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Impact of Capital Structure on Financial Performance of Listed Manufacturing Companies in Tanzania – Evidence From Listed Manufacturing Companies in Tanzania

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Abstract – This paper evaluates the impact of capital structure on the financial performance of listed manufacturing companies in Tanzania. The study was guided with three predicting variables namely internal equity, leverage and external equity; tested towards financial performance measured using return on assets (ROA). The study employed explanatory design that knowledge generation was facilitated by means of causal relationship testing. Secondary data were used in facilitating knowledge generation process covered the period of eight (8) years between 2016-2023. The collected information were computed in Excel sheet and imported in E-view software to generate statistical tests to present the results. Regression analysis through ordinal least square (OLS) model was used to describe the relationship between study variables. results indicate that all three tested predictors to the dependent variable namely internal equity, external equity and leverage are positive with significant results towards financial performance among listed manufacturing companies with $p<0.05$. This implies that financial performance of listed manufacturing companies in Tanzania through return on assets (ROA) is positively influenced with internal equity, leverage and external equity respectively.

Keywords – Capital structure, financial performance, listed manufacturing companies

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1 Introduction

Capital structure is essential practice in the business entities to assure success and prosperity in the entity (Berk & DeMarzo, 2019). This is the case because it assures the financing of the company which enables the commencement of the planned activities and realization of the set goals and objectives (Bossaerts & Odegaard, 2018). It is the platform that fosters the financing of the business entity(s) such as company(s), firms and others which assures the actual generation of the required outcome. Capital structure in the entity is basically attained through three main ways which are equity financing, leverage and sometimes external equity (Bealey *et al,* 2017).

Equity financing entails the internal equity whereas the source of financing for the company is own source as the capital and not from any other source (Damodaran, 2018). This is the most reliable source that assures prosperity and profit generation without any implication on the investor towards liability(s). Leverage is the form of corporate financing through debts which takes place when internal equity reaches its limit and the company further financing (De Matos, 2021). This is facilitated through loans and bonds that are generated from various financial entities such as banks and other institutions legally allowed to issue such assistance to the entities paid with interests (Ogden *et al,* 2022). This is also a common practice used besides internal equity to support financing of the firms in the organization.

In addition to that, external financing is the other corporate financing measure whereas the entity is financed from external sources through selling of its shares to the public through equity or debt (Quiry *et al,* 2011). This is the form of financing perceived as the last resort by most business entities because it has implications on the ownership pattern of the company(s) (Ross *et al,* 2022). This is the case because the new shareholders become new owners required to be paid their share in the generated profit as dividends. In that case, external equity is basically performed through listing of the company in the respective stock market(s) whereas the shares are being sold to the public for the company to generate capital (Stern, 2019).

This is also risk because the generated capital through selling of shares may be less beyond the expectations which becomes a setback to the management that the expected goal fail to be realized while new shareholders that have been enrolled are supposed to be granted their rights as owners through dividends which may be difficult to be issued (Tirole, 2019). In that note, capital structure is the practice which is embedded in entities all over the globe because corporate financing is the practice that is executed all over both in developed and developing countries (Vuong, 2021). However, with listed companies in the stock market are usually entities that in most cases experience capital structure effectively since they have practice all three forms including external financing which is less preferred by many companies (Maverick, 2021).

Tanzania in particular consist of listed companies in the stock market which is open for companies all over to be listed and access the avenue to generate capital from the public (Welch, 2019). The stock market consist of two markets which are the main market and the alternative market as the enterprise growth market (EGM) with the aim of targeting small and medium enterprises (SMEs) (Maina, 2016). The market has been operational since 1998 but has been progressing slowly with limited companies being listed in both markets and engage in trading at limited pace as well.

The market comprise of listed companies in several sectors such as mining, aviation, publishing and printing, banking and several others (Mugwe, 2018). However, the listing of the companies entails the opportunity towards raising of the capital signifying the attainment of financial performance through returns on assets and equity. Since that is the case, the market has been growing very slow to the extent that it has been volatile in terms of inflation and volatility in the stock prices that brought concerns regarding financial performance of the listed companies.

The size of the market itself is very low to the extent that signifies deficiency in the returns which is also reflected in the level of public participation that is extremely low (Welch, 2019). With listed manufacturing companies in most cases are among the well performing entities in the market and the economy because they are the leading in paying dividends than other entities in the other sectors. For example, Tanzania Breweries Limited (TBL) is the leading in paying dividends with good performance noted in Tanzania Cigarette Company Limited (TCC), Tanzania Portland Cement Company (TPCC) and others.

Also, some of the manufacturing companies listed are among the leading taxpayers such as Tanzania Breweries Limited (TBL) and Tanzania Cigarette Company Limited (TCC) that they are among the leading taxpayers in the economy. With the performance of the market entails that there is contribution towards financial performance through capital adequacy generation, investment facilitation and liquidity facilitation enabling the turning of inputs into outputs leading to the generation of financial performance respectively. Since that is the case, the entities comprise of almost all three categories capital structure generation namely internal equity, leverage financing and external equity financing.

This brought about the concern towards the undertaking of the inquiry since several studies have been conducted on stock market in Tanzania in several respects. They include small and medium enterprises (SMEs) listing (Winani, 2020), dividend policy (Mallya, 2021) and others. However, both studies among several areas of recommendations for further studies suggested the need to envisage on the capital structure impact on financial performance among listed manufacturing companies. This signified that little studies had been envisaged in the area which was the gap that needed to be filled. Hence, the study was conducted to address the situation as the gap in Tanzanian environment respectively.

2 Literature Review

The study was guided with perking order theory emphasizing on capital structure generation as the source of capital in business entities (Myers & Majluf, 1984). The theory suggest that the capital structure generation as the source of finance in the organization(s) is determined using three main ways that first is through internal equity by means of own sources within investor(s) (Timmer, 2011). This entails that the source of capital or finance is by means of own sources from the investors. The theory suggest that once the source depletes may lead to other form of financing.

The other means after internal equity fails is debt financing or leverage. This is generated through seeking for financial assistance in form of loans or bonds from the lending financial entities (Levy & Hennessy, 2007). The theory suggest also that once leverage financing depletes that the company becomes difficult to be financed by means of debts then the other means may be resorted with the aim of attaining capital structure generation (Fernandez, 2014).

The last way towards capital structure generation is by means of external equity which is through selling of shares by means of either equity or debt respectively (Timmer, 2011). This mode is basically through the listing in the stock markets that companies raise capital from the public through selling of shares by issues initial public offerings (IPO) (Ibid). However, companies indeed are less favorable to this mode of financing since has implication with ownership since those buying shares becomes owners liable to be paid their in the profit generated through dividends (Fernandez, 2014). Therefore, companies in most cases are in favour of the internal equity and leverage with less being forced to resort to external equity.

The theory is connected to the study on the ground that capital structure generation is essential in facilitating financial performance among listed entities. Since that is the case, the reality is that capital structure constitutes the impact towards financial performance among listed companies through capital adequacy facilitation, investment facilitation and liquidity facilitation. Therefore, the study seek was conducted to address the concern in Tanzania.

Several studies have been envisaged in the area including Maverick (2021) conducted a study assessing the difference between equity financing and leverage financing in the generation of capital structure of the firm. The study was conducted in Europe using comparative analysis through secondary sources and materials. Findings of the study revealed that equity and leverage financing differ in terms of financing pattern and practice, implications to the investors and outcomes that follow afterwards. This is the case because with internal equity the investor(s) use own resources and sources with no implication to any one on the returns as profit.

Leverage financing the practice is facilitated through loans or bond and sometimes both whereas the investor(s) have the implication to pay the debts with interests. Moreover, external equity investor(s) have the implication of accommodating new owners and also distribute the profit to them based on their shares through dividends. This signified the need to conduct the study in Tanzania on listed manufacturing entities prior to performance since with capital structure patterns still they have been outstanding on performance which is necessary to inquire the situation.

Levy and Korajczyk (2019) examined the capital structure choice by firms in financing the entities. The study was conducted in United States using survey approach with the findings indicating that the choice of the capital structure pattern largely depend on the macroeconomic conditions and also the constraints that the company encounters in the operations. This determines whether the pattern could be through internal equity, leverage or external equity since the conditions fosters the decision which suits the existing reality.

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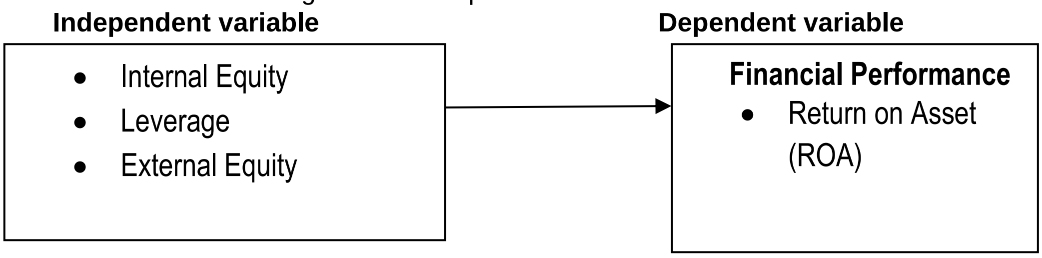
This signified the need to conduct the study in Tanzania because with listed manufacturing companies the pattern of choice with regard to capital structure has already been made such that with performance noted surpassing entities in other sectors the inquiry is conducted to address the situation.

2.1 Conceptual Framework

This is the model specifically describing the variables under study both predictors and the dependent variable with the aim of successfully facilitating knowledge generation process. Therefore, figure 1 below describes the variables as follows.

Figure 1: Conceptual framework



Source: Researcher (2024)

The framework describes the study on the impact of capital structure on financial performance among listed manufacturing companies in Tanzania. The study was guided by the assumption that financial performance among listed manufacturing companies in Tanzania is positively influenced with capital structure. Therefore, three predicting variables have been identified for testing stated as follows.

H1: Internal equity positively influence financial performance among listed manufacturing companies in Tanzania.

H2: Leverage positively influence financial performance among listed manufacturing companies in Tanzania.

H3: External equity positively influence financial performance among listed manufacturing companies in Tanzania.

3 Methods and Data

The study employed explanatory design in facilitating knowledge generation process since the pattern of addressing the study gap was facilitated by means of relationship testing between study variables. The study comprised of three predicting variables namely internal equity (IE), leverage (L) and external equity (EE) tested on financial performance measured using return on assets (ROA) as the dependent variable. The study employed quantitative approach because knowledge generation was objectively undertaken. Secondary data were employed in the process of knowledge generation obtained from four listed manufacturing companies in Tanzania namely Tanzania Breweries Limited (TBL), Tanzania Cigarette Company Limited (TCC), Tanzania Portland Cement Company (TPCC) and Tanga Cement. The study employed panel data covered the period of eight (8) years 2016-2023 since the time is essential for all selected listed manufacturing with adequate and reliable data for the generation of study outcomes. The collected results were computed in Excel sheet and imported in E-views software to generate statistical tests to present the results. Regression analysis specifically ordinal least square (OLS) model was used in facilitating outcome towards relationship testing between study variables. The study was described by the model that;

FP = βo + β1IE + β2L + β3EE + e

Where by
FP = Financial Performance
βo = Constant Factor
β1IE = Internal Equity
β2L = Leverage
β3EE = External Equity
e = Random Variable.

4 Results

The results of the study are described using regression analysis by means of ordinal least square (OLS) model. Therefore, the results of the study basically comprise of the illustrations shown in table 4.1 below.

Table 4.1: Regression Analysis
Dependent Variable: ROA
Method: Least Squares
Sample: 2016 2023

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.014630	0.000215	-70.74724	0.0000
IE	0.200611	0.000378	526.1150	0.0323
L	0.112430	0.001720	68.32632	0.0248
EE	0.031361	0.000276	126.1730	0.0076

Source: E-View 9 (2024)

The study results indicate that all three tested predictors to the dependent variable namely internal equity, external equity and leverage are positive with significant results towards financial performance among listed manufacturing companies with $p<0.05$. This implies that financial performance of listed manufacturing companies in Tanzania through return on assets (ROA) is positively influenced with internal equity, leverage and external equity respectively.

5 Discussion

The study outcome indicated that all three tested predictors to the dependent variable namely internal equity, external equity and leverage are positive with significant results towards financial performance among listed manufacturing companies with $p<0.05$. This implies that financial performance of listed manufacturing companies in Tanzania through return on assets (ROA) is positively influenced with internal equity, leverage and external equity respectively.

The statement is connected with the views by Mugwe (2018) suggesting that listed manufacturing companies in the Tanzanian stock market in most cases are the leading entities in the performance especially in the payment of dividends, tax payment and others. In that case, performance is certain financially in the sense that Tanzania Breweries Limited (TBL) for instance the fact that is a public listed company has been for many years operating under internal equity financing before it was officially sold to the new investors.

The listing is the additional platform for more income that is being generated through external equity financing measures that enables income generation at their will and need. Also, Welch (2019) suggest that listed manufacturing companies in most cases have engage in the production and manufacturing of products and services that are in high demand assuring performance in the market fostering automatic wealth generation. This is the case with Tanzania Breweries Limited (TBL), Tanzania Cigarette Company Limited (TCC), Tanzania Portland Cement Company (TPCC) and Tanga Cement that the items generated have been assured with market share that guarantees possibility and attractions for the internal equity, leverage financing and external equity financing.

Furthermore, Kumndaya (2019) suggest that listed manufacturing companies in Tanzania indeed are useful in the market and the economy especially on the performance financially. This is the reality since most constitute adequate financial coverage including means that are internal in generating wealth and income. Most are lendable to foster capital structure by means of leverage and may be successfully be attractive for the public to acquire shares and earn capital through selling their shares in the open stock markets since they are good in paying dividends.

6 Conclusion

Capital structure is indeed necessary and important on financial performance among listed manufacturing companies since it fosters well-being of the entities through internal equity, external equity and leverage. Since that is the case, the performance of the entities is assured as it is necessary to ensure that they successfully operate in line with the attainment of the set goals and objectives that need to be achieved and or realized. In that note, it is further suggested that the companies are necessary to work consistently to make sure that they design workable measures for successful and stable capital structure generation.

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