Finance Cost and shareholders wealth maximization of Listed Oil and Gas Companies in Nigeria

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Abstract

This study explored the interplay between finance cost and shareholders wealth maximization of listed oil and gas companies in Nigeria. It therefore focused on the positivist paradigm and adopted the ex post facto method of research design. Four listed oil and gas companies were randomly selected as samples for investigations. The annual financial statements of these companies were the source of the secondary data collected for the study. Applying the Pearson correlation model as the tool of analysis on the data gathered, the investigation showed that finance cost does not significantly impact on price earnings ratio which indicated a negative correlation of -0.018 with a significant value of 0.912. The investigation further revealed that finance cost does not significantly impact EPS with a significant value of 0.614 and correlation value of 0.082, the correlation is positive but very weak. The study concluded that finance cost does not significantly impact on price earnings per share of listed oil and gas companies in Nigeria. Thus, the research recommended that the management should ensure optimal gearing that would enhance earnings in order to boost companies P/E ratio without overshooting debt servicing obligations; and that borrowed funds should be channeled to areas that will boost profits in order to enhance EPS which is a key performance indicator.

Keywords: Finance Cost, Shareholders Wealth Maximization, Price Earnings Ratio, Earnings Per Share

1.0 Introduction

The motive for incurring finance cost is largely hinged on the quest to improve a company's size and profitability which in turn enhances cash flows, investable funds and maximizes shareholders' wealth. It is therefore imperative that finance costs are incurred, however, within some acceptable limits to control operating cost. The ability to control the operating costs of a company has positive or negative effects on the value of shareholders' equity as a result of its impact on the company's profits (Kinyugo, 2014, Akinleye, 2023). Companies therefore consider borrowing (finance cost) for viable capital investment to expand businesses and impact shareholder wealth. The managers of the Oil and Gas companies therefore constantly engage strategic options that sustain shareholders interest, profitability and the corporate image of the sector.

Finance cost has consistently occupied a sensitive and significant proportion of operating cost in the income statements of oil and gas companies, globally. Controlling these costs is done by saving

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money on operating expenses and avoiding unnecessary costs (Sinta, Kembaren & Fadli, 2021). Magdalena, and Suhatman (2020) among others have identified some inefficiencies in the way of managing costs in some oil and gas companies in Nigeria that lead to inconsistencies in their working capital which leads to an increase in wages and a decrease in income.

Earnings are seen as inputs that are major in investors' valuation models as it affects prices of securities. Price Earnings Ratio (P/E Ratio) and Earnings Per Share (EPS) are fundamental financial indices for shareholders wealth maximization. They are used in the measurement of company's financial profitability and strength (Ogaluzor & Chukwu, 2022). Therefore, earnings play a vital role in the decision of investors and in the appraisal of the management. Earnings per share (EPS) are so important to an organization due to the fact that its performance can either encourage investors or discourage them. EPS has been projected by pundits and other financial statements users, possibly, not well informed, as financial performance "Holy Grail" (Wet, 2013). It is the key player in making strategic decisions. Earnings per share depend on the profit made in the relevant year. For a reasonable management, optimal gearing must be sort as higher cost, such as high finance cost, will certainly reduce the profit, hence lowering the EPS. It is worthy of note therefore that the EPS declared have a way of determining investors' decisions.

In a capitalistic financial system, investors have quite a lot of opportunities in investing their money. According to Becirovic (2009), among others, the investor can make choice of either on equity-based investment or interest-based investment opportunities. Ivascu and Barbuta-Misu (2017) opined that a company's performance is measured by achieved results that are good, resulting from actions taken. To earn profit, a company must effectively minimize cost, which includes finance cost.

Operations of companies are financed using equity financing or borrowings and these sources of fund are not free. Fund providers want reward in respect of their invested funds (International Financial Reporting Tool, 2023). These rewards given have a way of affecting the profit of the companies. Thus when the profit is reduced, it is expected that earnings per share would also decline as these two factors are always positively correlated.

Providers of finances are rewarded in diverse ways as returns on investment. Holders of equity need dividends as well as capital gains while the debt instrument holders need interest and fees. Among the goals that are major in financing is to reduce financing costs (Wohe, 2000). No matter the financial result of a company it is expedient that finance costs are paid regularly as at when due. There are various implications and risk associated with financing and this necessitates finance managers constantly seeking optimal capital mix that will lead to maximization of returns and minimization of cost of capital (CoC). The task of finding this optimal capital structure seems to have increasingly and persistently plagued the profit earnings potentials of entities, which in turn, reduces earnings per share of the providers of equity capital. Low earnings power has constantly threatened the survival of the oil and gas companies especially as a highly hazardous and volatile sector requiring high wages to workers. The higher the CoC or the finance cost, the lower the profit. Consequently, higher net profit of a company produces a higher EPS and vice versa.

The interpretation is that higher finance cost leads to lower earnings and the lower the finance cost, the higher the earnings. However, studies appear to be scanty in this field, hence the need to show empirical result on the impact of finance cost on Price Earnings Ratio and Earnings per Share of shareholders. Particularly, studies on finance cost and shareholders wealth maximization using price earnings Ratio and earnings per share as proxies seem not to be available. As a result, this study tends to bridge the gap in literature and scholastic research, by investigating the relationship between finance cost of corporate organisations and shareholders wealth maximization using Price

Earnings Ratio and Earnings per Share as proxies. This is designed to address the research questions: to what extent does finance cost affect earnings per share of listed oil and gas companies in Nigeria? To what extent does finance cost affect Price Earnings Ratio of listed oil and gas companies in Nigeria? Subsequently, the null hypotheses: Ho₁, there is no significant relationship between finance cost and Price Earnings Ratio of listed oil and gas companies in Nigeria; and Ho₂, there is no significant relationship between finance cost and Earnings per Share of listed oil and gas companies in Nigeria; were formulated and tested to arrive at some empirical findings.

2.0 Conceptual Review

2.1 Finance Cost.

The term Finance costs (FC) is also called cost of finance, borrowing costs or financing costs. It is comprised of the cost, the interest, and other charges associated with borrowing. Interests expenses are accounting costs incurred servicing debt obligations and instruments. Interest expenses are often given favourable tax treatment (Kogan, 2020). It is the cost involved in raising any form of finance. International Financial Reporting Tool (2023) asserts that the International Accounting Standard (IAS) 23 defines it to be the interest and any other costs incurred by an entity that is associated with funds borrowed. In calculating annual finance cost, implicit interest rate is applied to liability outstanding and is then charged to finance cost in the Statement of Profit or Loss and other Comprehensive Income. Finance cost refers to the expenses incurred by a company for borrowing funds or financing its operations through debt instruments such as loans, bonds, or credit facilities. Finance cost, often referred to as interest expense or borrowing costs, is a crucial aspect of a company's financial operations, particularly for those that utilize debt financing. It represents the expenses incurred by a business entity as a result of borrowing funds or obtaining financing through debt instruments to support its operations, investments, or other financial activities. It includes interest payments on borrowings, fees related to debt issuance, and any other costs associated with raising and servicing debt capital.

International Financial Reporting Tool (2023) believes that finance costs includes among others:

- discounts amortization or premiums related to borrowings
- ancillary costs amortization incurred which is connecting with borrowings or with the arrangements
- Finance charges in regard to the leases, that is, finance lease
- Exchange difference that arises from a foreign currency borrowing to the degree that such are seen as modification to interest cost

2.1.2 Price Earnings Ratio

Wu (2014) argued Valuation models such as, Gordon Growth model and Ohlson and Jeuttner-Nauroth model, and proposed that P/E ratio should be seen as a function of earnings-growth expected and return-rate expected. Price-earnings ratio compares price of stock to earnings. It assists investors in valuing stock and also gauges market expectations (Sajeetha et al, 2023). The price-earnings ratio is classified as ratio used in giving value for firms that measure their current share price as it relates to its earnings per-share. Sajeetha et al (2023) assert that the ratio is influenced by various factors accountable for the price earnings ratio variations and the P/E ratio changes impact significantly on investor's perception. The ratio avails investors an insight into whether shares may have been overvalued, priced appropriately, and/or undervalued since it is a means that is useful in comparing stocks, particularly within the same industry (San et al, 2010). Ghaeli (2017) argued that price earnings ratio is generally calculated by comparing market value per share with earnings per share. Shares with high P/E ratios are expected to have superior future earnings growth (Sajeetha et al, 2023). The price earnings influence the decision of investment and also reflect the confidence of investors and their opinion on the future performance of the firm (Babak et al, 2015) The price-earnings ratio (P/E ratio) is a valuation metric used to evaluate the relative value of a company's stock by comparing its current market price per share to its earnings per share (EPS). A higher P/E ratio typically indicates that investors are willing to pay more for each unit of earnings, suggesting optimism about the company's future prospects. Conversely, a lower P/E ratio may indicate undervaluation or pessimism about future growth potentials.

2.1.3 Earnings per Share

Earnings are significant for every organization since earnings affect the decision of investors; as a result, some companies regularly get involved in unhealthy financial practices in their annual financial reports. This action of various companies underscores the importance of EPS reported or declared by a company. Alao and Olatifede (2021) referred to earnings as net revenue and classified it as the most significant factor of a company's accounts. Badruzaman (2020) sees EPS as a ratio which shows the amount of profit (return) shareholders or investors obtain per share. Earnings per share (EPS) are financial metrics that represent the portion of a company's profit allocated to each outstanding share of its common stock. It serves as a key indicator of a company's profitability and is widely used by investors to evaluate the financial health and performance of a company. EPS is a key indicator of a company's profitability and is often used by investors to assess its financial performance and growth potential. Higher EPS typically indicates higher profitability on a per-share basis. It is the total of a company's profit after tax minus preference dividend, if any, divided by total numbers of shares outstanding (Egbeonu, et al, 2016). It is classified as the most significant index that guides investor's decisions. An entity with a high EPS is profitable and has more profit to distribute to shareholders. Due to the fact that outstanding number of shares has the capacity to fluctuate, weighted average is used generally.

2.2 Theoretical Review

2.2.1 Pecking Order Theory

The theory maintains that businesses adhere to a hierarchy of financing sources and prefer internal financing when available, and that debt is preferred over equity if financing is external. The pecking order theory, proposed by economists Donaldson and Miller, suggests that companies prefer to finance investments using internal funds first, followed by debt, and finally equity. This theory has implications for how companies manage their cost of capital, capital structure and financing decisions.

2.3 Empirical Review

There seems to be paucity of researches on this topic, however, Becirovic (2009) assessed and analysed the impact of finance costs on economic crises. The study revealed that, with time value of money, whether the financing of companies are done using equity capital or debt capital, entities are required to generate at least a minimal return, and if the minimal return is unearned, investors will turn away from such companies. Further findings from the research suggest that managers consciously and persistently seek goals that reduce companies' total financing costs and if the companies do not reach the minimal return, investors may opt for divestment.

Mohamad and Saad (2012) empirically reviewed the effect of cost of capital on firm's value and profitability. The study concentrated on Bursa Malaysia listed companies. Employing the two

model specifications on 415 listed companies spanning six years (2005-2010), the findings for the research showed a significant relationship amongst cost of capital, firm value and profitability.

In order to identify and appraise capital structure and the market value of firms, Isaac (2014) investigated the impact of capital mix, debt capital role and factors influencing a firm's capital choice and the overall effect it has on the firm's market value within Nigeria. Combining primary data and secondary data sources, the study revealed that a firm's market value is influenced positively and significantly by the choice made by the firm on capital structure (financial leverage). Looking at listed 100 index firms of Karachi Stock Exchange, Abdul-Sattar (2015) attempted bridging the gap in literature by empirically reviewing the relationship amongst weighted average cost of capital (WACC), profitability and firm value. The result established a significant negative relationship between WACC and firm value and ROA. Further, findings from the research revealed insignificant effect of Total Debt Ratio on Return on Asset.

Zhang and Sun (2017) expounded ways of financing SMEs using traditional financing and sort reasons why SMEs find it difficult sourcing finance. The work identified poor and slow development of SMEs and their unique characteristics as hindrances to adequate financing. The study, however, suggests that the rapid development in Internet financing has paved way for SMEs financing. The study however, only looked at the theoretical aspect of financing without considering the effect of finance cost on the value or earnings of SMEs.

Lucky (2017) explored the effect of cost of capital on corporate earning using quoted firms in Nigeria as its population. Costs of capital (short, medium and long term costs) were used on earnings per share as measure of corporate earnings. Cross sectional data of twenty selected firms from 2011-2016 were used for the study. Trade credit, short term bank loans, commercial paper, banker acceptance, line of credit, evolving credit, hire purchase, operating lease, debt, preference share and equity were proxies of cost of capital. The findings revealed that short term and long term costs had significant relationship with corporate earnings but there was insignificant relationship between medium term costs and corporate earnings.

Ibrahim et al (2021) examined if financial performance is impacted by cost of capital. Covering non-financial listed firms from 2015-2019 in Nigeria. The study employed 2-step system "Generalized Method of Moments (GMM)". Findings from the research revealed negative significant impact between the study variables. The author's believed that firms that are profitable have the opportunity to use retained earnings to finance new investments instead of going for a new equity issue and/or debt. Again, to raise the firm's level of debt may end in distress costs increase, and as a result may reduce the benefits from tax shield which accordingly result in a fall of the firm's value.

Konieva (2021) evaluated the relationship between financing policy and cost of debt of Ukrainian food processing companies from 2013–2020. Data were distributed according to the forms of financing policies. Cases conservative policy has twenty two per cent, fifteen per cent for moderate, twenty six per cent for aggressive and thirty seven per cent for super-aggressive. The results indicate that the weighted cost of debt of conservative policy had 24.10%, and super-aggressive policy had 20.80%. Moderate policy had 2.10% and conservative financing produced 1.2%. The result means that selecting the desired form of financing policy by a company indicates possibility of adopting a capital structure with the capacity of reducing cost of debt.

Muriithi (2017) explored the relationship between operational expenses and the financial performance of pension companies in Kenya not in Nigeria. Sinta et al. (2020) reviewed the effect of operating costs, trade payables and sales on the net income in Indonesian Food & Beverage Sector.

Peter and Imo (2023) investigated the affect of cost of capital on firm's performance in Nigeria. The study examined listed construction companies from 2012-2021. Cost of debt and cost of equity were the selected proxies for cost of capital while ROA was used as a measure of firm's performance. OLS regression and the pool least square regression were used to analyse the data collected. Cost of debt showed negative insignificant effect, but cost of equity revealed insignificant positive effect on ROA. The study did not look at finance cost and earnings and also did not cover oil and gas firms.

3.0 Methodology

This study adopted an ex-post facto research design and secondary data were collected from the annual financial reports of four listed oil and gas companies, Conoil Plc, Ardova plc, Mrs Plc, Eterna Plc in Nigeria, over the period between 2012 and 2021. The Pearson Product Moment Correlation was adopted as the inferential statistic for the data collected. This was designed to explore the relationship between the study variables (finance cost, price earnings ratio, and earnings per share).

3.1 Data Presentation

Data collected for the study were presented as follows:

Year	Conoil Plc	Ardova plc	Mrs Plc	Eterna Plc
	N'000	N'000	N'000	N'000
2021	757,540	1,534,583	376,333	1,180,555
2020	704,573	1,408,180	1,089,611	1,001,618
2019	1,113,323	4,825,394	617,674	1,685,849
2018	1,508,064	3,101,580	218,116	867,859
2017	2,137,170	2,174,254	210,263	534,823
2016	1,764,897	2,622,410	635,771	3,531,058
2015	3,757,508	3,091,295	1,880,203	531,238
2014	2,307,767	3,102,519	1,427,577	386,042
2013	2,251,826	1,446,586	784,508	743,449
2012	4,166,857	1,782,534	1,358,196	511,650

Cost of Finance

Source: Companies' Financial statements

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Price Earnings Ratio					
Year	Conoil Plc	Ardova plc	Mrs Plc	Eterna Plc	
2021	0.11	0.42	0.45	0.60	
2020	0.24	0.31	-0.07	0.64	
2019	0.18	0.17	-0.09	-12.5	
2018	0.19	0.04	-0.12	0.57	
2017	0.22	0.17	0.09	0.31	
2016	0.25	0.52	0.09	0.43	
2015	0.15	0.11	0.14	0.52	
2014	0.42	0.21	0.17	0.52	
2013	0.11	0.12	0.20	0.94	
2012	0.49	0.82	0.62	0.68	

Source: Author's Computation based on Companies' Financial statements

Earnings per Share

Year	Conoil Plc	Ardova plc	Mrs Plc	Eterna Plc
	NGN	NGN	NGN	NGN
2021	4.44	1.18	1.12	0.83
2020	2.08	1.60	-7.43	0.78
2019	2.84	3.00	-5.59	-0.04
2018	2.59	0.48	-4.15	0.87
2017	2.27	2.89	5.45	1.59
2016	2.00	0.97	5.77	1.17
2015	3.33	4.39	3.68	0.97
2014	1.20	2.42	2.94	0.97
2013	4.42	4.25	2.50	0.53
2012	7.14	0.61	0.18	0.73

Source: Companies' Financial statements

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3.1.2	Data Analysis	
Analy	s of the Significant Impact of Finance Cost on Price Earnings Rat	tio

Correlations

		Finance Cost	Price Earnings
	Pearson Correlation	1	018*
Finance Cost	Sig. (2-tailed)		.912
	Ν	40	40
Price Earnings	Pearson Correlation Sig. (2-tailed)	018 [*] .912	1
	Ν	40	40

*. Correlation is significant at the 0.05 level (2-tailed).

The Pearson correlation coefficient measures the strength and direction of the linear relationship between two variables. In this case, the correlation coefficient between Finance Cost and Price Earnings is -0.018. The significance value, often denoted as Sig. (2-tailed), indicates the probability of observing the correlation coefficient if there were no true correlation in the population. Thus, the significance value for the correlation between Finance Cost and Price Earnings is 0.912.

The correlation coefficient of -0.018 suggests a very weak negative linear relationship between Finance Cost and Price Earnings Ratio. The significance value of 0.912 is greater than the conventional significance level of 0.05. However, there is a note indicating that the correlation is significant at the 0.05 level (2-tailed), which suggests that this correlation might have been found by chance. Therefore, caution should be exercised when interpreting this result. It is possible that the observed correlation between Finance Cost and Price Earnings Ratio is not meaningful and could be due to random variation in the data.

In summary, the correlation analysis suggests a very weak and statistically insignificant relationship between Finance Cost and Price Earnings Ratio in the dataset. The note indicating significance at the 0.05 level should be interpreted cautiously, as it may be spurious. Consequently, the study upheld the stated null hypothesis which states that there is no significant relationship between finance cost and price earnings ratio of listed oil and gas companies in Nigeria.

Analysis of the Significant Impact of Finance Cost on Earnings per Share

Correlations

		Finance Cost	EPS
Einen og Cost	Pearson Correlation	1	.082
Finance Cost	Sig. (2-tailed)		.614
	Ν	40	40
EPS	Pearson Correlation	.082	1
	Sig. (2-tailed)	.614	
	Ν	40	40

*. Correlation is significant at the 0.05 level (2-tailed).

From the analysis above, the correlation coefficient between Finance Cost and EPS is 0.082 with a significance value of 0.614. The correlation coefficient of 0.082 suggests a very weak positive linear relationship between Finance Cost and EPS. Since the correlation coefficient is close to zero and the significance value is relatively high (0.614), there is no statistically significant correlation between Finance Cost and EPS at the 0.05 significance level. Therefore, based on this analysis, there is no evidence to suggest a meaningful relationship between Finance Cost and EPS in the dataset.

In summary, the correlation analysis indicates a weak and statistically insignificant relationship between Finance Cost and EPS in the dataset. Consequently, the study confirmed the stated null hypothesis. That is, the study upheld that finance cost does not significantly impact on EPS of listed oil and gas firms in Nigeria.

4.0 Discussion of Findings

The study was carried out with the aim of revealing the significant impact of finance cost on price earnings ratio and earnings per share.

The first hypothesis which sought to investigate if significant impact exists between finance cost and price earnings ratio showed insignificant impact. That is, finance cost does not significantly impact price earnings ratio of listed oil and gas companies in Nigeria. The negative correlation of -.018 reveals that, finance cost and price earnings ratio move towards the opposite direction. This therefore established an inverse correlation and supports the formulated null hypothesis.

The second hypothesis sought to assess if significant impact exists between finance cost and earnings per share. The result showed insignificant impact. That is, finance cost does not significantly impact on earnings per share of listed oil and gas companies in Nigeria as the correlation was positive but insignificant (.082 or 8.2%). This means that, finance cost and earnings per share move towards the same direction but suggest minimal relationship.

Based on the results from the analyses, the two null hypotheses were accepted because the probability values of 0.912 and 0.614 are higher than the 0.05 benchmark. Therefore, the null

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hypotheses that finance cost does not significantly impact on price earnings ratio and earnings per share of oil and gas companies in Nigeria were upheld.

5.0 Conclusion and Recommendations

Conclusion

The study explored the relationship between finance cost, earnings per share and price earnings ratio of listed oil and gas companies in Nigeria. The findings showed an absence of significant impact between the independent and the dependent variables. Thus, the study concludes that in the listed oil and gas companies in Nigeria, finance cost does not significantly impact on price earnings ratio and earnings per share. The correlation results again further conclude that there is a very weak and negative correlation between finance cost and price earnings ratio, and a very weak positive correlation between finance cost and earnings per share.

Recommendations

Recommendations made by the study based on the results are:

- i. The management should ensure optimal gearing that would enhance earnings in order to boost companies P/E ratio without overshooting debt servicing obligations.
- ii. Borrowed funds should be channeled to areas that will boost profits in order to enhance EPS which is a key performance indicator.

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APPENDIX

a. Finance Co	ost			
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Source: Companies' Financial statements

b. Price Earnings Ratio

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2018	0.19	0.04	-0.12	0.57
2017	0.22	0.17	0.09	0.31
2016	0.25	0.52	0.09	0.43
2015	0.15	0.11	0.14	0.52
2014	0.42	0.21	0.17	0.52
2013	0.11	0.12	0.20	0.94
2012	0.49	0.82	0.62	0.68

Source: Author's Computation based on Companies' Financial statements

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c. Earnings per Share				
Year	Conoil Plc	Ardova plc	Mrs Plc	Eterna Plc
	NGN	NGN	NGN	NGN
2021	4.44	1.18	1.12	0.83
2020	2.08	1.60	-7.43	0.78
2019	2.84	3.00	-5.59	-0.04
2018	2.59	0.48	-4.15	0.87
2017	2.27	2.89	5.45	1.59
2016	2.00	0.97	5.77	1.17
2015	3.33	4.39	3.68	0.97
2014	1.20	2.42	2.94	0.97
2013	4.42	4.25	2.50	0.53
2012	7.14	0.61	0.18	0.73

Source: Companies' Financial statements

2. Results of Data Analyses

a. Analysis of the Significant Impact of Finance Cost on Price Earnings Ratio

Correlations

		Finance Cost	Price Earnings	
	Pearson Correlation	1	018*	
Finance Cost	Sig. (2-tailed)		.912	
	N	40	40	
	Pearson Correlation	018*	1	
Price Earnings	Sig. (2-tailed)	.912		
	N	40	40	

*. Correlation is significant at the 0.05 level (2-tailed).

b. Analysis of the Significant Impact of Finance Cost on Earnings per Share

Correlations

		Finance Cost	EPS
Einen og Cost	Pearson Correlation	1	.082
Finance Cost	Sig. (2-tailed)		.614
	Ν	40	40
EPS	Pearson Correlation	.082	1
	Sig. (2-tailed)	.614	
	Ν	40	40

*. Correlation is significant at the 0.05 level (2-tailed).