OBAFEMI AWOLOWO UNIVERSITY

INFLUENCE OF FINANCIAL CRISIS ON LEVERAGE DECISIONS AND PERFORMANCE OF SELECTED QUOTED COMPANIES IN NIGERIA (2006-2013)

Yetunde Sylvia YUSUFF

B.Sc. Accounting (JABU).

A THESIS SUBMITTED TO THE DEPARTMENT OF MANAGEMENT AND ACCOUNTING, FACULTY OF ADMINISTRATION, OBAFEMI AWOLOWO UNIVERSITY, ILE-IFE, NIGERIA

IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE AWARD OF MASTER OF SCIENCE DEGREE IN ACCOUNTING

2015

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

OBAFEMI AWOLOWO UNIVERSITY

AUTHORISATION TO COPY

OBAFEMI AWOLOWO UNIVERSITY, ILE-IFE, NIGERIA

HEZEKIAH OLUWASANMI LIBRARY

POST GRADUATE THESIS

AUTHOR: YUSUFF Yetunde Sylvia. (ADP11/12/H/1316)

TITLE: INFLUENCE OF FINANCIAL CRISIS ON LEVERAGE DECISIONS AND PERFORMANCE OF SELECTED QUOTED COMPANIES IN NIGERIA (2006-2013)

DEGREE: MASTERS OF SCIENCE (M.Sc.), ACCOUNTING

YEAR: 2015

I, YUSUFF YETUNDE S., hereby authorize the Hezekiah Oluwasanmi Library to copy my thesis in whole or in part in response to request from individual researchers or organizations for the purpose of private study or research.

…………………. …………………………

Date Signature

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

OBAFEMI AWOLOWO UNIVERSITY

CERTIFICATION

This is to certify that YUSUFF YETUNDE SYLVIA. (ADP11/12/H/1316) carried out this study under my supervision in the Department of Management and Accounting, Faculty of Administration, Obafemi Awolowo University, Ile-Ife, Osun State, Nigeria.

……………………….. ……………..

Dr. (Mrs.) O. O. Akinlo Date

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

DEDICATION

This thesis is dedicated to God Almighty, the giver of life and the preserver of my soul.

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

ACKNOWLEDGEMENTS

I thank God Almighty for His protection, strength, love and blessings during my course of study. To Him alone be the glory.

I am profoundly grateful to my supervisor, Dr. (Mrs.) O. O. Akinlo for her contributions, corrections, remarks, efforts and supervisory role in making this thesis a remarkable success. God bless the work of your hands ma.

I equally appreciate the Head of Department, Prof. A. A. Agboola and the Dean, Prof. T. O. Asaolu for being an inspiration to me in character, integrity, learning, work ethics and academics.

I am equally grateful to all members of staff in the Department of Management and Accounting; you have all contributed in your different ways to the completion of this thesis. I cherish your invaluable contributions.

I lovingly appreciate my parents, Mr. & Mrs. Oyekanmi Yusuff for their support and encouragement throughout my study period. To all my loving siblings; Mr. & Mrs. Oloyede Oyekanmi, Akinboye, Oyebunmi, Oyebola and Toyese, I say thank you for being there always.

I am equally grateful to my friends, Adedoyin Adewumi, Oladejo Titilayo, Busari Romoke, Oloketuyi Sandra, Ayobamidele Adebowale, Azeez Titilayo, Akinpelu Mobolaji, Kilanko Omodele, Akande Olabanji, Bukky and Ebun, God bless you all.

I will also like to appreciate the entire staff of the department of Accounting, Joseph Ayo Babalola University for their immense contribution towards the success of my programme. I will also specially like to thank Prof. T. O. Olowokure, Dr. S. A. Adereti, Dr. J. A. Adetoso, Mr. Adeyele and Mr. Kayode Oladejo for their fatherly and brotherly roles, I am really grateful.

Finally, my special thanks go to my son Oluwatomisin and my loving husband, Akinwale Akinjare for his help, love, support, understanding and encouragement. Thank you for being there for me when I was down. God bless you.

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

TABLE OF CONTENTS

TITLE PAGE		i
AUTHORIZATION		ii
CERTIFICATION		iii
DEDICATION		iv
AKNOWLEDGEMENTS		v
TABLE OF CONTENTS		vi
LIST OF TABLES		ix
LIST OF FIGURES		x
ABSTRACT		xi
CHAPTER ONE: INTRODUCTION		
1.1	Background to the Study	1
1.2	Statement of the Problem	3
1.3	Research Questions	6
1.4	Objectives of the Study	7
1.5	Justification for the Study	7
1.6	Scope of the Study	10
1.7	Organization of the Study	10
1.8	Operational Definition of Terms	10
CHAPTER TWO: LITERATURE REVIEW		
2.1	Conceptual Review	13
2.1.1	Financial Cum Economic Crisis	13
2.1.2	Financial Crisis in Nigeria	14

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

2.1.3 Determinants of Capital Structure 18

2.1.3.1 Profitability 18

2.1.3.2 Growth 18

2.1.3.3 Firm Size 19

2.1.3.4 Risk 20

2.1.3.5 Tax 20

2.1.3.6 Asset Structure/Tangibility 21

2.1.4 Capital Structure and Bankruptcy Costs 21

2.2 Theoretical Perspectives on Leverage 22

2.2.1 Modigliani and Miller (MM) Theorem 23

2.2.2 Trade-off Theory 24

2.2.3 The Pecking Order Theory 26

2.2.4 Market Timing Theory 27

2.3 Review of Empirical Studies 28

2.3.1 Review of Empirical Study in Developed Countries 28

2.3.2 Review of Empirical Study in Developing Countries 32

2.3.3 Review of Empirical Study in Nigeria 34

2.4 Conceptual Framework 36

CHAPTER THREE: METHODOLOGY

3.1 Population and Sample Size 37

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

3.2 Sample Characteristics and Sources of Data 37

3.3 Model Specification 38

3.3.1 Financial Leverage and Firms' Performance 38

3.4 Measurement of variables 41

3.5 Data Analysis Techniques 43

3.5.1 Approaches to Study Objectives 43

3.5.2 Techniques of Analysis 45

3.5.2.1 Panel Regression Analysis 45

CHAPTER FOUR: DATA ANALYSIS AND INTERPRETATION

4.1 Descriptive Statistics of the Data Series 50

4.2 The Trend of Financial Leverage in Selected Quoted Non-financial Firms (2006-2013) 53

4.2.1 Descriptive Statistical Analysis 53

4.2 The Determinants of Financial Leverage 59

4.3 Influence of Financial Crisis on Firms' Leverage Decisions and Performance. 68

4.3.1 Regression Result 70

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction 74

5.2 Summary 74

5.3 Conclusion 75

5.4 Recommendations 75

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

5.5 Contribution to Knowledge 76

BIBLIOGRAPHY 78

APPENDIX 85

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

LIST OF TABLES

TABLE 4.1 Descriptive Statistics for Dependent and Explanatory Variables (2006–2013) 51

TABLE 4.2 Return Rate of Questionnaire 59

TABLE 4.3 Source of Debt Financing 60

TABLE 4.4 How often Debt is issued 61

TABLE 4.5 Source of Finance 62

TABLE 4.6 Factors Affecting Capital Structure Decisions 63

TABLE 4.7 Factors affecting Source of Debt Financing 64

TABLE 4.8 Factors that Determine the Financial Leverage of firms 65

TABLE 4.9 Factors that Determine Appropriate Amount of Total Debt 66

TABLE 4.10 Chi-square Distribution of Firms' Financial Leverage 67

TABLE 4.11 Correlation Matrix of the Variables (2006 -2013) 69

TABLE 4.12 Estimation Results for TOBIN'S Q for the period 2006 – 2013 71

TABLE 4.13 Estimation Results for ROA for the period 2006 – 2013 73

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

LIST OF FIGURES

FIGURE 2.1 Phases of financial Crisis in Nigeria 15

FIGURE 2.2 Trade-off Theory 25

FIGURE 2.3 Conceptual Framework 36

FIGURE 4.1 Percentage change in long term and short term debt financing 54

FIGURE 4.2 Change in Total long term debt and Total short term debt 55

FIGURE 4.3 Percentage change in total debt/leverage 57

FIGURE 4.4 Change in Total Debt/Leverage 58

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

ABSTRACT

This study examined the trend of financial leverage in quoted firms in Nigeria between 2006 and 2013 and also identified the determinants of financial leverage in non-financial firms in Nigeria. It also determined the influence of financial crisis on leverage decisions and performance of quoted companies in Nigeria.

This study employed primary and secondary data. The population for this study was non-financial firms quoted on the Nigerian Stock Exchange (NSE). Forty firms were purposively selected based on the availability of data required for the analysis, that is, each firm must have financial data reported on the Nigerian Stock Exchange database from December 31, 2005 to December 31, 2013 and complete financial information for the sample period. Primary data were obtained by administering structured questionnaires to the finance department of the selected firms.

The trend of financial leverage was analyzed and the results showed that the respondent firms depend heavily on debt financing and rely more on short term debt financing especially during the crisis before attempting to reverse it after the crisis between 2010 and 2012. Short term debt increased slightly by 4.8% between 2006 and 2007 and increased abruptly by 51.5% between 2007 and 2008 but however declined by 57% between 2009 and 2010. Long term debt increased sharply before the crisis year by 99% almost doubling itself and increased in 2008 by 32%. Also, Seven factors (growth opportunities, profitability, tangibility, earnings per share, issuing cost, tax economics associated with debt financing and risk/cost of financial distress) were tested on the possible determinants of leverage from the analysis of the result obtained

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

from the questionnaire administered to the finance unit of the selected firms; all the factors were significant in determining the financial leverage of a firm at 10% significant level except tangibility. The study also investigated the relationship between firms' performance, leverage decisions and financial crisis. The results showed that short term debt ($t=6.489$, $p<0.05$), total debt ($t=0.647$, $p<0.05$), growth (0.938, $p<0.10$) and size ($t=7.521$, $p<0.10$) had positive significant effect in determining the market performance of a company while long term debt ($t=1.680$, $p>0.10$) and tangibility ($t=0.391$, $p>0.10$) has insignificant influence on firms' market performance. Short term debt ($t=0.665$, $p<0.10$) and total debt ($t=0.715$, $p<0.10$) have positive and significant relationship with the accounting performance measure (ROA) while size ($t=0.274$, $p>0.10$) has a negative significant effect. Long term debt ($t=0.162$, $p>0.10$), growth ($t=0.469$, $p>0.10$) and tangibility ($t=0.134$, $P>0.10$) have insignificant effects on accounting performance. Financial crisis have negative but significant effects on both marketing and accounting performance measures. This implies that firm performance reduced during the financial crisis years.

The financial crisis that occurred in the late 2000s had a major impact on firms' capital structure greatly disrupting the leverage decisions of firms. In line with the findings of this study, it is concluded that firms rely more on debt, especially short term debt during financial crisis and that financial crisis negatively affect the performance of firms.

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

OBAFEMI AWOLOWO UNIVERSITY

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

The two major financial policy decisions a firm makes are its dividend policy decision and its capital structure mix. An important decision to be made in any business organization is how the operations of the business are to be financed. Firms' survival depends on their financial performance, it is therefore important for firms to source for the funds needed in running their operations. Financing decisions is concerned with obtaining the best financing mix or capital structure for the company, after considering the cost of the finance and risk involved.To finance their operations, firms frequently have to make decision about the composition of their capital structure, whether to increase debt, issue shares or finance internally. The capital structure of a company enhances its operations and as such cannot be overemphasized (Uremadu and Efobi, 2012). As a result, many studies have examined the determinants of capital structure choice and its impact on performance of firms, that is, the adequate capital structure suitable for corporate organizations to apply in order to maximize shareholder value.

According to Weill (2002), many institutional and economical factors influence the relationship between leverage and performance of firms. Several things can lead a firm to choose different capital structures at different points in time, this include, accessibility of the firm to financial market, changes in the relative pricing of asset classes and economic crisis among others. A list of factors relative to capital structure decisions such as profitability, growth of the firm, size of the firm, debt maturity, debt ratio, tax and tangibility have been identified. However these factors are affected during financial crisis.

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

Financial crisis can be defined as a situation in which some financial institutions or assets suddenly lose a large part of their value. Financial crisis cannot be characterized by a single

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

indicator or phenomena. It is often associated with one or more of the following phenomena: substantial changes in credit volume and asset prices; severe disruptions in financial intermediation and the supply of external financing to various actors in the economy; large scale balance sheet problems (of firms, households, financial intermediaries and sovereigns); and large scale government support which can be in the form of liquidity support and recapitalization.

The recent financial crisis saw the collapse of financial institutions, the bailout of banks, downturns in stock markets and a general decline in economic activity. The global financial crises started with the meltdown of the United States subprime mortgage market in 2007, grew worse in 2008, and resulted in a loss of trillions of dollars of financial wealth, thereby putting the world's economy into an unexpected lasting real economy recession (World Bank, 2009). The collapse of the auction rate securities market in the early 2008 was a major indication that subprime mortgage defaults were creating problems in other markets. This was later followed by the bankruptcy of many businesses and many financial institutions refusing to lend to customers. Initially the financial crisis affected mainly the US and Europe, but spread to other economies of the world due to the connectivity of the financial system also known as the "contagion effect".

The global crises which started in 2007 led to a sharp decline in the currencies and stock market prices of a number of developing countries including Nigeria. In Egypt and Nigeria, the stock market indices declined by about 57 percent between March 2008 and March 2009. The crisis provides a natural experiment that significantly lowered the available return on investment opportunities of firms in the affected economies while holding firm leverage relatively constant. This is because banks and other financial institutions were afraid to give out loans to firms whose returns are already on the reducing side. The performance of firms typically deteriorates during a crisis. Hence, to a certain extent, firm performance will be impacted by the crisis.

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

OBAFEMI AWOLOWO UNIVERSITY

Akingunola and Sangosanya (2011) in their study of the influence of the global financial crisis on industrial sector performance in Nigeria conclude that industrial performance is negatively influenced by external shocks and that there exist slight structural changes in industrial performance during the global economic meltdown.

The Firms facing financial constraints do not choose capital structure in the same manner as unconstrained firms. Firms only issue equity when it is overpriced under asymmetric information and investors will not buy these equities due to the signalling effect of equity issuance. Guyan (2002) states that low leverage firms almost turned to their pre-crisis profitability patterns but high leverage firms could not turn to their pre-crisis profitability patterns and that firms can immunize themselves against the shock of economic crisis by having low debt ratio. Opler and Titman (1994) identify various industries that have experienced economic crisis and whether the firms in those industries with high financial leverage prior to the crisis period performed differently from those with low financial leverage. They make use of market share and sales growth to measure firms' performance and find that the relationship between firm performance and financial distress is negative and significant.

1.2 Statement of the Problem

The relationship between leverage and corporate performance varies across countries and many factors such as bank credit, efficiency of the legal system and other institutional factors influence the relationship between leverage and corporate performance (Weill, 2002). Many factors have been identified to influence the leverage decisions of firms. Harris and Raviv (1991) and Rajan and Zingales (1995) identify that leverage is positively related to Growth, Size and Tangibility but negatively related to profitability.

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**

Barine (2012) states that the amount of debt a firm uses for finance depend on the interest on debt, corporate income taxes, withholding taxes, personal income taxes, costs of financial

For more information, please contact **ir-help@oauife.edu.ng**

OBAFEMI AWOLOWO UNIVERSITY

© Obafemi Awolowo University, Ile-Ife, Nigeria
For more information contact **ir-help@oauife.edu.ng**