notes payable, while equity is classified as common stock, preferred stock or retained earnings Neto (2013).

Capital structure usually also to how much of each type of financing a company holds as a percentage of all its financing. Generally speaking, a company with a high level of debt compared to equity is thought to carry higher risk, though some analysts do not believe that capital structure matters to liquidity (Rehman, 2017).

Statement of the Problem

The relationship between capital structure and liquidity has been always a major concern for the financial managers in many companies. Debt and equity are the two major classes of liabilities, with debt holders and equity holders representing the two types of investors in the firm. Each of these is associated with different levels of risk, benefits, and control. While debt holders exert lower control, they earn a fixed rate of return and are protected by contractual obligations with respect to their investment. Equity holders are the residual claimants, bearing most of the risk and have greater control over decisions (Modigliani and Miller 2015). This problem drawn the attention of this study to investigate on how managers of quoted consumer goods companies in NSE combine different sources of funding to enhance liquidity performance of the companies.

Research Questions

In view of this research sought to address the following research questions:

- i. Does equity total assets ratio determine the liquidity position of quoted consumer goods firms on Nigerian Stock Exchange?
- ii. Total debts to equity ratio and total debt to total assets mean the same concept (Debt ratio). Therefore, total debt to equity ratio should be replaced with equity to total assets?
- iii. What is the effect of long term debt-total asset ratio on the liquidity position of quoted consumer goods firms on Nigerian Stock Exchange?

Objectives of the Study

Consequently, general objective of this work was to examine the relationship and effect of capital structure on the liquidity position of quoted consumer goods firms in Nigerian Stock Exchange.

The specific objectives of this study are to:

- i. examine the effect of equity ratio total debt to equity ratio on the liquidity position of quoted consumer goods firms in Nigerian Stock Exchange.
- ii. analyze the relationship between total debt to total asset ratio and the liquidity position of quoted consumer goods firms in Nigerian Stock Exchange.
- iii. evaluate the effect of long term debt-total asset ratio on the liquidity position of quoted consumer goods firms in Nigerian Stock Exchange.

Justification of the Study

This study will provide information to the financial institutions, consultants and entrepreneurs with the necessary tools to plan the financing of their businesses, The findings was also to provide information for the regulatory organizations involved in promoting investment, such as the Capital Markets Authorities in Nigeria, to assist them analyze and harness the financial resources relevant to businesses. Lastly, the study will also be useful to other researcher who want to carry out their study in relation to this topic.

Literature Review

The section is sub-divided into three namely: conceptual framework, theoretical framework and empirical review.

Capital Structure

Capital structure denotes means an establishment funds its operations using some blend of equity plus debt (Tsai, 2010). Nirajini and Priya (2013) define it as the technique an establishment applies for financing based on a blend of long-term capital (ordinary and preference shares, debentures, loans, loan stock, etc.) in addition to short-term obligations like overdraft and other payables. Also, Lambe (2014), Akinyomi and Olagunju (2013), Salawu (2009) opined that capital structure is the mixture of diverse securities utilized by a company in financing its profitable ventures. What is common to the above definition is that capital structure reflects each component of finance from equity to debt that a company uses in financing its operations.

Liquidity Position

Begg, Fisher and Rudiger. (2011), liquidity refers to the speed and certainty with which an asset can be converted back into money (cash, income) whenever the asset holder desires. Cash is the most liquid asset of all. In terms of accounting, liquidity can be defined as the ability of current assets to meet current liabilities (working capital). In terms of investment, it is the ability to quickly convert an investment portfolio to cash with little or no loss in value. A liquid company is one that stores enough liquid assets and cash together with the ability to raise funds quickly from other source to enable it meet its payment obligation and financial commitment in a timely manner.

This is further in explained with the diagram below:

Capital structure

Equity to Total Asset Ratio

Debt to Assets

Long Term Debts Ratio

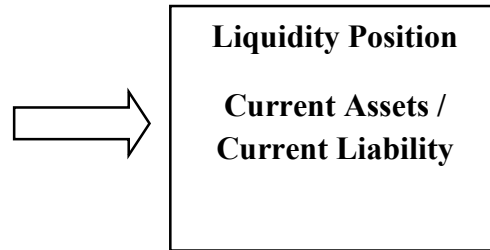


Figure 2.1 Conceptual Frameworks

Theoretical Framework

Pecking Order Theory

Myers & Majluf (1984) came up with this theory. According to this theory, there is no predefined optimal capital structure but instead asserts that, firms display different preference for utilizing internal funds or retained earnings over external capital. It is the one of the most significant theories of company leverage and goes against the firm's idea of having distinctive combination of equity and debt finance, which minimizes the corporation costs of funds.

Trade-Off Theory

This theory was proposed by Myers (1984). The theory holds that, there exists an optimal capital structure for every firm, which can be determined by balancing the costs and benefits of equity.

As a result, a firm decides on how much debt capital and how much equity capital to include in their capital structure by balancing on the costs and benefits of each source. Debt capital results to benefits such as tax shield though high debt levels in the capital structure can result to bankruptcy and agency expenses.

Empirical Review

Muhammad & Madiha (2015), in their study of the impact of capital structure on firms' financial performance in Construction and Material (Cement) Sector of Karachi Stock Exchange also noted negative relationship. Jude Leon (2013) investigated the relationship between capital structure and the financial performance of 30 listed manufacturing firms in Sri Lanka from 2008 to 2012 discovered significant negative relationship between leverage and return on equity. Do Xuan. And Wu Zhong. (2013) investigates the impact of ownership structure and capital structure on firms' financial performance in the context of emerging transitional economy.

Ogundipe & Idowu. (2012), conducted a study to examine the impact of working capital management on the performance and market value of companies. The study used Tobin Q, ROA, EBIT, and ROI as the dependent variables while the independent variables were cash conversion cycle; current ratio; current asset to total asset ratio; current liabilities to total asset ratio; and debt to asset ratio. Using correlation and multiple regression analysis techniques, the study established that a significant negative relationship exists between cash conversion cycle and market valuation and a firm's performance.

Mubeen and Akhtar (2014) examined the effect of capital structure on the financial performance of 155 Textiles firms between 2006 and 2011 using ROA, ROE and EPS as proxy for financial performance. The results of regression analysis show that the capital structure positively impact the firm's financial performance and shareholders Wealth. Following similar result, the study by Mwangi (2010) on capital structure of firms listed at the Nairobi Stock Exchange identified a strong positive relationship between leverage and return on equity, liquidity, and return on investment.

Methodology

The study adopted a similar regression model from the study of Oman (2012). This model assisted in testing the stated hypotheses of the study and in achieving the objectives earlier stated. The functional specification of the model takes the following form.

$$Y = b_0 + b_1 D_1 + b_2 Z_2 + e_{it}$$

Where; Y is the dependent variable

D_1 is the explanatory variable

Z_2 is the controllable variable

B_0 and B_1 are the coefficient of the explanatory and controllable variables

e_{it} is the error term

The econometric specification is as follows:

$$ROA = B_0 + B_1 DR + B_2 TURN + B_3 SIZE + B_4 AGE + B_5 TANG + B_6 GROWTH + e_{it}$$

(With the inclusion of industrial sector variable)

$$ROA = B_0 + B_1 DR + B_2 TURN + B_3 SIZE + B_4 AGE + B_5 TANG + B_6 GROWTH + B_7 IND + e_{it}$$

The model used in this study was built on the modification of the above-stated model. Some of the variables were excluded from the model because they do not actually measure firm's liquidity which is the focus of this study. For the purpose of this study, firm's liquidity was measured total debt-equity ratio, total debt-asset ratio and long term debt-asset ratio. This is considered as an appropriate proxy for capital structure as it measures the liquidity of an organization. The functional specification of the model takes the following form:

$$LP = f(DER + DAR + LDAR + SIZE + GROWTH)$$

The econometric specification is as follows:

$$LP = a + b_1 DER + b_2 DAR + b_3 LDAR + b_4 SIZE + b_5 AGE + e_{it}$$

Where;

LP = Liquidity Position

DER = Equity to Total Asset Ratio

DAR = Total Debt-Asset Ratio

LDAR = Long Term Debt-Asset Ratio

SIZE = Firm Size

GROWTH = Changes in Sales

a = Intercept for X variable of firms

$b_1 - b_5$ = Coefficients for the independent and control variables of firms, denoting the nature of relationship with dependent variable LP (or parameters)

e_{it} = Error Term

A priori expectation: There is an expectation of a significant positive relationship between firm's liquidity (current ratio/liquidity position) and all measures of asset efficiency and also a significant positive relationship between firm's liquidity and firm's size i.e. $b_1, b_2, b_3, b_4, b_5 > 0$ (Oluwaremi & Member, 2016).

Research Design

According to Ghauri and Gronhaug (2005), research design involves establishing a plan or a specified framework for collecting data for the study and its subsequent analysis, which contains research approach and the priorities of the great interest to the researcher. This research study employed descriptive research design in order to establish the effects of capital structure. Descriptive research design is a powerful type of quantitative analysis (Kothari, 2004).

The descriptive design is chosen because it enables the researcher describe research area, establish the relationship and explain the data collected in order to examine the similarities and differences with our frame of reference within a specific period of time.

Population, Sampling Technique and Sample Size

The population of this study was taken from the consumer goods firms listed on the Nigerian Stock Exchange. Therefore, out of the 27 listed companies in the consumer goods sector, 2 companies will be used for the purpose of this research work whereas the financial statements are sufficient for the analysis to be efficiently carried out. As regard this, the two companies used and the period covered are as follows;

S/N	NAME OF THE COMPANIES	YEAR COVER	OBSERVATIONS
1.	Cadbury Nigeria Plc.	2001-2017	17

2.	Unilever Nigeria Plc.	2001-2017	17
	Total		34

Table 3.1: Sample Size

Type and Source of Data

This research is basically based on secondary data. To gather data which is used in the present study, financial information was from the audited financial statements. The data was from the annual report are reliable, because according to part X1, chapter one of the Companies and Allied Matters Act 2004, companies are required to keep accounts and to produce accounts that give true and fair view of the company.

Measurement/Definition of Variables

The topic of the research, ‘effect of capital structure on the liquidity of manufacturing companies’ has two variables; the dependent variable and the independent variables

Dependent Variable (Firm’s Liquidity)

The dependent variable of the study is firms’ liquidity position. In order to analyze the effect of assets efficiency on the firm’s liquidity, the liquidity position/ current asset ratio was used as proxy for dependent variable. Current asset ratio measures the level at which the current asset available can satisfy the available accrued current liability. This ratio gives investors a figure that can be compared between different firms and investment opportunities.

The ratio is calculated as follows:

$$\text{Current asset ratio} : \frac{\text{Current asset}}{\text{Current liability}}$$

Independent Variables

With regards to the independent variables, capital structure of firms is measured by using total debt equity ratio, total debt total asset ratio and long-term debt total asset ratio.

The independent variables are defined by the following formula:

$$\text{Equity to Total Asset Ratio} : \frac{\text{Total Debt}}{\text{Equity}}$$

$$\text{Total debt-total asset ratio} : \frac{\text{Total Debt}}{\text{Total Assets}}$$

$$\text{Long Term debt-total asset ratio} : \frac{\text{Long-term Debt}}{\text{Total Assets}}$$

Method of Data Analysis

The study made use of both descriptive and inferential statistics for the analysis of the data from the period of 2001 – 2017. Inferential statistics employed in this study included correlation and regression analysis. Pearson correlation was used to measure the degree of association between different variables under consideration and unbalanced panel data regression method was used for the analysis of the hypotheses to determine the relationship of independent variables with dependent variable and know the effect of independent variables on the dependent variable.

Findings and Discussion

Descriptive Analysis

Shows the descriptive statistics of the variables used in the study. It embodies number of observation, mean, standard deviation, minimum and maximum, of the variables used.

Descriptive statistics showing mean, standard deviation, minimum and maximum values of the variables for the selected firms considered in this study

	N	Minimum	Maximum	Mean	Std. Deviation
Current Ratio	34	.39	2.45	.9744	.43478
Total Debt/Equity Ratio	34	-8.93	12.57	2.6324	3.21985
Total Debt/Total Assets	34	.37	1.13	.6841	.15632
Long Term Debts/Total Assets	34	.05	.41	.1809	.09472
Firm Size	34	6.87	8.08	7.4871	.23356
Growth	34	-45.75	298.14	11.1785	53.08207
Valid N (listwise)	34				

Source: Authors Computation, 2019.

The standard deviation measures the amount of variability in the distribution of a variable. The liquidity position measured by current ratio gives mean value of 0.9744. This indicates that the average performance of the selected firms is below the standard ratio of 2:1 indicating the firms do not have sufficient current assets to pay all their current liabilities. The descriptive statistics reveals that under the study period, the selected capital structure ratios as measured by total debt/equity ratio (TDER), debt ratio (TDTA), long term debt total assets (LDTA), firm size (FS) and growth rate (GR) have positive mean values which ranges from 0.64 for total debt/equity ratio (TDER) to 11.17 for debt ratio (TDTA), long term debt total assets (LDTA), firm size (FS) and growth rate (GR). Growth rate and debt/equity ratios have the highest standard deviation of 53.08 and 3.22. This indicates that the observations in the data set are widely dispersed from the mean. So the management of consumers' goods firms in Nigeria should monitor their growth rate and debt/equity ratios.

Correlation Analysis

It is assumed that the explanatory variables are not correlated with one another, but in any practical context, the correlation between explanatory variables will be non-zero, although this will generally be relatively being in the sense that a small degree of association between explanatory variables will almost always occur but will not cause too much loss of precision.

However, a problem occurs when the explanatory variables are very highly correlated with each other, and this problem is known as multicollinearity. It is possible to distinguish between two classes of multicollinearity: perfect multicollinearity and near multicollinearity (Brooks C., 2008).

Table 2: Correlation Matrix of all variables (2001 -2017)

	CUR	TDER	TDTA	LDTA	SIZE	GTH
Current Ratio	1.000	-.265	-.791	-.366	.259	.258
Total Debt/Equity Ratio	-.265	1.000	.207	.102	.214	-.197
Total Debt/Total Assets	-.791	.207	1.000	.159	.032	-.166
Long Term Debts/Total Assets	-.366	.102	.159	1.000	-.221	-.271
Firm Size	.259	.214	.032	-.221	1.000	-.086
Growth	.258	-.197	-.166	-.271	-.086	1.000

Source: Authors Computation, 2019.

As can be presented in the above table, multicollinearity test of the model, the study checked the correlation matrix, which varies between -1 and 1, if the p-value is 0, there is no linear correlation, and if the p-value is -1 or 1, the study has a perfectly negative or positive relationship between the variables.

Correlation coefficients among the explanatory variables range from 3.2% to 79%. This correlation matrix reflects the relative strength of the linear relationship between these variables.

According to (Pallant, 2005), usually the multicollinearity exists if the correlation between two independent variables is more than 0.9 ($r=0.9$ or above). As it appears in the correlation matrix table above, there is no such high correlation between independent variables of both models. It can therefore be concluded that there is no problem of multicollinearity among independent variables.

Model Summary

This section of the study presents model summary to indicate the explanatory power of the independent and control variables of the study.

Table 3 Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.877 ^a	.769	.728	.22692	.769	18.629	5	28	.000	1.929

a. Predictors: (Constant), Growth, Firm Size, Total Debt/Total Assets, Total Debt/Equity Ratio, Long Term Debts/Total Assets

b. Dependent Variable: Current Ratio

Source: Authors Computation, 2019.

The above table shows that the coefficient of multiple determination R square which explains the extent to which the independent variables affect the dependent variable in this case, 0.769 or 76.9% of the variations in the dependent variable were explained by the independent and control variables. The adjusted R square, a more conservative way of looking at the coefficient of determination is 0.728 or 72.8% which suggests that only 72.8% of the variations in the dependent variable is explained by the independent variables. So this implies that independent and control variables of this study are not the only determinant factor of liquidity ratio of the consumer goods firms in Nigeria as only 27.2% of the variations in dependent variable are determined by other factors outside the selected independent and control variables of this study. Moreover, this table also shows the result of $f=18.62$ with $df(5, 28)$ and Durbin Watson of 1.929.

Regression Analysis

The study conducted a multiple regression analysis so as to determine the relationship between dependent variable of liquidity position measured by current ratio and capital structure measured by total debt/equity ratio (TDER), debt ratio (TDTA), long term debt total assets (LDTA) as independent variables and firm size (FS) & growth rate (GR) as control variables of the study. The data of the study was analyzed using statistical package for social science (SPSS) which generated table 3 given below:

Table 4: Regression of Current Ratio on Total debt Equity Ratio, Total Debt Total Assets Ratio, Long Term Debt Total Asset, Firm Size and Firm Growth

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-1.491	1.376		-1.084	.008
Total Debt/Equity Ratio	-.019	.013	-.142	-1.471	.152

Total Debt/Total Assets	-2.036	.262	-.732	-7.765	.000
Long Term Debts/Total Assets	-.669	.454	-.146	-1.475	.001
Firm Size	.537	.180	.288	2.981	.006
Growth	.001	.001	.094	.969	.341

a. Dependent Variable: Current Ratio

Source: Authors Computation, 2019.

Table 4 reports the empirical regression results of the variables used in the study.

According to the regression equation established, taking all variables into account and constant at zero, liquidity position will be -1.491. This means, when all explanatory variables take a value of zero, the average value current ratio would take 1.491 which is statistically significant at 5% of significance level.

As also presented in the table 5, a coefficient of capital structure measured by total debt/equity ratio (TDER) is -0.142 and its P-value is 0.152. This implies that though there is a negative relationship between total debt to equity ratio and current ratio of selected consumer goods companies yet the relationship is not statistically significant at 5%. This indicates that, holding other variables constant at their average value, when total debt to equity ratio (TDER) is increased by 1 unit, current ratio of the sampled firms may not necessarily decrease by 14%.

This therefore suggests that though debt/equity ratio is good for explaining liquidity position of consumers' goods firms, it is not a critical variable to consider when taking decision to improve liquidity position of consumers' goods firms in Nigeria. In view of this, the study fails to reject hypothesis one which states that there is no significant relationship between total debt/equity ratio and liquidity position of consumers' goods firms in Nigeria. As presented in the above table, the coefficient of debt ratio (TDTA) is -0.732 and its p-value is 0.000. It means that there exists a negative relationship between total debt/total asset ratio and liquidity position of consumers' goods firms in Nigeria suggesting that holding other independent and control variables constant at their average value, when debt ratio (TDTA) increased by one unit, current ratio would be decreased by 73%.

Therefore, the study rejects hypothesis two which states that there is no significant relationship between long term debt ratio and liquidity position of consumers' goods firms in Nigeria and accept alternate hypothesis which state otherwise.

The study also reveals that long term loan total asset ratio has negative effect on liquidity position as indicated by negative slope coefficient of -0.146 which is statistically significant at 5% as the probability value is less than 0.05 ($p=0.001 < 0.05$). It means that there exists a negative relationship between long term debt simply called total debt ratio and current ratio of consumers' goods firms in Nigeria suggesting that increasing the ratio by one percent will lead to a 14.6% decrease in current ratio of the selected firms. Therefore, the study rejects hypothesis three which states that there is no significant relationship between long term debt total assets ratio and liquidity position of consumers' goods firms in Nigeria and accepts alternate hypothesis which state otherwise.

It is important to note that all the components of capital structure had negative relationship with liquidity position of consumers' goods firms in Nigeria. This result follows the assumptions of pecking order theory which states companies with higher financial leverage tend to choose more aggressive working capital strategies such practices as tightening credit conditions for customers (debtors) and reducing inventories in order to ensure the internal financing and therefore avoid the issuance of debts and equity. These negative relationships can therefore be interpreted on the ground of pecking order theory that selected consumers' goods firms, considering their higher debts ratio prefer more aggressive working capital strategies because firms with high debts tend to need more cash flow from operations in order to repay their debts or to renew it.

Conclusion

The study has examined the relationship between capital structure variables and the solvency state (current ratio) of quoted consumer goods firms listed on the Nigerian Stock Exchange (NSE)

The data has then been analyzed with the application of the descriptive and the inferential analysis on the statistic covering the period from 2001 to 2017 on two firms in the consumer goods sector. The study noted that all the components of capital structure had negative relationship with liquidity position of consumers' goods firms in Nigeria. These negative relationships can therefore be interpreted on the ground of pecking order theory that selected consumers' goods firms, considering their higher debts ratio prefer more aggressive working capital strategies because firms with high debts tend to need more cash flow from operations in order to repay their debts or to renew it.

Recommendations

The study also recommend that consumer goods firms listed under NSE should adopt a better and more profitable capital structure and implement better strategy to source income for the firm and reduce the rate at which the fund comes from external source especially creditors and bank or any financial institution. It also recommends the adoption of pecking order theory which states companies with higher financial leverage tend to choose more aggressive working capital strategies such practices as tightening credit conditions for customers (debtors) and reducing inventories in order to ensure the internal financing and therefore avoid the issuance of debts and equity.

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