Effect of Financial Structure on the Value of Selected Manufacturing Firms in Nigeria

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ABSTRACT
This study sought to examine the effect of financial structure on the value of manufacturing firms listed on the Nigerian Stock Exchange. The specific objectives are to (i) examine the effect of short term debt financing on earnings per share (EPS) (ii) analyse the effect of long term debt financing on EPS; (iii) examine the effect of share capital (common stock) on EPS; and (iv) ascertain the effect of retained earnings on EPS. In line with these objectives, four research questions and four hypotheses were formulated and each hypothesis was tested at 5% level of significance. The study adopted the ex-post facto research design and the data were sourced from the financial statements of ten (10) selected firms in the manufacturing sector for the period 2007-2016. Unit root and co integration were conducted to test the variables for stationarity property and long run relationship. The tool for statistical test was the Ordinary Least Square (OLS) which was used to test the four hypotheses. The study found that short term debt had significant and positive effect on earnings per share (EPS); long term debt had significant and positive effect on EPS; share capital had insignificant negative effect on EPS; and retained earnings had significant positive effect on earnings per share (EPS) of the selected firms in Nigeria. The study concluded that firms’ engagement of short term, long term and retained earnings had significant effect on earnings per share, although funding from share capital had insignificant negative effect. Among other recommendations, firms should always appraise their financial structure policy with a view to ensuring that the funds are not procured at high cost.

Keywords: financial structure, value, manufacturing firms

INTRODUCTION
Firms employ various types of financing in their operations for two main reasons which include the need to maximize earnings and also the need to minimize cost. Earnings (profit) maximization suggests that a firm should source its finances at a minimum cost and employ same in projects that could guarantee high returns. The main objective here is to maximize profit and also the wealth of the owners. Although these two objectives are conflicting, the bottom line is that the company’s value, measured around the EPS is improved when profit is increased. Arising from economic, social, political, environmental constraints, a firm is usually unable to influence the cost of these sources of financing which include equity, debt, debenture and preference stock.

However, a firm has the option of flexibility in sourcing for funds from these sources depending on the cost implication associated with each. Other factors that are considered at the time of designing a firm’s
Financial structure is the totality of firm’s financing and includes equity (common stock and retained earnings), debt (long term and short term), debenture and preference stock it discloses how a firm finances its assets (Mayer, Mcglugan and Kretlow, 1999). Capital structure on the other hand is a firm’s aggregate source of financing less its short term obligations (Pandey, 2010). Each of these sources of financing attracts some costs. For instance, interest is paid on long term as well as short term borrowing, dividends are paid to both common stock and preference stock holders. At the same time, these funds are used to acquire assets, make investment in income earning assets etc. If the cost of funding the assets is higher than the earnings generated from these asset investments, it will decrease the amount available to common stock holders. However, if the earnings outweigh the cost, it will increase the earnings per share and add value to the firm.

Thus, flexibility in the composition of funds procured by a firm is an important consideration. For instance, the concept of leverage analysis states that highly levered firms (firms with relatively high level of debt financing) are favoured in a favourable rather than recessive economic conditions as the EBIT improves with transition from favourable to very favourable economic conditions.

The issue of linkage between financing mix and firm performance has attracted wide discourse among researchers. Extant studies have produced conflicting results with respect to mixed findings, variation in methodology and scope as well as the models applied. For instance Nwaolisa and Chijindu (2016) used the pooled ordinary least square to test the effect of financial structure on performance of Nigeria consumer goods firms and found that firms that are highly geared are negatively affected and concluded that financial structure had negative effect on financial performance. Another study that found negative effect is Nwude, Itiri & Ude (2016). Hassan, Faisal and Muhammad (2016) studied the impact of debt on profitability of firms in Pakistan and found significant but negative relationship between short term debt, total debt and return on assets. This finding is supported by that of Prempe, Sekyere, and Asre (2016).

The variable for these studies as well as the methodology were not robust as only a component of the financing mix was used. Muchiri, Muturi and Ngumi (2016) found mixed results among the financial structure variables. In essence, the study revealed that short term debt, long term debt, retained earnings and external equity had insignificant negative relationship with return on equity and also on aggregate, financial structure had a significant positive and negative relationship with return on equity and return on assets respectively.

Adenuga, Ige and Kesinro (2016) investigated the relationship between financial leverage and firms’ value of selected Nigerian banks and used a sample of five (5) firms listed on Nigerian Stock Exchange for a period 2007-2012. The study found that financial leverage has significant effect on firm’s value, thus concluded that financial leverage is a more preferred source of finance than equity in financing their long term projects. In contrast however, Kajirwa(2015) found that debt negatively but insignificantly affects firm performance in Kenya.

Extant studies also revealed that some of the studies on capital structure wrongly includes short term debt (a financial and not capital structure variable (Amah and Chimara, 2016; Kakanda, Bellow and Abba; 2016 and Farida, Shagufta and Syed, 2014). Also most of these studies used ROA and ROE as performance assessment variables expressed as a percentage of the net profit over the average composition of her assets and owners’ equity respectively. This study used EPS as proxy for firm value and expressed in naira and is generally designed to assess the worth of the owners’ investment as well as the value of the company. A review of extant studies also revealed that to the best of our knowledge, no study on the topic revolving around the selected firms had been conducted in Nigeria within the period. These created a knowledge gap which the study intends to fill by addressing the following objectives. such as to examine the effect of financial structure on the value of selected manufacturing firms in Nigeria, to ascertain the effect of short term debt financing on earnings per share (EPS) of manufacturing firms in Nigeria, to analyze the effect of long term debt financing on EPS of manufacturing firms in Nigeria, to examine the effect of share capital (common stock) on EPS of manufacturing firms in Nigeria and to ascertain the effect of retained earnings on EPS of manufacturing firms in Nigeria.
METHODOLOGY
Research Design
The study adopted an ex-post-facto research design relying on secondary data already documented in the financial statements of the affected companies.

Population of the study
The population of this study comprises all the quoted firms that operate in the manufacturing sector of the Nigeria economy. These firms engage in the production and manufacturing of final goods that are generally classified for personal use and also intended for the mass market. The products are classified under the following: Beverages (Brewers of distilled/alcoholic or non-alcoholic), consumer electronics, foods products, household durables, personal/ household items, Textiles/ Apparels, Tobacco items, Toy and games. The population of the study is the nine product classification entities comprising about thirty two firms.

Sample and Sampling technique
The sample consist of ten (10) manufacturing firms that had complete records within the period under study and also listed on the floors of Nigerian Stock Exchange. The companies include Vita foam Nigeria Plc, Dangote Cement Plc, Flour Mills Of Nigeria Plc, Avon Crowncaps & Containers Nigeria Plc, Sokoto Cement Company of Northern Nigeria Plc, Nascon Allied Industries Plc, Cutix Plc, Champion breweries Plc, Morison Industries Plc, Seven-up bottling Company Plc.

Nature and Sources of Data
This study used secondary data which were generated from the selected company’s annual report for ten years (2007-2016). The variables in the company’s statement of financial position that were drawn as sample for the study are short term debt, long term debt, share capital, retained earnings and earnings per share (EPS). Debenture stock and preference share were intended to be among the variables except that most companies did not report same as sources of financing.

Variables for the study
The variables for this study were grouped as dependent and independent variables. The dependent variable was represented by Earnings per share (EPS) which is used as a proxy for firm value. It was derived as net profit divided by number of shares outstanding for each year. The independent variables were represented by short term debt (STD), long term debt (LTD), share capital (SC) and retained earnings (RE). Each of these variables was expressed as a ratio of total asset. The justification is that the sources of finance generally provide the needed funds for the acquisition of a firm’s assets.

Model Specification
A linear equation that related the financial structure variables to firm value is stated in a functional notation as :

\[ \text{EPS} = F (\text{STD}, \text{LTD}, \text{SC}, \text{RE}) \]  

The regression model used to analyse the data is expressed in econometric form as:

\[ \text{EPS}_t = \beta_0 + \beta_1 \text{STD}_t + \beta_2 \text{LTD}_t + \beta_3 \text{SC}_t + \beta_4 \text{RE}_t + \mu_t \]  

Where:

- \( \text{EPS}_t \) = earnings per share (net profit/ share capital outstanding)
- \( \text{STD}_t \) = short term debt (short term debt/ total asset)
- \( \text{LTD}_t \) = long term debt (long term debt/ total asset)
- \( \text{SC}_t \) = Share capital (share capital/ total asset)
- \( \text{RE}_t \) = Retain earnings (retain earnings/ total asset)

The above model is a modification of those used by Baron and Kenny (1986) and Muchiri, Muturi and Ngumi (2016), Foyeke, Olusola and Aderemi (2016); Nwude et.al (2016). These models are shown as contribution to knowledge in the last section of this work.

Although these models varied some of the independent variables, all of them adopted either ROA or ROE as dependent variable, a variance of researcher’s model which used EPS as dependent variable.
Data Analysis Techniques
The main tool employed in the course of this research work is the Ordinary Least Square (OLS) regression technique. Regression analysis includes many techniques for modeling and analyzing several variables, when the focus is on the relationship between a dependent variable and one or more independent variables. The statistics analyzed from the results used for interpretations include: coefficient of determination ($R^2$), F-statistic (ANOVA), and the coefficient of the regression analysis. The statistics are explained hereunder:

1. Coefficient of Determination ($R^2$) Test measures the explanatory power of the independent variables on the dependent variable. The coefficient of determination varies between 0.0 and 1.0. A coefficient of determination, say 0.20 means that 20% of changes in the dependent variable is explained by variations in the independent variable(s).

2. F-Test measures the overall significance. The extent to which the statistic of the coefficient of determination is statistically significant is measured by the F-test. Coefficient of the analysis produces a value that explains the nature and degree of relationship between the dependent and independent variables. A positive value means positive relationship while negative value means negative relationship.

PRESENTATION AND INTERPRETATION OF RESULTS
Cumulative Regression Result

Regression

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<th>Variables Entered</th>
<th>Variables Removed</th>
<th>Method</th>
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<td>1</td>
<td>STDcum, LTDcum, SCcum, REcum,</td>
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</table>

a. All requested variables entered.

![Model Summary](image)

a. Predictors: (Constant), STDcum, LTDcum, SCcum, REcum,
b. Dependent Variable: EPScum
### ANOVA\(^b\)

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<th>Model</th>
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a. Predictors: (Constant), STDcum, LTDcum, SCCum, REcum,
b. Dependent Variable: EPScum

### Coefficients\(^a\)

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<th>Model</th>
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<td>B</td>
<td>Std. Error</td>
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<td>LTDcum</td>
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<td>.562</td>
<td>.174</td>
<td>.481</td>
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<td>SCCum</td>
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<td>.782</td>
<td>-.361</td>
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<td>REcum</td>
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<td>.263</td>
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a. Dependent Variable: EPScum

### Residuals Statistics\(^a\)

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<td>Mean</td>
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*a. Dependent Variable: EPScum*
### Regression of the Financial Structure on firm’s Performance

<table>
<thead>
<tr>
<th>Model</th>
<th>Seven Up Plc</th>
<th>Morrison Ind Plc</th>
<th>Cutix Plc</th>
<th>Nascon Plc</th>
<th>Flour Mills Plc</th>
<th>Vittorosom Plc</th>
<th>Dangote Cement Plc</th>
<th>Avon Plc</th>
<th>Champion Breweries Plc</th>
<th>Sokoto Cement Plc</th>
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<td></td>
<td>(2.760)</td>
<td>(7.421)</td>
<td>(.901)</td>
<td>(7.620)</td>
<td>(3.741)</td>
<td>(2.341)</td>
<td>(2.234)</td>
<td>(2.564)</td>
<td>(-3.249)</td>
<td>(1.721)</td>
</tr>
<tr>
<td>term Debt (STD)</td>
<td>-.100</td>
<td>-.008</td>
<td>.028**</td>
<td>.070</td>
<td>-.062*</td>
<td>.102**</td>
<td>.141</td>
<td>.031</td>
<td>.132</td>
<td>-.062</td>
</tr>
<tr>
<td></td>
<td>(-2.601)</td>
<td>(-.622)</td>
<td>(3.112)</td>
<td>(.861)</td>
<td>(-4.621)</td>
<td>(2.631)</td>
<td>(3.125)</td>
<td>(16.21)</td>
<td>(2.611)</td>
<td>(-2.801)</td>
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<tr>
<td>Long term Debt (LTD)</td>
<td>-.362**</td>
<td>-.564**</td>
<td>.097**</td>
<td>-1.263*</td>
<td>.294</td>
<td>-.312</td>
<td>.921</td>
<td>-.079</td>
<td>.310</td>
<td>.016</td>
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<tr>
<td></td>
<td>(-3.60)</td>
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<td>(3.269)</td>
<td>(-5.213)</td>
<td>(1.861)</td>
<td>(-3.81)</td>
<td>(-2.831)</td>
<td>(-1.421)</td>
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<td>(.019)</td>
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<tr>
<td>Share Capital (SC)</td>
<td>-.712**</td>
<td>.181*</td>
<td>.281</td>
<td>.365</td>
<td>-.181**</td>
<td>.721</td>
<td>.391</td>
<td>.622</td>
<td>1.091</td>
<td>-.031</td>
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<tr>
<td></td>
<td>(-3.213)</td>
<td>(6.521)</td>
<td>(2.711)</td>
<td>(2.861)</td>
<td>(-3.3462)</td>
<td>(2.461)</td>
<td>(1.321)</td>
<td>(1.112)</td>
<td>(2.910)</td>
<td>(-.312)</td>
</tr>
<tr>
<td>Retain Earnings (RE)</td>
<td>.671*</td>
<td>-.324**</td>
<td>.163</td>
<td>-.006</td>
<td>-.022</td>
<td>-.115</td>
<td>-.612</td>
<td>.032</td>
<td>-.322</td>
<td>.195</td>
</tr>
<tr>
<td></td>
<td>(5.321)</td>
<td>(-2.511)</td>
<td>(1.821)</td>
<td>(-.081)</td>
<td>(-.622)</td>
<td>(-1.461)</td>
<td>(-.891)</td>
<td>(.051)</td>
<td>(-.874)</td>
<td>(1.1351)</td>
</tr>
</tbody>
</table>

| R²             | .931         | .962             | .996     | .940       | .946.           | .972           | .981                 | .832     | .961                   | .916              |
| Adj-R²         | .942         | .941             | .936     | .932       | .872            | .956           | .962                 | .932     | .961                   | .933              |

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<table>
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<th>Durbin-Watson</th>
<th>2.216</th>
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</tr>
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</table>

*Significant at *1% ; **significant at 5%; (t) = t-values
Predictors: (Constant), STD, LTD, SC, RE
Dependent Variable: Earnings Per Share (EPS)
INTERPRETATION OF RESULTS

From the results the adjusted $R^2$ for columns 1 to 10 (the firms) ranges from 0.88 to 0.99. The cumulative adjusted $R^2$ is 0.87. The results indicate that at least, about 87% of the changes in EPS (earnings per share) can be explained by financial structure variables. To further investigate this finding, the F-value is used to test the overall significance of the model from which the adjusted $R^2$ derives. The statistics in the table above indicate that at 5% level of significance, the models for each firm and the cumulative results are positively but not statistically significant. More so, the Durbin Watson for most of the models are close to 2 (that is, can be approximated to 2). This indicates that the models are not auto correlated. Having interpreted the model summary of the analyses, we can now use the coefficients and t-values to address our specific objectives and the hypotheses of the study.

Effect of Short term debt on Earnings Per Share

The coefficient of the Short term debt (STD) in the models for the selected companies are Seven up Plc (-.100), Morison Plc (-.008), Cultix Plc (.028), Nascon Plc (.070), Flour Mills Plc (-.062), Vitafoam Plc (0.102), Dangote Plc (.141), Avon Plc (.031), Champion Plc (.132), and Sokoto Cement Plc (0.062) and the cumulative is -.312. From the results, the STD of most of the firms are on the positive; but the group (cumulative) result is negative. This suggests that the overall effect of financial structure mix (Short term debt) on (EPS) is negative even though majority of the firms showed positive effect.. The test of significance is done with the t-value of the cumulative results. The t-value of the cumulative coefficient result is -9.25. This value is negative and as well not statistically significant at 5% level. Thus, the study infers that Short term debt has no significant negative effect on EPS of the firms. This finding is in contrast with that of Habib and Waziri (2016) who found significant but negative relationship between Short term debt and return on asset and Kakanda, etal(2016) who found no significant positive effect on ROE.

Effect of Long term debt on Earnings Per Share

The coefficient of the Long term debt (LTD) in the models for the selected companies are Seven up Plc (-.362), Morison Plc (-.564), Cultix Plc (.097), Nascon Plc (1.263), Flour Mills Plc (.294), Vitafoam Plc (.312), Dangote Plc (0.921), Avon Plc (.079), Champion Plc (.310), and Sokoto Cement Plc (0.016) and the cumulative is -2.43. From the results, the Long term debt for most of the firms is on the negative including that of the group (cumulative) result. Thus, though, some of the firms recorded positive effect, the study generally concludes that there is a negative effect of Long term debt on EPS of the firms. This suggests that Long term debt is not being well utilised by the firms in Nigeria. The cumulative t-value is .450. From the table, the result is not statistically significant at 5% level. Thus, the study concludes that there is no significant negative effect of Long term debt on EPS of the selected firms. This finding is in conflict with Deovita et.al (2015) who found significant positive effect but agrees with Kajirwa (2015) who found insignificant negative effect of long term debt on firm performance.

Effect of Share Capital on Earnings Per Share

The coefficient of the Share Capital (SC) in the models for the selected firms are Seven up Plc (-.712), Morison Plc (.181), Cultix Plc (.281), Nascon Plc (.365), Flour Mills Plc (-.181), Vitafoam Plc (.721), Dangote Plc (.391), Avon Plc (.622), Champion Plc (1.091), and Sokoto Cement Plc (.031) and the cumulative is -.221. From the results, the Share Capital of most of the firms is on the positive; but the group (cumulative) result is negative. This suggests that the overall effect of Share Capital on EPS of the firms is negative.

The test of significance is done with the t-value of the cumulative results. The t-value of the cumulative coefficient result is -.313. This value is negative and as well not statistically significant at 5% level. Thus the study infers that there is no significant negative effect of Share Capital on EPS of the firms. This finding disagreed with that of Angahar and Ivarave (2016) who found positive and significant effect of share holders funds on firms performance.

Effect of Retained Earnings on EPS

The coefficient of the Retain Earnings (RE) in the models for the selected firms are Seven up Plc (-.671), Morison Plc (-.324), Cultix Plc (.163), Nascon Plc (-.006), Flour Mills Plc (-.022), Vitafoam Plc (-.115), Dangote Plc (.612), Avon Plc (.032), Champion Plc (-.322), and Sokoto Cement Plc (.195) and the cumulative is .171. The results showed that the coefficients of Retained Earnings
(RE) for some of the firms and the cumulative are positive while the others are negative as seen above. Besides, the industry result indicates that there is positive effect of Retained Earnings of firms on their EPS.

The test of significance is done with the t-value of the cumulative results which is .171 and not statistically significant at 5% level. The study therefore states that there is no significant positive effects of retain earnings on EPS of the firms.

The finding contradicts with Angahar (2016) who found positive and significant effect of shareholders fund which includes retained earnings on firms’ performance.

Summary of Findings

The following are the summary of the findings from the study:

87% of the changes in financial structure on EPS can be explained by firms’ performance indicators, which means that firms’ performance can be indispensible factor in determining firms financial structure mix.

1. The overall effect of Short term debt on EPS is negative, even though most of the firms earnings per share are impacted positively by their financial structure variable (short term debt). The effect however is not statistically significant
2. There is no significant negative effect of financial structure variable (long term debt) on firms value (EPS)
3. There is no significant negative effect of financial structure (Share Capital) on earnings per share of the affected companies
4. There is insignificant positive effect of retained earnings on firm value which implies that as the firms employ retained earnings in their operations, they tend to increase the EPS of the affected firms.

CONCLUSION

The study has shown that firm’s employment of various sources of funds for acquisition of her assets is inevitable and when such funds are judiciously employed, they produce some fortunes for the company. The general position is that the financing mix on the average made negative contribution to the value of the firms. Flexibility among the financial structure mix is necessary considering the cost and aggregate return from this combination. This will further promote the earnings capacity of the firms especially when agency interests are not allowed to undermine the corporate expectations of the firms.

RECOMMENDATIONS

The following recommendations are hereby made:

1. Short term debt engagement in the company produced a cumulative negative effect even though the position favoured the individual firms associated with financial structure mix. The firms should always appraise the financial structure policy with a view to ensuring that these funds are not procured at a high cost. This action will also address the adverse effect of long term debt on firm value and share capital.

The insignificant positive effect of retained earnings is worrisome and suggests that they are not making judicious use of this source of fund. Firms should lay more emphasis on profit retention as this will enable the firms take meaningful investment options through project expansion.

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