

EQUITY FINANCING OPTIONS AND FINANCIAL PERFORMANCE OF LISTED MANUFACTURING FIRMS IN NIGERIA

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ABSTRACT:

This study empirically assessed the effect of equity financing options on financial performance of listed manufacturing firms in Nigeria. Secondary data were obtained from purposively selected 60 out of the 70 listed manufacturing firms. Return on assets (ROA) was used to measure performance while the equity finance options used in the study are; retained earnings, ordinary share capital and preference shares. The overall effect of all the independent variables are statistically significant in explaining the variation in return on assets as their individual probability values are less than 0.05 level of significance. The individual effect of each of the explanatory variables reveals that retained earnings and preference shares significantly influence performance listed manufacturing firms in Nigeriagiven its probability value of 0.000 which is less than 5%. Although, the effect of ordinary share capital on performance of listed manufacturing firms in Nigeria was positive but statistically insignificant with a probability value of 5%.The study thus concluded thatequity financing option composition significantly affect financial performance of listed manufacturing firms in Nigeria.

1. INTRODUCTION:

Business organizations in the Nigeria manufacturing sector require finance for fixed assets acquisition; to meet day to day expenses; to fund business growth; to bridge the time gap between production and sales; meet contingencies and avail of business opportunities. Often times, firms source their finance through various means such as equity contribution, credit facilities from financial institutions, lease or hire purchase arrangements, or through part of profit retained (Myers & Majluf, 1984) which is considered vital to firm's growth (Thirumalaisamy, 2013). It is worthy of note that there are possible implications that goes with whatever source of finance employed by firms. Usually, funds raised by firms through issue of new shares results in diluting ownership pattern which is capable of resulting in critical changes in board composition as well as executive management. Also, considering loans as a source of financing, would sometimes require collateral which might not be readily available. Previous studies on capital structure have categorised sources of finance into two namely; equity financing and debt financing. Empirical findings regarding the effect of capital structure on financial performance of firms is mixed. Although, several studies have been conducted on the nature and extent of relationship between capital structure and financial performance of firms (Olokoyo, 2012; Babalola, 2012; Uremadu & Efobi, 2012; Idode, Adeleke, Ogunlowo & Ashogbon, 2014; Dahiru, Dogarawa, & Haruna, 2016) but this study examines the influence of Equity financing options composition on financial performance of listed manufacturing firms in Nigeria. The study is expected to make a holistic view of the various equity financing options available to manufacturing firms in Nigeria and their impact on financial performance.

2. LITERATURE REVIEW: EQUITY FINANCE OPTIONS

The sources of finance for manufacturing concerns can be categorized into three, namely, short, medium and long term (Olowe, 1997). However, what determines the best form of finance manufacturers opt for should be conditioned on the purpose for which the fund is required. Generally, short-term funds are not used for a long-term project but rather as working capital. Equity finance options of manufacturing firms comprises of; retained earnings, ordinary and preference shares. Equity is the difference between a company's total assets and total liabilities often referred to as residual interest. According to Kurfi (2003), shareholders' equity refers to a company's equity held by individual investors while Erasmus (2008) described it as what belongs to the owners. On the other hand, the retained earnings of a company are the accumulated net income of the company retained at the end of each financial year. This undistributed profits retained over the years are plough back to support the capital base of the enterprise. It is the most risk-free and stress free source of finance. Kim and Suh (2010) described retained earnings as revenue reserves that is set aside from the net profits in line with a firm's dividend policy to be reinvested into the business or to offset any outstanding. Furthermore, Onuorah and Ezeji (2013) noted that a company's dividend decision relates to how much of a company's earnings have been earmarked to be paid out as dividend to shareholders and the amount intended to be retained by the firm for self-financing. Ordinary share capital are funds raised by a company through the private or public listing while preference shares are share capital with fixed rate of dividend as well as preferential right over ordinary equity shares with respect to profit sharing and any claims over assets of the firm.

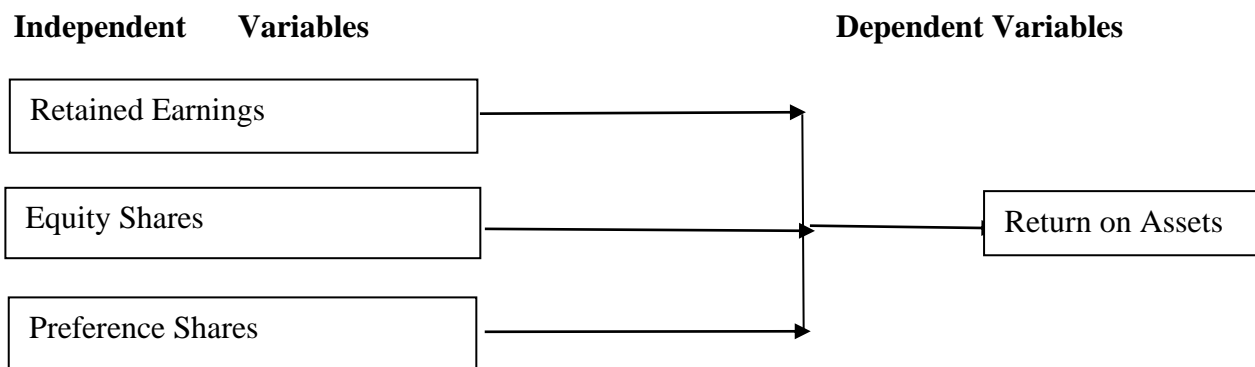
2.2. FINANCIAL PERFORMANCE:

Generally, performance is the ability of a firm to achieve its set goals using its available resources (Rahul, 1997; Suleiman, 2013) while financial performance measures how well an organisation can deploy its assets to generate revenues (Van Horn, 2005; Owolabi & Obida, 2012). Pandey (2001) confirms that financial performance depicts a firm’s overall financial health. There are however, numerous ways of measuring financial performance. The prominent ones are; returns on equity (ROE), returns on asset (ROA), and earnings per share (EPS) which are used to evaluate a manager’s contribution towards the growth and sustainability of the business entity. This is directly related to shareholders wealth maximization which enables companies to achieve growth and consistent dividend payment as well as capital appreciation. Olowe (2018) opined that shareholder’s wealth is a key determinant when making investment decisions. This study considers return on assets (ROA) as a measure of the selected firms’ performance. ROA is a financial ratio that measures the proportion of a company’s profit vis-a-vis its total assets. It is a return on investment (ROI) metric which is usually expressed as:

$$ROA = \frac{\text{Net Income}}{\text{Average Assets}}$$

FIGURE 2.1: Conceptual Model

The model below represents the connection between the dependent and independent variables of the study.



2.3 THEORETICAL FRAMEWORK: PECKING ORDER THEORY AND MARKET TIMING THEORY OF CAPITAL STRUCTURE:

The pecking order theory of capital structure was introduced by Donaldson in 1961 and later improved upon by Myers and Majluf in 1984. It is among the vital theories relating to corporate leverage. The theory posits that firms have a well-laid-out order of preference when sourcing for long-term funds. Proponents of the theory argued that a firm’s first preference should be to utilize its accumulated earnings, before considering debt and issues of shares. The theory argues that firms borrow less as they become more profitable due to the fact that they would have generated enough internal funds over time. The argument is that firms should only consider external sources of finance like bank borrowings and/or corporate bonds when internal finance becomes inadequate to cater for the current level of business operations. Similarly, there is the market timing theory which is often contrasted with the pecking order theory. Critics of the theory argue that just concentrating on market conditions by firms in an attempt to time the

market is an age-long hypothesis. According to Baker and Wurgler (2002), market timing is the first order factor that determines a company's mix of debt and equity. Furthermore, proponent of the theory argues that firms do not particularly care whether they finance with debt or equity; but are more concerned with the type of financing considered to have better value in the financial markets at a particular point in time. Baker and Wurgler, (2002) further opine that equity marketing timing entails the issuing of shares at a time when equity valuations are higher compared to book and past market valuations and repurchasing equities when their market values are low.

2.4 REVIEW OF EMPIRICAL FINDINGS:

Tian and Zeitun (2007) examined the effect of capital structure on corporate performance of companies' in Jordan between the period 1989 and 2003. Data obtained were analysed using panel data analysis. Corporate performance was proxied using return on asset (ROA), return on equity (ROE) and earnings before interest and tax plus depreciation to total asset (PROF) as accounting performance's measurement and Tobin's Q market value of equity to book value of equity (MBVR), price earnings (PIE) ratio and market value of equity plus book value of liabilities divided by book value of equity (MBVE) as market performance's measurements. Findings from the study reveals that using market and accounting measurement a firm's capital structure has a significant negative impact on the firm's performance. This agreed with the findings of Soumadi and Hayajneh (2013) who examined the effect of capital structure on financial performance of 76 listed Jordanian firms for a period of 2001-2006. The study conducted by Nimalthasan and Brabeta (2010) on the relationship between capital structure and profitability for listed manufacturing firms in Sri Lanka revealed that capital structure positively and significantly affect firms' profitability. This is in line with the findings of Simon and Afolabi (2011); Umar, Tanreer, Aslam and Sayid (2012); and Muhammed and Shah (2014) which showed that capital structure influences firms' financial performance. However, the study conducted by Hasan, Ahsan, Rahaman and Alam (2014) on the influence of capital structure on firm performance in Bangladesh showed no statistically significant relation between capital structure and firm performance. Kim and Suh (2010) examined retained earnings as a key item in shareholders' equity while Thirumalaisamy (2013) noted that retained earnings played a significant role in India financing pattern.

3. METHODOLOGY:

The study employed explanatory research design towards achieving the study objectives. Secondary data were obtained from the financial reports of selected 60 out of 70 manufacturing firms listed under Consumer Goods, industrial goods, oil and gas, conglomerates and health sub-sector of Nigerian Stock exchange, over a 10 years period (i.e. 2008 to 2017). The study used criterion sampling technique to select the sample for the study. The sample selection was based on two criteria; the company must have been listed before 2008 and must have complete records for the ten years. A total of 60 manufacturing firms out of the 70 met the criteria and were used as the sample of the population. Manufacturing sector was considered because it is seen as engine of growth, an antidote for unemployment, a creator of wealth, a channel for sustainable development capable of promoting industrialization in the economy (Kaldor, 1967; Mike, 2010). The study used various statistical techniques for data analysis such as diagnostic tests, descriptive and inferential analysis test. Descriptive statistics used are mean, median, standard deviation, maximum and minimum.

MODEL SPECIFICATION:

Model specified in the study is hinged on the model of Shoaib, Onaolapo and Kajola (2010) adapted to achieve the study objective. The model is as follows:

$$EFO = f(OSC, PSC, RE) \tag{1}$$

$$PERF = f(EFO) \tag{2}$$

$$PERF = f(OSC, PSC, RE) \tag{3}$$

Using multiple regression analysis, the model is stated below

$$ROA_{it} = \beta_0 + \beta_1 OSC_t + \beta_2 PSC_t + \beta_3 RE_t + e_{it} \tag{4}$$

Where;

PERF = Performance measured by ROA; EFO = Equity Financing Options; OSC = Ordinary Share Capital; PSC = Preference Share Capital; RE = Retained Earnings; e_{it} = Error term

ROA = Return on asset; $\beta_1 \beta_2 \beta_3 \beta_4$ = Co efficient of independent variables; and β_0 = constant

4. DATA ANALYSIS AND DISCUSSION OF FINDINGS:

4.1. DESCRIPTIVE STATISTICS:

Table 1 represents the descriptive statistics result obtained for this study, the mean are; ROA (₦10013599), and Equity Financing Options which includes Ordinary Share Capital (₦4610609), Preference Share Capital (₦7.000062), and Retained Earnings averages (₦6.399426) respectively. The variables ranges from ₦249258 to ₦25183483, ₦102978 to ₦11292333, ₦0.014000 to ₦17.75000, ₦0.006000 to ₦17.63809 and ₦22.32597 to ₦0.080100 for the respective variables. Also the variables have standard deviation of ₦7932891, ₦3476836, ₦5.495190, and ₦5.766966 respectively.

Table 1: Descriptive statistics

	LogROA	LogRE	PSC	OSC
Mean	10013599	4610609	7.000062	6.399426
Median	8772081	4006875	5.850000	5.271225
Maximum	25183483	11292333	17.75000	17.63809
Minimum	249258	102978	0.014000	0.006000
Std. Dev.	7932891	3476836	5.495190	5.766966

Source: Authors Computation, 2021

Table 1 shows that time series data used, display a high level of consistency. The mean and medium values are within the minimum and maximum values with low deviations from the actual data. The statistics in table 1 reveals that the series are positively and negatively skewed. The dispersion in the distribution is not much since all the scores are relatively smaller when compared with one another. Also, the scores are spread centrally across the distribution, as shown in the kurtosis indicating that the distribution is normal. The sum of square deviation for the distribution is large for some of the variables indicating that they are widely distributed while the smallness of some shows that they are close to the mean score.

4.2. DIAGNOSTIC TEST:

This study, also examine the stationarity of the variables as presented in table 2.

Table 2: Unit Root Test

	Levin, Lin & Chu t*	Im, Pesaran and Shin W-stat	ADF - Fisher Chi-square	PP - Fisher Chi-square
logROA	-3.04196***	-0.41304	26.4448	26.8907
D(logROA)	-8.65387*	-3.66227*	56.0381*	62.0582*
logRE	-3.51260***	-1.68058	37.1301	34.6389
D(logRE)	-18.1618*	-4.18813*	61.7566*	89.0585*
PSC	-2.55055**	0.17339	24.8389	40.1526
D(PSC)	-23.5858*	-6.17489*	74.1938*	89.7965*
OSC	-30.4518*	-11.1516	35.2905	24.1936
D(OSC)	-116.481*	-3.86364*	70.3220*	82.6438*

Source: Authors Computation, 2021

Table 2 reveals that the variables are I(0) order, considering Levin, Lin & Chu t* for instance, returns on assets, Ordinary Share Capital, Preference Share Capital, Corporate Bond, and Retained Earnings are stationary at levels, hence, panel least square model can be applied. In the fixed effect model, the Durbin Watson Statistics is estimated to 1.993672, this value is greater than the Adjusted R – Squared value of 0.709627, and this confirms the absence of autocorrelation in the estimated model. Test of serial correlation was further conducted to confirm or refute this claim.

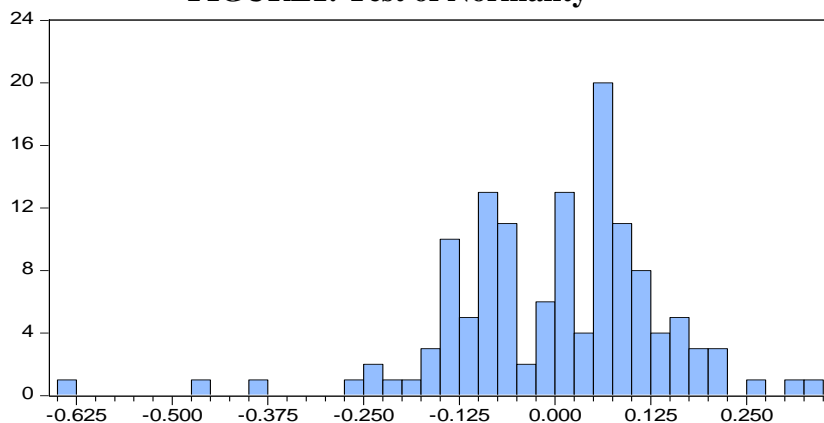
Table 3: Test of Serial Correlation

Test order	m-Statistic	rho	SE(rho)	Prob.
AR(0)	-4.592085	-1.427707	0.310906	0.1080
AR(1)	-1.031974	-0.309532	0.299942	0.3021

Source: Authors Computation, 2021

The study used Arellano-Bond Serial Correlation Test, comparing the stationary at level and first difference. The corresponding Probabilities value is higher than 5% at level and first difference, meaning that the Residual of the panel least square Model is not serially correlated. This test was further confirmed with the residual plot where the residual plot shows a uniform distribution across the sampled companies except for AGLEVENTIS, VITAFOAM and BOCGASES.

FIGURE1: Test of Normality



Table

Series: Standardized Residuals	
Sample 2008 2017	
Observations 600	
Mean	7.57e-18
Median	0.016461
Maximum	0.328569
Minimum	-0.639535
Std. Dev.	0.138263
Skewness	-0.980387
Kurtosis	6.357635
Jarque-Bera	83.15091
Probability	0.300800

H₀: Residual of the Panel Least square Model is normally distributed

The graph in figure 1 reveals the result of normality test of the residual of the Panel Least Square Model, the Jarque-Bera statistics of 83.15 has a probability value of 0.300800 which is more than 5%, therefore we cannot reject the null hypothesis that Residual of the Panel Least Square Model is normally distributed, this result further proves credence to the model.

Table 4: Panel Regression Result

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.609114	0.34248	7.78520	0.0000
LogRE	0.853309	0.72894	9.48170	0.0000
PSC	0.184633	0.19764	3.41777	0.0000
OSC	0.135681	0.50117	6.93537	0.0000
R-squared	0.809120	Mean dependent var		10013599
Adjusted R-squared	0.791114	S.D. dependent var		7932891.
S.E. of regression	236095.1	Akaike info criterion		27.59016
Sum squared resid	3.32E+13	Schwarz criterion		27.62680
Log likelihood	-8272.047	Hannan-Quinn criter.		27.60442
F-statistic	168917	Durbin-Watson stat		1.882313
Prob(F-statistic)	0.000000			

Source: Authors' Computation, 2021

Table 4 represents the Panel Least Square results, from the table it is evident that the R-squared is 0.809120 which implies that approximately 81% of the variation in returns on assets is explained by Ordinary Share Capital, Preference Share Capital, and Retained Earnings, the remaining 19% is attributed to unexplained variation which is not captured in this model. Furthermore, results from the table, The F-statistic of 168917 is significant at 1 percent level as the probability value estimate of 0.000000 has indicated. The F-statistics shows that Ordinary Share Capital, Preference Share Capital, and Retained Earnings are jointly significant in explaining returns on assets. The coefficient of the independent variables reveals that all the variables have positive relationship with returns on assets that is Retained Earnings (0.853309), Preference Share Capital (0.184633), and Ordinary Share Capital (0.135681) respectively. These positive values show that a unit increase in Retained Earnings increases returns on assets by 85.3%, a unit increase in Preference Share Capital increases returns on assets by 18.5%, a

unit increase in ordinary share capital increases returns on assets by 13.6%. Similarly from the table, all the independent variables are statistically significant in explaining Returns on assets of the sixty (60) sampled companies as their individual probability values are less than 0.05 level of significance, but the outcome of the pooled least square estimate cannot be accepted since it cannot be assume that all the companies are the same. The model to be accepted is that of fixed effect.

Table 5: Fixed Effect (LSDV) Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	67.10261	39.15647	1.696022	0.0905
logRE	0.976346	0.034375	2.140275	0.0000
PSC	0.105167	0.016683	6.303583	0.0000
OSC	0.995543	0.919047	1.083241	0.2792
CB	0.146386	0.025330	6.818993	0.0000
Effects Specification				
Cross-section fixed (dummy variables)				
R-squared	0.831762	Mean dependent var		10013599
Adjusted R-squared	0.709627	S.D. dependent var		7932891.
S.E. of regression	153155.0	Akaike info criterion		26.81683
Sum squared resid	1.26E+13	Schwarz criterion		27.28583
Log likelihood	-7981.048	Hannan-Quinn criter.		26.99940
F-statistic	25500.09	Durbin-Watson stat		1.993672
Prob(F-statistic)	0.000000			

Source: Authors' Computation, 2021

Table 5 represents the fixed effect model results indicating that the R- squared is 0.831762 which implies that approximately 83.17% of the variation in returns on assets is explained by Ordinary Share Capital, Preference Share Capital, and Retained Earnings, the remaining 16.7% is attributed to unexplained variation which is not captured in this model. Furthermore, results from the table, The F-statistic of 25500.09 is significant at 1 percent level as the probability value estimate of 0.000000 has indicated. The F-statistics shows that Ordinary Share Capital, Preference Share Capital, and Retained Earnings are jointly significant in explaining returns on assets. The coefficient of the independent variables reveals that all the variables have positive relationship with returns on assets that is Retained Earnings (0.976346), Preference Share Capital (0.105167), and Ordinary Share Capital (0.995543) respectively. The positive values show that a unit increase in Retained Earnings increases returns on assets by 97.6%, a unit increase in Preference Share Capital increases returns on assets by 10.5%, a unit increase in ordinary share capital increases returns on assets by 99.6%.

Table 6: Random Effect Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	98.65173	42.91606	4.61936	0.0000
RE	0.95193	0.03041	3.66895	0.0000
PSC	0.12104	0.00613	7.50338	0.0000
OSC	0.48425	0.01861	5.92029	0.0000
DCB	0.30271	0.01952	5.44935	0.0000

Effects Specification

		S.D.	Rho
	Cross-section random	150017.8	0.4897
	Idiosyncratic random	153155.0	0.5103
Weighted Statistics			
R-squared	0.895563	Mean dependent var	3076448.
Adjusted R-squared	0.725531	S.D. dependent var	2450542.
S.E. of regression	163785.6	Sum squared resid	1.60E+13
F-statistic	33374.01	Durbin-Watson stat	2.848540
Prob(F-statistic)	0.000000		
Unweighted Statistics			
R-squared	0.898845	Mean dependent var	10013599
Sum squared resid	4.35E+13	Durbin-Watson stat	0.311063

Source: Authors' Computation, 2021

The table above represents the fixed effect model results, from the table it is evident that the R-squared is 0.895563 which implies that about 89.6% of the variation in returns on assets is explained by Ordinary Share Capital, Preference Share Capital, and Retained Earnings while the remaining 16.7% is attributed to unexplained variation which is not captured in this model. Furthermore, results from the table, The F-statistic of 33374.01 is significant at 1 percent level as the probability value estimate of 0.000000 has indicated. The F-statistics shows that Ordinary Share Capital, Preference Share Capital, and Retained Earnings are jointly significant in explaining variation in returns on assets. Table 6 also reveals absence of autocorrelation as the Durbin Watson Statistics of 2.848540 is close to 2 and the value is larger than the R-Square value of 0.895563, further test is conducted to confirm or refute this claim. The coefficient of the independent variables reveals that all the variables have positive relationship with returns on assets, that is Retained Earnings (0.95193), Preference Share Capital (0.12104), and Ordinary Share Capital (0.48425) respectively. The positive values show that a unit increase in Retained Earnings increases returns on assets by 95.2%, a unit increase in Preference Share Capital increases returns on assets by 12.1%, and a unit increase in ordinary share capital increases returns on assets by 48.4%. Similarly from the table, all the independent variables are statistically significant in explaining Returns on assets of the sixty (60) sampled companies as their individual probability values are less than 0.05 level of significance, but we cannot accept the outcome of the pooled least square estimate because we cannot assume that all the companies are the same.

Table 7: Appropriate Model Selection

Test Summary		Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random		89.464999	4	0.0000
Cross-section random effects test comparisons:				
Variable	Fixed	Random	Var(Diff.)	Prob.
	0.976316	0.051990	0.000218	0.0991
	0.105167	0.021049	18084789	0.0002
	0.199554	0.044200	17573253	0.0000
Wald Test:				
Equation: Untitled				
Test Statistic	Value		Df	Probability

F-statistic	78953.46	(5, 595)	0.0000
Chi-square	394767.3	5	0.0000

H₀: Random effect model is appropriate

H₁: Fixed effect model is appropriate

Source: Authors’ Computation, 2021

Table 7 checks for which of the model is appropriate through the Correlated Random Effects – Hausman’s Test, and a further robustness check through Wald Test Statistics, the Chi-Sq. Statistic value for Hausman’s test is 89.464999 with its corresponding probability value of 0.0000 which is less than 5% significant level, this is further proved by the Wald Test with F-Statistics of 78953.46 and Chi- Square value of 394767.3 with probability values less than 5%, hence, we reject the null hypothesis that Random effect model is appropriate and accept the alternative hypothesis that fixed effect model is appropriate, therefore, the result obtained from the fixed effect model is justified to be used as the conclusion of our findings.

5. CONCLUSION AND RECOMMENDATIONS:

This study examined the effect of equity financing options on financial performance of listed manufacturing firms in Nigeria. All variables used have standard deviation and exhibit increasing returns and normally distributed with positive JB statistics. The coefficient of the independent variables shows that all variables have positive relationship with return on assets. And all the independent variables are statistically significant in explaining return on assets of the sixty sampled as their individual probability values are less than 0.05 level of significance. But the probability value of Ordinary share capital is 5% indicating that it is not statistically significant and the residual plot shows a uniform distribution across sampled firms except on 3 companies. Based on the results, the study concluded that equity financing option composition has significant influence on financial performance of listed manufacturing firms in Nigeria. This is in line with the findings of Nimalthasan and Brabeta (2010); Umar, Tanreer, Aslam & Sayid (2012); and Muhammed & Shah (2014). Also, Retained Earnings significantly influence performance listed manufacturing firms in Nigeria. This result agrees with the findings of Thirumalaisamy (2013) who examine the role of retained earnings on firms’ performance in India, and whose results showed that retained earnings played significant role in the corporate India financing pattern. However, the study shows that ordinary share capital has positive but statistically insignificant effect on performance and this agrees with the study carried out by Simon, and Afolabi (2011) while preference share capital has positive and statistically significant effect on financial performance given its probability value of 0.000 which is less than 5%. The study thus recommend that listed manufacturing firms should maximise the equity financing options available to them in order to increase the financial performance. The study contributed to knowledge by empirically analysing the equity financing options available to managers of companies and the effect of each funding options on performance of the selected manufacturing firms. Future studies can be conducted using other performance measures such as return on equity, return on investment and Tobin’s Q as their dependent variables to assist in providing a clear guidance to finance managers in Nigeria on the appropriate financing mix that could optimize the value of a firm.

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