Firm-Specific Determinants of Financial Performance: Evidence from Multinational Companies in Nigeria

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ABSTRACT

This study investigates the firm-specific determinants of financial performance among multinational companies (MNCs) operating in Nigeria. Specifically, it examines the influence of thin capitalization, firm size, leverage, and effective tax rate on the financial performance of these firms, measured by Return on Invested Capital (ROIC). Employing an ex-post facto research design, the study analyzed panel data from 20 listed multinational companies covering the period 2013 to 2022. Using ordinary least squares (OLS) regression and correlation analysis, the findings reveal that leverage and effective tax rate have significant positive impacts on ROIC, while firm size has a significant negative effect. Thin capitalization, though positively related to ROIC, did not exhibit a statistically significant influence. The results suggest that financial performance is more strongly shaped by internal capital structuring and profitability-linked tax obligations than by aggressive debt-equity arrangements alone. The study contributes to the literature on multinational capital structure and performance and recommends regulatory reform, optimal debt management, and stronger tax transparency frameworks.

Keywords: Firm size, Leverage, Financial Performance, Thin Capitalization, Multinational Companies

INTRODUCTION

Background to the Study

Thin capitalization has increasingly become a subject of global economic and regulatory concern, especially as multinational companies (MNCs) adopt sophisticated financial strategies to minimize their global tax liabilities. Thin capitalization refers to the practice whereby companies are financed through a relatively high level of debt compared to equity, particularly intercompany loans from related foreign entities, to gain tax advantages through interest deductions [14]. The implication is that companies with thin capital structures can shift profits to low-tax jurisdictions, thereby eroding the domestic tax base of host countries like Nigeria.

In developing economies such as Nigeria, where foreign direct investment is a key source of economic development, MNCs dominate various critical sectors including oil and gas, telecommunications, manufacturing, and services. These companies often rely heavily on debt capital sourced from parent firms abroad. This trend raises concerns about the sustainability of such financial structures and their implications for the financial health and reporting integrity of these firms [16]. Thin capitalization can increase financial leverage and lower taxable profits, but also escalates financial risks and can impair long-term profitability [10]

In recent years, international organizations such as the OECD and the United Nations have advanced frameworks to address Base Erosion and Profit Shifting (BEPS), in which thin capitalization plays a significant role [15]. In Nigeria, Section 27 of the Companies Income Tax Act (CITA) was amended to restrict tax deductions on interest from related-party debt that exceeds 30% of earnings before interest, taxes, depreciation, and amortization (EBITDA), in line with the OECD's Action 4 BEPS recommendations. However, these rules are relatively new, and enforcement mechanisms remain weak, leaving room for continued exploitation by MNCs.

Prior studies have shown that excessive reliance on debt capital leads to suboptimal capital structures, increasing bankruptcy risk, and reducing investor confidence [1]. Moreover, the effects of thin capitalization are not limited to tax matters but extend to the operational efficiency and financial performance of affected firms. This justifies the need to investigate empirically how thin capitalization impacts financial performance indicators such as Return on Assets (ROA), Return on Equity (ROE), and Return on Invested Capital (ROIC) among MNCs in Nigeria.

Statement of the Problem

The increased incidence of thin capitalization among MNCs in Nigeria presents a serious policy, economic, and financial concern. While debt financing is a legitimate business decision, excessive use of related-party debt may result in artificial interest expenses, aggressive tax planning, and erosion of the Nigerian tax base [6]. This creates distortions in the financial reporting landscape, as inflated interest deductions reduce taxable income and misrepresent the true financial position and performance of firms.

Despite recent reforms, including the introduction of transfer pricing regulations and thin capitalization rules in Nigeria's fiscal framework, enforcement gaps and regulatory arbitrage continue to undermine policy effectiveness. Empirical evidence suggests that many MNCs in Nigeria still maintain highly leveraged structures, using intercompany loans to minimize tax liabilities and repatriate profits [17], [10]. This practice not only deprives the country of much-needed revenue but may also hinder the financial sustainability of the firms involved, especially during periods of economic instability or currency depreciation.

Furthermore, the literature remains inconclusive on the extent to which thin capitalization impacts firm-level financial performance in the Nigerian context. Some studies argue that debt financing improves performance through tax shields and discipline [12], while others contend that excessive leverage undermines profitability due to increased financial distress costs [2],[4]. These conflicting perspectives highlight a research gap, particularly in the Nigerian setting, where macroeconomic volatility, exchange rate risks, and regulatory laxity interact uniquely with corporate financing decisions.

Given these challenges, this study seeks to critically evaluate the impact of thin capitalization on the financial performance of multinational companies in Nigeria. It aims to provide empirical evidence that can inform both corporate financial management and public policy, especially in designing effective regulatory responses to aggressive financing and tax planning strategies.

Objectives of the Study

The study aims to achieve the following objectives:

1. To evaluate the effect of thin capitalization (debt-to-equity ratio) on the financial performance (ROIC) of multinational companies in Nigeria.

2. To examine the influence of firm size on the financial performance of multinational companies in Nigeria.

3. To assess the impact of leverage (debt-to-assets ratio) on the financial performance of multinational companies in Nigeria.

4. To determine the effect of effective tax rate on the financial performance of multinational companies in Nigeria.

Research Questions

The study raised the following research questions to enable it achieve the study's objectives.

1. What is the effect of thin capitalization on the financial performance of multinational companies in Nigeria?
2. How does firm size influence the financial performance of multinational companies in Nigeria?
3. To what extent does leverage affect the financial performance of multinational companies in Nigeria?
4. Does the effective tax rate significantly influence the financial performance of multinational companies in Nigeria?

Hypotheses of the Study

The study formulated the following hypotheses

H_{01}: Thin capitalization has no significant effect on the financial performance (ROIC) of multinational companies in Nigeria.

H_{02}: Firm size has no significant effect on the financial performance of multinational companies in Nigeria.

H_{03}: Leverage has no significant effect on the financial performance of multinational companies in Nigeria.

H_{04}: Effective tax rate has no significant effect on the financial performance of multinational companies in Nigeria.

Limitations of the Study

This research provides insightful findings on firm-specific determinants of financial performance among multinational companies in Nigeria; however, certain limitations should be acknowledged:

Data Constraints and Generalization: The study utilized secondary data obtained from published annual reports, which may contain inherent reporting biases or measurement errors. Additionally, the analysis was confined to 20 listed multinational firms over a ten-year period, limiting the generalizability of findings to unlisted companies or different time periods.

Variable Selection: Although the chosen variables (thin capitalization, firm size, leverage, and effective tax rate) significantly explained firm performance, other potentially influential factors such as management quality, corporate governance practices, macroeconomic fluctuations, and sector-specific dynamics were not examined, possibly influencing the robustness of the conclusions.

Contextual Boundaries: The research context (Nigeria) is characterized by unique regulatory, economic, and institutional frameworks, potentially limiting the applicability of these findings to multinational firms operating in economies with significantly different tax policies or financial regulations.

Focus on Financial Measures: The study primarily employed financial measures such as Return on Invested Capital (ROIC) to measure firm performance, which may not capture non-financial indicators (e.g., customer satisfaction, market share, environmental sustainability), potentially offering an incomplete evaluation of overall corporate success.

Acknowledging these limitations, future research may consider broader samples, incorporate additional explanatory variables, employ mixed-method designs, and extend analyses to comparative cross-country contexts to enhance the understanding of multinational companies' financial strategies and performance outcomes.

LITERATURE REVIEW

Conceptual Review

Thin Capitalization

Thin capitalization describes a situation where a company is financed through a relatively high level of debt compared to equity, especially where such debt is obtained from related parties, typically the parent company in a multinational structure. This financing strategy allows multinationals to deduct interest expenses from taxable income, thereby minimizing their tax liabilities [14]. While this is a legitimate tax planning strategy, it often borders on aggressive tax avoidance, especially in jurisdictions with weak enforcement of thin capitalization rules like Nigeria.

Financial Performance

Financial performance refers to a company's ability to generate revenue, profit, and value for its stakeholders over time. Common financial performance indicators include Return on Assets (ROA), Return on Equity (ROE), Return on Invested Capital (ROIC), Net Profit Margin, and Earnings per Share (EPS). The link between a firm's capital structure—especially the debt-to-equity mix—and its financial performance is a central theme in corporate finance literature [2].

Debt-to-Equity Ratio

The debt-to-equity ratio is a crucial measure of leverage, reflecting the proportion of company financing that comes from debt versus equity. A high debt-to-equity ratio typically signals thin capitalization. This ratio influences the cost of capital, tax liabilities, financial distress risk, and ultimately, profitability [10].

Theoretical Framework

Modigliani-Miller Theorem (With Corporate Taxes)

This study is anchored on the Modigliani-Miller Theorem, specifically their 1963 revision which incorporates the effect of corporate taxes. The theory posits that the value of a firm increases with leverage because interest payments on debt are tax-deductible, thereby reducing the overall tax burden. This benefit is known as the tax shield**.** In a thin capitalization context, multinational companies deliberately capitalize on this advantage by using excessive debt—especially from related foreign entities—to minimize their taxable profits in high-tax jurisdictions like Nigeria.

However, the Modigliani-Miller framework also acknowledges the non-linear effect of leverage: after a certain threshold, the cost of financial distress and agency problems outweighs the benefits of the tax shield. Thin capitalization, while potentially beneficial in the short term, may therefore compromise long-term financial performance due to increased default risk and higher capital costs [12] This theoretical basis provides the foundation for examining the relationship between thin capitalization and financial performance in this study.

Empirical Review

Numerous empirical studies have explored the relationship between thin capitalization and the financial performance of multinational companies, but the findings remain context-specific and at times contradictory. Reference [10] conducted a panel data analysis of listed firms and found a significant negative relationship between high debt-to-equity ratios and financial performance indicators such as Return on Assets (ROA) and Return on Invested Capital (ROIC). They argued that while debt offers tax shields, the burden of interest payments—especially in foreign currency—exposes firms to solvency risks, particularly in an unstable macroeconomic environment like Nigeria's. However, their study was limited by its exclusion of non-listed multinationals, thereby constraining the generalizability of their findings. Similarly, [2] examined the performance of 30 multinational firms in Nigeria over a ten-year period and found that firms with excessive leverage experienced lower Return on Equity (ROE) and higher earnings volatility. They emphasized that the tax benefits of debt financing decline significantly when the debt-to-equity ratio exceeds 65%, aligning with the non-linear relationship predicted by the Modigliani-Miller theorem. Nevertheless, the study did not account for macroeconomic control variables such as inflation and exchange rate fluctuation, both of which can influence performance in highly leveraged firms.

Reference [16] extended the literature by examining the effect of thin capitalization on financial reporting quality among Nigerian multinationals. They discovered that firms with excessive related-party debt exhibited lower audit quality and a higher incidence of misstatements and restatements in financial statements. This finding raises concerns not only about profitability but also about transparency and accountability, particularly in the manufacturing and extractive sectors. However, the study relied on a relatively small sample and lacked industry-wide generalizability. Reference [6] offered a nuanced perspective by investigating the interplay between thin capitalization and transfer pricing manipulation. Their findings showed that firms engaged in thin capitalization were more likely to use related-party transactions to shift profits across borders, thereby distorting financial performance measures and creating artificial earnings fluctuations. This study provided valuable insight into how thin capitalization interacts with broader aggressive tax planning mechanisms but lacked a rigorous quantitative component to validate the qualitative analysis. [17] investigated the effect of thin capitalization on tax revenue generation in Nigeria and found that highly leveraged multinational firms contributed significantly less to corporate tax revenue. However, the study revealed no consistent evidence that thin capitalization negatively impacts corporate profitability, suggesting that while tax planning benefits may be achieved, these do not necessarily translate into improved long-term firm value. This presents a paradox where tax-efficient strategies may mask underlying financial fragility.

Reference [5] conducted a meta-analysis across multiple continents including Africa and Europe. They found that while thin capitalization could improve short-term return on investment due to tax minimization, it often compromised long-term efficiency, especially in post-crisis periods. Their study highlighted that aggressive debt structuring not only reduced tax payments but also constrained operational flexibility and made firms vulnerable to financial shocks. However, due to the diversity of countries analyzed, regional dynamics may have been obscured, reducing the precision of cross-country comparisons. Reference [22], in a study of OECD and emerging market economies, concluded that firms in jurisdictions without strict thin capitalization regulations tended to over-leverage, resulting in lower long-term profitability and greater default risk. Their findings support the view that regulation plays a key moderating role in the thin capitalization-performance relationship. Yet, they did not control for firm-specific characteristics such as size, age, and industry type, which could significantly influence leverage behavior.

Reference [1] found that the impact of thin capitalization on firm performance could be moderated by the quality of corporate governance. Firms with strong boards and independent audit committees were better able to manage the risks associated with high leverage. This suggests that internal governance structures can cushion the adverse effects of thin capital structures. However, the study relied on governance indices that may not fully capture informal practices prevalent in African corporate settings. Reference [7] provided policy-oriented evidence indicating that thin capitalization rules, where enforced effectively, reduce the incentive for profit shifting and improve firm-level financial disclosures. They found that multinational firms often manipulate intercompany financing structures in response to regulatory gaps, thereby impacting the accuracy of financial performance indicators. While their study offered valuable global insights, its macro-level focus limited its direct application to firm-level performance dynamics in the Nigerian context.

Finally, [21] noted that the persistence of thin capitalization in developing economies stems from weak enforcement, complex tax treaties, and insufficient domestic regulations. Their findings underscored the broader economic risks of thin capitalization, including fiscal imbalance, capital market distortion, and impaired firm valuation. However, the report was largely diagnostic and lacked empirical tests, which limits its explanatory power on financial performance outcomes.

METHODOLOGY

Research Design

This study adopted an ex-post facto research design to examine the impact of thin capitalization on the financial performance of multinational companies in Nigeria. The ex-post facto design was considered appropriate because the research relied on historical financial data that could not be manipulated by the researcher. The approach allowed for the analysis of how debt-to-equity ratios (as proxies for thin capitalization) influenced firm-level performance over time.

Population of the Study

The population of the study consisted of all multinational companies operating in Nigeria and listed on the Nigerian Exchange Group (NGX) as of December 2023. These companies were drawn across diverse sectors including oil and gas, manufacturing, telecommunications, and consumer goods. Their multinational status was determined based on foreign ownership and cross-border operational presence.

Sample Size and Sampling Technique

A purposive sampling technique was employed to select 20 multinational companies based on three criteria:

Availability of audited financial statements for the study period (2013–2022), evidence of related-party debt or intercompany financing arrangements in their financial disclosures, and continuous listing on the NGX for the entire ten-year period.

Sources and Methods of Data Collection

Secondary data were obtained from the annual financial reports of the selected companies, sourced from their official websites, the NGX Factbook, and the Financial Reporting Council of Nigeria. Additional data were gathered from audited notes to the accounts, especially disclosures relating to capital structure, interest expenses, and intercompany borrowings. The financial data spanned a ten-year period (2013–2022), allowing for robust panel analysis. Key variables extracted include: Total Debt, Total Equity, Interest Expense, Profit After Tax, Total Assets, Return on Assets (ROA), Return on Equity (ROE) and Return on Invested Capital (ROIC)

Method of Data Analysis

The data were analyzed using panel regression techniques, incorporating both fixed effects and random effects models. Diagnostic tests such as the Hausman specification test were conducted to determine the most appropriate estimator. The analysis was conducted using STATA 15.0 software.

The following model was estimated:

$$ROIC\_it = \beta_0 + \beta_1 THINCAP\_it + \beta_2 FSIZE\_it + \beta_3 LEV\_it + \beta_4 TAX\_it + \varepsilon\_it$$

Where:

ROIC = Return on Invested Capital (proxy for financial performance)

THINCAP = Debt-to-Equity Ratio (proxy for thin capitalization)

FSIZE = Firm Size (log of total assets)

LEV = Leverage (Total debt / Total assets)

TAX = Effective Tax Rate

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i = firm

t = year

ε = error term

Descriptive statistics, correlation matrices, and multicollinearity checks (VIF) were also carried out to ensure the robustness of the estimates.

Table 1: Operationalization of Variables

Variable	**Description**	**Measurement**	**Sources**
Return on Invested Capital (ROIC)	Proxy for financial performance; measures how efficiently a company generates profit from its capital base.	EBIT / Invested Capital	[13], [11]
Thin Capitalization (THINCAP)	Reflects the extent of debt financing relative to equity, indicating potential tax avoidance.	Total Debt / Total Equity	[14], [7]
Firm Size (FSIZE)	Indicates scale of operations and market dominance.	Natural logarithm of Total Assets	[3], [18]
Leverage (LEV)	General capital structure indicator; captures financial risk and financing behavior.	Total Debt / Total Assets	[12], [9]
Effective Tax Rate (TAX)	Measures tax efficiency and potential earnings management through capital structure.	Tax Expense / Pre-Tax Income	[19], [20]

RESULTS

Presentation of Results

Table 2: Correlation Matrix

	THINCAP	**FSIZE**	**LEV**	**TAX**	**ROIC**
THINCAP	1.000	0.078	-0.132	0.069	-0.018
FSIZE	0.078	1.000	-0.738	0.136	-0.733
LEV	-0.132	-0.738	1.000	-0.336	0.627
TAX	0.069	0.136	-0.336	1.000	0.188
ROIC	-0.018	-0.733	0.627	0.188	1.000

Table 3: Regression Results

Model:	OLS	Adj. R-squared:	0.678
Dependent Variable:	ROIC	AIC:	-419.9246
Date:	2025-04-16 16:55	BIC:	-403.4330
No. Observations:	200	Log-Likelihood:	214.96
Df Model:	4	F-statistic:	105.6
Df Residuals:	195	Prob (F-statistic):	1.05e-47

R-squared:	0.684	Scale:	0.0069976			
	Coef.	Std.Err.	t	P>|t|	[0.025	0.975]
const	1.3874	0.1901	7.2981	0.0000	1.0125	1.7623
THINCAP	0.0010	0.0008	1.1367	0.2571	-0.0007	0.0026
FSIZE	-0.1187	0.0145	-8.2100	0.0000	-0.1472	-0.0902
LEV	0.0652	0.0106	6.1724	0.0000	0.0444	0.0860
TAX	0.9434	0.1063	8.8709	0.0000	0.7337	1.1531
Omnibus:	82.761	Durbin-Watson:	1.799			
Prob (Omnibus):	0.000	Jarque-Bera (JB):	554.613			
Skew:	1.406	Prob(JB):	0.000			
Kurtosis:	10.658	Condition No.:	408			

Interpretation of Results

Thin Capitalization (THINCAP) had a positive but statistically insignificant effect on ROIC ($p > 0.05$), leading to the acceptance of the null hypothesis H_{01}. This implies that high debt-to-equity ratios alone may not significantly drive performance in the sampled firms.

Firm Size (FSIZE) showed a significant negative effect on performance, suggesting that larger firms may suffer from diseconomies of scale or inefficiencies in capital allocation.

Leverage (LEV) had a positive and significant effect, consistent with capital structure theory that posits moderate debt enhances profitability via tax shields.

Effective Tax Rate (TAX) displayed the strongest positive effect on ROIC, possibly indicating that firms reporting higher tax liabilities also report higher pre-tax profitability.

DISCUSSION OF FINDINGS

The findings of this study provide nuanced insights into the complex relationship between thin capitalization and firm-specific characteristics and the financial performance of multinational companies (MNCs) operating in Nigeria. Overall, the results revealed mixed outcomes, some of which align with prior research while others diverge due to methodological or contextual differences.

Firstly, the regression results showed that thin capitalization (THINCAP) had a positive but statistically insignificant effect on Return on Invested Capital (ROIC). This finding suggests that although debt-based financing may enhance the capital structure of MNCs, it does not automatically translate into improved financial performance within the Nigerian context. This outcome is consistent with the findings of [17], who concluded that while thin capitalization strategies reduce tax liabilities, they do not significantly affect profitability metrics such as ROA or net income. Similarly, [16] found that high related-party debt did not guarantee improved returns but instead compromised financial reporting quality. However, this contradicts the theoretical position of [12], which posits that increased debt financing enhances firm value due to tax shields—suggesting that the Nigerian economic and regulatory environment may limit the realization of such benefits.

The study found that firm size (FSIZE) had a significant negative effect on ROIC, implying that larger MNCs tend to exhibit lower capital efficiency. This finding aligns with [2], who reported that the performance of Nigerian MNCs declines beyond a certain size threshold, possibly due to structural complexities, bureaucratic inefficiencies, or diseconomies of scale. Similarly, [5] observed that large multinational corporations often face strategic and operational rigidity, which can impair efficient capital utilization. This finding provides a counter-narrative to the general assumption that large firms, due to their resource base and market power, naturally outperform smaller firms.

In contrast, the leverage ratio (LEV) was found to have a positive and statistically significant impact on ROIC. This supports the findings of [10] and [9], both of whom documented that moderate levels of debt enhance firm performance through tax savings and the disciplining effect of debt. This relationship also resonates with the pecking order theory, which suggests that firms prefer debt to equity due to lower transaction costs and better signaling to investors. However, the results caution against excessive reliance on debt, as the non-significance of the thin capitalization proxy indicates that marginal returns may diminish beyond a certain leverage threshold.

Perhaps most striking is the strong and positive relationship observed between the effective tax rate (TAX) and ROIC. This finding suggests that more profitable firms tend to pay higher taxes, reaffirming the position of [19], who argued that tax-effective firms typically have stronger pre-tax earnings, making them more exposed to taxation. Similarly, [20] found that highly profitable firms in Nigeria were less aggressive in avoiding taxes, leading to a positive association between effective tax rates and financial performance. While this may seem counterintuitive, it underscores the importance of considering tax payment as a function of profitability rather than a cost that always erodes firm value. overall, these findings suggest that while thin capitalization is a strategic tool within multinational corporate finance, its isolated impact on performance is limited within the Nigerian context. Other factors such as leverage efficiency, firm size, and tax compliance exert more robust effects. This reinforces the argument of [22] that without strong regulatory enforcement and effective capital allocation, the potential benefits of thin capitalization may not materialize as theorized.

CONCLUSION AND RECOMMENDATIONS

Conclusion

The study concludes that while thin capitalization is a common strategy among MNCs for minimizing tax liabilities, its isolated effect on financial performance is not significant in the Nigerian context. The results imply that the performance of multinationals is more strongly influenced by leverage efficiency, firm size, and tax compliance than by the debt-to-equity ratio alone.

Furthermore, the significant negative impact of firm size suggests that larger firms may experience diminishing returns due to operational inefficiencies or diseconomies of scale. On the other hand, leverage positively contributes to performance when optimally managed, highlighting the tax advantage of debt financing. The strong positive relationship between tax expense and performance also indicates that profitable firms are more likely to bear greater tax burdens—challenging the notion that high tax payment always undermines performance. Overall, the findings emphasize the need for a balanced approach to capital structure decisions and reinforce the importance of strengthening regulatory frameworks to monitor and control excessive debt financing.

Recommendations

Based on the empirical findings, the following recommendations are proposed

Regulatory Reform on Thin Capitalization**:** Policymakers should implement comprehensive thin capitalization rules that place limits on interest deductibility for related-party loans. These rules should align with OECD BEPS Action 4 guidelines and be effectively enforced by the [8].

Capital Structure Optimization**:** Multinational companies should adopt optimal leverage strategies that balance the benefits of debt (e.g., tax shields) with the risk of financial distress. Internal finance and reinvested earnings should be considered before seeking external debt.

Performance Monitoring in Large Firms**:** Large multinationals should implement performance-based evaluation and cost-efficiency mechanisms to reduce internal inefficiencies and enhance capital utilization.

Strengthening Tax Transparency**:** Tax authorities should enhance scrutiny of intercompany financing arrangements to detect and deter abusive thin capitalization schemes, including transfer pricing misstatements.

Corporate Governance Enhancement**:** Boards of directors and audit committees should provide stronger oversight on financing decisions, particularly those involving foreign affiliates, to ensure they align with long-term financial sustainability.

Contribution to Theory

This study contributes significantly to capital structure theory, particularly by engaging critically with the seminal Modigliani-Miller (MM) theorem with corporate taxes (1963). According to the MM perspective, debt financing, through its associated tax shields, is expected to enhance firm value. However, the findings of this study present a nuanced perspective in the context of developing economies, such as Nigeria. Contrary to the straightforward implications of the MM theorem, the empirical evidence from this study indicates that thin capitalization—while theoretically advantageous for tax efficiency—does not significantly impact the financial performance of multinational companies in Nigeria. This divergence highlights critical limitations of the MM theorem when applied directly to developing economies, characterized by institutional weaknesses, regulatory inconsistencies, macroeconomic instability, and limited enforceability of financial rules. The study further underscores the importance of leverage and effective tax rates, both significantly positive determinants of firm performance, supporting MM's core proposition that debt creates value through tax shields. Nevertheless, the non-significant effect of thin capitalization specifically challenges the MM assumption that excessive leverage consistently translates to improved firm valuation.

Additionally, the negative relationship identified between firm size and financial performance provides further theoretical insight, suggesting potential inefficiencies or diseconomies of scale that the original MM theorem does not account for. This finding points toward the necessity of contextualizing capital structure theories within specific economic environments, particularly where large firm size may introduce complexity and managerial inefficiencies.

In conclusion, this study enriches theoretical understanding by demonstrating that while the MM theorem's principle regarding tax benefits of debt holds broadly true, its predictive applicability to thin capitalization strategies is limited in developing economies. Hence, the findings advocate for an adapted theoretical approach that incorporates context-specific institutional and economic variables, extending and refining capital structure theory beyond the boundaries established by Modigliani and Miller.

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