

**THE RELATIONSHIP BETWEEN CAPITAL STRUCTURE AND
FINANCIAL PERFORMANCE OF TOURISM STATE
CORPORATIONS IN KENYA: A CASE STUDY OF TOURISM
FINANCE CORPORATION SUBSIDIARIES**

BY

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DECLARATION

This Research project is my original work and has not been presented for a degree in any other university.

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DEDICATION

This project is dedicated to my family especially my Wife and my two daughters Edelqueen Nyabokei and Gabriella who gave me ample time and support during my study period.

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LIST OF ABBREVIATIONS

DIIs - Domestic Institutional Investors

KTDC - Kenya Tourist Development Corporation

ROA - Return on Assets

ROCE - Return on Capital Employed

ROE - Return on Equity

SMEs - Small and Medium Enterprises

TFC - Tourism Finance Corporation

DFI - Development Financial Institution

ABSTRACT

The choice between debt and equity financing has been directed to seek the optimal capital structure. Several studies show that a firm with high leverage tends to have an optimal capital structure and therefore it leads it to produce good performance, while the Modigliani-Miller theorem proves that it has no effect on the value of firm. The importance of these issues has only motivated researchers to examine the relationship between capital structure and firms financial performance. The purpose of the study was to investigate the relationship between capital structure and financial performance of tourism state corporations in Kenya with reference to Tourism Finance Corporation subsidiaries. The relationship between capital structure and financial performance was explained through various theories such as Trade-off Theory, Pecking Order Theory, Market Timing Theory and Modigliani and Miller. The study adopted descriptive research design where data was retrieved from the Statement of Financial Position, Income Statements and Notes of five (5) TFC subsidiaries in Kenya during the period 2011-2015. The relationship between the dependent variable and the independent variables was determined by the use of the linear regressions. The data was analysed using Statistical Package for Social Sciences (SPSS) and Microsoft (MS) Excel. The significance of capital structure variable as a predictor of financial performance was tested using the t-test. The significance of the overall model in explaining performance through the independent variables was measured through the f-test. The coefficient of determination (R^2) was used to measure the strength to which independent variables explain variations in the dependent variables. The research findings established that the independent variables (Debt ratio, Asset Tangibility and asset turnover) explain and can therefore predict the financial performance of TFC subsidiaries. These variables could explain 100% of the variations in profits of TFC subsidiaries ($r^2=1.00$). This indicated that the regression model had a very strong explanatory power as all the variability in profitability in the TFC subsidiaries could be explained by the model. The goodness of fit results of standard linear regression with ROA as the dependent variable and various determinants as predictors are reported in Table 4. The model summary is in Table 3. The model reveals that there is a statistically significant relationship between ROA and determinants (Sig. < 0.05). The model coefficients are shown in Table 5. The findings indicate that all of the indicators of ROA were significant ($p < 0.05$ in all cases). The study explored the relationship between ROA and various determinants by suggesting that there is a statistically significant relationship between ROA and capital structure and other determinants. Results of the study indicate that the relationship between ROA and capital structure and other determinants is statistically significant ($p < 0.05$) for all the three predictor variables (debt ratio, asset turnover and asset tangibility). The null hypothesis was therefore rejected, meaning that there is a significant relationship between ROA of TFC Subsidiaries and capital structure, asset turnover and asset tangibility. The results of his study revealed a significant impact of all the factors of liquidity and leverage on financial performance of commercial state corporations in the tourism industry in Kenya.

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

Business failure can be solved by use of strategies that involves financing decisions which propel growth and realization of set targets. For this reason, financing decisions cannot be over looked (Salazar, Soto & Mosqueda, 2012). The financial performance of a firm is gauged by evaluating the share values at the period end compared to its value at the beginning (Roshanak, 2013). Capital structures are as a result of financing decisions and if such decisions are not optimized it can often result in corporate failure. The existence of an optimal capital structure still remains a mystery to both investors and management alike. All financial decision makers' objective is to maximize wealth and the quality of their decisions can be measured by examination of the decision impact on the performance of the firm (Mwangi, Makau & Kosimbei, 2014).

Debt and equity comprise capital structure. Equity sources of financing include shares, bonds and debentures. Modigliani & Miller (MM) (1958) set out a base for developing a capital structure through their presentation of paper. The paper gives the situations in which a capital structure can be relevant or otherwise to listed companies' financial performance. Certain factors explain the variance in financial leverage across firms. Such factors include cost of borrowing, tax rates, interest rates, availability of collateral, size of the firm, et cetera (Titman & Wessels, 1998). After consideration of such factors, a firm can then choose a debt to equity ratio that best suits and benefits the organization (Pratheepkanth, 2011).

1.1.1 Capital Structure

The capital structure provides the blend of a company's sources of finance which include debt and equity. It gives a structure of how a firm finances its assets either by debt (long term or short term), equity (common or preferred) or a hybrid of the two (Saad, 2010). Capital structure is important in explaining how an organization finances its growth and operations by use of various sources of funds (San & Heng, 2011). The ownership structure of the firm is a mixture of its liabilities and it gives a combination of current liabilities, for example, creditors and bank overdrafts and non-current liabilities, for example, ordinary and preference shares, debentures, convertible loans, banks loans, et cetera (Saad, 2010).

Capital structures vary according to firms. One which has no debt is called an unleveraged firm and has an all-equity capital structure (Ahmadpour & Yahyazadehfar, 2010). It is however difficult to establish the capital structure of a firm and much less what the optimal capital structure is given that companies have to issue securities in very many different combinations in order to come up with a certain mixture which can optimize its value hence optimal capital structure (San & Heng, 2011).

1.1.2 Financial Performance

A firm's performance is measured by appraising particular indicators, efficiency, effectiveness, green environment and waste reduction (Ngugi & Karina, 2013). The of a firm's performance is a multidimensional derivative which is derived from four elements (Alam et al. 2011).

Tourism Finance Corporation is the leading development finance institution in the tourism sector. It provides accessible financial services and business advisory services to the tourism industry in Kenya. Its mission is based on development and diversification of the Kenya's tourism industry through provision of financial services to tourism sector investors. TFC also provides business advisory services to the private investor at economical costs. This is meant to ensure that they rise to the investment challenge and also enhance the opportunities presented in the economy globally. The services entail preparing feasibility studies, evaluation of businesses, strategic advisory services and researching the market developments.

1.1.3 Capital Structure and Financial Performance

Titan and Zeitun (2007) argued that capital structure and performance's relationship has got many researchers' attention in finance. The options a firm has in investment is determined on its performance and also debt equity which influences the choice of capital structure and debt maturity structure. It is expected that capital structure will be positively correlate with the financial performance of firms.

Firms with high growth potential may borrow loans and issue new bonds compared to low growth ones. In the future when a firm decides to issue debt it will be exposed to bankruptcy risk due to increased debt cost leading to reduced performance (Ross, 1977). In the examining opportunities of growth in capital structure, Myer (1997) perceived firms with high growth to likely be suffering from challenges in debt management. In effect, this may result to high risk which is accompanied with debt being an opportunity cost of profitable opportunities to invest. Additionally, more emphasis by firms will be on equity sources compared to debt sources to mitigate the

risk and to finance projected growth opportunities, thus reflecting positively on performance (Hovakimin et al., 2011).

1.1.4 Tourism Finance Corporation Subsidiaries in Kenya

KTFC is a development finance institution mandated to provide accessible and economical financial products and advisory services to the tourism industry in Kenya. Its mission is to enhance growth and broaden the tourism industry in Kenya by the development of a range of financial products, services to existing and potential tourism investors. The corporation provides business development services to the private sector at competitive prices which are based on the challenges and leveraging on the opportunities in the local, regional and global economies.

Tourism Finance Corporation subsidiaries comprise of Kenya Safari Lodges and Hotels, Golf Hotel Kakamega, Sunset Hotel, Mt. Elgon Lodge and Kabarnet Hotel. Kenya Safari Lodges and Hotels were started in 1966. Main shareholders are KTDC, CDC, Mountain Lodge (TPS) and Kenya Wildlife Service. Sunset Hotel commenced its business 26th November 1977. It is owned by the government through KTDC. It's conjointly owned with the Municipal Council of Kisumu (Tourism Finance Corporation, 2016).

Kabarnet Hotel opened its doors in the year 1980 being under the management of Kenya Tourism Development Corporation; currently known as Tourism Finance Corporation. Kabarnet Hotel is located in the tranquil suburbs of Kabarnet Town, off the Kabartonjo road. The corporation holds 98% shares with the remaining 2% shares owned by Kipngochoch farm Ltd. Golf Hotel was started in the 1979, located in a splash area of Kakamega town next to the Golf Course. The corporation holds 98%

shares. Mt. Elgon Lodge Ltd is housed in a grand colonial building located in the suburbs on the Eastern slopes of Mt. Elgon bordering Mt. Elgon National park. The corporation holds 72.91% shares with the remaining shares held by Trans Nzoia County (Tourism Finance Corporation, 2016).

1.2 Research Problem

Sound financial performance of firms enables firms to manage various types of risks (Sangmi & Nazir, 2010). Theoretically, a positive relationship between a firm ownership structure and performance is expected to exist. This argument is inconsistent with several previous studies conducted. Some studies have come up with different results. This research addressed the research question from the perspective of the TFC subsidiary companies and utilized indicators such as ROA, debt ratio, asset turnover and asset tangibility to answer the research question. The adoption of optimum capital structure by the TFC subsidiaries is expected their financial performance to improve.

Ebaid (2009) conducted a research on the choice of capital structure on the performance of firms in Egypt. To measure financial performance, he used Return on Equity, Return on Assets and gross margin ratios. The results of the study revealed that capital structure had little or did not have any effect on the performance of the firm. This conclusion was inconsistent with an empirical study done by Hadlock and James (2002) who found a positive significant effect of financial leverage and performance of the firm. The results of a study done by Berger and Udell (2006) revealed a negative relationship between lower equity capital and higher financial

performance. This contradiction provides room for more research and consideration of more variables in further investigations.

In a study to examine the relationship between capital structure and profitability of industrial and allied sector at the NSE, Kaumbuthu (2011) established that capital structure was negatively related with financial performance. Capital structure was measured by debt equity ratio while financial performance was measured by return on equity. The study concentrated on one sector of the listed firms and emphasized on financing decisions only. This implies that the study results cannot be generalized to other sectors.

The observations above reveals mixed results on the association between capital structure variables and financial performance indicators. Both global and local studies examined elicit mixed results. Further, there is no study which has been done systematically to explain the effect of capital structure on financial performance of Tourism Finance Corporation subsidiaries. This necessitated an investigation to evaluate the association. The study intended to answer the question; what is the correlation between capital ownership structure and financial performance of Tourism Finance Corporation subsidiaries in Kenya?

1.3 Research Objective

The objective of this study was to investigate the effect of capital structure on financial performance of tourism state corporations in Kenya with specific reference to the Tourism Finance Corporation Subsidiaries.

1.4 Value of the Study

Tourism Finance Corporation (TFC) is the only state commercial agency in Kenya that is mandated to provide finance and business development services to the tourism industry. TFC was established by an Act of Parliament, Chapter 382 laws of Kenya. In fulfillment of its mandate, the Corporation provides project and loan funding to existing and potential investors coupled with business advisory services, in the form of consultancy services, enterprise valuations, business plans and baseline surveys.

The findings of the study will help the management of the TFC to make essential investment decisions in pursuit of driving the growth of the economy of Kenya. It will also help in evaluation of the financing decisions of the subsidiaries in view of the performance of the tourism sector.

The study will provide a basis for further research because students and other academic researchers will use the findings to form basis for further knowledge and critique it for the development of knowledge in issues involved in the study. The study further adds to existing literature in order to verify the claim of traditional theory of capital structure.

Financial practitioners will make critical decisions for any business organization and to exercise their decision with respect to capital structure decisions and have the ability to deal with the competitive environment

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter has reviews the theoretical and empirical literature in the study. Theoretical review literature reviews past studies related to the current study. The subsections review the theory and empirical studies which provide evidence on the impact of capital structure on financial performance of companies in order to identify the potential gaps on the present study.

2.2 Theoretical Review

Different scholars have come up with several theories to explain capital structure. The study was guided by four major theories relevant in the evaluation of ownership structure and its effect on the performance of TFC subsidiaries in Kenya. These include: Market timing Model, Trade-off Theory, Perking- Order Theory, & Modigliani-Miller theorem.

2.2.1 Trade off Theory

Famously known associated with Kraus and Litzenberger (1973), this theory states that managers tend to choose the capital structure that provides a balance between debt's tax advantage and the agency costs as payments of interest is made by firms from the taxable income. Further, borrowing is directly correlated with agency costs of debt. Particularly, debt increases the chances that the firm will likely face financial distress and other related costs. This theory suggests that companies evaluate the tax

savings of the debt against the expected financial distress costs when making choices on capital structure (Megginson, Smart & Gitman, 2007).

According to this theory, corporations are financed by debt and equity. The theory states that there are more advantages of debt financing as the marginal benefits of decrease in debt as the marginal cost increases. For a company to maximize its optimal value, it tends to shift its focus to this trade-off when making decisions on how much debt and equity to use in financing (Kraus & Litzenberger, 1973).

2.2.2 Pecking-Order Theory

This theory is pegged on the assumption that managers understand their firms better than investors themselves. This leads to asymmetrical information. Holding all other factors constant, due to disparity of the information, managers will issue debt when their firms' future holds positive prospects and when unsure they will issue equity (Pandey, 2015). Myers (1984) argued since firms do not have a well-defined debt equity target and there are two equities, that is, internal and external, the pecking order theory as one is on the top and the other one is at the bottom. Because of this lower value is place by investors when new equity is issued.

Managers follow a preference order of retained earnings to debt to external equity Weiner (2006). With the case of retained earnings, there are no floatation costs which are incurred whereas debt is used to avoid dilution of shares. Equity is least preferred because with it, floatation costs are incurred and there is dilution of firm's ownership because risks are spread among various and increasing stakeholders.

2.2.3 Market Timing Model

The theory explains the debt-equity choice as developed by Baker and Wurgler (2000). The concepts of the theory suggests that companies study the market and issue equity when share prices are high and also issue debt when share prices are low. Therefore the capital structure of a company will reflect the cumulative effect of the past market timing activities of the managers. According to this theory, companies that raise their capital when stock prices are low are highly levered while firms that raise capital when share prices are high are considered to be lowly levered. Proponents of this theory cite studies that support their theory. One of the studies is Graham and Harvey's (2001) survey where the executives reported that the level of stock prices affected their decisions on issuing equity (Megginson et al, 2007).

2.2.4 The Modigliani and Miller Theory

This theory forms the foundation of modern thinking in capital structure although it is regarded by its critics as purely theoretical because it makes assumptions that are critical to the capital structure determination process. Modigliani and Miller argued that in a tax less economy, cost of capital remains independent of changes in the capital structure. This can only be possible in a perfect efficient market and two identical firms with similar capital structure must command the same value. If this is not the case and investors realize the differences in firm value, they will practice arbitrage, by selling their ownership in overvalued firm and buying shares in undervalued firm, until the two firms have the same market value. Where the assumptions held in proposition I are removed step by step, this was to lead to capital structure puzzle (Myers, 1984).

In 1963, Modigliani and Miller Introduced corporate tax to proposition I. It was revealed that higher value is placed on levered firm compared to unlevered firm. According to tax legislation interest on debts is tax allowable while dividends are not tax allowable this explains the reason on why high value is placed on levered firms compared to unlevered firms. In 1978, proposition II was modified by Miller include both corporate and personal taxes. The proposition holds that personal taxes do not eliminate, but reduces net leverage benefit (Pandey, 2015).

2.3 Determinants of Financial Performance

According to Daniel and Press (2008), measures of organizational performance target, shareholders return, product and market outcomes and financial outcomes. Accounting, financial indicators and ratios frequently used to measure performance of organizations. Performance analysis can be based on multivariate dimensions and this section only looked at the financial part. Previous studies have documented several determinants of financial performance of firms. It is therefore imperative to discuss these factors.

2.3.1 Size

The performance of a company could be determined by its size. Big firms can leverage their size to obtain better deals in terms of finance, products and other factor markets (Mathur and Kenyon 1998). Large firms can obtain rent from product markets in which they are dominant in addition to being able to access key factor inputs such as land, labor and other non-human resources (Hill, 1985). Hardwick (1997) postulated that there is a positive association between the performance and size

of companies. This is because large companies have efficiencies in operating costs due to their increasing output and economies of scale.

2.3.2 Leverage

More importantly, the performance of a firm is affected by its capital ownership (Kakani & Reddy, 1996). According to Margaritis and Psillaki (2010) capital structure and company performance are positively correlated. Vithessonthi's and Tongurai (2015) concluded that debt correlates negatively with the performance of a firm, but they also found moderating effects on their result.

The traditional Modigliani-Miller classical theory hypothesizes the irrelevance of financial structure to the performance of the firm because in a free market without disparity information and contract management costs, only the real factors that influence the firm's performance. Myer's (1984) According to the pecking order hypothesis; Firms would rather retained earnings compared to debt and they prefer debt to new equity to finance new capital projects. Additionally, firm's cost of capital is dependent on its source of financing.

2.3.3 Domestic Institutional Investors

It involves the amount of equity shares held by the financial institutions and nationalized banks of the public sector in public limited companies. Large firms investment requirement were financed by financial institutions. Since the institutions fund large firms by both debt and equity, it exposes them. The debt-equity positions leads to institutional arrangements where institutions exercise major management control over firms and in times of distress economies (Kakani et al., 1996).

It has been argued that DIIs ownership affects the performance of a firm by presenting constraints to their strategies given that the consent of the financial institutions is often required before any major decisions are made (Sridev, 1998). Such structures help firms to gain access to financial resources usually at lower costs as such financial institutions extend cheaper credit as part of policy initiatives of the state to finance aggressive growth.

2.3.4 Working Capital Ratio

The solvency position of a business shows how much a firm currently has in form of liquid assets to fund its growth, produce value and build its business. The working capital ratio usually gives usually a firm's long term solvency position and is a derivative of the industry it operates in. If a firm can manage the amount of money held up in the business, it can be liquid. Consequently reduce the cost of debt or this will also support more sales and additional investments. This can also be achieved if they negotiate for better terms with suppliers (Gup, 1983).

A firm may experience reduced long term solvency position if it is growing and its present activity is considered to have increased compared to a corresponding period of time in the preceding year. Fast expansion of a firm represents a need for more cash to increase working capital and investments. A firm may face financial distress if its industry experiences poor working capital management (Martin et al, 1991).

2.3.5 Inflation

A country's economic conditions affect firms and hence their performance. One macroeconomic variable of a country is the inflation rate. A higher inflation rate

adversely affects the performance of a firm (Mirza & Javed, 2013). This is in line with Forbes (2002) who investigated how large depreciations affect a firm's performance.

2.4 Empirical Evidence

Sam and Heng (2011) looked at capital structure and its impact on performance of listed companies in Malaysia for the period between 2005 and 2008. They investigated the construction companies. The firms were grouped into paid up capital which comprised of large, medium and small companies. The study found out that capital structure had a significant effect on the corporate performance. The study also revealed that there was no relationship between the variables investigated.

Goyal (2013) analyzed the effect of capital structure on financial performance of public sector banking firms in India between 2008 and 2013. His study revealed a positive association between capital structure as measured by short term debt and ROA, ROE and EPS using multiple regression analysis.

Pouraghajan et al (2012) conducted a study to examine the relationship between the capital structure and performance of listed firms at the Tehran stock exchange between 2006 and 2010. Return on Equity and Return on Assets were regressed against debt ratio. The results showed a strong negative correlation between performance and debt ratio. The study also revealed a positive significant correlation between financial performance and asset turnover, asset tangibility, company size and growth opportunities. The results of the study also revealed that reduction of debt ratio will lead to increase in profitability thus shareholder wealth will also increase as a result of the improved firm performance.

A study by Priya and Nirajini (2013) to examine the effect of capital structure on performance of listed companies in Sri Lanka from 2006 to 2011 showed that capital structure had a significant effect on the financial performance of the firms. Using regression analysis at 5% and 1% significance levels, the study revealed that long term debt, debt/equity ratio was strongly associated with the profitability measures. The profitability measures were gross profit margin, return on assets, return on equity and return on capital employed.

A study conducted by Ebaid (2009) in Egypt to examine how choices of capital structure affected firms. Return on Equity, Return on Assets and gross profit margin were utilized as the measures of financial performance. To establish the measures of capital structure, the study used total debt to total assets ratio, long term debt to asset ratio and short term debt to asset ratio. In order to establish the relationship between performance and leverage levels, multiple regressions were used. The results of the study conclusively revealed that capital structure had an insignificant effect on the firms' performance.

In his study on the effect of capital structure and firm's performance, Adekunle (2009) concluded that debt ratio had a significant effect on the firm's financial performance. The study used a proxy of debt ratio to measure capital structure. The measures of financial performance in this study were Return on Assets and Return on Equity. The study however considered mediating effect on internal cash flow as one of the financing decisions which was also available in the analysis.

A panel data approach was used by Abor (2007) on 160 and 200 SMEs from Ghana and South Africa respectively. The objective of the study was to establish the association between leverage and the performance of the firms. The results of the study showed that under extreme reliance on debt, the firms will not enjoy tax shields due to the negative effect of leverage levels on the financial performance. In effect, this will lead to increased cost of debt which easily exposes the firms to risk of bankruptcy hence reducing their returns.

Mwangi and Birundu (2015) conducted a study to investigate the impact capital structure has on the financial performance of SMEs in Thika County for the period 2009 to 2011. The research design used in the study was a descriptive design and multiple regressions together with correlation analysis were utilized. The study observed that capital structure, asset tangibility and asset turnover are not significant in the financial performance of the firms under study.

A study by Kaumbuthu (2011) was carried out to examine how capital structure and return on equity related. The firms which were considered were industrial and other sectors in the NSE from 2004 to 2008. Debt to equity ratio and return on equity were used as the measures for capital structure and performance respectively. The study revealed that capital structure was negatively correlated with financial performance. However, the study focused on one sector only. This sector was the companies listed at the NSE. While determining the impact of financing decisions on financial firms, the study concentrated on all non-financial firms listed at the NSE. The study also considered one dimension of financing decisions. With the preceding considerations, the conclusions arrived at cannot be generalized in other sectors.

Maina and Kondogo (2013) analyzed the relationship between capital structure and performance of listed firms at the NSE for the period from 2001 to 2011. Using regression analysis, the study revealed that there was a negative relationship between capital structure as measured by debt ratio and financial performance of the firms listed at the NSE. The research found out that the firms preferred short term debt to long term debt in their capital structure.

Muhaji (2014) did a research to investigate how liquidity and debt affected the financial performance of commercial state corporations in Kenya's tourism industry. Correlation analysis and multiple regressions analysis were used on a data covering years 2008 to 2012. During the study, the operating profit margin was the dependent variable and debt ratio was the independent variable. The study results revealed that there was a negative insignificant relationship between debt and firm profitability.

A study conducted by Omar (2009) examined how capital structures affect the performance of pharmaceutical firms in Kenya. The study used debt ratio and return on assets to measure capital structure and financial performance respectively. The study also utilized Ordinary Least Squares estimation method. The results of the study showed that debt ratio had a significant negative effect on firm performance. The study did not make a consideration of financing decisions like the available internal cash flow.

2.5 Summary of Literature Review

The literature review has in a broad manner introduced capital structure together with its effects on firms' performance both locally and globally. It has also extensively discusses various theories underlying capital structure. The performance of firms cannot solely be determined by capital structure. A global study on the public sector banks shows a strong positive correlation of capital structure with all profitability measures applied. These measures include return on assets, return on equity and earnings per share.

Some of the study results have established a significant negative association between debt ratio and financial performance. The reviewed studies have revealed that the management can help increase a firm's performance by debt ratio reduction. The increase of a firm's performance will consequently translate to shareholder wealth increase. It has also been established that high debt ratios can result into negative effect on the performance of firms. When there is a heavy reliance of debt, firms will not enjoy tax shield. This will result into high debt costs exposing the firms to high bankruptcy risks and reduced returns.

Conflicting conclusions have been observed on the review of the local studies on the association between capital structure and financial performance. The study done on the SMEs has revealed that capital structure do not have a significant effect on the financial performance. The factors variables considered were asset turnover and asset tangibility. This implies that more control variables need to be considered. Studies done on the Kenya industrial sector show that there is a negative relationship between

debt to equity ratio and return on equity. A study by Muhaji (2014) on the commercial tourism state corporations revealed that there was a negative relationship between leverage and performance of the corporations considered. The study considered liquidity ratio and leverage ratio as the independent variables. However, there is need to consider more variables like asset tangibility and asset turnover in the tourism industry state corporations.

Evidently, both local and global studies have established mixed conclusions on the effect of capital structure indicators and financial performance indicators over varied periods in time. There is deficiency of studies on capital structure in Kenya despite the importance of corporate financial decision on firms. This study therefore sought after establishing if there was a relationship between capital structure and financial performance of tourism state corporations in Kenya with reference to Tourism Finance Corporation Subsidiaries.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The purpose of the study was to examine the relationship of capital structure and financial performance of tourism state corporations in Kenya with a special reference to the TFC subsidiaries. This section elaborated the research design, the study population, the sample size, data collection and analysis methods.

3.2 Research Design

Descriptive research design was used in the study. It was chosen because it allowed the analysis and relation of the variables under study. According to Cooper and Schindles (2003), a descriptive study design is used to describe or define, often by creating a profile of a group of problems, people or events, through the collection of data and tabulation of the frequencies on research variables or their interaction.

3.3 Population and Sample

Ngechu (2006) defined a population as a complete set of individuals, cases, events or objects having common observable characteristics which a researcher wants to generalize the findings. Different populations are heterogeneous. The population of this study comprised of all the five Tourism Finance Corporation subsidiaries in Kenya as at 30th June 2015 (See Appendix 1). Therefore a census survey will be carried out.

3.4 Data Collection Instruments

Secondary data was obtained from the audited annual financial reports by the Kenya National Audit Office (KENAO) and used in the study. The researcher developed a data collection sheet, which also helped in calculating ROA as the dependent variable, was used to calculate and capture the capital structure measures of debt ratio, asset turnover and asset tangibility. The study covered the period between 2011 and 2015.

3.5 Data Analysis

To determine the association between variables used in the study (both the dependent and the independent), multiple linear regression analysis was used. The data analysis tools used in the study were the Statistical Package of Social Sciences and Microsoft Excel. The regression model was of the form;

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon \text{ Where;}$$

$$Y = \text{Financial Performance (ROA)}$$

X_1 =Debt ratio (total debt to total asset ratio), X_2 =Asset tangibility (net fixed assets to total assets ratio), X_3 =Asset turnover (Sales to total assets ratio), β_0 =Regression constant, ε =Error term of the regression model and β_1 - β_3 = regression coefficients.

The t-test was used to test the significance of the dependent variable in measuring the independent variable in the study. On the other hand, F-test was used to measure how significant the overall was in explaining the association of the variables. The coefficient of determination was also used to measure the strength to which the independent variables explained the variations in the dependent variables.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This section provides six main sections. Section 4.2 provides details on the response rate. Section 4.3 gives details on the data validity used in the study. Sections 4.4 to 4.6 provide the results of data analysis. These include descriptive statistics, correlation analysis and regression results. Section 4.7 gives a conclusive summary of the data analysis and results.

4.2 Response Rate

The study relied on secondary data from the Tourism Finance Corporation subsidiaries in Kenya. This data includes audited financial reports by the Auditor General from each of the subsidiary. The data was acquired through a formal writing to the finance managers of the subsidiaries. The researcher was able to get all the required data from the five subsidiaries under study. This means that the response rate was 100% which is considered to be excellent for the study. Rahman and Ramos (2013) noted that a fifty percent response rate of was good for analysis and for reporting and a 70% rate and over was excellent.

4.3 Data Validity

The data which was sought on the financial reports was available, in complete form as needed. This data includes total debt, total assets, sales and net profit for the particular years and was adopted for this study.

4.4 Descriptive Statistics

Table 1 provides the results of the descriptive measures used in the study. These measures include the central tendency, mean deviation, kurtosis, minimum and maximum.

Table 1: Descriptive Statistics

	Minimum	Maximum	Mean	Standard Deviation	Variance	Skewness	Kurtosis
Return on Assets	-1.06	0.1	-0.2265	0.4732	0.224	-2.121	4.64
Debt Ratio	0.38	0.91	0.6148	0.22921	0.053	0.347	-2.209
Asset Tangibility	0.56	1	0.8467	0.17382	0.03	-1.449	2.39
Asset Turnover	0.12	5.48	1.4612	2.26076	5.111	2.175	4.787

Source: Author Computations

The results in table 1 indicate that Return on Assets (ROA) has a maximum of -1.06, a minimum of 0.1, and a mean of -0.2265, skewness of 2.121 and a kurtosis of 4.64. Comparatively, Debt Ratio has a minimum of 0.38, a maximum of 0.91, a mean of 0.6148, skewness of +0.347 and kurtosis of -2.209. Asset Tangibility has a minimum of 0.56, a maximum of 1, mean of 0.8467, skewness of -1.1449 and kurtosis of +2.39. Asset Turnover has a minimum of 0.12, maximum of 5.48, mean of 1.4612, skewness of +2.175 and kurtosis of +4787. Analysis of skewness shows that ROA and Asset Tangibility are asymmetrical to the left around their mean. The analysis also shows that Debt Ratio and Asset Turnover are asymmetrical to the right around their mean. Additionally, Asset Turnover is highly peaked compared to the other regressors.

4.5 Correlation Analysis

Table 2 shows the results on the study through the correlation between the dependent and independent variable(s).

Table 2: Correlation Matrix

	ROA	Debt Ratio	Asset Tangibility	Asset Turnover
ROA	1			
Debt Ratio	.447	1		
Asset Tangibility	-.494	.225	1	
Asset Turnover	-.973**	-.527	.282	1

** two tailed test at significant level 99%

Source: Author Computations

From the above table, results indicate that each variable is perfectly correlated by itself. This is evidenced by the correlation coefficient of +1 as indicated in the correlation matrix. The return on equity is positively but weakly correlated to the debt ratio ($r = 0.447$). This means that the increase of debt in the TFC subsidiaries' capital structure will result to the increase in financial performance. Asset tangibility has a negative weak correlation with the return on assets ($r = -0.494$). The correlation between return on assets and asset turnover is -0.973 . This means that there is a strong adverse correlation between the asset turnover and the financial performance of TFC subsidiaries. The correlation is significant at 99%.

4.6 Regression Analysis

Below are the results of the regression model used by the study.

Table 3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	1.000 ^a	1.000	1.000	.00083

a. Predictors: (Constant), Asset Turnover, Asset Tangibility, Debt Ratio

From the above table, r-square for the model is 1.000. Meaning that the independent variables explained 100% variation in dependent variable and also explained response data variability around its mean.

4.6.1 Analysis of Variance (ANOVA)

Table 4 shows the results generated by the regression estimate on the analysis of variance for the study model.

Table 4: Analysis of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.896	3	.299	4.297E5	.001 ^a
	Residual	.0001	1	.0001		
	Total	.896	4			

a. Predictors: (Constant), Asset Turnover, Asset Tangibility, Debt Ratio

b. Dependent Variable: ROA

The ANOVA indicates that the regression has a sum of squares 0.896 compared to the model residual of 0.0001 with a mean square of 0.299 for the regression and 0.001 for the residual. The results produced an *F*-significance value of $p < 0.001$ less than 0.05. The model has a probability of less than 0.1% prediction and the model was reliable to draw conclusions from. This also implies that the independent variables used had a strong effect on the performance of the TFC subsidiaries.

4.6.2 Test of Statistical Significance of Independent Variables

Table 5 shows regression coefficients estimating the linear relationship between independent and the dependent variable(s).

Table 5: Regression Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	.580	.002		266.383	.002
Debt Ratio	.084	.002	.041	34.846	.018
Asset Tangibility	-.696	.003	-.256	-247.397	.003
Asset Turnover	-.184	.000	-.879	-742.419	.001

a. Dependent Variable: ROA

Results of regression model in Table 5 indicate that the independent variables have differing associations with the dependent variable. The model provided a constant with a positive coefficient at 0.58 ($t = 266.383$) with p – value of 0.002. Standard error explains more about the mean. When the standard error is small, it means that the sample mean can more accurately reflect the actual population mean. This is evidenced by the small standard error of 0.002. The model confirmed a statistically significant factor of debt ratio in determining the change in financial performance with a positive coefficient of 0.084 ($t = 34.846$) and a p – value of 0.018. On the other hand, asset tangibility has negative coefficient of -0.696 ($t = -247.697$) with a p – value of 0.003. Asset turnover had a coefficient of -0.184 ($t = -742.419$) and p – value of 0.001. The regression model therefore can be summarized as follows from the analysis results:

$$Y = 0.58 + 0.84X_1 - 0.696X_2 - 0.184X_3 + \varepsilon$$

4.7 Discussion of Findings

The Main aim of the study was to examine the association between capital structure and financial performance of tourism state corporations in Kenya with specific reference to TFC subsidiaries. Return on Assets was the dependent variable and it was used to measure the financial performance. Debt ratio was used to measure capital structure. Asset tangibility and asset turnover were the control variables.

The research findings established that the independent variables (Debt ratio, Asset Tangibility and asset turnover) explain and can therefore predict the financial performance of TFC subsidiaries. These variables could explain 100% of the variations in profits of TFC subsidiaries ($r^2=1.00$). This indicated that the regression model had a very strong explanatory power as all the variability in profitability in the TFC subsidiaries could be explained by the model.

Mean represents either a value about which the data tend to center. The mean for ROA, debt ratio, asset tangibility and asset turnover were -0.2265, 0.6148, 0.8467, and 1.4612 respectively.

As indicated in the model summary in Table 3, the results indicated a statistically significant association between Return on Assets and the independent variables (Sig. <0.05). Table 4 shows the results on the goodness of fit of the standard linear regression with the Return on Assets and the independent variables. The F-significance value of p is less than 0.01. This value is below 0.05 indicating that the model has a probability of less than 0.1% prediction and it was reliable to draw conclusions. The results in Table 5 shows the model coefficients and it indicates that

all the indicators of Return on Assets were significant ($p < 0.05$ in the cases of the debt in ratio, asset tangibility and asset turnover).

From the study, results show indicate that the relationship between Return on Asset and capital structure as measured by debt ratio is statistically significant ($p < 0.05$). This holds true for the other control variables (asset tangibility and asset turnover). The main suggestion for the study was that there is a statistically significant link involving Return on Assets and capital structure, over and above the other determinants used in the study. The results of the study lead to the rejection of the null hypothesis. There exists a momentous association between the Return on Assets of Tourism Finance Corporation subsidiaries and debt ratio (a measure of capital structure), asset tangibility and asset turnover. The outcome of the study are dependable with the findings of Muhaji (2014). Muhaji did a study on capital structure decisions by tourism state corporations in Kenya and revealed a significant cause of liquidity and leverage on performance of commercial tourism state corporations in Kenya.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

A synopsis of the study done is given out with conclusions drawn out from the results. An outline of the research findings is provided in Section 5.2. A presentation of conclusions from the findings are in Section 5.3 while the recommendations of the study are presented in section 5.4 provides the recommendations of the study. Restrictions of the study are provided in Sections 5.5. An insight for further study is offered in Section 5.6.

5.2 Summary of Findings

Data was collected from five Tourism Finance Corporation subsidiaries in Kenya. The research findings presented the vivid information of the variables used in the data scrutiny. These variables were the Return on Assets, debt ratio and the two control variables; asset tangibility and asset turnover. The results of the study indicated that there was an encouraging connection with economic performance as measured by ROA and capital structure as measured by the debt ratio. The findings also showed that there was a pessimistic affiliation involving ROA and the incorporated control variables (asset tangibility and asset turnover).

The findings of the study indicate that the capital structure adopted by the Tourism Finance Corporation subsidiaries is weakly but positively correlated. This is indicated by the correlation coefficient of 0.447 in the correlation matrix. Return on Assets (ROA) and asset tangibility are negatively correlated with a correlation coefficient of

-0.494. Meaning that there existed a weak negative association involving financial performance as calculated by Return on Assets and the asset tangibility of the TFC subsidiaries. The correlation between Return on Assets and asset turnover produced a coefficient of -0.973. This denoted a very strong relationship involving financial performance and asset tangibility of TFC subsidiaries in Kenya.

Analysis of variance (ANOVA) results show that the regression has a sum of squares 0.896 compared to the model residual of 0.0001 with a mean square of 0.299 for the regression and 0.001 for the residual. The results produced an *F*-significance value of $p < 0.001$ which is below 0.05. The model had a probability of less than 0.1% prediction and the model was reliable to draw conclusions from.

5.3 Conclusions

The study was seeking to determine the link between capital structure and financial performance of tourism state corporations in Kenya with specific reference to TFC subsidiaries. The research findings portrayed that there was a weak positive affiliation flanked by capital structure and financial performance of TFC subsidiaries. The debt ratio represented the capital structure while return on assets (ROA) represented financial performance. Financial health of firms was determined by Debt ratio. The ratio is of benefit to investors for it helps them to identify the rate of risk for firms. It assists them to make investment decisions. In their study, Saeedi and Mahmoodi (2011) noted that financial leverage was positively associated with financial performance as measured by return on assets (ROA). The findings of this study agree with the conclusion made by Saeedi and Mahmoodi.

Assets are usually used as collateral for borrowing debt by firms. When Assets are used as collateral a number of things are considered. The first consideration is how the asset is tangible because it is believed that tangible assets are more liquid than intangible assets. Secondly how is the liquidity level of the asset in terms of it being converted to cash because assets with high liquidity assets increase a firm's accessibility to debt financing. Another perspective of capital structure is in terms of what the firm buys with its finance when investing, firms can use their Debt- Equity finances to invest in income generating assets with high liquidity. This in turn may impact the capital structure in two ways, one the earnings from this income generating asset may be ploughed back in the firm investments leading to improved firm capital structure. However, a firm may use this income generating as collateral for debt financing on the basis of their liquidity.

The management of Tourism Finance Corporation needs to be aware of the profitability of its different product lines. This awareness will assist the management to properly advise the subsidiaries on ways to enhance their investment portfolio, in addition to providing the required loans, and also provide a competitive edge in the tourism industry. It is of utmost importance and priority to the entire management of commercial tourism state corporations to be attentive so as identify liquidity problems and promptly addresses them.

5.4 Recommendations for Policy and Practice

Tourism in Kenya is not only an instrument of earning foreign exchange but also a means of seeking international cooperation, understanding and peace between nations. To achieve these, there is need of adopting promotion of tourism traffic as a matter of national importance. This deserves a whole-time attention of different organizations

which should take initiative of such matters as addressing the crippling debt burden in the tourism state corporations.

During the years under review, it was noted that loss for some subsidiaries had accumulated. The total net assets increased due to revaluations. This study recommends the support of the TFC subsidiaries and the entire tourism state corporations through more injection of sufficient resources in terms of capital and skilled manpower. This will help in boosting the financial performance which has been disappointing over the years as evidenced by the continual losses of some subsidiaries.

Vision 2030 mandates the Tourism Finance Corporation to develop additional facilities in the tourism industry within the medium term and in the long term so as to satisfy the rapidly growing demand by the year 2030. The corporation and the ministry of tourism could have this achieved through credit offer to potential investors. This can be used for rehabilitating and upgrading the existing lodging facilities and also to invest in new 4 and 5 star hotels in Kenya.

5.5 Limitations of the Study

Several challenges were encountered during the study. Firstly, the annual financial statements are prepared under the underlying assumptions and concepts. The assumptions are biased thus non-standardization of their applicability especially in terms of provisions and estimates. Secondly, they report historical data therefore unable to adequately predict the future due to the volatility in the market. Thirdly, most of the financial statements having been restated in the previous year lead to misstatement of the firm's performance where this creates an opportunity for prior

year adjustments and the public is not informed adequately on the same. This implies that the pattern portrayed may affect the conclusions established.

5.6 Recommendations for Further Research

The study considered only the TFC subsidiaries on data from 2011 to 2015. Thus, the researcher recommends for an event study to be carried out in the same field on the entire commercial state corporations in Kenya. With the introduction of Sacco Societies Regulatory Authority (SASRA), further research is recommended to establish whether the co-operative societies, firms quoted in the stock exchange exhibit the same relationship as the quoted firms in Kenya. From the behavioral finance point of view, relationship between liquidity, dividend policy and share price should be established.

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APPENDICES

Appendix I: List of Tourism Finance Corporation Subsidiaries

1. Sunset Hotel
2. Golf Hotel
3. Kabarnet Hotel
4. Mount Elgon Lodge Limited
5. Kenya Safari Lodges and Hotels Limited

Source: Kenya Tourism Finance Corporation (2016).

Appendix II: Summary of Data

SUBSIDIARY	ROA	Debt Ratio	Asset Tangibility	Asset Turnover
Sunset Hotel	-0.05254	0.78538501	0.863419247	0.52723761
Golf Hotel	0.098006	0.581211622	0.559521246	0.769749695
Kabarnet Hotel	-0.06256	0.908959618	1.003383133	0.115060319
Mount Elgon Lodge Limited	-1.06453	0.414939518	0.963105366	5.483320633
Kenya Safari Lodges and Hotels Limited	-0.05063	0.383604624	0.844106423	0.410388108