

**EFFECT OF CAPITAL STRUCTURE ON THE FINANCIAL PERFORMANCE OF
ENERGY AND PETROLEUM FIRMS LISTED AT NAIROBI SECURITIES
EXCHANGE**


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**A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF THE
REQUIREMENT FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS
ADMINISTRATION, FACULTY OF BUSINESS AND MANAGEMENT SCIENCES,
UNIVERSITY OF NAIROBI**

2021

DECLARATION

I, the undersigned declare that this is my original work and has not been submitted for any degree or examination in any other university.

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

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DEDICATION

This study is in honor of my loved ones who include my loving wife Nancy Kemunto, my sons Zachary and Austin, my dad James ombati and my mum Mary Boyani who have shown their unwavering support, encouragement, and love over the years.

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LIST OF ABBREVIATIONS

ERC	Energy Regulatory Commission
CMA	Capital Markets Authority
KPLC	Kenya Power and Lighting Company
NSE	Nairobi Securities Exchange
ROA	Return on Assets
ROE	Return on Equity

ABSTRACT

The capital structure of a firm is simply the composition of its financial liabilities. There are many empirical and theoretical studies that have been conducted to clarify the relationship between capital structure and business performance. The pecking order theory asserts that companies have a preference for different types of funding alternatives in a certain order, theoretically. The sequence of funding is determined by the costs associated with these capital sources as well as their accessibility. The Modigliani and Miller hypothesis certifies that in a perfect market, financial performance is not influenced by the capital structure blend of debt and equity. Despite years of research, capital structure decisions still remain a puzzle. The goal of the study was to see how capital structure affected the performance of NSE-listed energy and petroleum companies. The study's population included all five NSE-listed energy and petroleum companies. Capital structure, defined as the ratio of long term debt to long term assets in a particular year, was used as a predictor variable in this study. Liquidity was measured by the current ratio while company size was measured by the total assets natural log per year. Return on assets served as the response variable for financial performance. Secondary data was collected on an annual basis for ten years (January 2011 to December 2020). The research variables were analyzed using a descriptive cross-sectional design. SPSS software was used to conduct the analysis. The results yielded a 0.333 R-square value, indicating that variations in the chosen independent variables account for 33.3 percent of changes in financial performance amongst energy and petroleum firms, whereas other factors accounting for 66.7 percent of variation in financial performance amongst NSE listed energy and petroleum firms. Independent variables had a strong relationship with company performance ($R=0.577$) in this study. The F statistic was significant at 5% with $p<0.05$, according to the ANOVA results. This demonstrated that the overall model was effective in determining the variables' relationships. Capital structure had a negative as well as statistically significant impact on financial performance while liquidity had a positive and statistically significant impact on the performance of the NSE listed energy and petroleum companies. The size of the company had no bearing on the results of this study. According to the findings of this research, energy and petroleum firms listed on the NSE should concentrate on optimizing their capital structure and liquidity situations since these two aspects have a significant effect on their financial results.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Energy and petroleum companies' financing decisions are crucial since they affect their long-term profitability and survival. Of all the major functions in corporate finance, financing decision is regarded as the most crucial function compared to other functions since it forms the basis of the acquisition and allocation of the investment funds required by the energy and petroleum firms. The choice of debt financing by energy and petroleum firms can be advantageous or can lead to financial distress depending on how the finances are utilized by the finance managers. Prudent allocation and use of the borrowed funds lead to improved financial performance. Therefore, financial managers of any energy and petroleum firm got to be cautious while settling on financial decision. The capital structure decisions affect the company's worth in almost every management decision. The theory of capital structure seeks to determine whether or not the various sources of funding for investment projects have any bearing (Palmer, 2009).

According to the idea of the pecking order, businesses prefer internal financing sources over external funding sources (Myers, 1985). If internal finances aren't enough, it believes businesses would turn to external sources of funding rather than debt financing. The theory further maintains that the business entities which are profitable is as a result of prudent use of debt financing. According to Black and Sholes' (1974) trade-off theory, a company would choose a combination of debt and equity financing to balance borrowing's costs and advantages. There will be maximum profit and minimum expense in the optimum capital structure.

Energy and petroleum companies were chosen because of their impact on other businesses and the overall economy. Petrochemical and energy sector progress affects almost every country. Oil provided 34% of global energy requirements in 2008, and it is expected to continue providing a significant portion of the global energy mix in the future. Price hikes in other sectors are felt via operational expenses, productivity, and return on investment (ERC's 2017). Capital structure of the entities when properly addressed has proven to greatly improve the financial performance of the entities (Burakat, 2012).

1.1.1 Capital Structure

In order to maximize investment returns, companies often use a capital structure that relies on borrowed funds (Oraqir, 2013). The use of stock and debt financing by companies to fund their assets is known as capital structure (Rehman, 2013). Debt and equity financing of assets is the subject of this study. Equilibrium requires that the relationship between shareholders' equity and loaned funds be defined. According to Burakat (2012), capital structure is the use of external funds in form of debts in backing the business entities aimed at improving their profitability. It is possible for shareholders to improve their returns on investment by using debt financing, which in most cases results in returns in terms of the tax imposed on borrowing.

A number of factors should be considered when deciding on a company's capital structure. These include: costs associated with obtaining new sources of capital, risk attitudes of capital providers, firm management's attitude toward risk, and the tax benefits associated with using debt. Firm value may be affected by the risk structure in one of two ways: either by altering anticipated returns or by increasing or decreasing the cost of capital. Because of the interest tax shelter, using debt in capital structure often raises gearing. Since the relationship and nature of capital

structure theories obscure the effect, it's difficult to draw solid conclusions from them. When a company's capital structure includes a lot of debt, it's in financial trouble (Titman, 1988).

Capital structure has been measured differently by previous researchers. Capital structure and equity were employed as proxies for capital structure in Engwebe (2013)'s study of the impact of Indonesian banks' capital structures on productivity. Using debt and equity as proxies, it was shown that the capital structure of a sample of NSE-listed businesses had an impact on financial performance between 2010 and 2014. Using the debt ratio as a proxy, Olly (2014) found that debt financing has a substantial influence on Peruvian pharmaceutical firms' value. In other words, evidence suggested that using debt was good for the company's worth. The study's capital structure was assessed using the debt-to-equity ratio.

1.1.2 Financial Performance

If a business is financially successful, its goals, in this instance financial goals, will be met (Yahaya & Lamidi, 2015). There is a direct correlation between the financial success of business entities and how efficiently they utilize their assets in their primary function of doing business and generating income. A company's financial performance is important since it shows how motivated the company is to make a profit (Yahaya & Lamidi, 2015). Factors that have a direct effect on a company's financial statements or reports are the most important when it comes to financial performance. The financial performance study may cover a variety of different variables that are relevant to the company (Omondi & Muturi, 2013).

The financial performance of certain economic units is an important indication or measure of their success, for example, in achieving their aims and objectives. Shareholders being the owners of firms would want the managers to maximize the investment values and they can achieve this

by measuring and making value judgments concerning the performance of the firm by ensuring no conflict of interest exist between the owners of the firms and the managers. Long-term shareholder value creation and ultimate financial performance maximization are the primary goals of every company. This is known as wealth creation and the ultimate maximizing of shareholder value. Firm stakeholders are primarily concerned with the financial success of the company (Nyamita, 2014). The most common way to convey financial success is to compare it to increases in sales or stock prices (Maghanga & Kalio, 2012). ROA and ROE are two financial performance measures that companies use to measure their success (ROE). Because of its wider applicability in previous investigations, ROA was chosen for this investigation.

1.1.3 Capital Structure and Financial Performance

A company's capital structure is made up of its financial assets and liabilities. There are many empirical and theoretical grounds to believe that a company's financial structure affects its performance. Organizations, according to the pecking order hypothesis, have a preference for some types of funding over others. The sequence in which funds are funded is determined by the costs associated with these fund kinds and the ease with which they are accessible (Mule & Mukras, 2015). A company's financial success has no effect on the debt-to-equity ratio in its capital structure, according to the Modigliani and Miller hypothesis (1958).

The trade-off hypothesis predicts that a company's choice of debt-to-equity financing mix will be equal. According to their findings, the capital structure has a substantial effect on a company's success. Research revealed that debt financing was directly linked to the company's success. A consequence of this was that more leveraged companies outperformed their leaner counterparts, according to the research. After looking at the long-term financial effects of debt financing,

Funguni (2015) discovered that sales growth, debt-to-equity, and profit all go hand in hand. Negative correlation exists between net income and return on equity (ROE) due to high debt-to-equity ratios.

1.1.4 Energy and Petroleum Firms Listed at Nairobi Securities Exchange

Organizations involved in the distribution and marketing of oil-related products, as well as the selling of various forms of energy in Kenya, make up the energy and petroleum business there. Local and global organizations are also included. The Energy Regulatory Commission is primarily responsible for industry regulation (ERC). Kenya's oil sector is dominated by around 75 companies. All aspects of the business are regulated by Kenyan law, including crude imports, refining, and retail sales. According to the PIEA, Total Kenya has a 21.7% market share, Vivo Kenya an 18.9% share, and KenolKobil a 13.9% share. These three big corporations have complete command of the market (2017). Energy like electricity is delivered by KPLC, which is a monopoly, and produced by KenGen, which also functions as one.

Kenya's economy is heavily dependent on the energy and petroleum sector. The industry is characterized by stringent taxing systems, non-differentiable products, and price restrictions, making it very competitive (NSE, 2017). Oil fuel comprises the fundamental source of energy business in Kenya. Working capital management is only one of many factors that go into a company's overall financial health in the energy and petroleum industry. Strikes by employees and supplier boycotts are only two examples of what may happen if a company is unable to fulfill its obligations. Key bottlenecks facing energy and petroleum industry incorporates persistent increase in operation cost due to poor infrastructure, exchange rate fluctuations,

adverse taxation from the government and regulation. Other difficulties include continuing security concerns as a result of terrorism (ERC, 2016).

1.2 Research Problem

Finance professionals pay close attention to the financial structure and performance of a business. The pecking order theory finds the optimal capital structure by integrating debt financing costs with tax advantages from using obligation funds. Debt financing has an effect on the capital structure of a business since it influences management's financial choices. These financial choices then affect performance according to McKinney and Jensen (1976). According to Modigliani and Miller (1958), the value of an organization is entirely defined by the quantity of actual assets it possesses rather than the number of shares and debt in its capital structure. As a result, there's a conundrum regarding how capital structure affects a company's success.

A company's short-term debt commitments and operational costs are met thanks to capital structure choices made by energy and petroleum companies. With capital structure, the firm's ability to operate and generate cash flow is ensured (Ganesan, 2014). In a growing economy, the energy and petroleum industries are important because of their contribution. While the fortunes of Kenya's oil and petroleum companies have improved, others have experienced a decrease, which has been attributed to corporate managers' inability to make optimum monetary decisions (Githui, 2015). It has been reported that a large number of Kenyan energy and petroleum companies have failed due to financial problems ranging from financing plans to the source of funds (Mwangi, Makau, and Kosimbei 2014).

The connection between a company's financial structure and its success has been extensively researched. Engwebe (2013) looked at the productivity effect of Nigerian manufacturing firms'

capital structures. Debt financing was shown to have a detrimental impact, thus businesses with low debt ratios were more productive. The return on equity (ROE) and debt-to-equity (D/E) ratios were linked in Vamishan (2014), however the D/E ratio harmed Tehran stock market firms' performance. Financial success is inversely proportional to the capital structure, according to Burakat (2014).

Kimani (2017) came to the conclusion that the financial performance is substantially affected by the capital structure. Debt financing had no substantial impact on NSE-listed businesses' financial performance, according to Mutisya and Otieno's study (2015). As a consequence, a longer time horizon was utilized and all Nairobi Securities Exchange-listed energy and petroleum firms were investigated to address the study question: what is the effect of capital structure on the financial performance of energy and petroleum firms listed at Nairobi Securities Exchange?

1.3 Objective of the Study

The study sought to determine the effect of capital structure on the financial performance of energy and petroleum firms listed at Nairobi Securities Exchange.

1.4 Value of the Study

The findings of this study will contribute to the advancement of capital structure theories. The study will also contribute to the increasing body of academic research on capital structure and financial performance by serving as an empirical reference for academic researchers. The researchers' findings will be included into the expanding body of knowledge on capital structure. It will serve as a repository for literary works.

CMA and other policymakers will be able to utilize the study's results to develop suitable procedures for monitoring and evaluating companies' funding in the long term. Identifying industry-specific debt limits may help accomplish this by ensuring that companies aren't exposed to unnecessary financial risk.

According to the results, industry practitioners who are responsible for making financial choices will be more aware of the need for companies to establish and maintain an optimum financing structure in order to protect enterprises from the financial cost threats.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

An overview of capital structure research is provided in this chapter. Emphasis is placed on a theoretical review, financial performance variables and empirical research. The chapter ends by summarizing what has been learned from this study.

2.2 Theoretical Review

According to Modigliani-Miller (1958), Kraus & Litzenberger (1972), and the Pecking Order concept, the study will be driven by three capital structure hypotheses (Myers & Majluf, 1985).

2.2.1 Pecking Order Theory

Myers and Majluf (1985) are credited with coming up with this theory. The hypothesis is based on the financial choices made by businesses. According to this idea, companies always prefer to raise money from inside. Firms often follow a certain sequence of funding from internal to external sources. Firms would rather hold on to their cash than take on more debt. Some companies choose short-term debt since it has a shorter payback period than long-term debt, which may take a long time and have higher financing expenses owing to interest payments that must be made. As the knowledge gap between insiders and outsiders grows, issuing stock may become prohibitively expensive for certain companies (Pandey, 2005). Business entities that need external funding have the option of issuing extremely secure market securities, which means that they begin with debt securities and equity qualifies as a last choice.

Using internal resources over external ones is preferred by companies that believe in the pecking order hypothesis, which says that there is a financial hierarchy. This idea has been challenged by Desai (1990), who points out that it relies only on financing costs and ignores other variables that may influence the way companies decide how much money they need. One element is the government's policy; another is interest rates; and still another is the connection between borrowers and lenders. Because it sheds greater light on the importance of internal funding in comparison to external financing, this theory is relevant to this research.

2.2.2 Trade off Theory

Kraus and Litzenberger (1972) came up with the theory. To maintain a balance between costs and advantages associated with financing choices, companies should establish a balance between debt finance and equity finance, according to this idea. It assumes that capital structure has benefits to the firms as long as it is employed up to that point where an optimal capital structure is attained. According to this theory, the tax shield is increased by the reduction in the tax liability since debt interest is tax deductible. The riskiness of an investment increases with an increase in debt which implies that investments which are financed purely by debt are very risky to invest in (Myers, 1984).

The optimal debt ratio of firms can be determined by the tradeoff between the bankruptcy costs and the advantages associated with taxation advantage of borrowing. According to the findings of Ingham (1985) research, prosperous companies borrow less, contrary to common wisdom, which holds that successful companies should borrow more in order to minimize their borrowing-related tax obligations. Firms must do cost benefit analysis in financing decisions to

avoid losses. According to this idea, in order to enhance financial performance, it's important to weigh the costs and advantages of different financing options side by side.

2.2.3 Modigliani and Miller Propositions

As a consequence of the Modigliani and Miller (1958) debates, new ideas about capital structure emerged. Key assumptions in Modigliani and Miller's ideas include information symmetry, no transaction costs on the market, no taxes, and a faith in capital markets' perfection. A leveraged firm's market value will equal its unlevered firm's market value if all assumptions are met, as Modigliani and Miller found. Whether companies choose to fund their operations with equity or debt may or may not have an impact on their financial performance and overall worth.

Baxter (1980) however argued that the influence of bankruptcy costs cannot be underestimated because they have a direct effect on the unlevered firms. The bankruptcy costs include the restructurings costs, liquidity costs and the legal fees incurred by the business entities. His argument was that when business entities use high proportions of debt in their capital structure, they will definitely incur high bankruptcy costs compared to the firms with minimal debts. When taxes are present and the value of the companies may be maximized, an optimal capital structure exists, according to Baxter (1980). There is no impact on the company's cost of capital or value from changes in its capital structure. If you believe this theory, then smart finance is the key to improving financial success.

2.3 Determinants of Financial Performance

The capital structure of a business has a significant impact on its financial success. Financing performance is greatly improved by optimizing capital structure since it lowers the overall cost

of obtaining money. The determinants of financial performance include capital structure, company size, external factors, liquidity and corporate governance.

2.3.1 Capital Structure

Ganesan (2014) defines capital structure as the mix of debt and equity utilized to fund the activities of a business. The combination of various types of financing used by the business determines its capital structure (Modigliani & Miller, 1965). A company's capital structure, according to Musyoka (2012), is made up of a mix of stock and debt to fund operations. There is no optimum capital structure, say Modigliani and Miller. Whether a business succeeds or fails will be determined by how it uses debt and equity. Companies may either employ a high percentage of equity capital and minimal debt, or the opposite. The capital structure mix will affect the financial performance, the use of high debt financing exposes the company to bankruptcy because of high finance charges which the company cannot fully cater for, high amount of equity capital in the capital structure will help the company mitigate the risks associated with financial distress. Hence companies should strike a balance on the composition of the capital structure so that financial performance can be improved.

2.3.2 Company Size

Firm size is defined as measure of company proxies such as total assets, total sales or total market capitalization (Kemal, 2011). Pipeda (2016) defined firm size as the level of market share of a firm in a given industry within a specified period. Muturi (2014) characterized firm size as number of employees and amount of fixed assets of a firm in a given period. According to financial performance, the size of the business has a direct correlation; nevertheless, it may either adversely or favorably affect the organization's financial success. In contrast to smaller

businesses that cannot afford the bulkiness of services, large corporations may obtain most services at lower prices because of their buying power. It's possible for businesses to diversify their risks more effectively by taking use of low-cost services (Myers, 1984).

2.3.3 External Factors

External factors are a set of variables which influence performance of firms but they have no control over them (Kimani, 2017). External factors are macroeconomic variables that affect a company's capacity to accomplish its goals, such as competition, GDP, and inflation rates (Nielsen, 1974). The more the revenue, the better the company's financial performance is. However, the decrease in GDP indicates that revenues are limited and this has a negative impact on financial performance. For businesses with earnings that are not affected adversely by inflation, high inflation lowers income levels. Sales growth will have a positive effect on financial performance since consumers' purchasing power is high. A person's financial well-being is also heavily influenced by interest rates. As a result of the higher default rates caused by high interest rates, businesses' earnings suffer, while revenues soar as a result of the reduced risk of default that occurs with lower rates (Nielsen, 1974).

2.3.4 Liquidity

A firm's capacity to sell or purchase an item without its price drastically changing is described as liquidity, according to Harvey (2011). Liquidity refers to the ease with which assets may be purchased and traded (Wood, 1988). The availability of assets that may quickly be turned into cash is referred to as liquidity (Malik, 2003). The deal will have no impact on the market price of assets. It is measured by the quick ratio and current ratio. The fast ratio tells us about the ability to meet short-term commitments as they come due using the most readily available cash,

excluding inventory. Currently, a company's net current assets are less net current liabilities. As a result, we may use the current ratio to determine the assets that will become liquid within a year, after all of our obligations have been fulfilled. The current ratio measures the difference between an accounting system's current assets and liabilities. A company with a higher proportion of liquid assets often performs better since it has more money on hand to meet its commitments (Wood, 1988).

2.3.5 Corporate Governance

Managing and controlling a company is referred to as corporate governance (Korir, 2014). A strategy designed to assist managers in planning, monitoring, and assessing the company's total financial performance while managing risks and uncertainties was described by Malik (2003). Having a good corporate governance system may help a company's financial results. The goal of good corporate governance is to make money for the company's stakeholders, which include suppliers, shareholders, creditors, and other financial institutions, such as banks. The protection of shareholders' interests and full disclosure of financial results by management will also be ensured as a consequence of this measure (Manne, 1965).

2.4 Empirical Review

There is a distorted relationship between capital structure and financial performance, according to empirical research. More evidence of the financial advantages of capital structure emerged early in the study process. Other research on the other hand, has shown that the different financing proportions selected by the companies had no advantages for the enterprises.

Muturi (2014) investigated how insurance companies' financial performance was influenced by the capital structure in Kenya between 2012 and 2014. From a total of 34 insurance firms, a representative sample of 18 was chosen for further investigation. Almost all of the study was done using secondary data, which was provided by the insurance regulating body. The researchers used a linear regression analysis in their investigation. Because the research was so short, it was unable to draw any solid findings. The researchers found that using debt as a capital structure has a substantial impact on financial performance. Due to the short time span, a robust regression analysis could not be performed in this research.

Obligation financing lowered the value of Peruvian pharmaceutical businesses, which had a population of 300 entities, according to Olly (2014). A sample of 215 businesses was chosen for the research due to time and budget limitations. To determine how strong the link was, researchers used a multivariate linear regression model. There were a number of different capital structure ratios calculated. The approach used was carefully thought out. As a result, they came to the conclusion that the company's long-term debt was an important factor. Due to the study's emphasis on company value, which is distinct from financial success, there is a conceptual divide.

Pipeda (2016) carried a study to find out how the capital structure of a Ghanaian financial institution affects its profitability. A total of 215 financial institutions were studied between 2010 and 2012. A sample size of 86 financial institutions was utilized. It was done using secondary data obtained from financial institutions' web pages. For the sake of accuracy, the researchers used a linear regression model as well. From the research, he came to the conclusion that the

profitability was strongly influenced by the capital structure. As a result of the studies short duration and methodological gap.

Ganesan (2014) studied the financial performance of Indian pharmaceutical companies, focusing on the role of capital structure. The research period lasted from the year 2000 to the year 2010. Only 152 out of a possible 340 pharmaceutical companies were included in the study's sample. It was possible to quickly obtain secondary data from the companies' websites for use in this research. Additionally, the research used a well-organized and time-saving linear regression model. It was shown in his study that long-term debt has an important bearing on financial performance. With regard to social and economic contexts, Kenya and India have a contextual divide to deal with.

According to Harvey (2011), pharmaceutical firms in Nigeria between 2005 and 2010 had a positive effect on their profitability due to their capital structure. 103 pharmaceutical companies were selected at random from a pool of 314 pharmaceutical companies. Secondary data was analyzed in the research. Regression models were also used in this research to show how the variables studied were linked. The research technique used in this study was appropriate. The investigation had been carefully prepared in advance. From this, he concluded that the capital structure of pharmaceutical firms in Nigeria had little effect on their profitability or overall financial performance. Kenya and Nigeria have distinct social and economic contexts, thus there is a chasm.

Rehman (2013) looked at the connection between a Pakistani sugar company's capital structure and its financial results. For this study, secondary data were gathered from sugar company financial statements released in Pakistan. In addition, the researchers used a linear regression

model. The inquiry proceeded according to plan. Pakistani sugar businesses' profitability is boosted by their financial structure, according to the results. Out of the 84 sugar businesses surveyed, 42 were chosen as a sample for the research. For example, Kenya and Pakistan have very different social and economic contexts.

Kenya's oil and petroleum businesses, according to Githui (2015), have a major effect on their profitability because of capital management. Of Kenya's 20 petroleum companies, the researchers selected a sample of ten for the study. In the poll, researchers also used a linear regression model. Variables related to the capital structure, such as capital structure and EPS, were computed and analyzed. The information was presented in a way that was easy to comprehend. Based on his research, he concluded that the capital structure of the company had no effect on its market value. When it comes to this research, a conceptual chasm exists since it concentrated on company value rather than financial performance

According to Korir (2015), between 2010 and 2014, the financial performance of selected NSE-listed firms was affected by capital structure practices. Only 14 out of 53 publicly traded businesses were included in the research. The research drew on publicly accessible secondary data for its findings. The researchers also used a multiple regression model to carry out their investigation. The variables chosen were the correct ones. According to the findings of the research, the NSE listed businesses' financial performance was substantially influenced by their capital structure. There was a conceptual void in the research since petroleum and energy companies were not included.

According to Kimani (2017), between 2010 and 2016, an insurance company's financial performance in Kenya was assessed for the effect of the company's capital structure. From a pool

of 63 insurance firms, 8 were randomly chosen for further study. Companies' audited financial accounts provided secondary data for this study. Linear regression modeling was used as well in this research. It was a good idea to use this technique in this research. According to the findings, the capital structure had a little effect on financial performance. While insurance companies have activities that are distinct from petroleum and energy companies, the study's findings have a contextual gap.

2.5 Conceptual Framework

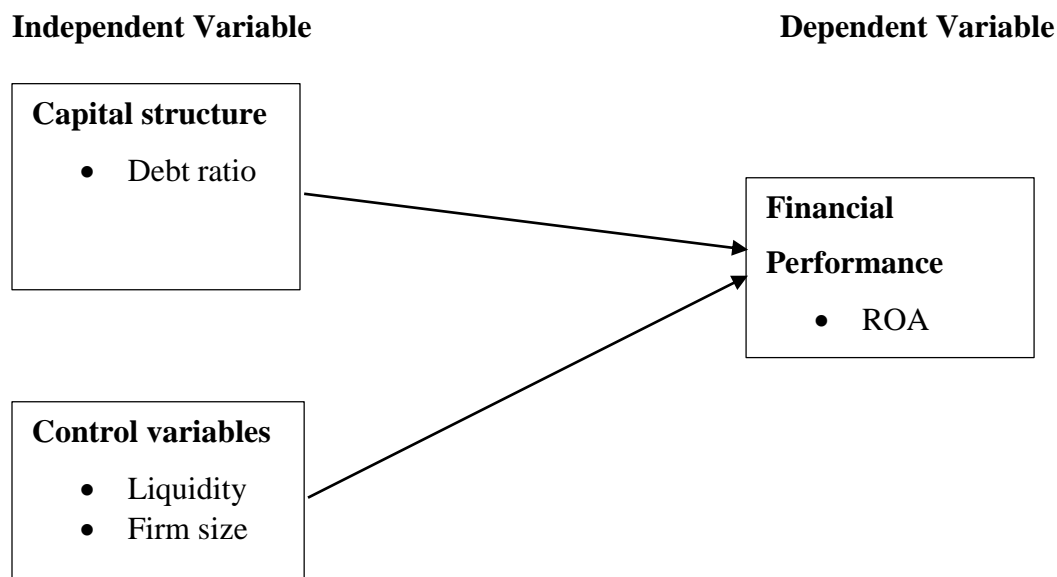


Figure 2.1: Conceptual Framework

The study's aim was to find out how a company's capital structure affected its performance on the New Stock Exchange financially. Determinants like business size and liquidity are in charge of the independent variable (debt ratio), while return on assets is used to assess financial success.

2.6 Summary of Literature Review

The following theories were reviewed, Pecking order theory (Myers, 1985), Modigliani and Miller propositions, (1958), trade off theory (Black & Scholes, 1974). Various empirical literatures were reviewed and they include Muturi (2014), Olly (2014), Pipeda (2016), Ganesan (2014), Harvey (2011), Rehman (2013), Githui (2015), Korir (2015), Kimani (2017) and the conceptual framework. From the review of the literature, some studies failed to employ analytic model and the context of the study was in the developed markets. This study will therefore aim to address these research gaps.

Financial performance of different businesses was studied in depth by researchers who came up with a number of findings. Capital structure, according to certain research, enhances the value of their companies significantly. The capital structure does have an impact on financial results, although it is little, according to previous research. A company's NSE financial performance and equity capital structure are intertwined, and understanding this relationship is critical.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The study's methodology is described in detail in this chapter. They consist of research design, research subjects, samples, data collecting, and analysis.

3.2 Research Design

The study's methodology is outlined in the research design. Due to its usefulness in explaining the issue, this study made use of a descriptive research approach. When gathering information on the present state of variables of interest or circumstances, a descriptive study approach was suitable (Mugenda, 2009).

3.3 Population

A population is made up of a variety of different things that may be studied (Mugenda, 2009). The study's participants were the five publicly traded energy and petroleum companies on the NSE (Appendix 1).

3.4 Data Collection

Data from public financial statements was utilized in this research since it was readily available from the NSE and the websites of a wide range of energy and petroleum businesses. For a decade, from 2011 through 2020, researchers gathered data. Data gathered comprised total assets, current liabilities, current assets and net income.

3.5 Data analysis

Data analysis, according to Mugenda (2009), is the path of putting the information collected into some kind of order. In order to collect secondary data, descriptive statistics were used, which yielded mean values.

3.5.1 Diagnostic Tests

To make sure the data met classical linear model assumptions, diagnostic tests were run on it. Tests such as autocorrelation, stationarity, Kurtosis, and Skewness were employed to assess the connection between variables, as well as multicollinearity testing by variance inflation and correlation coefficient.

3.5.2 Analytical model

For the purpose of demonstrating the relationship between the independent and dependent variables, the following multiple linear regression model was used;

$$Y = \beta_0 + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + e$$

Where Y is the financial performance as measured by return on assets. β_0 is the free term of the equation. β_1, β_2 and β_3 are the coefficients of independent variables

x_1 = debt ratio which is the long term debt divided by long term assets.

x_2 = firm size determined by natural logarithm of total assets

x_3 = Liquidity as measured by the ratio of current assets to current liabilities

e = error term

3.5.3 Test of Significance

NSE listed energy and petroleum companies' financial performance was studied using F and T tests with a 5% significance threshold to determine model strength as well as how capital structure affects financial performance.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND FINDINGS

4.1 Introduction

This chapter looks into CMA data to see how the capital structure affects the financial performance of energy and oil companies. Correlation and regression data were represented in tables utilizing descriptive statistics, as indicated in the segments below.

4.2 Descriptive Analysis

This study presents the average, maximum, minimum, and standard variables. Table 4.1 displays the variable statistics. For all four energy and petroleum companies whose data was gathered, SPSS was utilized in the analysis from 2011 to 2020. The figures are listed below.

Table 4.1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
ROA	49	.0041	.4645	.093216	.0814725
Capital Structure	49	.1158	.9734	.512518	.2350510
Firm size	49	9.3433	19.6518	15.119073	4.2455738
Liquidity	49	.3156	6.5259	2.312880	1.4102121
Valid N (listwise)	49				

Source: Research Findings (2021)

4.3 Diagnostic Tests

On the data gathered, diagnostic tests were run. The research utilized a 95% confidence interval or a 5% significance threshold to obtain variable information. Diagnostic tests were helpful in determining if the data was false or true. As a result, the closer the confidence interval is to 100

percent, the more correct the data utilized is assumed to be. The tests performed in this example were normality, multicollinearity, heteroskedasticity, as well as autocorrelation.

4.3.1 Normality Test

This study included the Shapiro-Wilk and Kolmogorov-Smirnov tests. This criteria stated that data was considered normal if the probability was higher than 0.05.

Table 4.2: Normality Test

	Kolmogorov-Smirnov ^a			Shapiro-Wilk		
	Statistic	Df	Sig.	Statistic	Df	Sig.
Firm value	.161	49	.300	.869	49	.853
DPR	.173	49	.300	.918	49	.822
Firm size	.178	49	.300	.881	49	.723
Leverage	.175	49	.300	.874	49	.812

a. Lilliefors Significance Correction

Source: Research Findings (2021)

Since the p values are above 0.05, the aforementioned findings indicate that the data was regularly distributed. As a result, the normal distribution null hypothesis was accepted, indicating that the researcher fails to reject the null hypotheses.

4.3.2 Multicollinearity Test

William et al (2013) defined this characteristic as correlations between the predictor variables. This attribute was tested using VIF. Field (2009) says that VIF values over 10 suggest that this feature exists.

Table 4.3: Multicollinearity Test

Variable	VIF	1/VIF
Capital structure	1.675	0.597
Firm size	1.724	0.580
Liquidity	1.644	0.608

Source: Research Findings (2021)

Table 4.3 shows the VIF values that were discovered to be less than ten, indicating that Multicollinearity was not present, as per Field (2009).

4.3.3 Heteroskedasticity Test

The error process in cross-sectional units may be homoscedastic, yet vary across units called groupwise Heteroskedasticity. Breuch Pagan is calculated for each group using the hettest program. Heteroskedasticity is a term used to describe the heteroskedasticity of residuals. According to the null hypothesis; $\sigma^2_i = \sigma^2$ for $i = 1 \dots Ng$, where Ng is the cross-sectional units.

Table 4.4: Heteroskedasticity Test

**Modified Wald test for group wise heteroskedasticity
in regression model**

H0: $\sigma(i)^2 = \sigma^2$ for all i
 chi2 (49) = 244.33
 Prob>chi2 = 0.1849

Source: Research Findings (2021)

The null hypothesis of Homoskedastic error terms is not rejected, according to the results in Table 4.4, which are supported by a 0.1849 p-value

4.3.4 Autocorrelation Test

The Breusch-Godfrey autocorrelations test was employed to detect serial correlations in a model's idiosyncratic term since typical serial correlation biases make the results more efficient.

Table 4.5: Autocorrelation Test

**Wooldridge test for autocorrelation in panel data
H0: no first-order autocorrelation**

F(1, 49) = 0.324
 Prob> F = 0.3364

Source: Research Findings (2021)

Table 4.5 shows that the null hypothesis of no serial connection is not rejected since the p-value of 0.3364 is significant.

4.4 Correlation Analysis

Correlation analysis is a method used to find links between different variables. Using the Pearson correlation, we looked at the relationship between several performance and variable metrics in the energy and oil industries (capital structure, liquidity and firm size).

Table 4.6: Correlation Analysis

		ROA	Capital Structure	Firm size	Liquidity
ROA	Pearson Correlation	1			
	Sig. (2-tailed)				
Capital Structure	Pearson Correlation	-.280	1		
	Sig. (2-tailed)	.051			
Firm size	Pearson Correlation	.091	.227	1	
	Sig. (2-tailed)	.533	.117		
Liquidity	Pearson Correlation	.087	-.218	.642**	1
	Sig. (2-tailed)	.553	.132	.000	

** . Correlation is significant at the 0.01 level (2-tailed).
b. Listwise N=49

Source: Research Findings (2021)

Capital structure had a negative but not significant association with energy and petroleum company financial success ($r = -.280$, $p = .051$), according to the findings. The size of a firm and liquidity have been proven to have a positive but not substantial connection with its financial success ($r = .091$, $p = .533$; $r = .087$, $p = .553$).

4.5 Regression Analysis

Capital structure, liquidity and firm size were the variables upon which performance was modeled. The significance level for the analysis was set at 5%. The regression result was contrasted to the crucial value from the F – table. The results are listed below.

Table 4.7: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.577 ^a	.333	.324	.4964932	2.230

a. Predictors: (Constant), Capital structure, Firm size, Liquidity

b. Dependent Variable: ROA

Source: Research Findings (2021)

Variables that change as a result of changes in predictor variables are shown by the R square. R square was 0.333, showing that differing capital structure, liquidity and size represent 33.3 % of the variability in energy and oil companies' financial performance. 66.7 % of the financial performance variation may be ascribed to factors outside the model. Furthermore, as demonstrated by a 0.577 correlation coefficient(R), the independent factors had a high link with financial performance.

Table 4.8: Analysis of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.017	4	.006	6.523	.000 ^b
	Residual	.158	44	.001		
	Total	.175	48			

a. Dependent Variable: ROA

b. Predictors: (Constant), Capital structure, Firm size, Liquidity

Source: Research Findings (2021)

In this case, the significance threshold is 0.000, which is significantly lower than $p=0.05$. This indicates that the model was adequate for evaluating the capital structure, liquidity, and firm size of NSE-listed energy and petroleum companies.

The R-square indicated the way the variables were connected. The significance of the link between responder and predictor factors was shown by the p-value of the sig. column. The confidence interval of 95% indicates a p-value of less than 0.05. As a consequence, a p-value higher than 0.05 indicates that the predictor and response variable are unrelated. The results are listed below.

Table 4.9: Model Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
1 (Constant)	-.289	.282		-3.155	.000
Capital structure	-.179	.037	-.138	-2.112	.036
Liquidity	.352	.038	.524	3.973	.000
Firm size	.115	.139	.182	1.326	.101

a. Dependent Variable: ROA

Source: Research Findings (2021)

All other factors, except for company size, have generated significant findings (high t-value, $p < 0.05$). Because a p value greater than 0.05 is displayed, the business size generated a positive but insignificant result. Capital structure generated negative and substantial results while liquidity produced positive but not significant results.

The following equation was created:

$$Y = -0.289 - 0.179X_1 + 0.352X_2 + 0.115X_3$$

Where,

Y = Financial performance

X₁= Capital structure

X₂= Liquidity

X₃= Firm size

The constant = -0.289 in the model indicates that performance would be -0.289 if the variables (capital structure, liquidity and company size) were all zero. While firm size was insignificant, a unit rise in capital structure resulted in a 0.179 loss in performance, but a unit rise in liquidity resulted in 0.352 increase in financial performance while size was statistically insignificant.

4.6 Discussion of Research Findings

The study looked at how capital structure affects the performance of NSE energy and oil companies. The capital structure as a proportion of total assets was the dependent variable for total debt. Existing assets against current obligations and total assets were used to limit liquidity assessment ratios. The performance response variable was ROA.

According to Pearson's correlation coefficient, a company's performance is positively associated with its size, although the relationship is not statistically significant. However, there was only a little link between the NSE Energy and Oil companies' financial performance and capital structure. According to the findings, there is a small but significant link between NSE energy and oil firms' liquidity and their performance.

The result shows that 33.3% of changes in the response variable according to R², which implies other factors other than the model explain 66.7% of performance changes. The predictor variables of capital structure, liquidity and size of a business were significant determiners as exhibited by an F-value of 6.523, the model was significant at 95% confident interval.

Individually, only capital structure and liquidity had a significant influence.

Insurance companies' financial health was examined in Kenya between 2012 and 2014, according to Muturi (2014). From a total of 34 insurance firms, a representative sample of 18 was chosen for further investigation. Almost all of the study was done using secondary data, which was provided by the insurance regulating body. The researchers used a linear regression analysis in their investigation. Because the research was so short, it was unable to draw any solid findings. The research found that borrowing in the capital structure had a substantial impact on financial performance.

Olly (2014), who studied the impact of debt financing on the value of Peruvian pharmaceutical businesses with a population of 300 firms, also agreed with the findings of this study. Only 215 businesses made up the final sample due to the study's time and financial constraints. The researchers used a multivariate linear regression model to gauge the strength of the link. A variety of capital structure ratios have been figured out for various scenarios. The technique was applied in a methodical manner. It was therefore discovered that a company's long-term debt was critical to its worth.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents an overview of the project's results, conclusions, and study limitations. Publicly traded energy and petroleum businesses should be held to a higher standard because of the suggestions in the report. There are also recommendations for further research in the study's results.

5.2 Summary of Findings

Research's goal was to discover how NSE's capital structure impacts its financial performance. Capital structure, liquidity and business size were among the variables studied. This was accomplished using a descriptive cross-section design. SPSS has been used to analyze secondary CMA data. Annual data for five energy and oil corporations has been obtained during a ten-year period from their annual reports.

The size of a business has a positive but not significant connection with its financial success in the energy and oil sectors, according to correspondence studies. The capital structure of NSE energy and petroleum companies was negative but not substantially linked to their financial success. The study also found a modest but substantial link between liquidity and NSE energy and petroleum companies' financial success.

As depicted by 0.333 R square, indicating that differences in capital structure, liquidity and business size account for 33.3 % of the variance in NSE listed energy and petroleum enterprises performance. 66.7% of financial performance variation is attributable to variables outside the

model. The results showed that the predictor parameters selected were significantly linked with the business results of energy and oil companies ($R=0.577$). The F value was calculated as 5% higher than the crucial value while the p value was 0.000 and showed that the model included data on the effects of the three independent variables on NSE power and animals.

The regression outcomes suggest that performance might be performance would be -0.289 if the variables (capital structure, liquidity and company size) were all zero. While firm size was insignificant, a unit rise in capital structure resulted in a 0.179 loss in performance, but a unit rise in liquidity resulted in 0.352 increase in financial performance while size was statistically insignificant.

5.3 Conclusion

The financial performance of publicly traded energy and oil businesses are affected significantly by capital structure. The results indicate that a one-unit increase in that variable has a substantial negative effect on energy and petroleum business performance. Company liquidity has a strong positive performance connection and therefore greatly improves liquidity performance. Furthermore, business size has a favorable but modest financial impact, meaning that corporate size is not a big predictor of financial performance.

There was a strong correlation between the chosen variables such as capital structure, liquidity and the size of a company. Energy and oil businesses are substantially affected by these variables, because the ANOVA p value is less than 0.05. It's clear that other non-model factors account for 66.7% of variance in energy and oil firms' financial performance if the variables chosen account for 33.3% of variation in performance.

The findings of this research are in line with those of Korir (2015), who examined the impact of NSE-listed company capital structuring practices on financial performance between 2010 and 2014. Out of the 53 listed businesses, a random sample of 14 was chosen for the research. The research was based on publicly accessible secondary data. In the investigation, the researchers also employed a multiple regression model. The variables chosen were appropriate. According to the findings of the research, the NSE-listed businesses' financial performance was substantially influenced by their capital structure.

According to Kimani (2017), who looked at the effect of Kenya's insurance company capital structure on the country's financial performance from 2010 to 2016, this research is different. A representative sample of 8 insurance companies was selected from a pool of 63. Researchers used audited financial records to collect secondary data for their study. The researchers also used a linear regression model to improve their accuracy. This study followed a reasonable technique. According to the findings, the capital structure had a little impact on financial results.

5.4 Recommendations for Policy and Practice

According to the findings, capital structure has an adverse effect on financial performance. Policy reforms include: energy and oil companies listed in NSE shall assess fiscal advantages and bankruptcy costs connected with loan funding. Levels of debt should be kept at appropriate levels because a high debt level has been shown to decrease financial performance. This will assist in achieving the objective of enhancing shareholder value.

Financial performance and liquidity were found to have a positive relationship in the research. The suggestion is that a detailed examination of the liquidity condition of publicly traded energy and petroleum firms be performed to ensure that the firms are functioning at adequate levels of

liquidity, consequently boosting financial performance. The rationale for this is that liquidness is extremely vital since it has an impact on how a company operates.

5.5 Limitations of the Study

The research looked at some of the elements thought to influence the NSE-listed energy and petroleum companies performance. The research focused on three explanatory variables in particular. Nevertheless, additional factors, some of which are internal, like the firm's age and corporate governance, though others which lack management's regulation, like rate of exchange, economic growth, balance of trade, as well as rate of unemployment, are influential in determining financial performance of companies.

Quantitative secondary data were included into the study. The research also overlooked qualitative data that may explain additional variables influencing the connection between capital structure and energy and oil company performance. Qualitative techniques like focus groups, open surveys and interviews may help to provide more definitive results.

The research focused on a span of 10 years (2011 to 2020).It is unclear whether the outcomes will last long. It's also uncertain if same results can be expected beyond 2020. A multivariate linear regression model for data analysis was used. The investigator cannot correctly extrapolate results due to the model's shortcomings, such as misleading conclusions from a change in variable financial performance. When data is added into the model, conflicting outcomes may occur.

5.6 Suggestions for Further Research

The research makes use of secondary data to look at how the capital structure affects the performance of NSE energy and oil companies. In order to complement this research, same survey on the basis of primary data obtained through thorough surveys as well as interviews on all 5 NSE listed energy and petroleum corporations might suffice.

Further research on variables such as growth prospects, industrial practices, business age, political stability, and other macroeconomic variables is required since the study did not cover all of the elements that affect the financial performance of NSE oil and energy companies. Policymakers may use a tool that evaluates the influence of different factors on performance to help them make decisions.

The research was restricted to NSE-listed energy and oil businesses. Other corporations operational in Kenya should be investigated further, according to the study's recommendations. Future research should look into how capital structure affects characteristics other than financial performance, such as business value, operational efficiency, and dividend payment, to name a few.

The focus of this research was drawn to the last ten years. Future studies may span a lengthy period of time, such as thirty or twenty years, and may have a major effect on this study by confirming or refuting its findings. A longer research has the benefit of allowing the researcher to catch the effects of business cycles like booms as well as recessions.

Lastly, this research relied on model of multiple linear regressions that has its own set of drawbacks, including the possibility of erroneous and misleading conclusions due to changes in

variable financial performance. The Vector Error Correction Model should be used in future study to investigate the numerous links between financial performances.

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APPENDIX 1: LIST OF LISTED ENERGY AND PETROLEUM FIRMS

- a. Kengen Company ltd
- b. Umeme ltd
- c. Kenya Power and Lighting Company ltd
- d. Total Kenya ltd
- e. Kenol Kobil ltd

APPENDIX II: DATA COLLECTION TEMPLATE

Company	Year	ROA	Capital Structure	Firm size	Liquidity
KENGEN	2011	0.0659	0.4582	18.8299	4.7131
	2012	0.0208	0.4803	18.8969	1.7358
	2013	0.0208	0.4803	18.8969	1.7358
	2014	0.0265	0.4685	18.9101	1.4858
	2015	0.0265	0.4685	18.9101	1.4858
	2016	0.0704	0.6232	19.0555	1.4218
	2017	0.0704	0.6232	19.0555	1.4218
	2018	0.0531	0.4908	19.3378	1.0966
	2019	0.0531	0.4908	19.3378	1.0966
	2020	0.4645	0.4712	19.6518	1.2049
KPLC	2011	0.1293	0.3133	18.2585	1.0625
	2012	0.1065	0.3328	18.6127	1.2496
	2013	0.1065	0.3328	18.6127	1.2496
	2014	0.1032	0.3308	18.7143	0.8973
	2015	0.1032	0.3308	18.7143	0.8973
	2016	0.0999	0.4763	19.0316	0.9705
	2017	0.0999	0.4763	19.0316	0.9705
	2018	0.1374	0.4950	19.2096	1.0320
	2019	0.1374	0.4950	19.2096	1.0320
	2020	0.0918	0.6265	19.4224	1.4488
KETRACO	2011	0.0933	0.4931	15.9858	6.5259
	2012	0.0497	0.4942	16.7592	3.0184
	2013	0.0497	0.4942	16.7592	3.0184
	2014	0.0387	0.9632	17.1739	1.5510
	2015	0.0387	0.9632	17.1739	1.5510
	2016	0.2471	0.9680	17.5427	1.7391
	2017	0.2471	0.9680	17.5427	1.7391
	2018	0.0041	0.9734	17.7301	0.7966
	2019	0.0041	0.9734	17.7301	0.7966
	2020	0.1680	0.4043	18.0819	0.3156
TOTAL KENYA	2011	0.1400	0.2742	10.6604	3.9120
	2012	0.1500	0.3254	10.5285	3.8918
	2013	0.1200	0.2887	10.6222	3.8712
	2014	0.0900	0.2953	10.6033	3.8501

Company	Year	ROA	Capital Structure	Firm size	Liquidity
	2015	0.1100	0.2754	10.6336	3.8286
	2016	0.0100	0.6428	9.9731	4.3944
	2017	0.0200	0.6662	9.9870	4.3820
	2018	0.0200	0.6639	9.9537	4.3694
	2019	0.0400	0.6526	9.9113	4.3567
	2020	0.0600	0.6372	9.8389	4.3438
KENOL KOBIL	2011	0.1300	0.1158	9.5194	3.1781
	2012	0.1200	0.1323	9.4888	3.1355
	2013	0.1300	0.1656	9.4726	3.0910
	2014	0.1700	0.1472	9.4037	3.0445
	2015	0.2200	0.1270	9.3433	2.9957
	2016	0.0400	0.7007	9.7688	2.0794
	2017	0.0500	0.6912	9.7041	1.9459
	2018	0.0100	0.7020	9.6570	1.7918
	2019	0.0100	0.6503	9.5858	1.6094

EFFECT OF CAPITAL STRUCTURE
ON THE FINANCIAL
PERFORMANCE OF ENERGY
AND PETROLEUM FIRMS LISTED
AT NAIROBI SECURITIES
EXCHANGE

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Submission date: 01-Nov-2021 03:21AM (UTC-0500)

Submission ID: 1689836121

File name: Ombati_george_MBA_project.docx (108.8K)

Word count: 10267

Character count: 57843



19th NOVEMBER 2021

EFFECT OF CAPITAL STRUCTURE ON THE FINANCIAL PERFORMANCE OF ENERGY AND PETROLEUM FIRMS LISTED AT NAIROBI SECURITIES EXCHANGE

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19th November 2021