CRAWFORD JOURNAL OF BUSINESS & SOCIAL SCIENCES (CJBASS)
VOL. VIII NO. II, SEPTEMBER 2018: 15-21
ISSN 2141-9094; website:cjbasscru.org

EFFECT OF FINANCIAL LEVERAGE ON CORPORATE PERFORMANCE: EVIDENCE FROM NIGERIAN HOSPITALITY INDUSTRY

AKINYOMI Oladele John[1], OMOKEHINDE Joshua Odutola[2] & OLURIN Enitan Olurotimi[3]
[1,2,3]Department of Accounting and Finance, Mountain Top University, Ibafo, Ogun State, Nigeria
[1,2,3]e-mail: akinyomio@gmail.com, joshuaomokehinde@gmail.com, eoolurin@mtu.edu.ng,

Abstract
Funding is critical for the existence and survival of every business. Essentially, businesses obtain necessary funding from any of equity, debts, or a combination of both. Appropriate combination of equity and debts is not an easy task. The optimum combination of equity and debts remains a cardinal feature of profitable businesses. Despite several studies carried out on the relationship between financial leverage and financial performance; these studies have not been able to present a uniform conclusion which is appropriate for businesses in all situations. Therefore, this study attempts to fill this gap in knowledge by surveying the effect of financial leverage on performance in the context of Nigerian hospitality industry. The objective of this study is to examine the relationship between financial leverage and performance in the Nigerian hospitality industry. The target population of this study includes the three (3) hotels that are quoted in the Nigerian stock exchange as at December 2017. Using quasi-experimental research design, a census setting comprising of all the three companies was carried out. Data obtained from the audited financial statements between 2008 and 2017 of the companies were utilized for the study. The variables considered include leverage (independent variable) and financial performance (dependent variable). Leverage was measured with a total debt to equity ratio, financial performance was measured by return on assets, while the log of total assets served as the control variable. Regression analysis was carried out using SPSS version 21 software. The findings indicate the existence of a positive and statistically significant relationship between leverage and financial performance in the Nigerian hospitality industry. The study recommended that financing decisions should be taken with due consideration given to shareholders' wealth maximization objective.
Key Words: Hospitality-Industry, Financial-Performance, Capital-Structure, Finance, Leverage,

1. Introduction

Finance is fundamental to the existence and survival of any business organization. Every investment decision has a financial implication. Finance in the form of capital is obtainable from two main sources which include debts and equity (Akinyomi, 2013). The proper mix between debts and equity in the capital arrangement is not a simple task. The optimal capital arrangement is a central component of any viable business organization, particularly in the contemporary business environment. The optimal capital structure represents one of the foremost techniques for maximizing the value of the business (Pandey, 2004). It is the combination of debt and equity. It describes how an organization funds its whole processes through the utilization of diverse sources of finance. In order to make the capital structure decision in any organization, there is a need to ascertain the suitable blend of loan capital and shareholders' capital. Business concerns that utilize more loan capital than shareholders' capital are regarded as more levered in the financial sense. Operating only with shareholders' capital is considered as safe principally because it excludes the risk of liquidation, conversely, it does not permit the organization to take the advantage of fixed charge funding to increase returns to its shareholders (Akinyomi, 2013).

Maghanga and Kalio (2014) observed that leverage is so critical when taking a decision on capital structure. The concept of leverage is narrowly linked to the cost of capital, and consequently on the company's value. Usually, a rise in leverage leads to an improved return and risk, while the reduction in leverage leads to a reduction in return and risk. Finance executives accordingly, need to appraise leverage before taking capital structure decision. Leverage can be grouped into three categories as follows: operating leverage, financial leverage and combined leverage (Pandey, 2004; Akinyomi, 2013).

According to Cooper and Schindler (2000) financial leverage has to do with the magnitude to which an organization depends on debt to fund its activities. It is the utilization of fixed income securities such as debt in funding the business activities. The utilization of debt, in funding an organization's processes, can certainly increase the organization's return on equity and earnings per share. This is due to the fact that the organization is not diluting the shareholder's earnings through the utilization of equity financing. Excessive financial leverage, nonetheless, can result in a situation where the risk of non-payment of interest as and when due and compulsory liquidation. The financial risk of any business organization can be measured by the level of financial leverage (Cooper & Schindler, 2000).

Although numerous studies have been conducted on the relationship between financial leverage and business financial performance; nevertheless, these studies have been ineffective in arriving at a consensus which is appropriate for businesses in all situations (Al-Tally, 2014). Myers (2001) opined that a comprehensive theory which guides debt-equity decision is yet to be developed. Furthermore, Brealey and Myers (1991) acknowledged financial leverage as one of the ten unsolved problems in business finance. Extant literature revealed that a universally accepted relationship between financial leverage and financial performance is yet to be reached. While some of the previous studies reported the existence of a significant negative relationship between leverage and organizational financial performance (Mukaria, Mugenda & Akenga, 2015; Enekwe, Agu & Eziedo, 2014). Other studies reported the existence of a significant positive relationship between financial leverage and financial performance (Akhtar, Javed, Maryam, & Sadia, 2012; Maghanga & Kalio, 2012; Tauseef, Lohano & Khan, 2015). Consequently, it is evident that these studies on the relationship between financial leverage and corporate performance have not been able to arrive at a consensus, thus necessitating further studies. Besides, most of these prior studies were carried out in the advanced market economies, only limited studies have thus far been conducted in the emerging economies, particularly in Nigeria. Therefore, the current study attempts to fill this identified gap in knowledge by surveying the effect of financial leverage on corporate financial performance in the context of Nigeria.

Hospitality industry which is an integral part of the tourism sector has demonstrated over the years to be a strong industry and an essential contributor to economic growth by attracting the inflow of billions of foreign exchange in exports and creating substantial employment (Yusuff, 2016). Thus, any strategy employed in order to further enhance the financial performance of the hotels in Nigeria should be considered a worthwhile effort.

The capacity to make a profit is contingent on management's ability to obtain the right amount of funds from the right source and at the right time. Furthermore, the funds obtained must be utilized in financing assets which will enhance the earnings capacity of the business (Vijayalakshmi & Manoharan, 2014). Generally, successful businesses have the capacity to permit a high degree of debt financing due to their ability to timely perform their financial obligations. Although several measures of profitability have been recognized in the literature, the current study employs return on assets (ROA). Moreover, profitable businesses have the capacity to make a huge sum of money with the use of a reduced amount of debt capital than businesses that generate a small amount of profit (Alkhatib, 2012).

Objective of the Study

The primary objective of this study is to examine the relationship between financial leverage and financial performance in the listed hotels in Nigeria. Specifically, the study seeks to examine the existence of relationship between return on assets (as a measure of financial performance) and debt to equity ratio (as a measure of financial leverage) in the listed hotels in Nigeria. In order to achieve the objective of this study, the following research hypothesis has been formulated: H_0: There is no significant relationship between return on assets and debt to equity ratio in the listed hotels in Nigeria; H_1: There is significant relationship between return on assets and debt to equity ratio in the listed hotels in Nigeria.

The paper is divided into five sections. Following the introduction as section one, section two is literature review, methodology is section three, results and discussion section four while section five is conclusion and recommendations.

2. Literature Review

Theoretical Review

In the financial management literature, two major theories provide the basis upon which discussion on financial leverage anchors (Modigliani & Miller, 1958). These theories include the irrelevant theory and the trade-off theory both developed by Modigliani and Miller. The study of a business enterprise's optimal capital structure dates back to 1958, when Franco Modigliani and Merton Miller published their Nobel Prize winning work on "the cost of capital, corporation finance, and the theory of investment." As an important premise of their work, Modigliani and Miller illustrated that under conditions where corporate income taxes and distress costs are not present in the business environment, the use of financial leverage has no effect on the value of the company. This view, known as the irrelevance proposition theorem, is one of the most important pieces of academic theory that has ever been published. The irrelevant theory has been widely criticised by scholars on the ground that some of the assumptions upon which the theory was based were defective. For instance, one of the irrelevant theory's assumptions is the existence of perfect capital market. This specifically means that (a) investors are free to buy and sell securities; (b) they can borrow without restriction at the same terms as the firm do; and (c) they behave rationally. It is also implied that the transaction costs, i.e., the cost of buying and selling securities, do not exist. These assumptions are very elusive in real life situation.

In recognition of the defects associated with the irrelevance theory, Modigliani and Miller expanded their irrelevance theory to include the impact of corporate income taxes, and the potential impact of distress cost, for purposes of determining the optimal capital structure for a company (Modigliani & Miller, 1958). Their revised work, universally known as the trade-off theory of capital structure, makes the case that a company's optimal capital structure should be the prudent balance between the tax benefits that are associated with the use of debt capital, and the costs associated with the potential for bankruptcy for the company. Today, the premise of the trade-off theory is the foundation that corporate management should be using to determine the optimal capital structure for a company. It is upon this trade-off theory that the current study anchors.

Empirical Review

The relationship between financial leverage and stock value (as a measure of financial performance) was conducted by Hasanzadeh, Torabynia, Esgandari, & Kordbacheh, (2013) in Tehran. The sample comprised of active listed companies in Tehran between 2005 and 2008. The result of the analysis revealed the existence of a non-statistically significant relationship between financial leverage and financial performance.

In Pakistan, a study conducted by Akhtar *et al.,* (2012) focused on the association between financial leverage and financial performance in the fuel and energy sector. A total of twenty companies listed in the Karachi Stock Exchange were included in the study. The data obtained were subjected to regression analysis. The result indicated the existence of a positive association between financial leverage and financial performance of the fuel and energy sector.

Another study carried out in Pakistan by Tauseef, Lohano and Khan (2015) investigated the relationship between financial leverage and financial performance among ninety-five textile sector companies. The study covered 2002 to 2008 financial years. The result of the data analysis revealed the existence of a significant relationship between financial leverage and financial performance in the sector, although, the relationship was nonlinear.

In Kenya, Mukaria, Mugenda and Akenga (2015) examined the relationship between leverage and performance of non-financial firms listed at the Nairobi Securities Exchange. A total of 38 non-financial companies were involved in the study. The study employed mainly secondary data extracted from the annual reports of the selected companies for the 2008 to 2013 period. The result of the regression analysis revealed that no significant relationship existed between the financial performance of highly geared and lowly geared companies. The study also reported the existence of a negative relationship between financial leverage and financial performance.

Using a descriptive research design, Maghanga and Kalio (2012) also conducted their study on the relationship between leverage and financial performance in Kenya, focusing on the Power firm. Both primary and secondary data were utilized for the study. The outcome of the analysis indicated the existence of a significant relationship between leverage and financial performance.

In Nigeria, Ahmadu (2015) examined the correlation between financial leverage and financial performance among the deposit money banks. Data were obtained from eleven deposit money banks covering the three categories of the banks. The result of the analysis revealed the existence of a significant relationship between financial leverage and financial performance of the banks. The result also indicated that over 80 percent of the banks' assets were financed by debts.

Furthermore, Enekwe, Agu and Eziedo (2014) examined the association between financial leverage and financial performance in the Nigerian pharmaceutical industry for the period between 2001 and 2012. Three companies were selected from the pharmaceutical industry in the study. Relevant data were obtained from the annual reports of the selected companies. The results of the correlation and regression analysis revealed the existence of a negative relationship between leverage and financial performance.

Likewise, Abdul and Adelabu (2015) conducted their study on the impact of financial leverage on firm performance in the Nigerian oil and gas industry. The study spanned the period between 2004 and 2007. Data for the study were obtained from the secondary sources. The results of the ordinary least square regression analysis revealed the existence of a positive and significant relationship between financial leverage and financial performance in the case study company.

John-Akamelu, Iyidiobi and Ezejiofor (2017) conducted a recent study on the association between leverage and financial performance among Nigerian food production companies. The study adopted the ex-post facto research design. Necessary data for the study were extracted from the audited financial statements of six selected

companies for 2009 to 2014 financial years. The result of the correlation analysis revealed the existence of a strong relationship between financial leverage and financial performance.

3. Research Method

The target population of this study includes the three (3) hotels that are quoted in the Nigerian stock exchange as at December 2017. These hotels include: Ikeja Hotel Plc, Capital Hotel Plc, and Transcorp Hotels Plc. Using quasi-experimental research design, a census setting, comprising of all the three listed companies was carried out. Secondary data obtained from the published audited financial statements between 2008 and 2017 of the companies were utilized for the study. The variables considered include leverage (independent variable) and financial performance (dependent variable). Leverage was measured with a total debt to equity ratio while the log of total assets served as the control variable. Meanwhile, financial performance was measured by the return on assets. The data collected were subjected to regression analysis using the SPSS version 21 software.

4. Results and Discussion

The data analysis result carried out on the data collected is as presented in this section, followed by the discussion of the findings.

Table 1: Regression Result with ROA as Dependent Variable

Independent Variable	Coefficient Estimate	Standard Error	t-Statistics	*P*-Value
Constant	104.315	19.827	5.261	0.000
Debt to Equity Ratio	-6.524	2.110	-3.093	0.005
Total Assets	-12.672	2.700	-4.693	0.000

R = 0.693; R^2 = 0.480; F-statistic = 12.453; (p-value = 0.0000)

Source: Researcher's Computation (2018)

The result revealed the existence of a high (69.3%) and a positive relationship between return on assets and debt to equity ratio in the Nigerian hospitality industry. Furthermore, the probability of a t-test of return on assets is statistically significant at 5% with a *p*-value of 0.0000 which is less than the critical value of 0.05. This suggests that there is a statistically significant relationship between leverage and financial performance in the Nigerian hospitality industry. Return on assets will increase by 48% when the debt to equity ratio level changes by one. This means a change in financial leverage will result in improved financial performance until the optimum level is reached, after which an increase in financial leverage will lead to a decrease in financial performance.

In order to identify an optimum level of leverage, a cost-benefit analysis needs to be carried out by the financial manager. Every debt comes with interest payment, which is a cost to the organization. The assets acquired with the debt facility usually generates revenue. It remains profitable for the organization to keep on utilizing debt in financing its assets as long as the revenue generated from such assets exceeds the cost of the debt. Therefore, optimum level of leverage is attained when the cost of debt equals the benefits derived from such debt. If after this point a company continue to utilize additional debts in its operations, it will lead to a decrease in profitability.

This result aligns with that of Tauseef, Lohano and Khan (2015), John-Akamelu, Iyidiobi and Ezejiofor (2017), Abdul and Adelabu (2015), Maghanga and Kalio (2012), and Ahmadu (2015), who reported the existence of a positive and significant relationship between financial leverage and financial performance. On the other hand, the result of this study contradicts those of Enekwe, Agu and Eziedo (2014), and Mukaria, Mugenda and Akenga (2015) who both reported the existence of a negative relationship between financial leverage and financial performance. Negative relationship only occurs when the optimal leverage level has been exceeded. As long as the cost of debt exceed the benefits derived from it, a negative relationship would be reported.

5. Conclusion and Recommendations

The optimum combination of equity and debts remains a cardinal feature of profitable businesses. This study examined the effect of financial leverage on corporate financial performance in the context of Nigerian hospitality industry. Three listed companies in the industry were surveyed. The result of the regression analysis indicated the existence of a positive and statistically significant relationship between leverage and financial performance in the Nigerian hospitality industry. This denotes that optimum leverage level enhanced profitability in the industry. Thus, it is recommended that financing decisions should be taken with due consideration given to shareholders' wealth maximization objective. Management should also ensure that debt financing is always at the optimal level so as to guarantee enhanced profitability. If the cost of debt (interest payment) exceeds the additional revenue to be generated by using such funds, managers should avoid utilizing such debt so as not to erode the company's profitability.

References

Abdul, A., & Adelabu, I. T. (2015). Impact of financial leverage on firm performance: Evaluation of Toyota Nigeria Plc. *International Journal of Science Commerce and Humanities, 3*(6), 68-74.

Ahmadu, A. (2015). The relationship between financial leverage and financial performance of deposit money banks in Nigeria. *International Journal of Economics, Commerce, and Management, 3*(10), 759-778.

Akhtar, S., Javed, B., Maryam, A., & Sadia, H. (2012). The relationship between financial leverage and financial performance: Evidence from Fuel and Energy Sector of Pakistan. *European Journal of Business and Management, 4*(11), 7 – 17.

Akinyomi, O. J. (2013). Effect of capital structure on firm performance: Evidence from the Nigerian manufacturing industry. *International Journal of Innovative Research & Studies*, 2(9), 468-480.

Al-Tally, H. A. (2014). *An investigation of the effects of financial leverage on firm performance in Saudi Arabia's public listed Companies* (Doctoral Thesis, Victoria Graduate School of Business, College of Business, Victoria University, Melbourne, Australia). Available from Vuir.vu.au/24843/1/Hassan%20Ahmed%20Al.Tally.

Brealey, R. A., & Myers, S. C. (1991). *Principles of corporate finance*. New York: McGraw- Hill

Cooper, D. R., & Schindler, P. S. (2000). *Business research methods* (8th Ed.). New York, McGraw-Hill.

Enekwe, C. I., Agu, C. I. & Eziedo, K. N. (2014). The effect of financial leverage on financial performance: Evidence of quoted Pharmaceutical companies in Nigeria. *IOSR Journal of Economics and Finance, 5*(3), 17-25

.Hasanzadeh, B., Torabynia, S., Esgandari, K., & Kordbacheh, S. (2013). Evaluating effects of financial leverage on future stock value at stock exchange. *Research Journal of Recent Sciences, 2*(2), 81-84.

John-Akamelu, R. C., Iyidiobi, F. C., & Ezejiofor, A. R. (2017). Leverage and financial performance: Evidence from Nigerian food production firms. *European Journal of Research and Reflection in Management Sciences, 5(*4), 1-11

Maghanga, E. N., & Kalio, A. M (2014). Effects of leverage on the financial performance of parastatals: A case study of Kenya power. *International Journal of Science and Research, 3*(10), 990-994

Maghanga, E. N., & Kalio, A. M. (2012). Effects of leverage on the financial performance of parastatals: A case study of Kenya Power. *International Journal of Science and Research, 3*(10), 990 – 994.

Maghanga, E. N., & Kalio, A. M. (2014). Effects of leverage on the financial performance of parastatals: A case study of Kenya Power. *International Journal of Science and Research, 3*(10), 990-994-

Modigliani, H., & Miller, M.H. (1958). The cost of capital, corporation finance and the theory of investment. *American Economic Review, 48*(6), 261-297.

Mukaria, H. K., Mugenda, N. G., & Akenga, G. M. (2015). Effect of leverage on the performance of non-financial firms listed at the Nairobi securities exchange. *Journal of Finance and Accounting, 3*(5): 132-139

Myers, S. C. (2001). Capital structure. *Journal of Economic Perspectives, 15*(2), 81- 102.

Pandey, I. M. (2004). *Financial management* (8th edition). New Delhi, Vikas Publishing House PVT Ltd.

Tauseef, S., Lohano, H. D., & Khan, S. A. (2015). Effect of debt financing on corporate financial performance: Evidence from textile firms in Pakistan. *Pakistan Business Review*, 903-916

Tauseef, S., Lohano, H., & Khan, S. A. (2015). Effect of debt financing on corporate financial performance: Evidence from textile firms in Pakistan. *Pakistan Business Review, 1*, 903-916.

Vijayalaskshmi, D., & Manoharan, P. (2014). Corporate leverage and its impact on profitability. *Indian Journal of Applied Research, 4*(10), 125-128.

Yusuff, M. A. (2016). Performance assessment of the tourism sector as a vital tool for economic growth in Nigeria. *International Journal of Academic Research in Business and Social Sciences,* 6(10):1-8

Appendix:

TLTL	TA	SHF	INT	EBIT	ROA	LogTA	TDTE
1730520	7850330	4050800	70580	685500	8.73	6.89	.43
1684413	7564157	3966839	68868	601651	7.95	6.88	.42
1909762	7036425	3474579	50266	618984	8.80	6.85	.55
1749960	6393317	3228131	41278	285917	4.47	6.81	.54
2285009	6436327	2715568	51699	425907	6.62	6.81	.84
3902034	5749911	707033	44821	549757	9.56	6.76	1.44
1525002	5640271	2974425	48721	1068606	18.95	6.75	.51
1551152	4913451	2491994	41832	1225607	24.94	6.69	.62
1472830	4731480	2280193	38730	1007480	21.29	6.67	.65
1335700	4480730	2150500	36780	955700	21.33	6.65	.62
7950580	17855400	7800330	350570	404800	2.82	7.25	1.02
7855730	17680480	7380800	330470	504300	2.85	7.25	1.06
7272127	17446440	7329124	256008	214447	1.23	7.24	.99
6947324	17141365	7370686	431281	915247	5.34	7.23	.94
6463695	15776084	6459226	393677	1791193	11.35	7.20	1.00
6299709	14518674	5059466	369905	1078704	7.43	7.16	1.25
6075850	13430840	4973842	361508	987508	7.35	7.13	1.22
5873438	13082480	4875433	358730	955840	7.31	7.12	1.20
5580430	12987230	4630220	330450	905500	6.97	7.11	1.21
6370708	14812422	4810899	203055	885530	5.98	7.17	1.32
8231283	57913703	30945499	3131737	439925	.76	7.76	.27
10045155	56619499	31222740	2396053	2166643	3.83	7.75	.30
9469438	54241970	33460873	1418722	3486021	6.43	7.73	.28
9198952	49079491	32918935	1316472	3899530	7.95	7.69	.28
10003427	38646730	17734017	847991	3272640	8.47	7.59	.56
2094478	28254280	14209961	730450	1139425	4.03	7.45	.15
1321429	16400716	15754085	2043887	1942916	11.85	7.21	.08
1170432	21523002	15244276	137053	3319796	15.42	7.33	.08
1005500	18735420	13870430	485440	2780050	14.84	7.27	.07
1321429	18300500	12870550	285300	2572000	14.05	7.26	.10

Keys:
TLTL means Total Long Term Liabilities
TA means Total Assets
SHF means Shareholders' Funds
INT means Interest
EBIT means Earnings before Interest and Tax
ROA means Returns on Assets
LogTA means Logarithms of Total Assets
TDTE means Total Debts to Total Equity Ratio