



EFFECT OF PTOFITABILITY ON TOTAL DEBT OF CONSUMER GOODS MANUFACTURING COMPANIES IN NIGERIA

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Abstract: *The study examined the effect of profitability on debt of consumer goods manufacturing companies in Nigeria. Ex Post facto research design was adopted for the study. A sample size of eighteen (18) quoted consumer goods manufacturing companies were selected from a population of 20 companies. Data were extracted from the annual reports and accounts of the samples companies from 2010 to 2021. Regression analysis was employed to test the hypotheses via E-view 9.0. Based on the analysis of data, the study found that profitability of company has a positive significant effect on debt of consumer goods manufacturing companies in Nigeria. The study recommended that because short-term debt has a positive effect on cash value added, firms should use more short-term debt in their capital structure to avoid paying a high cost of capital. Firms with more current assets, on the other hand, are less likely to be financially constrained.*

INTRODUCTION

The very purpose of a corporation is to make money by increasing the value of its shareholders (Sun, Mustafa, Naveed, Muhammad, Guping, Zia-Ud-Din, .and Qinghua, 2020). Firms maximize shareholder value by lowering overall capital costs and increasing share market prices (Hassan, Mustafa, Jennifer, Abu and Himani, 2022; Karim, Mustafa and Mohammad, 2021). One method of lowering the cost of capital is to finance the firm's capital with an optimal mix of debt and equity capital (Khan, Mustafa, Iqbal and Abu, 2022). Firms typically use debt or equity to fund their business operations and investment needs. Capital Structure is the composition of a company's capital in terms of debt and equity, and it is commonly measured

using debt-to-equity or debt-to-total asset ratios. Many factors are involved in deciding whether to use debt or equity to finance operations, and it is a challenge to balance the two and find an optimal equilibrium (Corporate Finance Institute 2022).

The financing decision is an important one that an organization must make because it affects not only the company's future cash flows but also its profitability and liquidity. This decision determines the source of funding, which is either property rights financing or loan financing, and the proportion of funding from each source. According to Anh and Thao (2019), there are numerous benefits to loan financing for institutions, including tax savings because the cost of interest is eroded by taxable profits. This type of financial decision only delays the

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onset of the crisis, not prevents it. This prompted the researchers to investigate the effect of debt structure on financial performance of companies listed on the NYSE (Abuamsha and Shumal, 2022).

The empirical findings from studies into the determinants of capital structure are uncertain and contradictory, ranging from positive to negative statistically insignificant relationships and mostly conducted in foreign countries. Despite the fact that there are few studies on the impact of Capital Structure, such as Wiyasa and Basyith 2020; Fauzi et al. 2022, none of these studies provide a comprehensive empirical analysis of consumer goods manufacturing companies. This makes studying the determinants of capital structure of Nigerian consumer goods manufacturing companies more appealing. As a result, the study determines the effect of company profitability on debt of consumer goods manufacturing companies in Nigeria.

CONCEPTUAL REVIEW

Over the last decade, large and persistent current account imbalances have led to historic highs in countries' net international investment positions, raising concerns about the disorderly unwinding of the resulting stock imbalances (International Monetary Fund) (2019). The deterioration in financial market sentiment caused by the COVID-19 pandemic resulted in a sharp reversal of capital flows and currency depreciation in a number of emerging market and developing economies. While exceptional monetary and fiscal policy support resulted in an improvement in risk sentiment and the stabilization of capital flows, the outlook for external positions remains highly uncertain,

and risks remain elevated (International Monetary Fund) (2020).

These developments have highlighted the importance of understanding the factors that determine countries' external vulnerabilities when they are exposed to global shocks. Previous research found that the composition of foreign liabilities, or the relative shares of items such as foreign direct investment (FDI), portfolio equity, and external debt in a country's gross foreign liabilities, is an important determinant of a country's vulnerability to external crises. Given that liquidity crises are rarely caused by sudden stops in equity flows but are frequently caused by sudden stops in debt flows, a high share of equity in total liabilities is usually associated with a lower crisis risk (Uros and Tobias, 2022). The external sources of financing consist of bond issuance and short- and long-term loans, whilst the internal sources of finance comprise equity stock, retained earnings, reserves, and preferred stock. Salam and Shourkashti (2019) maintain that there is an optimal capital structure, which involves the one that increases the wealth and value of shareholders whilst minimizing the cost of capital.

The debt-to-equity ratio measures the relationship between creditors' and shareholders' capital contributions. It also demonstrates the extent to which a company's shareholders' equity can meet its obligations to creditors in the event of liquidation (Averkamp, 2019). An increase in debt has the distinct feature of requiring the borrower to repay the amount borrowed plus interest over a predetermined period of time. The terms of the agreement between the two parties would include a repayment schedule as well as the

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interest rate that the lender is required to pay on the total amount borrowed. Even if a corporation incurs financial losses and is unable to meet its obligations, it is still obligated to its creditors and must pay them (Saad, 2021). Even though they do not have control of the company, holders of its debt are entitled to a portion of its profits. The corporation's debt structure may change in the future. Depending on the circumstances, the total amount of debt could be extremely low or extremely high. When a company's total debt grows, so does the risk it poses to its shareholders. On the other hand, if the conditions are favorable, this could result in an increase in the company's earnings for shareholders (Saad, 2021). The debt-to-equity (D/E) ratio is calculated by dividing a company's total liabilities by its equity. These numbers are available on the statement of financial position of a company's financial statements. The ratio is used to evaluate a company's financial leverage

Debt-to-equity (D/E) ratio = $\frac{\text{Total Liabilities}}{\text{Shareholders' equity}}$

The numerator consists of the total of current and long term liabilities and the denominator consists of the total stockholders' equity including preferred stock. Both the elements of the formula are obtained from company's statement of financial position. A ratio of 1 (or 1: 1) means that creditors and stockholders equally contribute to the assets of the business. A less than 1 ratio indicates that the portion of assets provided by Stockholders is greater than the portion of assets provided by creditors and a greater than 1 ratio indicates that the portion of assets provided by creditors is greater than the portion of assets provided by stockholders. A

ratio of 1: 1 is normally considered satisfactory for most of the companies (Welch, 2019).

Profitability of company

Some academics have studied the impact of capital structure on profitability in the telecommunications industry. Wiyasa and Basyith (2020), for example, investigated the impact of capital structure on the profitability of five listed telecommunication firms on the Indonesian Stock Exchange. The authors concluded that debt to asset ratio (DAR), a capital structure variable, has a negative and significant impact on ROE. Meanwhile, the variable capital structure Long-Term Debt Equity Ratio (LTDtER) has a positive but non-significant impact on ROE. In 2019, a research paper focused on the relationship between capital structure and profitability of four major Indian telecom firms. The empirical findings supported the existence of a significantly positive relationship between profitability and the three variables and the telecom industry's ratio of net operating profit (NOP), cost of equity (Ke), and cost of debt (Kd) (Kumawat and Morani 2019). The effects of leverage in capital structure on the profitability of ten selected Indian telecom firms were investigated in a similar research study on the same industry. According to the study, capital structure has a significant impact on firm profitability as measured by return on total assets (ROTA) and return on investment (ROI) (ROI). A panel data analysis of 208 Canadian non-financial firms listed on the Toronto Stock Exchange from 1999 to 2016 found that age, liquidity, asset tangibility, size, growth opportunities, and profitability were all important factors, and profitability are the determinants of capital structure (Amatya

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2020). In another research paper, to determine the effect of capital structure on firms' performance in the Indian service sector, the researchers used panel data. The findings revealed that short-term debt to total assets and long-term debt to total assets have a negative and significant association with firms' performance measured by ROA, return on capital employed (ROCE), and earnings per share (EPS) (Farhan et al. 2020).

Empirical Review

Few empirical studies have been conducted to investigate the factors that influence capital structure. Okerekeoti (2022) investigated the impact of company size on debt in Nigerian consumer goods manufacturing firms. Data were obtained from the sampled companies' annual reports and accounts. According to the regression results, there is a significant positive relationship between total debt and firm size of listed consumer goods companies in Nigeria. According to the study, financial institutions and debt suppliers should assist businesses by charging lower financing costs. The lower cost of debt financing reduces the required rate of return on the capital project being financed, increasing the size of the company. Uro and Tobias (2022) investigated whether the composition of a firm's foreign liabilities matters for its resilience during economic downturns and which characteristics determine a firm's foreign capital structure. According to the study, firms with a positive equity share in their foreign liabilities were less affected by the global financial crisis and were also less likely to default in the aftermath. Furthermore, they demonstrate that larger, more open, and more productive firms have a higher equity share of total foreign liabilities. Chukwu, Egbuhuzor,

Namapele, Willy, Chukwu, and Okoba (2022) investigated the relationship between capital structure (CS) and corporate financial performance (CFP) of Nigerian Stock Exchange-listed deposit money banks (DMBs). The data was analyzed using multiple regression. The findings revealed a negative and insignificant relationship between the debt ratio and the return on assets (ROA), a negative and insignificant relationship between the debt ratio and the net profit margin (NPM), and a positive and significant relationship between the equity ratio and the ROA. It also revealed a significant and positive relationship between equity ratio and NPM. Firm size was found to have a significant positive relationship with firm performance, whereas firm age was found to be negatively related to both ROA and NPM. Afroze and Khan (2022) investigated the impact of capital structure on firm performance in Bangladeshi pharmaceutical and chemical firms. A sample of 22 Pharmaceuticals & Chemicals Companies listed on the DSE from 2013 to 2020 was used to conduct this study. A panel corrected standard error multiple regression model was used to analyze eight (8) years of panel data. When measured in terms of earnings per share, the total debt ratio and debt-to-equity ratio are insignificant. The study discovered that external funds (debt) have a negative impact on performance, implying that external funds (debt) are negatively correlated with performance for Pharmaceuticals and Chemicals Companies in Bangladesh. Olaniyi, Abiloro, and Olaniyan (2022) investigated the relationship between Nigerian manufacturing companies' capital structure and financial performance. Statistics such as Pearson correlation and panel regression were used for

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both descriptive and inferential purposes. According to the study, equity capital, total debt, and long-term debt have the potential to positively and significantly influence the financial performance of Nigerian manufacturing firms, whereas short term debt has the potential to positively and insignificantly influence financial performance. Sofyan, Ratna, and Faisal (2021) investigated the effect of firm size on the effect of capital structure choice on firm value in one of the emerging markets, Indonesia, over a seven-year period from 2012 to 2018. The finding lends support to the existing literature that optimal capital structure selection reflects an appropriate mix of debt and equity that increases firm value. This means that capital structure is an important consideration for investors when making investment decisions. Between 2014 and 2018, Omar and AL-Tahat (2020) investigated the capital structure determinants of Jordanian service firms. The panel regression approach was used to analyze secondary data from 45 companies. The findings indicate that the independent variables proposed as capital structure determinants have an effect on the debt ratios used by service companies. Size and non-debt tax shield have a significant positive impact on the debt ratio, whereas profitability and business risk have a significant negative impact on the debt ratio. Fixed assets are not used as collateral in Jordanian service companies, and companies with higher collateral values tend to borrow less debt. Although the institutional investor coefficient is statistically insignificant, it is still negative and economically significant. According to their findings, size, profitability, business risk, non-debt tax shelters, and

institutional ownership are critical in shaping the capital structure of Jordanian service companies. Review of empirical from investigations into the determinants of capital structure are uncertain and are contradictory; ranging from positive, to negative statistical insignificant relationship and mainly conducted in foreign counties. This makes it more attractive to study the determinants of capital structure of consumer goods manufacturing companies in Nigeria.

METHODOLOGY

This study used an *Ex-Post Facto* research design because the study sought to establish a cause-effect relationship and the researcher had no control over the variables under study. This design is ideal when the researcher is unable to directly manipulate the independent variable (Farrar, 2017).

Population of the Study

The population for this study consists of the twenty (20) consumer goods manufacturing companies quoted on the floor of Nigeria Exchange Group as at 31st December, 2021

Sample Size and Sampling Technique

The sample size for this study was determined using the purposeful sampling technique. The sample size for this study is eighteen (18) publicly traded consumer goods manufacturing companies that were continuously listed by Nigerian Exchange Group from 2010 to 2021, and whose financial statements and reports are available and have been consistently submitted to the Nigeria stock exchange during the study period.

Source of Data

This study employed the use of secondary data. Information was sourced from Nigerian Exchange Group (NGX) annual reports and

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accounts of the sampled companies. These variables include; total debt as dependent variable, while size, profitability and age of company are independent variables.

Model Specification

This study adapted the model of Akintomide, Nwaobia and Ogundajo (2021);

$$ROE = \beta_0 + \beta_1TD + \beta_2LTD_{it} + \beta_3STD_{it} + E_{it} - \text{equ (i)}$$

Where:

ROE = Return on Assets

TD = Total Debt

LTD = Long Term Debt

STD = Short Term Debt

Thus, the researcher modified Akintomide, Nwaobia and Ogundajo (2021) model as follows:

$$TDBT_{it} = \beta_0 + \beta_1PFT_{it} + \mu_{it} - \text{ii}$$

Where:

β_0 = Intercept coefficient

β_1 = Coefficients of independent variables

$TDBT_{it}$ = Total Debt of firm i at time t comprise of; Debt-to-Equity, Short term debt and Long term debt

PFT_{it} = Profitability of company i at time t

μ_{it} = The error term which account for other possible factors that could influence Y_{it} that are not captured in the model.

i stands for the i th firm (18 companies)

t stands for year t (2010-2021) (Twelve Years)

Method of Data Analysis

The analysis of data for this research was done based on the data collected from publications of the Nigerian exchange Group and the annual reports of the quoted companies. Both the dependent and independent variables were computed from the data gotten from the Nigerian Exchange Group from 2010 to 2021.

Descriptive statistics were employed to summarily describe the mean, median, standard deviation, kurtosis and skewness of the study variables. Inferential statistics was also utilized with the aid of E-Views 9 using:

- Coefficient of correlation: which is a good measure of relationship between two variables that tell us about the strength of relationship and the direction of the relationship as well?
- Panel Least Square (PLS) regression analysis: Regression analysis predicts the value the dependent variable based on the value of the independent variable and explains the impact or effect of changes in the values of the variables.

Decision Rule

Accept the alternative hypothesis, if the Probability value (P-value) of the test is less than 0.05 (5%). Otherwise reject.

ANALYSIS AND RESULTS

Table 1 Descriptive Statistics

	DEBT	PFT
Mean	16652613	1857083.
Median	16096772	1243303.
Maximum	20117152	6023219.
Minimum	14851894	-296403.0
Std. Dev.	1585581.	1733284.
Skewness	1.102538	1.192796
Kurtosis	3.179336	3.807517
Jarque-Bera	2.447260	3.171564
Probability	0.294160	0.204788
Sum	2.00E+08	22284996
Sum Sq. Dev.	2.77E+13	3.30E+13
Observations	12	12

Source: E-Views 9.0 Output, 2023

Interpretation of Descriptive Statistics

The descriptive statistics in table 1 revealed that the average debt of the sampled companies is 166526.13; the maximum of 20117152 with a minimum of 14851894 with a standard

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deviation of 1585581.0. The mean value of PFT stood at 1857083, a standard deviation of 1733284.0; maximum observation of 6023219 with a minimum value of -296493.0.

Test of Hypothesis

Ho₁: Profitability of company has no significant effect on debt of consumer goods manufacturing companies in Nigeria.

H₁: Profitability of company has a significant effect on debt of consumer goods manufacturing companies in Nigeria.

Table 3 Panel Least Square Regression analysis testing the relationship between DEBT and PFT

Dependent Variable: DEBT

Method: Least Squares

Date: 01/21/23 Time: 21:49

Sample: 2010 2021

Included observations: 12

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	15551851	548758.1	28.34009	0.0000
PFT	0.592737	0.220339	2.690115	0.0227
R-squared	0.419843	Mean dependent var	16652613	
Adjusted R-squared	0.361827	S.D. dependent var	1585581.	
S.E. of regression	1266653.	Akaike info criterion	31.09267	
Sum squared resid	1.60E+13	Schwarz criterion	31.17348	
Log likelihood	-184.5560	Hannan-Quinn criter.	31.06274	
F-statistic	7.236716	Durbin-Watson stat	1.749893	
Prob(F-statistic)	0.022695			

Source: E-Views 9.0 Regression Output, 2023

Interpretation of Regression Result

Table 3 shows that there is a significant positive relationship between profitability of company and DEBT of consumer goods companies in

Nigeria. This can be observed from the beta coefficient (β_1) of 0.592737 with p value of 0.022 which is significant at 5%.

The F-statistic of 7.236716 with an associated Prob (F-statistic) of 0.022695 is statistically significant at 5%, which reveals that the model is well fitted, while the coefficient of determination R^2 of 0.419843, explains the individual variation of the dependent variable (DEBT) as a result of the changes in the independent variable, company profitability (PFT). It can be said that PFT has combined predictive power of 42% in affecting DEBT of consumer goods companies in Nigeria, while the remaining 58% is accounted for by other factors which are not captured in the model.

Decision

Since the P-value of the test = 0.022695 is less than 0.05 (5%)., this study upholds that profitability of company has a significant effect on debt of consumer goods manufacturing companies in Nigeria Thus, Ho₁ is Rejected and H₁ Accepted.

DISCUSSION AND CONCLUSION

This study examined the relationship between capital structure determinant (profitability) and total debt of consumer goods manufacturing companies in Nigeria for a period of twelve (12) years spanning from 2010 to 2021. Data were sourced from the annual reports and accounts of the sampled companies. Inferential statistics using Pearson correlation analysis, least square regression estimate test were employed via E-Views 9.0 statistical software. The result of the hypothesis revealed that profitability of company has a significant effect on debt of consumer goods manufacturing companies in Nigeria Thus, Ho₁ is Rejected and H₁ Accepted. This can be observed from the beta coefficient

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(β_1) of 0.592737 with p value of 0.022 which is significant at 5%. The F-statistic of 7.236716 with an associated Prob (F-statistic) of 0.022695 is statistically significant at 5%, which reveals that the model is well fitted, while the coefficient of determination R^2 of 0.419843, explains the individual variation of the dependent variable (DEBT) as a result of the changes in the independent variable, company profitability (PFT). The result of this study supports the works of Uroš and Tobias (2022); Chukwu, Okoba and Ebilaowei (2022); Mishelle (2021); Sofyan, Ratna and Faisal (2021). According to the study, because short-term debt has a positive effect on cash value added, firms should use more short-term debt in their capital structure to avoid paying a high cost of capital. Firms with more current assets, on the other hand, are less likely to be financially constrained.

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