DETERMINANTS OF CAPITAL STRUCTURE IN A DEVELOPING ECONOMY EVIDENCE FROM NIGERIA COMPANIES

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ABSTRACT

Corporate organisation make choices in terms of the capital structure which maximises their value. The factors that determine this choice has generated a lot of academic research and most of this research has been focused on developed economies.

Rajan and Zingales (1995) in their empirical study identified four main factors (size, tangibility, profitability and growth opportunities) as determinants of capital structure in the G•7 Countries and their results shows that two of the factors size and tangibility has a positive correlation with leverage while the other two profitability and growth opportunities has a negative correlation with leverage, but the results crucially depended on the exact definition of leverage. The purpose of this study is to investigate whether the four factors identified has the same relationship with leverage in a developing economy using companies listed on the Nigerian stock exchange as a case study.

My result shows that size has a positive correlation with leverage, while tangibility, profitability and growth opportunities have a negative correlation with leverage in Nigeria. This confirms previous studies by Rajan and Zingales (1995) with the exception of tangibility which shows a positive correlation in the G7 Countries (developed countries) but a negative correlation with leverage in Nigeria (developing country).

1.0 INTRODUCTION

The capital structure of a firm can be defined as the ratio of debt to equity capital used by the firm in financing its assets and operations. It is the way a firm finances itself through various combination of equity sales, equity options, bonds & loans. In financing its operations, firms use a combination of debt and equity that best maximises the value of the firm.

Previous research has been carried out by various authors to determine whether or not there is an optimal capital structure that best maximise the value of the firm. Rajan and Zingales (1995) in their study established a relationship between factors identified as determinants of capital structure of firms in the G7 Countries: Size of a firm (Log of sales) and Tangibility (proportion of fixed asset to total assets) were found to be positively correlated to the gearing level of a firm while the level of profitability and growth opportunities (market to book value) were found to be negatively correlated to the gearing of the firms.

The purpose of this study is to determine whether or not the factors identified by Rajan and Zingales (1995) in their research on determinants on capital structure in the G7 Countries (developed countries) are the same factors that determine the capital structure of a developing economy using Nigeria as a case study.

1.1 AIM OF THE STUDY

The capital structure of a firm has attracted a lot of research and debate; however most of the research done has been concentrated on the developed countries leaving out developing countries. The aim of this study is perform a similar research as carried out by Rajan and Zingales (1995), but contrary to their research, efforts is being made to test whether or not the factors affecting the capital structure in G7 countries identified as size, tangibility, profitability and growth opportunities have the same effect on developing countries using selected companies listed on the Nigerian Stock Exchange.

1.2 OBJECTIVES OF THE STUDY

The main objective of this research work is to determine whether factors that determine the capital structure in developed countries are the same with developing countries and to test whether the same relationship exists between these factors and the gearing level of the firms. Objectives to be tested include:

1. Does the gearing level of Nigerian firms have a positive relationship with size?
2. Does the gearing level of Nigerian firms have a positive relationship with tangibility?
3. Does the gearing level of Nigerian firms have a negative relationship with profitability?

4. Does the gearing level of Nigerian firms have a negative relationship with growth opportunities?

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