

Effect Of Indirect Cost On The Profitability Of Listed Firms In Nigeria

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ABSTRACT

This study examined the effect of indirect cost on the profitability of listed brewery firms in Nigeria, the scope of the study in relation to time covers a period between 2010-2015. The study used ex post factor research design and the secondary data gathered were analyzed using regression analysis. The regression result show a strong relationship between (COR,SAW,ADC) and PROF at 75.5%. Also the R² stood at 0.570. Findings revealed that there exist a significant effect of Cost of rent on profitability of firms, there is no significant effect of Salary and wages on the profitability of firms and there exist a significant effect of Administrative Cost on the profitability of firms. In consonance with this study's findings, it is recommended that Listed firms in Nigeria should incorporate a cost reduction policy that enables cost efficiency and effectiveness these will enhance the profitability of the firms.

Keywords: Cost of rent, Salaries and wages, Administrative cost and Profitability.

INTRODUCTION

1.1 BACKGROUND TO THE STUDY

The main goal of a business organization as stated in Lucey (1993) is to make and maximize profit while other secondary goals include going concern, growth, corporate social responsibility, benefits to employees and so on. Lucey (1993) holds an opinion that a business objective is the starting point for any business organization to thrive and it provides direction for action. It is also a way of measuring the effectiveness or otherwise of the actions taken by the management of the organization. Though other objectives are also considered very important as listed above, but profit maximization is usually the ultimate because it maximizes the shareholders wealth which is the ultimate aim of investing in a business. People will naturally prefer to invest in a highly profitable business (Charles, 1998). Therefore, in the long run only the profit maximizers survive in the business environment.

However, for proper profit to be recorded from a business there is a need for adequate control of cost. As stated in Robert (2007) a company with adequate cost structure possess the higher chance of attaining its profit target. Innes, John, Mitchell and Sinclair (2000) assert that the survival triplet today for any company is how to manage product/service cost, quality, and performance. The shareholders are demanding a required rate of return on their investment from the company. Thus cost has become a residual. The challenge is being able to manufacture products or provide services within the acceptable cost framework. Innes, John, Mitchell and Sinclair (2000) concluded in their study with a recommendation that cost has to be managed in an ongoing and continuous improvement activity within the company so as to enhance profitability and survival.

There have been substantial research efforts made by different scholars using different approaches in determining what seems to be the optimal cost reduction strategy or trying to explore the theories of indirect cost for firms and the effect on the reported profit, yet there is no universally accepted findings, for example:

Okwo and Ugwunta (2012) studied the impact of input costs on firm profitability of the breweries industry in Nigeria. they among others found that general administrative expenses (overhead) had no significant relationship with profitability while, Ezekiel, Michael and Solomon (2014) who their resultt indicates that a positive significant relationship exists between cost management practices and firm's performance in the manufacturing organization. It is therefore recommended that a cost reduction strategy with

emphasis on production overhead cost and administrative overhead cost should be embarked upon if their profit maximization and wealth creation objective must be achieved. In regards to this contradicting findings of authors on the effect of indirect cost on the profitabililty of firms in Nigeria, there is a need for a further research to be carried out to ascertain the effect of indirect cost on the profitabililty of firms in order to fetch of more findings than the already existing one thus given rise to this research

1.2 OBJECTIVES OF THE STUDY

The main objective of the study is to examine the effect of indirect cost on the profitability of firms in Nigeria and its specific objectives include;

- i. To examine the effect of Cost of Rents on the profitability of firms in Nigeria.
- ii. To ascertain the Effect of Salaries and wages on the profitability of firms in Nigeria.
- iii. To examine the effect of Administrative expenses on the profitability of firms in Nigeria.

1.3 RESEARCH HYPOTHESES

The following research null hypotheses are set to be tested during the course of the study;

HO₁: Cost of Rents has no significant effect on the profitability of firms in Nigeria

HO₂: Salaries and wages has no significant effect on profitability of firms in Nigeria.

HO₃: Administrative expenses has no significant effect on the profitability of firms in Nigeria.

1.4 SCOPE OF THE STUDY

This study specifically restricts itself to the brewery manufacturing sector as a result of it been one of the sector with the highest record of sales volume and consistency on the Nigerian stock exchange (NSE) market, this study covers all the 8 listed brewery firms on the NSE, of which four selected brewery firms will be used. The scope of this study in relation to time covers a period between 2010-2015 (i.e. a period of six years) in regards to the availability of financial statements to be used during the course of this work.

REVIEW OF RELATED LITERATURE

2.1 The Conceptual framework

Studying Cost behavior as stated in Asaolu and Nassar (2007) involves ways in which costs vary or do not vary with the level of activity in an organization. The level of activity is described as the amount of work done or the number of events that have occurred. Also, Drury (2005) on the other hand, defines cost as expenses, which have been consumed in earning revenue. Profitability was

however defined by Lucey (1997) as the excess of revenue and cost. In other words, profit is determined by deducting cost from revenue. This shows the linearity of profit and cost. The term "variable" and fixed cost otherwise known as indirect and direct expenses have been traditionally used in the management accounting literature to describe how costs react to changes in activity level. Short-term variable costs vary in direct proportion to the volume of activity that is, doubling the level of activity double the total variable costs. This was assumed by Fischer and Schmitz (1998) to lead to increase in profit. Consequently, total variable costs are linear and unit variable cost is constant (Adeniji, 2011). In like manner, Horngren (2006), pointed out that a fixed cost remains unchanged in total for a given time period despite wide changes in the related level of total activity or volume. Furthermore, Horngren et al. (2009), added that costs are defined as variable or fixed with respect to a specific cost object and for a given time. More argument was brought up by Adeniji (2011) who reported that over a sufficiently long period of time, virtually, all costs are variable. During such a long period of time, contraction in demand will be accompanied by reductions in virtually all categories of costs. For example, senior managers can be relieved of their jobs, machinery may not be replaced and buildings and land may be sold. Similarly, large expansions in activity will eventually cause all categories of costs being incurred by enterprise to increase. According to Olabisi et al. (2012) Step fixed costs are fixed within specific levels of activity within a given time period. Many items of cost are fixed costs in nature within certain levels of activity i.e. relevance range exists (Asaolu & Nassar, 2007). Step fixed costs are actually increased or decreased by a constant amount at various activity levels. Semi-variable costs include both fixed and variable components. The cost of maintenance is a semi-variable cost consisting of planned maintenance that is undertaken whatever the level of activity, and variable element that is directly related to the level of activity (Horngren, 2006).

2.3 Theoretical framework

This study is anchored on the Kaizen costing theory but other theories that are relevant to the study are also discussed here.

2.3.1 Kaizen Costing Theory

According to Rof (2012) Kaizen a term with Japanese origin was propounded by Masaaki Imai, the concept is a coinage of two Japanese words: KAI (Change) and ZEN (for better) (Rof, 2012). Thereafter, Yashuhiro Monden from Japan developed Kaizen Costing as the costing counterpart to the Kaizen approach (Sani & Allahverdizadeh,

2012). This concept refers to the process of 'continuous improvement' (Rof, 2012). The principle behind Kaizen Costing application is on achieving small, gradual but continuous improvements in the production process at minimal cost (Rof, 2012).

2.3.2 The Tradeoff Theory

The tradeoff theory refers to the idea that a company chooses how much debt finance and how much equity finance to use by balancing the cost and benefits. The classical version of the hypothesis goes back to Kraus and Litzenberger (1973) who consider a balance between debt weight costs of bankruptcy and the tax saving benefits of capital structure. It states that there is an advantage to financing with debts and there a cost for financing with debts. The cost of financing with debts results mostly from financial distress i.e. bankruptcy cost of debts and non-bankruptcy cost of debts. Examples of non-bankruptcy cost include: staff leaving, suppliers, demanding disadvantageous payment terms, bond/stock holders in fighting etc.

2.4 Empirical review

The following works of various authors are reviewed in order to ascertain the effect of Indirect cost on profitability of firms in Nigeria.

Ezekiel, Michael and Solomon (2014) Investigates the relationship that exists between cost management practices and firm's performance in the manufacturing organizations using data from 40 manufacturing companies listed on the Nigeria stock exchange during the period of 2003 to 2012. Four hypotheses were formulated for the study and tested using t-statistic. The study relied on secondary data extracted from the audited financial statement of the selected companies. Direct material cost, direct labour cost, production overhead cost and administrative overhead cost were taken as independent cost management variables while profitability (Operating profit) was taken as dependent variable representing the firm's performance. The result indicates that a positive significant relationship exists between cost management practices and firm's performance in the manufacturing organization. It is therefore recommended that a cost reduction strategy with emphasis on production overhead cost and administrative overhead cost should be embarked upon if their profit maximization and wealth creation objective must be achieved.

Etale and Bingilar (2016) Examined the effect of cost management on the profitability of listed brewery companies in Nigeria. Cost management proxy by raw materials cost, work in progress cost and finished goods cost was regressed against profitability proxy by gross profit margin.

Secondary time series data was collected from the annual reports and accounts of selected brewery companies from the Nigeria Stock Exchange from 2005 to 2014. A multiple regression technique using the computer software statistical package Windows SPSS 20 version to analyse the data obtained from NSE. The study revealed that efficient cost management have positive influence on the profitability of brewery companies in Nigeria. Based on the findings, the study recommended that brewery companies should adopt effective and efficient inventory cost management practices; deploy appropriate modern technology for effective inventory cost management; and employ capable and qualified staff who should be trained regularly on proper and efficient inventory cost management

Kim and Robert(2014) Took a study to integrate research from strategy, economics, and applied psychology to examine how organizations may leverage their human resources to enhance firm performance and competitive advantage. Little research has examined whether and why staffing and training influence *firm-level* financial performance (profit) *growth* under different environmental (economic) conditions. Using 359 firms with over 12 years of longitudinal firm-level profit data, we suggest that selective staffing and internal training directly and interactively influence firm profit growth through their effects on firm labor productivity, implying that staffing and training contribute to the generation of slack resources that help buffer and then recover from the effects of the Great Recession. Further, internal training that creates specific human capital resources is more beneficial for prerecession profitability, but staffing is more beneficial for post-recession recovery, apparently because staffing creates generic human capital resources that enable firm flexibility and adaptation. Thus, the theory and findings presented in this article have implications for the way staffing and training may be used strategically to weather economic uncertainty (recession effects). They also have important practical implications by demonstrating that firms that more effectively staff and train will outperform competitors throughout all pre- and post-recessionary periods, even after controlling for prior profitability.

Abowd, Kramarz and Margolis (1999) show that while worker- "quality" is most important in explaining overall individual wage variation, firm specific effects are also significant and the two are not highly correlated. What are these firm-specific effects? There is evidence that part of the effect is related to the profitability of the firm. Firms that have more profits appear to pay higher wages than otherwise identical firms. Manning (2011) reviews this literature. There are two key

difficulties with this body of evidence. First, most studies use data on the average wage in a firm, so the panel is at the firm-level rather than the individual-level. This then raises the concern that more profitable firms hire more-able workers and that the positive correlation is capturing this effect.

METHODOLOGY

3.1 Research Design

The study adopts ex-post facto research design. Ex-post facto research design involves the ascertaining of the impact of past factors on the present happening or event.

3.2 Data Analysis Technique

The descriptive statistics is used to summarize the collected data in a clear and understandable way using numerical approach. The multiple regression technique using ordinary least square regression (OLS) method is adopted in investigating the relationship between the dependent and independent variables. The study adopts the preliminary test for incidences of co linearity in the model are also necessary. To do this, the variance inflation factor (VIF) statistics and the tolerance level statistics were deployed to be used. The main advantage of these two statistics is that it filters out variables that might distort the result of regression analysis.

3.3 Model Specification

$$PAT_{it} = \alpha + \beta_1 COR_{it} + \beta_2 SW_{it} + \beta_3 AEX_{it} + U_{it}$$

α = Constant

COR = Cost of rent (The natural log of Cost of rent of the firm at that time)

SW = Salaries and Wages (The natural log of Salaries and wages of the firm at that time)

AEX = Administrative expenses (The natural log of administrative expenses of the firm at that time)

PAT = Profit after tax (The natural log of Profit after tax of the firm at that time)

FT = Firm (_F) at time (_T)

U = Error term used in the model.

$\beta_1, \beta_2, \beta_3$ = Beta coefficient of the independent variables.

Decision Rule

Accept the null hypothesis if the calculated value is greater than the significant level of 0.05.

DATA PRESENTATION AND ANALYSIS

4.1 Data Analysis

4.1.1 Data Validity Test

In order to ensure that the results are robust, several diagnostic tests such as variance inflation factor (VIF) and Tolerance statistics were computed as shown in Table 4.1, 4.3 & 4.4.

The Variance Inflation Factor (VIF) statistics for all

the independent variables consistently fall below 2.520. This indicates the absence of multi collinearity problems among the variables under investigation (Berenson and Levine, 1999). This statistics ensures that the independent variables are not so correlated to the point of distorting the results and assists in filtering out those ones which are likely to impede the robustness of the model. There is no formal VIF value for determining presence of multi collinearity. Values of VIF that exceed 10 are often regarded as indicating multi collinearity, but in weaker models values above 2.5 may be a cause for concern (Kouisoyiannis, 1977; Gujarati and Sangeetha, 2007). Thus, this model exhibit low risk of potential multi collinearity

problems as all the independent variables have a variance inflation factor (VIF) below 5 (Myers, 1990). This shows the appropriateness of fitting of the model of the study with the three independent variables.

In addition the tolerance values consistently lie between 0.940 and 0.397 (see table 4.4). Menard (1995) suggests that a tolerance value of less than 0.1 almost certainly indicates a serious collinearity problem. In this study, the tolerance values are more than 0.1; this further substantiates the absence of multicollinearity problems among the explanatory variables.

4.1.2 Descriptive Statistics

The descriptive statistics for both the dependent and independent variables are presented in table 4.1 below:

Descriptive Statistics						
	N	Minimum	Maximum	Mean		Std. Deviation
	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic
PROF	24	5.46	7.63	6.8077	.12537	.61419
COR	24	5.33	7.18	6.5600	.11893	.58265
SAW	24	.00	7.32	6.4960	.29269	1.43386
ADC	24	.00	7.48	6.3032	.40440	1.98117
Valid N (listwise)	24					

Table 4.1 presents the descriptive statistics of all the variables. N represents the number of paired observations and therefore the number of paired observation for the study is 24.

Profitability reflects a mean of 6.8077 and a standard deviation of 0.61419, it has a minimum value of 5.46 and a maximum value of 7.63. The Cost of rent (COR) has a mean of 6.5600 with a deviation of 0.58265 also, with a minimum and maximum value of 5.33 and 7.18 respectively. The result also reveals that, Salaries and wages (SAW) has a minimum and maximum value of 0.00 and 7.32 respectively and reflects a mean of 6.4960 with a deviation of

1.43386 and Administrative expenses (ADC) with a mean of 6.3032 with a deviation of 1.98117 while it reflects a minimum and maximum value of 0.00 and 7.48.

The result of the descriptive statistics in respect to the study's independent variables indicates that Nigerian brewery firms consider the Cost of rent more as a major variable of indirect cost that influence the financial performance of firms as a result of its high mean, the reason for this could be due to the fact that firms incur more cost on rent on different facilities which enhances their performance and in turn burst their profitability.

4.1.3 Regression of the Estimated Model Summary

This section of the chapter presents the results produced by the model summaries for further analysis.

Table 4.2: Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.755 ^a	.570	.505	.43208	.570	8.824	3	20	.001	.883

a. Predictors: (Constant), ADC, COR, SAW

b. Dependent Variable: PROF

Table 4.2, presents the regression result between COR, SAW, ADC and PROF. From the model summary table above, the following information can be distilled.

The R value of 0.755 shows that, there is a strong relationship between (COR,SAW,ADC) and PROF at 75.5%. Also the R² stood at 0.570. The R² otherwise known as the coefficient of determination shows the percentage of the total variation of the dependent variable (PROF) that can be explained by the independent or explanatory variables (COR,SAW and ADC). Thus the R² value of 0.570 indicates that 57.0% of the variation in the PROF of listed brewery firms can be explained by a variation in the independent variables: (COR,SAW and ADC) while the remaining 43% (i.e. 100-R²) could be accounted by other variables not included in this model.

The adjusted R² of 0.505 indicates that if the entire population is considered for this study, this result will deviate from it by only 0.065 (i.e. 0.570 – 0.505). This result shows that there is a deviation of the sample examined and the total population by 6.5%.

The table further shows the significant change of 0.01 with a variation of change at 57.0% indicate that the set of independent variables were as a whole contributing to the variance in the dependent.

The results of the model summary revealed that, other factors other than COR, SAW and ADC can affect the profitability of listed firms. According to Ezekiel, Michael and Solomon (2014) this factors include Direct material cost, direct labour cost, production overhead

4.1.4 Regression Results

Regression analysis is the main tool used for data analysis in this study. Regression analysis shows how one variable relates with another. The result of the regression is here by presented in this section.

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.	Correlations			Collinearity Statistics	
	B	Std. Error	Beta			Zero-order	Partial	Part	Tolerance	VIF
(Constant)	2.587	1.208		2.142	.045					
1 COR	.473	.159	.449	2.965	.008	.287	.553	.435	.940	1.064
SAW	-.087	.099	-.204	-.881	.389	.365	-.193	.129	.401	2.494
ADC	.267	.072	.863	3.704	.001	.598	.638	.543	.397	2.520

a. Dependent Variable: PROF

The regression result as presented in table 4.3 above to determine the relationship between COR, SAW, ADC and PROF shows that when the independent variables are held stationary; the PROF variable is estimated at 2.587. This simply implies that when all variables are held constant, there will be a significant increase in the PROF of listed firms up to the tune of 2.587 units occasioned by factors not incorporated in this study. Thus, a unit increase in COR will lead to a significant increase in the PROF by 0.449. Similarly a unit increase in SAW will lead to a significant decrease in PROF by 0.204. Also a unit increase in ADC will lead to a significant increase in PROF by 0.863.

4.2 Test of Research Hypotheses

The hypothesis formulated in chapter one will be tested in this section inline with the decision rule. Accept the Null hypothesis if the calculated value is greater than the significant level of 0.05.

4.2.1. Test of Research Hypothesis One

Ho₁: Cost of rent has no significant effect on the Profitability of listed firms.

Given that the significant level is 0.05 and the calculated value for Cost of rent (0.008) is less than

the significant level, we therefore reject the Null hypothesis.

4.2.2. Test of Research Hypothesis Two

Ho₂: Salaries and wages has no significant effect on the Profitability of listed firms

Given that the calculated significance level for Salary and wages is 0.389 which is greater than the accepted significance level of 0.05, therefore the null hypothesis accepted and the alternative accepted.

4.2.3. Test of Research Hypothesis Three

Ho₃: Administrative cost has no significant effect on the Profitability of listed firms.

Given that the significant level is 0.05 and the calculated value for Administrative cost (0.001) is less than the significant level, we therefore reject the Null hypothesis.

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary of Findings

The following are the summary of the major findings of this study arrived at through the test of the research hypotheses earlier formulated in this study.

- There is a significant effect of Cost of rent on

profitability of firms.

- There is no significant effect of Salary and wages on the profitability of firms.
- There is a significant effect of Administrative Cost on the profitability of firms.

5.2 Conclusions

The study made the following conclusions in line with the findings:

- Cost of rent has a significant effect on the profitability of firms.
- Salary and wages has no significant effect on the profitability of listed firms.
- Administrative cost has a significant effect on the profitability of listed firms.

5.3 Recommendations

In consonance with this study's findings, it is recommended that Listed firms in Nigeria should incorporate a cost reduction policy that enables cost efficiency and effectiveness these will enhance the profitability of the firms this assertion is supported by the findings of The comparative study conducted by Joshi (2001) revealed that Indian manufacturing companies rely heavily on the traditional management accounting techniques such as variable costing, budget for day-to-day operations, capital budgeting tools, return on investment based performance evaluation, and performance evaluation.

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