

**EFFECT OF DEBT FINANCING ON FINANCIAL PERFORMANCE
OF COMMERCIAL AND SERVICES FIRMS LISTED IN NAIROBI
SECURITIES EXCHANGE**

**BY
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DECLARATION

I declare that this is my work and has not been presented to any institution or university other than the University of Nairobi for examination.

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

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DEDICATION

I dedicate this research work to my dear family who provided the enabling environment & resources; and have greatly supported my education journey.

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LIST OF ABBREVIATIONS

ANOVA:	Analysis of Variation
BOD:	Board of Directors
CDSC:	Central Depository and Settlement Corporation
CEO:	Chief Executive Officer
CMA:	Capital Market Authority
EACSE:	East African Community Security Exchanges
GSE:	Ghana Securities Exchange
MM:	Modigliani and Miller
NPV:	Net Present Value
NSE:	Nairobi Securities Exchange
ROA:	Return on Asset
ROE:	Return on Equity
RSE:	Rwanda Stock Exchange
SMEs:	Small Medium Enterprises
SPSS:	Statistical Package for Social Sciences

ABSTRACT

Debt financing decision is among the key financial decisions that are taken by firms because debt financing has an effect on the financial performance. Theoretical foundations on debt financing have found different conclusion where Modigliani and Miller argued on the irrelevance of debt on capital structure and agency theory to stress on the importance of debt in capital structure to control the actions of management. No agreement exists on the nature of the impact of debt financing on financial performance from both the theoretical and different empirical studies. The aim of this study was to ascertain the effect of debt financing on financial performance of commercial and service firms quoted at the NSE. The population for the study was all the 12 commercial and service companies quoted at the NSE. The independent variables for the study were debt financing as measured by the ratio of debt to assets, corporate governance as measured by the ratio of independent directors to total number of directors, liquidity measured by current ratio and asset tangibility as measured by the ratio of fixed assets to total assets. Financial performance was the dependent variable and was measured by return on assets. Secondary data was collected over a five 5 year time frame (January 2013 to December 2017) annually. The descriptive cross-sectional research design was employed for the study and the relationship between variables established using multiple linear regression analysis. Data analysis was undertaken using the SPSS software. The results of the study produced R-square value of 0.279 which means that about 27.9 percent of the variation in financial performance of commercial and service firms quoted at the NSE can be explained by the four selected independent variables while 72.1 percent in the variation of financial performance of commercial and service firms listed at the NSE was associated with other factors not covered in this research. The study also found that the independent variables had a strong correlation with financial performance of commercial and service firms listed at the NSE ($R=0.528$). ANOVA results show that the F statistic was significant at 5% level with a $p=0.002$. Therefore the model was fit to explain the association between the selected variables. The findings also showed that firm liquidity produced positive and statistically significant values for this study. Debt financing and corporate governance produced negative but statistically insignificant values while asset tangibility was also found to be a statistically insignificant determinant of financial performance of commercial and service firms' quoted at the NSE. This study recommends that when firms are setting their capital structure they should strike a balance between the tax savings benefit of bankruptcy and debt costs associated with borrowing. The study also recommends that commercial and service firms quoted at the NSE should maintain adequate levels of liquidity as the findings of this study depict a positive significant effect of firm liquidity on financial performance.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Financing decision is an important function in a company's decision making that helps finance managers to decide when to obtain finances and how to meet their investment needs (Zhao & Wijewardana, 2012). Debt financing is the key source of capital in many growing firms since their retained earnings may not be sufficient enough or may be unavailable. If firms settle on poor debt financing decisions, the outcome to the firm will lead to higher costs in capital, which in turn lead to reduction in overall financial performance. On the other hand, effective debt financing decisions results in higher present value, thereby boosting the worth of a company as more of its projects will be accepted. However, finding the optimal structure has always been an area of emphasis for a long time. This decision gives a firm an edge over its competitors as it is very critical (Onchong'a, Mututi & Atambo, 2016).

This study is anchored by the following theories; Signaling theory, Pecking order theory, Agency theory and the Trade-off theory. Signaling theory was founded by Lintner (1956), which argues that capital structure levels of a firm show the position of the firm to external users. Pecking order theory was propelled by Majluf and Myers (1984) and argues that managers are in favor of internal financing as compared to external, and where internal funds are insufficient, debt financing is given first priority to equity financing. According to Kraus and Litzenberger (1973) trade-off theory is applied in a situation where the firm works towards striking a balance between taking advantage of tax shield on interest expense arising from debt financing and the actual cost of the debt. Agency theory favors firm's uptake of high debt financing levels at it encourages

management to work hard to safeguard the shareholders' interests (Jensen and Meckling, 1976).

Of concern, is establishing whether commercial and services firms listed at NSE stand to gain from debt financing and criteria of establishing the debt proportion that will constitute their debt financing across various industries. Interest on debt is tax allowable and deductible in Kenya hence financing the entire of firm's operation by use of debt will benefit the firm on one side as interest on debt is tax exempt whereas it will have an adverse effect as the firm will be under the control of the creditors who will have a large stake of control. Using debt as a funding source will increase the agency conflict and cost between the debt holders and shareholders (Omollo, Muturi, & Wanjare, 2018).

1.1.1 Debt Financing

Debt financing refers to the acquisition of capital from a specific lender to undertake business operations and repay it back within a pre-determined period with interest (Hussain, Millman & Matlay, 2006). Debt is a financing option that is structured to improve the owners' rate of return through a higher rate of return on investment compared to the cost of borrowed funds. According to Baltaci and Ayaydin (2014) debt financing is a major source of external funding for corporate firms. . Debt entails two types of options; short-term debt repayable within a period of twelve months and long-term debt payable within a time frame of more than twelve months (Lokong, 2011).

Fama and French (2002) found debt to be beneficial in resolving free cash flow problems and through tax shield benefit. However, it may be ineffective to use debt because of conflicts amongst capital providers and associated bankruptcy costs. Debt financing helps

in cushioning financial deficits in the firm in case of limited financial resources. Debt financing may be advantageous or disadvantageous to the firm in respect to the resulting costs. Debt financing results to interest expenses which is paid before the maturity period of the debt in excess of partial principal payments of the loan (Harelimana, 2017).

Decision on source of financing is among the key financial decisions that are taken by firms since debt financing has an effect on the financial performance. Leverage financing provides the borrower with an opportunity to finance an investment on short-term source at the same time spreading the cost of capital over time so as to meet the affordability and budgetary constraints (Vengesai & Kwenda, 2017). Financial leverage is largely employed in most commercial activities, particularly in cases where funding via preferred stock instead of common stock is involved. In short, effects of a variation on the extent where most organization's resources are being funded through loanable funds on the return for each share of the organization are called financial debt (Miras, 2015). Debt financing will be measured using debt ratios that compare the firm's total debt to its total asset.

1.1.2 Financial Performance

Financial performance is described as the measure of how well a firm uses its available resources in the generation of revenues. It provides a guideline that gives a way for future decisions relating to business developments, assets acquisitions and managerial control (Kraus, & Litzenberger, 1973). It reflects what has been achieved by the management in monetary terms over a specific duration and can be utilized in making comparison of like firms in the one industry. According to Onger (2014), financial performance provides an avenue for the evaluation of business activities in objective monetary terms. Financial

performance also helps in evaluating the well-being of firm shareholder wealth, given different accounting periods by utilizing financial ratios derived from financial statements or using data on market share prices. The firm's main objective is to maximize the wealth of the shareholders and therefore performance measurement helps to evaluate how richer the shareholder becomes as a result of the investment decisions over a given period (Baum et al, 2006).

According to Kaplan & Norton (1992) financial performance is measured using various parameters such as; Return on Equity and Return on Asset. ROE is measure in terms of net income after tax divided by total equity capital. On the other hand, ROA indicates the return on all assets of the company and is frequently used by firms as an overall index of financial performance. It is computed by dividing Net Income after Taxes by Total Assets (Reese & Cool, 1978). As a result, ROA will be applied in measuring financial performance.

1.1.3 Debt Financing and Financial Performance

Debt financing decisions are geared towards improving earnings of the business through recovery of debt cost and proprietors gains and in the process retain the excess gains. Modigliani and Miller (1958) argued that gains from a cheaper loan are exactly off-set by the increase in equity cost and therefore, the financing decisions of the firm were irrelevant in perfect market conditions. However, according Kraus and Litzenberger (1973) in their trade off theory they state that earnings from borrowed funds and cost of borrowing these funds are key determinants of debt financing (Myers, 1984). The level of profitability of a firm has an inverse effect on debt ratio which agrees on pecking order theory. Rationally managers and owners of small scale firms prefer to manage their firms.

Therefore there are less chances of excessive investment. Majority of these firms do not support debt financing but instead opt to use internal financing for example use retained earnings other than external sources of financing business operations.

According to Jensen (1986), debt has an influence on the quality of the investment opportunities that are undertaken by the management by forcing managers to invest in the projects, which add value to the shareholders. This in return minimizes agency and other related costs hence enhancing financial performance of the firms. The impact of the capital structure on the firm's financial performance has for long time been investigated by different researchers and seen to have an effect on the firm's financial performance. For instance, Ikapel and Kajirwa (2017) found a negative association exists between long-term borrowed funds and the financial performance of firms. Firm profitability is a key determinant of capital structure of a firm. Due to the fact that when a firm is making huge profits, it finances its operations using internal funds and it will only opt to use external finds when there is need for additional finds. A profitable firm uses less debt than unprofitable firm as argued by Kemsley and Nissim (2002).

1.1.4 Commercial and Services Firms Listed at Nairobi Securities Exchange

The NSE remains as the main securities exchange market of Kenya and also the leading securities market in East Africa. NSE is a body corporate established under the Companies Act (CAP 486) of the Kenyan law and comprises of all licensed stock brokers. The NSE was privatized in 1988 when government of Kenya sold 20% of its holdings. The NSE market is structured in a way that its operations are carried out

through Central Depository & Settlement Corporation. CMA of Kenya is the main regulator of all firms listed where the regulator ensures compliance of the listed companies (Olang, 2017).

According to NSE (2017) companies listed are categorised into fourteen economic sectors; Commercial and Services, Automobiles and Accessories, Agricultural, Telecommunication and Technology, Banking, Real Estate Investment Trust, Construction and Associations, Energy and Petroleum, Insurance, Investment services and commercial and service firms. Under commercial and services firms, there are total of 12 firms listed. This includes; Nation media group, Express LTD, Sameer Africa PLC, Standard Group Ltd, Kenya Airways, TPS Eastern Africa (serena), Scangroup LTD, Longhorn Publishers, Atlantas Development, Deacons (East Africa) PLC and Nairobi Business Ventures LTD. The NSE focuses on helping trade clearance arrangements of equities, debt derivatives and other related financial tools (Kioko, 2015)

Commercial and services firms that manage capital structure efficiently aims to ensure an optimum balance between profitability and risk. Recent activities by these firms indicate their awareness on role of capital structure on performance of the firm (Muchugia, 2015). To increase their profitability, commercial and services firms should efficiently manage their capital structure components in order to minimize costs and maximize profits in their operations. Debt financing decisions play a fundamental role in firm strategy with a view to maximize shareholder's wealth in listed commercial and services firms (Orua, 2009)

1.2 Research Problem

Debt financing decision is among the key financial decisions that are taken by firms because debt financing has an effect on the financial performance (Tausee, Lohano & Khan, 2013). Leverage financing provides the borrower with an opportunity to finance an investment on short term and on the same time spread the cost of capital over time to meet the budgetary constraints. Theoretical foundations on debt financing have found different conclusion where Modigliani and Miller argued on the irrelevance of debt on capital structure and agency theory to stress on the importance of debt in capital structure to control the actions of management. No agreement exists on the nature of effects of debt financing on financial performance from both the empirical and theoretical perspectives.

Commercial and services companies listed in the NSE have embarked on use of debt in their capital structure with expectation of improving their financial performance. According to Al-tally (2014) debt finance offers an opportunity for the firm to increase its performance by facilitating acquisition of the productive assets. Financial analyst have argued in support of debt use and considers debt finance as good in enhancing firms performance provided its acquired at the favorable rate and its proceeds utilized in a good way. According to Obiero (2016) in the recent past companies with huge debts in their capital structure such as Kenya Airways, Home Africa, Uchumi Supermarkets, ARM cement, Mumias Sugar Company and Trans century have reported huge losses and found themselves in serious debt crises owing creditors more than their net worth. This is reason enough to explore on the effect of debt financing on the firm financial performance, which motivated this research study.

Globally, Harelimana (2017) found that debt levels are strongly related to bank profitability. Pradhan and Khadka (2017) found that the relationship between independent variables; bank size, interest coverage and short-term debt on bank profitability was positive while, long-term debts showed a negative relationship on profitability. Kwadwo, Nsiah and Sekyere (2016) revealed that debt both long-term and short-term had a negative impact on firm performance. Darush and Peter (2015) that debt level has a strong effect on the performance of SMEs.

Locally, Karuma, Ndamiri and Oluoch (2018) found that short term debt is positively related to firms' ROA of listed manufacturing companies in Kenya. Mudeizi (2017) found that debt financing has a negative and statistically significant effect on dividend payout ratio. Ng'ang'a (2017) found that debt financing has no effect on schools performance in financial terms. Onchong'a, Muturi and Atambo (2016) found that increase in short term and long term debt reduces return on asset. Obiero (2016) observed that debt ratio has a negative correlation effect on return on asset. Even though many researchers have tested and observed the effect of debt financing on financial performance, there still lies a research gap.

Although the findings of all the studies undertaken in Kenya so far indicate positive responses to firm financial performance, the studies done in the Kenyan market are quite few to give a conclusive result. Furthermore, several studies conducted in Kenya have attempted to explain the effect of capital structure in general on financial performance and share prices of listed firms at NSE. The lack of consensus among the various theoretical arguments on the effect of debt financing on firm's financial performance by international and local researchers is reason enough to conduct further examination on the

area of study. This paper sought to determine how debt financing influences financial performance of quoted commercial and services firms in Kenya. It attempted to give an explanation to the question, what is the effect of debt financing on the financial performance of listed commercial and services firms in Kenya?

1.3 Objective of the Study

The study's objective was to determine the effect of debt financing on financial performance of commercial and services firms listed at Nairobi Securities Exchange.

1.4 Value of the Study

The research findings will benefit current and potential investors of listed commercial and service firms, in understanding the impact of leverage level on firm performance and make informed decisions before venturing into any investment. The study will also benefit the management of commercial and services firms in Kenya, in making best choice of debt financing decision that will enhance performance of the firm and maximize shareholders wealth.

The study findings will be of assistance to the NSE and CMA and other policy makers in formulating appropriate mechanisms necessary to continuously monitor and evaluate the financing aspect of corporations. This could be achieved by identifying specific industry-based debt thresholds that would ensure that firms are not unnecessarily exposed to risk of financial failure that results to erosion of investors' wealth.

Scholars and academicians in the finance discipline can also use the study recommendations for further study to conduct future studies to broaden the knowledge on debt financing. Furthermore, they can consider the methods and results of this research and possibly extend it

in various directions. The study will add to the present information on debt financing and financial performance in the Kenyan context. This study will also add to the existing theoretical knowledge on debt financing and financial performance.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This section reviews the relevant literature associated with the effects of debt financing and financial performance. It presents the theoretical literature review and the determinants of firm performance. Empirical literature from international and local studies, conceptual framework and summary based on the review is also discussed.

2.2 Theoretical Review

The section outlines the theories that explain the associations between various determinants of financial distress. This study is anchored by the following theories; Signaling Theory, Agency theory, Trade-off Theory and the Pecking order theory.

2.2.1 Signaling Theory

Signaling theory was founded by Lintner (1956), which argues that capital structure levels of a firm show the position of the firm to external users. This is on assumption that insiders have information which is not available to the market and outside investors. Signaling theory is suitable for assessing information especially when describing the behavior of two distinct parties. Managers of firms prefer usage of equity financing options than debt because debt financing signifies that higher chances of them losing their job is high in case the business becomes insolvent or goes to liquidation as a result of inability to clear the outstanding debts, although the investors have a different look on the firms position in relation to debt because they consider the debt as favorable due to the fact that high debts levels signals high quality (Chomba, 2013).

Despite the relevance of signaling theory to capital structure of listed firms on securities exchange, the theory has little impact on small firms since these firms are not publicly listed in securities exchange hence they have no impact on influence of potential investors in the capital markets. However these firms need to send signals to the lenders and creditors for financing. Ross (1978) argues that the level of information among the managers and investors debt level shows the possible effect hence this is regarded as a signaling game due to the fact that the liability and the period of the giving out a new sale of shares which signifies the performance of the firm that may lead to selection problem. Although these has been highlighted by scholars especially on its significance in order to determine the leverage, signaling theory forms an important framework for our study since this study is aimed at revealing the effects of the signal (change in capital structure) to the market because debt equity ratio should be balanced between the demands of the firm and speculations of investors & general public on prospect of the firms future performance (Akerlof, 1970).

2.2.2 Pecking Order Theory

The pecking-order theory was propagated by Myers and Majluf (1984) and it considers internal finance as the cheapest source of finance, then debt and finally external equity. They consider retained earnings as having no floatation costs and therefore, require no additional disclosure of financial information (Kishore, 2009). Based on asymmetric information, the theory highlights issuing securities to raise external capital signals out a lower profitability to investors than what they had expected. Being rational in their decisions, investors adjust the discount rate for the firm upward since they now require a higher return on their investment.

The theory assumes managers will be obliged to act in the best interest of the investors since they know more about the company future growth opportunities (Sheikh & Wang, 2011). Also, it is assumed information asymmetry exists between them. This case may not be realistic in practice as it also ignores the problems that may occur when a firm's managers get more comfortable with the companies financials and become indisciplined (Kishore, 2009). The theory is significant to this study because commercial and services firms in Kenya tends to support the argument of pecking order theory, because this firms maximizes on internal sources available to fund their operations before seeking external funds.

2.2.3 Trade-off Theory

The theory was advanced by Kraus and Litzenberger (1973). According to trade-off theory firms usually choose how much debt finance or equity finance to use by looking at advantages and disadvantages of both debt and equity. According to Kraus and Litzenberger (1973) trade-off theory is applied in a situation where the firm works towards striking a balance between taking advantage of tax shield on interest expense arising from debt financing and the actual cost of the debt. Companies will use debt but will be cautious of any risks that could come due to bankruptcy. At this point, the tax saving from other additional debts equals to costs that will arise from an increase in the likelihood of financial distress arising (Wang & Sheikh, 2011). So long as a company uses debt effectively, shareholders benefit from more debt than equity (Baker & Martin 2011).

According to Luigi and Sorin (2009), trade-off theory was postulated after the debate over the MM irrelevance theorem when corporate tax was added on the theory this

created debt benefits in that it was a tax shield implying a 100% debt financing. Companies with high returns with tangible assets will use more debt than firms with low returns and consequently risky assets. In practice however, firms do not operate with a 100% debt financing due to distress, bankruptcy and agency costs hence the need to match the costs and benefits. In addition, the target capital structure is not determined directly and that taxes are more complex hence conflicting conclusions on the targets a company could reach depending on the taxes. The theory is applicable since the quoted firms that carefully select equity and debt levels for their financing were well adjusted to generating higher profits as opposed to those that disregarded their debt and equity levels.

2.2.4 Agency Theory

Founded by Jensen and Meckling in 1976, the theory suggests that there exists an association relating the owner of a business, who is the principal, and those bestowed with the responsibility to manage the business, (agents), so as to ensure maximization of shareholders' profits. Problems arise when the agents to the principal fail to act in a way to satisfy the interest of the principal, who is the shareholder. That means that the managers will now be working towards satisfying own interests. It is worth realizing that the problem arises due the fact that managers' salaries are ever constant regardless of the huge profits they realize in the firms' operations and when the firms incur losses, they are the only ones who suffer the consequences of the loss (Rayan 2010). Hence, the theory states that there is need for firms to manage the relationship between principals and agents. Both the principals and the agents have varying motives, which may levy agency costs to a firm.

Thus, firm shareholders knowing the likely selfish interests by the managers, they institute constricting measures and resolutions geared towards safeguarding and multiplying their wealth. One of restrictive measure is the use of debt capital rather than employing internal funds. Such a measure aids in maintaining the firm ownership and also forces managers to remain focused on profitable ventures so as to fulfill the financing obligations (Nwaolisa and Chijindu, 2016). The agency cost theory is applicable in capital financing because of managers' intent to achieve maximum returns prior to putting into consideration the shareholders' interests. This theory is relevant to this study since commercial and services firms can obtain debt financing to act as discipline mechanism against managers and to deter them from capitalizing on negative NPV projects.

2.3 Determinants of Financial Performance

Firm financial performance is determined by both the internal and external factors. Each firm faces specific internal factors while external factors are general and result from prevailing industrial and macroeconomic conditions. Adekunle and Sunday (2010) found that internal factors which determine financial performance were: debt financing corporate governance, asset tangibility and firm liquidity.

2.3.1 Debt Financing

Debt financing has both merits and demerits on the firm's financial performance. The advantages of leverage financing may include the tax deductibility of interest charge and the reduction of problems association with free cash flows. On the other hand debt financing will entails the agency conflicts between the stock-holders and the debt-holders

and also the potential bankruptcy cost (Lambe, 2014). Firms use borrowed funds to enhance their operations since it provides them with the potential of increasing the firm efficiency and improve the ROE. Using debt in financing the operations of the firm will enhance the performance if only the return on investment is higher than the cost of capital borrowed (Githaigo & Kabiru, 2015).

2.3.2 Corporate Governance

Hülya (2016) argued that corporate governance of a firm plays a key role in financial performance of firms since key decisions by managers directly affects the financial outcome. They found that good corporate governance practices leads to higher chances of better performance and business survival. Although conflict of interest may affect relationship between managers and shareholders, the board of directors helps in resolving these issues. Therefore, through oversight managers are forced to pursue investments that are beneficial and contribute to the firm's financial performance to guarantee shareholders fair returns. Board structure will be the variable of interest and will be measured using the ratio of independent directors to board members in totality.

2.3.3 Asset Tangibility

Asset tangibility refers to the ratio of fixed assets to the total firm's assets. The fixed assets play a vital role in determining firms debt level, turnover and finally firms profitability. Fixed assets of the firm have bigger economic value than intangible asset, which tend to lose value quickly in case of bankruptcy and have minimal informational asymmetries. The tangible assets are usually used as guarantee and collateral for firm's creditors in case a firm requires external financing. Therefore, companies with high

amount of tangible assets are expected to have high debt level in the capital structure than a firm with fewer tangible assets. These external finances in turn lead to high turnover and enhance the firm's performance if efficiently utilized (Rajan, & Zingales, 1995). Asset tangibility is measured as a ratio of fixed assets to total assets.

2.3.4 Firm Liquidity

Liquidity in a firm is the capability of a firm to convert its assets into cash. Firms with high liquidity are able to leverage on the opportunities that will yield high returns and at the same time protect the firm from going bankrupt during financial distress times. With the pecking order theory, liquidity reserves are easily created from profits available as firms opt for funds generated internally than externally. Firms won't be required to seek external funds if its assets they have are liquid enough to finance the various projects in the firm. Liquidity of a firm is measured using the current ratio or quick ratio. It brings out the capacity of a firm to meet its obligations that are immediate using the current assets available. A good current ratio indicates that a firm is capable of paying up its obligations using current assets (Etyang, 2012).

2.4 Empirical Review

Debt financing and firm performance is a subject of concern by many investors. Therefore, this matter has drawn the attention of researcher in the recent past. There are many empirical studies on debt financing and firm performance, but these studies have outlined mixed results. This section covers various studies conducted both globally and locally. Karuma, Ndamiri and Oluoch (2018) studied on relationship between debt financing and financial performance in the Kenya manufacturing industry. The study

surveyed all the 9 listed manufacturing firms between 2013 and 2017 and relied on secondary data. Using regression model, the data collected was tabulated and analyzed using SPSS. The study found that short term debt measures (account payable) has a negative significant effect on ROA, while (bank overdraft) has a positive insignificant effect on ROA. Similarly, long term debt measures (debentures) have a positive significant effect on financial performance. The study recommends that listed manufacturing firms should put measures in place that will help control the short term and long term debts to reasonable levels, since both affects the financial performance. The study presents contextual knowledge gap since the focus is on listed manufacturing firms. This study therefore will focus on commercial and services firms listed at NSE.

Madeizi (2017) examined the effect of debt financing on dividend policy of listed firms at NSE. The study population involved 64 firms that were listed during the study period, starting from 2012 to 2016. Descriptive cross sectional research design was used to show the association between the variables and the study relied on secondary data collected from annual audited financial reports. Data collected was tabulated on a linear regression model to enhance the analysis through the use of SPSS. The independent variables used were; debt financing, profitability, size of the firm and liquidity while the dividend policy was dependent variable. The study revealed that there exist a weak negative and statistically substantial association between debt financing and dividend policy. Asset tangibility had a positive significant effect on dividend policy. On the other hand, liquidity and profitability were observed having a negatively statistically insignificant effect on dividend policy. The conclusion of the study was that debt financing by listed firms leads to decrease in dividend payout ratio. The study recommends that when firms

are setting their capital structure they should strike a balance between debt cost and tax shield benefits associated with borrowing. The study presents both conceptual and contextual knowledge gap since the focus is on relation between debt financing and dividend policy of all firm listed at NSE. This study therefore will focus on the relationship between debt financing and financial performance of services and commercial firms quoted at NSE

Ng'ang'a (2017) examined the effect on schools performance in financial terms of privatized secondary schools in Kajiado County. A descriptive research design was adopted to show the relationship among the variables. Secondary data was used for the study period of three years (2014-2016). Data collected was tabulated on a linear regression model to enhance the analysis through the use of SPSS. The study found that there was positive and insignificant association between the independent variables (debt financing and revenue growth) and dependent variable (financial performance). The study also showed that a negative and significant association exists between independent variables (administrative efficiency and operational efficiency) and financial performance of the private secondary schools at kajiado. The study concluded that debt financing has no effect on schools performance in financial terms. The recommendation of the study was that the administrations of private secondary schools in Kajiado County should employ optimal levels of debt since interest payments on debts can affect the schools cash flows. The study presents contextual knowledge gap since the focus is on private secondary schools in Kajiado only. This study therefore will focus on commercial and services firms listed at NSE.

Onchong'a, Muturi and Atambo (2016) examined the relationship between of leverage financing firms Return on Asset of firms at NSE. The study targeted a population of 60 firms with debt in their capital structure in Nairobi Securities Exchange and utilized secondary data from audited financial reports of these firms between periods of 2009-2016. Using regression analysis analyzing coefficient on the debt effects on return on asset the study revealed that a unit increase of short term debt reduces return on asset. However the study found that a unit increase in short term debt however will reduce the profit margin ratio. The study concluded that high debt financing reduced the returns of shareholders through decrease in profit margins. It also recommends that listed firms to put more emphasis on employing more shareholders funding rather than borrowing loans so as to reduce risks associated with borrowing. The study presents contextual knowledge gap since the focus is all listed firms at NSE. This study therefore will be specific on one segment of commercial and services firms listed at NSE.

Obiero (2016) researched association between capital structure and performance in financial perspective of commercial and services firms quoted at NSE. The study comprised of all listed commercial and services firms at NSE from the year 2011 to the year 2015. A descriptive research was adopted. Data was collected from the firms consolidated financial statements. The study population comprised of all ten listed firms under the commercial and services sector at NSE from 2011 to 2015. Data was further analyzed using linear regression models using SPSS to determine if there is any impact of capital structure on performance in financial perspective. Pearson correlation coefficients between the variables showed that a negative correlation exists between log of sales and debt ratio. Relationship between current ratio and leverage was found to be weak. The

model summary concluded that the independent variables: debt ratio, liquidity, size and solvency are significant predictors of firm performance of commercial and services firms listed at NSE. The study presents conceptual knowledge gap since the focus is capital structure in general. This study therefore will focus on debt only which is a component of capital structure of commercial and services firms listed at NSE. The study will also employ other predictors of financial performance such as corporate governance which was not used on the study.

Harelimana (2017) researched on effect of debt financing on the level of performance of business in Rwanda. The study used comparative research design because it was a case comparing two businesses. Multiple regression analysis was applied for data analysis to show the association between the predictor variable (debt level) and the responsive variable (financial performance). The study found that debt levels are strongly related to bank profitability. The research concluded that Bank of Kigali was far better in performance compared I&M Bank. The study presents a contextual knowledge gap because it was a case study in Rwanda and therefore, the need of the current study that focus on a sector.

Kwadwo, Nsiah and Sekyere (2016) researched on the effect of debt policy on performance of Ghanaian manufacturing firms. The population of the study was five manufacturing firms that were listed in Ghana Stock Exchange. The predictor variables were short-term debt and long-term debt and were measured as a percentage of total debt and responsive variable firm performance was measured through ROA. The study revealed that debt both short-term and long-term debt had a negative effect on firm

performance. The study creates a contextual knowledge gap because it was done in Ghana and the focus was on manufacturing firms only.

Pradhan and Khadka (2017) researched on the effect of debt financing on profitability of commercial banks in Nepal. The population of the study was twenty two commercial banks. The study used a descriptive research design. Data analysis was done using multiple regression model where relationship of independent variables (interest coverage, bank size, short-term debt, long-term debt and total debt) and dependent variables (ROE and ROA) was shown. The results revealed a positive association of bank size, interest coverage and short-term debt on bank profitability while, long-term debts showed a negative relationship on profitability. This study creates a contextual knowledge gap because it was done in Nepal and the focus was commercial banks therefore, the need of the current study.

Darush and Peter (2015) researched on the relationship debt level had on performance of SMEs in Sweden. The study employed cross-section research design where 15,879 SMEs were sampled. Data analysis was done through a three-stage least squares model. The predictor variables were short-term debt and long-term debt while responsive was firm performance. They research concluded that debt level has a significant influence on the performance of SMEs. This study presents a contextual knowledge gap because it was done in Sweden and cannot be generalized in Kenya. The focus was on the SMEs and the current study will look at commercial and services firms listed.

2.5 Conceptual Framework

The Conceptual framework describes the relationship between independent and dependent variables of the study. This research seeks to establish effect of debt financing, corporate governance, asset quality and liquidity (independent variables) on financial performance (dependent variable).

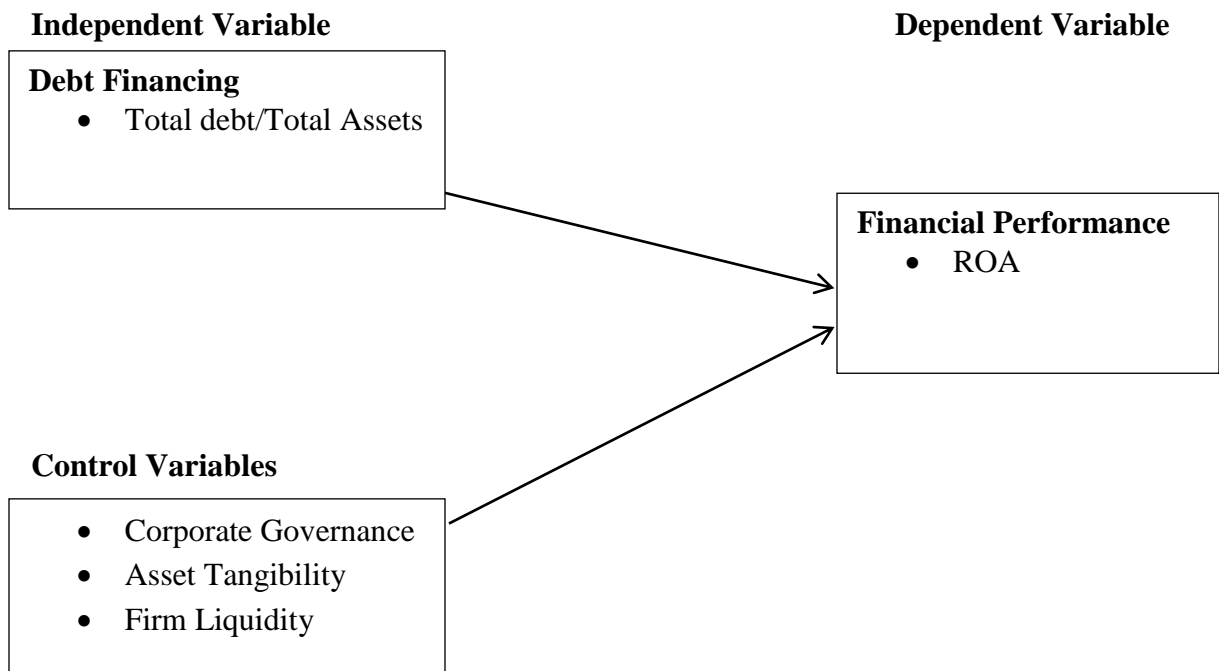


Figure 2.1: Conceptual Framework

Sources: Researcher, 2018

2.6 Summary of Literature Review

Theoretical frameworks have tried to explain the concept of debt financing. The study has used Signaling Theory, Agency theory, Trade-off Theory and Pecking Order Theory. Some of the key determinants of financial performance are also explained in this section. Empirical review on global and local perspective on debt financing and financial

performance has also been done. However, most literature reviewed on the relationship between debt financing and financial performance is on international markets with very few carried out in the local market. The findings on the studies reveal conflicting outcomes depending on the markets and the model of analysis used. Therefore, both global and local studies lack a conclusive argument explaining the association between debt financing and financial performance and the present study anticipates adding more knowledge in the area.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

The section describes methods of research applied to objectively establish the effect of debt financing on financial performance of commercial and services firms listed in the NSE. It also illustrates the study's population, research design, data collection, diagnostic tests, analysis criteria and analytical model.

3.2 Research Design

A research design is a framework that monitors the collection and data analysis (Zikmund et al., 2011). A research design presents a framework or arrangement of action for a study. This study used a descriptive survey research design. A descriptive survey study involves a description of all the elements of the population. A descriptive design is used to determine and report things as they are. The choice stemmed from the fact that the study does not require any manipulation of variables but desires to establish the state of affairs as they are (Kothari, 2008).

3.3 Population

A population is a total collection of components from which a researcher obtains interpretations from. It is the bigger set of observations. The population of this study comprised of all the 12 commercial and service firms listed at the NSE market. A list of these firms is provided in the appendixes section. The census technique was applied in the study since all the 12 firms making up the commercial and services listed firms were included in the sample. A census technique is that system where all the elements of the

population participate in the study. The advantage of census technique is that it improves the extent of accuracy and reliability (Mugenda, 2003).

3.4 Data Collection

Data collection methods refer to the systematic procedures applied by a researcher to gather and collect data for use in the study (Zikmund, et al., 2011). The study employed secondary data attained from the yearly published financial statements and annual reports of the 12 listed commercial and services firms. The annual published financial reports were obtained from the Nairobi Securities Exchange. The study collected data on financial performance from the financial statements, which comprised of net income and total assets. While on financial leverage, liquidity and asset tangibility data collected were obtained from financial statements. Information regarding corporate governance was obtained precisely from annual reports. Data used was for a period of 5 years between 1st January 2013 and 31st December 2017.

3.5 Diagnostic Test

The nature and strength of the association between the dependent and independent variables in linear regression model was measured through various diagnostic tests such as the tests of normality, autocorrelation and multicollinearity tests.

3.5.1 Normality Test

Normality test is done because it is impractical to achieve accurate and reliable deductions about the reality on whether the population from which the sample is derived is normally distributed (Ghasemi & Zahediasl, 2012). This study used Kolmogorov-

Smirnov test of normality and the graphical method to assess whether the data is normally distributed.

3.5.2 Multicollinearity Test

To ensure the data collected is free from biasness and one variable data is not related to another variable data, the study conducted a multicollinearity test. It occurs when there is nearly exact or exact linear relation among two or more of the independent variables. The variance of Inflation was used to test multicollinearity. Whenever the values of VIF less than 1 and 10, then there is no multicollinearity while when the VIF is less than 1 or greater than 10, then there is presence of multicollinearity. When the test fails you should standardize the continuous variables by choosing on a standardization method on the regression dialog box. For instance you may choose variable centering approach (Cohen, West & Aiken, 2013).

3.5.3 Autocorrelation Test

Autocorrelation is the measurement of the similarity between a certain time series and lagged value of the same time series over successive time intervals. It will be tested using Durbin-Watson. This test depicts a test statistic with a value of 0 to 4 where 2 no autocorrelation exists, where the statistic is less than two a positive autocorrelation exists and where greater than two, negative autocorrelation exists (Khan, 2012).

3.6 Data Analysis

This is a systematic process that applies statistics techniques to evaluate data through inspecting, changing and modeling data to derive fundamental information for sound decision making. The study used SPSS version 22 for data analysis. The study relied on

various regression techniques in evaluating the correlation between the selected debt financing options and the financial performance of commercial and services firms listed in NSE. The analysis involves figuring out of the various coefficients of correlation in the model to determine the connection.

3.6.1 Analytical Model

The study used a multiple regression in carrying out analysis in finding out the outcome between the responsive variable and predictor variables. A responsive variable is the financial performance while the predictor variables are debt financing, corporate governance, firm liquidity, and asset tangibility.

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \epsilon$$

Where;

Y = Financial Performance; measured by ROA (Net Income/ Total Asset)

X₁ = Debt Financing; measured by debt to asset ratio

X₂ = Corporate Governance; Measured by ratio of independent directors to total directors.

X₃ = Asset Tangibility; measured as a ratio of fixed assets to total assets

X₄ = Firm Liquidity; measured by ratio of current liabilities to current assets.

α = Constant; y intercept that is, the value of y when x is equal to zero

β = Coefficients of the model

ϵ = Error term

3.6.2 Test of Significance

The F and t tests were used to test statistical significance where F test was applied to determine the significance of the analytical model while t – test was used to establish the significance of the coefficients of the regression model where a t value greater than two ($t > 2$) was considered significant at 95% confidence level.

CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND INTERPRETATION

4.1 Introduction

This section represents study's findings established on the objectives of research. This chapter focused on collected data analysis from CMA & NSE to determine the impact of debt financing on financial performance of commercial and service firms quoted at the NSE. Using descriptive statistics, correlation analysis and regression analysis, the results of the study were presented in form of tables for easy interpretation.

4.2 Diagnostic Tests

The researcher carried out diagnostic tests on the collected data. A test of Multicollinearity was undertaken. Tolerance of the variable and the VIF value were used where values more than 0.2 for Tolerance and values less than 10 for VIF means that there is no Multicollinearity. For multiple regressions to be applicable there should not be strong relationship among variables. From the findings, all the variables had a tolerance values >0.2 and VIF values <10 as shown in table 4.1 indicating that no Multicollinearity exists among the independent variables.

Table 4.1: Multicollinearity Test for Tolerance and VIF

Variable	Collinearity Statistics	
	Tolerance	VIF
Debt Financing	0.310	1.326
Asset Tangibility	0.380	1.367
Firm Liquidity	0.706	1.417
Corporate Governance	0.503	1.99

Source: Research Findings (2018)

Shapiro-walk test and Kolmogorov-Smirnov test was used in normality test. The null hypothesis for the test was that the secondary data was not normal. If the p-value recorded was more than 0.05, the researcher would reject it. The test findings are as illustrated in table 4.2.

Table 4.2: Normality Test

ROA	Kolmogorov-Smirnov ^a			Shapiro-Wilk		
	Statistic	Df	Sig.	Statistic	Df	Sig.
Debt Financing	.149	55	.300	.857	55	.853
Asset Tangibility	.156	55	.300	.906	55	.822
Firm Liquidity	.172	55	.300	.869	55	.723
Corporate Governance	.165	55	.300	.880	55	.784
a. Lilliefors Significance Correction						

Source: Research Findings (2018)

Both Kolmogorov-Smirnova and Shapiro-Wilk tests recorded p-values greater than 0.05 implying that the data used in research was distributed normally and therefore the null hypothesis was rejected. This data was therefore appropriate for use to conduct parametric tests such as Pearson's correlation, regression analysis and analysis of variance.

Autocorrelation tests were executed so as to check for correlation of error terms across time periods. Autocorrelation was tested using the Durbin Watson test. A durbin-watson

statistic of 1.945 indicated that the variable residuals were not serially correlated since the value was within the acceptable range of between 1.5 and 2.5.

Table 4.3: Autocorrelation Test

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.528 ^a	.279	.221	.1516976	1.945

a. Predictors: (Constant), Corporate Governance, Firm Liquidity, Debt

Financing, Asset Tangibility

b. Dependent Variable: ROA

Source: Research Findings (2018)

4.3 Descriptive Analysis

Descriptive statistics gives a presentation of the mean, maximum and minimum values of variables applied together with their standard deviations in this study. Table 4.4 below shows the descriptive statistics for the variables applied for the research. An analysis of all the variables was obtained using SPSS software for the period of five years (2013 to 2017) on an annual basis. Financial performance had -0.0286 as mean with a 0.1718 standard deviation. Debt financing had a 0.2784 mean and 0.2493 standard deviation. Corporate governance resulted to 0.8080 mean with a 0.8697 standard deviation. Asset tangibility had a mean of 0.5120 and a standard deviation of 0.2450 while liquidity recorded a 1.5243 mean with a 0.08772 standard deviation.

Table 4.4: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
ROA	55	-.6137	.2209	-.028580	.1718727
Debt Financing	55	.0000	1.0000	.278367	.2493071
Asset Tangibility	55	.1760	.8906	.511978	.2450069
Firm Liquidity	55	.0827	3.3886	1.524364	.8772459
Corporate Governance	55	.57143	.93750	.8079775	.08696921
Valid N (listwise)	55				

Source: Research Findings (2018)

4.4 Correlation Analysis

Correlation analysis are used to test whether a relationship exists between two variables and often range between (-) strong negative correlation and (+) perfect positive correlation. The study employed the Pearson correlation to analyze the level of correlation between the financial performance of service and commercial firms quoted at the NSE and the independent variables for this study (debt financing, corporate governance, firm size and liquidity).

The study found out that there was a negative and statistically significant correlation ($r = -0.341$, $p = .011$) between debt financing and financial performance. The study further established that a positive and significant correlation exists between liquidity and financial performance of quoted commercial and service firms as evidenced by ($r = .502$,

p = .000). Asset tangibility was found to have a weak negative but significant association with financial performance as evidenced by (r = -.350, p = .009). Corporate governance was found to have an insignificant correlation with financial performance as evidenced by (r = -.002, p = .988).

Table 4.5: Correlation Analysis

		ROA	Debt Financing Ratio	Asset Tangibility	Liquidity Ratio	Corporate Governance
ROA	Pearson Correlation	1	-.341*	-.350**	.502**	-.002
	Sig. (2-tailed)		.011	.009	.000	.988
	N	55	55	55	55	55
Debt Financing	Pearson Correlation	-.341*	1	.342*	-.411**	.128
	Sig. (2-tailed)	.011		.011	.002	.350
	N	55	55	55	55	55
Asset Tangibility	Pearson Correlation	-.350**	.342*	1	-.779**	.155
	Sig. (2-tailed)	.009	.011		.000	.258
	N	55	55	55	55	55
Firm Liquidity	Pearson Correlation	.502**	-.411**	-.779**	1	.009
	Sig. (2-tailed)	.000	.002	.000		.948
	N	55	55	55	55	55
Corporate Governance	Pearson Correlation	-.002	.128	.155	.009	1
	Sig. (2-tailed)	.988	.350	.258	.948	
	N	55	55	55	55	55

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

** . Correlation is significant at the 0.01 level (2-tailed).

Source: Research Findings (2018)

4.6 Regression Analysis

Financial performance of commercial and service companies listed at the NSE was regressed against four predictor variables; debt financing, corporate governance, asset tangibility and liquidity. The regression analysis was executed at 5% significance level. The study obtained the model summary statistics as illustrated in table 4.6 below.

Table 4.6: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.528 ^a	.279	.221	.1516976

a. Predictors: (Constant), Corporate Governance, Firm Liquidity, Debt

Financing, Asset Tangibility

Source: Research Findings (2018)

R squared is the coefficient of determination and depicts the variations in the response variable that is brought about by the changes in the predictor variables. From the outcome in table 4.6 above, the value of R square was 0.279, a discovery that 27.9 percent of the deviations in financial performance of commercial and service firms quoted at the NSE are caused by changes in debt financing, liquidity, asset tangibility and corporate governance of the firms. Other variables not included in the model justify for 72.1 percent of the variations in financial performance of service and commercial firms quoted at the NSE. Also, the results revealed that there exists a strong relationship among the selected independent variables and the financial performance of commercial and service companies listed at the NSE as shown by the correlation coefficient (R) equal to 0.528.

Table 4.7: Analysis of Variance

Model	Sum of Squares	Df	Mean Square	F	Sig.
1 Regression	.445	4	.111	4.830	.002 ^b
Residual	1.151	50	.023		
Total	1.595	54			

a. Dependent Variable: ROA

b. Predictors: (Constant), Corporate Governance, Firm Liquidity, Debt Financing, Asset Tangibility

Source: Research findings (2018)

The significance value is 0.002 which is less than $p=0.05$. This implies that the model was statistically significant in predicting how debt financing, liquidity, asset tangibility and corporate governance affects financial performance of commercial and service companies listed at the NSE.

The researcher used t-test to determine the significance of each individual variable used in this study as a predictor of financial performance of commercial and service firms listed at the NSE. The p-value under sig. column was used as an indicator of the significance of the association between the dependent and the independent variables. At 95% level of confidence, a p-value of less than 0.05 was interpreted as a statistical significance measure. As such, a p-value above 0.05 shows that a statistically insignificant association between the dependent and the independent variables. The findings are as indicated in table 4.8.

Table 4.8: Model Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-.189	.207		-.912	.366
Debt Financing	-.113	.092	-.164	-1.234	.223
Asset Tangibility	.080	.139	.114	.574	.568
Firm Liquidity	.103	.040	.523	2.573	.013
Corporate Governance	-.007	.248	-.003	-.026	.979

a. Dependent Variable: ROA

Source: Research Findings (2018)

From the above results, it is evident that liquidity produced positive and statistically significant values for this study (high t-value (2.573), $p < 0.05$). Debt financing and corporate governance produced negative but statistically insignificant values for this study as shown by p values that are more than 5%. Asset tangibility produced positive but insignificant values for this study as shown by a high p value.

The following regression equation was estimated:

$$Y = -0.189 - 0.113X_1 + 0.080X_2 + 0.103X_3 - 0.007X_4$$

Where,

Y = Financial performance

X₁ = Debt financing

X₂ = Asset tangibility

X₃ = Firm liquidity

X₄ = Corporate governance

On the estimated regression model above, the constant = -0.189 shows that if selected independent variables (debt financing, corporate governance, asset tangibility and liquidity) were rated zero, commercial and service firms' financial performance quoted at the NSE would be -0.189. A unit increase in asset tangibility would result to an increase in financial performance of commercial and service companies listed at the NSE by 0.080. A unit increase in liquidity would result to an increase in financial performance of commercial and service firms quoted at the NSE by 0.103 while a unit increase in corporate governance and debt financing would lead to a decrease in financial performance of commercial and service companies listed at the NSE by 0.007 and 0.113 respectively.

4.7 Discussion of Research Findings

The research purposed to explore the effect of debt financing on financial performance of commercial and service firms quoted at the NSE. Debt financing as measured by debt to assets ratio, corporate governance as measured by ratio of independent directors to total directors, liquidity as measured by current ratio and asset tangibility as measured by the ratio of fixed assets to total assets; these were the independent variables. Financial performance of commercial and service companies listed at the NSE as measured by return on assets on an annual basis; this was the dependent variable. The effect of each of the independent variable on the dependent variable was analyzed in terms of strength and direction.

The Pearson correlation coefficients between the variables revealed that a strong positive correlation exists between liquidity and financial performance of service and commercial firms quoted at the NSE. The association between asset tangibility and financial performance of commercial and service firms quoted at the NSE was found to be weak and negative. The study also showed that there exist a weak negative association between debt financing and financial performance of commercial and service firms quoted at the NSE while corporate governance was found to have a weak and insignificant negative relationship with financial performance of service and commercial companies listed at the NSE.

The model summary revealed that the independent variables: debt financing, asset tangibility, liquidity and corporate governance explains 27.9% of variation in the dependent variable as depicted by an R^2 value implying that other factors were not included in the model that account for 72.1% of changes financial performance of service and commercial companies listed at the NSE. The model is fit at 95% confidence level as the F-value was 4.830. Therefore, the overall multiple regression model is statistically significant and suitable in predicting how the independent variables selected affects financial performance of commercial and service firms quoted at the NSE.

The findings of this study are in line with Ogutu et al., (2015) who investigated the weight of financial elements on the performance of services and commercial companies listed on NSE. The study covered the ten year period from 2003 to 2013. The researchers utilized secondary data from nine commercial and services companies listed companies and adopted the descriptive research design in conducting the research. The data was subjected to panel multiple regression analysis and correlation analysis leading to a

conclusion that increased financial leverage negatively affects the performance of commercial and services companies.

This study is in agreement with Obiero (2016) who researched on association between capital structure and performance in financial perspective of commercial and service companies quoted at NSE. The study comprised of all listed commercial and services firms at NSE from the year 2011 to the year 2015. A descriptive research was adopted. Data was collected from the firms consolidated financial statements. The study population comprised of all ten listed firms under the commercial and services sector at NSE from 2011 to 2015. Linear regression models were analyzed using SPSS to explore if there exists is any effect of capital structure on performance in financial perspective. Pearson correlation coefficients between the variables depicted that a negative correlation exists between log of sales and debt ratio. Relationship between current ratio and leverage was found to be weak. The model summary concluded that the independent variables: debt ratio, liquidity, size and solvency are significant predictors of firm performance of commercial and services firms listed at NSE.

This study differs with Harelimana (2017) who researched on effect of debt financing on the level of performance of business in Rwanda. The study used comparative research design because it was a case comparing two businesses. Multiple regression analysis was used for data analysis to show the association between the predictor variable (debt level) and the responsive variable (financial performance). The study found that debt levels are strongly related to bank profitability. The research concluded that Bank of Kigali was far better in performance compared I&M Bank.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This section summarizes the previous chapter's findings, conclusion and study limitations. The section also elucidates the policy recommendations that policy makers can implement to achieve the expected financial performance of commercial and service companies listed at the NSE. Lastly the chapter presents suggestions for further research which can be useful by future researchers.

5.2 Summary of Findings

The study sought to investigate the effect of debt financing on financial performance of commercial and service companies listed at the NSE. The independent variables for the study were debt financing, corporate governance, asset tangibility and liquidity. The study adopted a descriptive cross-sectional research design. CMA reports were used to retrieve secondary data which were analyzed using SPSS software version 22. The study used annual data for the 12 commercial and service firms listed at the NSE covering a five year time frame as from January 2013 to December 2017.

From the results of correlation analysis, a strong positive correlation exists between liquidity and financial performance of service and commercial firms quoted at the NSE. The association between debt financing and financial performance of commercial and service firms quoted at the NSE was found to be weak and negative. The study also showed that there exist a weak negative association between asset tangibility and financial performance of commercial and service firms listed at the NSE while corporate

governance was found to have a weak and insignificant negative relationship with financial performance of commercial and service companies listed at the NSE.

The co-efficient of determination R-square value was 0.279 implying that the predictor variables selected for this study explains 27.9% of changes in the dependent variable. This means that there are other factors not included in this model that account for 72.1% of changes in financial performance of commercial and service companies quoted at the NSE. The model is fit at 95% confidence level and F-value of 4.830. Therefore, the overall multiple regression model was statistically significant and thus suitable in explaining how the financial performance of the commercial and service companies quoted at the NSE is affected by the selected independent variables.

The regression results show that when all the independent variables selected for the study have zero value, financial performance of commercial and service companies listed at the NSE would be -0.189. It is also noted that a unit increase in asset tangibility would result to an increase in commercial and service companies' financial performance quoted at the NSE by 0.080. A unit increase in liquidity would lead to an increase in financial performance of service and commercial companies quoted at the NSE by 0.103 while a unit increase in corporate governance and debt financing would lead to a decrease in financial performance of commercial and service companies listed at the NSE by 0.007 and 0.113 respectively.

5.3 Conclusion

From the findings of the study, it can be concluded from the study that financial performance of commercial and service companies listed at the NSE is significantly

affected by debt financing, corporate governance, asset tangibility and liquidity of the companies. Debt financing was noted to have a negative but statistically insignificant association with financial performance of commercial and service companies listed at the NSE and this means an increase in leverage leads to a decrease in financial performance though not to a significant extent. The study found that corporate governance had a negative but insignificant impact on commercial and service firms' financial performance quoted at the NSE. The study therefore concludes that corporate governance leads to a decrease in financial performance of service and commercial companies listed at the NSE but not to a significant extent.

The study established that liquidity had a positive and significant impact on financial performance of commercial and service companies quoted at the NSE and therefore it is concluded that higher levels of liquidity leads to an increase in financial performance. Asset tangibility was found to be statistically insignificant determinant of financial performance of commercial and service companies quoted at the NSE and therefore this study concludes that asset tangibility does not significantly influence financial performance of commercial and service companies quoted at the NSE.

This study concludes that independent variables chosen for this study debt financing, corporate governance, asset tangibility and liquidity affect to a large extent financial performance of service and commercial firms quoted at the NSE. It could be therefore concluded that these variables significantly affect financial performance as depicted by the p value of ANOVA summary. Since the four independent variables explain 27.9% of changes in financial performance of commercial and service companies listed at the NSE

imply that the variables not included in the model explain 72.1% of changes in financial performance.

This finding concurs with Pradhan and Khadka (2017) who researched on the effect of debt financing on commercial banks' profitability in Nepal. The population of the study was twenty two commercial banks. The study used a descriptive research design. Data analysis was done using multiple regression models where relationship of independent variables (interest coverage, bank size, short-term debt, total debt and long term debt) and dependent variables (ROE and ROA) was shown. The results showed that a positive relationship of bank size, interest coverage and short-term debt exists on bank profitability while, long-term debts showed a negative relationship on profitability.

5.4 Recommendations

Debt financing was found to have an insignificant negative impact on financial performance of commercial and service companies quoted at the NSE. The research therefore recommends that when firms are setting their debt financing they should strike a balance between the tax savings benefit of debt and bankruptcy costs linked with borrowing. High levels of debt has been found to reduce financial performance of listed commercial and service firms from the findings of this study and so firm managers should maintain debt in levels that do not impact negatively on financial performance to ensure the goal of maximizing shareholders' wealth is attained.

The study found out that a positive relationship exists between financial performance and liquidity position. This study recommends that a comprehensive assessment of listed commercial and service firm's immediate liquidity position should be undertaken to

ensure the company is operating at sufficient levels of liquidity that will lead to improved financial performance of firms. This is because a firm's liquidity position is of high importance since it influences the firm's current operations.

The study established that there was a negative influence of asset tangibility on financial performance of commercial and service firms quoted at the NSE though not significant. This study recommends adequate measures should be put in place by managers of these firms to improve and grow their financial performance by increasing their tangibility. Listed commercial and service firms and all firms in general should work on increasing their tangible assets that will lead to an increase in financial performance because this translates to improved shareholder wealth which is the main goal of a firm.

5.5 Limitations of the Study

The scope of this study was for five years 2013-2017. It has not been determined if the results would hold for a longer study period. Furthermore it is uncertain whether similar findings would result beyond 2017. A longer study period is more reliable as it will take into account major happenings not accounted for in this study.

One of the study's limitations of was the quality of the data. It is illusion to derive conclusions from the study since the legitimacy of the situation cannot be ascertained. The data that has been used is only assumed to be accurate. The measures used may keep on deviating from one year to another subject to prevailing condition. Secondary data that had already been retrieved was utilized for the study, unlike the primary data which is first-hand information. The study also considered selected determinants and not all the

factors affecting financial performance of service and commercial companies quoted at the NSE mainly due to limitation of data availability.

For data analysis purposes, the researcher applied a multiple linear regression model. Due to the shortcomings involved when using regression models such as erroneous and misleading results when the variable values change, the researcher cannot be able to generalize the findings with certainty. If more and more data is added to the functional regression model, the hypothesized relationship between two or more variables may not hold.

5.6 Suggestions for Further Research

This study focused on debt financing and financial performance of service and commercial firms quoted at the NSE and relied on secondary data. A research study where data collection relies on primary data i.e. in depth questionnaires and interviews covering all the 12 commercial and service firms listed at the NSE is recommended so as to compliment this research.

The study was not exhaustive of the independent variables affecting financial performance of commercial and service firms quoted at the NSE and this study recommends that further studies be conducted to incorporate other variables like management efficiency, growth opportunities, firm size, industry practices, age of the firm, political stability and other macro-economic variables. Establishing the impact of each variable on financial performance of service and commercial companies quoted at the NSE will enable policy makers know what tool to use when maximizing shareholder's wealth.

The study concentrated on the last five years since it was the most recent data available. Future studies may use a range of many years e.g. from 2000 to date and this can be helpful to confirm or disapprove the findings of this study. The study limited itself by focusing on listed commercial and service firms at the NSE. The recommendations of this study are that further studies be conducted on other non-listed commercial and service firms operating in Kenya. Finally, due to the shortcomings of regression models, other models such as the Vector Error Correction Model (VECM) can be used to explain the various relationships between the variables.

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APPENDICES

Appendix I: Listed Commercial and Services Firms in Kenya

1. Atlas African Industries Ltd
2. Express Kenya Ltd
3. Hutchings Biemer Ltd
4. Kenya Airways Ltd
5. Longhorn Publishers Ltd
6. Nairobi Business Ventures Ltd
7. Nation Media Group Ltd
8. Standard Group Ltd
9. TPS Eastern Africa Ltd
10. Uchumi Supermarket Ltd
11. WPP Scangroup Ltd
12. Deacons (East Africa) PLC

Appendix II: Data Collection Form

VARIABLE	DESCRIPTION	YEARS				
		2013	2014	2015	2016	2017
Financial Performance	Net Income					
	Total Assets					
Liquidity	Current Assets					
	Current Liabilities					
Asset Tangibility	Fixed Assets					
	Total Assets					
Debt Financing	Total Debt					
	Total Asset					

CORPORATE GOVERNANCE

FIRM	YEAR	NON-EXECUTIVE DIRECTORS	TOTAL NUMBER OF DIRECTORS
	2013		
	2014		
	2015		
	2016		
	2017		