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ABSTRACT

The study examined the impact of capitalstructure on the profitability of selected quoted insurance companies inNigeria between 2011 and 2016. The data were obtained from the publishedfinancial reports of selected firms. The panel data analysis was employed inthe study. The findings showed that: Total debt ratio (= 0.07; p>0.05) anddebt-to-equity ratio (= 0.01; p>0.05) had insignificant positive impact onreturn on asset of selected quoted insurance firms in Nigeria; The combinedeffect of total debt ratio and debt-to-equity ratio is statisticallyinsignificant on return on asset of selected quoted insurance firms in Nigeria(F=2.65; p>0.05); Total debt ratio (= 0.14; p>0.05) and debt-to-equityratio (= 0.08; p>0.05) had insignificant positive impact on return onequity of selected quoted insurance firms in Nigeria; The combined effect oftotal debt ratio and debt-to-equity ratio is statistically insignificant onreturn on equity of selected quoted insurance firms in Nigeria (F= 1.95;p>0.05); Total debt ratio (=0.08; p>0.05) had insignificant positiveimpact on net profit margin while debt to equity ratio (=0.04; p<0.05) hadsignificant positive impact on the net profit margin of selected quotedinsurance firms in Nigeria;The combined effect of total debt ratio anddebt-to-equity ratio is statistically insignificant on net profit margin ofselected quoted insurance firms in Nigeria (F= 3.55; p<0.05). The studyconcludes that capital structure in the form of debt financing and equityfinancing contributes to the profitability of selected quoted insurance firmsin Nigeria, but its influence on profitability is negligible. The study suggestthat; Insurance companies should introduce more debt, especially long-termdebt, into their capital structure mix as this will have an automatic effect ofreducing the overall cost of capital as a result of its tax advantage thataccrue to the organization when this decision is taken, and this often couldlead to enhanced profitability of the organizations.

CHAPTER ONE
INTRODUCTION

1.0BACKGROUND OF STUDY

The success of insurance companies in Nigeriabusiness environment depends on the ability of the managers to effectivelydetermine the optimal capital mix which is necessary to ensure that they makeprofit and shareholders get to see that objective fulfilled which is wealthmaximization, capital structure decision is very crucial to any organization;it is very difficult to decide the best combination of debt and equity. Capitalstructure reflects the firms financing strategy. Therefore the optimal capital structureis said to exist when the debt and equity can be combined to reduce the cost ofcapital and enhance the firms' profitability (Mohammed & Khalifa, 2014).Modigliani and Miller (1958) demonstrated the irrelevance of capital structurein firm value, although the assumption is valuable only in perfect marketconditions, where all investors have free access to market information, thereare zero transaction costs and no tax difference between dividends and capitalgains.

However, real economies are far from perfectand thus many financing decisions theories were developed over time in order todemonstrate the purpose of capital mix and its role in company value. (Sorana,2015) Capital structure is the way in which a firm finances its operation whichcan either be through debt or equity or the combination of both (Brigham,2004). A number of theories explained the relationship between profitabilityand value of firm. It has been argued that firms with high growth rate havehigh debt to equity ratio and it has been observed that bankruptcy has aneffect on capital structure (Zeituna & Tian, 2007). According to (Kochhar,1997), poor capital structure may lead to a possible reduction or loss in thevalue derived from strategic assets. Hence, the capability of a firm inmanaging its financial policies is important if the firm is to realise gainfrom it specialised resources (Olokoyo, 2013). The raising of appropriate fundsin an organization will aid the firm in its operation. Hence, it is importantfor firms in Nigeria to know the debt equity mix that gives effectiveperformance after a good analysis of business operation and obligation(Olokoyo, 2013).

The cost of capital is having greaterinfluence on the Earnings before interest and tax level of

the firm, which willdirectly affect the amount of earning available to the investor that finallyreflects on the value of the firm. If the manager of an organization decide notto maintain the capital structure of the firm it will affect the firm growthand profitability which will later have financial distress on the profitabilityof the firm. Firms can also issue dozens of distinct securities in a countlesscombination to maxima overall market value (Abor, 2005). Profit has relevancein comparing the efficiency of a business organization. Profitability is theability of a lucrative activity to generate revenue higher than expensesinvolved. The profitability measures are known as profitability ratios oraccumulated margin (Stefeap, 2008). Profitability means ability to make profitfrom all business activities of an organization. Profitability is the abilityof a given investment to earn a return from its use (Tulsian, 2014). (Erasmus,2008) noted that financial performance measure like profitability and liquidityamong others provide available tools to shareholders to evaluate past financialperformance and current position of a company. Profitability is a primary goalof all business a business that does not make profit cannot survive. The ratiosused to measure profitability are Return on Capital Employed (ROCE), Return oninvestment (ROI), Earnings per share (EPS), Gross Profit Margin, Net profitMargin.

Financial performance refers to the degree towhich to which financial objectives being or has been achieved. It is theprocess of measuring the results of firm's policies and operations in monetaryterm. Firm performance reflects how effectively companies manage theirresources. There is a multitude of capital structure indicators that influencethe firm performance and profitability (Sorana, 2015). Firm performance andcapital structure has succeeded in attracting a good deal of public interestbecause it is a tool for socio-economic development (Ayad and Mustafa 2015).Erasmus (2008) noted that financial performance measure like profitability andliquidity among others provide available tools to shareholders to evaluate pastfinancial performance and current position of a company. Financial performance playsa large role in measuring the success of business firms. Evaluating the firm'sperformance has three dimensions: the firms' productivity, profitability,

1.2STATEMENT OF RESEARCH PROBLEM

This study is undertaken because it has beenobserved that a lot of research has been done on effects of capital structureon the profitability of companies like the effect of capital structure onprofitability: An empirical Analysis of listed firms in Iraq by (Ayad andMustafa, 2015), the effect of capital structure on profitability of energyAmerican firms (Mohamed and Tailab, 2014) and Capital Structure and FirmsPerformance: Evidence from Malaysian listed firms (Salim and Raj, 2012). Thereare only a limited number of studies that examine factors that influence thecapital structure of Nigerian firms. Although the capital structure issue hasreceived substantial amount of attention in developed countries, it hasremained neglected in the developing countries However, little attention hasbeen paid to effect of capital structure on the profitability of quotedinsurance companies especially in developing countries like Nigeria.

If there has been any area of finance theorythat has attracted the greatest attention and caused the highest controversy,it is definitely the theory of capital structure and leverage and how theyaffect firms' performance. The choice of capital structure has however beingsubject to several debates and investigations. The capital structure and firmsvalue has been subject to lots of arguments for many years and it stillrepresented one of the most unresolved issues in corporate finance literature.Only a few people have developed theories that have been tested by empiricalstudies and theories. Morri and Beretta (2008) explained that numeroustheoretical studies and much empirical research have addressed those issues,but there is no generally accepted theory and the debates on the significanceof the determinant of factors of capital and profitability is still open.

1.3OBJECTIVES OF THE STUDY

The general objective of the study is toexamine the impact of capital structure on the profitability of quotedinsurance companies in Nigeria. The specific objectives are:

To examine the impact of capital structure onreturn on asset of quoted insurance companies

in Nigeria.
To examine the impact of capital structure onreturn on equity of quoted insurance companies in Nigeria.
To examine the impact of capital structure onnet profit margin of quoted insurance companies in Nigeria.

1.4 RESEARCHQUESTIONS

Does capital structure has impact on returnon asset of quoted insurance companies in Nigeria.
Does capital structure has impact on returnon equity of quoted insurance companies in Nigeria.
Does capital structure has impact on netprofit margin of quoted insurance companies in Nigeria.

1.5 RESEARCHHYPOTHESES

H01: Capital structure has no significantimpact on return on asset of quoted insurance companies in Nigeria.
H02: Capital structure has no significantimpact on return on equity of quoted insurance companies in Nigeria.
H03: Capital structure has no significantimpact on net profit margin of quoted insurance companies in Nigeria.

1.6OPERATIONAL MODELS

Objective One: Capital Structure and Returnon Asset
ROA= f (CAP)
ROA= f (DR, DER)
ROAit= 0 + 1DEit +2DERit + μ
Where:
ROA= Return on asset
DR= Debt ratio
DER= Debt-to-equity ratio
i= Cross-section of firm; t=time
Objective Two: Capital Structure and Returnon Equity
ROE= f (CAP)
ROE= f (DR, DER)
ROEit= 0 + 1DEit +2DERit + μ
Where:
ROE= Return on equity
DR= Debt ratio
DER= Debt-to-equity ratio
i= Cross-section of firm; t=time
Objective Three: Capital Structure and Netprofit margin
NPM= f (CAP)
NPM= f (DR, DER)
NPMit= 0 + 1DEit +2DERit + μ
Where:
NPM= Net profit margin
DR= Debt ratio
DER= Debt-to-equity ratio
i= Cross-section of firm (i= 1, 2…., 5);t=time (1, 2… 6)

1.6 SCOPE OFTHE STUDY

This study is concerned with the effect ofcapital structure on the profitability of quoted insurance companies inNigeria; the evaluation of the profitability of insurance firms is for a periodof six years 2011-2016.

1.7SIGNIFICANCE OF THE STUDY

Acquiring knowledge on the effect of capitalstructure on the profitability financial of quoted

insurance companies inNigeria will help finance manager to predict potential problems associated withfinancing decisions and also help to achieve the goals of shareholders Thisstudy have a significant role to play in filling the gap and understanding theeffect of capital structure decision on the profitability of quoted insurancecompanies in Nigeria. It will also help financial managers to decide andunderstand the effect that firm's capital structure has on profitability inorder to maintain and optimal and ideal capital structure. It will also helpinvestor who wants to in insurance companies to understand and analyze theeffect of capital structure on their profitability and maximizing theirobjectives. It will also serve as a reference for other researchers in the areaof financial management.

1.8ORGANISATION OF STUDY

This research work is organized into fivechapters. Chapter One: This present the introduction, the statement of problem,objective of study, research questions, hypothesis, scope of study, significantof study. Chapter Two: This chapter reviews the conceptual framework,theoretical framework, empirical literatures on capital structure andprofitability. Chapter Three: This present the research methodology usedChapter Four: Data analysis Chapter Five: This chapter contains findings,recommendation and summary.

1.9OPERATIONAL DEFINITION OF TERMS

Capital Structure: This is how a firmfinances its overall operations and growth by using different sources of funds.It is a way a company finances its asset through a combination of equity, debtetc.

Optimal Capital Structure: This indicates thebest debt to equity ratio for a firm that maximises its value. It is the onewhich proffers a balance between the debt to equity ranges thus minimizing the

Long Term Debts: This consists of loans andfinancial obligations lasting over one year.

Short Term Debts: This is made up of any debtincurred by a company that is due within one year.

Equity: A stock or any other securityrepresenting an ownership interest. This is one's degree of ownership after alldebts associated with the asset has been paid off.

Leverage: This is the investment strategy ofusing borrowed money, specifically the use of various financial instruments orborrowed capital to increase the potential return of an investment. It is theamount of debt used to finance assets.

Risk: This is the chance that an investment'sactual return will differ from the expected return, it is the possibility oflosing some or all of an original investment.

Financial Risk: this is the possibility thatshareholders will lose money when they invest in a company that has debt, ifthe company's cash flow proves inadequate to meet its financial obligation.

Business Risk: this is the possibility that acompany will have lower than anticipated profits or experience a loss ratherthan taking a profit.

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