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FINANCIAL LEVERAGE AND MANUFACTURING FIRMS PERFORMANCE IN NIGERIA

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ABSTRACT

A company's level of financial leverage is one of the main elements affecting its financial performance and sensitivity to changes in its capital structure. In an attempt to quantify this relationship, Tobin's Q was employed as the dependent variable, while measurements for the independent variables were debt-equity ratio (DER), total assets (TA), debt-ratio (DR), equity-ratio (ER), and current-ratio (CUR). The study employed the panel unit root technique to evaluate the stationarity of the variables. Similarly, a panel technique comprising pooled least squares, random-effect, and fixed-effect was used to assess the secondary data from the annual reports of the selected quoted manufacturing businesses in Nigeria from 2011 to 2021.The panel unit root test data showed that while ER, TA, DER, and CUR were stationary at level (1), DR and Tobin's Q were stationary at first order. Additionally, the study conducted the Hausman Test, which validated the selection of the fixed effect model. Empirical findings from the fixed effect model revealed a significant positive correlation between Tobin's Q and the debt and current ratios. However, it was found that the debt-to-equity ratio and equity ratio had a major negative impact on the performance of Nigerian manufacturing companies. Based on the findings, the study concluded that a company's financial performance will be improved by using financial leverage to finance its operations because it will enable them to reduce their taxable income. Based on these results, the report recommended that Nigerian manufacturing enterprises seek to reduce tax expenditures through effective tax planning and boost the firm's worth by incorporating leverage into their capital structure through outside finance. This will not only increase after-tax income but also remove any possible conflicts of interest between stockholders in manufacturing companies and financial managers.

Keywords: *Financial Leverage, Capital Structure, Financial Performance, Tobin's Q*

1.0 INTRODUCTION

Financial issues rank among the most significant factors affecting corporate success on a worldwide basis. Before making a new investment proposal, every business must thoroughly consider the advantages and disadvantages of possible funding sources (Abdul & Nur, 2017). It is crucial to keep in mind that a company's financial choices will have an impact on its existence, growth, and sustainability.

As part of his assessment of the elements required for the proper and successful execution of a business plan, a business owner must ask oneself, "How much do I need to execute this project at hand?" and

"How do I source for fund?" According to Taqi et al. (2020), it is essential to look into and evaluate all possible funding sources in order to find answers to these significant issues. This study makes it easy to assess the required amount and a number of possible funding sources. It should be underlined that determining the required investment amount is only half the fight; the other half involves properly handling the capital structure issue. The company's profitability and viability may suffer if this isn't taken into account.

Scholars and business financial managers worldwide have recently paid close attention to the subject of financing decisions (Mwangi et al., 2014). This concept has been the subject of numerous corporate finance studies from both developed and developing countries. Akintola (2019) asserts that a company's financial structure continues to be the primary determinant of whether its financial policy actions are successful or unsuccessful. According to Okoye (2019), choices regarding a company's finances include those regarding the source of funding for investments and the general state of the business's finances.

Thus, the most basic definition of financial leverage is the ratio of a company's debt to its equity. However, its composition varies according to the kind and scale of the collaborating companies as well as the quantity of outside funding they are looking for (Abina & Akinola, 2020). Evaluating the importance of financial leverage to the company and the function of profitability in the business's ongoing operations is crucial for the firm's survival and ongoing competitiveness in the market. Abina and Akinola (2020) state that whereas low-profit companies with insufficient internal funds turn to loan financing, the majority of financial institutions prefer equity financing. According to Mwangi et al. (2014), most companies use loan financing to evade paying taxes. Debt can increase a company's value because interest payments are frequently tax-free. Another choice for companies trying to curb excessive spending by high management is debt financing. This strategy will force managers to choose between putting their money in initiatives with a higher return on investment or hoarding it.

However, if the company is not required to pay certain fixed expenses, such interest costs, management can see this as an opportunity to squander additional free cash flows. In the early

1970s, Nigeria's manufacturing sector was crucial to the country's economic expansion and industry diversification. However, some of these benefits have been squandered as a result of government policy execution flaws, such as the structural adjustment program (SAP), trade liberalisation, and indigenous policy. Despite the nation's reforms, the number of businesses registered in Nigeria's manufacturing sector decreased from 4,550 in 1983 to just 2000 in 2010 (Ajibola et al., 2018). According to Imeokparia et al. (2021), statistical evidence indicates that a shortage of capital and an uneven financial strategy prevent some Nigerian manufacturing companies, including Michelin and Dunlop Nigeria Plc, from reaching their full productivity potential.

Financial leverage and business performance have been extensively studied in both developed and developing countries, but the information about manufacturing businesses is more common in the former. The limited research that has been done on the topic in Nigeria has paid little attention to the connection between financial leverage and the effectiveness of deposit money institutions. Consider the DMB performance-focused empirical studies conducted by Imeokparia, Adesanmi & Fadipe, 2021; Abina & Akinola, 2020; and Okoye, 2019. Akinyomi, Omokehinde, and Olurin (2018) evaluate the performance of three listed Nigerian hospitality companies, whereas Jeleel and Olayiwola (2017) examine the effect of financial leverage on the performance of Nigeria's chemical and paint industries. Based on the findings of these studies, there hasn't been a definite agreement on the connection between financial leverage and business performance. Financial leverage has been found to have a weakly favourable impact on business profitability (Abina & Akinola, 2020; Taqi, et-al., 2020; and Usman, 2019) but a negative impact on firm performance (Fadipe et al., 2021; Okoye, 2019; Abdul & Nur, 2017).

Empirical research addressing this field of study were undoubtedly unable to provide a sufficient and more reliable conclusion regarding the relationship between leverage and financial performance due to flaws in estimating techniques. Nevertheless, this study was able to overcome these methodological constraints by employing panel estimate techniques, which produce reliable results on this subject. Notwithstanding the conflicting and inconsistent findings, this study contributes to the body of knowledge by demonstrating the relationship between financial leverage and manufacturing enterprises' performance. As a result, the study provides helpful policy suggestions for raising the effectiveness of the nation's industrial businesses.

2.0 Literature Review

The degree to which a business uses borrowed funds to finance its operations is known as leverage in the financial industry. According to Ajibola et al. (2018), it has to do with a company's capital structure and the makeup of long-term fixed loans. The various funding options a firm has employed to operate its business, such as debt, preference shares, and stock, are displayed by its financial leverage. This strategy, which is predicated on the idea that the asset's net profit and price increase will outweigh the cost of borrowing, aims to finance investments through debt (Aza, 2018). Determining if the arrangement will boost the firm's value is a crucial initial step for financial management before choosing a capital structure. A financial management has to decide whether to use retained earnings, short-term debt, long-term debt, or stock.

Fadipe et al. (2021) define a company's performance as its overall financial result over a specified period of time. It displays the overall financial health of the organization over a certain time period. It is a gauge of the overall financial well-being of a company over a given period of time. Abina and Akinola (2020) defined financial performance as an intrinsically subjective measure of a business's capacity to generate profits from its assets. Ajayi and Araoye (2017) claim that financial performance is a useful instrument for self-evaluation and, consequently, for enhancing accountability power. Performance evaluation indices are meant to act as a road map outlining both the intended future state and the existing state. Analysing business performance can help with decisions about investments, expansion, and sustainability. Profitability and liquidity are two examples of financial performance metrics used to assess a company's past and current financial performance. The most often employed metrics in the research published in this field of study were Return on Assets (ROA), Return on Equity (ROE), Operating Cash Flow (OCF), Earnings per Share (EPS), and Tobin's Q. Tobin's Q is a perfect fit for this study since it removes the issues related to indicator fluctuation by combining financial and market-based measurements.

Many articles have been written regarding financial leverage, the ideal capital structure, and the various ways that capital structure impacts a business. The fundamental assertion made by Modigliani and Miller (1958), which effectively revealed the relationship between capital structure and the financial performance of businesses, is where capital structure theory got its start. The theory states that a company's value is independent of its capital structure given ideal market conditions, which include the absence of taxes, transaction costs, bankruptcy costs, symmetric information, and debt to equity (Obigbemi, Faboyede & Adeyemo, 2016). The "Irrelevance Theory" got its name from the fundamental idea that a company's value is directly correlated with its potential for profits and the inherent risk of its assets. The fundamental idea of the theory is that arbitrage possibilities will generate one's own leverage by cancelling out any influence on leverage. The concept that was thought to be unimportant was later corrected by Modigliani and Miller's (1965) trade-off theory. The latter emphasised that taxes serve as a tax shield for firms, and that a company's value might increase by modifying its leverage because interest paid on debt is tax deductible.

Fadipe et al. (2021) investigate how the capital structures of DMBs and Nigerian manufacturing businesses impact their financial performance using a trade-off theoretical method. The study uses secondary data from the Nigerian Stock Exchange for the years 2009–2019.We employed financial performance proxies, including return on assets (ROA), total debt ratios (TDR), total debt to equity ratios (TTLE), and interest cover ratios (ICR), to quantify leverage. The firm's size served as the control variable. Pooled ordinary least square regression, correlation matrices, and descriptive statistics were among the data analysis techniques judged appropriate for the investigation. The study's empirical findings demonstrate that the total debt ratio and total debt to equity ratio have an impact on the financial performance of some DMBs. The overall debt ratio had a slight but positive impact on the financial performance of Nigerian manufacturing companies, whereas the total debt to equity ratio continued to have a large negative correlation. According to the study's findings, DMBs should use less debt to finance their operations, while manufacturing companies should maximise their debt to finance assets.

Abina and Akinola (2020) examine the profitability and financial structure of Nigerian deposit money institutions from 1981 to 2019 using a trade-off and pecking order theory-leaning methodology. The return on equity, equity ratio, and leverage ratio were calculated using secondary data from NSE reports. The study employed unit root tests, co-integration tests, and an error correction mechanism as estimation techniques. The study found a considerable and statistically significant positive association between the equity and leverage ratios, but a modest negative correlation between the debt ratio and ROA.

Anifowose, Soyebo, and Tanimojo (2020) examine how the financial structure affected the profitability of Nigerian listed pharmaceutical businesses between 2003 and 2018 using the same methodology. The results showed that the chosen company's profitability was positively impacted by the debt-to-equity ratio. However, the study indicates that financial managers should optimise leverage in order to enhance shareholder profits. Taqi, Khan, and Anwar (2020) also look at the relationship between financial leverage and the profitability of Indian oil and gas businesses between 2008 and 2017. The debt-to-equity and debt-to-total-assets ratios were used in the study to quantify financial leverage, while the return on assets (ROA), margin ratio, and return on equity (ROE) were used to measure financial performance. The study employed regression analysis, correlation, and descriptive statistics. The study discovered a positive relationship between financial leverage and the included companies' financial performance.

Talwar (2020) examined the profitability of Indian automakers and consumer goods manufacturing companies between 2004 and 2017, examining the impact of corporate governance and leverage. The author employed least square dummy procedures to compute her performance statistic, which is based on accounting. The study's independent variables include corporate governance, debt-to-equity ratio, growth in income, and return on assets. The empirical findings of the study demonstrated a strong relationship between the explanatory variables and the dependent variable (Tobin's Q). The fixed-effect model is more stable than the pooled regression model, as demonstrated by the Wald test.

Okoye (2019) examined how DMBs in Nigeria's capital structure impacted their financial performance from 2005 to 2017 using ordinary least squares methodology. Using the debt-to-equity ratio, firm size, and ratio as stand-ins for the independent variables, the study employed return on equity (ROE) as a gauge of financial performance. The author found that factors pertaining to the capital structures of the selected DMBs had a substantial and adverse effect on their financial performance. According to the report, DMBs in Nigeria must have the proper ratio of debt to equity if they hope to enhance their financial performance.

Usman (2019) examines how leverage affected the financial performance of Nigerian consumer products manufacturing companies between 2012 and 2016. Return on assets (ROA), return on equity (ROE), short-term debt, long-term debt, and the debt to equity ratio are among the study's factors. Regression, correlation, and descriptive statistics were used as estimation techniques. According to the study, the companies' bottom lines were unaffected by either short-term or long-term debt.

Abdul and Nur (2017) examine the impact of leverage on the profitability of publicly traded Malaysian enterprises manufacturing industrial goods using data from 2011 to 2015. This study

used debt to equity (D/E), total debt (TDR), and total equity (TE) as independent factors and return on assets (ROA), return on equity (ROE), and earnings per share (EPS) as dependent variables. The empirical data from several regressions and descriptive statistics demonstrated that debt to equity significantly reduced ROA and ROE. Total debt and equity ratios, however, were found to have a positive and statistically significant impact on EPS but no influence on ROA.

Abdul and Badmus (2017) investigated the Nigerian chemical and paint industries between 2000 and 2009 to ascertain the connection between financial leverage and financial success. The study's financial performance metric was ROA, and it employed the ordinary least square estimation method. The independent variables were replaced by ratios of debt to equity. The empirical findings of the study demonstrated a positive and significant correlation between ROA and equity financing, but not with the debt ratio. The study's findings suggest that businesses in this sector should avoid debt and employ more equity financing.

Keeping with manufacturing enterprises, Akani and Kenn-Ndubuisi (2017) examine the effects of company features and capital structure on the value of companies listed on the Nigeria Stock Exchange between 2008 and 2016 using the Vector Auto Regression2008–2016. The findings demonstrated that capital structures (DER) negatively affect business performance. The debt to equity ratio was the independent variable in this study, while return on assets (ROA) and return on equity (ROE) were the dependent variables.

Marandu and Sibindi (2016) examined the connection between South African banks' performance from 2002 to 2013 and financial leverage. Leverage was calculated using capital adequacy, deposits, bank size, and credit risk. The study's analytical tool was ordinary least squares (OLS). ROA, on the other hand, was used as a performance indicator. According to the study, ROA is significantly correlated with all capital structure characteristics.

3.0 Methodology

This study examined financial leverage and the financial performance of Nigerian manufacturing companies between 2011 and 2025. The base era is determined by the data's availability. The study employed the panel unit root methodology to determine whether the variables were stationary while examining the three primary panel estimation techniques: pooled least square, fixed effect, and random effect.

3.1 Model Specification

In an attempt to investigate the relationship between financial leverage and the financial performance of Nigerian manufacturing businesses, this study updates the model from Abina and Akinola's work (2020). According to their model, the functional statement of the model for this study is as follows:

Tobin's Q = f(TA, DR, ER, DER, CUR)……..... (1)
From equation 1 above, the model can be stated in econometric term as;
$Tobin's\ Q = \beta_0 + \beta_1 \text{TA} + \beta_2 \text{DR} + \beta_3 \text{ER} + \beta_4 \text{DER} + \beta_5 \text{CUR} + \cdots \mu$ …….... (2)

There Tobin's Q = Market based financial performance indicator, TA = Total Assets, DR = Debt
Ratio, ER = Equity Ratio, DER = Debt-Equity Ratio, CUR = Current Ratio, and f = Functional notation.

Table 1. Variables used and the expected signs based on theories

Dependent Variables	Independent Variables	Expected relationship based on Signs
Tobin's Q	Total Assets	+ /-
	Debt Ratio	+/ -
	Equity Ratio	+/ -
	Debt to Equity Ratio	+/ -
	Current Ratio	+/ -

4.0 RESULTS

Table 4.1 Panel Unit Root Test

Variables	LLC Test		IPS - Test		ADF – Test		PP – Test		Stationary Order
	LLC stat	Prob. Value	IPS W-Stat	Prob. V	ADF Stat	Prob. V	PP Stat	Prob. V	
Tobin's Q	-3.26403	0.0005	-2.37068	0.0089	31.6502	0.0045	94.2453	0.0000	**1(1)**
TA	-390.015	0.0000	-181.430	0.0000	27.7001	0.0156	28.4173	0.0125	**1(0)**
DR	-2.38679	0.0085	-2.21379	0.0134	29.8147	0.0081	85.0733	0.0000	**1(1)**
ER	-6.10434	0.0000	-2.28354	0.0112	26.3537	0.0096	20.9903	0.0505	**1(0)**
DER	-23.1272	0.0000	-5.90217	0.0000	28.6882	0.0115	38.7879	0.0004	**1(0)**
CUR	9.40682	0.0023	-2.54925	0.0054	-2.54925	0.0054	95.9998	0.0000	**1(0)**

Source: Authors' Computation (2025)

From Table 4.1 above the panel unit root test result revealed that except Tobin's Q and DR, all other variables were found stationary at level.

4.2 Correlation Analysis

Table 4.2 Correlation Analyses

	TOBINS_Q	TA	DR	ER	DER	CUR
TOBINS_Q	1	0.4586	0.0793	0.0862	8.9643	0.0728
TA	0.4586	1	0.1364	0.1269	0.0667	0.0232
DR	0.0793	0.1364	1	0.9621	0.0750	0.0738
ER	0.0862	0.1269	0.9621	1	0.0665	0.0617
DER	8.9643	0.0667	0.0750	0.0665	1	0.0608

CUR	0.0728	0.0232	0.0738	0.0617	0.0608	1

Source: Authors Computation (2025)

Table 4.2 displayed the correlation between financial leverage and Nigerian manufacturing enterprises' performance. Tobin's Q, which has a positive correlation of 0.4586 with total asset, can be used to gauge the performance of the selected manufacturing companies. For DR, ER, DER, and CUR, Tobin's Q revealed positive correlations of 0.0793, 0.0862, 8.9643, and 0.0728, respectively.

4.3 Estimates of Parameters for Panel Regression Model

Table 4.3: Pooled Least Square, Random Effect and Fixed Effect Specification

	Dependent Variable Tobin's Q		
Independent Var	**Pooled OLS**	**Fixed Effects**	**Random Effects**
Constant	12455473 (1.166913)	35164829 (3.053143)	16730663 (1.500627)
TA	0.207028 (4.283524)	-0.001197 (-0.017800)	0.166785*** (3.375610)
DR	1026997 (0.239549)	3108921 (0.787711)	1480291 (0.377799)
ER	-675223.0 (-0.301210)	-1915942. (-0.912020)	-948549.4 (-0.460523)
DER	492287.8 (0.077107)	-5346216 (-0.858629)	-534096.6 (-0.090143)
CUR	-440450.9 (-0.587841)	51585.71 (0.071373)	-334924.3 (-0.481289)
No. observations	77	77	77
R-squared	0.216473	0.403655	0.133630
Adjusted R^2	0.161295	0.302735	0.072618
F-statistics	3.923186	3.999759	2.190226
Prob. (F-	0.003381	0.000183	0.064778
Dubin-Watson	0.932567	1.110287	0.953438

Note: Standard errors are provided in parentheses. *, **, *** showed the significance at 10%, 5% and 1% level respectively.

The results of a panel regression analysis that examined the relationship between financial leverage and the performance of a selection of Nigerian manufacturing businesses using a pooled least square, fixed effect, and random effect model are displayed in Table 4.3. The manufacturing firm's performance will increase by 12, 45, 487, and 1,673,663 units, respectively, according to the empirical data from the fixed effect, pooling least square, and random effect models, all other things being equal. Total assets and the performance of the selected enterprises are positively correlated, according to both the pooled least square and random effect models (r=0.207028 and

0.166785 units, respectively). Therefore, an increase of one unit in TA will result in an increase of 0.207028 and 0.166785 units, respectively, in Tobin's Q, the dependent variable, when pooling and random effects are used. Empirical results from the fixed effect model indicate a significant negative relationship between total asset and company performance, with a unit rise in total asset augmenting a fall in Tobin's Q by -0.001197 units. Tobin's Q and the debt ratio showed a positive correlation in all three models (pooled, fixed, and random effects). Accordingly, Tobin's Q will increase by 1026997, 3108921, and 1480291 units for each unit increase in the debt ratio. Tobin's Q and the equity ratio have a negative association in all three models. Therefore, a unit rise in ER results in a decline in Tobin's Q of -675223.0, -1915942, and -948549.4, respectively. Because the debt-to-equity ratio has a favourable impact on the firm's performance, a unit increase in DER will boost a comparable increase in Tobin's Q by 492287.8 units under the pooling effect. For both the fixed effect and random effect scenarios, there is a negative connection between DER and Tobin's Q; for instance, an increase in DER of -5346216 units will cause a decrease in Tobin's Q of -534096.6 units. Ultimately, it was found that the current ratio and Tobin's Q were negatively correlated under both the pooled and random effect models. According to this statement, for each unit increase in the current ratio, the value of Tobin's Q, which assesses the firm's performance, will drop by -440450.9 and -334924.3 units, respectively. Tobin's Q and current ratio were found to be positively correlated under the fixed effect model. This indicates that Tobin's Q will rise by 5.11585.71 units for every unit increase in the present ratio.

The F-statistics, which demonstrate the model's statistical significance when combined, indicate that all three of the models used to describe the relationship between financial leverage and performance of selected Nigerian manufacturing businesses are statistically significant.

4.4 Hausman Test Result

Table 4.4 Hausman Test Result

Correlated Random Effects - Hausman Test			
Test summary	Chi-Square. Statistic	Chi-Square. d.f.	Probability
Cross-section random effects	14.853610	5	0.0110

Source: Authors Computation (2025)

Table 4.5 above shows that the Chi-square probability value is 0.0110. Because this number is significant, the fixed effect model was used for forecasting and prediction in this study.

5.0 Conclusion

Researchers in Nigeria have examined the relationship between financial leverage and business performance using panel data regression models, such as a pooled regression, a fixed-effect model, and a random-effect model. In order to do this, the author took panel data from seven manufacturing businesses' annual reports from 2011 to 2025: May & Baker Plc, Dangote Flour Plc, Uniliver Plc, Berger Paint Plc, Lafarge Plc, Nigeria Breweries Plc, and Dangote Cement Plc.

The results of this study indicate that raising the debt ratio of manufacturing companies can significantly increase their performance. The fixed effect model performed better than the random effect model, according to the results of the Husman test, an empirical investigation. In line with this conclusion, Tobin's Q and the debt-to-current ratio showed a positive association. A business can reduce its tax obligation and improve its financial performance by using financial leverage to finance its activities.

According to research by Anifowose et al. (2020), Abina and Akinola (2020), and Taqi et al. (2020), financial leverage improved a company's performance.

Additionally, the debt-to-equity ratio and equity ratio have a significant influence on the performance of Nigerian manufacturing companies. This negative correlation supports both the study of Fadipe et al. (2021) and the empirical results of Okoye (2019). The joint predictor of the entire model, the F-statistics value, which was significant at all levels, indicated that the five independent variables—TA, DR, ER, and CUR—were good predictors of the performance of Nigerian manufacturing businesses. The R-Squared coefficient of multiple determinations was 0.403655, much like the modified R2 value of 0.302735. Put another way, when all of the independent variables are taken into account, they account for 40% of the variation in Nigerian manufacturing companies' performance.

6.0 Recommendations

Nigerian manufacturing companies should try to add leverage to their financial structure by looking for outside funding to boost the company's worth. According to empirical results from the panel data study, which demonstrated a positive and significant association between financial leverage and the performance of manufacturing enterprises, this will assist them in lowering tax expenditure through efficient tax planning. In addition to raising the after-tax profit, this will remove any potential conflicts of interest between financial managers and stockholders in manufacturing businesses. In order to increase overall sales for Nigerian manufacturing companies, the Nigerian government should implement effective economic policies that encourage Nigerians to purchase goods made in the country. In a similar vein, the Nigerian government should prioritise lowering taxes and offering other incentives to industrial businesses, especially those in the infantry, in order to boost their productivity.

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