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Corporate Financing and Value of Quoted Consumer Goods Companies in Nigeria

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Abstract

Financial management aims at maximizing shareholders' wealth and this requires financial decision makers balance capital funding between investments in projects that increase the firm's long term profitability and sustainability (value). Thus, the need for examination of the relationship between corporate financing and value of quoted consumer goods companies in Nigeria. Data for the study were collected from annual reports and accounts of the sampled companies for ten years (2009 – 2018). Data collected were analyzed using generalized least square (GLS), interpretations were made using ordinary least square in line with the results of Hausman specification test and lagrange multiplier test of random effect. The study reveals that long term debt improves firm value significantly while short term debt has a negative significant effect on value of the selected companies. In addition, paid-up share capital and share premium as equity capital reduce values of the companies as retained earning has a positive significant effect. The findings imply that corporate financing variables have mixed effects on firm value. The study recommends that corporate financial decision makers should employ more of long term debt and retained earnings in financing mix since they impact positively on value of companies.

Keywords: Corporate Financing, Value, Debt, Equity, Earnings

Introduction

The main goal of financial management is to maximize or to continually increase shareholder value. This requires managers to balance capital funding between investments in projects that increase the firm's long term profitability and sustainability, along with paying dividends to shareholders. Firm value is the present value of the firm's current and future profits. Thus, it is linked to profit maximization. It is more comprehensive than market capitalization, which only reflects common equity. Firm value reflects the opportunistic nature of a business and may change sustainability over time because of both external and internal situations. One of such situations is financing.

There are three forms of decisions in financial management which influence firm value; these are investment decisions, financing decisions, and dividend decisions. Corporate financing decisions deal with the amount of capital required for a firm to operate and the best mix of capital structure for the firm (Pike & Neale, 2009).

Achieving the goals of corporate finance requires that any corporate investment be financed appropriately. Financial literature identifies two sources of finance, which are equity and debt. Equity capital includes paid-up share capital, share premium, reserves, and retained earnings. While debt capital encompasses borrowed funds from external parties, it could be short term or long term. Therefore, the objective of a firm should be directed towards maximization of its value by examining its financing decisions vis-a-vis its effect on the value of firms (Ogbulu, & Emeni, 2012).

The Modigliani and Miller (M-M) theory, proposed by Modigliani and Miller (1958 and 1963), forms the basis for modern thinking on corporate financing. In their seminal article, Modigliani and Miller (1958 and 1963) demonstrate that, in a frictionless world, financial leverage is unrelated to firm value, but in a world with tax-deductible interest payments, firm value and corporate financing are positively related. Empirically, the relationship between corporate financing and firm value has been the subject of several studies. Evidence on these relationships has been mixed, thus, there is lack of clarity on the effect of corporate finance and firm value whereby managers need to choose suitable source of finance that contributes to maximizing its value, hence maximizing shareholders' wealth (Ramadan & Ramadan, 2015). Most of the extant corporate finance studies have been carried out in developed markets, while limited studies have examined the relationship between corporate finance and value of firms in developing countries like Nigeria. Available studies (for example Ogbulu, & Emeni, 2012) in emerging markets (Nigeria) have not made distinctions between various classes of equity (example share capital, share premium, and retained earnings) and debt (long term and short term debts) by examining the effect of each on firm value. Thus, this study examines the said categories of equity and debt financing. As argued by Eldomiaty (2008) that, in emerging economies capital market is incomplete and less efficient and suffers from a greater level of information asymmetry more than those in developed markets. Hence, the need for distinction between the variables in this study.

Based on this background, the study examines the effect of corporate financing on value of quoted consumer goods companies in Nigeria with a view to assisting managers make appropriate decisions in financing companies with less cost. The study also adds to little literature on the subject matter in emerging markets especially Nigeria. Thus, will be a valuable source of knowledge and information for both students and researchers.

Literature Review

The Concept of Value

Firm value is coined in different ways. Christiawan and Tarin (2004) as cited in Moeljadi (2014) stated some concept of values to describe firm value: nominal value, market value, intrinsic value, book value and liquidation value. These variables differ from one company to another. The value of a firm is defined as the present value of expected future cash flows in addition to current cash flows. Firm value depends upon expected earnings stream of the firm and the rate used to discount this stream.

Firm value can be seen from several approaches (Moeljadi, 2014). Statement of financial position sees firm value as value of its assets. This implies that firm value is seen in the statement of financial position. In addition, measuring firm's income, value is based on income statement. Firm value can be determined by sales, earnings or other indicators. Another approach is goodwill. Company value is calculated from book value plus goodwill. Company value is a function of future cash flows and level of return. Brigham and Houston (1999) define firm value as the value given to management of financial markets and corporate organizations as a company continues to grow. A firm looking to maximize her profits is concerned with maximizing its value. Pandey (2004) opines that firm value is the sum of the values of all its securities. That is, the sum of its equity and debt if it is a leveraged firm and the value of only its equity, if it is an unleveraged firm. In understanding firm value, the principles of time value of money can be used.

In measuring firm value, Tobin's Q and market value added (MVA) are mostly used. Prior studies such as Yermack (1996), Chaleeda, Aminul, Tunku, and Anas (2019) used Tobin's Q which is the ratio of book value of debt plus the market value of equity divided by book value of equity. Brigham and Houston (1999), and Wahyudi and

Prawesti (2006) used a proxy ratio of market value to book value. Consistent with their studies, this study uses MVA. It is the valuation of shares in the market over and above the book value of equity, which helps to identify firm value.

Debt Financing and Value of Companies

Companies may rely on borrowed funds as sources of investment to sustain ongoing business operations or to fund future growth. Therefore, debt is an external finance to companies on which interests are paid; it could be long-term or short term. Myer (1977) and Stulz (1990) documents that debt might affect the value of firms positively or negatively because debt functions as a means to manage agency costs of managerial discretion (underinvestment and overstatement). Debt financing is known to be a mechanism for managers to increase the shareholders' value and not to make money for themselves (Chen, 2004). Contrary to this assertion, debt financing may destroy value as a result of bankruptcy costs that come with it. In fact, firms with high debt in capital structure raise the firms' risk of insolvency (Chaleeda *et al.* 2019). More so, firms with a higher possibility of bankruptcy would be required to pay higher debt interests and should comply with more constraints in debts agreements.

Prior studies such as Jiraporn and Liu (2008), Elkelish and Marshall (2012), Kodonga, Mokoaleli-Mokoteli and Maina (2014) revealed that debt financing does not have significant effect on firm value. However, Ogbulu and Emeni (2012) found that long term debt is the major determinant of firm value, and Chaleeda *et al.* (2019) revealed mixed result as short term debt has a positive significant effect on firm value while long term debt has insignificant effect on firm value. Based on this, the hypothesis is formulated as:

H₀₁ : Debt financing (long term and short term debts) has a negative effect on value of quoted consumer goods companies in Nigeria.

Equity Financing and Value of Companies

Companies can sell shares to investors to raise capital. Investors, or shareholders, expect that there will be an upward trend in value of the company over time to make their investment a profitable purchase. Shareholder value is increased when companies invest equity capital and other funds into projects (or investments) that earn a positive rate of return for the owners. Investors prefer to buy shares of stock in companies that will consistently earn a positive rate of return on capital in the future, thus increasing the market value of the stock of that company. Shareholder value may also be increased when companies payout cash surplus (from earnings) in form of dividends. Equity financing consists of paid-up share capital, retained earnings, share premium and reserves. Empirically, Ogbulu and Emeni (2012) found that equity capital has insignificant effect on firm value in Nigeria. The research hypothesis is stated as follows:

H₀₂: Equity financing (paid-up share capital, retained earnings and share premium) has a negative effect on value of quoted consumer goods companies in Nigeria.

In explaining the relationship between corporate financing and firm value, certain theories are appropriate. The M-M (1958 and 1963) theory forms the basis for modern thinking on corporate financing. In their seminal article, Modigliani and Miller (1958 and 1963) demonstrate that, in a frictionless world, financial leverage is unrelated to firm value, but in a world with tax-deductible interest payments, firm value and corporate financing are positively related as a result of imperfect markets. The pecking order theory of Myers and Majluf (1984) states that there is a correlation between corporate financing and value of firms. This is due to the fact that a firm's value can increase if the right form of financing is used. Pecking order theory implies that firms prefer to finance internally (equity). That if external financing is required, the safest securities are issued first. Debt tends to be the first security issued and external equity is the security of last resort. Trade-off theory states that there is a relationship between corporate financing and firm's value. This is because a firm's value can increase if the proper debt equity mix is used. Trade-off theory argues that optimum financing mix coincides with the level of leverage at which the benefits and costs of debt financing are exactly balanced.

Methodology

This study is quantitative research. The purpose of research under quantitative approach is to establish relationship between measured variables. In line with this approach, the study adopts correlational research design as identified by Creswell (2012). The population of the study consists of twenty-three quoted consumer goods companies in Nigeria as at 31st December, 2018. A sample of eleven companies was drawn from the population based on two-point filter. First, the companies were listed throughout the period of the study, secondly companies that have required data to achieve the aim of the study. Data were collected from the annual reports and accounts of the sampled companies for ten years (2009 – 2018). The data were analyzed using multiple regressions, ordinary least square (OLS) robustness.

The study has dependent and explanatory/independent variables. The dependent variable is firm value represented by market value added. The explanatory variables are paid-up share capital, retained earnings, share premium, long term debt, short term debt, and firm size as a control variable. The model is expressed as follows:

$$FV = (SC, RE, SP, LTD, STD, FS) \dots\dots\dots (i)$$

$$MVA_{it} = \beta_0 + \beta_1 SC_{it} + \beta_2 RE_{it} + \beta_3 SP_{it} + \beta_4 LTD_{it} + \beta_5 STD_{it} + \beta_6 FS_{it} + e_{it} \dots\dots\dots (ii)$$

Where MVA = firm value, SC = share capital, RE = retained earnings, SP = share premium, LTD = long term debt, STD = short term debt, FS = firm size, β_0 = average amount the dependent variable increases when the independent variable increases by one unit, other independent variables held constant, $\beta_1 - \beta_6$ = gradient of the independent variables, e = error term.

Results and Discussions

The study utilized panel data method using STATA statistical software version 14. Robustness test was conducted to ascertain the validity of all statistical inferences for the study. This is done to assess the impact of distribution problems, in addition to the problem of outliers before taking decision on the appropriate statistical method to adopt. The robustness tests include multicollinearity, heteroskedasticity, normality of dependent variable and hausman specification test. This study adopts variance inflation factor (VIF) in checking for the presence of multicollinearity between the explanatory variables in the model. Result from VIF test is less than 10 for all the study variables which is an indication of absence of multicollinearity. Result of Breusch-Pagan/Cook-Weisberg test for heteroskedasticity reveals that there is absence of heteroskedasticity in the model with probability of chi square 0.0000. Furthermore, Shapiro-Wilk normality test shows that data are normally distributed as the p-value of the variables is 0.0000. In analyzing the effect of corporate financing on value of companies, this study used ordinary least square robust regression in line with the results of Hausman specification test and lagrange multiplier test of random effect. The results are presented and discussed as follows:

Table 1: Descriptive Statistics

Variables	Mean	Std. dev.	Min.	Max.
MVA	101.08	181.97	2.32	982.81
STD	0.132	0.151	0	0.612
LTD	0.047	0.079	0	0.370
SC	0.031	0.046	0	0.318
RET	0.305	0.147	0	1.047
SP	0.055	0.081	0	0.469
FS	10.613	0.678	9.008	11.590

Sources: STATA 14.0 Output.

Table 1 shows the descriptive statistics of the study variables. Firm value measured using market value added has a mean of approximately 101 kobo. This means that on average, value is ₦1.01. The standard deviation is 182 which implies that there is no great dispersion between the values of the sampled consumer goods companies in Nigeria. The minimum value is 2.32 kobo with a maximum of 983 kobo. The companies' short term debt on

average is 13% which shows the percentage of short term debt in their source of finance. It has a standard deviation of 0.105 which means there is fair dispersion in the short term debts of the selected companies. The minimum short debt is 0 with a maximum of 61%. Long term debt of the sampled companies has a mean of approximately 5%. This indicates low usage of long term debt in corporate financing. The standard deviation of 0.079 low variations in long term debt of the sampled companies. The minimum long term debt is 0 which means there are companies without long term debt while the maximum is 37%.

Furthermore, on average paid-up share capital of the companies is 3%. This means 97% of the companies' capital structure comes from other sources. Share capital has a standard deviation of 0.046 with minimum of 0 and maximum of 0.318. Retained earnings/profit which refers to earning ploughed back to the companies constitute on average 31% of corporate financing of the sampled companies. It has a standard deviation of 0.146 which signifies variability in the use of retained earnings in the companies. The minimum is 0 with 1.048 as maximum. Also, share premium has a mean of 5% with standard deviation of 0.081. Finally, firm size has a mean of 10.61. The standard deviation is 0.678 which shows high variation in the size of the firms, the minimum value is 9.008 with 11.590 as a maximum value.

Table 2: Correlation Matrix

Var	MVA	STD	LTD	SC	RE	SP	FS	VIF
MVA	1.000							
STD	-0.054	1.000						1.33
LTD	0.404	0.437	1.000					1.25
SC	-0.699	-0.291	-0.468	1.000				1.22
RET	-0.203	-0.357	-0.312	0.283	1.000			1.15
SP	0.014	-0.446	-0.117	0.101	0.029	1.000		1.39
FS	0.470	-0.200	0.376	-0.397	-0.160	0.565	1.000	1.72

Source: STATA 14.0 Output.

Table 2 shows the correlation between variables. All the variables (dependent and explanatory) have perfect positive linear relationship with themselves as indicated by 1.000 on the diagonal. Short term debt, share capital and retained earnings have weak negative relationship with firm value. However, share capital depicts strong negative correlation with the dependent variable. This implies that an increase in short term debt, share capital or retained earnings reduces firm value but is weak except share capital. Long term debt, share premium and firm size have weak positive correlations with firm value which indicates they move towards the same direction with firm value. Other explanatory variables have weak negative correlation with short term debt except long term debt. In addition, share capital, retained earnings, and share premium have weak negative correlation with long term debt as firm size depicts weak positive relationship with it. Retained earnings and share premium have weak positive correlations with share capital while firm size shows weak negative correlation. Share premium has a weak positive correlation with retained earnings but firm size shows negative association. Lastly, firm size has a strong positive correlation with share premium.

Table 3: Regression Results

variables	coef.	std errr.	t	p> t
STD	-166.294	69.058	-2.41	0.018
LTD	881.460	292.222	3.02	0.003
SC	-470.583	238.607	-1.97	0.051
RET	36.254	71.684	0.51	0.614
SP	-449.690	197.942	-2.27	0.025
FS	63.699	24.499	2.60	0.011

F stat	5.32
P value	0.000
R ²	0.327

Source: STATA 14.0 Output

The regression results in Table 3 shows R² of 0.327 (33%) which is the multiple coefficient of determination, gives the proportion of the total variation in the dependent variable explained by the corporate financing variables jointly. It indicates that 33% of the total variation in value of quoted consumer goods companies in Nigeria is caused by short term debt, long term debt, paid-up share capital, retained earnings, and share premium. The F-statistics testing the overall hypothesis of the slope coefficient shows a very significant relationship based on the probability output of 5.32 at a probability level of 0.000 which is less than the critical value of 0.05 ($0.00 < 0.05$). This indicates that the model is fit and statistically significant in influencing the value of the selected quoted consumer goods companies in Nigeria.

The result depicts that short term debt has a negative significant effect on value of the sampled companies. This implies that ₦1 increase in short term debt all other explanatory variables remaining constant, reduces value of companies by same amount. This is statistically significant at 5% level of significance. This contradicts Chaleeda *et al.* (2019) who found short term to have positive effect on firm value. Also, long term debt has a positive significant effect on firm value which is statistically significant at 5% level of significance. This indicates that ₦1 increase in long term debt *ceteris paribus* increases firm value by ₦1. This is in tandem with Ogbulu and Emeni (2012), Chaleeda *et al.* (2019) who documented that long term debt has a positive effect on value of firms. The finding also supports pecking order and trade-off theories. However, it disagrees with Kodongo *et al.* (2014) who found negative relationship between long term debt and value of companies. Therefore, higher long term debt increases firm value. This finding has taken into cognizance imperfections in all markets (developed and emerging). Based on this finding, the study accepts H₀₁ in respect of short term debt and rejects that of long term debt. Thus, it can be inferred that short term debt does not improve firm value while long term debt increases value of companies.

Furthermore, paid-up share capital and share premium have negative significant effect on value of sampled quoted consumer goods companies in Nigeria. This means a unit increase in share capital and share premium increase the value of sampled companies by the same unit, other explanatory factors remaining constant. This finding is in agreement with Ogbulu and Emeni (2012) who revealed that equity capital is irrelevant in determining firm value. It is also in line with capital structure irrelevancy theory of Modigliani and Miller (1958) which says that equity capital is not related to value of companies. However, the finding is not in line with pecking order theory. In addition, retained earnings as equity capital has a positive insignificant effect on value of companies. This implies that retained earnings increases value of companies but is statistically insignificant at 10% level of significance. It therefore supports pecking order theory and disagrees with Ogbulu and Emeni (2012). Based on these findings, the study accepts H₀₂ in relation to share capital and share premium, and rejects same hypothesis with respect to retained earnings. Thus, paid-up share capital and share premium reduce firm value while retained earnings increases value of the sampled consumer goods companies in Nigeria. Finally, firm size which is used as a control variable has a positive significant effect on value of companies. This implies that the larger the size of companies, the higher their values. Thus, firm size is a major determinant of value of the sampled companies.

Conclusion and Recommendations

The study shows mixed results on the relationship between corporate financing and value of quoted consumer goods companies in Nigeria. Based on this, it can be concluded that short term debt, paid-up share capital, and share premium do not increase value of firms while long term debt, and retained earnings increase firm value. This indicates that, although debts have benefits, costs of debts need to be considered. It therefore implies that debt and equity financing variables have different impact on value of companies which firms need to consider separately in taking decisions.

The study recommends that; in selecting debt financing, companies should use long term debt since it impact positively on value of firms. In relation to equity financing, attention should be given to retained earnings more than share capital, and premium since it increases value of companies. Therefore, combination of long term debt with retained earnings would impact more on value of the sampled companies.

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