International Journal of Academic Research in Accounting, Finance and Management Sciences
Vol. 10, No.1, January 2020, pp. 239–249
E-ISSN: 2225-8329, P-ISSN: 2308-0337
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To cite this article: Adeniyi, A. J., Marsidi, A., Babatunji, A. S. (2020). *Capital Structure and Commercial Banks Performance in Nigeria,* International Journal of Academic Research in Accounting, Finance and Management Sciences 10 (1): 239-249

http://dx.doi.org/10.6007/IJARAFMS/v10-i1/7134 (DOI: 10.6007/IJARAFMS/v10-i1/7134)

www.hrmars.com
ISSN: 2225-8329

Capital Structure and Commercial Banks Performance in Nigeria

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Abstract

Decision relating to capital structure is of great important to an organization as capital performs several indispensable functions in the operations of banks, among which are to mitigate against risk and fragility, maintenance of public confidence as well as enhancing deposits mobilization and efficiency. It is imperative for managers to choose an appropriate financing mix which is a key decision for the growth and going concern of any financial institutions. This study used profit after tax and earnings per share as a measure of performance and employed panel regression technique to analyse data collected from a sample of fourteen quoted commercial banks between 2009 to 2016. The result shows a significant relationship between debt and profitability of commercial banks in Nigeria. The study concludes that debt can be significantly influenced by liquidity and shareholders' wealth. Consequently, the study recommend that commercial bank managers should not depend on debt capital as a source of financing the organization capital structure but rather use retained earnings of the business and consider debt as the least alternatives.

Key words Capital Structure, Commercial Banks, Debt, Financial Performance, Nigeria

Received: 28 Mar 2020
Revised: 07 Apr 2020
Accepted: 12 Apr 2020
Published Online: 21 Apr 2020

1. Introduction

The banking institutions are financial institutions that play the intermediation role between the surplus and deficit sectors in any economy. Banking sector enhances the flow of funds for productive purposes. It is possible that the amount given as loan is less than the total sum paid by the deficit sector and in that case, the banking institution is supposed to payback the surplus sector from the equity of the banks (Al-Mutairi & Naser, 2015). The banking sector is of great interest to investors because banks are primarily concerned with liquidity and much more committed to solvency and their liabilities are majorly in short-term which are payable on demand with few fixed costs and low operating leverage compare to other counterpart sectors of the economy like telecommunication and manufacturing. Therefore, financing in bank is of paramount importance to both the management and providers of funds because if a wrong mix of finance is used, it will seriously affect the performance and the going concern of such bank.

Capital structure explains the owners' rights and interests of creditors' proportional relationship; it indicates the ratio between the corporate structure and the various sources of financing, and their mutual combinations Bauer (2004). The capital structure theory is an essential theory in finance as it addresses sources of finance available to business organizations wishing to raise funds to finance their operations. These includes equity sales, retained earnings, bonds, bank loans, accounts payable and line of credit