

PDF - THE IMPACT OF WORKING CAPITAL STRUCTURE ON GROWTH AND SUSTAINABILITY OF BUSINESS ENTITY ON CORPORATE PERFORMANCE IN NIGERIA - researchcub.info **ABSTRACT**

The study investigates the impact of working capital structure on growth and sustainability of business entity. Specifically, it assesses the relationship between profit after tax and debt, equity and retained earnings. A sample of ten selected quoted companies on the Nigerian stock exchange was used.

The study used the multiple regression model to look at The impact of working capital structure on growth and sustainability of business entity on the profit after tax of the sampled companies spanning a period of ten years (2001 -2010).

The finding of the study showed that there is a significant relationship between capital structure and corporate performance of selected companies measured in terms of profit after tax. The regression showed that retained earnings showed more relationship with profit after tax than equity and debt.

The study thus recommended that companies should make a proper appraisal of the various sources of capital required for better performance and emphasized the importance of efficient management of capital structure of a firm.

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CHAPTER ONE: INTRODUCTION

1.1 BACKGROUND TO THE STUDY

Capital structure remains one of the popular topics among the scholars in finance field. It refers to the financial framework of a firm which comprises of debt and equity used to finance the firm. Capital structure in financial term means a way a firm finances its assets through the combination of equity, debt or hybrid security (Saad, 2010).

According to Pandey (1995), capital structure is define as the proportionate relationship between the various long-term forms of financing such as debenture, long- term debt, preference capital and common/ share capital including reserves and retained earnings.

The capital structure choice has long been an issue of great debate in the corporate finance

literature. For sometime now, there has been argument whether the way a firm is financed matters. That is, whether exist an optimum capital structure which a firm must adhere to in order to achieve its objective of shares holder's wealth maximization. Another area of argument is the probable effect of changes in a firm financing mix on its market value and its cost of capital.

Determination of an appropriate capital structure for a firm is a critical decision. This is not as a result of the importance of such decision to maximize return but because of the impact such decision has on the firm ability to deal with its competitive environment. Capital structure can be used to finance investment which is other wise refers to as financing decision. This financing decision can affect the debt-equity mix of a firm and this debt-equity mix has an overall implication on the shareholders earning and corporate performance firms in Nigeria.

Generally, there are basic two source of capital. The internally generated source of capital and the externally generated source of capital (Oyejide, 1987). The internally generated source of capital comprises of mainly equity capital and retained earnings. These two forms of capital under internally sources of finance are referred to as the shareholder's funds.

The other source of finance is the externally generated source of capital. This is loan capital or debt finance. Thus, investment projects of a capital can be financed either by increasing the owners claims or the creditors claims. The owners' claims increase when the firm raises funds by issuing common shares or by retaining earnings; The creditors claims increase by borrowings.

The financing or capital structure decision is a significant managerial decision as it influences the shareholders returns and risks. Consequently, the market value of the firm is determined by the capital structure decision. The company will have to plan its capital structure initially at the end of its promotion and subsequently. Whenever, funds have to be raised to finance investment projects, capital structure decision is involved.

Generally, the capital structure of a firm presumed any of the following patterns (10% equity, 0% debt), 0% equity, 100% debt, (X% equity, Y% debt). Option one is that of unlevered firms where the firm ignores advantages (if any) of leverage. Option two is quite unrealistic in real life situation as no investors would want to invest his money in a firm without equity capital.

This partially explains the term “trading on equity”. That is, it is the equity element that is present in the firm’s capital structure that encourages the debt providers to give their resources to the business. Option three is the most realistic one in that it contained both a certain percentage of equity and debt in the capital structure and thus, the advantage of leverage (if any) is exploited.

1.2 STATEMENT OF THE PROBLEM

Capital imposed different obligations and costs on the firm. Managers when deciding on the optimal capital structure for the firm, take into consideration the cost of capital and the risks. The actual effects of capital structure on corporate performance in Nigeria has been a major problem among researchers that has not been resolved. Zeitun and Tian (2007) find out that capital structure has a significant and negative effect on the firm’s performance measure in both accounting and market measures. However, the proportion in which debt and equity are combined would influence both the firm’s value and the overall cost of capital (K_0). At this point, the management has to decide from the outset whether or not to employ debt in its financing mix. If ‘yes’ what proportion of debt-equity will maximize the total value of the firm or minimize the overall weighted average cost of capital (WACC).

Moreover, the capital structure and corporate performance in Nigeria which sought to find the actual financing behaviour of firms in Nigeria and the factors that influence the financing decision had not been stable over time. However, a great number of these empirical studies carried out in Nigeria have not been given attention as it is in developed countries.

In light of the above, it was necessary to evaluate the impact of working capital structure on growth and sustainability of business entity or corporate performance in Nigeria.

1.3 OBJECTIVE OF THE STUDY

The broad objective of this research is to evaluate the impact of working capital structure on growth and sustainability of business entity on corporate performance in Nigeria. The specific are:

- i. To determine whether the capital structure of a firm has effect on the corporate performance or firm’s value.
- ii. To determine the effect of leverage on the growth in earning of a firm.
- iii. To know the particular proportionate combination of debt and equity that provides the best expected trade off
- iv. To test the validities of capital structure theories on the experience of quoted companies in

Nigeria and thereby providing up-to date evidence to validate existing studies and thereby serving as guiding post for the future conduct of capital structure in Nigeria.

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