Financial Stability and Firms' Performance: A Study of Selected Oil and Gas Firms in Nigeria

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Abstract: The relationship between financial stability and performance measurement has been an issue of discussion in recent past. Considering the over-dependence of Nigerian economy on Oil and Gas, the study therefore investigates financial stability of Oil and Gas firms' in relation to their performance. Secondary data which were sourced from Annual reports of seven (7) Oil and Gas firms for twelve years (2007 – 2018) were used for the study. The model estimation showed that Return on Assets (ROA) serves as proxy for performance indicator while Fixed Asset Ratio, Proprietary Ratio, Debt Ratio and Equity Ratio serve as proxy for financial stability indicators. The study made used of descriptive statistics and panel data regression estimation technique to analyze the data. The results of the study showed that financial stability ratios have no effects on firms' performance, while financial risk ratios have effects on firm's performance in Oil and Gas firms. The study concluded that financial stability ratios (fixed assets ratio and proprietary ratio) do not influence firms' performance, while, financial risk ratios (debt and equity ratio) do influence firms' performance. Thus, the recommendation to Oil & Gas sectors managers is to develop a sustainable yardstick to curtain the use of debt source of finance in order to implement capital projects that yield no immediate returns.

Keywords: Debt Ratio Equity Ratio; Financial Stability; Financial Performance; Fixed Asset Ratio; Proprietary Ratio

JEL Classification: G32; M41

1. Introduction

The opportunity to increase international business is through establishing strong financial stability which creates competitiveness and comparative advantage. Entering international trade agreements with countries in the world in order to ensure smooth business relationship by government is also dependent on companies' activities. Due to this agreement, the economic activities increase and the financial system of the country becomes stable (Uhde & Heimeshoff, 2009). Financial stability of a firm is associated with its ability to generate profit; increase the value

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of invested capital and at the same time repays its short and long-term liabilities (Myšková & Hájek, 2017). Financial stability in business terminology refers to making enough money from business operations to pay for regular business expenses and being confident that the long term financial success of the business is secured (Donohoe, 2019). Having financial stability is important since it ensures that business expenses can be paid and potential downturns in the market is handled as well as take advantage of opportunities to expand (Donohoe, 2019).

Financial stability analysis is the parameter of major techniques for financial performance assessment. Firm's financial stability need to constantly be examined in carrying out capital projects, utilization of funds and channeling of constraints resources to achieve firm's objectives; this responsibility is vested in the management of a firm (Thalassinos, Venediktova, Staneva-Petkova, 2013; Carstina, Siminica, Cîrciumaru, & Tănasie, 2015). The analysis of financial statement enables the investors to review the level of financial stability, making relevant and rational economic decision about the operational effectiveness, efficiency via production trend, planning of pricing strategy and innovation of products brand (Singh, Lokho, Kishore, & Virmani, 2015). Uniform competitive field is the strong medium for high production in the western culture and it encourages better financial stability through level playing field and stand as general rules for action to all (Spengler as cited in Vovchenko, Holina, Orobinskiy & Sichev, 2017; Hamid & Won Kie, 2016). Kuznetsov (2015) explained that the surrounding process and circumstances will influence the operating protocol signal. Therefore, business processes and development of business models must be critically examined by companies in order to attain financial stability (Allegret, Raymond &Rharrabti, 2016; Grima., Romānova., Bezzina &Dimech, 2016). Utilization of related industries financial resources for business development and adopting flexible financial strategy for survival and development of business are necessary elements of financial stability such as construction and processing of companies (Averina., Kolesnik &Makarova, 2016; Havlíček, Thalassinos& Berezkinova, 2013).

The financial performance of companies needs to be examined on daily, weekly, monthly, quarterly, semi-annually and yearly basis because it gives opportunity to plan and utilize financial resources. To measure a company's financial performance, the best economic interest of the management of the company needs to be defined; the past, present and future opportunities also need to be examined; then the potentials of the company should also be considered. The strengths and weaknesses of the company can be identified through financial performance measurement indicators like return on investment, return on assets, gross profit margin and net profit margin but in some cases performance can be measured through none financial indicators like customers' satisfaction and quality of services rendered (ICAN, 2015).

Most previous works on financial stability have been carried out in the banking sector or stock market (Mustafa & Mohammad, 2014, Myšková, & Hájek, 2017; Habimana, Tom, & Niyompano,2017), none has focused on Oil & Gas sector. Also, most of these works did not consider variables such as fixed asset ratio and proprietary ratio as a measurement of financial stability in carrying out research model and analysis. Thus, creating a gap which this study intends to fill. Other considerable problems associated to financial stability are inappropriate techniques for assessing firm's financial performance and position in respect to risk (such as inflation rate, hedging issues in foreign transaction and natural disaster); this makes non-financial method of analysis an important yardstick for measurement of performance.

It has been discovered that some financial statements presented by companies were window dressed such as Enron and WorldCom issues. Failure to practically analyse the trend of financial imbalance contributed to the failure of some healthy businesses in Nigeria. These issues brought about the objective to review the relationship between financial stability and firms' performance in Oil and Gas sector. Subsequently, the objective is broken down to examining the effects of financial stability ratios (fixed assets ratio and proprietary ratio) on firms' performance; determination of the effects of financial risk ratios (debt and equity ratio) on firms' performance in Nigerian Oil and Gas sector.

2. Literature Review

2.1. Theoretical Review

An economist, Modigliani and Miller (1963) propounded financial theory which was static trade-off theory. The theory explained that company's debt payments are tax-deductible considering that there is less risk involved in taking out debt over equity, that is debt financing is cheaper than equity financing. The Modigliani and Miller model explained that capital structure of firms have an independent relationship with market value of any firm indicating that the firm's cash flow are not affected by its capital structure (Kyereboah-Coleman, 2007). It was further explained that a firm's value is not affected by the financing decision through their revised review but explaining that the more the debt usage, the higher the profit. This reveals the ratio of increase in profit as a dependent of increase in debt and it shows that to gain advantage and interest induced tax shields, there is need for debt to substitute equity. The theory explains that marginal value of the tax advantage occurs when a firm borrowed up to the point in which increase in the bankruptcy costs present value is balanced. Thus, financial stability effect on profitability is the ability of using more debt to increase profitability level of firms. Kyereboah-Coleman (2007) reviewed Static trade-off theory by advancing on Myers (1984) previous research. It was

revealed that in order to balance the costs and benefits of additional debt, companies need to define their optimal financial structure (Miller 1988). The tax deductibility on interest and improvement in cash flow are the benefits of leverage which have effect on profitability of firms (Voulgaris, Asteriou, & Agiomirgianakis, 2000). Bankruptcy costs and conflicting interest cost between the bondholders and shareholders are included in the borrowing costs, therefore, for optimal leverage level, the marginal gain balances the cost of debt.

Agency theory was propounded by Alchian and Demsetz (1972) and later established by Jensen and Meckling (1976). It is defined as the relationship between the principals and agents. Jensen and Meckling (1976) used agency costs to explain and predict the choice of capital structure of a firm to analyze the financial stability due to conflicts of interest. The study examined the two sources of conflicts between shareholders and managers. The conflicts indicted that manager's effort on maximizing profit of firm with less effort and through incentive to increase profit. The entire costs of profit maximization are borne by the managers and gain of the entire firm not received by the manager. So, the agency managerial discretion cost can be reduced through maintaining significant debt level. According to Jensen (1994), there is always a conflicting interest between the shareholders' and managers' decisions which results to agency cost.

The pecking-order theory was propounded by Donaldson in 1984 to explain the capital structure. The theory was modified and made popular by Myers and Majluf, as it explained that in choosing sources of finance, the managers must follow a hierarchy based on first preference to internal financing. The assertion of pecking order theory is basically to explain the usage of debt by firms when there is an inadequate retained earnings and the last resort is raising fund through external equity capital. Windows of opportunity and optimism by the management are the choice of debt to equity in maintaining financial stability in firms (Heaton, 2002). The period of increase in price of shares through issuing of equity for public sales could be a technique used by managers to reduce cost of capital and pecking order is affected by market conditions. According to Hovakimian (2006) the significant impact on financial stability (debt-to-equity) was not based on equity issuance timing, therefore, there is need for firms to use financing mix of debt and equity.

2.2. Empirical Review

Albulescu (2010) examined the process of achieving financial stability and increase in survival of firms' in the market with the economic variables as the key factors. Islamic banks have proved that the low sensitivity of its financial statements in the case of non-financial stability due to the nature of banking operations, which reduce the financial risk (Ariss, 2010). The ability of the firm's in achieving assets utilization and optimization depends on positive measurement of relationship

between financial stability, firm's competitive advantage and performance index of firms' (Anginer., Demirguc-Kunt., Huizinga., & Ma, 2018).

According to Andreeva (as cited in Vovchenko, Holina, Orobinskiy & Sichev, 2017), proper firms' information flows chart designed by financial manager will help the companies in effective utilization of constraints financial resources. Effective operation and business development planned process to achieve desired organizations objectives and goals by the financial manager are the current financial management system which firm's must adopt. The control mechanism of the firm's in achieving financial strategy and sustainable developments are the major responsibilities of the financial manager in order to achieve optimum debt-to-equity policy.

Kumara (2015), conducted research in India on selected automobile companies using parameters of financial performance to determine the level of financial growth and performance. His finding helps in appropriately application of actions on the performance of selected automobile companies'. According to Mazen (2013) research conducted on trade sector considering 2,325 French companies for a period of 1999-2006 using unbalanced panel via generalized method of moments (GMM) for debt impacts on profitability to consider empirical review. To determine the debt on profitability linear effect and non-linear effect, the author analyzed by using quadratic model estimate it. The negative effect of debt on profitability was established by the study in all trade enterprises size classes whereas using linear model the effect of debt on profitability in small and medium enterprises (SMEs) is larger while the relationship between debt and profitability is concave in all size classes but significant only in small and medium enterprises (SMEs) due to the non-linearity.

According to Vieira (2017) on the nature of the debt-performance relationship offers a number of insights into an issue that is relevant for several stakeholders of firms, such as shareholders, debt holders and managers. The studies did not establish a clear relationship between financial risk ratio, stability ratio and profitability of various sectors in Nigeria by considering comparative analysis of firms. In addition, and to the best knowledge of the researcher, possibly no other research has successfully used the two variables of financial stability which consists of Fixed Asset Ratio, Proprietary Ratio, Debt Ratio and Equity Ratio as independent variables while considering return on assets as the dependent variable. Thus, this constituted a gap necessitating this study.

3. Research Methods

This study adopted judgmental sampling design to select seven listed firms from Nigerian Oil & Gas sector. The firms selected were Oando Plc, Eterna Plc, Total Nigeria Plc, Conoil Plc, MRS Plc, Japaul Oil & Maritime Services Plc and Forte Oil. The selection was based on their web presence and availability of annual reports for the period of 2007to 2018.The data for this study was obtained from mainly secondary sources, particularly from the annual report of the firms and their Registrars. The data collected include Return on Assets, Fixed Asset Ratio, Proprietary Ratio, Debt Ratio and Equity Ratio. The procedure for analyzing the data was econometric process which include panel data regression (in estimating the effects between financial stability and performance of listed Nigerian Oil and Gas firms). Panel regression was used to derive the estimates of the parameters which show the relationship of the statistical observations in dependent and independent variables related with a linear function under the standard assumptions.

3.1. Model Specification

The model for the study is stated below:

$$ROA_{it} = \beta_0 + \beta_1 FAR_{it} + \beta_2 PR_{it} + \beta_3 DR_{it} + \beta_4 ER_{it} + \mu_{it}$$

Where:

ROA = Return on Asset

FAR = Fixed Asset Ratio

PR = Proprietary Ratio

DR = Debt Ratio

ER = Equity Ratio

β_0 = Intercept Coefficient

β_1 = Partial Regression Coefficient of ROA with respect to FAR

β_2 = Partial Regression Coefficients of ROA with respect to PR

β_3 = Partial Regression Coefficients of ROA with respect to DR

β_4 = Partial Regression Coefficients of ROA with respect to ER

μ = Error term

i = 1, 2, …, 7 (individual firm)

t = 2007, 2006, … ,2018

. Results and Findings

4.1. Descriptive Statistics

Table 1 showed the descriptive statistics of collected data. Return on Asset (ROA)has skewness (-2.6891), Jacque-Bera statistic (295.1973) and p-value (p=0.0000<0.05) which indicated that the series of ROA is not normally distributed. Fixed Asset Ratio (FAR), Proprietary Ratio (PR), Debt Ratio (DR) and Equity Ratio (ER) series were observed to have a skewness of -2.9602, 2.3591, 7.5618 and 8.3164 respectively suggesting considerable clustering of return on assets for the distribution around the skewness of 0.5. The Jacque-Bera statistic of 736.8374, 263.2352, 14209.37 and 18499.92 respectively with their p-value (p=0.0000, 0.0000, 0.0000, 0.0000 and 0.0000<0.05) indicated that the data for series FAR, PR, DR and ER respectively were not normally distributed.

Table 1. Descriptive Analysis of Dependent and Independent Variables

	ROA	**FAR**	**PR**	**DR**	**ER**
Mean	-0.0016	0.6780	1.1468	0.9117	0.4708
Median	0.0414	0.9092	0.8890	0.7384	0.2952
Maximum	0.2104	3.1962	5.7817	11.3176	9.9980
Minimum	-0.7127	-6.1886	0.0974	0.1048	0.0491
Std. Dev.	0.1615	1.1959	0.9138	1.2186	1.0803
Skewness	-2.6891	-2.9602	2.3591	7.5618	8.3164
Kurtosis	10.4442	16.2467	10.2766	64.8959	73.7746
Jarque-Bera	295.1973	736.8374	263.2352	14209.37	18499.92
Probability	(0.0000)***	(0.0000)***	(0.0000)***	(0.0000)***	(0.0000)***
Sum	-0.1331	56.9485	96.3314	76.5789	39.5467
Sum Sq. Dev.	2.1648	118.6972	69.3104	123.2520	96.8606
Observations	84	84	84	84	84
*** level of significance at 1%					

Source: Researchers' computation, 2020 using E-view

4.2. Panel Unit Root Test

Following Engle and Granger (1987) procedure, Augmented Dickey-Fuller (ADF) was used to test for the order of properties of the variables. Adopting the simple economic relationship of random walk with drift, the results of the unit root tests were reported on Table 2. From the analysis, it revealed that ROA, FAR, DR, ER and PR were all stationary at level.

Table 2. Panel Unit Root Test- ADF Statistics

Variables	**Level**	
	Intercept	**Trend & Intercept**
ROA	-0.1063 (0.9156)	-5.0378 (0.0000)***
FAR	-3.4772 (0.0008)	-6.4321 (0.0000)***
PR	-2.3161 (0.0231)	-2.3321 (0.0222)**
DR	-4.7445 (0.0000)	-8.0206 (0.0000)***
ER	-3.2998 (0.0014)	-8.3000 (0.0000)***
***,** level of significance at 1% and 5% respectively		

Source: Researchers' computation, 2020 using E-view

4.3. Panel Regression Test

4.3.1. Test of Relationship between Financial stability ratios (Fixed Assets Ratio and Proprietary Ratio) and Firms' Performance (ROA).

Table 4 showed the partial regression coefficient (β_1) of ROA with respect to FAR is 0.016465. This implied that for every 1% increase in FAR, ROA increases by approximately 0.016%. This is in line with the theoretical expectation of positive slope coefficient between ROA and FAR i.e. β<0. This also applies to PR.

The p-value of 0.2771 indicated that FAR is not statistically significant to influence ROA. Also, Proprietary Ratio (0.3056) is not statistically significant at p>0.05. The coefficient of determination (R^2) is 0.023315. This means that the value of the dependent variable can be explained by about 2.3% of the independent variable. This can be considered sufficient because Return on Assets (ROA) can also be influenced by other factors besides Fixed Assets Ratio and Proprietary Ratio respectively.

The overall statistically significance of the function is evaluated by examining the probability of F-statistic. P-value of 0.384640 indicated that Fixed Assets and Proprietary Ratio do not explain firms' performance in Oil & Gas Sector. Thus, financial stability ratios (fixed assets ratio and proprietary ratio) have no effects on firms' performance. The F-statistic = 0.966807 < F_{tab} 2.82 this suggests that Fixed Assets and Proprietary Ratio do not explain firms' performance in Oil & Gas Sector.

Table 4. Relationship between Financial stability ratios (Fixed Assets Ratio and Proprietary Ratio) and Firms' Performance (ROA).

Variables	Coefficient	Prob.
ROA	-0.036029	0.2586
FAR	0.016465	0.2771
PR	0.020302	0.3056
F-statistic	0.966807	0.384640
F-Statistic: 0.966807 (0.384640)		

Source: Researchers' computation, 2020

4.3.2. Test of Effects of Financial Risk Ratios (Debt Ratio and Equity Ratio) on Firms' Performance (ROA).

The results showed that the estimates of the variables conform to a priori expectations. The estimated panel regression revealed that the coefficient of Return on Assets (ROA) with respect to Debt Ratio is -0.084571. It indicated that for every 1% increase in DR, ROA decreases by 0.085%, while for every 1% increase in Equity Ratio (ER), ROA increases by 0.017%. The coefficient of determination (R^2) is 0.286687 which means that the value of the ROA can be explained by 28.7% of the independent variables. This can be considered sufficient because Return on Assets (ROA) can also be influenced by other factors besides Debt Ratio and Equity Ratio respectively. The individual effects of Debt Ratio (DR) is statistically significant with p-value of 0.0110, $p<0.05$, while Equity Ratio (ER) is not statistically significant $p=0.6460>0.05$.

The F-statistic p-value of 0.000001 indicated that Debt Ratio and Equity Ratio have effect on firm's performance of the selected companies in Oil & Gas Sector. Hence, financial risk ratios (debt and equity ratio) have effect on firms' performance. The F-statistic = 16.27729 > F_{tab} 2.82 this suggests that Debt Ratio and Equity Ratio have effect on firm's performance of the selected companies in Oil & Gas Sector.

Table 5. Effects of Financial Risk Ratios (Debt Ratio and Equity Ratio) on Firms' Performance (ROA).

Variables	Coefficient	Prob.
ROA	0.067558	0.0022
DR	-0.084571	0.0110
ER	0.016901	0.6460
F-Statistic: 16.27729 (0.000001)		

Source: Researchers' computation, 2020

4.4. Discussion of Findings

The empirical results showed that the asymptotic significance of each of the tested hypotheses is less than 0.05 decision criterion. Using panel data regression techniques in analysing hypothesis one and two; hypothesis one revealed that financial stability ratios (fixed assets ratio and proprietary ratio) have no effect on firm's performance in Oil and Gas firms in Nigeria. This is an indication that none of the estimated coefficient is equal to zero and that there is a linear relationship between return on asset with fixed asset ratio and proprietary ratio. While hypothesis two indicated that financial risk ratios (debt and equity ratios) have effects on firms' performance (return on asset). This is also an indication that none of the estimated coefficient is equal to zero and that there is a linear relationship between the return on asset with debt and equity ratios.

Anginer, Demirguc-Kunt, Huizinga and Ma (2018) stated that firm's ability to gain assets recruitment optimization is to ensure positive relationship between financial stability, competition of firms in industries and index of performance of firms. Thus, their findings agreed with hypothesis one that financial stability ratios (fixed assets ratio and proprietary ratio) have no effects on firm's performance, while Kumara (2015) disagreed with the findings.

Study on stakeholder's reactions expectation by Yekini, Wisniewski and Yuval (2016) agreed with the findings of hypotheses two that financial risk ratios (debt and equity ratio) have effects on firms' performance (return on asset). Also in agreement with the results of hypothesis two is the work of Mazen (2013) which revealed that the effect of debt on profitability is larger in small and medium enterprises (SMEs), while in all size classes there is a concave relationship between debt and profitability. Also in agreement with the findings of hypothesis two is the results of some researchers (Berger & Bonaccorsi, 2006; Margaritis &Psillaki,2007, 2010) who discovered that debt has positive effect on profitability.

5. Conclusion and Recommendations

During the period under review, financial stability ratios (fixed assets ratio and proprietary ratio) do not have effects on firms' performance. This implied that Oil and Gas firms' investments in fixed assets do not reflect in the performance of the firms. The firms also show a mixed financing method for their operations, that is, debts and equity financing and these influence the performance of Oil and Gas. This conclusion was reached based on the findings that financial risk ratios (debt and equity ratio) have effect on firms' performance.

The findings of the study have far implications for management of firms in the Oil & Gas sector. Firms' management need to carefully examine their financial stability in carrying on capital project and as well investing in fixed assets because they do

not yield instant returns. The principle to use as yardstick for carrying out investment in fixed asset should be matching concept. The concept is more suitable for firms that are financially stable. The suggested solution in achieving corporate objective is for the management to map out cutting-edge financial stability strategies reputed to engender increased profitability. Also, Management should through fixed assets control policy, improve the return on assets via financial constraint and project ranking strategy, as well as analyse the effect of debt finance and equity finance. Besides, giving the proper attention to the rate of gearing (debt) and equity position, firms need to finance capital projects with long term funds or set aside proportion of profit realized for capital projects and analyzing the inverse relationship between debt and equity finance which will improve the return on assets.

There is need to consider the implicating effect of higher debt which will leads to higher interest rate and reduce the profitability of the firm. The debt ratio which indicates positive effects on the firms' performance is in line with maximizing the firm's valuation by increasing financing via borrowed funds has shown that the target debt ratio can be achieved in two phases: the static trade-off phase and dynamic trade-off phase in accordance to trade-off theory. Oil & Gas firms should carry out risk assessment in order to evaluate the effect of debt-to-equity on the financial strength and growth of the firms. Thus, there is need for investors and stakeholders' interaction process for proper feedback to credit organisations, customers and suppliers on the financial strength and weaknesses of the firms. Equally, firms' management should improve the return on assets through fixed assets return ratio policy and minimizing proprietary ratio on investment. Besides, investors should critically appraise firms' strengths through equity and debt (gearing) ratio. Finally, the financial sector in Nigeria needs to focus on debt proportion and consider resource utilization that enables leverage and liquidity performance by expanding the sector and amount of capital investment on fixed asset in Oil and Gas sector in Nigeria.

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