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THIN CAPITALISATION AND FINANCIAL PERFORMANCE OF LISTED MULTINATIONAL FIRMS IN NIGERIA

MUSA, ANTHONY AHMED[1*], ONMONYA LUCKY OTSOGE[2] and OJEKA STEPHEN[3]

[1,2,3]Department of Accounting, Faculty of Management Sciences, Nile University, Abuja.
*Corresponding Author Email: anthonymusa72@yahoo.com

Abstract

Taxation constitutes a significant cost that influences corporate financial performance and wealth maximization objectives. In response, multinational firms often engage in tax planning strategies such as thin capitalization to reduce tax burdens. This study examines the effect of thin capitalization on the financial performance of listed multinational firms in Nigeria. Anchored on tax planning theory, the study adopted an ex post facto research design. The population comprised all multinational firms listed on the Nigerian Exchange Group as of 31st December 2024. Using purposive and filtering sampling techniques, secondary data were extracted from audited annual reports of selected firms covering the period 2015 to 2024. The Random Effect regression was employed after relevant diagnostic tests to estimate the relationships. The results reveal a significant positive relationship between related-party debt-to-equity ratio and return on assets (ROA). Conversely, debt-to-total assets and interest-to-revenue ratios have a significant negative effect on ROA. However, debt-to-equity ratio and effective tax rate showed no significant relationship with ROA. The findings suggest that profitability influences thin capitalization practices among Nigerian listed multinational firms. The study recommends that Nigerian listed multinational firms can strategically leverage related-party financing to enhance profitability, while ensuring compliance with CBN and FIRS thin capitalization regulations to avoid regulatory penalties. This study provides current evidence from Nigeria on how specific thin capitalization proxies differentially affect financial performance, offering insights for policymakers, regulators, and corporate managers in emerging economies.

Keywords: Thin Capitalization, Financial Performance, Multinational Firms.

1. INTRODUCTION

The capital structure of a company normally includes both equity and debt components. What is taxable income for corporations is largely a function of the corporate capital structure. Since under many tax systems interest on debt is deductible from taxable income, a firm's taxable income will fall with its debt level and interest payments. This is referred to as thin capitalization and is believed to be a more tax efficient form of financing. Thin capitalization is the concept of a company being financed with relatively a lot of debt and too little equity. The term is used to represent a company whose capital structure is highly skewed towards debt rather than equity financing (Otuya & Omoye, 2021).

Thin capitalization has raised concern among the tax authorities which include erosion of tax base and profit shifting which have potential to cause substantial losses of revenues to the government (KPMG, 2024).The Finance Act 2019, in Nigeria brought in limitations on interest deductions so as to discourage the practice of thin capitalization. According to Section 24(a) of the Companies Income Tax Act, interest on loans is deductible, but only up to 30% of

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earnings before interest, taxes, depreciation, and amortization (EBITDA). Any excess interest paid beyond this limit is disallowed and can be carried forward for up to five years (Federal Inland Revenue Service, 2024). Any excess interest is disallowed and can be carried forward for up to five years. Failure to comply with these rules results in a penalty of 10% on the excess interest, along with additional interest calculated using the Central Bank of Nigeria's monetary policy rate plus a spread set by the Minister of Finance (FIRS, 2024).

A review of extant literature such as Igbinovia (2024), Umaigba et al. (2025), Pajo et al (2024), Otuya and Omoye (2021), and Olayiwola and Okoro (2021) shows some factors which are considered as gaps for a study on the relationship between thin capitalization and financial performance of multinational firms in the context of Nigeria.

First, available empirical evidence regarding the relationship between various dimensions of tax optimization measures and corporate financial performance provides an unclear picture. Some studies such as Akpan et al. (2025), Osamor et al. (2023), Ayuba et al. (2019), Otuya and Omoye (2021) and Tian et al. (2024) have confirmed a positive connection between corporate financial performance and some thin capitalization dimensions such as tangibility of assets, capital intensity, effective tax rate, debt to equity ratio (thin capitalization) and interest cover ratio.

However, other studies such as Oyeshile and Adegbie (2020), Awaji-Mere (2023), and Pajo et al. (2024) have recognized corporate thin capitalization measures such as capital intensity, tax planning, tax savings, and interest expense to have no significant impact (and in some cases negative impact) on corporate financial performance of firms.

In addition, existing studies on thin capitalization and tax planning among Nigerian multinational firms exhibit notable methodological and conceptual gaps. From a methodological standpoint, prior studies are based on aggregate debt ratios or statutory thin capitalization thresholds as proxies, which do not allow to assess the differentiated effect of intra-group financing structures. This ignores the heterogeneity of the arrangements in debt at the firm level.

Theoretically, the significance of related party debt to equity ratio is largely unknown in Nigerian environment. Although thin capitalization is a known channel for profit shifting, only a handful of papers distinguish external debt from related party debt when looking at the effect on financial performance. Since multinational corporations (MNCs) tend to rely heavily on intra-group loans to bleed the tax base, not having measures of related party debt curtails our insight into how internal financial decisions uniquely influence profitability, tax burden and quality of earnings.

To close these gaps and add to the body of existing research, it is necessary to examine the topic in the context of multinational companies in Nigeria using the integrated framework of thin capitalization and other tax planning strategies. The remainder of the paper is structure as follows. Section deals with the literature review and hypotheses development, section three is concerned with the methodology including the data collection and analytical strategies. Section four analyses and discuss the findings while the fifth section concludes the study.

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2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

2.1 Financial Performance

Financial performance reflects the extent to which a firm achieves its economic objectives and creates value for stakeholders. It is a key indicator of firm health and is widely used in management, accounting, and taxation research to assess differences in firm valuation and efficiency (Sinebe & Akpomiemie, 2023; Umeh et al., 2020). Several accounting and market-based proxies exist for measuring financial performance. However, accounting-based measures remain predominant in studies involving taxation and capital structure due to data availability and comparability (Farhat, 2024). Return on Assets is the most widely used among these indicators as a measure of profitability and operational efficiency. ROA measures the enterprise's profitability on using its total assets and is calculated as earnings before interest and taxes divided by total assets. ROA is particularly relevant to thin capitalization studies because it captures the net effect of interest tax shields on profitability while controlling for firm size through total assets (Ijaz & Zafar, 2021; Ouni et al., 2022). Moreover, as far as financing decisions are concerned, ROA captures the performance emanating from the core operating activities, and thus it is good to examine whether financing decisions affect value creation (Farhat, 2024). In line with the existing empirical literature on thin capitalization and tax planning (Otuya & Omoye, 2021, Sinebe & Akpomiemie, 2023, Umeh et al., 2020), this research employs ROA as a proxy for financial performance. The subsequent section addresses the independent variables and their predicted association with ROA.

Total Debt-to-Equity Ratio and Return on Assets

Debt-equity ratio is a calculation investors and analysts use to assess the relative amounts of debt and equity in a company's capital structure. It shows how much a company is being funded by its creditors as opposed to its shareholders and is an important measure of financial leverage and risk (Ross et al., 2022). Firms that are more indebted from a tax planning perspective, will enjoy greater interest tax shield benefits and higher profitability. Yet too much debt adds to financial risk and the probability of financial distress, which may erode earnings (Myers, 2001; Modigliani & Miller, 1963).Therefore, the leverage-performance relation is likely to be non-monotonic and there exists an optimal leverage beyond which we will observe the negative effect of further debt on performance. The empirical results on the debt-to-equity ratio and performance is still inconclusive. Arif et al. (2025) reveal a negative significant association between debt-to-equity and return on equity for a sample of Malaysian manufacturing firms indicating that high leverage leads to decrease in profitability. Similarly, Tian et al. (2024) demonstrate that over-leverage is detrimental to asset efficiency and ROA for firms listed in Asia. Contrarily, Akpan et al. (2025) found debt-to-equity to be positively associated with ROA for Nigerian firms, and explained it by tax shields benefit from interest payments. In view of these conflicting results and the fact that Nigerian multinationals handle under thin capitalization rules, this study hypothesizes that total debt to equity has effect on ROA. Therefore, the following hypothesis is tested:

H02: Total debt-to-equity ratio has no significant effect on return on assets of listed multinational firms in Nigeria.

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2.2 Debt-to-Total Assets Ratio and Return on Assets

Debt to total assets ratio calculates the percentage of a firm total assets which is financed via debt. It is total debt divided by total assets and is a measure of financial leverage and risk in capital structure and decisions (Brigham & Houston, 2019). From tax-planning perspective, firms have incentives to employ debt because interest is a tax-deductible expense reducing taxable income and increasing after-tax cash flows. However, as debt levels increase, the influence of financial distress costs and agency costs prevails, and so the advantages of debt financing are counterbalanced by these costs following trade-off theory (Myers, 2001).Therefore, moderate debt can improve profitability but, too high debt can reduce asset efficiency and firm performance.

The empirical studies on the effect of debt-to-total assets on financial performance remain inconclusive. Tajudeen & Mustapha (2019) and Andre et al. (2022) observed that high debt-to-total assets ratios translated into low profitability and high default risk for companies in emerging markets. Also, a substantial negative impact of debt-to-assets ratio on return on equity was reported by Patel and Gaywala (2019) indicating that a high leverage reduces the profitability. Fitria et al.(2024) additionally that companies with high debt-to-assets ratios incur higher borrowing costs and have limited means to raise more funds as a result of they are considered to be credit risk.

Considering the limitation on interest deductions in Nigeria and the possibility of debt to either magnify tax shield benefits or financial risk, the overall impact of debt-to-total assets on ROA among listed multinational firm is still an issue to be resolved empirically. Therefore, this study tests the following hypothesis:

H03: Debt-to-total assets ratio has no significant effect on return on assets of listed multinational firms in Nigeria.

2.3 Related Party Debt-To-Equity Ratio And Return On Assets

The related party debt to equity ratio indicates how much a company is using debt from subsidiaries, affiliates, the parent company or major shareholders - and equating this to the amount of equity the company holds. It is the ratio of related party debt to total equity and is considered a direct measure of in house financing and thin capitalization behavior (Igbinovia & Usman, 2024; Otuya & Omoye, 2021). Multinational companies also employ related party debt to shift profits between countries, from a tax planning perspective. The interest payments on these intra group loans are tax-deductible which decreases the tax burden on the borrowing company and increases the income of the lending company that is generally based in a country with low tax rates (Fitria et al., 2024). And it is this practise that is the main route by which thin capitalisation results in base erosion and profit shifting. But too much related party debt can increase financial risk and agency problems. Greater RPDE signifies higher reliance on insider financing, which could be an indicator of limited access to external capital markets and raises concerns about earning quality and the possibility of financial distress (Igbinovia & Usman, 2024). During recessions, intra-group debt service can put pressure on cash flows and cause financial distress, to the detriment of asset returns.

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There is a scarcity of empirical study in the Nigerian setting. Although Otuya and Omoye (2021) observed an impact of related party transactions on tax aggressiveness, there is a dearth of literature directly addressing the effect of RPDE on accounting profitability such as ROA. To this end, since the 30% EBITDA interest limitation rule has been introduced in the Nigerian Finance Act 2019, it is important for both the tax authorities and corporate managers to know the impact of RPDE on ROA. Based on the above, this study tests the following hypothesis:

H04: Related party debt-to-equity ratio has no significant effect on return on assets of listed multinational firms in Nigeria

2.4 Interest-to-Revenue Ratio and Return on Assets

The interest-to-revenue ratio is the share of interest expense over revenues of a firm. It is the total interest cost divided by total revenue and captures the burden of debt service relative to earnings before interest (Palomino et al., 2019). Interest expense, however, is tax deductable from income, resulting in a tax shield that may increase after tax profits. But a high interest-to-revenue signals the company is heavily leveraged, so while it may be generating revenue, it has less cash flow to put back into the business or pay dividends (Ademola & Oboh, 2011).Thus, even though interest can reduce taxable income, a too high interest burden might reduce asset productivity and firm performance.

Evidence on interest expense and performance is inconclusive. High interest expense adversely influences the profitability of Nigerian firms as it results in an increase in the cost of capital and a decrease in the earnings that were available for the purpose of growth - Adeyemi and Oboh (2011). In contrast, Chen and Chen (2021) documented that interest expense has a positive impact on performance, through tax shield benefits and incentives for more leverage, which results in higher returns. Odalo (2016) also found that interest cover had a moderate influence on the performance of a firm indicating the effect is contingent upon the size of leverage and the type of industry.

Under Nigeria's thin cap rule which provides a restriction on deduction of interest to 30% of the EBITDA, companies with high interest to revenue ratios are more likely to be the ones with disallowed interest being carried forward and this can depress their reported ROA. Therefore, this study tests the following hypothesis:

H04: Interest-to-revenue ratio has no significant effect on return on assets of listed multinational firms in Nigeria.

2.5 Theoretical Framework

This research is based on Hoffman's Tax Planning Theory introduced by Hoffman (1961). The theory differentiates tax evasion as an illegal practice and tax avoidance as a legal exploitation of tax laws or code ambiguities to minimize the amount of tax paid (Hoffman, 1961). The key insight of the model is that the rational shareholder wealth maximizing firm will do tax planning to reduce taxable income, not necessarily accounting profit. They do this by arranging transactions to take advantage of allowable deductions, tax credits and gaps in tax laws. Thus, cash is left holed within the firm and which can be reinvested or paid out to the shareholders

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to increase the value of the firm (Hoffman, 1961). In the context of this study, Hoffman's theory is useful in explaining the thin capitalization issue in tax planning. Multinationals increase the ratio of debt to equity, especially related party debt, in order to increase interest deductions and reduce taxable profit. The theory also suggests that feasibility of strategies of this kind rests on the 'flexibility' of the firm and the 'stability' of its tax laws. Tax law is a moving target with countries such as Nigeria implementing a 30% EBITDA interest cap rule in the 2019 Finance Act–and companies need to adapt their capital structure on a continuing basis to stay tax efficient.

However, it has been argued that aggressive tax planning with high leverage may increase financial risk and agency costs, which may outweigh the tax benefits and have the opposite impact on profits (Desai & Dharmapala, 2009). Therefore, while Hoffman's theory explains the incentive for firms to use debt for tax purposes, it does not guarantee improved financial performance. Based on this theory, this study expects that measures of thin capitalization and tax planning will influence the return on assets of listed multinational firms in Nigeria.

3. METHODOLOGY

3.1 Research Design, Population and Sample

This study adopted an ex post facto research design to examine the effect of thin capitalization and tax planning on financial performance. Ex post facto design is appropriate because the study relies on historical data where the variables have already occurred and cannot be manipulated by the researcher (Hair et al., 2019). The population consists of all 32 multinational firms listed on the Nigerian Exchange Group as at 31st December 2024. A purposive sampling technique was used based on the following criteria:

1) Firms must be continuously listed on the NGX from 2015 to 2024 to ensure a balanced panel.
2) Audited annual reports must be publicly available for the entire 10-year period.
3) Firms in the financial and insurance sectors were excluded due to different regulatory capital requirements.
4) Firms must report in Nigerian Naira to ensure comparability.
5) After applying the filters, 17 multinational firms met the criteria and were used for the study, resulting in 170 firm-year observations. This sample size is adequate for panel data analysis.

3.2 Sources of Data and Method of Analysis

The study utilized secondary data extracted from the audited annual reports and financial statements of the sampled firms for the period 2015-2024. The data constitute a balanced panel consisting of cross-sectional and time series observations. The data were analyzed by descriptive statistics, Pearson correlation matrix, and panel regression. The Breusch-Pagan LM test was employed to test for panel effects to select the suitable model. The Hausman test

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was then applied to decide between FEM and REM. All analyses were conducted using Stata 17.

3.3 Model Specification

Following Otuya and Omoye (2021) and Fitria et al. (2024), and modifying it to include all four independent variables of this study, the functional relationship is specified as:

Functional Form:

$$ROA = f(RPDE, DE, DTA, ITR, ETR, SIZE)$$

Econometric Form:

$$ROA_{it} = \beta 0 + \beta_1 RPDE_{it} + \beta_2 DE_{it} + \beta_3 DTA_{it} + \beta_4 ITR_{it} + \beta_5 SIZE_{it} + \epsilon it \ldots\ldots (1)$$

Where:

ROA_{it} = Return on Assets of firm i in year t

$RPDE_{it}$ = Related Party Debt-to-Equity Ratio

DE_{it} = Total Debt-to-Equity Ratio

DTA_{it} = Debt-to-Total Assets Ratio

ITR_{it} = Interest-to-Revenue Ratio

$SIZE_{it}$ = Firm size

β_0 = Intercept

$\beta_1 - \beta_6$ = Coefficients

ϵ_{it} = Error term

i = 1,2,3...17 firms;

t = 2015,2016...2024

A priori expectation: β_1 to β_4 are expected to be negative at high levels due to financial distress. B_5 is expected to be positive.

3.4 Operationalization Definition of Variables

Table 1: Operational Definitions and Measurement of Variables

Variable	Variable Type	Acronym	Measurement	Sources	A priori
Return on Assets	Dependent	ROA	EBIT / Total Assets	Appah (2022), Otuya and Omoye (2021)	
Related Party Debt to Equity	Independent	RPDE	Related Party Debt / Total Equity	Fitria, et.al (2024), Oeta et al (2019)	+
Debt to Equity	Independent	DE	Total Debt / Total Equity	Fitria, et.al (2024), Osamor (2022)	+
Debt to Total Assets	Independent	DTA	Total Debt / Total Assets	Appah (2022) Fitria, et.al (2024),	+
Interest to	Independent	INEX	Interest Expense /	Otuya and Omoye	

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Revenue			Total Revenue	(2021)	+
Firm Size	Control	SIZE	Natural Log of Total Assets	Igbinovia, and Usman (2024) Umaigba et al. (2025)	+

Source: Researcher's compilation 2026

4. DATA PRESENTATION, ANALYSIS AND INTERPRETATION

4.1 Descriptive Statistics

Table 2 presents the descriptive statistics for the variables used in the study over the 10-year period from 2015 to 2024, totaling 170 firm-year observations.

Table 2: Descriptive Analysis

Variable	Obs	Mean	Std. Dev.	Min	Max
ID	170	9	4.913452	1	17
YEAR	170	2019.5	2.880767	2015	2024
ROA	170	.0273133	.1304704	-.4494526	.6326354
DE	170	.4980499	1.808786	0	14.32609
DTA	170	.0723073	.1247502	0	.6609907
RPDE	170	.1337117	.2162914	0	.9493895
ITR	170	.1910042	1.139234	0	13.97222
SIZE	170	2159.4	8694.154	16.11	110183.4

Computation from Stata 17 Output, 2026

Note: SIZE is measured as Natural Log of Total Assets in ₦'million

The results show that the average Return on Assets for the sampled multinational firms is 2.73%. This suggests modest profitability in asset utilization over the period. However, the standard deviation of 0.1305 and the wide range from -44.95% to 63.26% indicate substantial variation in performance across firms and years. The negative minimum reflects that some firms incurred losses during the period. For the thin capitalization proxies, Related Party Debt-to-Equity has a mean of 0.134. This implies that, on average, related party debt constitutes about 13.4% of equity. The maximum of 0.949 suggests that some firms finance nearly all their equity with intra-group loans, which is consistent with aggressive thin capitalization practices. Total Debt-to-Equity averages 0.498, but with a high standard deviation of 1.809 and a peak of 14.33, indicating that while most firms maintain moderate leverage, a few operate with very high debt levels. Debt-to-Total Assets averages 0.072, meaning debt finances roughly 7.2% of total assets on average. The Interest-to-Revenue Ratio has a mean of 0.191, but a maximum of 13.97. This shows that while interest burden is generally low, a subset of firms dedicates a disproportionate share of revenue to servicing debt. Firm Size, measured as the natural log of total assets, averages 7.23 with a standard deviation of 1.89. The inclusion of both small and very large firms is evident from the minimum and maximum values, justifying its use as a control variable.

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4.2 Correlation Analysis

Table 3 reports the Pearson correlation coefficients and Variance Inflation Factor for the independent and control variables. This test is essential to ascertain the degree of association among regressors and to ensure that multicollinearity does not distort the regression estimates (Hair et al., 2019).

Table 3: Correlation Matrix Containing All Independent Variables for the Model

	DE	DTA	RPDE	ITR	SIZE	VIF	1/VIF
DE	1.000					1.11	0.8968
DTA	0.2801	1.0000				3.26	0.3063
RPDE	0.0746	0.5425	1.0000			1.51	0.6621
ITR	-0.0338	-0.0477	-0.0607	1.0000		1.06	0.9567
SIZE	-0.0471	-0.0612	-0.0316	-0.0280	1.0000	1.02	0.9763

Source: Computation from Stata 17 output, 2026

An examination of the correlation matrix reveals that the relationships among the explanatory variables are generally weak. The correlation coefficients range from -0.0612 to 0.5425. The strongest association is observed between DTA and RPDE at 0.5425. This moderate positive correlation is plausible because firms that rely heavily on related party debt are also likely to exhibit higher total debt relative to assets.

All other pairwise correlations are below 0.30, indicating that the variables move largely independently of one another. Notably, ITR and SIZE exhibit near-zero correlations with the leverage variables, suggesting they capture different aspects of firm characteristics.

To further assess multicollinearity, the VIF was computed. The VIF values range from 1.02 for SIZE to 3.26 for DTA, with a mean VIF of 1.79. All individual VIF values are substantially below the conventional threshold of 10, and all tolerance values 1/VIF exceed 0.10 (Gujarati & Porter, 2009). This confirms the absence of severe multicollinearity in the dataset.

4.3 Diagnostic Tests and Model Selection

Prior to estimating the panel regression, several diagnostic tests were performed to determine the appropriate estimator and to validate the classical assumptions. The results are presented in Table 4.3.

Table 4: Diagnostic Tests Results

Test	Statistics	P value	Decision
Breusch-Pagan LM Test	Chibar2 = 29.04	0.0000	Reject H0: Use RE over Pooled OLS
Hausman Test	Chi2 = 5.01	0.4149	Fail to Reject H0: Use RE over FE
Wooldridge Test for Autocorrelation	F(16, 144) = 0.320	0.5792	Fail to Reject H0: No autocorrelation
Breusch-Pagan Test for Heteroscedasticity	Chi2 = 0.19	0.6649	Fail to Reject H0: Homoscedastic

Source: Computation from Stata 17 output, 2026

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The Breusch-Pagan LM test is significant at the 5% level with a Chibar2 value of 29.04. This rejects the null hypothesis of no panel effect and confirms that unobserved firm-specific effects exist. Consequently, pooled OLS is inappropriate for this dataset and panel estimation techniques are required. To choose between Fixed Effects and Random Effects, the Hausman test was conducted. The test statistic of 5.01 is not significant at the 5% level, implying that the difference in coefficients between FE and RE is not systematic. Under this result, the Random Effects estimator is both consistent and efficient and is therefore adopted for the analysis. The Wooldridge test for autocorrelation in panel data yields an F-statistic of 0.320 with a p-value of 0.5792. The result is insignificant, indicating the absence of first-order serial correlation in the residuals. Similarly, the Breusch-Pagan test for heteroscedasticity produces a Chi2 of 0.19 with p = 0.6649. This also fails to reject the null hypothesis, suggesting that the error variance is constant across firms and time.

4.4 Random Effects Regression Results and Discussion of Findings

Table 4.4 presents the Random Effects estimation results for the impact of thin capitalization on firm performance, proxied by Return on Assets. The model is significant and explains the variation in ROA across the sampled multinational firms.

Table 4: Random Effects Regression Results. Dependent Variable: ROA

	Coef.	Z	P>z
DE	.0000302	0.03	0.974
DTA	-.2649535	-2.38	0.017
RPDE	.1262186	2.73	0.006
ITR	-.0175643	-2.87	0.004
SIZE	2.14e-07	0.028	0.779
_CONS	-.0393991	-02.54	0.011

Source: Computation from Stata 17 output, 2026

The regression results reveal mixed effects of leverage on profitability, consistent with the complexity of capital structure decisions in multinational firms.

Debt-To-Equity and Performance

The coefficient of DE is positive but statistically insignificant. This suggests that overall leverage, measured as total debt to equity, does not exert a systematic influence on ROA for Nigerian multinational firms. The finding implies that marginal changes in external debt financing are not translating into measurable changes in asset returns. This is consistent with Otekunrin et al. (2020) who reported an insignificant relationship between DE and ROA for Nigerian consumer goods firms, and with Modigliani-Miller's proposition that in imperfect markets, capital structure may be irrelevant in the absence of other frictions.

Debt-To-Total Assets and Performance

On the other hand, DTA has an adverse and significant effect on ROA at 5%. Controlling for other variables, a 1-unit increase in DTA decreases the ROA by 0.265. This finding suggests that financing assets with debt activities result in a net profitability loss for the sampled firms.

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Possible channels include interest burden, costs of financial distress, and limited managerial flexibility. This is in line with Enekwe et al (2014) who concluded negative influence of total debt on ROA of Nigerian pharmaceutical companies, and with the trade-off theory which asserts that the costs of debt will exceed the tax benefits after an optimal point is reached. For Nigerian multinationals, combating a turbulent macro-environment, high asset-based leverage looks injurious.

Related Party Debt-To-Equity and Performance

RPDE has a positively significant coefficient at the 1% level. Implications for the importance for the thin capitalisation rule. It implies that intra-group lending strengthens ROA. ROA increases by 0.126 for every one unit rise in RPDE. One reason could be that related party loans are a source of inexpensive financing, by-pass external credit constraints and represent an efficient means for internal capital allocation within the multinational group. This is in accordance with the internal capital market hypothesis of Goossen and Greeff (2021) and Anindita and Mertha (2022). However, this premiums the new challenges in relation to profit shifting, since interest on related party debt is tax-deductible in Nigeria and this may have implications for the tax base.

Interest-To-Revenue and Performance

ITR has an adverse and significant impact on ROA at 1%. The negative coefficient of 0.0176 means that a higher interest burden over revenue reduces directly the profitability. This establishes that ability to meet debt obligations is paramount for Nigerian multinationals. The finding supports the findings of Otuya and Omoye (2021) and Awotomilusi et al. (2024), they documented that firms with weak interest coverage hold lower returns on assets. Furthermore, it serves as an empirical test for Nigeria's rule on interest limitation under the Finance Act 2019.

Control Variable

Size is positive and insignificant, which means that the size of the firm does not significantly affect the ROA in this sample after controlling for leverage. Taken as a whole, the results recover that not all types of debt are harmful. Asset-based leverage and interest burden both have a negative effect on profitability, however related party debt seems to add value for multinational firms in Nigeria. This dichotomy highlights a critical need for tax policy that differentiates between arm's length financing and aggressive thin capitalization.

5. CONCLUSION AND RECOMMENDATIONS

The study, using results of the statistics and exploratory variables in a random effect regression model show significant positive relationship between related party debt to equity and return on assets; and a significant negative relationship between debt to total assets, interest expense and return on assets. Study findings further revealed no significant relationship between debt to equity, and return on assets of listed multinational firms in Nigeria.

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In line with the findings of this study, the following recommendations are proffered:

First, MNCs should avoid using leverage as a primary driver of profitability and instead keep it moderate and purpose-driven.

Second, Nigerian listed MNCs should reduce reliance on high leverage and prioritize deleveraging or maintaining conservative debt levels.

Third, Nigerian listed MNCs can leverage related party financing as an effective tool to enhance profitability, but only with strong governance controls.

Fourth, Nigerian listed MNCs do not need to overhaul tax strategy for profitability gains, but should still minimize tax leakage through compliant planning.

Finally, Nigerian listed MNEs should manage debt servicing costs prudently but do not need to avoid debt entirely.

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