Capital Structure and Financial Performance of Companies listed under Manufacturing and Allied Sector at Nairobi Securities Exchange in Kenya

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ISSN: 2616-4965
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Abstract

Capital structure is a prevalent subject that has continued to pose a challenge among scholars in the field of finance and has increased remarkable attention since 1950’s. The manufacturing and allied sector’s contribution of Gross Domestic Product has remained stagnant with inadequate increases in the previous three decades, giving an average of 10% from 1964-73 and increasing slightly to 13.6% from 1990-2007 and averaging below 10% recently. The purpose of this study was to assess capital structure and financial performance of companies listed under manufacturing and allied sector at Nairobi Securities Exchange, Kenya. The study employed descriptive research design and data was analyzed using multiple regressions. The target population comprised all the eight companies listed under manufacturing and allied sector at the Nairobi Security Exchange, Kenya where census approach was adopted. Results of the study revealed that retained earnings and equity have negative influence on financial performance of firms listed under manufacturing and allied sector in Kenya. Long term debt however, was found to have a positive impact on financial performance as measured by Return on Equity. The study recommends that the management board of manufacturing and allied sector should revamp their policies by adopting strategies that ensure optimum capital structure. Moreover, manufacturing companies should come up with more investing schemes and products diversification to increase their proceeds and hence additional capital.

Keywords: Capital Structure, Financial Performance, Retained Earnings, Equity & Long Term Debt.
1.0 Background of the Study

Capital structure is a prevalent subject that has continued to pose a challenge among the researchers in world of finance and has increased remarkable attention. Capital structure is the most significant decision in a company not only on the maximization of shareholders wealth, but also the decision determines the ability of the company to sustain a competitive edge (Arulvel & Ajanthan, 2013). It is essential to note that one of the key financing decisions that a company ought to make is how to optimize its capital structure because it helps determine financing and investment prospects of that company. Leon (2013) agrees with this ideology by asserting that a skill by company to meet the shareholders interest as well as be able to deal with the competitive environment is closely linked to its capital structure. Capital structure is a word used to signify the mixture of debt and equity which is used by a company to fund its operations.

According to Nassar (2016), the capability of a company to define its capital structure is a complex assignment to attain. The key sources that organizations may get their finances from are internal funding which are retained earnings, and the external funding which could either be equity or debt. Retained earnings refer to the amount of company’s profit that remain after allotment of surpluses to the stockholders and then plowed back to the business. Retained earnings are quite significant source of internal funding in a company because they do not involve floatation costs as well as increasing financial responsibility and risk. Therefore, retained earnings promote growth of a company as well as its ability to maximize the shareholders wealth (Masood, 2018). Moreover, companies have access to various sources of borrowing which could either be long term or short duration obligation. Short period liability may be cheaper compared to long duration obligation however may pose a higher risk to a company compared to long term debt because it may require periodic renewal.

Furthermore, the choice between debt and equity funding by a company is dependent on many factors that may include prevailing market circumstances, share prices etc. Equity may be in form of common stocks or preferred stocks. In instances where a company faces income shortages, it would be prudent for it to choose equity financing because obtaining debt and paying it back would be challenging (Salman & Munir, 2012). The capability that a business has in fulfilling the shareholders’ interests is closely connected to its structure or composition of its capital. This is mainly so because capital structure is crucial on how an organization funds its general processes and development by using debt, equity or mixture of securities (Arulvel & Ajanthan, 2013). The connection amongst capital position and financial fulfillment has established much consideration in world of funding literature. This means that there are yet many answers that researchers seek as far as capital structure and performance are concerned. Various scholars have established a positive rapport concerning capital structure and productivity although others have established that the liaison is negative (Pratheepkanth, 2011). This is a heated debate that finance scholars are faced with.

Manufacturing and allied sector in Kenya has been growing at a slower rate than the economy. Additional price increased slightly by 0.2% in 2017 in relation towards a progress of 2.7% in 2016 (KNBS, 2018). This indicates that the portion of manufacturing in GDP has been sinking with time. The Economic Survey reports in the recent past also continue to confirm that firms in the sector have continued to face growth challenges. For instance, Manufacturer worth Index (PPI) improved by 3.91 percent in 2015 in relation with an upturn of 3.03 in 2014, largely owing to increased expenses incurred in importation of raw resources. Furthermore, most of the manufacturing and allied companies listed at Nairobi Securities Exchange (NSE) have continued to register decline in their net profits (Handbook,
2018). For instance, BOC Kenya PLC had a decline of 49% in 2017 from 2016; British American Tobacco Kenya PLC declined by 21% in 2017 from 2016 and a decline of 15% in 2016 from 2015; Carbacid Investment PLC declined by 18.7% in 2015 from 2014 while there was a decrease of 6.19% in 2017 from 2016. Currently, the company has issued a profit warning in 2019 (NSE, 2019). Mumias Sugar has continued to make losses over the last five years.

1.1 Statement of the Problem

Globally, the manufacturing and allied sector has had a major part in the expansion of the economy by motivating in addition to supporting high industrious growth, enhancing employment prospects for semiskilled labor and constructing country competitiveness through exports. However, most of the developing countries have not been able to cultivate a strong manufacturing and allied sector. In Kenya, growth has mainly been determined by the agriculture and services sectors respectively. The country has therefore gone through an untimely deindustrialization as revealed by the decline in Gross Domestic Product (GDP) contribution by the manufacturing and allied sector which was at 9.2% in 2016 and 8.4% in 2017. The sector has experienced momentous challenges in the last 15 years. The Vision 2030, the Kenya Industrial Transformation Programme (KITP) and most lately the Big 4 Agenda are key government development plans to help restore the manufacturing and allied sector in Kenya by 2022 along with increasing GDP from the current 8.4% to 15% (KAM, 2018).

Moreover, the sector’s contribution of GDP has remained stagnant with inadequate increases in the previous three decades, giving an average of 10% from 1964-73 and increasing slightly to 13.6% from 1990-2007 and averaging below 10% recently (KAM, 2018). The latest Handbook (2018) reveals that the Return on Equity (ROE) of the companies registered under the sector has been declining. For instance, ROE for the East African Breweries was at 0.6% in 2014, 0.5% in 2015, and 0.7% in 2016 and at 0.6% in 2017. Even though there stands numerous studies done in relation to capital position and financial performance in the scope of finance not many researchers focused on how capital structure and financial performance of manufacturing and allied sector as a whole relate. Most of them have looked at all the firms listed at NSE whereas Leon (2013) asserts that capital structure is a dynamic process and is dependent on a sector. For instance, Ogebe, Ogebe and Alewi (2013) studied the influence of financial position of Nigerian companies; Gathogo and Ragui (2014) examined the determinants of capital structure of organizations in Kenya and adopted stratified sampling technique; Masavi, Kiweu and Kinyili (2017) focused on structure of farming companies registered at NSE by adopting longitudinal research design; Makori and Jagongo (2013) researched on operating capital management and company viability of the companies registered under the manufacturing and construction at NSE.

Moreover, there exist both conceptual and empirical gaps that this study sought to address by focusing on capital structure and financial performance in the manufacturing and allied sector in relation to its retained earnings, long duration obligation and equity since they were major bases of finance in most of the companies in the sector (Handbook, 2018). The methodological gap was addressed by adopting census and descriptive research design. Additionally, most of studies done were not within the Kenyan context. Ajibola, Wisdom and Qudus (2018) studied on capital position and achievement of listed manufacturing firms in Nigeria by adopting the Panel methodology. This research sought to address the contextual gap by assessing the capital structure and financial performance in the Kenyan context.
1.2 The objectives of the study

The general objective of this study was to assess the capital structure and financial performance of companies listed under manufacturing and allied sector at Nairobi Securities Exchange, Kenya.

The specific objectives were:

1. To determine the influence of retained earnings on financial performance of companies listed under manufacturing and allied sector at Nairobi Securities Exchange, Kenya.

2. To establish the impact of long-term debt on financial performance of companies listed under manufacturing and allied sector at Nairobi Securities Exchange, Kenya.

3. To determine the effect of equity on financial performance of companies listed under manufacturing and allied sector at Nairobi Securities Exchange, Kenya.

2.0 Literature Review

2.1 Theoretical review

2.1.1 Pecking Order theory

Pecking order theory hypothesized by Myers and Majluf (1984) asserts that there is irregular information between the insiders of a company and the outside investors. Managers know the true position of a firm as far as its value is concerned compared to outside investors. Pecking order theory has various limitations which include: it does not take into account the consequence of levies; charge of allotting fresh shares; intervention costs; and economic anguish of the venture prospects. Assumptions involve; existence of perfect market; organizations with advanced productivity use interior funding more than debt; and there is no objective capital structure (Khan & Nafees, 2013).

According to Myers and Majluf (1984), organizations fund their projects with retained earning when likely. When the retained earnings remain inadequate, at that time debt is employed. It is only in risky cases when organizations use new equity funding. Therefore, the order of monetary sources preferred is the internal financing from profits (retained earnings) then debt then the chosen stock and then ordinary stock is the last choice. The theory forecasts that the issuance of equity (common stock) is the last alternative sources of funding. It claims that there is not at all ideal debt proportion. Organizations will prefer internal financing of retained earnings because there are no floatation costs as is the case with the external financing. It is only at the point when the reserved incomes stand not enough when an organization may choose debt funding as its second option (Bhama, Jain & Yadav, 2017). The pecking order concept is applicable to the research because it advocates for retained earnings financing as the first option compared to other external financing because no overheads (bankruptcy in addition to transaction outlays) linked using it. The study sought to define the influence of retained earnings on financial productivity.

2.1.2 Modigliani and Miller theory of capital structure

The famous Modigliani-Miller (henceforth MM) proposition that the worth of an enterprise rests on the productivity and not on its capital structure is openly a claim to the field of finance of the principle that money is neutral. This theory was developed by two professors namely Modigliani and Miller in 1958 (Miller, 1977). The MM proposition is the original theory about capital structure and was hypothesized under a perfect market condition. It states that business worth may be no chance relate to capital structure or financing decisions.
(Mostafa & Boregowda, 2014). In an ideal situation, the price of a company may perhaps be linked with the capital structure of that firm since debt holders are paid first before the shareholders in an event of a financial leverage. According to Miller (1977), there were several assumptions that they made which included; principal arcades are impeccable when no bankruptcy and operation expenditures are present; there is symmetry of market data and without impact of obligation in a firm’s income past charges and tax. However, it is important to note that in an ideal capital market, there exists bankruptcy and transaction costs, asymmetric information and the impact of debt on income before interest and tax is there. The theory was relevant towards the study mainly considering the first proposal that states that with the concept of taxes, organizations will prefer debt because of tax shield effect since they are deemed to perform better than those with no debt. This helped explain the impact of long-term debt on financial performance.

2.2.3 Trade off theory

The tradeoff philosophy was proposed by Robichek and Myers (1966). The theory proposes that an organization should relate the costs of debt (for instance debt overhang) to its paybacks in order to determine its optimal capital structure, and at that point implement this optimal (Myers, 2016). The main assumptions of trade off theory include: capital markets are perfect; no costs on tax, agency and transaction (Adair & Adaskou, 2015). The theory attempts to argue that there exists prime capital structure which can maximize the worth of a company. However, in an ideal situation it may not be possible to have an optimal capital position.

Moreover, according to Myers and Majluf (1984) an organization which uses that concept establishes a goal obligation ratio and then progressively moves near the goal. The mark is regulated by harmonizing debt tax guards in contradiction of rates of insolvency. Benefits and costs may be attained in many different ways (Frank & Goyal, 2009). The tax-bankruptcy tradeoff viewpoint is that organizations poise the levy benefits of debt contrary to the burden expenses of bankruptcy. Trade off theory is significant in the sense that it helps to articulate that organizations are partially funded with debts and partly with equity. In a going concern situation, the firm may have inadequate reserves to back all its ventures. Therefore, the principle helps to demonstrate the effect of equity and its influence on financial performance.

2.2 Empirical Review

Yemi and Seriki (2018) assessed the retained earnings and the value of the firm market in the period of 2003-2014 for Nigerian firms. Descriptive and multiple regression methods stood adopted. The study shown that there was a progressive and sizable connotation between the retained earnings, paychecks per share dividend payout and value of organizations whereas market assessment is completely on the other hand unsubstantially linked with financial leverage. The results of this study clearly point out that retained earnings and earnings per share have control on the value of a business. It is clear that retained earnings have a major part in fulfilling the shareholders interest of maximization of wealth. The study presented a contextual gap that the current study sought to address by looking that the Kenyan context.

Eklof, Podkorytova and Malova (2018) determined the link between customer satisfaction and financial performance in the period of 2004-2014. The study revealed that there is a constructive association between customer satisfaction and wellbeing of a firm. The concept of customer satisfaction is critical in any organization that is focused on creating a competitive advantage in the current market environment. It is a major area that has a lot of weight in marketing department of any organization. The study highlights that extraordinary
points of customer fulfillment eventually cause better performance in terms of huge volumes of sales. Most of the organizations have changed their approach to marketing and rather preferred to be customer centric to boost the performance. In a going concern situation, managers should invest in customer loyalty among other strategies because it has gradual control on the performance of business operations. The study presented a conceptual gap by using customer satisfaction as the only variable that affects financial performance. The present study looked at capital structure and financial performance as one of the key financing decisions of a firm.

Matar and Eneizan (2018) assessed determinants of financial performance of industrial firms in the period of 2005-2015 and adopted regression model for data analysis. The study revealed that variables of liquidity, profitability and revenue are positively connected to return on assets. The aspect of financial performance of a firm is significant to both shareholders and scholars since it enlightens on the factors that influence it. Performance is the most appropriate device to measure the degree to which a firm is productive. It is the extent of the financial fitness of the organizations and demonstrates the performance of the managerial governance of the company. The study sought to generally find out the determinants of financial performance and hence presenting an empirical gap that the current study sought to address by concentrating on capital structure and financial performance.

Examination of long term debt and financial performance was conducted by Omete and Isabwa (2017) using a retrospective research design. The study employed a simple linear regression model for analysis of data. The results revealed a substantial negative connection of long period debt and productivity of a firm. Outcomes of this study were consistent with the results of Magoro and Abeywardhana (2017). It therefore possibly means that finance managers should adopt a well-structured assortment of debt so as to lessen threats linked with the use of long term debt. Firms may consider investing in retained earnings or equity financing more than long term debt to ensure that its proportion does not negatively affect its financial statements. A lot of caution is required by firms that solely depend on extensive loan as basis of financing. The study presented a methodological gap that was addressed by the current study by adopting a descriptive research design.

Sung and Jang (2017) sought to understand the restaurants companies in relation to their debt and equity using the fixed-effects regression simulations in analyzing data. It was revealed that restaurant companies issue non-current debt to offset existing debt. The research articulates that restaurant firms prefer debt to equity financing. To decide on the type of funding that a company may adopt, finance managers weigh downsides and upsides relating to debt and equity. Firms that issue equity are found to have less financial leverage than those using debt. The study concluded that unequal debt financing often leads to extra financial costs, including extra business expenditures. Further, it was found out that restaurant firms employed more equity financing than debt to minimize the financial leverage. The study was limited to restaurant companies and how they use debt-equity financing. This study looked at the influence of debt and equity financing in manufacturing companies listed at NSE, in Kenya.

2.3 Conceptual Framework

Following a thorough review of literature, the conceptual model here below was drawn to analyze the capital structure and financial performance of companies listed under manufacturing and allied sector at Nairobi Securities exchange in Kenya. The conceptual framework is a breakdown of the variables of the problem under study. There were two main variables in the study. Financial performance was the dependent variable and capital structure was the independent variable. The capital structure was analyzed using the retained earnings,
long term debt and equity. It is important to note that the study had no specific measures of retained earnings and long term debt because they were obtained directly from the financial statements. However, for equity, retained earnings were deducted from it to ensure that the aspect of retained earnings was not repeated.

Moreover, the researcher thought that ROE would sufficiently measure financial performance and also the measure was found to be significant in accounting as established and commonly acknowledged ration of financial performance. ROE could be regarded as a degree of administration’s proficiency in using equity to generate returns.

**Independent variable**
Capital Structure

**Figure 2.3: Conceptual Framework Model**

**3.0 Methodology**
This study employed the descriptive research design and analysis of quantitative data was done. The target population comprised of all the companies listed under manufacturing and allied sector at NSE in Kenya as long as they had six years annual reports for the period of 2013 - 2018. A census of the eight companies was taken. Document analysis was used for gathering statistics from 2013-2018 annual reports. To enhance accuracy and reliability, secondary data was used. The required data was collected by evaluation of yearly reports of the companies. Secondary data that was assembled was in the form of soft protected copy and hence high reliability. This collection method was used because it was economical, valid and accurate. Information gathered was examined using a statistical package for the social sciences (SPSS version 20). Data gathering guide was employed to collect the information category, dimension, and interval period of data pertinent to the study. The quantitative data was presented using figures and tables while analysis was done by use of a descriptive statistics of standard deviation, and mean and multiple regressions.
4.0 Results and Discussion

4.2 Descriptive Statistics

Descriptive statistics data of all the variables was presented as shown on the table below:

<table>
<thead>
<tr>
<th>Table 4.1 Descriptive statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum</td>
</tr>
<tr>
<td>Retained earnings</td>
</tr>
<tr>
<td>Long term debt</td>
</tr>
<tr>
<td>Equity</td>
</tr>
<tr>
<td>Return on Equity</td>
</tr>
</tbody>
</table>

The above table 4.1 shows that long term debt had the highest mean of 5103053933.86 followed by equity with a mean of 2215098291.37 and then retained earnings was the least with a mean of 2015346990.50 as independent variables. The dependent variable reflects that return on equity had a mean of 0.100817. The equivalent standard deviation of long term debt was 9481808392.594, equity 4493133470.374, retained earnings had 6096932461.156 and return on equity had 1.3854381. This suggests that the data for ROE was extremely spread from the mean.

The outcomes of the research attested that long term debt had the uppermost impact on financial performance of a firm. Further, all the independent variables have quite substantial means which expresses that they have a momentous influence on firms productivity. The results are consistent with those of Hatem (2017) which revealed that those firms that engage in long term debt are more profitable to those that adopt short term. Additionally, Al-Qudah (2017) established that capital structure has a progressive association with performance of an enterprise. However, the findings differ with those of Aziz and Abbas (2019) which demonstrated that debt has a negative effect on performance.

4.3 Regression Analysis

<table>
<thead>
<tr>
<th>Table 4.2 Analysis of Variance (ANOVA) - ROE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Model</td>
</tr>
<tr>
<td>Regression</td>
</tr>
<tr>
<td>1 Residual</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Return on Equity
b. Predictors: (Constant), Equity, Long term debt, Retained earnings

Table 4.2 above illustrates results of how well the statistics fits the regression function. The significance level was at 0.002 a suggestion that the model fits sound and was statistically appropriate because it was below 0.05. The results of the analysis of variance are supported by the findings of a study that was carried out by Das and Swain, (2018) which revealed that there was a significant impact of capital structure on financial performance of a firm.
Table 4.3 Coefficients table - ROE

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>(Constant)</td>
<td>.363</td>
<td>.074</td>
<td></td>
<td>4.897</td>
</tr>
<tr>
<td>Retained earnings 1</td>
<td>-3.484E-011</td>
<td>.000</td>
<td>-.551</td>
<td>-2.776</td>
</tr>
<tr>
<td>Long term debt</td>
<td>2.490E-011</td>
<td>.000</td>
<td>.618</td>
<td>3.846</td>
</tr>
<tr>
<td>Equity</td>
<td>-4.270E-011</td>
<td>.000</td>
<td>-.506</td>
<td>-2.826</td>
</tr>
</tbody>
</table>

The above Table 4.3 provides results to assist forecast ROE from the predictors (retained earnings, long term debt and equity). The unstandardized coefficients beta values portrayal that long term debt had a significant and positive association with ROE. The results are consistent with those of Muchiri, Muturi and Ngumi (2016) that sought to establish the connection between financial organization and financial performance and revealed that long-term debt had a positive relationship with ROE. However, retained earnings and equity had a negative but significant influence on financial performance of companies listed under manufacturing and allied sector in Kenya. The results were supported by a study carried out by Nassar (2016) which revealed that capital structure had a negative significant effect on financial performance. The t-values show that retained earnings = -2.776, p-value = <0.05; long term debt t=3.846, p <0.05; and equity t=-2.826, p<0.05. Additionally, outcomes signpost that the constant was described by 0.363 which demonstrates the value of financial performance of companies listed under manufacturing and allied sector in Kenya when the independent values were equal to 0.

4.4 Regression function (ROE)

\[ Y = 0.363 - 3.484X_1 + 2.490X_2 - 4.270X_3 \]

Where \( Y = \) ROE

- \( X_1 = \) Retained earnings
- \( X_2 = \) Long term debt
- \( X_3 = \) Equity

The coefficients elucidate the dependent variable of one unit contribution by independent variables. It is clear that when all other independent variables are constant, a unit increase in retained earnings will decrease the financial performance with 3.484; a unit increase in long term debt will increase performance with 2.490 while a unit increase in equity will decrease performance by 4.270.

Statistical significance of components of capital structure is shown through P-values on table 4.12. Retained earnings had a p-value of 0.009, long term debt p- 0.000 and equity a p-value of 0.008. Therefore, the results designate all independent variables were statistically significant on financial performance of companies listed under manufacturing and allied sector in Kenya as measured by ROE because they had a p-value of <0.05. The findings of this study are supported by a study carried out by Bulle and Omagwa (2017) which indicated that capital structure had a significant impact on financial performance of firms listed under manufacturing and Allied sector at NSE.
The above table 4.2 indicates the outcomes of a regression analysis using the ROE as the dependent variable. The R-value illustrates a correlation of 0.564 which is 56.4% and therefore high. R square expresses the level of Return on Equity, which could be explained by the predictors at 0.319. It shows a variation of 31.9% of financial performance of companies listed under manufacturing and allied sector in Kenya.

5.1 Summary of findings

5.1.1 Retained Earnings

The study sought to determine the influence of retained earnings on financial performance of companies listed under manufacturing and allied sector, Kenya. The results highlighted that retained earnings had a negative effect on financial performance based on t-value of 2.776 as measured by ROE with a P<0.05. The mean of 2015346990.50 indicated that companies had significant amount retained from profits that could be used on investments. Retained earnings are a source of finance that a firm holds after apportioning payouts to shareholders. The findings indicated that increase in one unit of retained earnings would decrease financial performance by 3.484.

5.1.2 Long term debt

The specific objective to establish the impact of long term debt on financial performance of companies listed under manufacturing and allied sector in Kenya was met when the findings revealed that long term debt had the highest mean of 5103053933.86 compared to other independent variables. Companies listed under manufacturing and allied sector were found to largely rely on long term debt as a source of finance. Further, it was discovered that long term debt had a positive influence on performance as shown by t-values of ROE which was 3.846 p-value of <0.05. The debt was not found to negatively affect the performance of manufacturing companies in Kenya which means that the relationship between long term debt and performance was positive.

5.1.3 Equity

The study intended to find out the effect of equity on financial performance of firms listed under manufacturing and allied sector. Equity in this study implied the amount that was attributable to the owners of the firm but deducting the amount of retained earnings. It was established that equity had a negative impact on financial performance of manufacturing and allied companies listed at NSE in Kenya. The results showed negative t value of 2.826 on measures of performance ROE but the p<0.05. Further, it was revealed that the mean was at 2215098291.37 an indication that companies had quite a significant value of equity.

5.2 Conclusion

It was concluded that capital structure was quite significant in financial performance of companies listed at manufacturing and allied sector in Kenya. Further, different components of capital structure have unlike effects on performance. Long term debt was found to play a positive role in productivity of manufacturing and allied companies listed at NSE and that
most of the companies relied on it as the mode of funding. Moreover, it was concluded that perhaps most of the companies relied on debt as a source of funding because they did not have sufficient returns to preserve as shown by the low mean of return on equity. Furthermore, it was concluded that companies also depended on retained earnings as indicated by the descriptive statistics mean regardless of its negative impact on financial performance of a firm. The negative effect could have arisen due to low equity although it would be preferable because it is the cheapest source of finance compared to equity and debt.

The findings of the study also concluded that equity was more preferred by manufacturing and allied listed companies to retained earnings. Equity had a higher mean compared to retained earnings although it was revealed that it had a negative effect on financial performance. Since both equity and retained earnings had negative influences on firms’ productivity, perhaps it was imperative to conclude that finance managers of companies listed under manufacturing and allied sector in Kenya consider restructuring their capital structure to curb these effects. It was noteworthy observed that regardless of the effect of any given source of finance, all the sources (retained earnings, long term debt and equity) as found in the study were significant in performance of those firms.

5.3 Recommendations

Given that the findings of the study affirm that capital structure is so substantial in financial performance of companies listed under manufacturing and allied sector in Kenya, the study recommended that the management of the sector should come up with strategies of ensuring that there was optimal capital in their operations. This would be done through having mix of debt and equity that will decrease cost of capital. The study further established that most of companies relied on debt financing. It was therefore recommended that firms should be careful on the use of debt given the risks associated with it such as bankruptcy due to intensification in interest payments. The optimal capital structure in this case would be obtained by investing more on equity to balance the risks of debt such as failure to pay back.

The study recommended that the companies listed under manufacturing and allied sector should come up with more investing strategies and products diversification to increase their proceeds and hence shareholders expectation to maximize value was met. Companies that would employ this tactic would find it easy to raise profits and therefore increase their retained earnings as a source of finance. Based on pecking order theory, it would be vital to use internal source of funding due to its low costs before adopting debt funding. Therefore, it is important that the companies advance their efforts more on broadening their merchandises to have a higher market base and hence increased sales.

The manufacturing and allied sector is a fundamental instrument in the enlargement of economic progress in Kenya. This study therefore recommended that the government should also invest in subsidization of the sector’s products by policy formulation so as to boost its growth. Since manufacturing sector is one of the key government’s plans in Kenya by 2022, local manufacturers should be strengthened to make this a reality. The call to revamp the sector by the government would go long way if more strategies on increasing investment opportunities were put in place through Kenya Association of Manufacturers (KAM). The association in its bid to uphold trade and investment should develop comprehensive policies that relate to capital structure since this study has proven that it is significant to financial performance and hence expedites a competitive commercial atmosphere and minimizes the cost of running operations.
References:


