

Financial Leverage in Corporate Finance

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Abstract- Corporate finance play a role in determining the capital structure of the firms, this study has been examined the relationship between corporate finance and the use of debt financing. The study shown that funds holdings have a negative and significant impact on leverage, suggesting that financial leverage degree decreased with the increased monitoring power of funds and institutional stockholdings. In this study, a number of explanations by viewing that entrenched managers may obtain a better access to debt market and then they can finance with extra debt this possibly is consider as an outcome of conservative investments policy they used. Our findings could be a helpful and practical for not only investors and financial managers, it could be useful also for financial consultants.

I. INTRODUCTION

Corporate finance is the area of finance dealing with the sources of funding and the capital structure of corporations, the actions that managers take to increase the value of the firm to the shareholders, and the tools and analysis used to allocate financial resources. The primary goal of corporate finance is to maximize or increase shareholder value Wormald (2007). Although it is in principle different from managerial finance which studies the financial management of all firms, rather than corporations alone, the main concepts in the study of corporate finance are applicable to the financial problems of all kinds of firms. Thus, the terms "corporate finance" and "corporate financier" may be associated with transactions in which capital is raised in order to create, develop, grow or acquire businesses. Recent legal and regulatory developments in the U.S. will likely alter the makeup of the group of arrangers and financiers willing to arrange and provide financing for certain highly leveraged transactions

The corporate finance is a structure which monitors and controls the behaviour of corporate executives in different areas such as financial one which can be applied by the board of directors (large owners), and institutional investors. Corporate Finance Issue can have an effect on the various aspects of firm's management including the performance management, earnings management and capital structure. The management of capital structure, which reflects the financial leverage of companies and the way by which the capital of company is applied by the managers, is one of the important issues, since the inclusion of debt in the capital structure may affect the performance and the market value of the firm.

Leverage is a practice which can help a business drive up its gains / losses. In business language, if a firm has fixed

expenses in P/L account or debt in capital structure, the firm is said to be levered. Nowadays, almost no business is away from leverage but very few have struck a balance. In finance, leverage is very closely related to fixed expenses. We can safely state that by the introduction of expenses which are fixed in nature, we are leveraging a firm. By fixed expenses, we refer to the expenses, the amount of which remains unchanged irrespective of the activity of the business. Leverage refers to the use of fixed charges source of funds such as debt, bond, and debenture capital along with the owners' equity in the capital structure. Leverage provides a good avenue of measuring risk. It could also be defined as a relative change in profit due to a change in sales. It can be further divided into operating leverage, financial leverage and combined leverage.

Every firm whether small scale firms or large scale firms need funds to operate; especially large scale firms, they need funds to expand their operations and activities. The motive of every firm is to make profit, maximize owner's wealth, and to achieve this motive they need to source for fund in order to finance their operations and activities. Firms have multiple financing sources to finance their investment. Firms must choose the best financing sources to reach the optimal capital structure so that they can make suitable financing decision that would enable them achieve positive returns. Financial leverage is the extent to which fixed income securities (debt) are used in a firm's capital structure. A firm's capital structure is the composition or structure of its liabilities. Furthermore, financial leverage reflects the amount of debt used in capital structure of the firm. Debt carries fixed obligation of interest payment. Thus, financial leverage increases as the fixed financial expenses of a firm increases i.e. interest expenses increases as higher amount of debt is incurred. Also with a high level of debt relative to equity, a small percentage change in earnings before interest and tax (EBIT) will lead to a large percentage change in net income.

Technically, financial leverage is defined as the percentage change in earning after tax (EAT) divided by percentage change in EBIT. An example of financial leverage is when a firm is financed with #100,000 having a capital structure of #20,000 owner equity and #80,000 loan debt having an interest rate of 5% annually. A firm can be either highly levered (having more debt than equity than debt in its capital structure) or lowly levered (having more equity than debt in its capital structure). Furthermore, having debt in a firm's capital structure is beneficial to a firm; this is because a firm with debt in its capital structure enjoys tax savings as interest is paid before tax is deducted from the firm's income. Financial experts also stated that financial leverage is a financial tool that is widely used to

improve a firm's rate of return and its value. However, financial leverage irrespective of its benefit to a firm, also creates financial risk such as risk to the company; if a highly levered firm is unable to make sufficient EBIT, such firm might go into liquidation as it may not be able to meet its interest obligations and also finance other expenses of the firm.

Another risk is to the stockholder; if the firm incurs losses, this will cause greater volatility in earning and therefore greater volatility in the stock price and also such firm may not be able to pay any dividend to its ordinary stockholders as it would have to pay preferred stockholders prior to ordinary shareholders. However, the objective of a firm according to James C. Van Horne (1974) is to maximize its value to its shareholders. Value of a firm is represented by the market value of the company's ordinary shares, which in turn is a reflection of the firm's investment, financing and dividend decisions. And since financial leverage affects the cost of capital of a firm, it will also affect the value of the firm.

Optimal capital structure and sound corporate governance and an optimal are very important for each firm to improve the firm's market value. In literature, corporate finance is defined as the system by which businesses firms are directed and controlled, Kajola (2008). While Gill, Biger and Mathur, (2011), defined that the optimal capital structure includes debt, but the firm not financed 100% of debt. The ideal debt to equity ratio for the firm is when its minimize the costs of financing and reduce the likelihood of insolvency. Berle & Means (1932) were considered the first researchers that have discussed the theory of corporate finance. Modigliani and Miller (1958) also pioneered the theory capital structure. It was alleged that the obtained understandings in the valuation of firms depending on the technique of funding depending on the accepting the structure of capital and the firm's assets.

Problem Identification

Financial leverage in corporate finance is correlated with each other. This relationship can be either positive or negative.

Objectives of the Study

The study objectives covers all the aspects explained in the hypothesis. The primary objective of the study is to investigate financial leverages in corporate finance.

Research Hypotheses

There is no significant relationship between corporate finance and the degree of financial leverage

II. LITERATURE REVIEW

Financial Leverage

In general context, financial leverage is the use of debt in a firm's capital structure. In finance, capital structure refers to the way a corporation finances its assets through combination of equity, debt or hybrid securities. A firm's capital structure is then the composition of its liabilities. For example, a firm that sells N20 billion in equity and N80 billion in debt, is said to be 20% equity financed and the firm's ratio of debt to total financing 80% in this example is referred to as the firm's leverage. Hence, a firm's capital structure is an indicator of the proportion of debt to

equity. Ross, Westerfield and Jordan (1998), retreated that the use of debt in a firm's capital structure is called financial leverage. The more debt a firm has, the greater is its degree of financial leverage. To them (Ross et al 1998), debt acts as a lever in the sense that using it can greatly magnify both gains and losses. Hence, financial leverage increases the potential rewards to shareholders, but it also increases the potential for financial distress and business failures.

According to Horne (2002), the change in capital structure that is caused by an increase or decrease in the ratio of debt to equity is referred to as financial leverage. When a firm includes debt as a proportion of funds employed to finance its project, financial leverage is brought into being. Financial leverage is a company practice of the acquisition of part assets of the company with fixed interest capital with the hope of increasing ends results of the common stock holders. (Oloyede, 2000).

Leverage ratio is a portion of firm assets financed with any type of fixed-charge financing such as debt or leases. Thus, leverage is a tool if prudentially employed increase earnings potential of the residual owners. Goldsmith and Lipsey (1963), contend that leverage ratio is a measure of potential, rather than actual, capital gain. Therefore, leverage ratio suggest the effects of possible changes in price-pointing out which groups might be vulnerable to, or favoured by, price changes of various type. Leverage ratio indicates the firm's risk exposure in meeting debt service charges. A high leveraged firm faces a higher risk that its equity capital can be wiped out when outcomes from its exposure to risky assets are unfavourable. Higher leverage magnifies market risk as leverage firm may be forced to sell assets in order to reduce exposure under adverse market conditions. Thus, firm that is heavily financed by debt offers creditors less protection in the event of bankruptcy. For example, if a firm's assets are financed with 75 percent debt, the value of the assets when decline by only 25 percent, creditors' funds are endangered. In contrast, if only 25 percent of a firm's assets are debt financed, assets value can drop by 75 percent before jeopardizing the creditors' funds.

On the other hand, leverage ratios also are of concern to owners of the firm because it influences the rate of return they can expect to realize on their investment and the degree of risk involved. Nwude (2003) postulate that higher leveraged firm is faced with greater fixed charge interest rate, decrease in profit and cash flow is limited by financial leverage resulting to reduced dividends or no dividends and, in turn fall in share price. This however, can increase the probability of default in interest payments, thereby increasing the chances of corporate failure. Thus, the level of leverage ratio employed by a firm is paramount to potential earnings of the firm.

Advantages of Financial Leverage

The following are advantages a firm enjoys in using debt to finance its assets:

1. Interest on debt is tax deductible and as such the cost of debt is reduced.
2. Debt holders are limited to a fixed return, so stockholders do not have to share profits if the business does exceptionally well.
3. Debt holders do not have voting right over the company.

4. Financial leverage maximizes returns.

However, the use of high debt ratio leads to greater risk (financial risk) and higher required interest rates (to compensate for the additional risk). Also financial leverage increases shareholder risk as it concentrates the firm's business risk on the shareholders, because debt-holders who receive fixed interest payments bear none of the business risk. However, financial leverage will enhance shareholders' returns on the condition that the fixed charges funds (such as the loan, debentures) can be obtained at a cost lower than the firm's rate of return on net assets (ROWA or ROI).

However, measures of financial structure used in most empirical studies are debt ratio, debt equity ratio, long term debt ratio, short term debt ratio, long term debt to market value equity, short term debt to market value equity, convertible debt to market value equity, long term debt to book value equity, short term debt to book value equity, convertible debt to book value equity, times interest earned ratio, fixed-charge coverage ratio (Titman and Wessels, 1988; Majumdar and Chhibber, 1999; Zeitun and Tian, 2007; Tze-Sam and Heng, 2011; Zambuto et al., 2011; Hatfield et al., 1994; Onaolapo and Kajola, 2010; Baker and Wurgler, 2002; Staking and Babbel, 1995; Schiantarelli and Sembenelli, 1997; Long and Malitz, 1985; Booth et al., 1999; Almazan et al., 2007; Ju et al., 2004; Olatundum and Ademola, 2008; Kasozi and Ngwenya, 2010; and Muradoglu and Sivaprasad, 2008; Khan, 2012; Azhagaiah and Gavoury, 2011) among others.

Total Debt Ratio

Total debt ratio measures the amount of a firm's total assets that is financed with external debt. This measure encompasses all short term liabilities and long-term liabilities. Nwude (2003) contend that this measures portion of the firm's assets that is financed by creditors. As the total debt ratio increase, so do a firm's fixed-interest charges, if the total debt ratio becomes too high, the cash flow the firm generates during economic recessions may not be sufficient to meet interest payments. In terms of its significance to a firm, theoretical literatures predict that debt is positively correlated with level of investment. For example, long and Malitz (1985) found a significant positive relationship between the rate of investment in fixed plant and equipment and level of borrowing. The total debt ratio is measured by dividing total debt with the total assets of the firm. This proxy variable remained most notable measure of leverage ratio of a firm as adopted in many empirical studies (Zeitun and Tian, 2007; Onaolapo and Kajola, 2010; Tze-Sam and Heng, 2011; Kasozi and Ngwenya, 2010; Baker and Wurgler, 2002; Ju et al., 2004; and Booth et al., 1999; Khan, 2012; Azhagaiah and Gavoury, 2011).

$$\text{Total Debt ratio} = \frac{\text{Total Debt}}{\text{Total Assets}}$$

Debt Equity Ratio

Debt equity ratio is similar to the debt ratio and relates the amount of a firm's debt financing to the amount of equity financing. Actually, this measure of leverage ratio is not actually a new measure; it is simply the debt ratio in a different format. Debt equity ratio is the quantitative measures of the proportion of

the total debt to residual owners' equity (Nwude, 2003). Thus, it is an indicator of company's financial structure and whether the company is more reliant on borrowing (debt) or shareholders capital (equity) to fund assets and activities. Many empirical studies in different jurisdictions have employed this measure of financial structure in their various studies (Zeitun and Tian, 2007; Majumdar and Chhibber, 1999; Azhagaiah and Gavoury, 2011) among others.

$$\text{Debt equity ratio} = \frac{\text{Total Debt}}{\text{shareholders' funds}}$$

Long Term Debt Ratio

Although this measure is incorporated in the last two measures highlighted above, some analysts generally use this measure because most interest costs are incurred on long-term borrowed funds, and because long-term borrowing places multi-year, fixed financial obligations on a firm. Titman and Wessels (1988) contend that significant results are good reason for employment of different measures of leverage ratio because some of the theories of financial structure have different implications for not combining them as aggregate "debt ratio". Long term debt ratio is measured by dividing long term debt with the total assets of the firm, and has been adopted in several empirical studies (Titman and Wessels, 1988; Zeitun and Tian, 2007; Tze-Sam and Heng, 2011; Long and Malitz, 1985; Booth et al., 1999).

$$\text{Long term debt ratio} = \frac{\text{Long Term Debt}}{\text{Total Assets}}$$

Short Term Debt Ratio

Short term debts are debt obligation that matured within one accounting year. This measure is very appropriate to be included in the measures of leverage ratio due to implication it normally revealed when there is occurrence of mismatch of funding by a firm. This may be one of the reasons that led to adoption of different measures of leverage ratio rather than narrow measure of financial structure by some scholars. Titman and Wessels (1988) contend that theories have different empirical implications in regard to different types of debt instruments. Thus, mismatching funds is a situation when long term investments are financed by short term debt rather than long term debt.

Apparently, the occurrence of this is prone to default as payment of interest and repayment of principal may fall due when the proceeds (cash inflow) from the investment are not readily available. The inability of the firm to repay the principal will expose it to the embarrassments resulting from legal actions. This measure however, indicates the magnitude of current liabilities (obligations) to changes in the value of overall assets of a firm. Schinasi (2000) contends that leverage is the magnification of the rate of return whether positive or negative on a position or investment beyond the rate obtained by a direct investment of own funds in the market. The body of theoretical literatures have argued that short term measure is a good measure of leverage ratio in transition economy with less developed debt market where most firms' external debt finance are majorly commercial bank loans. Lucey and Zhang (2011) are of the view that market liberalization at the country level decreases the use of long-term debt, and debt maturity shifts to short term. Empirical investigation by Khan (2012) revealed that engineering sector

firms in Pakistan are largely dependent on short debt but debts are attached with strong covenants which affect the performance of the firm. A good number of authors have employed this measure in their empirical studies (Timan and Wessels, 1988; Zeitun and Tian, 2007; Long and Malitz, 1995; Khan, 2012) among others. This is measured thus;

$$\text{Short term debt} = \frac{\text{ShortTerm Debt}}{\text{Total Assets}}$$

Times Interest Earned Ratio

Times interest earned ratio is one of the measures of leverage ratio that employs income statement data to measure financial structure. This measure tells the financial analyst the extent to which the firm's current earnings are able to meet current interest payments. The earnings before interest and tax of the firms are used because the firm makes interest payments out of operating income. Theoretical literatures contend that when the times interest earned ratio falls below 1.0, the continued viability of the firm is threatened because the failure to make interest payments when due can lead to bankruptcy. Olatundum and Ademola (2008) point out that when times interest earned declines; the firm is likely to face a high premium. The times interest earned ratio is measured by dividing the earnings before interest and tax with the interest charges. This has remained the used standard to ascertain the ability of the current earnings of the firm to offset its current obligations. Olatundum and Ademola (2008) employed this measure in their empirical study.

$$\text{Time interest earned ratio} = \frac{\text{Earnings Before Interest and Taxes}}{\text{Interest charges}}$$

Fixed-Charge Coverage Ratio

Fixed-charge coverage ratio measures the number of times a firm is able to cover total fixed charges, which include (in addition to interest payments) preferred dividend and payments required under long term lease contracts. Firms in some time are required to make sinking fund payments on bond issues, these are annual payments aimed at either retiring a portion of the bond obligation each year or providing for the ultimate redemption of bonds at maturity. Under most sinking fund provisions, the firm either may make these payments to the bondholders' representative (the trustee), who determines through a lottery process which of the outstanding bonds will be retired, or deliver to the trustee the required number of bonds purchased by the firm in the open market. Either way, the firm's outstanding indebtedness is reduced.

In calculating the fixed-charge coverage ratio, an analyst must consider each of the firm's obligations on before-tax basis. However, because sinking fund payment and preferred stock dividends are not tax deductible and therefore must be paid out of after-tax earnings, a mathematical adjustment has been made. Nwude (2003) contend that this measure the extent to which earnings may fall without causing problem to firm as regards the payment of interests and other fixed charges. A high coverage ratio is preferred and suggests strength.

III. THEORETICAL FRAMEWORK

There are two main theories of capital structure as to the effect of financial leverage or financial gearing (debt financing) on cost of capital and hence market value of a firm. The two main theories are:

1. Traditionalist theory
2. Modigliani and Miller theory (M&M)

The Traditional View

The traditional theory states that as a company gearing increases above zero, the weighted average cost of capital (WACC) will fall initially, because of the higher proportion of lower cost debt capital in the firm's capital structure, but eventually increase when gearing gets above a certain level because of the rising cost of equity offsets the higher proportion of low cost debt. According to this view, a judicious mix of debt and equity capital can increase the value of the firm by reducing the WACC up to certain level of debt. A firm has an optimum capital structure when the WACC is at minimum and thereby maximizing the value of the firm. However, the traditional theory was criticized for inferring that investors value levered firms than unlevered firms. This means that they pay premium for the shares of levered firms. The contention of the traditional theory that moderate amount of debt does not really add very much to the riskiness of the share is not defensible. There does not exist sufficient justification for the assumption that investor's perception about risk of leverage is sufficient at different levels leverage.

Modigliani and Miller (M&M) Theory

M&M did not agree with traditional view. They argued based on the following assumption:

1. Perfect capital market.
2. No taxation.
3. No transaction cost.

With this assumption, they debated that a firm's value and cost of capital remains invariant to the changes in the capital structure i.e. the capital structure does not affect the firms' value and its WACC. They indicated that the value of the firm depends on the earnings and risk of its assets (business risk) rather than the way it finances its assets. Since the form of financing (debt or equity) can neither change the firm's net operating income nor its operating risk, the value of levered firm and unlevered firm ought to be same. They also stated that financing changes the way in which the net operating income is distributed between equity holders and debt holders and concluded that firms with identical net operating income and operating risk, but different capital structure should have same total value. However, M&M reversed their decision with the introduction of tax. Also, both theories agreed that:

1. The cost of equity is higher than the cost of debt; this is because of the higher investment risk.
2. The cost of equity will increase as a company's level of financial gearing rises, because of the higher financial risk as debt rises.

Empirical Reviews

Kajola (2008), higher financial leverage decrease firm value by increasing bankruptcy risk. Therefore, an optimal capital structure is necessary for every firm to enhance the market value the firm. Gill, Biger and Mathur(2011), an optimal capital structure includes some debt, but not 100% debt. It is a 'best' debt/equity ratio for the firm that minimizes the cost of financing and reduces the chances of bankruptcy. Cuong and Canh (2012) found that the optimal debt ratio (total debt to total assets ratio) should not exceed 59.27% because a higher debt ratio will have negative impacts on firm value. Financial leverage plays an important role in increasing market value of the firm (Black 2001, Gompers et al 2003, Gill and Mathur 2011). Bancel and Mitto (2004) found in their sample survey of managers from 16 Europeans countries that over 40% of the managers issued debt when interest rate are low or when the firm's equity is undervalued by the market. These findings suggest that managers use windows of opportunity to raise capital. They further reasoned that managers issue convertible debt because it is less expensive than straight debt, or to attract investors who are unsure about the riskiness of the firm. Nolan {2002}, in his study of leverage changes of UK adopted what can be regarded as a behavioural approach to leverage behaviour using the framework of Stein (1989). He claimed to have used managerial utility function in his model. Implicit in his model is that a low debt (D) implies that the cost of short run behaviour is low. At low debt (D), he opined that the extra probability of going bankrupt is low also. As the debt level rises, the loss should also rise.

According to Pandey (2008), the variance and covariance and therefore beta depend on three fundamental factors; the nature of the business, the operating leverage and the financial leverage. In his words, operating leverage is the use of fixed costs, the degree of which is defined as the change in a company's earnings before interest and tax (EBIT) due to change in sales. Going by his words on the other hand, financial leverage is seen as the existence of debt in a firm's capital structure. Hence, a levered firm is the one that has debt in its capital structure. He also opined that financial leverage increases the firm's (financial) risk and hence, the equity beta of the firm. Ojo (2012) in his study of financial leverage on corporate performance in Nigerian firms, opined that financial leverage causes variability in the returns of shareholders, thus, adds financial risk. Consequently, beta (risk) of a levered firm's equity will increase as debt is introduced in the firm's capital structure.

Sharma (2006) took a sample of Indian manufacturing firms and found that there is a direct relationship between firm's value and financial leverage. Adeyemi and Obboh (2011) took a sample size of 90 firms from Nigeria and found that the market value of a firm is positively influenced by its choice of capital structure (financial leverage). Cheng and Tzeng (2011) collected data from 645 companies listed in the Taiwan Securities Exchange (TSE) from 2000 – 2009 and found a positive relationship between leverage and firm value. A recent study on the relationship between financial leverage and financial crisis in Nigeria using co-integration technique, vector error correction mechanism (VECM), Granger causality and exponential generalized autoregressive conditional heteroscedascity (EGARCH) methodology shows that there is an equilibrium relationship between macro-economic financial leverage and the financial soundness.

Methodology

Dependent Variable: The degree of financial leverage (LEVi,t): which is measured as the ratio of total liabilities to total assets for company (i) at year (t).

Independent Variables: Corporate Governance.

To examine the governance we used the following factors; the ownership of insiders, financial institution (funds), corporate stockholders and foreign stockholders. The Insiders ownership (INS) component has calculated by the ratio of insider's stockholding (insiders whom hold 5% or above of total outstanding common stocks. The financial institutions ownerships (FIS) have been measured by the ratio of financial institutions (Fund) stockholding. In the same way the ownerships of corporate were considered by the ratio of corporate stockholdings (CS), and foreign ownerships (FORS) is calculated by foreign stockholding's ratio.

Model

$$Leverage_{i,t} = \alpha_1 + Corporate\ finance \times_{i,t-1} + Leverage_{i,t-1} + C_{i,t-1} + \epsilon_{it}$$

Eq (1)

Where α_i represent regression coefficient and ϵ is an error term; and $C_{i,t-1}$ contains control variables (Size,cash,tobins'Q,ROE,DIVY).

SIZE: firm's size which is used as a proxy for the capacity to entree the capital market,

SIZE_{i,t} = The Natural logarithm firm's i total assets.

Dividends payments (DIVY_{i,t}) the dividend yields of firm i in time t , which is equal payments paid divided by the value of the stock.

Growth (Investment) opportunities Tobin's Q_{i,t} , measured as market value of asset-to-book value of asset ratio for firm i in time t, and equals (Book value of debt + Market value of equity) / Book value of assets.

CASH_{i,t}, Corporate Cash Holding for company i in time t, and it is cash equivalents divided by net Assets. Where: Net Assets= Total Assets – cash and cash equivalent (Opler et al. 1999).

Return on Equity (ROE_{I,t}) the measure of firm's performances and calculates as ROE = Net Profit after Tax/ Total Common Equity

Descriptive Statistics

	Mean	Median	Max.	Min.	Std. Dev.
Funds holdings	0.07323	0.03609	0.42324	0.00000	0.09251
Corporate holdings	0.40223	0.41095	0.99176	0.00262	0.24158

Pearson correlation coefficient between governance factors presented by ownership structure of firms

	Corporate holdings	Funds holdings
Corporate holdings	1.000	

Funds holdings	-0.140826 (-2.556432) 0.0110	1.0000
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Panel Data Regression (Random effect): Leverage and corporate Governance.

	Corporate Finance Proxies	
	Corporate Holdings	Funds Holdings
Coefficient for Corporate Finance Proxies.	0.020791	-0.058092***
Cash	-0.138564*	-0.131549
DivYld	0.157482	0.154740
Tobins'Q	0.000970	0.000760
Size	0.011983*	0.014229*
ROE	-0.001918*	-0.001961*
Leverage (-1)	0.787062*	0.774056*
Constant C	-0.128500	-0.150416**
Adjusted R ²	0.757959	0.757355
F-Statistic	124.9189	123.1748
Prob. (F-Statistic)	0.0000	0.0000
D.W	2.009996	1.999843
* Value is significant at 1%.	** Value is significant at 5%.	

IV. DISCUSSION

The selected firms were highly depending on debt and about 31.4% of its financing comes from other sources of funds. In addition, the statistics confirm that the means of dividends yields were 2.3 percent, with a maximum value of 3.2%. On average the companies hold 5.4% of net assets as cash. In this paper, factors of finance were tested include the firm's ownership capital structure, they were related to each other as presented, to deal with this dilemma, we examined the effect of ownership variable on financial leverage independently. According to the random effects regression outcomes revealed, funds show a negatively significant effect on leverage, suggesting that financial leverage degree decreased with the increased monitoring power of funds and institutional stockholdings, which can be explained using the arguments of the widely accepted pecking order hypothesis (POH)(Myers & Majluf, 1984) which consider the function of information asymmetry in influencing firm's financing policy. It argues that in the face of information asymmetry, corporations will have a preference debt more than equity, and since investors will significantly discount the value of equity taking into account agency cost and create an equity offering unpleasant for the firms.

V. CONCLUSION

The main objective of the study was to find out financial leverage in corporate finance. Financial leverage (debt) is a good source of finance to firms as it enables firms to carry out long-term projects and also reduce the tax payable by the firm. It has

also been observed that the large amount of debt (high leverage ratio) have negative effect on firms that makes low profit, thus the investors may receive little or no earnings (dividend). Investors' faith in both the companies and the capital market is shaken; hence the market value of firms' shares will fall same as its value.

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