DETERMINANTS OF CAPITAL STRUCTURE OF THE FIRMS LISTED ON THE NAIROBI SECURITIES EXCHANGE: A CASE STUDY OF THE AUTOMOBILE FIRMS.

BY

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DECLARATION

I hereby declare that this is my original work and has not been presented in any other university or college for examination purpose.

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This Research Project has been submitted for examination with my approval as the university supervisor.

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DEDICATION

I dedicate this research project to my dear parents Barnabas Mwamba and Truphena Moraa who stood by me throughout my studies and whose prayers kept me going.

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LIST OF ABBREVIATIONS

EBIT - Earnings Before Interest and Tax

MM - Modigliani and Miller

NI - Net Income

NOI - Net Operating Income

NSE - Nairobi Securities Exchange

ROA - Return on Net Assets

SME - Small and Medium Enterprises

WACC - Weighted Average Cost of Capital

ABSTRACT

Financial planning is an integral part of financial management which deals with the management of a firm's funds with a view to maximizing profit and the wealth of shareholders. Capital structure is a vital financial planning principal which details on how the firms leverage is structured. Selection of an optimal capital structure is always a critical issue for every firm. The reason for this is of course, financial risk and tax advantage which are directly influenced by a company's choice of capital structure. The aim of this research was to determine what influences the choice of capital structure of automobile companies listed on the Nairobi Securities Exchange. The factors which were tested are; growth of the firm, taxation, liquidity and dividend policy. The research study design was a census descriptive research. The research used secondary data which was analysed using SPSS. The population of interest in this study comprised of the more than 60 currently listed companies on the Nairobi Securities Exchange. The study used a census sampling technique. The sample for this study included all the automobile firms that were listed throughout the years 2007-2016. This study found out that growth of the firm, taxation, liquidity, and dividend policy are determinants of the capital structure of Automobile companies in Kenya. The most influential variable is the dividend policy followed by liquidity, then taxation and firm growth. Firm growth has the least impact on leverage of the automobile firms in Kenya. The study recommended that a well-adjusted combination of debt and equity be established so as to ensure that the firm maintains capital adequacy. Firms can thus be able to meet their financial compulsions and grasp investments that can promise attractive returns.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The importance of automotive industry in Kenya's economy cannot be ignored. The industry is involved in the distribution and retail sale of motor vehicles. The most established dealers in the industry include Cooper Motors Corporation(CMC), DT Dobie, Toyota (East Africa), Simba Colt and General Motors (GM). In Kenya, there are three vehicle assembling workshops which specialise in the assembling of pick-ups and heavy commercial vehicles.

The industry is facing a stiff competition from imported second-hand vehicles which even the already established firms are finding hard to deal with. Japan and United Arab Emirates are the leading exporters of second-hand vehicles in Kenya with an estimated of 70% of the Kenyan market share. The number of new vehicles sold in Kenya dropped significantly in the last decade. Although there has been an increase during the last five years, the number of new vehicles sold in the country dropped compared to the amount recorded in the previous decade. The second-hand vehicles have swept the market with a huge force.

In 2014, the four major motor vehicle firms registered sales of 15,459 units which was a 54% increase from the number of units registered in 2004 of 9,979 units. There has been a huge concern on the impact of the second-hand vehicles on the Kenyan motor vehicle market. The corporate members of the motor industry under the umbrella of the Kenya Motor Industry Association (KMI) have been lobbying for the reversal of this trend. The corporates have been proactive in reacting to their customers' needs by being innovative and flexible to address these needs. KMI has been active in defending and pushing for the implementation of strict rules and policies concerning the importation

of second-hand vehicles, policies to support local assembling of heavy commercial vehicles and other export incentives directed at supporting car assemblers to extend their operations far and wide in the east African region. The high level of competition in the motor vehicle industry creates an increased pressure to produce and hence there is an increase in price pressure.

This fast growth in the low-cost labour economies in China, Eastern Europe, India and South Asia is creating a great pressure on the labour-intensive manufacturer. This therefore requires the use of low costs of production and use of advanced technology to cut further on the labour costs.

1.1.1 Capital Structure

The way a company chooses to fund its operations and assets as a combination of equity, debt or the mix of the two sources of financing is defines its capital structure. It is the most appropriate mix of equity and debt which enhances the operation of the company well. When deciding on the type if capital structure to use, the primary objective is the maximization of the firm value through the best combination of equity and debt and is referred to as an optimal capital structure and is aimed at minimizing the overall cost of capital of the firm. Furthermore, there are approaches and arguments brought forward questioning the practical presence of an optimal capital structure. These arguments questions if a firm can influence its valuation and therefore, its cost of capital by altering the combination of the sources of financing used (Besley, 2005) the capital structure affects a company's decision on employment, investment and production hence it is very important to critically evaluate and examine a company's capital arrangement.

A theorem proposed by Modigliani and miller in 1958 presents an important approach on capital structure, albeit being criticised for assumption of many important factors.

The theorem derives certain conditions which render the capital structure decision irrelevant in the market valuation of a firm. Different theoretical literatures have been presented to show that a firm can improve its forecast or projections by influencing its market value therefore asserting the importance of capital structure. Theoretical approaches such as the trade-off theory (1977) depends on common factors like bankruptcy cost of debt and tax advantage which are assumed to be an optimal capital structure (Scott, 1977).

The pecking order theory employs the asymmetric information it believes in hierarchal funding decisions. This is where the companies depend first on internal sources of funding and if they are not sufficient, then the firm looks for external debt funding as an alternative. If these two are also not sufficient, the firm uses equity as the last resort (Meyers, 2011).

The agency cost theory assumes that debt offers fixed obligations that have been engaged by the firm. These obligations include controlling the company's free cash flow and therefore inhibit managers from embezzling the company's finances. It has been stated that none of the three theories can completely explain the concept of capital structure. In practice, choosing an optimal capital structure is impossible since there are conflicting variables that I considered in order to make such decisions. The contradicting influence of these variables makes it difficult for a firm adopt an optimal financial structure.

1.1.2 Determinants of Capital Structure.

The optimal combination of funding is the one that maximises the firm's value and also minimises the cost of capital. Since there's no definite formulae to determine the optimal capital structures, a firm analyses some crucial factors from which it sets a capital structure target which is deemed to be optimal (Talberg et.al., 2008).

These factors and their effects must be put into consideration whenever an investment opportunity arises and the firm requires raising funds. Some of these factors include the growth projectile of a firm, the firm's overall size, the profitability margin, the tangibility level of a firm's assets and the liquidity level of a firm only to mention a few. These variables have contradicting influences especially on the valuation of a firm which is the most important aspect considered when sourcing for external funding. This nature of these determinants is a challenge to any firm that tries to adopt an optimal capital structure. Each of the variables should be applied to a considerable level when a firm's management is deciding on the type of financial structure to employ (Ahmad et. al., 2011).

It therefore follows that if both an investor and the firm borrowed at the same rate of interest, then the investor would neutralise the decision of choosing an ideal capital structure. As a consequence of the irrelevance theory assumption, pecking order theory and the trade-off theory were formulated to explain the different aspects of capital structure.

1.1.3 Nairobi Securities Exchange

This is a financial institution in Kenya that facilitates the buying and selling of shares issued by both the publicly quoted companies and the Government in. The financial institution was founded in 1954 as a deliberate organisation of security brokers. It was then registered under the Societies Act after getting clearance from the London Securities Exchange to recognise it as an overseas stock exchange. The NSE is now among the most active financial markets in Africa regarding trading volumes; it has grown over the years and has undergone reforms culminating to live to trade in September 2006 eliminating the need for stock brokers sending dealers to the trading floor.

Through the NSE, firms are able to raise additional funds to finance their expansion and improve on their operations. If a firm is required to raise funds, all they have to do is publish a design with all the relevant information about the prospects and states the unit price of the shares they intend to offer. The NSE is a great avenue for the flow of international capital and also facilitates the privatisation process of institutions.

The bond market is an important tool of the NSE as it allows the government to exercise its monetary policies to control the cash flow in the economy. The bond market is also a lucrative market as it offers fixed interest rates hence reducing the possibility of risks and hence losses. According to a report by African market news, bond market in the NSE is demonstrating to be a good medium to raise capital. The report asserted that in most African economies, the bond markets have been mainly dominated by the government and a few corporate bonds due to their lack of development. In Kenya, the government is doing a good job in trying to ensure that the bond market is active and productive.

1.2 Research Problem

A number of conflicting theories have been formulated from the arguments of Modigliani and Miller (1958) on capital organisation. Among them is the statistic trade off theory. It examines the trade-off situation that exists between debt benefits in form of tax savings and bankruptcy dead weight-weight costs. The theory asserts that from this trade-off there exists an ideal or optimal financing combination. The second theory is the pecking order theory which presents hierarchal financing decisions which follows that a firm will firstly depend on internal sources of financing and if they are not sufficient, the firm will look for external financing from debt and only seek for equity financing as the last option. Finally, the agency cost theory also tries to explain the balancing act between the principal and agents' ideal optimal capital structure.

The reason why most companies in developing economies fail to operate or be profitable has been greatly attributed to the subject of finance. Companies in the developing nations should be very keen in their methods of financing. It is every company's goal to maximise its shareholders' returns. Subsequently, this reason creates the need for the companies to pay a great deal of attention to the cost of their operations, methods of financing, production costs and investment opportunities.

Several empirical studies conducted have tried to explain the subject of financing combination but they have focused mainly on the developed economies. For instance, Zingales (1995) studied the factors that determine financing structure in the great seven economies whereas Beran (2000) and Danbolt (2002) considered the economy of the United Kingdom. Antoniou et al (2002) analysed the determinants of capital structure in the UK, France and Germany.

Though several studies have been conducted in Kenya on capital structure, these studies have had conflicting results. These studies include Odinga (2003) who found a significant negative connection between non-debt tax shield and the profitability but an insignificant relationship of risk, growth and size with capital structure, Chonde (2005) finds high correlation between leverage and profitability. Kiogora (2000) observed a negative correlation between the business risk of a company and its leverage. This was for companies with a comparable capital structure. Ndirangu (1992) and Matibe (2005) show that there is a trend to avoid debt for companies without state interests.

Due to the above conflicting results from Kenyan researchers in particular and the fact that Kenyan's situation is very different from that of the developed world where most of these studies have been carried out, there is need to conduct research on the automobile industry in Kenya which has not been covered by any of the mentioned studies. Studies that have been previously conducted have focused on the determining

factors of capital structure of all listed firms, or factors determining capital structure of specific segments of the Kenyan economy. There was therefore need to assess determinants of capital structure for each sector separately. Therefore, this study sought answers to the following research question: What are the determinants of capital structure of the automobile firms listed on the NSE?

1.3 Objective of the Study

To identify the factors that determine the choice of capital structure of automobile firms listed on the Nairobi Securities Exchange (NSE).

1.4 Importance of the Study.

The results and findings of this study are expected to have a contribution to the existing theories of capital adequacy and financial performance as well as to practice in players of financial sector in the economy.

1.4.1 Value to Theories

In finance there exist different theories which seek to explain relation between capital adequacy and financial performance of a firm. Most of the theories base their explanations on capital structure and what pushes a firm to prefer holding given levels of debt and equity. In reviewing the theories this study sought to fill the research gaps and as well critiqued them based on the findings hence enriched them.

1.4.2 Value to Practice

Firms' management main concern is management of adequate capital to meet the statutory requirements and to support business operations. This study sought to act as guide to the automobile firms in ensuring compliance to the set limits and meeting regulators' requirements. Additionally, the findings of this study would be of benefit to the management of automobile firms for a clear foundation on what to consider when choosing a given type of financing policy.

1.4.3 Value to Policy

This study would be useful to regulatory authorities and government as it would inform policy making regarding capital adequacy.

The findings of this study would also be useful to scholars in and out of Kenya and as they would be able to understand automobile's capital structure and its determinants in Kenya. The findings of this study are also beneficial to researchers as a base upon other research that can be carried out in the same field or as reference material for scholars.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter reviews the theories of capital structure and facts researchers who have previously carried out research studies in the same field of our study. Section 2.2 presents the theoretical literature, section 2.3 discusses the determining factors of capital structure, section 2.4 presents the review on local research and section 2.5 summarises the literature review.

2.2 Theoretical Literature

The following theories form the basis of discussion of the concept of capital structure in companies:

2.2.1 The Static Trade-off Theory

This theory was forwarded by Kraus and Litzenberger in 1973 after they examined the trade-off situation that exists between the bankruptcy dead-weight costs and the debt benefits in form of tax saving. The theory also puts into consideration the existence and influence of agency costs.

As indicated by in trade-off theory hypothesis, an organization's ideal capital structure is influenced by a trade-off between the expenses and gains of getting, holding the company's assets and venture designs constant (Myers, 1984). The trade-off decision incorporates a few viewpoints, including the overview of an organization’s bankruptcy and agency costs in contrast to tax reductions. Bankruptcy cost is a cost forthrightly fetched when the actual possibility that a company will failure to raise its financing.

Liquidation costs are an example of bankruptcy costs that refers to a substantial loss of value due to the trade-off of resources in a company. This settlement fee decreases the

returns of a loan interest, should the company failure to pay on fund instalments and end up being dissolved. Given the decreased benefits, agents will modify their cost of subsidizing to organizations to consolidate this probable loss of noteworthy value. Companies along these lines will incur higher fund costs because of the impending winding up costs (Holmes, 2003).

Distress costs arise if there's a belief that a firm is likely to get bankrupt, customers become less willing to conduct business with that particular firm as a result of the fear that firm may fail to meet its obligations. On the other hand, employees can be demoralised to working for the company as well as its suppliers unlikely to continue with their trade credit services. The firm's value is subsequently reduced due to these actions of its stakeholders. It then follows that, the firm with high distress costs must create policies to reduce debt financing as a way of reducing these costs (Hutchinson & Mengersen, 1989).

Debt funding may likewise prompt organization costs. Organization costs are the costs that emerge because of an essential partner relationship, for example, the connection between managers, shareholders and creditors. Myers (1984) demonstrated that when a company has the capability to make profits, the shareholders must come up with a way to control the actions of the managers. These contracting actions raise the cost of capital presented to the organization. Notwithstanding, in the investigations of organizations recorded in Nairobi Securities Exchange, Nyaboga (2008) found a general feeble connection between capital structure and office cost.

Firms likewise consider inside the static exchange off structure, the tax reductions related with the utilization of obligation. This preferred standpoint is made as the intrigue instalments identified with obligation are impose deductible while instalments identified with value, for example, profits are appropriated from benefit. This duty

impact supports the utilization of obligation by firms as more obligation builds the after-assess continues to the proprietor (Martin, 1991). This theory is fundamental in the theoretical framework of this study since it gives an explanation on the varying consequences of each source of financing that is available for a firm to utilise. The theory details the advantages and disadvantages of both equity and debt as sources of funding.

2.2.2 The Pecking Order Theory

This hypothesis was first proposed by Donaldson in 1961 but later in 1984. It was modified by two economists Stewart Myers and Nicholas Majluf. The pecking request hypothesis proposes that organizations have a specific inclination arrangement to raise the finances required to fund their operations (Myers, 1984). Due to the asymmetric nature of information available between the firm's management and its potential investors, relative expenses of type of funding used vary. If a firm uses its retained profits or earnings to finance its investment projects rather than issue new debt-holders, then there is an expected increment in the returns of its shareholders since there is a reduction in the relative funding costs.

A firm will favour held profit financing to debt financing, here and now obligation over long haul obligation and obligation over value. An experimental examination by Gachoki (2005) infers that organizations recorded on the Nairobi Securities Exchange don't take after the pecking hypothesis of capital structure. Numerous speculations have been progressed on what influences the estimation of the firm. Modigliani and Miller in their unique suggestion advocate that the connection between the use and the cost of capital.

Market esteem is discovered by underwriting the networking wage at the in general or weighted normal cost of capital, which is a consistent. They demonstrated that an

organization's capital structure is immaterial in a flawless budgetary market since speculators can acknowledge the organization's choice or switch its impact on their portfolio by acquiring or loaning their own cash without adding expenses to them. An immaculate budgetary market has no exchange costs or expenses, data is promptly and unreservedly accessible to everybody, securities are endlessly distinct, and the market is aggressive.

2.2.3 The MM Theory/ The 'Irrelevance' Theory

The MM theorem was proposed from the works of two economists, Franco Modigliani and Merton Miller. This theorem forms the foundations of the modern school of thoughts on capital structure. It asserts that in an efficient market, free of taxes, bankruptcy costs, agency costs, and asymmetric information, the nature of a firm's capital structure do not affect its value. The MM theory sometimes is called the irrelevance principle. The Modigliani and Miller (1958), in their investigation of capital structure, built up the capital structure insignificance suggestion. Assuming that there existed a perfect market condition, that is, the interest rates of borrowing is constant to both the firms and individuals, the market does not have tax costs and that investment decisions are independent of financing choices, then the MM observed two propositions. Firstly, the MM theory holds that the value of a firm is independent of its capital organisation. The second observation states that in a perfect market condition, the value of a leveraged firm is the same as that of an unleveraged firm. Along these lines, MM's suggestion 1 is indistinguishable to the Net Operating Income (NOI) theory.

MM's unique work of 1958 accepted zero corporate duty. 5 years after, they distributed a second article, which incorporated the impacts of corporate expense. They inferred that use would build a company's esteem since enthusiasm on obligation is an

assessment deductible cost, and thus, all the more a utilized firms working wage moves through to financial specialists. In dismissal of NI approach, MM contended that for two organizations indistinguishable in all viewpoints with the exception of their capital structures, can't order diverse market esteems or have distinctive cost of capital. Their sentiment is that if these two firms have distinctive market esteems, arbitrage will occur to empower speculators to participate in individual or hand crafted use as against the corporate use to re-establish equilibrium in the market.

In the absence of charges, insolvency costs, exchange costs and data and a similar rate of enthusiasm of acquiring by people and enterprises, the estimation of a firm is free of its money related structure (Modigliani and Miller, 1958). The model depends on a structure that begins with presumptions of ideal rivalry in factor and item advertises and no exchange costs. It is not possible for a firm to increase its market value in the long run using debt financing (Modigliani and Miller, 1958). This preposition is founded on an assumption that if the value of the levered shares is more than those unlevered then investors use personal debt to raise funds for financing of the firm. This scenario then proves the irrelevancy of capital structure in the valuation of a company.

Modigliani and Miller (1963) explained that seeking for external debt will raise the worth of a firm only by the capitalised tax subsidy. Unwinding suspicions in their unique work and presenting flawed rivalry, insolvency costs, asymmetry information, and imposing business model power, money related structure has all the earmarks of being an impacting factor on firm esteem. The presentation of expense deductibility of intrigue payments has a suggestion on the decision of capital structure. Productivity increments, non-obligation charge shield decrease and liquidity increments.

2.3 Determinants of Capital Structure.

Following from these hypothetical points of view, various observational studies have distinguished firm-level features that influence the type of capital organisation for firms. Some of these components include growth of the firm, firm size and asset structure (Kiogora, 2000). These determinants were examined in detail in the accompanying sub-topics.

2.3.1 Growth of the Firm

Organization issues are probably going to be more serious for developing firms since they are more adaptable in their decision of future ventures. In this manner, the normal development rate ought to be adversely identified with long haul use. Additionally, firms with high-development openings give a positive flag about the company's future execution. Subsequently institutional speculators want to put resources into high-development firms instead of lower ones.

Hovakimian et al. (2004) propose that the high-development firms may bring more capital increases to institutional financial specialists than bring down development ones. This is on account of institutional financial specialists, as citizens, would want to put resources into capital-pick up stocks to defer assess payments and to stay away from twofold tax collection. In this way, a company's development openings are thought to be a positive flag for institutional financial specialists. The investigation utilizes advertise to-book proportion (MB) as a pointer of the development chances of a firm.

2.3.2 Taxation

Taxation is a governmental exercise of imposing levy on individuals and corporates to raise funds to finance its projects and social services. Numerous research studies have been conducted to examine the influence of government taxation policies on the

decisions of a financial organisation in the well developed economies. Shum (1996) conducted a research study of the effect of taxation on the financing decisions in Australia and found out that tax policy imposed on a company determines the type of financing sources adopted.

Similarly, Mackie-Mason (19900 found out that tax had substantial effect on the type of capital structure opted by commercial banks in state of Michigan, USA. Graham (1999) identified that generally taxes have an influence when firms are making their decision on the type of corporate financing source to employ though he also added that the effect is “not large”.

2.3.3 Liquidity

Ozkan (2001) found a negative connection between liquidity and use. A negative connection is normal amongst liquidity and use in showcase arranged economies since directors have a tendency to favour interior liquidity. At the point when there is a nearby connection between an organization and its lender, data asymmetry is decreased to its base level and thus director's hunger for inward liquidity turns out to be less important (Ghossan and Fadi, 2002).

Firms may likewise have a stimulus to pay out profits frequently and this may convey a positive flag. Jensen et al. (1992) gave recommendations that more significant profits are related with more remarkable liquidation level. Consequently, the response to profit margins may convey negative signs to speculators when a decrease in steady profit margins and drop in the dividends paid out (Brigham & Houston, 2004).

2.3.4 Dividend Policy

The topic of dividends has attracted the attention of many different writers and academicians. Bierman (2001) and Baker, et al. (2002) defined it as a distribution of firm earnings to stockholders after meeting tax and other payments on borrowed funds.

There have been a number of debates on the issue of the impact of dividend policy on a firm's value with some of the researchers supporting that the dividend policy is irrelevant to a firm's value. Subsequently, some believe that dividends are a tool to increase the returns of shareholders on their capital invested and hence their wealth. A higher cash dividend can be interpreted as a signal of low capital demand in a company with previous studies suggesting a negative correlation between the financing combination used and the dividend policy (Miller and Scholes, 1978).

The payment of dividends is normally from the earnings of the present year and occasionally from the reserves of profits. These payments of dividends are normally paid in cash form, and this form of paying dividends is called cash dividend (Adefila et al, 2013).

In firms' perspective, choosing an optimal policy of dividends is a crucial choice that the company must make since the ability to venture in potential projects is dependent on the payment of dividends to pay to their stockholders. Hence, some crucial considerations like management environment, behavioural factors, profitability of firms, the company willingness etc. are factored in the formulation of firm dividend policies (Khan, 2012).

2.4 Empirical Studies

From the findings of his study, Drobetz et al (2007) discovered that firms adjust faster towards their target leverage level when there are favourable macroeconomic factors as opposed to unfavourable conditions. When there are low interest rates and the possibility of financial systems disruptions is insignificant, the speed at which firms correct their financial organisation to an optimal combination is faster. The findings of the studies conducted by Banjeree et al (2004) and Loof (2004) have supported the

claim that economic factors also influence the type of financial structure that a firm opts to adopt.

Ferri and Jones (1979) studied the determining factors of financial organisation and used four variables. The findings confirmed that the operating leverage and the firm size have a positive and significant effect on the leverage level of a firm. Aggarwal (1981) used a firm's growth rate; profitability level and the level of international risk where he found out those three factors are not significantly correlated with leverage. Aggarwal (1981) asserted that the economic state of a country is also a key determinant of capital structure.

Harkbarthet et al. (2006) established that both the size and pace of a firm's capital are influenced by macroeconomic circumstances surrounding that particular company. Furthermore, their study suggested that when choosing the type of capital structure to adopt, the managers of a firm should not only consider the firm characteristics only but should also evaluate the state of the economy. However, in all of this studies, the factors that determine the choice of capital structure have not been clearly identified and examined.

These research studies incorporate Odinga (2003) who finds that there is a huge negative connection between gainfulness, non-obligation assess shield however an unimportant relationship of hazard, development and size with capital structure, Chonde (2005) discovers high relationship between benefit and use and a frail negative relationship between size and use.

Kiogora (2000) reasons that there is a negative connection between the business danger of an organization and use. As per Kiogora (2000), organizations inside an area have comparable capital structure. Her discoveries show that there are contrasts in the capital structure among industry groupings and firms inside a given segment which tend to

bunch towards some objective value/add up to resource proportion. Omondi (1996) found that the capital structures of firms on the sectoral premise are totally extraordinary. He inferred that mechanical class assumes a noteworthy part in capital structure.

Ndirangu (1992) and Matibe (2005) demonstrate that there is a pattern to keep away from obligation for organizations without state interests. Ndirangu (1992) found that the danger of operation increments with the utilization of obligation. This proposes in spite of MM (1963) speculation of development of the estimation of firms by utilization of obligation; firms cited on NSE still maintain a strategic distance from obligations. To relieve this, Matibe (2005), recommends that loaning foundation should offer assets at sensible rates that will pull in corporate borrowers and even seaward borrowers who appear to have a considerably more prominent abhorrence for obligation. Kamere (1987) in his investigation, "Factors that influence cited organizations" recommends that a few elements have more impact in attempting to comprehend the financing choices of firms, the issue of firm size and how it identifies with capital structure develops.

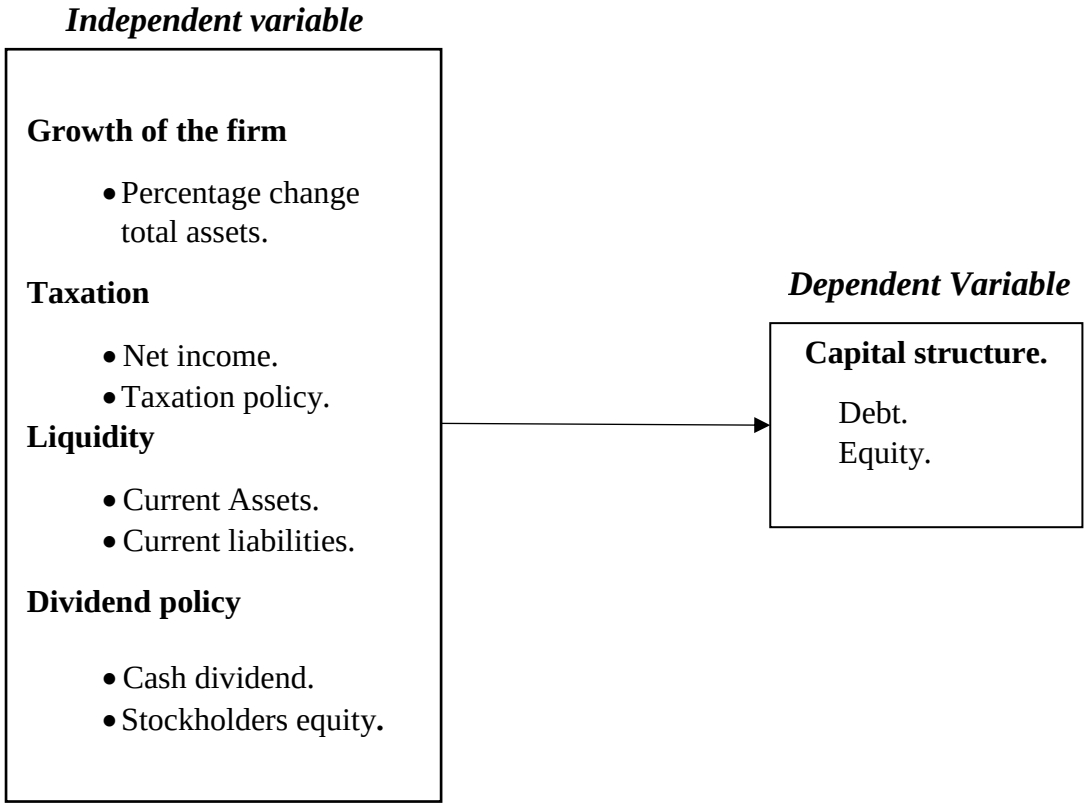
Nyaboga (2008) examined the connection between capital structure and organization cost for organizations recorded on NSE; she found a general frail connection between capital structure and office cost yet a positive relationship for high development firms. Orua (2009) investigated the connection between capital structure and monetary execution of microfinance foundations in Kenya and found that associations financed by outside sources did not perform like organizations supported inside, this was because of premium cost paid by the organizations. One shortcoming for this study was the inclusion of political goodwill and its impact.

2.5 Conceptual Framework

Mugenda and Mugenda (2003) defined a conceptual framework as a research tool which creates a better understanding of the connection between the independent and the dependent variables of the study.

The dependent variable was the capital structure of automobile firms in Kenya which was be equated to the ratio of debt to equity. The independent variables are; growth of the firm, taxation, liquidity and dividend policy.

Figure 2.1: Conceptual Model



Source; Author, 2017

2.6 Summary of Literature

There have been different examinations done on capital structure, however few investigations have been carried on the factors determining of capital organisation in Kenya and more particularly in the automotive industry. This chapter has investigated the different theories and exact studies done drawing out the negating perspectives of the distinctive specialists. Capital structure determinants are distinctive relying upon the idea of the firm, liquidity, hazard factor of the organization, development prospects, tax collection and age of the firm.

A few speculations express that financing choices take after a specific levelled arrange, while others say that organizations have an ideal target proportion of obligation to value that they modify their capital structure to accomplish it. No study has been taken to feature the connection between firm size and capital structure of the automobile organizations listed on the NSE. The examination addressed the research gap on the connection between firm size and capital structure of automobile organizations cited on the Nairobi Securities Exchange.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter sets to explain the population interest, the type secondary data that was used, the source of data and the techniques of analysis used, thus it's divided into research design, population and sample of the study, data and data collection instruments and data analysis. This study was done for the period between the year 2007 and 2016 to establish what the determinants of capital structure are.

3.2 Research Design

This study employed a census descriptive research design. Descriptive design was adopted since it seeks to explain the current state of affairs in the study (Kothari, 2003). The method is appropriate for the study as the study sought to determine whether there is a relationship between the variables identified and the capital structure of all the automobile firms listed on the NSE. In this case, the research problem was the investigation into the factors that determine capital structure of all the three automobile firms quoted at the NSE as at 31st December 2016.

3.3 The Population and Sampling of the Study

The population of interest in this study comprised of the more than 60 currently listed companies on the Nairobi Securities Exchange to establish if an important relationship exists between capital structure and the factors identified as determining the capital structure.

This study used a census sampling technique. The sample for this study included all the automobile firms; this restriction was necessary because little or no research studies have been carried out in this industry in Kenya. The study included only those

automobile companies that were listed throughout the years 2007-2016. Therefore, the sample size for this study was 3 automobile companies which were listed on the NSE.

3.4 Data Collection

The study utilised secondary data that was obtained from the annual financial statements of automobile companies quoted on the Nairobi Securities Exchange. Data used was collected from the individual companies' website and the NSE Handbook.

Secondary data for a ten-year period from 2007 to 2016 was collected for the purpose of this study. Variables for which data was collected include; Equity, Current assets, current liabilities, cash dividend, taxation and debt. This was done with the help of a data collection sheet, a sample of which can be seen at Appendix II.

3.5 Data Analysis

The SPSS version 20 software was used to carry out the analysis of the data that was obtained. The study used four independent variables. The researcher constructed a regression model that was used to analyse the reliance of leverage (the dependent variable) on the independent variables outlined below. Bryman (1998) states that regression analysis is the most common data analysis technique. From the above statement, the multiple regressions variables were: the growth of the firm, taxation, liquidity and the dividend policy.

The data collected was run through the various models aforementioned with a clear aim of establishment of the relationships that exist between the variables. The main focus of the study was the link between leverage and the determinants of capital structure in the Kenyan automobile industry.

3.5.1 Conceptual Model

The study was based wholly on secondary data available from the published financial statements. These reports of the firms were available from Nairobi Securities Exchange

and other sources. The following information was extracted from financial statements. The dependent variable was Leverage, which was calculated as the ratio of debt to equity and this was a function of growth of the frim, taxation, liquidity and Dividend policy as shown below.

$$\boldsymbol{Y = F(\ X_1, X_2, X_3, X_4)}$$

Where;

$\boldsymbol{Y}$ represented capital structure which was expressed as the ratio of debt to equity of the firm (leverage).

$\boldsymbol{X_1}$ represented Growth of the firm was measured by the book value of all assets less book value of all assets in the base year divided by book value of all assets of the firm in the base year. (total assets - assets in the base year/ total assets of the base year).

$\boldsymbol{X_2}$ represented Taxation which was represented by the ratio of tax paid to operating income for firm.

$\boldsymbol{X_3}$ represented Liquidity of the firm measured as the ratio of current assets to current liabilities.

$\boldsymbol{X_4}$ represented Dividend policy measured by cash dividend/stockholders equity.

3.5.2 Analytical Model

Descriptive statistics were used to analyse the data that was collected on the variables related to the study. Moreover, multiple regression and correlation analysis were used to explain the nature of relationship between changes of the dependent variables (leverage) and change in the independent variables identified in this study. The regression model that was used is shown below;

$$\boldsymbol{Y = \propto + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \ \beta_4 X_4 + \mathcal{E}}$$

Where;

Y = leverage

$\propto$ = The constant of regression

X_1-X_4 = predictor variables (independent variables) where;

X_1 = Growth of the firm

X_2 = Taxation

X_3 = Liquidity

X_4 = Dividend policy

Ɛ = The error term

$\boldsymbol{\beta_1}$- $\boldsymbol{\beta_4}$ are regression coefficients that defined the value by which Y is changed for every unit change in the predictor variables.

3.5.3 Test of significance

The t-test was used to test the significances of both the constant term and the coefficients of the regression. The F-test was utilised to test for significance of the regression model, whereas the correlation was tested using the Pearson's correlation coefficient. To test on the reliability of the regression model, ANOVA was employed. The level of accuracy for this study was 95%. The test was whether the independent variables (growth, liquidity, taxation and dividend policy) are capable of predicting leverage. The means for all the factors were calculated on an annual basis. Regression analysis was used to compute the significance of the relationship between capital structure and each respective factor.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter contains the results of the research and data analysis. The study data was reached from the statements of financial position and the declarations of comprehensive income for a ten-year period from 2007 to 2016. The data was analyzed and information presented in form of, pie charts, bar graphs and cross tables.

4.2 Descriptive Analysis

The section discusses the results of descriptive statistics for the data analysed for the ten-year period. The table below presents the summary of the descriptive statistics for independent variables represented by the determinants of capital structure.

Table 4.1: Descriptive results

	N	**Leverage**	**Growth**	**Liquidity**	**Taxation**	**Dividend policy**
Mean	3	0.61	0.0420	0.5682	0.2321	0.2357
Standard Deviation	3	0.018	0.0311	0.0583	0.0504	0.0784
Range	3	0.3258	0.3783	0.2141	0.1978	0.2736
Minimum	3	0.45	-0.1040	0.0710	0.0940	0.0690
Maximum	3	0.68	0.2743	0.2851	0.2918	0.3426

Source: Research Data (2017)

The results indicates that over the ten-year period the Automobile firms had a mean leverage of 0.61, growth of 0.042, liquidity of 0.5682, taxation of 0.2321, and dividend policy mean of 0.2357.

4.3 Correlation Analysis

A correlation matrix was employed to examine multi-Collinearity, that is, if there is a strong correlation between two predictor variables. A factor of 0.5 was used to check multi-Collinearity. In a position where two predictor variables have a correlation coefficient of more than 0.5, one of them must be dropped from the model using their P- values.

Table 4.2: Pearson Correlation

		Leverage	Growth	Liquidity	Taxation	Dividend policy
Leverage	Pearson correlation.	1				
	Sig. (2tailed)	*				
Growth	Pearson correlation.	0.002	1			
	Sig. (2tailed)	0.72*	*			
Liquidity	Pearson correlation.	0.051	.315	1		
	Sig. (2tailed)	0.621*	.001*	*		
Taxation	Pearson correlation.	0.124	.388	.188	1	
	Sig. (2tailed)	0.598*	.004*	.227	*	

Dividend policy	Pearson correlation	0.23	.733	.310	.217	1
	Sig. (2tailed)	0.634*	.054	.028	0.001	*

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

Source: Research data (2017)

The Pearson's correlation test is used to establish whether there is proof of a correlation between two variables. From the finding in the table above, the study found a strong positive association between the dividend policy and growth shown by correlation coefficient of 0.733, this too was realized to be substantial at 0.054 levels.

Comparing the obtained significant values with the significance level of the study, that is. 0.05, it can be concluded that the Pearson correlations between leverage, liquidity, dividend policy and growth of firms were statistically significant. Hence, it can be deduced that independent variables reliably predicted capital structure of firms listed at the NSE.

The study also found weak positive association between growth and liquidity as shown by correlation coefficient of 0.315 at 0.001 level of confidence. The study also found weak positive association between dividend policy and liquidity as shown by correlation coefficient of 0.310 at 0.028 level of confidence which is less than 0.5.

There were other correlations between the independent variables but they were not significant to the study since their confidence levels were above the 0.5 set limit.

4.4 Regression Analysis

The regression analysis was conducted using the leverage as the dependent variable and the independent variables firm growth, liquidity, taxation and dividend policy. The results are tabulated below.

4.4.1 Results the Model Goodness of Fit Test

Table 4.3 below gives the regression model summary findings.

Table 4.3: Model Goodness of Fit Test.

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.932[a]	.869	.864	1.01825

a. Predictors: (Constant), growth of the firm, liquidity, taxation, dividend policy

Source: Research data (2017)

The findings show that *R* which is the multiple correlation coefficients that shows quality of the prediction of the dependent variable by the independent variables is 0.932. This is a good indication since it points to a strong correlation. The *R-Square* which is the coefficient of determination equals 0.869 which shows that 86.9% of the variation in capital structure (leverage) can be explained by the changes in growth of the firm, liquidity, taxation and dividend policy leaving 13.1 percent unsolved. The P-value of 0.000 < 0.05 indicates that the model of capital structure (leverage) is important at the 5 percent significance level.

4.4.2 Results of ANOVA

Analysis of the variance (ANOVA) was employed to make concurrent comparisons between means; therefore, assessing whether a noteworthy relation exists between dependent and independent variables. ANOVA indicates a significant F statistic implying that the model was fit for the estimation. The outcomes presented in table 4.4 gives the ANOVA findings which indicate the dependability of the model established in explaining the relationship between the research variables.

Table 4.4: Significance level

Model		Sum of Squares	Df	Mean Square	F	Sig.
	Regression	.268	2	.08934	3.436	.015(a)
	Residual	.026	1	.026		
	Total	.294	3			

a. Predictors: (Constant), growth, liquidity, taxation, dividend policy

b. Dependent Variable: Leverage

Source: Research data (2017)

From the table 4.4, the F statistic is 3.436 with a distribution F (3, 1). This shows that the regression model developed is statistically significant and the variation in in the findings is insignificant that cannot result to a much variance in case of a change in the study units (population) and therefore the model can be depended upon to explain the factors that determine the choice of capital structure of automobile firms listed on the Nairobi Securities Exchange.

4.4.3 Estimate Model.

So as to answer the suggested model for the relationship between capital structure (leverage) and the independent variables (growth of the firm, liquidity, taxation and dividend policy), the regression coefficients were evaluated and shown in table 4.5 below. These with their significance values (also given in the table) measure the influence of the independent variables on leverage (dependent variable).

Table 4. 5: Results of Estimate Model.

Model	Standardized Coefficients	T	Sig.

	Beta		**P- value**
(Constant)	**.189**	**1.9487**	**0.54**
Growth of the firm(X1)	.003	2.957	0.00001
Liquidity (X2)	-0.24	1.765	0.002
Taxation (X3)	.196	2.513	0.0001
Dividend Policy (X4)	.388	3.626	0.003

a. Dependent Variable: Capital structure (leverage)

Source: Resource data (2017)

The standardized beta coefficient indicates the strength and the direction of the independent variables on the dependent variable. Table 4.5 above portrays that holding all the explanatory variables constant, capital structure will realize an average increase of 0.189. Growth of the firm and taxation were positively related to leverage as at 0.003 and 0.196 respectively. Meaning that an element increase in this variable led into a corresponding rise in leverage. Liquidity and dividend policy were negatively related to leverage at 0.24 and 0.388 respectively.

b1= 0.003, demonstrates that one-unit increase in growth of the firm results in 0.003 units increase in capital structure(leverage) holding other factors constant.

b2=- 0.24, shows that one-unit increase in liquidity results in 0.24 units decrease in capital structure(leverage) holding other factors constant.

b3= 0.196, indicates that one-unit increase in taxation results in 0.196 units increase in capital structure(leverage) holding other factors constant.

b4= 0.388, indicate that one-unit increase in dividend policy results in 0.388 units increase in capital structure(leverage) holding other factors constant.

From the results it is clear that the growth of the firm has the least effect on capital structure (leverage). Dividend policy has the greatest effect on capital structure (leverage).

The findings further established that liquidity, taxation, dividend policy, size and growth of the firms have a positive relationship with capital structure. The findings are supported by the argument by Wang (2010) and Wellalage (2012) that the use of debt increases growth.

4.5 Discussion

The regression analysis that was conducted utilized the leverage as the dependent variable and the independent variables of firm growth, liquidity, taxation and dividend policy. The findings show that *R*, which is the multiple correlation coefficients that shows quality of the prediction of the dependent variable by the independent variables, there is a strong correlation between the dependent and the independent variables. The *R-Square* which is the coefficient of determination shows that 86.9% of the variation in capital structure (leverage) can be explained by the changes in growth of the firm, liquidity, taxation and dividend policy leaving only 13.1 percent unexplained.

The study also revealed that dividend policy had a positive significant effect on capital structure of the automobile firms listed on the NSE. Empirical evidence supports the existence of positive association cash dividend and the value of equity of a firm (Booth et al., 2001). They further argued that as company's value increases the cash dividend paid out to shareholders improves.

From the findings of this study, a weak positive relationship exists between liquidity and the capital structure. These findings disagree with the findings of the growth of the firm that may require funding which is above the internal thresholds to finance their

investments. This may result into using more debt thus change capital structure. Similar results were established by Myers and Majluf pecking order theory (1984).

The study found weak positive association between growth and liquidity and a weak positive association between dividend policy and taxation. This explains the tax advantages that firms are able to offset by having a mix of debt and equity in the capital structure as opposed to equity alone.

4.6 Summary

The study aimed to determine the choice of capital structure of automobile firms listed on the Nairobi Securities Exchange within the study period of year 2007- 2016. The study relied on secondary data from the NSE. The researcher was able to get the required data. Descriptive results indicate that over the ten-year period the Automobile firms had a mean leverage of 0.61, growth of 0.042, liquidity of 0.5682, taxation of 0.2321, and dividend policy mean of 0.2357.

A correlation matrix was employed to assess multi-Collinearity, that is, if there is a strong correlation between two predictor variables. From the finding in the table above, the study found a strong positive association between the dividend policy and growth shown by correlation coefficient of 0.733, this too was also found to be significant at 0.054 level.

Holding all the explanatory variables constant, capital structure will realize an average increase of 0.189. Growth of the firm and taxation were positively related to leverage as follows: 0.003 and 0.196 respectively. Liquidity and dividend policy were negatively related to leverage as follows 0.24 and 0.388 respectively. From the results it is clear that the growth of the firm has the least effect on capital structure (leverage). Dividend policy has the greatest effect on capital structure (leverage).

The F statistic was used to make simultaneous comparisons between means; thus,

testing whether a significant relation exists between dependent and independent variables. The regression model developed is statistically significant. A variation in the results is insignificant that cannot result to a much difference in case of a change in the study units (population) and therefore the model can be relied upon to explain the factors that determine the choice of capital structure of automobile firms listed on the Nairobi Securities Exchange.

CHAPTER FIVE

SUMMARY AND CONCLUSION

5.1 Introduction

This chapter summarizes the study findings and presents conclusions and recommendations of the research. The conclusions are obtained from the findings of the research which sought to determine the choice of capital structure of automobile firms listed on the Nairobi Securities Exchange.

5.2 Summary

The aim of this research was to determine the choice of capital structure of automobile companies listed on the Nairobi Securities Exchange. The research used secondary data which was analysed using SPSS. The population of interest in this study comprised of the more than 60 currently listed companies on the Nairobi Securities Exchange. The study used a census sampling technique. The sample for this study included all the automobile firms that were listed throughout the years 2007-2016.

The study found out that 86.4 % of the changes on capital structure of Automobile firms can be explained by changes in the growth of the firm, dividend policy, liquidity and taxation. Descriptive results indicate that over the ten-year period the Automobile firms had a mean leverage of 0.61, growth of 0.042, liquidity of 0.5682, taxation of 0.2321, and dividend policy mean of 0.2357.

The study also found weak positive association between growth and liquidity as shown by correlation coefficient of 0.351 at 0.001 level of confidence. The study also found weak positive association between dividend policy and liquidity as shown by correlation coefficient of 0.310 at 0.028 level of confidence which is less than 0.5. Other factors revealed by the study to significantly affect capital structure of the firm include firm size, asset tangibility, firm growth and earnings volatility of the

Automobile firms.

Holding all the explanatory variables constant, capital structure will realize an average increase of 0.189. Growth of the firm and taxation were positively related to leverage as follows: 0.003 and 0.196 respectively. Meaning that an element increase in these variable led into a corresponding rise in leverage. Liquidity and dividend policy were negatively related to leverage as follows 0.24 and 0.388 respectively. From the results it is clear that the growth of the firm has the least effect on capital structure (leverage). Dividend policy has the greatest effect on capital structure (leverage).

5.3 Conclusion

Literature proposes that debt conditions of a firm in one industry vary from the firm in another industry; hence determinants of capital structure are not the same amongst industries (Titman & Wessels, 1988). The reason for this is because in the operating environment, business risk differs across the industries. The automobile industry is unique in many aspects compared to other sectors in Kenya.

This study concludes growth of the firm; taxation, liquidity, and dividend policy are key determinants of the capital structure of Automobile companies in Kenya. The most influential variable is the dividend policy followed by liquidity, then taxation and firm growth. Firm growth has the least impact on leverage of the automobile firms in Kenya.

5.4 Recommendations for policy.

Growth of the firm, taxation, liquidity, and dividend policy are some of the factors considered when making the capital structure choice. The study recommends that a well-adjusted combination of debt and equity to be established so as to ensure that the firm maintains capital adequacy. Firms can thus be able to meet their financial compulsions and grasp investments that can promise attractive returns.

Firms in the various sectors of economy should take into account the industry norms

when developing their financial policies.

5.5 Limitations of the Study

This study was limited because only firms listed under Auto mobile sector at the NSE were used as the case study for the entire population. Thus, other firms with different characteristics which otherwise could provide different results were not considered. Thus, there's room for little variations in the findings with respect to firms.

Because of time constraints it could have been appropriate for the researcher to execute an exploratory study to discover the 'cause and effect' on the link amid capital structure and its determinants. This might have given more insights on the long-term sustainability of capital structure.

5.6 Recommendations for Further Research.

A replica of this research study should be conducted in another sector such as the manufacturing sector to find out if similar results can hold. Capital structure varies significantly by industry.

If possible more firms from different sectors should be included in the sample so as to increase reliability on the results. Capital structure is the useful tool for growth and expansion and the overall financial performance of any firm. Further research can be undertaken considering a bigger sample size so as to produce more reliable results. Again undertaking the same research would help confirm if the observation would have changed.

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APPENDICES

Appendix I: List of Quoted Automobile Firms as at 31st December, 2016

1. Car & General (K) Ltd.
2. Sameer Africa Ltd.
3. Marshalls (E.A.) Ltd.

Appendix II: Data Collection Sheet

	Total Assets	Equity	current assets	Current liabilities	cash dividend	Stockholders' equity	Taxation	Debt	Operating Income
2007									
2008									
2009									
2010									
2011									
2012									
2013									
2014									
2015									
2016									

Appendix III: Data '000'

	Total Assets	Equity	current assets	Current liabilities	cash dividend	Stockholders' equity	Taxation	Debt
2007	1,100,669	886,599	1,271,836	965,848	15,000	525,305	82,652	319,459
2008	2,750,520	1,128,918	1,829,332	1,413,564	14,927	530,042	106,725	475,629
2009	3,214,248	1,307,802	2,191,107	1,681,144	14,927	571,623	81,406	1,100,617
2010	3,880,055	1,555,906	2,686,734	2,048,108	14,927	605,013	90,941	1,620,512
2011	5,562,239	1,920,322	3,487,990	3,105,247	17,824	719,261	139,220	1,863,143
2012	5,705,400	2,143,154	3,397,179	2,928,463	18,381	814,232	140,254	2,455,123
2013	6,901,430	2,504,178	4,188,592	3,766,604	25,113	998,245	143,179	3,629,491
2014	8,152,812	2,832,398	5,026,058	4,190,457	26,736	1,326,781	141,904	4,629,859
2015	8,988,047	3,021,113	5,276,589	4,995,790	24,062	1,483,284	46,078	4,344,004
2016	9,705,198	3,238,539	5,666,853	5,636,222	20,456	1,648,669	61,406	7,169,229