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Capital structure and survival dynamic of business organisation: The dividend approach

Kehinde, James Sunday

Department of Accounting and Finance Faculty of Management Science Lagos State University, Ojo

Email address:
pastorkehindebox@yahoo.com, Kehindejames@rocketmail.com

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Abstract: The capital structure of firms count in the determination of the financial risk of the firm a firm night be making good net profit before tax but might have less to distribute to the shareholders after the payment I of tax when compared with a similar firm in the same industries due to poor capital structure arrangement thus payment of low return to share holders most times is due to poor capital structure rather than to poor business return. In this study the return is the dividend paid to the shareholders. Secondary data was used for the study, collected from the financial report of the firm. The simple multiple linear regressions was applied for the study and the asymptotic probability and the t-statistic were adopted for the study the result of the study revealed that capital structure of the firm do not satisfied the optimal capital structure status of the Modigliani and Milan the firm for the period covered is mostly financed by equity and have a near zero debt finance a low relationship also exist between equity-debt finance of the firm and dividend of the firm. It was recommended that the firm should introduce debt finance to the capital structure of the firm to enjoy the tax advantage of debt finance.

Keywords: Dividend, Capital structure, Debt, Equity

1. Introduction

The operation of the firm is always influence by the business risk and the financing risk of industry, some of the risk are diversified and the others are not, the diversified risk are called the unsystematic risk while the non-diversifiable are called systematic risk. The business risks are due to factors within the framework of the firm while the financing risk is the whole capital structure of the firm. The business risk are sometime function of the culture, leadership, product and market structure of the firm and the industries, while the finance risk if not well decomposed and managed will fall in the systematic risk framework of the firm. It can bring growth to the firm and increase the wealth of the organization, Kehinde (2011), stated that the basic goal of the firm is to maximize the wealth of the firm. However, today the primary goal of the firm is to survive and not only to make wealth, will wealth only come to focus after survival of the firm is assured. This wealth firm may distribute immediately in form of dividend or plow such back to the business for future increase profit

Thus, the study attempt to examine the capital structure of Cadbury Nigeria ltd and the survival ability of the firm in line of ever dynamic environment of the nation, the dividend approach was used as the study for effective measure of the scenario.

The study also measures the relationship between the capital structure of the firm and the dividend structure of the firm. Many firms in the industry do not match the capital structure advantage against the dividend payment structure of the firm. The capital structures of most firms in Nigeria are not composed to give effective earning, dividend and revenue generation structure of the firm. The capital structure relevant theory by modegilaini and millan (1960) is not followed by several firms. Several firms possess a well mixed capital structure both with a lean earning and dividend structure which sometimes is not good enough for firm with the basic goal of profit and wealth maximization objective.

2. Conceptual Frame Work

Capital structure in finance, refers to the way a corporation finances its assets through the combination of equity, debt, or hybrid securities. It is the ratio of different kinds of securities raised by a firm as long-term finance.

The capital structure of a firm described the combination of both debt and equity finance structure of the firm. A firm's capital structure is therefore the composition or 'structure' of its liabilities. The relative ratio of securities can be determined by process of capital gearing. On this basis, the companies are divided into two namely highly geared companies: this are firms whose proportion of equity capitalization is small. Low geared companies: this are firms whose equity capital dominates total capitalization (Wikipedia, 2012, MSG,2012)

The Modigliani and Miller (M&M) capital structure relevant and irrelevant theorems posit that in the absence of company taxes, there are no benefits, in terms of value creation, to increasing leverage and on the other hand in the presence of taxes, such benefits, by way of interest tax shield, do accrue when leverage is introduced and/or increased. The capital structure theory by Modigliani and Miller are three types' namely static trade-off theory, agency theory and theories based on information asymmetries (Cohen, 2004)

3. Trade-Off Theory of Capital Structure

In the trade-off theory of capital Structure the bankruptcy cost is allowed to exist. It states that there is an advantage to financing with debt (namely, the tax benefits of debt) and that there is a cost of financing with debt (the bankruptcy costs and the financial distress costs of debt). The marginal benefit of further increases in debt declines as debt increases, while the marginal cost increases, so that a firm that is optimizing its overall value will focus on this trade-off when choosing how much debt and equity to use for financing. Empirically, this theory may explain differences in D/E ratios between industries, but it doesn't explain differences within the same industry.( )

The theory never the less, states that with no taxes, there are no debt-related tax benefits, and with no such benefits [assuming everything else remains constant] there is no optimal capital structure. With no optimal capital structure, therefore, one could only conclude that the whole notion [based on the contention that E + D = constant] of trying to locate the optimal capital structure becomes self-contradictory and, thus, meaningless (Cohen, 2003)

In another study by Cohen(2004) on determination of weighted average cost of capital and firms value in relation to capital structure with intent to locate the optimal capital structure, taking into consideration the relationship between debt, equity and taxes, and placing emphasis on the effects of default risk, as well as on the assumptions that underlie the curves discovered that the conventional optimal capital structure theory by Modigiliani and Millan is flawed as is not commonly used in practice,

Cohen also in the study of the difference in the capital structure of depository institutions(banks) and that of the corporate firms .using the basic Modigliani-Miller [M&M] methodology, but instead of using a constant EBIT as stated by (M &M), as classically done for corporate firms used a variable EBIT, which hinges on the interest earnings from the asset-based loans made to the borrower discovered that the optimal capital structure of a depository institution is not as easily identifiable as that of a corporate firms. The reasons for this include, among others, (i) the existence of regulatory capital restrictions, (ii) an inter-dependence between the borrower and the lender and (iii) a dramatic change in the behaviour of the return on equity with respect to leverage when risks and credit spreads of both, lender and borrower, are accounted for. The study also highlighted some of the main differences that exist between the treatment of the capital structure of corporate firms and depository institutions.

Mac an Bhaird (2010) In a study of samples of the capital structure of 299 Irish small and medium sized firms (SMEs) Using hypotheses formulated from pecking order and agency theories and also incorporating a financial growth life cycle approach discovered that the age, size, level of intangible activity, ownership structure and the provision of collateral are important determinants of the capital structure in SMEs.

Zellner(1962) also in a study of the capital structure in several firms discovered that the influence of age, size, ownership structure and provision of collateral is similar across industry sectors, indicating the universal effect of information asymmetries and also discovered that firms overcome the lack of adequate collateral security by providing personal assets as collateral for business debt, and by employing additional external equity .

Murphy, Ofer and Satterthwaite (2009) stated that Modigliani and Miller in their 1958 article showed that if firms are in the same risk class and in an economy with a perfect capital market having no transaction costs, taxes, or no bankruptcy costs, then their relative market values are independent of their capital structures how ever where they are in a taxable situation then their capital; structure counts in determination of their net return

4. Pecking Order Theory

Pecking Order theory tries to capture the costs of asymmetric information. It states that companies prioritize their sources of financing (from internal financing to equity) according to the law of least effort, or of least resistance, preferring to raise equity as a financing means "of last resort". Hence: internal financing is used first; when that is depleted, then debt is issued; and when it is no longer sensible to issue any more debt, equity is issued. This theory maintains that businesses adhere to a hierarchy of financing sources and prefer internal financing when available, and debt is preferred over equity if external financing is required (equity would mean issuing shares which meant 'bringing external ownership' into the company). Thus, the form of debt a firm chooses can act as a signal of its need for external finance. The pecking order

theory is popularized by Myers (1984) when he argues that equity is a less preferred means to raise capital because when managers (who are assumed to know better about true condition of the firm than investors) issue new equity, investors believe that managers think that the firm is overvalued and managers are taking advantage of this over-valuation. As a result, investors will place a lower value to the new equity issuance.(Myers, 1984, Mac and Bhaird ,2011))

Strebulaev(2012) study the capital structure theory using the calibrated dynamic trade-off model to simulate firms' capital structure path and stated that in the presence of frictions, firms adjust their capital structure infrequently. As a consequence, in a dynamic economy the leverage of most firms is likely to differ from the "optimum" leverage at the time of readjustment. It also noted from the results of standard cross-sectional tests on selected data a consistency between the practice and theory of capti9al structure with a little difference and thus suggested a rethinking of the way capital structure tests are conducted.

Leary and Roberts (2012) empirically examine whether firms engage in a dynamic rebalancing of their capital structures while allowing for costly adjustment. They begin by showing that the presence of adjustment costs has significant implications for corporate financial policy and the interpretation of previous empirical results. It confirms that financing behavior is consistent with the presence of adjustment costs and that firms actively rebalance their leverage to stay within an optimal range. Our evidence suggests that the persistent effect of shocks on leverage observed in previous studies is more likely due to adjustment costs than indifference toward capital structure

5. The Research Method

The research work made use of secondary data obtained from the financial report of the firm. It also made use of personal interview selectively conducted. The study covered a period of 2001 to 2010. The simple linear regression was used and the f-statistic and Mackinnon, one field, p. value was used for the test; the correlation coefficient and the coefficient of determination were also used for the study. The study is an attempt to measure the effect of the capital structure of the firm on dividend. The dividend of the firm is the total earning after tax of the firm paid to shareholder in form of return from time to time for the period covered and under study.

6. Model Specification

Dividend =f (equity, debt)

Dividend = $a_0 + a_1$ equity $+ a_2$ debt + C

Dividend: is the amount of return paid to the shareho9lder of the firm from time to time.

Debt: this refers to both the current and long term liability of the firm.

Table 1: Explanation information

	Coefficient	Probability
Constant	199087.6	0.7319
Equity	0.204537	0.0459
Debt	0.047017	0.4902
R		0.822755
R^2		0.676927
Adjusted R^2		0.547697
Prob(F-statistic)		0.059327

Source: the researcher's analysis

7. Interpretation

The relationship between dividend, equity and debt obtained from the financial report of the firm was tested. The dividend of the firm as a dependent variable was regressed against the equity (shareholders fund) and the debt (total debenture and loan) of the firm. The correlation coefficient (R) was 0.8227, that is, the relationship between the dividend of the firm and the independent variable is 83%, this is very high, however, the adjusted R^2 is 0.68 that is, 68% which shows that dividend by the firm is only determined by the equity and debt portfolio to the tune of 55% Other factors are responsible for the rest 45% change in dividend. Since the coefficient of determination is 55%, this revealed a very weak deterministic relationship between the variables tested. The slope are 0.204 and 0.047 for equity and debt respectively which shows that every one naira of equity will generate a 20k of dividend and every one naira of debt will generate 4.7k of dividend . It is also interesting to note that the firm is mostly financed by equity in recent times. The relationship between the debt portfolio and the dividend is very lean. The debt portfolio as regarding long term debt is near zero while only short-term or current liability remains. Thus, the influence of debt on the dividend is very ting.

The significance test was done with the asymptotic probability (Mackinnon one sided p value) which revealed that there is significant relationship between equity and dividend on one hand and non on debt and dividend on the other hand, at both 5% and 10% significant level respectively, since the p-value are 0.7319and 0.0459 for the constant and equity and that of debt was also 0.4902, thus there exist a significant relationship between dividend and equity on one hand and no significant relationship between dividend and debt portfolio of the firm.

The result from this study corroborate the assertion of Nwachukwu (2012) in a recent study by the world bank who said that firms operating in Nigeria are less productive when measured by their output in relation to the amount of labour and capital they put into the business and also when compared to firms in kenya who are 40% efficient more than those in Nigeria

Findings

1. The study revealed that in this firm debt finance is scarcely used the majority of the activity of that firms is done by way of equity

2. The weak relationship that exist between equity finance and dividend revealed that the firm is operating at sub-optimal level of activity
3. The low coefficient of determination also revealed a weak relationship between dividend and the deterministic variables of both equity and debt. this shows that the assets of the firm are not put to adequate use to generate dividend or that the dividend policy of the firm for the period covered by the research work is sub-optimal and not shareholders friendly
4. The opposite directional relationship between debt and dividend shows that exploited by the firm
5. The overall pictures of the firm shows unit directional capital structure position for the firm. The firm is basically lowly geared. Thus, the firm will have a low tax advantage generated by debt position like this firm

8. Conclusions and Recommendations

The study overall capital structure and dividend relationship shows a very weak financial gearing thus have a very strong financial risk. it would also be noted that the firm will have a weak debt equity ratio and probably liquidity ratio and poor survival stands, however, that most of it activity being equity finance suggest using a long term source to finance it working capital requirement . Thus is otherwise called not concept (kehinde, 2011) of working capital finance. Thus, this firm is a near all equity finance firm for the period

Recommendations

The firm should increase it the debt finance structure to gain a better tax advantage especially where the tax rate is high than the interest rate on debt. This will help reap a better industrial advantage and will increase net earning and ipso facto the dividend

Secondly the firm should also improve on it capital structure with a well mix of debt and equity for effective growth and expansion.

Thirdly The dividend paid by the firm is very low and revealed a poor result for a certain number of years of the firms operating the management should therefore put in place strategic policy that will enhance the earning capacity of the firm and that will make the firm generate greater dividend because a low dividend payment for a long period will lead to poor rate for the firm share in the capital market.

Moreover the business risk which is the increase of the functional organic efficiency of the firm should also be examined as this may also be a contributory factor to the poor earning and enhance the poor dividend paid out it.

The firm should do a financial restructuring to reposition the firm to gain better advantage in the industry and operate at optimal capacity. It should be noted that the firm operates in the food industry which in this economy has very low market volatility and thus a good mix of debt and equity finance will produce optimal capital structure.

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