

# **Impact of Capital Budgeting Decision on the Performance of MTN Nigeria Limited**

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## **Abstract**

*Capital budgeting is the process of analyzing investment opportunities in long-term assets which are expected to gain benefits for more than a year. Most companies in Nigeria hardly involved in sound capital budgeting decisions that will provide them the opportunity to improve on operational performance and profitability. On this basis this study seeks to examine the impact of capital budgeting decision on performance of MTN Nigeria covering the period of 2014 to 2020. Longitudinal research design is adopted with a time series data were extracted from the Annual Reports from the company website. Multiple regressions with the aid of STATA software (version 13.0) was used for data analysis. The study employed the diagnostic test such as heteroskedasticity and multicollinearity to examine if the variables are fit for the study and normally distributed. The findings of the study show that long term debt (borrowing) has a positive and significant impact on NPM and ROA and the Acquisition of fixed assets is established to have a negative and insignificant impact on Net Profit Margin and Return on Asset of MTN Nigeria limited. The study recommended among others that the company should maintain the current long term borrowing since it has been established to be efficiently utilized to boost the company performance. Also, the company should avoid unnecessary investment in the area where the return is relatively low as compare to the cost of investment.*

**Keyword:** *Capital Budgeting, Long term debt, Fixed Asset, NPM, ROA, MTN Nigeria*

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## **I. Introduction**

An efficient and effective allocation of capital is the most important finance function in modern era. It involves decisions to commit company's capitals to long-term assets. Such decisions tend to determine the value of company by influencing its profitability, growth and risk. Capital budgeting is the practice of analyzing investment opportunities in long-term assets which are expected to gain benefits for more than a year. The investment decision or capital expenditure are generally known as capital budgeting. This investment by companies involves expansion and acquisition of long term asset and replacement of such asset.

Capital budgeting is defined as the appraisal techniques which are used by companies to appraise the viability of the project when making capital decisions. Company decisions on capital investment largely shape the future with business and its ability to manage its future operations with sole objective of profit maximization (Nyarombe et al., 2015). The fundamental objective of a company is considered to be maximization of value or profitability and minimization of cost, which is generally accepted as the only rational basis for making capital budgeting decisions (Pratheepkanth et al., 2018). The importance of capital budgeting decisions in the telecommunication companies is to enhance performance and to improve profit levels which cannot be over

emphasized since the sustainability of any economic system is predicated on the viability of the information and technology system of that company.

Companies are established to accomplish their set goals which includes profit making and for these goals to be attained capital budgeting decision must play a significant role (Pearce, 2019). It is important to know that due to the intense competition amongst telecommunications firms there is the need for a firm to adapt and be involved in sound capital budgeting decisions to give them an edge over other competitors in the aspect of continuously improving on their levels of operational performance and profitability.

Capital budgeting is mostly concerned with sizable investments in long-term assets. These assets can either be tangible asset or intangible asset. The tangible assets are property, plant or equipment and the intangible asset includes new technology, patents or trademarks (Mrongo et al., 2016). However, investments in new technology and new products created may also be viewed as investments in tangible assets.

A sound system of capital budgeting does more than just accept or reject decisions on individual projects. The system should tie into the company long range planning process that decides what lines of business the company concentrates in and sets out for financing, production and marketing in order to satisfy customer needs. (Balarabe, 2020) pointed out that the essence of capital budgeting is to set and size a firm's real assets, which in turn generate the cash flows that ultimately determine its value, viability and profitability.

The motivation behind this study is due to the fact that companies are established with one objective, and that is to maximize shareholders wealth. Company management does not just want to select any investment, but optimal investments that would impact on the value of the shareholders wealth positively. Therefore, every company strives to take good investment decisions which are sometime difficulty to make. Furthermore, capital budgeting has generated various arguments over the years from different scholars especially in the area of financing and investment decisions as it affects the company value, performance and profitability.

According to Pike (1986) as cited in the study of Mushaho et al., (2015) capital budgeting decision denotes that efficient allocation of resources is not merely a matter of adopting sophisticated, theoretically superior investment techniques and procedures, but consideration must also be given to the fit between the corporate context and the design and operation of the capital budgeting system, but in Nigeria capital budgeting decision has been a very typical issue in the sustenance of a firm as a result several firms have lost their identity or liquidated due to wrong capital budgeting decision they made at a particular point of time.

Capital budgeting is used to make investment decisions so as to increase shareholders value (Demigurc, 2017). But due to limited resources experienced in the developing countries like Nigeria, capital budgeting decisions are intended to manage the limited resources effectively and efficiently. It does not develop an enduring technological base that can support the growth of its economies. Nigeria's capital budgeting decision is not usually well articulated. For instance, Nigeria vision 2020 finds that the Nigeria firms do not derive high benefits from budgeting and this leads to inefficient performance and loss. Based on these common problems in Nigerian industries and the effect of globalization on industries, it is important to use effective method before making any investment decision.

In addition, studies have been conducted on capital budgeting mostly on the techniques and methods of capital budgeting, for instance the studies of (Pearce, 2019), (Farragher, 1986), (Pratheepkanth et al., 2018), (Demigurc, 2017), (Imegi & Nwokoye, 2015), (Nyarombe et al., 2015), (Kinyua, 2018) but this study will bridge the gap by examining the impact of capital invested such as Acquisition of long-term assets and outsourcing of capital expenditure on performance of MTN Nigeria. In order to accomplish the research objectives, this study seeks to address the following research objectives;

- i) To assess how does long-term debt affects firm's performance
- ii) To determine how acquisition of fixed asset decision affects firm's performance

To achieve the objective of the study, the hypotheses of the study is stated in a null form

H01: long-term debt has no significant impact on company performance

H02: Acquisition fixed asset decision has no significant impact on company performance.

## **II. Empirical Review**

### **Conceptual and Theoretical Framework**

Companies are constantly faced with capital budgeting decisions. Any decision that requires the use of resources for a long term objective is a capital budgeting decisions. Capital budgeting is more or less a continuous process in any growing concern (Babu , Thaheer & Vanaja, 2019). Capital budgeting decisions are used to make investment decisions so as to increase shareholders returns on investment. This investment decision is based on long term asset. The asset may be tangible asset such as property, plant and equipment or intangible asset such as investment in technology, patents or trademarks by company. The cost of this investment is relatively high and the return is usually based on long time.

Mushaho et al., (2015) argued that irrespective of whether the investments are tangible or intangible assets, the capital investment project can be distinguished from recurrent expenditures with two features. One is that such projects are significantly large. Secondly, that investment is generally long-lived projects with their benefits or cash flows spreading over many years.

Capital budgeting is widely utilized as a management and strategic planning tool by companies with the aim of maximizing shareholder wealth and minimizing cost (Demigurc, 2017). Furthermore, firm used capital budgeting techniques for investment decision. These techniques are the modern techniques (discounted cash flows) and the traditional techniques (non-discounted cash flow) to determine a performing investment for a company. Financial performance is the level of viability of a company.

Financial performance measure based on the fact that the main objective for implementing capital budgeting procedures is to maximize, or at least increase, shareholders wealth with a possible low cost (Demigurc, 2017). Company's financial performance is affected by various factors and may be seen from some attributes of firm specific determinants such as firm growth opportunities, firm size, profitability and liquidity position of the company.

### **Capital Budgeting Theory**

The capital budgeting theory is deployed in Modigliarian and Millers theory in corporate finance. It suggested that when making capital budgeting decisions, five important factors are considered which includes; cost of capital life of project, the salvage value, initial investment and operating cash in-flows. The initial investment is the funds required upfront to start a project which includes but not limited to the price of assets purchase, taxes from sales, cost of transportation, installation cost and working capital needs. This approach bases a capital budgeting decision on the Net Present Value of the investment project which is the result of the discounted after the after-tax weighted average cost of capital less the initial investment (Pandey, 2000). Thus, the reason behind this investment decision process is for the company to be successful in the business. Therefore, a successful business must be aiming towards maximizing shareholders wealth, which is profitability. Profitability is the return on shareholder investment.

### **Empirical Review of Related Literature**

Pearce, (2019) examine the impact of capital budgeting techniques on commercial bank financial performance. A qualitative as well as quantitative research methodology was adopted in the study. A questionnaire was developed to get the opinion of employees working in 11 commercial banks in Sierra Leone. The results obtained from 187 employees show that the implementation of the payback period technique in capital budgeting decision is highly correlated with commercial banks performance followed by three other techniques except for the internal rate of return technique that was negative and insignificant in both the correlation and regression results.

Pratheepkanth et al., (2018) empirical analysis capital budgeting models, uncertainty tools, cost of capital and firm performance: A comparison between Australia and Sri Lanka. Quantitative descriptive literature review analysis was use for the study. The questionnaire was administered to 300 stock-exchange-listed firms (150 in Australia and 150 in Sri Lanka). Secondary data for 2013-17 were acquired from the ASX, CSE's websites and used to compute return on assets, return on equity, Tobin Q, and earnings per share for the sampled firms. Finding from the study shows that Australian firms tend to rely heavily on sophisticated CBTs, relatively small Sri Lankan firms prefer simple analysis techniques, but larger Sri Lankan firms tend to be as adept at sophisticated CBT analysis as Australian firms. Further, while Australian firms have a positive association between their performance and their use of more sophisticated CBTs (Tobin's Q, excepted), Sri Lankan firms tend to experience a negative association between their performance and their use of more sophisticated CBTs (EPS, excepted).

Demigurc, (2017) analysis the effect of capital budgeting methods on performance of water services boards in Kenya. A descriptive design is used for the study. A semi-structured questionnaire was used to collect primary data from the respondents through the email. The findings from the study point at a positive relationship between usage of capital budgeting techniques and organizational performance. Improved access to funding to undertake projects and informed decision making were cited by the respondents as being the major benefits of adoption of capital budgeting techniques.

Mrongo et al., (2016) analyzing capital budgeting as a strategy for project performance in Kenya Rural Roads Authority. The study target population is 15 project managers and 15 financial managers of Kenya Rural Roads Authority. Purposive sampling technique was used in the study. A structured questionnaire was developed and utilized in this study. Questionnaires were given to project managers and financial managers. The researcher conducted a multiple regression analysis so as to determine the impact of project management on variables of the study. The result of study found that policy on budgeting, expertise, financial resources, accountability and re-training measures affected the performance of project to a great extent. The study

concluded that the decision of whether to accept or deny an investment project as part of a company's growth initiatives, involves determining the investment rate of return that such a project will generate.

Imegi & Nwokoye, (2015) examine the effectiveness of capital budgeting techniques on the evaluation of projects' profitability. The population for this study was all the sixty-five (65) quoted companies in Rivers state with a sample size of fifty-six (56) companies. A simple random sampling technique was used for the study as the sample frame. The questionnaire was administered to the General Managers of the sample companies. From the results of the study analysis, the following findings were made: (i) the various capital budgeting techniques used in evaluating the profitability of a project are- pay-back, accounting rate of return, net present value, internal rate of returns, profitability index, and net terminal value (ii) the most significant factor influencing the choice of capital budgeting techniques is the wealth maximization factor, (iii) the capital budgeting technique lacks relevance in evaluating projects under conditions of risk and uncertainty, (vi) the most effective capital budgeting technique for evaluating the profitability of risk-free projects is the net present value (v) taxation has no significant effect on project evaluation.

Ofunya (2017) assess the impact of capital budgeting methods and performance of Water Services Boards in Kenya. The study population and sample size is eight (8) water service boards that were in existence in Kenya in 2008. The study relied on content analysis, descriptive design and regression in the analysis the data collected. The study revealed that there is a tendency among the Water Services Boards towards the use of capital budgeting techniques that are sophisticated.

Afonso, Jose, Fatima and Ney (2017) investigate capital budgeting practice among cotton firms in Brazil. The study sample size is ten (10) different firms and the study used exploratory and qualitative approach. Further content analysis was also employed in the study. The study revealed that Capital budgeting are unsophisticated techniques; nevertheless they are still used by businesses because they directly affects and impose high risks.

Gupta & Pradhan (2017) examine the effect of capital budgeting decisions on listed and non- listed manufacturing firms in India. The sample size are seventy five (75) manufacturing and non- manufacturing firms and regression model was used to interpret the result of the study. The findings of the study indicate that the discounted techniques are mostly preferred by the companies.

### III. Methodology and Model Specification

Longitudinal research design is adopt for the study, and the period of study is 2014 to 2020. The population and sample size of the study is one and a census sampling technique is adopted for the study. Secondary data is used from the annual reports of the MTN Nigeria Limited. The study also employs a positivist approach in which a quantitative design is employed to test the hypotheses. A regression is used to examine how capital budgeting decisions affect company performance in MTN Nigeria.

The model used in this study is given below:

$$NPM = \alpha + \beta_1 LTDR_i + \beta_2 AQFA_i + \epsilon_{it} \text{ ----- (1)}$$

$$ROA = \alpha + \beta_1 LTDR_i + \beta_2 AQFA_i + \epsilon_{it} \text{ ----- (11)}$$

Where,

NMP = Net Profit Margin (Profit after Tax to Turnover)

ROA = Return on Asset (Profit before Tax to Total Asset)

LTDR= Long Term Debt Ratio (Long Term Debt to Total Asset)

FAR= Total Fixed Asset Ratio (Fixed asset to Total Asset)

$\alpha$ = the intercept (it gives the value of DV when IV is zero).

$\beta$  = the slope measuring rate of change in dependent variable for a unit of change in explanatory variables and the coefficient of the explanatory variable

$\epsilon_{it}$ = Stochastic Variable (is the error term)

### IV. Results and Discussions

The study employs the descriptive statistics as a form of univariate analysis to access underlying trends amongst data employed from 2014 to 2020 (7 years)

**Table 1 Descriptive Statistics**

Variable	Obs	Mean	Std Dev.	Min	Max
ROA	7	0.1565	0.0992	-0.0123	0.2974
NPM	7	0.1861	0.1147	-0.0153	0.3523
LTDR	7	-3.2301	12.7037	-31.9898	2.3399
FAR	7	0.7334	0.0967	0.5888	0.8365

#### STATA 13 Result Output

ROA = Return on Asset

NPM = Net Profit Margin

LTDR = Long Term Debt Ratio

FAR = Fixed Asset Ratio

Table 1 is the descriptive statistics that shows the trend and attribute of MTN Nigeria study data, starting with the ROA and NPM as capture by aggregate company asset and turnover, it is seen that the average value for ROA and NPM are 0.1565 and 0.1861 respectively which means that MTN Nigeria has average return on asset and turnover at 15% and 18% respectively over the period of 7 years with a high standard deviation from the mean value. The minimum values of the company are -0.0123 and -0.0153 for ROA and NPM which implies that company is losing at minimum rate of 1.2% and 1.5% respectively and the maximum value are 0.2974 and 0.3523 for the ROA and NPM, this show the MTN Nigeria are making profit on asset invested and turnover at 29.7% and 35% respectively.

The table 1 show an average mean value of long term debt to be -3.2307 which shows that MTN Nigeria has long term borrowing to finance their asset for operation which is relatively high compare to the equity value of the company, with a high standard deviation from the company mean value. The minimum value of the borrowing is -31.98 and maximum value is 2.3399. Furthermore, the company fixed asset to operate the business operation revealed an average mean value of 0.7334 with standard deviation, and the minimum and maximum value of the company are 0.5888 and 0.8365, thus, the MNT Nigeria lowest value of fixed asset to total asset is at 59% and maximum rate is 84%, this implies that the company is performing in terms of utilization of its asset for investment.

**Table 2: Correlation Matrix of MTN Nigeria (2014-2020)**

Variables	ROA	NPM	LTDR	FAR
ROA	1.0000			
NPM	0.9585*	1.0000		
	0.0007			
LTDR	0.7440	0.7821*	1.0000	
	0.0552	0.0377		
FAR	0.0452	0.0357	0.5421	1.0000
	0.9233	0.9394	0.2087	

**STATA 13 Result Output**

ROA = Return on Asset

NPM = Net Profit Margin

LTDR = Long Term Debt Ratio

FAR = Fixed Asset Ratio

The correlation matrix shows that judging by the fore bearing, MTN Nigeria long term debt holds a positive and significant influence on net profit margin. This means an increase in long term borrowing to finance business operation can serve as a stimulus in increasing the profit on turnover. Also, the borrowing revealed a positive and insignificant relationship with ROA. The table 2 shows that fixed asset shows an insignificant positive relationship with ROA and NMP. The long term debt ratio is seen to possess positive relationship with fixed asset portfolio of MTN Nigeria.

**Regression Diagnostic Tests**

The Breusch-Pagan test is conducted for heteroskedasticity, table 3 show the heteroskedasticity test in this study and revealed that the P-value is 0.6673 and 0.7327 respectively for model one and two, which is quite higher than the standard that is 0.05. So, it can be concluded that there is no heteroskedasticity that means the squared residual is not correlated with explanatory variables (homoskedastic) or the variance for error term is constant. Furthermore, the mean variance inflation factor (VIF) calculated for the model is 1.42 which is less than 10 and 1/VIF which is tolerance level is more than 0.10 for all explanatory variables of the study. These tests confirm the presence of lower degree of co linearity among the explanatory variables.

**Regression Analysis and Discussion**

The coefficient of determination R-square shows an output of 0.8251 and 0.7351 for both models which shows that the long term debt and Fixed asset portfolio jointly account for up to 82% and 74% of variations in the net profit margin and return on asset respectively, while the probability level of 0.0306 and 0.0702 shows that the model has a statistical fit and is thus viable. Overall the study discovered that leaving

certain factors constant i.e. in the short run, the MTN Nigeria debt finance level are statistically significant in influencing the level of profitability.

**Table 3: Ordinary Least Square Models**

Variables	Model One (NPM)			Model Two (ROA)		
	Coeff. Value	T-Value	P-Value	Coeff. Value	T-Value	P-Value
LDR	0.0098	4.34	0.012	0.0079	3.33	0.029
FAR	-0.6526	-2.21	0.092	-0.5207	-1.66	0.173
Constant	0.6962	0.2217	0.035	0.5641	2.39	0.075
R <sup>2</sup>	0.8251			0.7351		
Adj R <sup>2</sup>	0.7377				0.6027	
F-statistic	9.44				5.55	
P-value (F-Statistics)	0.0306				0.0702	
Hettest Chi2)	0.18			0.12		
P-Value (Hettest)	0.6673			0.7327		
Mean VIF	1.42					

**STATA 13 Result Output**

**Hypothesis One**

Long term debt in model one revealed a coefficient value of 0.0098, t-value of 4.34 and a corresponding p-value of 0.012, in the same vein, model two show a coefficient value of 0.0079, t-value of 3.33 and a corresponding p-value of 0.029. This implies that long term debt is found to have positive and significantly impact on NPM and ROA respectively. Therefore, 1% increase in the long term borrowing by MTN Nigeria will increase the performance (NPM and ROA) by 0.98% and 0.79 respectively. Therefore, we reject the null hypothesis. This result is similar with research of Andrew & Iwedi, (2020) who found a positive significant relationship between debt ratio and firm performance. On the other hand, it contradict the research study of (Balarabe, 2020).

**Hypothesis Two**

Acquisition of fixed asset in model one revealed a coefficient value of -0.6527, t-value of -2.21 and a corresponding p-value of 0.092, also, model two show a coefficient value of -0.5207, t-value of -1.66 and a corresponding p-value of 0.173. These suggest that acquisition of fixed asset is established to have negative and insignificant impact on NPM and ROA respectively. Therefore, a 1% increase in acquisition of fixed asset to total asset will reduce the performance (NPM and ROA) level by 65% and 52% respectively. Therefore, we fail to reject the null hypothesis. This study is supported by the research work of Balarabe, (2020) that found and insignificant impact on profitability.

**V. Conclusion and Recommendation**

The study examines the impact of capital budgeting decisions on the performance of MTN Nigeria Limited covering the period of 2014 to 2020. For this purpose, both external sources of financing and the acquisition of fixed asset explanatory variables are incorporated, while the predictive variables are net profit margin and return on asset. The study found that long term debt or borrowing is found to have a positive and significant effect on the performance (NPM and ROA) of MTN Nigeria. The study finds that acquisition of fixed asset has negative and insignificant impact on net profit margin and return on asset of MTN Nigeria.

Based on the finding of this study the following recommendations are forwarded to MTN Nigeria Limited and regulatory bodies like NCC.

i) Given the relationship between long term debt or borrowing and company performance which is positive and highly significant, it is recommended to MTN Nigeria Limited should borrowing external than equity to finance their business operation since it is boosting their performance level. Also, increase the efficiency and effectiveness of utilization of the loan in order to maintain the return on investment. Furthermore, it was seen that sound financing decisions are critical to the long-term survival and sustainability of company.

ii) Fixed asset portfolio should critical review by channeling the asset utilization to right production output that improve the company performance. The company should avoid unnecessary investment in the area where the return is relatively low as compare to the cost of investment. Also, review the business center location where there fixed asset is not yielding any sound returns on investment in order to continuing running at loss.

In light of this study, future researchers in this area should focus on the determinants of the capital spending than the techniques or method and should also generate and incorporate measures of inclusiveness of the various stakeholders in the capital investment decision.

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### Appendix

Notes:

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1. (/v# option or -set maxvar-) 5000 maximum variables

. *(6 variables, 7 observations pasted into data editor)

. summarize roa rot ldr fata

Variable |      Obs      Mean   Std. Dev.   Min       Max
-----|-----
roa      |         7   .1564714   .099237   -.0123   .2974
rot      |         7   .1860662   .1147346  -.0152765 .3523321
ldr      |         7  -3.230743   12.70368  -31.9898   2.3399
fata     |         7    .7334    .0966577    .5888    .8365

. pwcorr roa rot ldr fata, sig star(5)

          |      roa      rot      ldr      fata
-----|-----
roa       |  1.0000
          |
rot       |  0.9585*  1.0000
          |  0.0007
          |
ldr       |  0.7440  0.7821*  1.0000
          |  0.0552  0.0377
          |
fata     |  0.0452  0.0357  0.5421  1.0000
          |  0.9233  0.9394  0.2087
    
```

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. regress rot ldr fata

Source	SS	df	MS	Number of obs =	7
Model	.065170614	2	.032585307	F( 2, 4) =	9.44
Residual	.013813611	4	.003453403	Prob > F =	0.0306
				R-squared =	0.8251
				Adj R-squared =	0.7377
Total	.078984225	6	.013164038	Root MSE =	.05877

rot	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]
ldr	.0097556	.0022474	4.34	0.012	.0035157 .0159956
fata	-.6526938	.2953815	-2.21	0.092	-1.472804 .1674168
_cons	.6962698	.2217687	3.14	0.035	.0805411 1.311998

. estat hettest

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity

Ho: Constant variance

Variables: fitted values of rot

chi2(1) = 0.18

Prob > chi2 = 0.6673

. estat vif

Variable	VIF	1/VIF
fata	1.42	0.706085
ldr	1.42	0.706085
Mean VIF	1.42	

. regress roa ldr fata

Source	SS	df	MS	Number of obs =	7
Model	.043437082	2	.021718541	F( 2, 4) =	5.55
Residual	.015650792	4	.003912698	Prob > F =	0.0702
				R-squared =	0.7351
				Adj R-squared =	0.6027
Total	.059087873	6	.009847979	Root MSE =	.06255

roa	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]
ldr	.0079596	.0023922	3.33	0.029	.0013177 .0146015
fata	-.5207454	.3144111	-1.66	0.173	-1.393691 .3521998
_cons	.5641016	.2360559	2.39	0.075	-.0912946 1.219498

. estat hettest

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity

Ho: Constant variance

Variables: fitted values of roa

chi2(1) = 0.12

Prob > chi2 = 0.7327

Apochi G, James, et. al. "Impact of Capital Budgeting Decision on the Performance of MTN Nigeria Limited." *IOSR Journal of Business and Management (IOSR-JBM)*, 24(01), 2022, pp. 12-19.