

Equity Financing Decisions and Performance of Selected Quoted Pharmaceutical Firms in Nigeria

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Abstract

Maximizing the wealth of shareholders through its financial prosperity is one of the most important objectives that finance managers globally seek to fulfill. At the frontline of ensuring this performance is the decision of how a firm finances its core operations through its capital structure which entails debt and equity. Equity financing decision entails two major components of finance OSC and RE. The importation of active pharmaceutical ingredient (API) from abroad, poor infrastructural facilities like power and high bank interest rates are the key bottlenecks that's has hampered the pharmaceutical industry growth potentials in Nigeria. The objectives investigate the effect of Equity financing decisions on financial performance of selected pharmaceutical firms in Nigeria from 2000-2019. Financial performance was measured in terms of profitability (ROA) and liquidity using the current ratio. The data were analyzed and hypotheses tested through regression analysis using STATA II statistical software. The findings revealed that equity financing decisions have a positive significant effect on return on asset (ROA) ($\beta_0 = 2.26 > 0$, $t(110)$, $p < 0.05$, Adjusted $R^2 = 0.241$). Equity financing decisions have a positive insignificant effect on liquidity ($\beta_0 = 132.56 > 0$, $t(110)$, $p > 0.05$, $R^2 = 0.0574$). The study recommended that Government should provide good power supply, give aids and enact laws and policies that favor local manufacturing of active pharmaceutical ingredient (API) to reduce dependency on importation.

Keywords: *Financial performance, Equity financing decisions, Ordinary share capital, Retained earnings, Return on asset, liquidity.*

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I. Introduction

Corporate finance managers globally continuously strive to maximize shareholders wealth and value through their decision on capital structure. In any case, both academicians and professionals of finance are yet to concur on the optimal mix between equity and debt that guarantees financial performance. The major problem affecting most firms in both developed and developing economies as regard their performance is the issue of adequate capital necessary for growth and sustainability. The worldwide pharmaceutical sector is developing quickly and is required to dramatically increase to \$1.3 trillion but Nigeria doesn't include among the distinguished 17 development markets in the sector. In spite of Nigeria's predominance inside the West Africa sub-area in drug production, the journey to become independent in drug manufacturing is disheartening as it loses over 1.5 billion naira every year to the importation of pharmaceutical materials (UNIDO, 2011).

The pharmaceutical industry in Nigeria is monopolistic and is described by an elevated level of competition; especially from imbuement of worldwide organizations; substitutes and consequently, the profit expectation for the sector is low. The commitment of the sector to gross domestic product (GDP) in 2009 was just about 0.19 percent (Ugbam & Okoro, 2017). Accessible performance list for the sector recommends lackluster performance; capacity utilization is 40 per cent, 25 per cent of the local demands are produced internally while imports principally from Asian nations represent for the remaining 75 per cent, around 70 percent of the drugs put on the market by pharmaceutical firms in Nigeria are imported (PMG-MAN; UNIDO).

The low profit expectation is a result of several factors which hinder the performance of firms operating in the industry. These factors include dependent importation of raw material i.e. active pharmaceutical ingredient (APIS) from India and Asian countries, competition between local pharmaceutical goods and branded goods of multinationals in which case the later is always preferred by consumers, high exchange rate and lack of adequate infrastructures such as power to aid the local capacity utilization and reduce their production costs to enable maximization of profit. Low profit maximization in the industry affects ability of firms to retain their

profit. Retained earnings are a firm profit after all necessary debt, expense and dividend are paid. Retained earnings are the cheapest and most necessary source of capital a firm needs and lack of it is dangerous, as resources needed for sustainable growth are not readily available. As a result the firm utilizes other sources of finance which possess higher cost and restrictions on them.

Strategic financing decision and its effect on firm value started since the development of the capital structure irrelevancy theory by Modigliani and Miller in 1958. This hypothesis expresses that "firm value is not affected by its capital structure; thus various theories have been developed to clarify the connection between capital structure and firm value. Equity financing consists of both internal and external sources i.e. retained earnings and share issue to a firm's existing and potential shareholders, in this way changing the previous ownership structure in the company. As it were, it's a way toward raising capital from the firms reserve and through investors while debt financing involves the use of debt securities such as bonds and debenture. Equity capital is raised through issuance of common and preferred stock, which gives firm ownership to the equity holders (Achieng, Muturi & Wanjare, 2018). Preferred share, OSC, and retained earnings components are viewed as equity capital (Muhanguzi, 2019).

Although financial theory proposes that financing by shareholders equity presents the most expensive means of attracting resources. Dilution of ownership interest can drastically impact the value of shareholders investment. Share issue is an adequate way of raising funds to finance a company capital project and help the company expand and grow sustainably. This is because providers of capital gain ownership status in the firm and are committed to see their investment blossom through the firm growth and its going concern. Retained earnings represent the cheapest source of capital a firm can use to finance its operation and grow sustainably because retained earnings are company's profit, which is left in the wake of deducting all cost and delivering dividends, and it held in the firm for future expansion and growth (Akinkoye & Akinadewo, 2018). The motivation behind of retention is that possibility for expansion and growth increases of retaining the profit into the firm.

Scholars discussing strategic financing decisions always concentrate on the debt and equity mix of the capital structure with only very few remembering the M&M hypotheses in the optimal capital structure model, where opined that although cost of debt will initially be cheaper than cost of equity. But by and by because of the implication of this on the controlling powers of business owners, who could also be agitating for increase in their interest. The cost of equity and debt can be moving up at the same time to the point where cost of equity equals cost of debt which is the optimal point in the capital structure model. It is this assumption that led to the thinking of the pecking order hypotheses by (Myers & Majluf, 1984). The Nigeria capital market environment has seen more of equity trade than debt. Other debt instrument such as bonds, debentures and preference shares are not frequently traded on the Nigeria stock exchange (NSE). Also, Nigerian banks are not willing to lend long term to firms to grow sustainably because of the need to remain highly liquid and meet the short term obligation of demand deposit of its customers. As a deviation from the usual, the study investigates the effect of equity financing decision on financial performance in Nigeria pharmaceutical industry.

II. Review of Literature

The literature review is presented in three sub-sections, namely conceptual, theoretical and empirical.

2.1 Conceptual Review

2.1.1 Equity Financing Decision

Equity finance is a financing option that comprise of both internal and external sources i.e. retained earnings and OSC. Equity finance stands for owners' interests in the firm's assets after debts are deducted and appear as OSC, preferred share, share premium, reserves, revaluation surplus and retained earnings in financial report (Choi, 2014; Kizito, 2017; Achieng, Muturi & Wanjare 2018). Share capital is the money a company raises by issuing common or preferred stock, retained earnings is the amount of net income left over for the business after it has paid out dividends to its shareholders (Akintoye, 2016).

Musila (2015) opined that there are two kind of equity finance, the first is initial public offering, and it happens when an organization "is publicly traded," selling its share on a major exchange for the first time. The second is called a "seasoned issue," happening when an established public company sells shares from its supply of authorized but unissued shares. To facilitate growth, a firm will require extra capital, which might be acquired through debt or equity. Equity financing involves the offer of a company's stock and giving a part of the ownership of the firm to the investors in return for money.

The extent of the firm that will be sold in an equity financing relies upon how much the owner has invested in the firm and the value of the venture at time of the financing (Uremadu & Onyekachi, 2019). Equity financing is exchanging a percentage of ownership of the business for a particular amount of cash. This type of financing empowers a business to get the capital required without assuming extra financial obligations through

debt. Outside investors will want to see an owner additionally investing their own cash to show they are willing to share the risks (Uremadu & Efobi, 2012).

2.1.2 Financial Performance

Financial performance can be explained as how well a firm's management utilized its available scarce resources to maximize shareholders wealth. The performance of a firm management is most frequently estimated or measured with respect to profitability which shows managers' capability to procure optimum returns on assets available to them over a financial year. This infers that profitability entails the ability of a firm to generate gains from its operating, investing and financing activities to maximize wealth of the shareholders. Additionally, the amount of money a firm has at hand or can produce quickly shows how financially healthy it is. Significant level of liquidity indicates that the firm can take care of its short term obligations when they fall due. Often, listed firms in Nigeria do find it hard to make a profit and remain profoundly liquid; this influences their performance which might be ascribed to insufficient funds or where capital is accessible at a cost extremely costly (Akinyomi & Olagunju, 2013; Lambe, 2014; Salawu, 2007; Uremadu & Onyekachi, 2019).

Owolabi and Obida (2012) assert profitability is a firm's ability to make returns higher than the cost of financing its core business activities to guarantee the going concern of the firm. The most commonly utilized measures of shareholders' financial prosperity are the returns on assets (ROA) and returns on equity (ROE) ratios gotten utilizing information from financial reports (Mahoney, LaGore & Scazzero, 2008; Fauzi & Idris, 2009). ROA is a measure of a firm's ability to generate profits from its assets used in the course of its core business operation over a financial year. Assets referred to are the overall firm properties, acquired from internal capital itself or from external capital that has been changed into firm assets used for corporate sustainability (Rosikah, Prananingrum, Muthalib, Azis & Rohansyah 2018). Higher ROA of a firm's performance will prompt a more effective company. So it very well may be viewed as a good sign for any investors to put their stock in the firm that will influence the expanded firm stock in the capital market. As it were, ROA influences the firm's performance. ROA is the indicator that a firm's management, potential and existing investors would be more interested in as regards the profitability of a firm; ROA is adopted as the measure of profitability in this research.

Liquidity alludes to the accessibility of cash to meet short-term working expenses. As it were, liquidity is the sum of assets that are convertible and are accessible to pay expenses and debts obligations as they fall due (Umobong 2015). Liquidity alludes to a firm's ability to pay short-term obligations; the term likewise refers to a firm's capability to dispose assets fast to raise capital. The current ratio shows the ability of a firm to meet its current liabilities as they fall due likewise their long-term liabilities as they become current. In the same vein, this ratio indicates the cash position of a firm and its capability to convert assets into cash to settle its current obligations (Uremadu & Efobi, 2012).

2.2 Theoretical framework

The first research on capital structure of firms started with Modigliani and Miller, (1958) capital structure irrelevancy theory. This theory expresses that the capital structure of a firm doesn't influence its performance. The hypothesis lays on the supposition that the market is perfect. As indicated by the theory, the market operates without transaction cost, bankruptcy cost; and market information is accessible for all participants. Uremadu and Onyekachi (2019) support this proposition. Even though M&M theory was substantial theoretically, a tax-free world was not accurate in real sense. So as to make it increasingly precise Modigliani and Miller (1963) joined the impact of tax on firm performance and its cost of capital. As a result of corporate taxes, the firm value goes up with leverage due to the tax advantage. (Animasaun & Baba yanju 2016) research shows support for this theory.

As a result of MM hypotheses other theories have been postulated to support how a firm's financing decisions affect its performance. Such theories include the trade-off theory, which centers around the benefits and costs of debt, indicates that an optimal debt ratio exists, which maximizes the shareholders' wealth, agency theory which asserts that an optimal capital structure can be ascertained by limiting the costs emerging from principal (owners) and agent (management) conflict and pecking order theory. The theory asserts that firms prefer to use internal financing i.e. retained earnings than external financing and it is just when the internal finance is depleted that firms explore other external financing options starting with debt and lastly equity (Mykhailo 2013 and Salawu, lawal, Adetunji & Inua 2018.) support pecking order theory.

This research was anchored on the pecking order theory. The theory argues that optimum capital is difficult to determine. This hypothesis argues that a firm will initially use internal funds i.e. retained earnings which may not be sufficient for a growing firm or an industry with low profit expectation which is the case for the firms in the Nigerian pharmaceutical industry. Therefore they will have to rely on external financing with debt coming first and equity as the last alternative. It posits that firms rank their financing options; from internal to external finance. Equity capital appears both at the start and end of the pecking order.

2.3 Empirical Review

Achieng, Muturi and Wanjare (2018) examined the effects of equity options (OSC and retained earnings) as ratios of total assets on the financial performance (ROA and ROE) between 2009 and 2015. The study utilized pooled ordinary least squares, random and fixed effect for data analyses. OSC ratio indicated a negative significant effect on ROA while retained earnings ratio showed positive and significant effect on ROA. Total equity ratio shows positive and significant effects ROA. Despite what was expected, equity financing options significantly does not affect ROE.

Bassey, Edom and Alfred (2016) investigated the effect of retained earnings on firm performance of Niger Mills Company, Calabar-Nigeria. The ex-post facto research design was adopted in the study. Then study utilized the Karl Pearson product moment correlation coefficient and t-test to investigate the objectives. The result showed positive and significant relationship between retained earnings and corporate performance measured by turnover.

Primus (2019) examined equity financing and bank performance in Nigeria; Special Performance to First Bank in Nigeria. Linear regression analysis (ordinary least square) was used in the research. The regression result depicts positive relationship between equity financing proxy with total fund (TFD) and bank performance proxy with return on equity (ROE) in Nigeria. Musila (2015) investigated the connection between equity financing and financial performance of energy and petroleum firms listed in Kenya. Descriptive statistics and regression were utilized to analyses the data. Result showed an insignificant but positive relationship between equity financing and financial performance.

III. Methodology

This study adopted the *ex-post facto* research design. The population of this study consists of all the Ten (10) listed healthcare firms on the Nigeria stock exchange (NSE) as at 31 December 2019. Target populations for this study are seven pharmaceutical firms. Secondary data was adopted for the study. Relevant data was extracted from financial statements of the sampled quoted pharmaceutical companies in Nigeria. In order to achieve this, both inferential and descriptive analysis were employed in this study. The descriptive analysis will be 5% level of significance through the aid of STATA II statistical software. The multiple regression analysis was employed in examining the effect between both variables. The dependent variable in this study is financial performance measured by return on asset (ROA) and liquidity while the independent variable equity financing decisions was measured by ratio of ordinary share capital (OSC) and retained earnings (RE) to total asset (TA)

3.1 Model Specification

To achieve the stated objective of this study, the following models were developed.

$$\text{PROF} = \beta_0 + \beta_1 \text{OSC}_{it} + \beta_2 \text{RE}_{it} + \mu_{it} \dots\dots \text{Model 1}$$

$$\text{LIQ} = \beta_0 + \beta_1 \text{OSC}_{it} + \beta_2 \text{RE}_{it} + \mu_{it} \dots\dots \text{Model 2}$$

Where profitability (PROF) = ROA, OSC = Ordinary share capital and RE = Retained earnings and LIQ = liquidity measured by current ratio.

3.2 A priori Expectation

In this study, it was expected that the equity financing decisions will positively affect financial performance proxies of profitability (ROA) and liquidity of selected listed pharmaceutical companies in Nigeria as firm in the industry utilize more of equity finance rather than debt.

IV. Data Analysis, Interpretation and Results

The study examined the effect of equity financing decisions on financial performance of selected quoted pharmaceutical firms in Nigeria. Descriptive and inferential analysis was used to examine the relationship between both dependent and independent variable.

4.1 Empirical Data Analysis

Table 4.1.1 Descriptive Statistics Result

Variables	Observation	Mean	Std.dev.	Min	Max
ROA	110	.7316363	11.55437	-37.06	26.63
Liquidity	110	143.9357	82.90021	15.1	569.62
OSC	110	10.22627	14.09032	1.72	103.13
RE	110	3.981727	33.09239	-104.34	62.13

Source: Researcher’s Computation, 2020

*Observations: 110

From the reported descriptive statistics in Table 4.1.1, Return on asset (ROA) of the sampled firms used is within the range between -37.06 and 26.63. This indicates that there is a wide gap between the minimum and maximum values of return on asset. The standard deviation of 11.55437 is large compared to the mean of .7316363 and this suggests that there is a wide dispersion from the mean and the variable and this implies high volatility.

Liquidity reported an average of 143.9357 and standard deviation of 82.90021.the extent of dispersion from the mean is large. This is confirmed by gaps between the minimum and maximum cash position of 15.1 and 569.62 respectively

(OSC) reported an average of 10.22627 and a standard deviation of 14.09032 and it falls within minimum and maximum OSC values of 1.72 and 103.13 respectively and this implies a high unpredictability.

Retained earnings (RE) show a range between -104.34 and 62.13. The standard deviation of 33.09239 is too large compared to the mean value of 3.981727 and this suggests that there is a wide dispersion from the mean and the variable which implies a high unpredictability.

Table 4.2: Regression Analysis for model one

Variables	Coefficient	Std Error	T-statistic	Probability
OSC	-0.1986141	0.0742296	-2.68	0.009
Retained earnings (RE)	0.1254401	0.031606	3.97	0.000
Cons	2.26325	1.259741	1.80	0.075
F statistics	18.34			
Prob (f-statistics)	0.0000			
R ²	0.2553			
Adjusted R ²	0.2414			

Source: Researcher’s Study, 2020

dependent variable: ROA

p<0.05

Interpretation

Ordinary share capital (OSC) reported a negative (-0.1986141) effect on return on asset (ROA) while retained earnings (RE) showed a positive (0.1254401) effect on return on asset (ROA). This is indicated by the sign coefficient that $\beta_1 = -0.1986141 < 0$ and $\beta_2 = 0.1254401$ respectively. The report of β_1 is not consistent with the *a priori* expectation as it was expected that OSC of a firm will have a positive significant effect on its return on asset, hence the increase or decrease the ROA i.e. the more OSC a company has, the more profitable and the less OSC it has, the less its ability to be profitable in terms of ROA. The result of β_2 is consistent with the *a priori* expectation as it was expected that retained earnings of a firm will have a positive significant effect on its return on asset, hence increase or decrease the ROA.

Coefficients of model one from Table 4.2 is significant. This is determined from the individual probability values of t-statistics of OSC (P-value=0.009) and RE (P-value=0.000) respectively which is lower than the 5% level of significance. We therefore infer from the result of this model that the effect of OSC on ROA is negative and significant, while the effect of retained earnings on ROA is positive and significant. The Adjusted R² of 0.2414 explains that only 24.14% of the total variation is explained by the independent variable while the balance of 75.86% is explained by factors outside this study.

At a level of significance 0.05, the F-statistics is 18.34, while the p-value of the F-statistics is 0.0000 which is lower than 0.05 adopted level of significance. The statistical significance of this model indicates that the study will reject the Null Hypothesis of this model which says that there is no significant effect of equity financing decisions on profitability of pharmaceutical firms; hence the study will accept the alternate hypothesis. The result is consistent with the *a priori* expectation of this model.

Table 4.3 Regression Analysis for Model Two

Variables	Coefficient	Std Error	Z-statistic	Z -Probability
OSC	0.4431185	0.7742401	0.57	0.567
Retained earnings (RE)	0.7000656	0.5224974	1.34	0.180
Cons	132.5654	12.77225	10.38	0.000
R squared	0.0574			
Wald chiq ²	3.48			
Prob.	0.1758			

Source: Researcher’s Study, 2020

dependent variable: liquidity

p<0.05

Interpretation

The result of the regression analysis shows that both coefficients, Ordinary share capital (OSC) has a positive (0.4431185) effect on liquidity (LIQ) while retained earnings (RE) has a positive (0.7000656) effect on liquidity (LIQ). This is indicated by the sign coefficient that $\beta_1 = 0.4431185$ and $\beta_2 = 0.7000656$ respectively. The result of the coefficients is consistent with the *a priori* expectation as it was expected that OSC and retained earnings will have a positive effect on its liquidity, hence increase or decrease the liquidity of the firm i.e. the

more equity financing decisions pharmaceutical firm's uses the more liquid they are and the less use of equity financing decisions the more difficult it is for them to remain highly liquid to meet their financial obligations when they fall due.

Both coefficients of model two from Table 4.3 is insignificant. This is determined from the individual probability values of z-statistics of OSC (P-value=0.567) and RE (P-value=0.180) respectively which is higher than the 5% level of significance. We therefore infer from the result of this model that the effect of OSC and retained earnings on liquidity is positive and insignificant. The R^2 of 0.0574 explains that only 5.74% of the total variation is explained by the independent variable while the balance of 94.26% is explained by factors outside this study.

At a level of significance of 0.05, the Wald statistics is 3.48, while the p-value of the Wald statistics is 0.1758 which is greater than 0.05 adopted level of significance. The statistical insignificance of this model indicates that the study will not reject the Null Hypothesis which says that there is no significant effect of equity financing decisions on liquidity; hence the study will not accept the alternate hypothesis. This result is consistent with the *a priori* expectation of this model.

V. Conclusion and Recommendation

Equity financing decisions of a firm influence its profitability. From the results, OSC has a negative and significant relationship with ROA while RE showed a positive significant effect on ROA. This suggests that equity financing decisions has significant effects on corporate performance. This result, is in line with those of Achieng, Muturi and Wanjare, (2018) which revealed that OSC significantly and negatively affects ROA while RE has a statistically significant and positive effect on ROA; Akinkoye and Akinadewo, (2018) which revealed retained earnings has a positive significant effect on a firms value; Bassey, Godwin and Alfred (2016). Which revealed that retained earnings has a positive significant effect on turnover; Musila, (2015) which revealed that equity financing showed a positive relationship with financial performance. This is however opposed by Suleiman and Ahmed (2016) which reveals a weak negative relationship between equity and Return on Asset.

Equity financing decisions of a firm has no influence on the liquidity position of the firm. From the results, liquidity has a positive and insignificant relationship with equity financing decisions. This suggests that equity financing decisions has no significant effects on the ability of selected quoted pharmaceutical to meet their short term obligations when they fall due. This result is in line with Mahvish and Qaisar (2016) found that liquidity along other variables showed a positive relationship with financial leverage. However this result is not consistent with the finding of Mahmoud (2017) which showed a negative significant effect between liquidity and firm value of Nigerian listed manufacturing companies. After reviewing existing literatures about the relationship between equity financing decisions and financial performance, deriving hypotheses from literature and theories, collecting and analyzing the data, the study concluded that equity financing decisions of ordinary share capital (OSC) and retained earnings significantly affects financial performance of selected quoted pharmaceutical firm in terms of profitability (ROA), but insignificantly in terms of its ability to meet short term obligations when they fall due.

5.1 Recommendations

In order to attain profitability, meet obligations, long term growth and value of the firm, managers and policing makers while trying to prioritize the growth and expansion of the business, should consider the choices and interests of shareholders. This suggests that the company's financing policy is a reflection of its corporate performance. When the shareholder's perceive that there is no increase based on their return on investment after capital has been attracted through OSC and also through retained earnings, they tend to lose interest and may sell off their investments. This could in turn have an adverse effect on the value of the firm. Furthermore, this study revealed the positive and negative effect of each proxy of equity financing decisions thereby giving managers an insight on the source of financing that should be prioritized over others in order to increase profitability and overall firm value which in this case is retained earnings.

Retained earnings which particularly have a positive significant effect on performance must be given careful consideration. This is because, the more debt financing and OSC used by the organization, the higher the leverage and cost of capital. This reduces the availability of cash for necessary growth and sustainability.

The governments are to ensure they provide necessary infrastructures like power and good road which has been lacking for decades to aid the corporate performance the performance of pharmaceutical firms. Government should also give aids, enact laws and policies that favor local manufacturing of active pharmaceutical ingredient (API) and reduce dependency on importation.

To researchers and academics, this study serves as a stepping stone for those who also have the intention to conduct a study on how equity financing decision affects corporate performance of a firm as well as other determinants of financing decisions. Researchers should test how equity financing decisions affects other corporate performance proxies in different sector and in different countries.

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