EFFECT OF CAPITAL STRUCTURE ON STOCK RETURNS OF NON-FINANCIAL FIRMS LISTED AT NAIROBI STOCK EXCHANGE
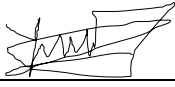
BY

JACKY JEMALEL YATICH

A RESEARCH PROJECT PRESENTED IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE DEGREE OF MASTER OF SCIENCE IN FINANCE, UNIVERSITY OF NAIROBI.

2022

DECLARATION

I, the undersigned, do hereby declare that is project is my original work that has not been submitted to any institution for the award of degrees, diplomas or certificate.

Signed:_____ Date: __14/09/2022

JACKY JEMALEL YATICH

D63/30147/2019

SUPERVISOR:

This research project has been submitted for examination with my approval as University Supervisor.

Signature: _____ Date: September 16, 2022

DR. WINNIE NYAMUTE

Department of Finance and Accounting

Faculty of Business and Management Sciences

University of Nairobi

ACKNOWLEDGEMENT

DEDICATION

My unwavering dedication to my visionary husband, Victor. In addition to being the greatest friend and companion and in my life, he became my mentor and cheerleader. This research excelled due to his steadfast, wholehearted and staunch approach to fundamental issues that were building blocks. It was highly relieving to see him assisting and managing our household chores in my absentia while committed to finish this research paper. My deepest appreciation.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF ABBREVIATIONS

ANOVA	Analysis of Variance
CBK	Central Bank of Kenya
CMA	Capital Markets Authority
EPS	Earnings per Share
FS	Financial Statements
GDP	Gross Domestic Product
NSE	Nairobi Securities Exchange
NPV	Net Present Value
ROA	Return on Assets
ROI	Return on Investment

ABSTRACT

For the purpose of this study, a descriptive research approach was utilized, and the sample population consisted of 47 non-financial firms that were listed on the Nairobi Security Exchange between January 1, 2015 and December 31, 2020. A collection sheet was developed with the help of secondary data taken from the financial accounts that were submitted to the CMA. In order to do the analysis, the user-friendly software known as SPSS was utilized. The data was entered in SPSS to aid descriptive, correlation, and regression analysis procedures. The variables studies proclaimed a weak but positive association for profitability and liquidity verse the stock return as elaborated by (r=0.030, p=0.616) and (r=0.425, p= 0.001) consecutively. Firm size recorded a strong positive association with the stock return as blueprinted by (r=0.892, p=0.001). In addition, debt ratio registered a negative association with the stock return as expounded by (r=-0.250, p=0.00). This study findings give detailed information about the regressor variables (Liquidity, Debt Ratio, Profitability and Firm Size) verse the regressed variable (Stock Returns). Therefore, R (Correlation Coefficient) is 0.927. This implied that there was 92.7% correlation between the variables. R Square (Co-efficient of determination) is 0.859. This insinuates that 85.9% of variation in stock return is explained by the explanatory variables (Liquidity, Debt Ratio, Profitability, and Firm Size). The remaining percentage, 14.1%, are factors not cited. The findings illustrated that if all factors are kept constant, the autonomous value stands at negative 5.046. Additionally, increase in one unit of debt ratio triggers a decrease in stock return by 5.4% all variables maintained constant. Moreover, an increment of a single unit of profitability translates to increment in stock return by 125.7% if all factor remains constant. Furthermore, an increment in firm size by a single unit causes the elevation of stock return by 73.3% when all variables are kept constant. In addition, a unitary addition of liquidity translates to increase in the stock return by 30.2%. The findings have been summarized in the multiple linear regression below. The study recommends for minimal relies on debts ratio since it reduces the stock returns. Moreover, the research can analyze the influence of corporate governance on the unpredictability of stock prices, inflation and stock fluctuation, firm characteristics and stock prices as well earning management verse the stock returns.

CHAPTER ONE
INTRODUCTION

1.1 Background to the study

Regardless of the economic sector in which a company operates, capital structure selection is crucial. Businesses frequently struggle to find the right debt-to-equity ratio. Due to the necessity to maximize returns to various organization stakeholders, capital structure combination is crucial; it also has an impact on how a corporation runs and performs in a competitive setting. A business may choose a different debt-to-equity ratio. Lease finance, the usage of warrants, the sale of convertible bonds, the signing of forward contracts, and trade bond swaps are all examples of debt. The purpose of combining several securities is to increase market value.

The purpose of capital structure research is to figure out how corporations maximize a combination in the form of both debt and equity finance in order to support their investments. (Myers, 2001). The capital structure of a corporation appertains the usage of finances its activities, which is doable through debt, stock, or their combination. Furthermore, Brigham Young University (2004The authors Modigliani and Miller (1958) asserted in their seminar paper that a firm's capital structure has no pertinence on its worthiness because value is coined by the sum of all profitable investments. Different researchers developed the strategic tradeoff and pecking order theories to extenuate the rationale for preferred capital structure based on this contentious concept. According to strategic tradeoff theory, firm's ideal capital structure demands a tradeoff connecting the benefits in furtherance to costs of borrowing as well as equity financing. Borrowing has the advantage of being tax deductible interest payments. On the other side, bankruptcy

and agency expenses are drawbacks (Jensen & Meckling, 1967). Additionally, pecking order explicate the informational asymmetric predicament linking the firm's management and the shareholders (owners). The corporation will choose to use internal money rather than external funds to reduce the agency problem (Myers & Majluf, 1984).

Masuli (2013) revealed that changes in leverage had a positive connection with changes in stock returns when looking at pure capital structure alterations. He looked at daily stock returns after recapitalization and exchange offers where the recapitalization happened all at once. However, his sample included a group of companies that had just experienced capital structure modifications, which may be considered a separate risk category. As a result, the characteristics of this sub-firm's samples may not be representative of all businesses.

According to the findings of a survey of the existing empirical research, while numerous studies have examined each variable individually with conjoining the capital structure stock returns to extenuate their relation. In addition, a few have examined both. According to the findings of certain studies, the structure of capital is influenced by stock returns (Barger & Wurgler 2002). In addition, Welch (2004) elaborates on the result by highlighting the significant part it plays. However, others assert that capital structure is influenced by stock returns (Barger & Wurgler, 2002; Welch, 2004). (Welch, 2004; Barger & Wurgler, 2002). (Welch, 2004; Barger & Wurgler, 2002). 2008, Bhandari et al. According to several studies, capital structure and stock returns have a synergistic effect.

1.1.1 Capital Structure

Rehman (2013) delineates capital structure as the unique combination of debt verse equity tapped in financing a business's overall operations and growth. A claim on a company's future cash flows and revenues created by its ownership shares is referred to as "equity capital." Debt is vindicated by bonds as well as loans. On the other side, equity is extenuated by preferred stock, common stock, and retained earnings. Additionally, short-term debt is included in the capital structure. Raviv and Harris (Harris & Raviv, 1991). When selecting whether to finance operations with debt or equity, organizations must make compromises, and management must balance the two to create the ideal capital structure.

Debt financing offers both advantages and disadvantages when it comes to financing a company's operations and expansion. Using debt has the advantage of providing a tax shelter while also reducing free cash flow difficulties by enhancing managerial behavior. Debt management costs, such as agency and bankruptcy fees, create a conflict of interest linking shareholders and debtholders Fama and French (2002). Before making debt capital decisions, these costs and benefits must be balanced in order to sustain solid financial performance (Kraus & Litzenberg, 1973).

According to Asteriou and Agiomirgianakis (2004), the composition and the capital structure is critical in affecting survival, performance, and growth. Companies use varied degrees of financial leverage to establish the best capital structure, and the strategies of these companies try to find a balance between risk and reward in their operations. As a company's debt grows, so does the risk of its returns, forcing investors to demand larger

rates of return. Increased risk reduces stock prices, whereas a high investment rate increases stock prices; thus, the company's capital structure has specific influences and the enabler of stock returns. (Berg, 1973).

1.1.2 Stock Returns

Returns on stocks are the fall or gain in value of an investment over a certain time period, and are often expressed as a percentage of the initial investment. Returns can be positive or negative. In the event that shares were sold at today's market values, the total return would be composed of the capital gain in addition to the dividends that were received on the shares. (Mugambi and Oketch 2016). Because it contains futuristic discount rates in addition to cash flow forecasts, it can be utilized to make investment decisions. In the vast majority of instances, investors search for companies that can offer a rate of return that is greater than their cost of capital, and they then choose to put their money into those companies (Wang, 2012).

The movement or fluctuations in stock prices are factors that influence the stocks demand in furtherance to their supply among investors (Taofik & Omosola, 2013). Stock markets react to any information that has the potential to alter stock prices as well as information that is significant to market development in the future (Sirucek, 2013).

The stock market index is commonly used to operationalize stock returns. Performance is measured by looking at how much a stock's price moved up or down. Rising stock prices and stock indices are signs of a stock's success (Dafarighe & Sunday, 2012). The NSE 20 share index is used as a benchmark for determining the overall performance of the market as well as a gauge for determining the returns on individual stocks traded on the Kenyan stock market. There are several factors beyond the stock market that might affect stock

values. It is a common practice among traders and investors to try to anticipate movements in stock prices.

1.1.3 Effect of Capital Structure on Stock Returns

According to Modigliani and Miller (1958), there is no such thing as an ideal capital structure because the cost of capital structure does not have any influence on it. The premise was that the organizational capital structure had no bearing on its value. The tradeoff hypothesis, on the other hand, posits that corporations must trade off the advantages of introducing debt, including interest tax deductibility, with the costs of debt, including agency charges and bankruptcy costs (Myers, 1977). Internal finance is preferable over external funding, according to Myers and Majluf (1984), because of the information asymmetry and agency dilemma between shareholders and managers. Because of this, the pecking order hypothesis predicts that large profitable enterprises that have larger earnings will always choose to finance themselves through internal resources rather than through loans from external sources.

Debt financing has a substantial impact on the stock market, according to Modigliani and Miller (1963), because many fund suppliers, both debt holders and equity holders, must share the company's earnings. When debt was introduced, they assumed that the organizational value is maximized. Therefore, the use of debt to mitigate the risk associated with leverage, equity holders will be compelled to seek a higher rate of return on their stock. Different studies carried out give contrasting outcome relating to capital structure and stock returns. Additionally, Chen et al. (2014) wrapped-up the same outcomes by stating that firms deal with stock return fluctuation by debt decrease rather than equity issuance. On Contrariwise, Sebnem and Vuran (2012) examination concluded

that capital structure affects stock returns, among other factors. Rathmore et al. 2015 postulated that the stock return is affected by the capital structure is typically implemented, although the degree to which this occurs varies greatly from industry to industry. When it comes to certain fields of business, the association is beneficial, but in others, it is detrimental. Except for commercial banks and insurance agencies, which are heavily regulated by the CBK and IRA, the purpose of this research is to establish whether or not there is a correlation between the capital structure of a company and the returns on its shares if that firm is quoted on the New York Stock Exchange (NSE).

1.1.4 Firms Listed at Nairobi Security Exchange

Since it was established in 1954, the Nairobi Securities Exchange (NSE) can be considered to be one of the oldest stock exchanges in all of Africa. Today, it is one of the continent's busiest and most successful organizations. The Nairobi Stock Exchange (NSE) is a key capital market organization that has played an important role in the economic growth of Kenya. It streamlines domestic savings, permitting previously stagnant financial fund to be reallocated to gratifying sectors of the economy (Fredrick, 2015). The transfer of securities between investors who trade on a securities exchange improves market liquidity. When long-term investments like treasury bonds are swapped, market liquidity is boosted.

Specifically, in global corporations wishing to conduct business in Kenya, allowing Kenyans to own a stake of those businesses. Companies with stock exchange listings may use the exchange market to raise capital for expansion and development. The NSE is a

fantastic approach to privatize enterprises that are having difficulty, as well as facilitate the flow of international money into an economy (Gakeri, 2012).

The number of companies that are listed on the NSE is 66; the exchange is projected to have a daily trading capacity of more than 10 million dollars and a market value of more than 23 billion dollars. There are three main market segments, and they are referred to by their respective names as follows: the Main Investment Markets Segment (MIMS), the Alternative Investment Markets Segment (AIMS), and the Fixed Income Market Segment correspondingly. The most important market, known as the MIMS, is where trading of quotes takes place. Micro, small, and medium firms, as well as startups, that are unable to satisfy the onerous listing standards of the MIMS may be eligible for funding options through the AIMS. The transactions that involve fixed income instruments like treasury bonds, preferred shares, corporate bonds, and debenture stocks are the ones that take place in the Fixed Income Securities Market System (FISMS). Additionally, the FISMS is applied in the trading of financial items that have a period of shorter than one year, such as commercial papers and treasury bills (Gatua, 2013).

1.2 Research Problem

Stock returns are significantly impacted by the capital structure of a company, but this is only the case when it is utilized effectively and responsibly. In finance circles, however, determining the optimal capital structure has proven difficult, contentious, and mostly unsolved (Kajola, 2010). Theoretical and empirical investigations on capital structure, profitability, as well as financial performance exhibited no definitive consequences. Companies prefer internal finance over external financing due to knowledge asymmetry. According to Myers & Majluf (1984), resulting in a negative association allying capital

structure (debt) and performance. MMs tax interest deductibility predicted a positive relationship because companies performing better would utilize more debt than internal financing or equity to shield their profits from taxation.

Furthermore, capital structure on stock returns has been assessed empirically, but the results have been mixed. On the Tehran stock exchange, Saaedi and Mahmoodi (2011) evaluated the impact of capital structure (CS) on business performance, concluding that CS had no influence on firm performance. According to Nirajini & Priya, capital structure and financial performance portrayed a positive correlation (2013). Sebnem and Vuran (2012) demonstrated that capital structure as well as financial performance have a positive link. Akbarian (2013) investigated the correlation amid leverage verse returns on Tehran stock exchange firms. Moreover, the finding that leverage has a negative association with free cash flow per share though a significant positive relationship with return on equity.

According to Maina & Ishnail (2014), capital structure has little bearing of the financial thriving of NSE-listed firms. This contradicts the findings and recommendations of Njeri and Kagiri (2015), who discovered a favorable association between CS and financial performance of Kenyan listed banks. Financial leverage and performance, according to Mwangi et al., have a considerable negative association (2014). Masereti (2014) analyzed the association between capital structures, stock performance and discovered that they are related. Ndungu (2014) claims that increasing operating leverage boosts stock returns.

As a result of my research, another researcher observed that there is no widespread agreement regarding the effect that capital structure has on stock returns. This led me to conduct additional

research on the topic. The vast bulk of work that has been done in this field in the past has focused mostly on doing analyses of the impact that the corporate capital structure has on performance. To achieve a more comprehensive understanding of the interdependencies between the various components, it is required to conduct additional study on the effect that capital structure has on stock returns. The primary purpose of this research is to acquire a more in-depth grasp of the various ways in which the capital structure of companies that are traded on the NSE effects the stock returns of those companies.

1.3 Objectives of the Study

This piece of study intends to perform an inquiry into the impact that the capital structure of a firm has on the stock returns of businesses that are traded on the Nairobi Stock Exchange. The businesses in question are those that are publicly traded on the Nairobi Stock Exchange. Both of these pieces of research have this as their primary focus, as it is the primary purpose of both of these pieces of research. All of these distinct businesses may be discovered at the Nairobi Stock Exchange, which is the name of the place where they are traded.

1.4 Value of the Study

This study's findings will enlighten investors and policymakers to identify factors that affect stock prices, enabling them to make strategic decisions when investing in capital markets. It will give adequate information and insight to investors to appreciate the interrelationship of risk and return in investment opportunities. The research will assist businesses in making financial decisions regarding capital structure and the effect it has on stock market returns in general. The research study has an objective to benefit NSE and capital market authorities to assist companies in identifying the appropriate capital

9

structure or combination that maximizes the shareholder's wealth. The study is a cornerstone for future undertakings while providing in-depth information on this specific title to academicians and future scholars.

CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction

This chapter unfolds the already existing theoretical perspective as well as the available literature on capital structure and returns legitimize the study. It also consists a theoretical review worthwhile in the understanding gaps and problems. Additionally, it is the epicenter for the examination of the determinants of stock returns. It coins the empirical examination, effectiveness of the schematic framework, and a summarized literature review.

2.2 Theoretical Review

Innumerable theories proposed to exemplify the linkage between CS and stock performance have been gratified. In the research analysis, we talk about Modigliani and Miller's model to justify the study, the pecking order theory to elaborate on this evaluation, the tradeoff theory to map out the connection, and the agency theory to improve our comprehension.

2.2.1 Modigliani and miller model

Modigliani and Miller's theorem is a foundational concept in corporate finance. According to the MM theory, which was introduced in 1958, the capital structure or equity to debt ratio has absolutely no effect on the firm's value and worth. It asserts that firms operate in ideal capital markets that are devoid of transaction costs and bankruptcy costs. Corporations pay out 100% of their dividends, and investors can use same interest rate with companies in borrowing and lending. The capital market is completely efficient because all investors have access to the same data.

According to Modigliani and Miller (1958), operating revenue has a significant and noticeable effect on the value of a company, which is separate and apart from the risk that is associated with the investment. According to MM, a company's worth is unaffected by its CS or financial operations. According to theorists, such businesses have the same market value regardless of how they are funded. According to the theorists, if the market prices of the two firms differ, investors (borrowing and lending at the same interest rates as corporations) will continue to participate in arbitrage by disposing their stocks in the overvalued companies and purchasing securities in the undervalued one (investment switching). As a consequence of this, there will be an increase in demand for the securities of the firm that is currently undervalued, while there will be a decrease in demand for the securities of the firm that is currently overvalued, so reestablishing equilibrium in the market valuation. Because of its ideal market assumptions, this concept has been criticized. As can be seen, academics have assigned each company to a distinct "risk class," with similar earnings across governments around the world. However, as Stiglitz (1969) established, this premise is unrepresentative because businesses do not operate in the same context. The idea that individuals and businesses can borrow at the same rate was also disputed by the author. Individual borrowing, unlike corporate borrowing, is subject to market rate constraints, he claimed. In this regard, he believes the handmade leverage concept is unsustainable.

Frank and Goyal (2003) expound on theory by coining that; it is built on an abstract mathematical model that does not incorporate data collection and analysis. This is in contrast to current approaches in the capital structure literature, which mostly rely on

quantitative or, less frequently, qualitative research methodologies to experimentally validate modern theories (Graham & Harvey, 2001).

Despite its flaws and the lack of normative pronouncements of practical utility, Modigliani and Miller's contribution to the capital structure theory was hailed as "ground-breaking" (Jensen & Meckling, 1976). The Modigliani-Miller theorem, according to Frank and Goyal, does not provide a complete explanation of how organizations finance their operations, but it does provide a method for determining why financing matters (2003). The overall theoretical framework, according to Miller (1988), is widely recognized and has evolved into an important aspect of economic theory as well as a cornerstone for modern finance theories.

This hypothesis is advantageous since it blueprints non-biased views about the significant association between capital structure and the financial crisis causes under investigation. The theory provides a neutral framework for conducting in-depth empirical research of this relationship within the targeted population by stating that funding decisions are irrelevant to the company.

2.2.2 Pecking Order Theory

The research authors Myers and Majluf are principally responsible for introduction the pecking order notion (1984). According to this notion, managers follow a predefined hierarchy when making financial decisions that require the source of cash. According to the notion, while finding capital for investment opportunities, managers prioritize retained earnings, loan financing, and finally equity financing.

The stipulations of uneven information underpin the pecking order theory. Additionally, whenever one party in a transaction has greater access to information hence disadvantaging other participants., thereby making quality decisions than the counterparty, resulting in a power imbalance in the transaction. External investors, such as debt holders, creditors, and shareholders, sometimes have more information about a company's performance, future prospects, and hazards than corporate executives. Because of the information asymmetry, external fund providers expect a larger return than internal financers to compensate for the risk.

Debt is frequently issued as a result of a low stock price and the board's belief that the venture is lucrative. Additionally, issuing equity posts a negative message, implying that the stock is expensive and that governance is attempting to obtain financial muscles by diluting company shares. It's useful to examine the precedence of claims to assets when examining pecking order theory. Debt-holders want a minimal return than stockholders as expounded by larger claim on assets whenever it is no longer a going concern. Therefore, it's critical to start at the bottom and work your way up when considering financing options: retained earnings, debt, and finally equity. Unlike the tradeoff theory, the pecking order theory postulates a definite financial hierarchy, but there is no well-defined goal debt ratio. To protect value and corporate stability, this technique favors internal funds over external funds, which comprise both debt and stock. In conclusion, a larger use of external resources, both debt and equity, results in a decrease in the value of the company and an increase in the risk of a financial catastrophe.

2.2.3 Trade off Theory

Corporate leverage is driven by the advantage or benefit of interest being tax deductible vs. the danger of financial hardship or insolvency, according to tradeoff theory. Despite numerous challenges, it remains the most widely accepted capital structure hypothesis. Modigliani and Miller's (1963) work were highly attacked for its irrelevance theory of capital structure due to their perfect market assumptions, and this idea evolved from their work. After acknowledging that taxes in the real world cannot be avoided and that attempts at arbitrage do not always result in lucrative outcomes, the writers emphasized the significance of capital structure as it relates to the market value of a company.

They reasoned that just because interest on debt is deductible from taxes, it blueprints additional cash flows to leveraged enterprises in the form of interest tax savings, which ultimately results in an increase in the firm's market value. In a nutshell, the theory claims that under the conditions in which debt is regarded as being permanent, the cost of debt does not vary, and the marginal tax rate does not shift, leveraged businesses will have a higher market value than organizations that do not use debt. This particular case is a direct result of the current value of the interest tax deduction that is connected to loan financing. In addition, Jensen and Meckling (1976) came up with the idea that if the costs of debt management are higher than the advantages of applying the tax, then the tax ought to be adopted (1976). According to the findings of this particular researcher, agency costs are the result of competing interests on the part of governance, shareholders, and debt holders. It added that executives may act in their own best interests and aren't entirely focused on growing shareholder wealth, resulting in the wasting of free cash flows through bonuses and poor investment decisions. Because shareholders are shielded

by the company's limited liability status, they may engage in unprofitable ventures. Monitoring measures, such as expert analysts, debt covenants, and limits, are utilized by debt holders in order to reduce the likelihood of experiencing losses and hazards. Additionally, the utilization of these mechanisms results in an increase in the agency expenses incurred by the company. This, in turn, nullifies the advantages of debt financing and reduces the value of the company. According to Myers (1977), the benefits of debt are limited because it entails dangers such as bankruptcy and agency fees. As a reward for taking on additional risk, equity holders need a higher rate of return in dividend pay-out ratios as a result of adding debt to a company's capital structure. Debt investors, like equity holders, become less excited about giving further capital or demanding high interest rates on debt, causing the company's cash outflow rate to increase. The present values of agency and bankruptcy costs outweigh the tax-sheltering benefits of debt to the firm, as proved by the hypothesis, which included the theoretical effects of agency fees and bankruptcy risk. In actuality, the presumption states that a company's worth increases as its debt levels increase, up until the point where additional debt results in increased agency and bankruptcy expenses, resulting in a decrease in value. This hypothesis is useful in the study because it explains how debt financing increases corporation value by allowing for tax deductions. In addition, the capital structure concept is incorporated with agency charges and financial distress costs. It highlights how the capital structure can be harmful to the company by increasing borrowing agency costs.

2.2.4 Agency Theory

According to agency theory, a relationship of agency is formed between the principal and the agent whenever the principal assigns the responsibility of decision making within the company to the agent, who then acts on the owner's behalf (Jensen & Meckling, 1976). This can lead to a conflicting interest between the agent (management) and the owner, causing the governance to prioritize their own interests over the principals', and making it detrimental and costly for the owner to monitor the agent's actions to ensure the governance is acting in the principals' greatest priorities. In a nutshell, the agency theory seeks to resolve the agency problem so that the two sides can collaborate effectively (Itiri, 2014). The basis of the theory is that the interest of the owner and management is not aligned to make them work towards a common goal.

Agency theory explains that managers prefer to hold a high level of cash flows even when there exist profitable opportunities to use the funds to maximize their interest rather than maximizing the firm's value (Calabrese, 2011). This theory proposes that debt is used to alleviate the agency problem since excess cash flows will be used to cover interest and principal payback obligations rather than sitting idle for managerial mismanagement (Calabrese, 2011). As a consequence of this, the concept suggests that making use of debt Ngumi, Mwangi, and Muturi is one of the methods in which to improve financial performance (2016).

2.3 Determinants of Stock Returns

Existing investors, new investors, and other capital market participants are all interested in stock returns. Various factors influence stock returns, according to empirical studies, as detailed below. The return on stocks is determined by a multitude of factors, and the

exact figure is unknown. Capital asset pricing theory (CAPT) and arbitrage pricing theory (ATP) are two fundamental and widely accepted models for explaining stock returns (Babar Zaheer Butt, 2009).

2.3.1 Capital Structure

Firms' debt and equity ratios have an impact on their ROA and ROE. In a perfect market without taxes, transaction expenses, or bankruptcy costs, according to MM's capital structure theory, capital structure is unimportant. This notion said that a company's value is unaffected by its financial actions. CS decisions affect a firm's worth in the real world, where taxes, bankruptcy costs, and knowledge asymmetry exist (Njoroge, 2014).

The use of debt usually comes with debt covenants (restrictions) that dictate the firm's operations (Lee, 2009). The restrictions translate into inflexibility, which may make a firm not venture into investments even though they may be profitable or have high returns rates (Amato & Burnson, 2007). This may finally affect overall firm financial performance hence low stock returns.

Theoretically, a high leveraged firm translates to a high risk of bankruptcy and high repayments of debt principal and interest, prioritizing dividends. Due to the risk and the cash outflows to the debt providers, equity investors demand a high rate of returns on their stock (Bhandari; Yang et al., 2010).

2.3.2 Market Sentiments

Market sentiments refer to the general mood or intuitions the general market has about a stock or an asset. Market sentiments are considered a factor that drives stock returns because investors with high sentiments tend to be overconfident and engage in

overtrading, which lead to subpar stock performance as they are trading on noise and emotions. Eventually, any mispricing caused by the investor sentiments is corrected when the market fundamentals are discovered. Hence investor sentiments are a contrarian predictor of stock returns.

Market sentiments are divided into two types: stock-specific emotions and market-wide emotions. Shangkari V. Anusakumar (2017) suggests that stock-specific sentiments possess a big and beneficial impact on stock returns after regulating the business factors. Brown and Cliff (2004) establish a substantial correlation between current stock returns and sentiment, corroborating this argument. Brown and Cliff (2005) discovered that mood had an effect on stock market mispricing in the United States. Chen (2011) discovered a correlation between negative sentiment minimal returns in the US market. Singal (2012) claims that stock returns are influenced by sentiment, utilizing a sample of hospitality companies in the United States as a case study. The returns of hospitality companies were linked to changes in sentiment.

2.3.3 Industry performance

The profitability and performance of the commercial entity in which a company operates have a substantial impact on the price of that firm's stock in the marketplace. Companies that are involved in the same industry frequently have stock prices that move in the same direction at the same time. This is because market conditions in a particular industry similarly affect companies. However, if two companies target the same market, bad news hitting one company in the same industry may benefit the stock price of the other (Madura, 2008). Usually, investors evaluate firms' performance based on earnings per share (EPS), prospected future earnings and revenue.

Market share gains and losses substantially affect the performance of company stock based on the company sector economic conditions. Businesses that operate in cyclical industries that have low growth rates are particularly susceptible to the negative effects that shifts in market share can have on their financial performance. According to Acheampong, Agalega, and Shibu, firms' securities prices tend to change as per the market and industrial peers (2014).

2.3.4 Company News and Performance

News significantly impacts security markets. The news and rumors affect the investor's prospects, sentiments, and company performance as the investors construe news or information differently depending on their cognitive power. Any news relating to a company, whether expected or unexpected, can shift the share price. The news could range from a substantial profit in an earnings report to the launch of a new product, missed targets, or the loss of key individuals, all of which could trigger a shift in demand and share prices (Alanyali, Moat & Preis, 2013).

Investors focus on industry characteristics such as product price movements, entry into the industry, and industry sales predictions since certain companies react more to their industry-specific circumstances than to general economic situations. An increase in dividends signals to investors that the company will be able to pay out even more dividends in the future. A decrease in dividends leads to investors trimming their prospects, affecting stock prices and stock returns.

2.3.5 Firm size

When seeking to determine the size of a company, one relevant statistic to consider is the company's stock market capitalisation, provided that the company is publicly traded. The entire assets of a firm are what are utilized to determine the size of the company. Ikikii and Nzomi (2013) state that the stock market capitalization provides an explanation of the total value of an entity's issued shares in compliance with the standards of the NSE. Market capitalization is higher for companies that have a significant number of outstanding shares, all other parameters being held constant. According to Musebe (2015), a market capitalization that is employed in the calculation of yield on investment is of vital significance to investors. According to Banz (1981), companies that have a low market capitalization tend to have higher returns than companies that have a high market cap. The findings of Idris and Bala (2015) were supported by the findings of our study, which showed that there is an inverse relationship between the size of a market's capitalization and the returns on its stocks. Our findings also showed that there is a positive relationship between the size of a market's capitalization and the returns on its bonds. This is due to the fact that investors consider smaller organizations to be riskier than larger ones, and as a result, they expect higher returns from smaller enterprises than they would from larger ones.

Irungu (2013) scrutinized the relation between financial performance metrics and the stock prices of Kenyan commercial banks. The overall assets and liabilities of the organization, as well as the cost-to-income ratio of the enterprise, are all examples of regressor variables. Regressor variables are used to analyze relationships. In addition to this, the price of the company's market share was included as a regressed variable. The

research sample consisted of ten commercial banks that were all listed on the NSE in Kenya. Multiple regression techniques were useful in assessment of the variables and their influences. The model is significant according to the findings.

2.3.6 Firm Liquidity

Liquidity coins the company's ability to meet its financial commitments on time. Too much liquidity causes straining of idle resources with its opportunity cost being returned from forgone investment opportunities. On the contrary side, insufficient levels of liquidity might result in harm to the goodwill of a company, low credit standard ratings due to failure to meet obligations when they fall due. Every firm desire to maintain an optimum level of liquidity that ensures Profitability is maximized and financial solvency is observed (Viera, 2010).

Illiquidity, in theory, puts a cost on the investor; consequently, liquidity affects returns. It is imperative to demystify that the linkage between illiquidity and stock returns, on the other hand, should be negative. Liquidity risk must be valued from the perspective of an investor since liquidity influences returns. According to Datar, Naik, and Radcliffe's (1998) findings, liquidity is an essential component in the process of explaining cross-sectional volatility in stock return. According to Mendelson and Pedersen, it has been demonstrated that liquidity is an essential quality of assets that has a significant impact on costs, demand pressure, inventory risk, symmetric information, and search frictions. This was discovered as a result of the fact that liquidity has a significant impact on these factors. This is in accordance with the findings of Amihud, who cites research conducted by Mendelson and Pedersen. This is because liquidity has been demonstrated to be an essential quality of assets (2005). Investors want to maximize their investment returns

after subtracting trading and liquidity costs, therefore fewer liquid assets should yield higher gross returns than more liquid ones.

2.4 Empirical Review

A significant amount of empirical research has been carried out with the purpose of determining whether or not there is a correlation between CS and stock returns, all of which have reached the same conclusion. However, the results of the study are inconsistent with one another.

2.4.1 Global Studies

Istanbul Stock Exchange variables affecting stock prices were investigated by Sebnem and Vuran (2012). They used annual secondary data for the 64 manufacturing enterprises that were continually listed covering 2003-2007. In addition, dynamic panel data statistic was used to explain the elements that influenced the firm's stock returns. According to the findings of the study, the CS of a firm does have an effect on the returns of its stock. Despite the fact that 30 additional independent variables were investigated to determine if they had an impact on stock returns, the research did not show how capital structure influenced market returns.

Monhlo (2013) looked into how a company's CS affects its value on the Johannesburg Stock Exchange (JSE). The researcher concentrated on 65 non-financial enterprises because the capital structure of listed financial organizations is controlled. Secondary data from the database of the listed firm was examined for the ten years 2002 to 2012. On the secondary data, which came in the form of panel data, regression analysis was improved. As per the study's findings, there is lack of correlation amid a company's

market value and its CS on the JSE. Despite the fact that financial organizations' capital structures are regulated, the researcher would have included them and analyzed them individually to see if the relationship holds.

Idris and Bala (2015) looked at the firm's specific characteristics as well as stock returns for Nigerian listed food and beverage companies. In this study, correlation and ex-post facto research designs were applied. Using ordinary least square as well as multiple panel data regression computation, the researchers looked at secondary data from 9 of the Nigerian Stock Exchange's 21 beverage and food listed companies. According to the findings of the research, the ratio of a company's debt to its equity as well as the earnings per share of the company have a substantial impact on the returns that are seen in the stock market. This is also true of the ratio of a company's debt to its total assets.

2.4.2 Local Studies

Ndung'u (2014) conducted research and investigations in order to determine the extent to which CS influenced the stock returns of companies whose shares were traded on the NSE. Because of the regulations placed on bank and insurance capital by the Central Bank of Kenya (CBK) and the Insurance Regulatory Authority, the population of the study could only consist of fifty publicly traded enterprises. This limitation is because of the fact that the CBK and the IRA are responsible for regulating the industry (IRA). The researcher examined the stock returns and capital structure of publicly traded companies over a three-year period, beginning in 2011, and continuing through 2013. He did this by employing an empirical study methodology and secondary data sources. During the process of analyzing the data, a Pearson correlation calculation and a multiple regression mechanism were used as examples. It was discovered that the amount of financial

leverage that an enterprise has has a positive correlation with the stock returns that are seen on the Nairobi Stock Exchange.

Ogutu et al. (2014) investigated the effect of CS commercial and service enterprises listed on the Nairobi Stock Exchange (2015). From the year2003 to the year 2013, the study lasted ten years. The researcher used a descriptive study approach to examine secondary data from nine NSE-listed commercial and service enterprises. The data were maximized using multiple regression and correlation analysis. Statistics show that a negative link exists between the use of financial leverage and the performance of companies trading on the Nairobi Exchange that are engaged in commercial or service activities.

The company's CS, in addition to the financial performance of businesses that are listed on the NSE, was studied by Maina and Ishnail (2014). The researchers followed a straightforward methodology, utilizing secondary data from financial statements of Nairobi Stock Exchange companies between 2002 and 2011. The data were analyzed using Gretl statistical software, which included panel regression analysis. There was no discernible effect that the study's capital structure, which was operationalized by Debt to Equity, Long Term Debt vs. Equity, and Aggregate Assets, had on the effectiveness of NSE-listed firms, which was evaluated by ROE and ROA in addition to the value. The study's capital structure was operationalized by debt to equity, long term debt vs. equity, and aggregate assets.

2.5 Conceptual Framework

Modigliani and Miller (1962) introduction of debt funding dramatically affects the market for shares because the wide-dimension of providers of finances are onboard, and shareholders strive for the apportionment of earnings with debt providers. The hypothesis implicate that the firm's value is optimized whenever debt financing is used. Due to the danger of debt financing, this change in financing causes shareholders to demand higher returns, resulting in an increase in stock returns.

Stock returns and capital structure are the two variables that have been highlighted. The debt ratio denotes capital structure, whereas the return on investment (ROI), the natural logarithm of total assets (NLTA), and the current ratio denote profitability, business size, and liquidity. Stock returns as the dependent variable are calculated using annual changes in stock market prices, as well as any stock dividends paid.

Figure 2. 1 Conceptual Model

Independent variable   **control variable**

Dependent variable

Capital Structure • Debt ratio		
Profitability • ROE		**Stock returns** Stock Returns (Movement in stock market prices plus dividends paid)
Liquidity • Current assets over current liabilities		**Firm size** • Natural log of total assets
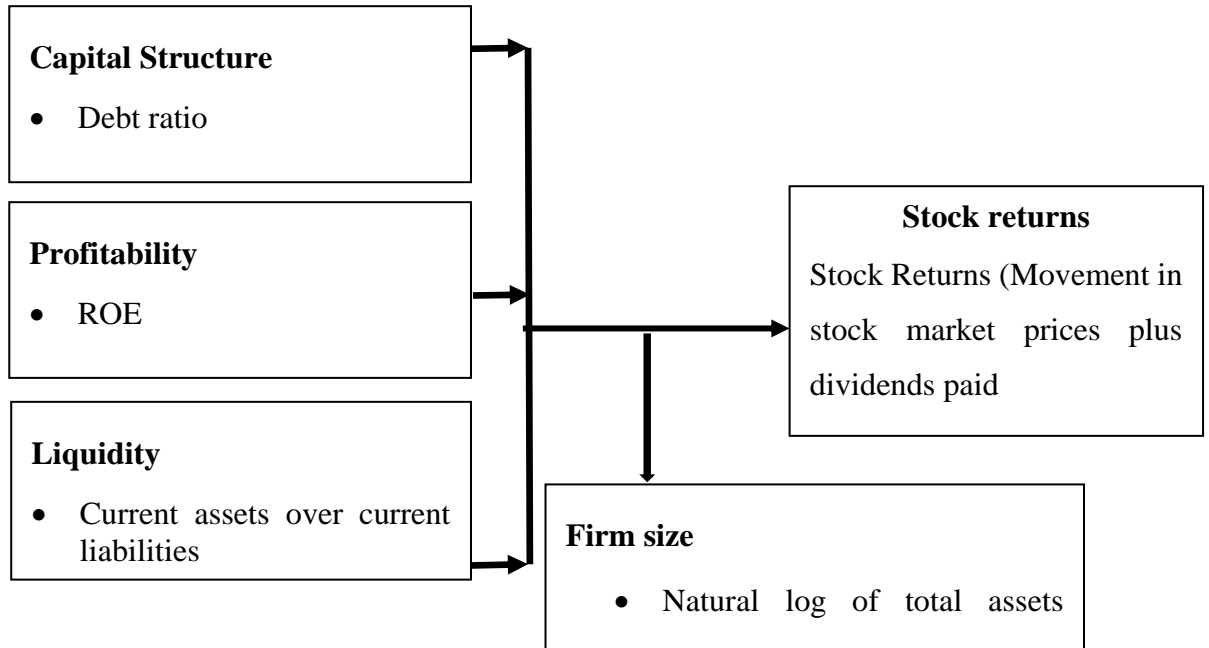
2.6 Summary of Literature Review

In order to provide a description of capital structure, a wide variety of theoretical frameworks have been adopted over the years. In the theoretical overview, topics such as the Modigliani and Miller model, the pecking order theory, the tradeoff theory, and the agency theory were all covered. In this section, we've also highlighted some of the most crucial aspects of stock returns, such as how they are calculated. In addition to that, there was a debate on empirical research on capital structure and stock performance that were conducted both locally and internationally.

There is not enough evidence available at this time to warrant drawing any conclusions regarding the connection between capital structure and stock performance. In their research, Saeedi and Mahmood examined how CS affected the stock prices of publicly traded firms that are listed on the Tehran Stock Exchange. These companies were all participants in the Tehran Stock Exchange (2011). The findings of the study indicate that CS has just a modest impact on the outcomes of economic activities. Both Nirajini and Priya came to the realization that there is a link between CS and productivity, which led them to their conclusion (2013).

Njeri and Kagiri (2015) did identify a correlation between the capital structure of publicly traded commercial and service enterprises and their financial performance, in contrast to the findings of Maina and Ishnail (2014), who found no such association. This assertion is backed up by findings from a study that investigated the role that capital structure (CS) had in discovering the stock returns of companies that were listed on the Nairobi Stock Exchange was the focus of this activity.

CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction

The strategies that were used to encapsulate the context of the Nairobi Security Exchange in order to delineate capital structure stock performance were described in this chapter. Furthermore, it explicates the target demographic that is adequate for generalization. Additionally, it blueprints research methodology, data collecting, and analysis, are all discussed.

3.2 Research design

The process of acquiring, evaluating, as well as interpreting data is known as Kairi research design (Kothari, 2005). The descriptive research strategy was maximized in this analysis. Cooper and Schindler (2013) associated it with description and operationalization of the cause-and-effect relationship amid the variables under investigation. It is employed in data collected to characterize people, firm's settings, or phenomena; it is an excellent choice for the study (Gerson & Horowitz, 2002). As a consequence of this, the purpose of the research, which is to determine the influence that CS has on the returns on stock investments, might be accomplished through the use of a descriptive research methodology. In this chapter, we go into the research methods that were fine-tuned to determine the impact of capital structure on NSE-listed companies' stock performance. In addition to discussing the study's methodology, data collection, and analysis, the authors also provided background on the study's intended participants.

3.3 Population

According to Burns and Burns (2003), the components of interest on which the researcher attempts to base a conclusion are referred to as the population (2008). The 47 businesses

that were listed on the Nairobi Security Exchange between January 1, 2015 and December 31, 2020 make up the population that would be of interest to the researchers. Financial institutions and insurance firms, the capital structures of which are heavily regulated by the CBK and the IRA, are included in this demographic.

3.4 Data collection

In order to compile the data, secondary sources were utilized to. Firms listed on the NSE must submit their financial accounts to the Capital Markets Authority on an annual basis, as required by law (CMA). Secondary data from the financial statements filed with the CMA was used to produce a collection sheet. The financial accounts contained information about capital structure and stock returns that was very interesting. Revenue, liabilities (long and short), current assets, equity, share prices, and dividends were all reviewed in detail.

3.5 Data analysis

The collected data were first organized and then cleaned such that clear analysis could be performed. In addition, it was coded before the tabulation. Descriptive and inferential computations were prioritized in the process.

Because SPSS is user-friendly, it was utilized in the examination of the situation. The data were generated with the assistance of SPSS, and descriptive, correlational, and regression analysis were performed on them. In the descriptive statistics, the mean, the standard deviation, and the maximum are all broken out into finer detail. Multiple regression models were used to investigate the link amid stock returns and the regressor variables of CS, profitability, company, and liquidity.

3.5.1 Analytical method

The researcher utilized a regression analysis, which he performed with the assistance of the data that was gathered, in order to investigate whether or not there is a correlation between CS and the performance of the stock market. This investigation was carried out with the help of the data that was gathered. A multiple regression model was used, the results of which are presented in the table that follows:

$Y = B_0 + B_1X_1 + B_2X_2 + B_3X_3 + B_4X_4$

Where:

Y= Return on stock, calculated as annual change in market share prices and dividends issued:

B_0 =Y intercept of the regression line

The slopes of the ratios are denoted by the letters B1, B2, and B3.

X_1= Debt ratio

X_2= Profitability measured by ROE

X_3= The size of the company is represented by the natural logarithm of its total assets.

X_4= The liquidity that is reflected in the current ratio

ε = is the Error term

3.5.2 Test of Significance

The F as well as the T tests were utilized with a 95% confidence level. Moreover, F-statistic blueprinted the mathematical significance of the regressed equation, whereas T-statistic extenuate the statistical significance of the research's coefficients.

3.5.3 Diagnostic Tests

Before estimating the regression model for this study, diagnostic tests were done to ensure that the model fitted properly. Moreover, it ensured that specific assumptions were met to fit the model. The normality assumption postulates that the distribution is regularly distributed, is necessary to conduct single or combined hypothesis tests about model parameters (Schmidt & Finan, 2018). The null hypothesis states that the data distribution is similar to that of a normal distribution. In the even that p-value outcome is below 0.05, the stated hypothesis is rejected at the 0.05 level of significance, and vice versa.

A scenario in which the predictor variables in a study exhibit a substantial link is known as multicollinearity (Gujarati, 2012). When a dataset has multicollinearity, it makes it more difficult for researchers to estimate the impact that each individual predictor variable will have on the variable they are studying (the dependent variable). Multicollinearity can also be written as "multicollinearity." This test was based on the premise that the regressor variables are not significantly connected. VIF was availed to measure multicollinearity because it is more precise than Pearson correlation coefficients. The assumption for multicollinearity is that there was no multicollinearity in the dataset expounded by the VIF score between 1 and 5. (Gujarati, 2009).

The assumption of heteroscedasticity is that the errors have the same/constant but unknown variance (Majid, Aslam, & Altaf, 2018). When there is a problem with heteroscedasticity in the data, the model may be inflated because it interferes with the predictive strength of the independent variables, resulting in erroneous conclusions. Serial correlation, also known as autocorrelation, is a prevalent predicament in panel data computation that should be handled if the model is to be correctly presented. The

autocorrelation test is commonly used to determine if the residuals have a relationship over time (Massidda & Etzo, 2012). The assumption is that there was minimal or absence autocorrelation in the data. Standard errors are skewed and parameter estimations are inefficient when autocorrelation is not taken into account and discovered (Baltagi, Song, Jung, & Koh, 2007). The Wooldridge F- statistic test was maximized to diagnose the presence of autocorrelation. In this case, null hypothesis opined absence of autocorrelation in the data. Autocorrelation is present when the p value is less than 0.05.

The tests of significance were spearheaded. This test compares an estimate's consistency against that of a less efficient estimator whose consistency has been established. In a study, the Balaji Hausman test is utilized in order to ascertain whether or not there is a considerable correlation between the variables used for explanation and the individual errors, and the results of the test lend support to the null hypothesis, which asserts that there is no such association between the two variables and which is refuted by the findings of the test. The null hypothesis is rejected and replaced with the fixed effects model if the difference between Prob>chi 2 and 0.05 is less than that (Greene, 2008). In a similar fashion, the opposite is also true.

CHAPTER FOUR

DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1 Introduction

The primary focus of the research, which is data analysis. This part is extremely important for explaining the descriptive analysis as well as the inferential statistics. Moreover, it coins the regression findings to expound on the correlation. Additionally, it gives chief latitude to discussion and the cornerstone of the research findings. In summary, the chapter highlights the data analyzed, its conclusive outcome and elaborates the meaning of statistical computation.

4.2 Firms Sectorial Representation

The total number of companies that were chosen was equivalent to 73% of the initial number of companies that had been sought. The research was interested in 64 different companies. The firms selected were; agriculture 100%, automobile 100% and banking were 0%. Additionally, commercial services targeted accounts 100%, construction 100%, energy and petroleum 100%, insurance 0%, investment 100% while the investment services were also 100%. In addition, manufacturing represented 100%, telecommunication 100%, real estate 100% and exchange trade fund accounted for 100%. The findings have been tabulated as 4.1.

Table 4.1 Sectorial Representation

Sector	Total Firms	Targeted Firms	% Representation
Agriculture	7	7	100
Automobiles	1	1	100
Banking	0	0	0
Commercial Services	11	11	100
Construction	6	6	100
Energy And Petroleum	5	5	100
Insurance	4	0	0
Investment	2	2	100
Investment Services	2	2	100
Manufacturing	10	10	100
Telecommunication	1	1	100
Real Estate	1	1	100
Exchange Trade Fund	1	1	100
TOTALS	**64**	**47**	**73**

4.3 Descriptive Statistics

Descriptive analysis pivotal for ascertain the nature of data. The descriptive statistics below present the summary of different variables. Therefore, minimum stock return expounded by years under investigation was 0.001 whereas, maximum stock return for the study for the period was 2.311. The minimum Debt ratio was 0.760 while the maximum debt verse equity ratio was 4.750. The average debt is to equity ratio was 2.536. Furthermore, the profitability, the lowest was 3.300 while the maximum was 4.090 bringing the average profitability for the firm as 3.357. The average for firm size was 1.615 with low and high values of 0.005 and 3.111 respectively. The average liquidity for the firms under study was 2.431. The findings are unfolded below in Table 4.2.

Table 4.2 Descriptive statistics

	Descriptive Statistics						
	N	Minimum	Maximum	Mean	Std. Deviation	Kurtosis	
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error
Stock Return	282	.00100	2.31100	.9574929	.67981181	-1.380	.289
Debt Ratio	282	.76000	4.75000	2.5375532	.81205379	-.225	.289
Profitability	282	3.30000	4.09010	3.3570943	.11220375	20.190	.289
Firm Size	282	.00500	3.11100	1.6159468	.83137906	-1.256	.289
Liquidity	282	2.30010	3.65230	2.4310301	.19757003	10.651	.289
Valid N (listwise)	282						

4.4 Correlation

A study of correlation was performed using the regressor, the variable that was supposed to be regressed, and both of those variables together. The computation was critical in expounding the magnitude as well as the direction. It ranged from strong substantial positive to the strong and significant negative value. From the mathematical computation of correlation, there was a weak positive association portrayed by two predictor variables; profitability and liquidity against predicted variable; stock return as shown by (r=0.030, p=0.616) and (r=0.425, p= 0.001) consecutively. Firm size registered a strong positive correlation towards the stock return as shown by (r=0.892, p=0.001). Further, the findings postulates that debt ratio had a negative correlation towards the stock return as coined by (r=-0.250, p=0.00).

Table 4.3 Correlation Analysis

Correlations

		Stock Return	Debt Ratio	Profitability	Firm Size	Liquidity
Stock Return	Pearson Correlation	1	-.250**	.030	.892**	.425**
	Sig. (2-tailed)		.000	.616	.000	.000
	N	282	282	282	282	282
Debt Ratio	Pearson Correlation	-.250**	1	-.031	-.200**	-.007
	Sig. (2-tailed)	.000		.599	.001	.906
	N	282	282	282	282	282
Profitability	Pearson Correlation	.030	-.031	1	-.222**	.223**
	Sig. (2-tailed)	.616	.599		.000	.000
	N	282	282	282	282	282
Firm Size	Pearson Correlation	.892**	-.200**	-.222**	1	.324**
	Sig. (2-tailed)	.000	.001	.000		.000
	N	282	282	282	282	282
Liquidity	Pearson Correlation	.425**	-.007	.223**	.324**	1
	Sig. (2-tailed)	.000	.906	.000	.000	
	N	282	282	282	282	282

**. There is a correlation, and this correlation is significant at the 0.01 level (2-tailed).

4.5 Diagnostic Test

The researchers performed a test for multicollinearity utilizing the Variance of Inflation (VIF) statistic as well as a test for normalcy utilizing the Kolmogorov-sminorv statistic. Both of these tests were carried out in conjunction with one another. The Researchers further conducted Autocorrelation through the Durbin Watson. The analysis was done to elaborate on the behavior of data and to warrant more analysis. The findings were cornerstone for far-reaching outcome for this assessment.

4.5.1 Multicollinearity Test

The multicollinearity test is carried out in order to determine the degree of correlation that exists between the explanatory factors. According to the data, each and every value for Tolerance was larger than 0.2, and each and every value for VIF was less than 10. This indicated that there is no multicollinearity among the regressor variables that were being investigated (Debt Ratio, Profitability, Firm Size and Liquidity).

Table 4.4 Multicollinearity

Model		Collinearity Statistics	
		Tolerance	VIF
	(Constant)		
	Debt Ratio	.946	1.057
1	Profitability	.844	1.185
	Firm Size	.761	1.314
	Liquidity	.796	1.256

The findings tabulated above emphasizes that tolerance value generated were all higher than 0.2 but below 10. In a nutshell, it posit a no multicollinearity present between the predictor variables. Johnson and Manley (2018) advocated that VIF≥2.5 is very considerate. According to James, Witten and Tibshiraim (2017) VIF beyond 5 is problematic while higher than 10 is dangerous for analysis. The findings are in order with the research guideline for further analysis.

4.5.2 Normality Test

The research depends on the Kolmogorov–Smirnova and Shapiro-walk diagnostics in order to establish out whether or not the findings were normal. From the outcome in table 4.5 below; Stock Return, Profitability, Firm Size and Liquidity except Debt ratio posted 0 values greater than 0.05. This revealed a normal distribution of data. Therefore, it opened

the window for the rejection of null hypothesis. The data was paramount for Pear

correlation matrix.

Table 4.5 Tests of Normality

	Kolmogorov-Smirnov[a]			Shapiro-Wilk		
	Statistic	Df	Sig.	Statistic	Df	Sig.
Stock Return	.124	282	.000	.921	282	.000
Debt Ratio	.044	282	.200[*]	.991	282	.087
Profitability	.305	282	.000	.464	282	.000
Firm Size	.107	282	.000	.947	282	.000
Liquidity	.254	282	.000	.665	282	.000

*. This is a lower bound of the true significance.

a. Lilliefors Sig. Corrections

4.5.3 Autocorrelation

Autocorrelation was done by the researcher to exemplify the error term across the time

period of analysis. From the findings below the Durbin-Watson value is 0.491. This value

is less than 2 thus lying within the required range.

Table 4.6 Autocorrelation

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.927[a]	.859	.857	.25692020	.491

a. Explanatory: (Constant), Liquidity, Debt Ratio, Profitability, Firm Size
b. Explained Variable: Stock Return

4.6 Regression Analysis

This is the process that is utilized to devise a formula that can be put to use in forecasting

what will happen in the future. The researchers also utilized the SPSS statistical package

to generate the outcome at 95% confidence interval. Regression is the cornerstone for explanation of association, nature and strength of the variables.

4.6.1 Model Summary

Stock Return was regressed against all the explanatory variables; Liquidity, Debt Ratio, Profitability and Firm Size. The findings are as shown on the table 4.7

Table 4.7 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.927[a]	.859	.857	.25692020	.491

a. Regressor: (Constant), Liquidity, Debt Ratio, Profitability, Firm Size
b. Regressed Variable: Stock Return

Table 4.7 give detailed information about the regressor variables (Liquidity, Debt Ratio, Profitability and Firm Size) verse the regressed variable (Stock Returns). Therefore, R (Correlation Coefficient) is 0.927. This implied that there was 92.7% correlation between the variables. R Square (Co-efficient of determination) is 0.859. This insinuates that 85.9% of variation in stock return is expounded by the regressor variables (Liquidity, Debt Ratio, Profitability, and Firm Size). The remaining percentage, 14.1%, are factors not cited.

4.6.2 Analysis of Variance (ANOVA)

As a result of the computation of variation in table 4.8, the P-Value is less than 0.05, which leads one to the conclusion that the explanatory variable Debt Ratio, Profitability, Firm Size, and Liquidity elaborates the variance in the explanatory variable (Stock Return).

Table 4.8 ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	111.578	4	27.895	422.594	.001[b]
1	Residual	18.284	277	.066		
	Total	129.862	281			

a. Regressor Variable: Stock Return

b. Regressed: (Constant), Liquidity, Debt Ratio, Profitability, Firm Size

4.6.3 Coefficient of Determination

Table 4.9 Correlation of Determination

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
	(Constant)	-5.046	.488		-10.337	.000
	Debt Ratio	-.054	.019	-.064	-2.761	.006
1	Profitability	1.257	.149	.208	8.458	.000
	Firm Size	.733	.021	.897	34.693	.000
	Liquidity	.302	.087	.088	3.471	.001

a. Dependent Variable: Stock Return

In the preliminary regressor variable known as "Debt Ratio," the regression coefficient was found to be -0.064. Because of this, the stock returns of companies that are listed on the NSE are expected to experience a negative impact. In addition to the findings, it was determined that profitability, business size, and liquidity each had a regression coefficient of 0.208, 0.897, and 0.088 respectively. This indicates that all three factors have a positive link towards the stock Return of firms that are listed on the NSE.

Profitability, Firm Size and Liquidity produce positive statistically significant values (t values (8.458, 34.696 and 3.471), P<0.05) respectively for this research while Debt ratio produce (t-value (-2.761, P<0.05) which is statistically significant.

The resulting regression model is;

$Y = -5.046 + -0.054 + 1.257 X_1 + 0.733 X_2 + 0.302 X_3$

Where;

Y=Stock return

B_0 =Y intercept of the regression line

B_1, B_2 and B_3 are the slopes of the ratios

X_1= Debt ratio

X_2= Profitability

X_3= Firm size

X_4= Liquidity

From the regression tabulation above the constant value = -5.046 shows that incase all the predictor variables values are 0 then the stock return of firm listed in the NSE would be -5.046. An increment of debt ratio by a single translates to a reduction of stock returns by 0.054. A unit increase in profitability brings about a positive change in stock return by 1.257 assuming there is no change in any of the other variables. If all other variables remain the same, the increase in stock return caused by adding one more unit to the firm's size is equivalent to 0.733 times the normal rate, whereas a unitary change in liquidity results in a positive change in stock return at NSE equal to 0.302 times the normal rate.

4.7 Discussion of the Research Findings

The goal of the research was primarily to whether or not changes in CS had an effect on the stock returns of companies whose shares were traded on the NSE. The variables of Debt Ratio, Profitability, Firm Size, and Liquidity were used to forecast the outcome. Several types of analysis, including descriptive and inferential analysis, were carried out. These analyses included percentages of sectorial representation. The findings were extremely important for the decision-making process and exemplified the correlation that exists between the capital structure and stock returns, which was tallied and explained.

The Pearson correlation analysis posted a weak even though positive association existed between profitability and Liquidity against Stock Return. There is a meaningful correlation, and it works in favor of the shareholder, between the size of the company and the yield on the shares. This correlation favors larger companies. On the other hand, it was believed that the debt ratio had a little negative association with stock return, despite the fact that its p-value was quite high. This was despite the fact that it had a high probability of being a false positive. On the other hand, it was believed that the debt ratio had a little negative association with stock return, despite the fact that its p-value was quite high. This was despite the fact that it had a high probability of being a false positive. This was despite the fact that it was considered that the debt ratio had a substantial negative connection with stock return. The data also showed that there was no multicollinearity among the predictor variables; as a result, they were adequate in explaining variations in the variable that was being predicted. Moreover, the data followed the normality distribution nature.

According to the results of this research effort, the findings indicate that the regressor components of debt ratio, profitability, business size, and liquidity are responsible for 85.9% of the variance in stock return. In this particular context, it pertained to the businesses that were mentioned in the NSE and were denoted by the R-Squared figure. According to the data, 14.1% of the fluctuations in the stock return might be attributed to different factors that were not given preference by the research study conducted. The results show that there is a strong association between priority regressors and stock returns. This is shown by a correlation coefficient that is 92.7 percent strong. In the regression computation, the model portrayed its' statistically significance at the 95% confidence interval reaffirming that its' appropriateness in explaining how the Stock Return of Firms Listed at NSE is affected by the Independent Variables. The findings reinforced the findings by Ngome (2016) that demonstrated the negative correlation between the stock prices and the firm size. However, it contracted the findings by Sifuna (2018) stipulation that debt is positively and substantially correlated with stock while the prevailing studies gives negative association. The summary has tabulated as 4.9 offers concrete explanation.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

Summary of the outcome is cardinal in presenting general outcomes. Furthermore, the conclusion is critical in reinforcing the recommendation. This section is a bedrock for giving concrete conclusions and pinpoint areas for further scrutiny. It is imperative to postulate that this chapter is useful in clarifying problems solved by the study and major steps to undertaken to intensive future analysis. It elucidates the policies, areas of further examination and initiatives needed for making decision.

5.2 Summary of the Study Findings

The widespread analysis portrays the correlation amidst the stock returns and capital structure. In a nutshell, the variables examined proclaimed a weak but positive association between profitability and liquidity verse the stock return as elaborated by (r=0.030, p=0.616) and (r=0.425, p= 0.001) consecutively. Firm size recorded a strong positive association with the stock return as blueprinted by (r=0.892, p=0.001). In addition, debt ratio registered an inverse correlation with the stock return as expounded by (r=-0.250, p=0.00). The study indicated increment in the company size, profitability and liquidity resulted in increase in stock return. Conversely, an increment in the debt ratio causes a decrease in the stock returns.

The sectorial representation indicated significant percentage of representation. All the four predictor variables met the diagnostic tests and requirement. This has been demonstrated by the normality, multicollinearity and autocorrelation tests in Table 4.4,

4.5, 4.6 respectively. The outcomes posted absence of multicollinearity, normal nature of data distribution and an existing association between predictor (Debt Ratio, Profitability, Firm Size and Liquidity) and the predicted variable (Stock Return).

5.3 Conclusion

The study wrap-up by postulating the regression analysis tabulated in table 4.9. Whenever all factors are kept constant, the autonomous value stands at negative 5.046. Additionally, increase in one unit of debt ratio triggers a decrease in stock return by 5.4% all variables maintained constant. Moreover, an increment of a single unit of profitability translates to increment in stock return by 125.7% if all factor remains constant. Furthermore, an increment of firm size by a singular unit causes the elevation of stock return by 73.3% when all variables are kept constant. In addition, a unitary addition of liquidity translates to increase in the stock return by 30.2%. The findings have been summarized in the multiple linear regression below.

$Y = -5.046 + -0.054 + 1.257 X_1 + 0.733 X_2 + 0.302 X_3$

Y=Stock return

B_0 = The point at which the regression line crosses the Y axis

The slopes of the ratios are denoted by the letters B1, B2, and B3.X_1= Debt ratio

X_2= Profitability

X_3= Firm size

X_4= Liquidity

The research findings data from the regression computation coined that all the predictor variables factored into the research (Debt Ratio, Profitability, Firm Size in addition to Liquidity) were explainable in the predicted variable (Stock Return). This was

46

represented as 85.9% of all variables affecting the stock return. The other variables causing deviation in stock returns but not included in analysis commanded 14.1%. Therefore, the four variables analyzed were sufficient for decision making.

5.4 Recommendation

The findings provide the road map for decision making. The research findings indicate the positive association between the stock returns verse the predictor variable (Profitability, Firm Size and Liquidity). Debt ratio posted a negative correlation with stock return. The researcher recommends benchmarking and increase productivity of the business to enhance stock return. Additionally, the research advocated for enhancing profitability, firm size and operating at optimum liquidity to boost the stock return.

The study recommends for minimal relies on debts ratio since it reduces the stock returns. This is demonstrated by the inverse association between the stock return and debt ratio. This study contradicts Mohamed (2016) presupposition that debt ratio is positively correlated with stock returns. Moreover, it reinforces the findings by Ngome (2016) posting a significant and inverse correlation between stock returns verse the debt ratio. Therefore, this study recommends for minimal long-term debts to increase the returns. This is because the business is not struggling to meet long-term debts obligations.

5.5 Limitation

The study undertaken through maximization of the secondary data to arrive at the conclusive findings. Therefore, it was historical in nature may have past trend and pattern hence may not be useful in forecasting future changes. The companies analyzed were cited in NSE and it very important to analyze other companies who have not been listed. The scope of study was 5 years period which may reflect everything longevity. The study

factored in four predictor variables hence did not exhaust all the determinants of stock returns.

5.6 Suggestions for Further Studies

It is imperative to conclude that this research is an eye-opener for more studies relating to capital structure verse the dividend announcement. The companies have a tendency of quarterly and semi-annually dividend announcement which can be analyzed by the researcher. Moreover, a study concentrated on firms not quoted in the NSE generate more information useful in policy formulation and decision making. Moreover, the research can analyze the consequences of corporate governance on the stock volatility, inflation and stock fluctuation, firm characteristics and stock prices as well earning management verse the stock returns. These studies are crucial in giving wide-spectrum of knowledge about the correlation among different predictors and the predicted variables.

REFERENCES

Babar Zaheer Butt (2009): Do economic factors influence stock returns? A firm and industry level analysis

Brown, G. W., & Cliff, M. T. (2004). Investor sentiment and the near-term stock market. *Journal of Empirical Finance, 11(1), 1–27.* https://doi.org/10.1016/j.jempfin.2002.12.001

Brown, G. W., & Cliff, M. T. (2005). Investor sentiment and asset valuation. *Journal of Business, 78(2), 405–440*. https://doi.org/10.1086/427633

Chang, S.-C., Chen, S.-S., Chou, R. K., & Lin, Y.-H. (2012). Local sports sentiment and returns of locally headquartered stocks: A firm-level analysis. *Journal of Empirical Finance, 19(3), 309–318.* https://doi.org/10.1016/j.jempfin.2011.12.005

Idris, I, & Bala H (2015). Firms' Specific Characteristics and Stock Market returns (Evidence from Listed Food and beverages Firms in Nigeria). *Research Journal of Finance and Accounting, 6(16), 188-200.*

Jensen M & Meckling, W (1976), The theory of the firm: Managerial Behavior, agency costs and ownership structure, *journal of financial economics 3, 305-360*

Maina, L., & Ishmail, M. (2014). Capital Structure and Financial Performance in Kenya: Evidence from firms listed at the Nairobi Stock Exchange. *International Journal of Social science and Entrepreneurship, 1(11), 209-223*

Maryyam Anwaar (2016): Impact of Firms' Performance on Stock Returns (Evidence from Listed Companies of FTSE-100 Index London, UK) *Global Journal of Management and Business Research: D Accounting and Auditing.*

Modigliani, F. and Miller, M.H (1958). The Cost of Capital, Corporate Finance and Theory of Investment. *American Economic Review, 48, 261-97.*

Mohohlo, N. R. (2013). Capital structure and its impact on firm value of JSE Securities Exchange-listed companies. *Univeristy of Witwatersrand Johannesburg.*

Mugambi, M. & Okech, T.C. (2016). Effect of Macroeconomic Variables on Stock Returns Listed Commercial Banks in Kenya. *International Journal of Economics, Commerce and Management, 4(6), 390-418*

Saeedi, A. & Mahmood, I. (2011). Capital Structure and Firm Performance. Evidence from Iranian Companies*, International Research Journal of Finance and Economics, 70(7), 20-29*

Sebnem, E.R., & Vuran,B. (2012). Factors affecting Stock Returns of Firms Quoted in ISE Market. A Dynamic Panel Data Approach, *International Journal of Business and Social Research, 2(1), 109-122.*

Shangkari V. Anusakumar, Ruhani Ali (2017). The effect of investor sentiment on stock returns: insight from the emerging Asian market

Singal, M. (2012). Effect of consumer sentiment on hospitality expenditures and stock returns. *International Journal of Hospitality Management, 31(2), 511–521.* https://doi.org/10.1016/j.ijhm.2011.07.009