

Effect of Corporate Debts on the Financial Performance of Healthcare Manufacturing Firms in Nigeria

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Abstract

This study empirically investigated the effect of corporate debt on the financial performance of Healthcare manufacturing companies in Nigeria. A random sample of three (3) Healthcare firms quoted in the Nigeria Stock Exchange as at May, 2019, were selected and studied for the period of ten years (2009-2018). The response variable used for the study was Return on Asset (ROA) while explanatory variables were Short-Term Debt (STD) and Long-Term Debt (LTD). Annual time series secondary data extracted from the annual report and financial statements of the selected firms were used while the ex-post facto research design was adopted. Statistical analysis techniques employed were descriptive statistics and random effect panel least squares multiple regression mechanism. Necessary diagnostic and robustness tests such as Levin, Lin & Chu t^ panel unit root and correlation analysis were performed. Findings revealed that corporate debt exert significant negative effect on the financial performance of pharmaceutical firms in Nigeria. Particularly, the empirical evidence provided that in disaggregated form, the effect of STD and LTD on ROA were individually negative and insignificant. The implication of this result is that debt of any sort is not favourable to pharmaceutical firms in Nigeria. Based on these findings, it was recommended among others that firms in Nigeria should strive to reduce their debt ratio as it draws back their profit levels in the company.*

Key Words: Long-term debt, Short-term debt, Total debt, Return on Assets, Pharmaceutical Company

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I. Introduction

Corporate finance executives around the world, in regional and local markets, are still grappling with the combined challenges of poor financial performance and seeking the best company financing solutions. These executives must also balance the triple demands of generating wealth for investors, maintaining firm operations, and contributing to an economy's growth. Debt financing is a crucial component of external finance for enterprises raising extra cash after incorporation, according to Baltac and Ayaydm (2014). It has both a positive and negative effect on corporate growth and strategic investments (O'Brien and David, 2010).

The impact of debt financing on financial performance is critical for all firms (Karuma, Ndambiri and Oluoch, 2018). Although existing theory shows that debt is one of the primary sources of funding for a firm's long-term activities, which significantly define its performance, determining the optimal capital structure remains an illusive goal (Nwude, Itiri, Agbadua, & Udeh, 2016; Prempeh, Sekyere, & Asare, 2016). Debt is the second most important type of capital structure after equity. It entails the issuance of financial instruments such as loans payable, notes payable, short-term debt, long-term debt, bonds, debentures, and other similar instruments to finance a company's activities and assets (Chadha and Sharma, 2016). Furthermore, because of the higher costs of financial crisis, debt overhang issues suggest that excessive levels of debt will inhibit investments (Diamond and He, 2014).

Theoretical projections on the relationship between debt financing and firm performance are conflicting in both established and developing economies, according to corporate finance literature. While some experts expect that debt has a favorable impact on financial performance (Margaritis and Psillaki, 2010; Fosu, 2013), others argue that debt has a detrimental impact, especially when enterprises are heavily indebted (Kayhan and Titman, 2007; Bhagat and Bolton, 2008; Ghosh, 2008; Prempeh, Sekyere and Asare, 2016). This study, on the other hand, aims to look into the impact of corporate debt on the financial performance of healthcare manufacturing companies in Nigeria over a ten-year period.

II. Review Of Related Literature

2.1 Conceptual Review

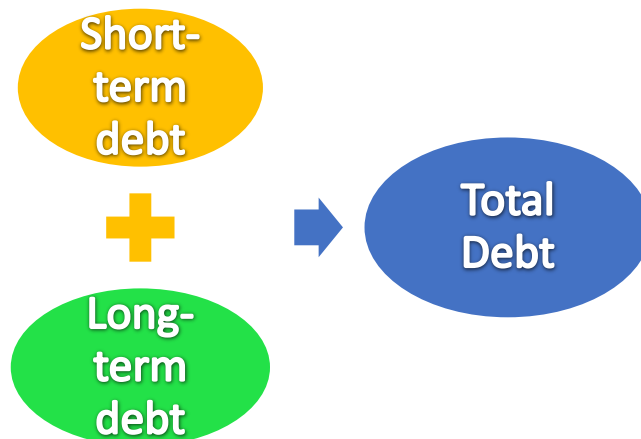
Debt is always wanted if a company's profits are reasonably high, resulting in positive leverage for shareholders. Taking on more debt becomes more dangerous if a company's income is steadily declining (Karuma, Ndambiri, & Oluoch, 2018). Short-term debt and long-term debt are two types of corporate debt.

Short-term debt comprises of any debt incurred by a company and which is due within the current fiscal year. It is measured as the ratio of current liabilities to total assets of a company. Geometrically, $STD = \frac{\text{Current Liabilities}}{\text{Total Assets}}$.

Long-term debt, on the other hand, refers to any sort of financing having a maturity of more than one year (including loans, bonds, leasing, and public and private equity). It contributes to faster growth, greater welfare, shared prosperity, and long-term stability in two ways: by lowering borrowers' rollover risks, thus extending the investment horizon and improving performance, and by increasing the availability of long-term financial instruments, allowing households and businesses to address their life cycle challenges (de la Torre, Ize, & Schmukler, 2012). Long-term debt is defined as a company's ratio of non-current obligations to total assets.

That is to say, $LTD = \frac{\text{Non-current liabilities}}{\text{Total Assets}}$.

Diagrammatically, corporate can be represented as:



Source: Researcher compilation (2019)

As a result, a firm's financial performance is a mathematical assessment of how successfully it uses available resources to generate profit (Omollo, Muturi and Wanjare, 2018). High performance, on the other hand, demonstrates management effectiveness and efficiency in utilizing the company's resources. Accounting-based measurements such as revenue, earnings per share, and a firm's growth rate can be used to successfully analyze a firm's performance. The major accounting-based performance indicators are Return on Assets (ROA), which is an indicator of how profitable a company is in relation to its total assets, Return on Equity (ROE), which is the amount of net income returned as a percentage of shareholders equity, and Return on Capital Employed (ROCE), which is used to compare the relative profitability of companies after taking into account their total assets. In this study, the financial performance was measured by Return on Assets (ROA) estimated as: $ROA = \frac{\text{Profit After Tax}}{\text{Total Assets}}$

2.2 Theoretical Framework

Donaldson's pecking order theory of capital structure is the foundation of this research (1961). According to the hypothesis, when a company is seeking for ways to fund long-term investments, it has a well-defined order of preference for the types of financing it utilizes. It asserts that a company's first priority should be to use internal money (i.e. retain earnings), then debt, and last external equity. According to the notion, the more lucrative a company becomes, the less it borrows because it has enough internal funds to fund its investment projects. The idea goes on to say that when internal money is insufficient, a company should seek external financing, preferably through bank borrowings or corporate bonds. After exhausting all other options, including internal and bank borrowing as well as corporate bonds, the final and least favored option is to raise new stock capital.

The Pecking Order theory, which asserts that corporations order their sources of financing (from internal financing to equity) according to the idea of least effort, or least resistance, preferring to seek equity as a

last resort, reflected the costs of asymmetric information. As a result, internal funds are used first, followed by debt, and then, when it is no longer feasible to issue more debt, equity is issued.

2.3 Empirical Reviews

Tauseef, Lohano, and Khan (2013) looked at the impact of loan financing on the financial performance of 95 textile enterprises in Pakistan between 2002-03 and 2007-08. Ordinary least squares regression analysis was used as the analytical technique, and the results revealed a nonlinear link between return on equity and total debt ratio. Although ROE rises initially as the total debt ratio rises, after an appropriate debt level is reached, ROE starts to fall.

Kwenda and Holden (2014) investigated the determinants of short-term loan financing on listed enterprises in South Africa using the generalized method of moment (GMM). For the period 2001 to 2010, data was collected from 92 companies listed on the JSE Securities Exchange (JSE). According to the findings of the study, businesses have a target amount of short-term debt and go through an adjustment process to get there. The usage of short-term debt as a short-term financing vehicle among the listed firms is influenced by spontaneous and internal resources, investment possibilities, and the state of the economy.

For the years 2010 to 2013, Nazaripour and Shadi (2015) evaluated the impact of funding on evaluating the performance of companies listed on the Tehran Stock Exchange through debt and the optimal debt structure. The assumptions were tested using multivariate regression analysis, which was based on the method of combined data. The findings revealed that debt financing has a negative and significant link with performance. In Tehran, there is also a favorable and significant association between the optimal debt structure and the company's performance, as well as a considerable difference in average efficiency between the optimal and non-optimal debt structures.

Prempeh, Sekyere, and Asare (2016) evaluated the impact of debt policy on company performance (Short-Term Debt, Long-Term Debt, and Total Debt). For the years 2005 to 2015, secondary data was acquired from the five (5) manufacturing businesses listed on the Ghana Stock Exchange (GSE). To see if there was a significant association between debt ratios and performance metrics, the panel data regression model was applied. According to the findings, listed manufacturing companies in Ghana use both equity and loan capital to fund their operations. Long-term debt makes up 49% of the debt structure, while short-term debt makes up 37%. Debt (Short-Term Debt, Long-Term Debt, and Total Debt) was also discovered to have a detrimental impact on firm performance.

Habib, Khan, and Wazir (2016) used empirical evidence from the non-financial sector of Pakistan to study the relationship between debt and corporate profitability. They used panel data spanning ten years, from 2003 to 2012. The influence of debt on profitability was investigated using random effect regression analysis. The findings demonstrated a strong but unfavorable association between Pakistan's non-financial sector's short-term debt, long-term debt, total debt, and return on assets.

Gallemore, Mayberry, and Wilde (2017) looked into the link between corporate taxes and bank outcomes such lending growth, leverage, liquid asset holdings, and risk-taking. The secondary data used was gathered from the U.S. Multistate Tax Guide, Individual State Income Tax Codes, State Revenue Department Websites, Book of the States, and the major aspects of fiscal federalism between 1996 and 2013. The data was analyzed using multi-regression analysis and the F-test, and the results revealed that tax rates had a considerable impact on specific institutions, particularly during economic downturns and credit risk uncertainty. Furthermore, the findings demonstrated that corporate income tax has an impact on bank outcomes such as lending and leverage, which in turn has an impact on the capital accessible to both individuals and non-bank firms.

Eriki and Osagie (2017) investigated the impact of debt-to-equity ratios on the financial performance of Nigerian downstream oil and gas companies. The study covered a five-year period from 2011 to 2015 and used the yearly financial statements of twelve (12) oil and gas companies listed on the Nigerian Stock Exchange. The data was analyzed using panel regression analysis. The findings revealed that debt to capital employed (DC) and long-term debt to common equity (LDCE) have a negative and small influence on company performance measured by ROA and ROE, whereas debt to asset (DA) and debt to common equity (DCE) had a positive and significant impact on ROA and ROE.

Onyema and Oji (2018) investigated financial leverage and profitability of quoted food and beverage firms in Nigeria using the Augmented Dickey Fuller test, co-integration test, granger causality test, and vector error correction models. Model one's level series results revealed that total liability ratio has a negative relationship with return on equity (ROE) and return on assets (ROA), which were used as dependent variables in the models, whereas long term debt, equity ratio, debt ratio, and debt equity ratio have a positive relationship with the dependent variables. Total liability ratio, long-term debt ratio, debt equity ratio, and debt ratio all have a negative association with return on equity, while equity ratio has a positive link. The Augmented Dickey Fuller test revealed that the variables are stationary at first difference; the co-integration test revealed the presence of a long run association; and the Granger causality test revealed that the dependent and independent variables have a bi-directional link.

For a five-year period, Karuma, Ndambiri, and Oluoch (2018) looked at the impact of short-term debt, long-term debt, interest rates, and corporation tax rates on the financial performance of manufacturing enterprises listed on the Nairobi Securities Exchange (2013-2017). The data was analyzed using descriptive statistics, correlation, and regression analysis approaches. The findings found that accounts payable, bank overdrafts, debentures, and interest on tax have a large impact on a firm's ROA, whereas a bank loan, interest payments, and expense deductibles had a minor impact.

Kurawa and Saidu (2018) investigated the effect of company income tax on the financial performance of listed consumer goods companies in Nigeria from 2006-2016. Data for the study was collected from the annual reports and accounts of the companies. Regression analysis was used as a technique for data analysis; findings provided an insignificant negative relationship between corporate tax and financial performance using return on assets as a measure. Age and risk however exhibits a positive but not significant relationship with ROA. Size on the other hand showed a positive and significant relationship with performance confirming prior expectations.

The implications of debt financing choices on the financial performance of enterprises listed on the Nairobi Securities Exchange, Kenya, were investigated by Omollo, Muturi, and Wanjare (2018). Between 2009 and 2015, secondary data was collected from 40 non-financial enterprises listed on the Nairobi Securities Exchange. The pooled ordinary least squares (OLS), fixed effects (FE), and random effects (RE) models were used as analytical tools. Short-term, long-term, and total debts all have negative and statistically significant effects on asset returns across OLS and RE, according to the findings. However, across all estimating approaches, debt metrics show no meaningful impact on returns on equity.

From 2006 to 2014, Sohail Aziz (2019) investigated the impact of debt financing on firm performance in Pakistan's non-financial sector. Panel least square was utilized in the investigation, and the Hausman test was used to determine whether a fixed effect or random effect model should be used. Debt financing has a negative but considerable impact on firm performance in Pakistan, according to the research.

The impact of operational efficiency on the financial sustainability of listed manufacturing companies in Nigeria was explored by Osazefua (2019). The Bloomberg portal provided a secondary panel dataset spanning 2009 to 2016 for 16 publicly traded manufacturing businesses, which was analyzed using the Ordinary Least Square regression analysis approach. Operating expenses and asset turnover exhibited a negative and positive significant association with ROA, according to the findings. Employee turnover, account receivables, and inventory turnover were all found to be minimal. Both inventory and asset turnover demonstrated a positive significant connection with Tobin's Q. There was a negative substantial link between operating expense and revenue.

III. Methodology

3.1 Research Design and Sources of Data

The study is an "after-the-fact" study; hence, research design adopted was *ex-post facto* design. Annual time series secondary were extracted from the selected firms' annual accounts and financial statements for the study periods (2009-2018). Other sources of numerical information were Journals articles, Newspapers, textbooks and other published and unpublished materials. The sample selection technique adopted for the study was simple random sampling. The reason was to make generalization about the entire Healthcare companies in Nigeria. With this technique, a sample of three (3) out of ten (10) quoted Healthcare manufacturing firms quoted in Nigeria Stock Exchange as at January, 2019, were selected and studied.

Model for this study follows from the work of Omollo, Muturi and Wanjare (2018). It is a Classical Linear Regression Model (CLRM), and particularly, the ordinary least squares regression technique. The choice of least squares technique is to minimize error sum of squares, maintaining the property of best unbiased linear estimator. The model did not undermine the assumption that: $Y \sim N(\theta, \sigma^2)$

$$(3.1)$$

Where, Y is the Dependent (or Response) variable; θ is the constant or intercept of the regression model, σ^2 is the variances and covariances of the random term.

Explicitly, the model is specified thus:

$$Y_{ij} = \beta_0 + \beta_1 X_{1ij} + \beta_2 X_{2ij} + \mu_{ij} \tag{3.2}$$

Such that,

$$Y_{ij} = \begin{bmatrix} Y_{i,1} \\ Y_{i,2} \\ Y_{i,3} \\ \vdots \\ Y_{i,k} \end{bmatrix}; \quad \beta_0 = \begin{bmatrix} \beta_{0j,1} \\ \beta_{0j,2} \\ \beta_{0j,3} \\ \vdots \\ \beta_{0j,k} \end{bmatrix}; \beta_j = \begin{bmatrix} \beta_{j,1} \\ \beta_{j,2} \\ \beta_{j,3} \\ \vdots \\ \beta_{j,k} \end{bmatrix}; \text{ and } \mu = \begin{bmatrix} \mu_{i,1} \\ \mu_{i,2} \\ \mu_{i,3} \\ \vdots \\ \mu_{i,k} \end{bmatrix}$$

μ = Error associated with the model.

Y is the estimator for Return on Assets while X_1 and X_2 are estimators of Short-term debt and Long-term debt respectively, β_j^s are coefficients of X_i^s in the model. Thus;

$$ROA_t = \beta_0 + \beta_1 STD_t + \beta_2 LTD_t + \mu_t \quad (3.3)$$

Where,

ROA_t = Return on Assets at time t, (Dependent variable).

STD_t = Short-Term Debt at time t, (Independent variable).

LTD_t = Long-Term Debt at time t, (Independent variable).

β_0 = Constant

β_1 is the coefficient of STD in the regression equation.

β_2 is the coefficient of LTD in the regression equation.

μ_t = Random error associated with the model.

Table 1: Description of Study Variables

Variable Name	Acronym	Description
Short-term debt	STD	This is the ratio of ratio of current liabilities to total assets of a company. That is to say, $STD = \frac{Current\ Liabilities}{Total\ Assets}$
Long-term debt	LTD	This is the ratio of non-current liabilities to total assets of a company. That is to say, $LTD = \frac{Non-current\ liabilities}{Total\ Assets}$
Return on Asset	ROA	This is the ratio of net income to total assets of the selected manufacturing companies. That is to say, $ROA = \frac{Profit\ After\ Tax}{Total\ Assets}$

Source: Author's compilation (2019)

IV. Data analysis

Descriptive statistics such as measures of central tendency (mean, median), measures of spread (standard deviation, minimum and maximum) as well as measures of distribution (skewness and kurtosis) were used in the data description to ascertain its behaviour as well spread over the period. The descriptive statistics result is as presented in table 2.

Table 2: Descriptive Statistics Result

	ROA	STD	LTD
Mean	8.799099	0.342805	0.131678
Median	9.786234	0.389170	0.075799
Maximum	14.08990	0.515035	0.472292
Minimum	1.835930	0.065153	0.000000
Std. Dev.	4.562995	0.145013	0.170859
Skewness	-0.316481	-1.115322	1.355209
Kurtosis	1.496556	2.857625	3.082650
Jarque-Bera	3.326230	6.245049	9.191499
Probability	0.189548	0.044046	0.010095
Sum	263.9730	10.28414	3.950351
Sum Sq. Dev.	603.8067	0.609833	0.846587
Observations	30	30	30

Source: Researcher's Result (2019)

From the descriptive statistics result, it was clearly shown that the series are volatile (with wide standard deviations) indicating poor prediction power. The skewness which measures the degree of symmetry from the mean indicates that series of ROA and STD were skewed to the left while that of LTD is skewed to the right. Looking the measure of peakedness of the distribution of each series, it was shown that ROA and STD are within the normal range while there is excess kurtosis ($k > 3$) in series of LTD.

4.3 Stationarity Test Result

Before lodging into the main analysis, the researcher found it necessary to check the stationarity properties of the variables to determine the right estimation model and also forestall the production of spurious estimates. The stationarity test result is as presented in table 3 below:

Table 3: Stationarity test result

Variable	Levin, Lin & Chu t* test statistic	Probability	Order of integration
ROA	-2.18	0.0147	I(0)
STD	-3.42	0.0003	I(0)

LTD	-3.26	0.0006	I(0)
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Source: Researcher's result (2019)

From Table 3, it is evident that the variables are integrated of same order; which is order zero. The p-values < 0.05 indicates that there is no unit root problem in data series. This confirms the application of Ordinary Least Squares (OLS) regression analysis technique.

Table 4: Covariance and Correlation test result

Covariance Analysis: Ordinary
 Sample: 2009 2018
 Included observations: 30

Correlation	ROA	STD	LTD
ROA	1.000000		

STD	-0.094376	1.000000	
	-0.501628	-----	
	0.6199	-----	
LTD	0.141707	-0.921429	1.000000
	0.757488	-12.54868	-----
	0.4551	0.0000	-----

Source: Researcher's Eviews 10 Output

The findings show that debt has no bearing on the Return on Assets of Nigerian healthcare manufacturing companies. In greater detail, the findings reveal that short-term debt has a negative relationship with financial success, whereas long-term debt has a favorable relationship with financial performance in Nigerian healthcare manufacturing enterprises. The short-term and long-term debts were shown to work in opposite directions, implying that as one rises, the other falls.

Table 5: Panel Regression Result

<i>Regression Method: Panel Least Squares</i>				
<i>Sample (adjusted): 2010 2018</i>				
<i>Dependent Variable: ROA</i>				
Regression line: $ROA = 11.235 - 14.032STD - 11.621LTD$				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	11.23522	5.257162	2.137126	0.0434
STD	-14.03169	9.475598	-1.480824	0.1522
LTD	-11.62078	10.44618	-1.112443	0.2774
Model validation				
R-squared= 0.523 (52.3%)				
Adjusted R-squared= 0.460 (46.0%)				
Durbin-Watson stat= 2.755308				
Jarque-Bera stat. = 3.255				
Prob(J-B) = 0.1964				

Source: Researcher's Eviews 10 output

The panel least squares regression result demonstrated that debts are unfavorable to Nigerian healthcare manufacturing companies. In particular, the Fisher's index (F-stat. = 8.39; p=0.001) revealed that corporate debt financing had a considerable negative effect on the financial performance of Healthcare manufacturing enterprises in Nigeria. Individual results, as indicated by t-statistics, show that these debt components as distinct entities have no significant impact on the financial performance of the firms.

The R-squared estimate, which assesses the model's explanatory power, indicates a strong match, since the amount of debts of the enterprises accounts for 52.3 percent of the variations in Return on Assets. Furthermore, the Durbin-Watson estimate of 2.755308 is in favor of Return and is in direct opposition to the financial performance of Nigerian healthcare manufacturing enterprises. The outcome, in particular.

V. Conclusion And Recommendations

Debt financing had remained an issue of concern to financial managers especially in developing economy. This is as a result of insufficient capital for running the business. This study analyzed the effect of debt financing option on the financial performance of Healthcare manufacturing firms in Nigeria for the period of ten years. Empirical evidence showed that corporate debt financing exert significant negative effect on the financial performance of Healthcare manufacturing firms in Nigeria. This implies that corporate debt financing is not favourable to maximizing the firm's value in Healthcare sector in Nigeria. However, based on these findings, the following recommendations were made:

- Financial managers of Healthcare sector in Nigeria should adjust debt levels to ensure that they operate at the optimum points. On the other hand, credit institutions should only finance businesses up to the point where profitability is maximized to mitigate against default risks associated with overleveraging.
- Drawing from the tenets of the agency theory, financial managers of Healthcare sector should strive to minimize debt and select other financing options that maximize shareholder's wealth.
- The healthcare industries when considering debt as a source of capital finance should do so in line with the costs benefits associated with its use.
- Federal government of Nigeria should consider subsidized interest rate on loans providing more equity funding.

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