RELATIONSHIP BETWEEN COST OF CREDIT AND FINANCIAL PERFORMANCE OF
MANUFACTURING FIRMS LISTED IN THE NAIROBI STOCK EXCHANGE

BY

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A PROJECT SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR
THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION (MBA),
KENYATTA UNIVERSITY

JULY 2003
DECLARATION

This research project is my original work and has not been presented for a degree in any other university.

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DEDICATION

To my loving Mum who laid the foundation of my academic world.

Dear brothers and sisters for their moral and financial support specifically Peter and his family who made great sacrifices for my academic success.

To my sweet, unknown wife and children to be a motivator in their life.
I wish to express my heart-felt gratitude to my supervisor Mr Yego for all the sacrifices he made to see me through the research project. The guidance, advice and dedicated support he gave me all through.

I acknowledge the support I got from my respondents who assisted me in getting the information I needed. I especially recognize; Grace of Unga group, Mr Mugenda of Kenya oil company, M. Baskaran and Millicent of Athi river Mining, the staff of Nairobi Stock Exchange information center and all the other companies that responded to my questionnaire.

Special thanks to all my friends who supported me in prayers and moral support that I needed so much throughout the whole period; Hellen, Anthony, Martha, and the whole of the MBA class 2000.

Finally Honor and Glory be unto the almighty GOD without whom I could not have come this far.
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ABSTRACT

The study analyzed empirically the relationship between the cost of credit and the financial performance of Kenyan manufacturing firms quoted in the Nairobi Stock Exchange and the consequent level of impact to their overall financial position. The study used a survey of the firms as well as the firms’ final accounts and balance sheets for the five years period. The result of the study showed a correlation between the cost of credit and the financial performance of the firms as regards firms’ borrowing. In the overall, however, the study revealed that there is no relationship between the cost of credit and financial performance of manufacturing firms under normal circumstances. It also revealed that interest rate contributes the highest percentage of the cost of credit.

On individual firm basis, the study indicated that the impact of the cost of credit varies from one firm to another. It further showed that the level of borrowing significantly affected the percentage cost of credit. However, the type of credit undertaken by the firms determined the cost of credit with bank borrowings taking the greatest share. Basically, all firms used trade credit to substitute their level of borrowings.

The study was limited in getting responses from all the targeted respondents. Access to financial information for the entire period of study in all the firms and measurement of the cost of credit acted as additional limitations. The study recommended reduction of interest rates across the board, relaxation of lending requirements by the financial institutions as well as strengthening of regulatory and legal systems in relation to lending and borrowing.
The study, therefore, underscore the need to formulate a prudent credit policy for individual firms as well as the need for a conducive macro and micro economic environment in an attempt to synchronize the benefits of using credit facilities and also facilitate the financial mobilization of firms, so that their optimum contribution to economic development can be achieved.
CHAPTER ONE
INTRODUCTION

1.1 Background to the Study

The financial systems of most developing countries have come under stress as a result of the economic shocks of the 1980’s. This resulted into inadequate funds due to the general lull in the economy as monetary and credit aggregate moved rather sluggishly. Consequently, there was persistent pressure on the financial sector, which necessitated a liberalization of the financial systems, (Davidson and Gabriel, 1999). This liberalization had a very negative impact to businesses whose reliance on the financial sector for funds was very vital at such a period. The adverse effect was a persistence of poor financial performance of firms, which opened doors for slow but sure business “death”. This was due to the cost of credit which skyrocketed to an unmanageable level.

Kenya started experiencing these problems in the early 90’s after the liberalization of the interest rates in July 1991. Interest rate liberalization was mounted amidst increasing inflationary pressure and deteriorating economic conditions, indicating failure to meet the prerequisite for successful financial reform. Inflationary pressure was attributed to the expansionary fiscal policy, which saw an increase in money supply. In addition, the financing of the fiscal deficit shifted to the domestic market using treasury bills and this accelerated the increase in interest rates. As a result, the lending rate went up while the low saving rate became negative in the real terms in the first half of the 1990’s, (Ngugi, 1985). The shifting of Government borrowing into the domestic market was aimed at securing “inexpensive” funding for her own activities. Undoubtedly, this move undermined financial development thus, failing to promote economic development through interest rates control as intended. According to Shaw (1973) financial repression has retarded the development process.
In response to these developments, various interest groups, business organizations and individuals started questioning the validity of the Structural Adjustment Programme (SAP) an International Monetary Fund (IMF) policy package where interest liberalization was a major recommendation. Parliament also joined in when an attempt to broker better understanding between Parliament and donors fell flat on its face after Members of Parliament (MPs) rebelled and accused lenders of imposing policies which hurt ordinary people. MPs were meeting officials of the IMF and the World Bank at a closed-door conference on economic management in Mombasa.

Donde (2002) notes that interest rates were between 30% and 70% in Kenya in 1993. This has made it impossible for companies to do any business which could cover cost of borrowing and operational costs. Overall, the interest liberalization brought more adverse effects that outweighed the perceived benefits. In response to this, companies resulted into major restructuring in an effort to reduce costs of operations as well as overcome the myriad of operational woes. However, these strategies did not have any significant improvement on the financial performance of these companies due to the fact that high interest rates formed the bulk of their cost of credit.

Commercial banks have, therefore, been blamed for crippling the Kenyan economy by charging exorbitant interest rates which have discouraged investment due to increase in the cost of credit. The importance of effective management of interest rates was demonstrated by discussion on it in parliament that led to the publication of the famous Donde bill early 2002 to try and regulate the ever increasing interest rates on borrowings.

According to Donde, many companies have gone out of business because of cripplingly high interest rates set by greedy commercial banks over the past few years. Donde stated that: - “We have a lot of idle factories, companies have gone under, people who borrowed have been auctioned, it has been
like a blood bath, it has been impossible for companies to do any business. There was a massive public support for the Donde Bill to regulate interest rates. This showed that, high cost of borrowing and lack of access to credit are very sore issues for many Kenyans. One can go further and argue that these two impediments are major constraints to private sector health and growth. At a conference on economic management in Mombasa, MPs from both sides of the House were categorical that interest rates needed to come down and pledged their support for the Donde Act. The Kenyan parliament passed the bill into an act of Parliament which was seeking to control the interest rates charged by banks. The act pegged interest rates charged by commercial banks to 3% above the rate fixed by the Central Bank of Kenya. There was an immediate reaction in the stock market as shares in commercial banks continued to fall. The Government and banks opposed the bill while warning that it could lead to a rise in inflation and a sharp fall in the value of the Kenyan currency, the shilling. It could also cut banks profit margins, force lay-offs and dry up credit - as they will refuse to lend at uneconomic rates, they argued. Financial analysts also warned that the bill could cause a massive capital flight which would destabilize the exchange rate. In addition, it could also threaten Kenya's planned programme of liberalization that it had agreed with the International Monetary Fund in return for fresh loans to help stabilize the economy. However, nothing was achieved from this bill as other technicalities arose hence the curtain on interest rates has refused to fall.

Kaman (1985) in his study on the magnitude and causes of corporate failures in Kenya for the period 1970-1984, found out that in Kenya undercapitalization, over borrowing and poor financial management accounted for 18.4%, 13.2% and 10.6% of business failures in Kenya respectively. The adverse effects of the use of debt to finance organizations have become more prominent in the recent past. This has been caused by the economic recession that has prevailed over a decade now.

The difficult economic situation in the country has been made worse by prolonged and persistent droughts, hence causing power shortages (as most electricity is generated by hydro-electric dams) towards the end of the 2000 and beginning of 2001. This and the effect of cheap imports specifically caused a slump in the manufacturing sector. Consequently, organizations that had heavily relied on borrowings to finance their operations have been unable to meet the cost of these borrowings due to declining or stagnant revenues. As a result, commercial courts are filled with bankruptcy cases, while most organizations have either been liquidated or put under receivership.

1.2 Statement of the Problem

"THE KISS OF DEATH:" Do receivers move in to wind up or revive a company?" This concern is due to the high number of companies that continue to be put under receivership and eventually wound up. In 1999 alone, according to Federation of Kenya Employees (FKE) study, thirty four companies were shut, six were placed under receivership and five others sold. In 2000, forty one firms closed, nine were in liquidation while six changed hands. In 2001, twenty seven firms shut down, four went into receivership and three were sold.  

3. Ibid
These findings portray how Kenyan businesses are exposed to the vulnerability of joining the ever expanding junkyard of Kenya's "condemned" business entities having been placed in receivership after having been weighed down by the riddle of accumulating, expensive cost of credit and a harsh operating environment.

In the last one decade, Kenya has seen most respected businesses suffering fatal blows due to the high cost of credit that have accumulated to huge amount overtime, not withstanding the existence of a myriad of operational woes. The manufacturing sector has been affected most with the sector leading in the list.

Now the question is how businesses in a terribly depressed economy where banks charged sky-high interest rates could possibly service the debts. There are ominous signs that if the current situation continues to prevail, many businesses would fold up with astonishing regularity. Whereas it is a common believe that the financial distress in the corporate world has mainly been caused by the high interest rates and the indirect costs of credit, it is important to establish factually the truth of this matter putting into consideration all the different types of credits and their contributions to the overall cost of credit. It is worth noting that, lack of critical evaluation of how cost of credit affects financial performance of organizations at present and in future have caused this mess in the corporate world cycle. It is very clear that managers have concentrated much effort in cutting cost of other variables that contribute to financial performance at the expense of the cost of debt. Various studies have been carried out to address these variables and most have dwelt on the capital structure.
Available literature indicates that so far, no study has attempted to address cost of credit as a contributor to financial performance. This study therefore investigated critically whether there is any relationship between cost of credit and financial performance of manufacturing firms.

Credit is a major source of funds to finance an organization’s operations and hence its importance cannot be overlooked. On the other hand, if its use has adverse effects on the financial performance, then its usage must be cautiously monitored.

1.3 The Importance of the Study

The findings of the study will assist the corporate financial managers in accessing the effects of the financing strategies they use as well as alerting them on the consequences thereof. The study findings will also help the financial institutions to access the impact of their charges on the borrowing firms. The findings of the study are also a source of reference to scholars and researchers as well as a foundation for further research.

1.4 Objectives of the Study

The purpose of the study was to derive any correlation between the cost of credit and the financial performance of Kenyan manufacturing firms and the consequent level of impact to their overall financial position. It examined empirically the pattern and direction of the influence of cost of credit on financial performance of these firms and the implication this have on the effectiveness of the various sources of credit. In the process, the effects of banks interest rates as a major source of credit on the overall cost of credit was also examined.
The specific objectives of this study were to:

- Establish the relationship between cost of credit and financial performance of manufacturing firms.
- Examine the impact of cost of credit on financial performance of manufacturing firms.
- Establish the problems faced by manufacturing companies in the use of credit and benefits accrued to.

1.5 Research Hypothesis

The objectives listed above were based on the following hypothesis.

Ho: There is no relationship between the cost of credit and financial performance of manufacturing firms.

H1: The financial performance of manufacturing firms in Kenya is related to their cost of credit.

1.6 Assumptions

The main assumption was that quoted manufacturing firms use similar accounting policies in reporting on their financial performance and financial positions. The other assumption was that all the firms in the study use credit only to finance the firms operations hence there is insignificant use of retained earnings or financing through sale of shares.
CHAPTER TWO
LITERATURE REVIEW

This chapter reviews literature related to the cost of credit in relation to the financial performance. It begins with an overview on corporate financing strategies. This is followed by literature on the various sources of financing, description and measurement of the costs of credit and finally related literature on the significance of interest rates on the overall corporate borrowings.

2.1 Overview of Corporate Financing Strategies

Corporate financial strategy incorporates the decision a firm makes about its capital structure that is, choice of the best debt equity mix to use to finance its operations. There is an ongoing debate on the literature about the effect of gearing on the weighted average cost of capital. Indeed the empirical evidence so far is inconclusive and the argument continues unabated.

The empirical evidence however seems to be somewhat tilted in favor of the view that debt has a net tax advantage, (Ndirangu, 1992). What is also clear from the theory on empirical work is that zero debt is not optimal. If there is a tax benefit from debt, then using some debt in the capital structure will increase the corporate wealth.

In practice, firms are found following different debt policies. Conservative debt policy is justified on the ground that it minimizes financial risk, provides financial flexibility and gives independence from the financial institutions. For a growing profitable firm too much obsession with the risk effects of debt is not desirable. Empirical evidence show that direct bankruptcy cost is trivial, (Pandey, 2001). Debt hardly poses bankruptcy threat to a profitable and growth company, the stability of the firm’s earnings certainly being an important determinant of its debt policy. It may be pointed out that
a well thought diversification policy by stabilizing the firm’s earnings will help to create higher debt capacity for the firm.

Prudent use of debt can lead to effective competitive capability since the reduction of operating cost resulting from the low cost of debt and interest tax subsidy. This competitive advantage will be much more valuable than any perceived increase in the financial risk.

However, whereas the above sentiments are true, a prudent choice and mix of the various sources of debt financing plays a key role in the determination of the overall cost of financing and the general performance of the organization. This is because debt financing and financial leverage offer unique advantages, but only to a point beyond which, debt financing may be detrimental to the firm as the use of debt in the capital structure is expanded, lenders will perceive a greater financial risk to the firm. For this reason, they may raise the average interest rate to be paid and demand that certain restrictions be placed on the corporation. Furthermore, concerned common stockholders may drive down the price of stock, thus forcing away the objective of maximizing the firm’s overall value in the market. The impact of financial leverage must be carefully weighed, (Block, 1992)

2.2 Financial Leverage

Financial leverage is related to the extent to which a firm relies on debt financing rather than equity. Measures of financial leverage are tools for determining the probability that the firm will default on its debt contracts. The more debt a firm has, the more likely it is that the firm will become unable to fulfill its contractual obligations. In other words, too much debt can lead to a higher probability of insolvency and financial distress. On the other hand if a firm uses debt, creditors and equity investors may have conflicts of interest. Creditors may want the firm to invest in less risky ventures than those the equity investors prefer.
On the positive side, debt is an important form of financing and provides a significant tax advantage because interest payments are tax deductible, (Ross, 2002).

### 2.3 Sources of Financing

There are various sources that a firm can use to finance its activities. These are debt and equity capital or through internally generated funds. The distinction between the equity and debt is basic too much of the modern theory and practice of corporate finance.

At its crudest level, debt represents something that must be repaid and is as a result of borrowing money.

Kamene (1987), in a study on the factors that influence the capital structure of public companies in Kenya, observed that there was very little or no change in the amount of stock issued in the period under his study. This shows that there is general preference for internally generated funds and credit financing. This study strictly investigates the use of credit financing in organizations.

### 2.4 Credit Financing

Use of credit has been at unprecedented levels in the 1980’s and early 1990’s. This growth is related to the rapid business expansion, the inflationary impact on the economy, and at times, inadequate funds generated from the operations of business firms due to the harsh operational environment, (Block, 1992).

An important feature of credit financing is that interest payment is a fixed cost to the business. As a firm increases the amount of credit in its capital structure, these fixed costs increases and unless the earning capacity of the firm is enhanced by additional borrowing, its future may be in jeopardy. If
lenders perceive a high probability of default they are bound to seek compensation by way of higher interest rates. Credit financing can be classified into either short-term or long-term.

(a) Corporate Long-term Credit

Long term credit is a promise by the borrowing firm to repay the principal amount by a certain date, called the maturity date. Long term credit almost always has a par value equal to the face value, and debt price is often expressed as a percentage of the par value. It can also be described as any obligation that is payable more than one year from the date it was originally issued. Typical credit securities are called notes, debentures, or bonds, (Ross, 2002).

(i) Debentures, Bond and Notes

A debenture is a long-term promissory note for raising loan capital. The firm promises to pay interest and principal as stipulated. An alternative form of debenture is bond. The term debenture is generally understood to mean unsecured bond. Bonds are issued mostly by public sector companies, (Pandey, 2001).

A debenture is an unsecured corporate debt, whereas a bond is secured by mortgage on the corporate property. However, in common usage the word bond is used indiscriminately and often refers to both secured and unsecured debt. Note refers to an unsecured debt with a maturity shorter than that of debenture, (Ross, 2002).

The interest rate on debenture is fixed and known. It is called the contractual rate of interest. It indicates the percentage of the par value of the debenture that will be paid out annually (or semi-annually or quarterly) in the form of interest. Payment of interest is legally binding on a company.
Debenture interest is tax deductible for computing the company’s corporate tax. The maturity date of a debenture is fixed ranging from 7 to 10 years after which it is redeemed, (Pandey, 2001).

Ndirangu (1992) studied the effects of firms’ capital structure on the risk of common stocks and concluded that most borrowings by Kenya’s companies are private; they usually borrow from banks and other conventional lenders of funds. There is very little reliance on public debt through sale of debenture. And in the few cases where debentures are issued they are normally not traded at the Stock exchange.

Companies in Kenya with strong cash flow base have been issuing medium term notes. These are short term bonds offered for subscription to the investors for a period of 5 years or so. The interest rate is normally pegged on the Treasury bill rates mostly 1% above the government treasury bills the bill is normally reprised every quarter to factor in any changes in the Treasury bill rates. The bond security is normally the company’s assets and cash flows or its bank.3

(ii) Term Loans

Term loans represent long-term debt with a maturity of more than one year. They are obtained from banks and specially created financial institutions.

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3. Ibid
Some features of term loan include: maturity, direct negotiations, security, restrictive covenants, convertibility and a repayment schedule. Repayment of a loan is a legal requirement. Interest charges are tax deductible in the hands of the borrowing firm, (Pandey, 2001).

In Kenya commercial bank loans are proving very costly to businesses going by the number of receiverships which have been in the news lately, and many companies are anxious to get an alternative source of financing.  

(iii) Other Long-term Means of Financing

The traditional financing is related to the liability side of the balance sheet. The firm issues long-term debt or equity to meet its financing needs, and in the process, expands its capitalization. However equity becomes an expensive method of financing because of decreasing corporate earnings and low price-earning ratios. The high rate of inflation causes long-term debt to be an expensive source of finance as interest rates rise. The corporate managers, therefore, are developing financing alternatives related to the asset side of the balance sheet. These alternatives may lower the cost and redistribute the risk. Asset-based financing uses assets as direct security: the most popular ones are lease and hire purchase, (Pandey, 2001).

(iv) Lease Financing

Lease is a contract between a lessor, the owner of the asset, and a lessee, the user of the asset.

Under the contract, the owner gives the right to use the asset to the user over an agreed period of time for a consideration called the lease rental. Leasing separates ownership and use as two

economic activities, and facilitates asset use without ownership, (Pandey, 2001).

The lessee pays the rental to the lessor as regular fixed payments over a period of time at the beginning or at the end of a month, quarter, half-year or year. At the end of the lease contract, the asset reverts to the lessor, who is the legal owner of the asset.

Long term leasing was not recognized as a debt obligation in the early post-world war two period, but since the mid-60’s there has been a strong movement by the accounting profession to force companies to fully divulge all information about leasing obligations to and the equivalent debt characteristics, (Block, 1992).

(v) Hire Purchase

This is a form of secured loan in which the owner of the asset i.e. the hiree i.e. the manufacturer or the financing company gives the possession of the asset to the hirer with an understanding that the hirer will pay agreed installments over a specified period of time. The ownership of the asset will transfer to the hirer on the payments of all installments, (Pandey, 2001).

(b) Corporate Short-term Credit

Funds available for a period of one year or less are called short-term finance. Two most significant short-term source of finance are trade credit and bank borrowing.

(i) Trade Credit

This refers to the credit that customers get from suppliers of goods in the normal course of business. It is therefore an inter-firm debt which is usually recorded as accounts receivable by the seller and accounts payable by the buyer in their respective books of accounts. In practice the buying firms do
not have to pay cash immediately for the purchases made. This deferral of payment is a short term financing called trade credit. It forms the largest single category of short term credit, representing about 40% of total current liabilities of non financial corporations. Thus, it is the major source of financing for firms.

However, trade credit is not formally recognized as a debt as there is no signing of any legal document, it therefore appears as sundry creditors on the balance sheet. Trade credit may also take the form of bills payable. When the buyer signs a bill-a negotiable instrument- to obtain trade credit it appears on the buyer’s balance sheet as bills payable, (Pandey, 2001).

Trade credit is a spontaneous source of financing, as the volume of purchase increases trade credit also expands. Unlike other sources of finance trade credit is relatively easy to obtain, flexible, more automatic and does not require negotiations.

(ii) Commercial Banks Loans

Banks are the main institutional sources of finance in Kenya. Commercial bank lending is the second in importance to trade credit as a source of short term financing.

A firm can draw funds from its bank within the maximum credit limit sanctioned depending on financial performance, securities provided or the future cash flow projections ascertaining the ability to repay the borrowings. These funds can be drawn in form of overdrafts, cash credit, bills of purchasing or discounting and working capital loan. A point to note is that capital loan is more expensive since it’s an additional ad hoc or temporary accommodation in excess of sanctioned credit limit to meet unforeseen contingencies, (Pandey, 2002).
Most credit plans require the borrower to pay back the principal and interest in installments instead of making one payment of principal and interest at the maturity of the loan. In some instances, one payment of principal and interest is made at the maturity of the loan. The cost of credit changes over time and varies from one lender to another.

The other short-term sources of working capital finance which have been very popular are:

(iii) Commercial Paper
Commercial paper consists of promissory notes of large firms that are sold primarily to other business firms, insurance companies, investment and pension funds, as well as banks with surplus funds to invest for a short period with minimum of risk. Commercial paper represents a short-term, unsecured promissory note issued to the public. This form of financing is important to particular lines of business. Approximately two thirds of the volume of commercial paper is placed directly by the issuer (usually a large finance company) with the investors. About one third of commercial paper is sold through commercial paper dealers who function primarily as note brokers.

Maturity of commercial paper varies from 2 to 6 months, with an average of about five months. For large and prestigious firms commercial paper may provide an outlet for raising funds. They are cheaper than bank loans because they may be issued below the prime interest rate, (Block, 1992).

(iv) Financing Accounts Receivable
Accounts receivable financing involves either the pledge or the sale of receivables as a basis of financing. The pledging of accounts receivable is called accounts receivable discounting. The process is characterized by the fact that the lender takes the receivable but has recourse to the
borrower (seller) and the buyer of the goods is not ordinarily notified about the discounting of the receivable. On the other hand factoring involves an outright purchase of debts, with a purpose of facilitating credit administration, collecting and protection. It is also a means of short-term financing. It provides protection against the default in payment for book debts. For these services, the factor, however, charges a fee from the client. Thus factoring has a cost, (Weston, 1962).

2.5 Description and Measurement of the Cost of Credit

Modigliani and miller (1963) argue that the firm’s value rises with leverage in the presence of corporate tax. Because this implies that the firm should choose maximum debt, the theory does not predict the behavior of the firm in the real world. Other authors have suggested that bankruptcy and related costs reduce the value of levered firm.

When more and more debt is added, the present value of these costs rises at an increasing rate. At some point, the increase in the present value of these costs from an additional dollar of debt equals the increase in the present value of the tax shield, hence the optimal level. Bankruptcy costs increases faster than the tax shield beyond this level, implying a reduction in firm value from further leverage. Unfortunately, no formula exists at this time to exactly determine the optimal level of debt of a particular firm. This is primarily because financial distress costs cannot be expressed in a precise way, (Ndirangu, 1992).

As discussed above bankruptcy costs can lower the value of the firm. In fact the same general result holds even if legal bankruptcy is prevented. Thus financial distress cost may be a better phrase than bankruptcy costs.
2.6 Direct Costs of Financial Distress

These are the legal and administrative costs of liquidation or reorganization. They would include the cost of lawyers’ administrative and accounting fees and if the trial takes place, the cost of the expert witnesses hiring.

A number of academic studies have measured the direct cost of financial distress, while large in absolute amount; these costs are actually small as a percentage of the firm’s value. White, Altaman and Weiss estimate the direct cost of financial distress to be about 3% of the market value of the firm. In a study of direct financial distress costs of 20 railroad bankruptcies, Warner found that the net financial distress cost were on average, 1% of the market value of the firm seven years before bankruptcy and were somehow a larger percentage as bankruptcy approached, of course few firms end up in bankruptcy . Thus, the preceding cost estimates must be multiplied by the probability of bankruptcy to yield the expected cost of bankruptcy Warner states, (Ndirangu, 1992).

2.7 Indirect Cost of Financial Distress

There are also the indirect costs of financial distress. This includes the impaired ability to conduct business. Bankruptcy hampers conduct with customers and suppliers. Sales are frequently lost because of the fear of impaired services and loss of trust. Sometimes the taint of impending bankruptcy is enough to drive customers away.

In summary, bankruptcy costs include:

- Experiencing difficulties, enormous terms, conditions and rates
- Loosing key employees due to uncertainty
- Deserted by suppliers for fear of non-payment or poor sales prospects
2.8 Agency Cost

When a firm has debt, conflicts of interest arise between stockholders and bondholders. Because of this, stockholders are tempted to pursue selfish strategies. These conflicts of interest, which are magnified when financial distress is incurred, impose agency costs on the firm. These strategies are costly because they will lower the market value of the whole firm.

2.9 Measurement of the Cost of Credit

(a) Cost of Financial Distress

Though these costs exist, it is quite difficult to measure them. Altman estimates that both direct and indirect costs of financial distress are frequently greater than 20% of firm value. Andrade and Kaplan estimate total distress costs to be between 10% and 20% of a firm’s value, bar-Or estimates expected future distress costs for the firms that are currently healthy to be 8 to 10% of operating value, a number below the estimate of either Altman or Andrade and Kaplan.

However unlike Bar-Or, Andrade and Kaplan consider direct costs for the firms already in distress not expected distress cost for currently healthy firms. Unfortunately, although it is quite likely that indirect costs play a great role in companies’ failure (impairment to conduct business) there is simply no way to obtain a decent, quantitative estimate of them, (Ndirangu, 1992).
(b) Cost of Debentures, Notes and Bonds

The cost of debt is measured by the interest rate, or yield, paid to bond holders. The computation may be more difficult if the bond is priced at a discount or premium from par value. For example, a firm preparing to issue new debt will determine the likely cost of the new debt in the market place; the firm will compute the yield on its currently outstanding debt. This is not the rate at which the old debt was issued, but the rate that the investors are demanding today. The yield to maturity indicates how much the corporation has to pay on a before tax basis. However, interest payment is tax deductible; hence its true cost is less than its stated cost, (Block, 1992). It is actually the yield to maturity time's one minus the tax rate as shown below.

\[ K_d = Y \times (1 - T) \]

(c) Cost of Commercial Bank Financing

(i) Determination of the Interest Rate

The effective interest rate on loan is based on the loan amount, the shilling interest paid, the length of the loan, and the repayment method as shown below, (Block, 1992).

\[ \text{Effective rate} = \frac{\text{interest/principal}}{\text{days in the year (360)/ days}} \]

Loan outstanding Interest rates vary for various types of loans as different loans have different levels of risk factors, the lower the risk the lower the interest rate to be charged.
(ii) Determination of Interest Amount

The amount of interest paid is determined by three elements: the amount of the loan, or the principal, the interest rate, and on the time during which the loan is outstanding. The simple interest formula includes all of these elements and is written as follows:

\[
\text{Amount of Interest} = (\text{Principal}) \times (\text{Interest Rate \%}) \times (\text{Time})
\]

The time variable is always figured on the basis of one year. This is the traditional way in which interest is figured. Borrowers can determine the total amount of interest they will pay by shopping around for the best interest rate, paying back the loan as soon as possible, and by paying off the principal of the loan earlier than expected.

(d) Cost of Trade Credit

Trade credit financing appears to be cost free since it does not involve explicit interest charge. But in practice, it involves implicit cost. The cost of trade credit would include:

- The increased cost of purchased goods charged by the suppliers to cater for the cost in the form of the opportunity cost of funds invested in accounts receivable.

- Trade credit cost also includes the opportunity cost of foregoing cash discount which can be very high.

- The costs relating to the penalty on interest charges especially when the company stretches its accounts payable (delaying the pay).

In additional to the high implicit costs the creditworthiness of the company will also be adversely affected leading to difficulty in obtaining credit in future.
Sometimes trade credit can be surprisingly expensive to the buyer. The user often does not have other alternative forms of financing available, and the cost to the buyer may be commensurate with the risk to the seller. But in some instances trade credit is used simply because the user may not realize how expensive it is.

(e) Cost of Commercial Paper

The rates on prime commercial paper vary, but are generally about 0.5% below the prime business loans, (Weston 1962).

Although the interest rate for commercial paper is determined by the market, in developed countries, it’s a function of prime lending rate, maturity, credit-worthiness of the issuer and the rating of the paper provided by the rating agency, (Pandey, 2001).

(f) Cost of Accounts Receivable Discounting/Factoring

Accounts receivable discounting and factoring services are convenient and advantageous but they can be costly. The credit checking commission is 0.5% to 2% of the amount of invoices accepted by the factor, (Weston, 1962).

The costs include the factoring commission, interest in advance and the reserve that the factor requires to cover bad-debts losses. The amount of reserve depends on the quality of factored receivable and usually ranges between 5 and 20 per cent, (Pandey, 2001).
(g) Significance of Interest Rates on Overall Corporate Borrowings

The level of interest rate ranked second in importance in determination of how much to borrow coming after the stability of cash flow. This is because high interest rates charged on short-term loans by commercial banks cannot allow growth in a recessionary period.

(h) Macroeconomic Environment and the Interest Rates

The macroeconomic environment affects the performance of the banking sector by influencing the ability to repay borrowed loans with the unpredictable returns from the investment and the quality of collateral determining the amount of premium charged and therefore the cost of borrowed funds to the investors. With an unstable macroeconomic environment and poor economic growth, investors face uncertainty about investment returns and these raise the lending rates as the level of non-performing loans goes up, squeezing the bank margin. For example, poor output prices reduce firms profitability while reduced asset prices reduce the value of assets for collateral and therefore the credit-worthiness of the borrowers. As a result, return on investment declines, increasing the level of non-performing loans, and banks charge high-risk premiums to cover their default risk.

At the micro level, results show that when the profit margin is threatened, banks sustain widening spread. Faced with a widening credit risk due to distress borrowing and the poor macroeconomic conditions, banks charge a higher risk premium on their lending rate. The accumulation of non-performing loans results from a weak legal system and poor business environment that squeezes the profit margin, and banks respond by increasing the lending rate.
The problem of non-performing loans was the major cause of the two major banking crises in Kenya, in the mid 1980s and during the early and late 1990s. In this crisis, between 1993 and 1996, six commercial banks and twelve Non Banking Financial Institutions faced insolvency problems and in 1998, five banks were placed under statutory management.
CHAPTER THREE

RESEARCH METHODOLOGY

This section gives a description of the methodology that was used in conducting the study. The section is divided into four parts namely; research design, population of study and sampling, data collection procedures, and data analysis techniques.

3.1 Research Design

In this study, descriptive survey approach was used. This approach is normally used to test a hypothesis or to answer questions concerning the current status of the subjects in a study (Gay 1981). Manufacturing firms quoted in the Nairobi Stock Exchange (NSE) were chosen to represent the overall direction of the corporate business world.

3.2 Population and Sample of the Study

The population of the study constituted all the quoted manufacturing firms in NSE as at 31\textsuperscript{st} December 2002. As at that date, sixteen manufacturing firms classified as industrial and allied were quoted. A census of these firms was taken; thus sampling was not required. The list of the firms was obtained from the NSE register. The classification is based on the main investment segment in the NSE. Firms quoted in the NSE were used because of the role that NSE plays in the economy. It's a barometer that reflects important economic changes in the country. In addition, since they are publicly quoted, they publish their annual reports and accounts. Hence, information about them was readily available than unlisted firms.
3.3 Data Collection Procedures

A questionnaire was used as the main instrument for data collection. The “drop and pick” method was used to administer the questionnaires to all respondents. The respondents included Finance and Administration managers, cost accountants and management accountants depending on the organization structure. The questionnaire contained both open ended and closed ended questions. The closed ended questions were used to obtain data that could be supported by information held in the firms’ records, while open ended questions were used to obtain qualitative data and observation by the respondents. The questions were not divided into sections. Questions covered both credit cost and financial performance details of the firms that formed the objective of this study. The questionnaire was first pre-tested to determine its clarity and validity.

The study relied on Primary and secondary data. Primary data was obtained from the sampled respondents through a questionnaire, while secondary data was obtained from the existing literature; the bulk of which were published annual reports and accounts held by NSE. Other sources of secondary data were, finance journals, magazines, newspapers articles, books and other relevant publications. For a meaningful analysis, the study used some key financial variable from the firms’ financial statements. Financial statements prepared under the historical cost convention were restated to the current cost. This is because with the rising rate of inflation, the historical cost financial statement no longer presents “true and fair view information” reflecting the effects of changing prices.

The researcher obtained a letter of introduction from the university before proceeding to the field. The data collection took one month.
3.4 Data Analysis Techniques

The data that was collected was analyzed using the Chi-square test and descriptive statistics such as tables, percentages and charts. Olive and Abel (1999) describe Chi-square as a statistical technique which attempts to establish the relationship between two variables both of which are categorical in nature. It enables the researcher to know the degree of confidence one can have in accepting or rejecting a hypothesis. The two variables in this study were cost of credit and financial performance. The technique was therefore very appropriate in testing the hypothesis that there exists no relationship between cost of credit and financial performance of firms under study. Chi-square has been used in the past by various researchers such as; Giteri (1990), Akinyi (2002) and Thuku (2002, in their studies on relationships of variables.

Descriptive statistics was used to analyze all closed ended questions as the first step in data analysis. This method has been used in the past by Wanjoga (2002), Mwaura (2001), Ger rarieya (2001) and Wanjjiru (2001) while analyzing data in their studies. The method enables the researcher to do a meaningful description of the data before analyzing it further. Qualitative analysis was used to analyze perceptions about the impact of borrowings on the overall financial performance of the firms. It was used to analyze open ended questions.
This chapter presents the overall findings of the study, from the analysis of both primary and secondary data collected. Every attempt was made to ensure that all the field survey questionnaires were completed. However, two out of the sixteen targeted respondents did not respond. The response rate was therefore 87.5%. This was considered adequate for the purposes of the study.

The chapter is divided into five parts. Part one covers the financial performance of the firms and their rankings. The second part covers cost of credit and its determinants. Part three covers an analysis of relationship between the cost of credit and financial performance of firms which is the main objective of the research project. While the fourth and fifth parts cover other issues relating to the use of credit and summary and discussion of the findings respectively.

4.1 Firms Financial Performance

The results presented in this section include the analysis of the firms' percentage financial performance in respect to the cost of credit reflected in their financial statements for the five years. The period is retained throughout the whole analysis. Financial performance was derived from the data collected from the Nairobi Stock Exchange. For the purpose of leveling and comparability, the performance was taken to be the percentage of profit after credit cost to the operating profit. Both the operating profit and credit cost were taken from the published annual accounts and balance sheets. The findings with the opinions expressed during the survey are also incorporated for the fourteen
firms that responded. The factors affecting the firm’s financial performance and their relative level of impact were also analyzed using the response from the field survey.

Table 4.1.1: Firms Financial Performance: 1998 - 2002

<table>
<thead>
<tr>
<th>Performance Level</th>
<th>Number of Respondents</th>
<th>Percentage Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very well</td>
<td>1</td>
<td>7.1%</td>
</tr>
<tr>
<td>Well</td>
<td>3</td>
<td>21.4%</td>
</tr>
<tr>
<td>Average</td>
<td>8</td>
<td>57.1%</td>
</tr>
<tr>
<td>Bad</td>
<td>2</td>
<td>14.3%</td>
</tr>
<tr>
<td>Total</td>
<td>14</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Research Data

Respondents were required to state their firm’s financial performance from any of the four categories as shown in the above table. From the findings shown in the table, 7% of the respondents reported that their firms performed very well, 22% well, 57% average performance while 14% reported bad performance. This test was aimed at capturing the average performance of the firms over the five-year period under study. These findings were reinforced by the data collected from N.S.E in appendix B. This data showed that the majority of firm’s performance ranged between 50% and 90% which was classified as average performance for the purpose of this study.
Table 4.1.2: Firms Financial Performance Trend: 1998-2002

<table>
<thead>
<tr>
<th>Performance Trend</th>
<th>Number of Respondents</th>
<th>Percentage Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increasing</td>
<td>3</td>
<td>21.4%</td>
</tr>
<tr>
<td>Decreasing</td>
<td>2</td>
<td>14.3%</td>
</tr>
<tr>
<td>Stable</td>
<td>1</td>
<td>7.1%</td>
</tr>
<tr>
<td>Fluctuating</td>
<td>8</td>
<td>57.1%</td>
</tr>
<tr>
<td>Total</td>
<td>14</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Research Data

The trend of the firm’s financial performance gave a comparison of the firm’s financial performance on a year to year basis from the year 1998 to 2002. Table 4.1.2 shows that 22% of the firms reported an increase in financial performance from one year to the other over the five year period, 14% a decreasing performance, 7% a stable performance 57% fluctuation in performance.

These results are supported by the operating profit of firms as shown in appendix B, which shows that many firms reported a fluctuating profit for the period. These results reflect the economic instability that was prevailing in Kenya over the period under study.

Table 4.1.3 reflects the perceptions of the respondents regarding their firms’ financial performance growth rate compared to the performance growth rate in the entire manufacturing industry. 14% of the respondents reported that their firms’ financial performance grew consistently above the industries average, 50% consistently average, 14% consistently below average and 22% fluctuating.

The implication of these results is that quoted manufacturing firms are not necessarily the best performers in the entire manufacturing industry.
Table 4.1.3: Firms Growth Rate in Relation to the Industry Growth Rate

<table>
<thead>
<tr>
<th>Rate of Growth</th>
<th>Number of Respondents</th>
<th>Percentage Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consistently above average</td>
<td>2</td>
<td>14.3%</td>
</tr>
<tr>
<td>Consistently average</td>
<td>7</td>
<td>50.0%</td>
</tr>
<tr>
<td>Consistently below average</td>
<td>2</td>
<td>14.3%</td>
</tr>
<tr>
<td>Fluctuating above average and below average</td>
<td>3</td>
<td>21.4%</td>
</tr>
<tr>
<td>Total</td>
<td>14</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Research Data

Table 4.1.4 gives the respondents views of the significant factors affecting financial performance. The factors were identified as the cost of credit, cost of power, taxes on raw materials and cost of labor. Cost of credit was identified as the major factor affecting financial performance with 21% of the respondents, of which 86% ranked it as a major factor while 14% ranked it as moderate. 57% of the respondents identified cost of credit in combination with cost of labor as a factors of which none of these respondents ranked them as major or moderate factors. The least factor was identified as cost of power with only 7% of the respondents, of which 57% ranked it as a major factor while 43% ranked it as moderate. These findings explain why the Kenyan business fraternity has always blamed the high cost of financing their business as a major cause for their poor performance.
Table 4.1.4: Ranking of Factors Affecting Firms’ Financial Performance

<table>
<thead>
<tr>
<th>Factors Rank</th>
<th>Cost of credit</th>
<th>Cost of power</th>
<th>Taxes on raw material</th>
<th>Cost of labor</th>
<th>Cost of credit + cost of labor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Major</td>
<td>85.7%</td>
<td>57.1%</td>
<td>50.0%</td>
<td>42.9%</td>
<td></td>
</tr>
<tr>
<td>Moderate</td>
<td>14.3%</td>
<td>42.9%</td>
<td>50.0%</td>
<td>57.1%</td>
<td></td>
</tr>
<tr>
<td>Percentage of respondents</td>
<td>21.4%</td>
<td>7.1%</td>
<td>14.3%</td>
<td></td>
<td>57.1%</td>
</tr>
</tbody>
</table>

Source: research data

4.2 Firms Cost of Credit

Credit costs consisted of only that component of the net finance costs that related to the credit facilities that firms were using for that particular period. This was picked from the financial data collected from NSE as shown in appendix B. Responses from the questionnaires were also incorporated. The various types of credit that firms used were identified as well as their percentage level of use. The cost of these credits and their trend was then determined and an analysis of their contribution to the overall cost of the credit to the firm done. This section also gives an analysis of the elements that make up the cost of credit and their ranking.

Firms use various types of credit to finance their operations but with different levels. This depends on the firm’s credit policies, financial performance and stability in revenue generation among others. From table 4.2.1, all firms used trade credit (also see appendix B). This may be explained by the perceived low level of its cost. It could also be explained by the fact that firms do not pay cash while purchasing goods due to the risk factor and the inconvenience involved. Trade credit is therefore
inevitable in the smooth running of these firms. However, it was not ranked as the highest contributor to the overall level of credit. Only 36% of all respondents ranked it as a high contributor to the level of credit, 57% ranking it as average and 7% as low. Bank overdrafts were used by 71% of the respondents of which 57% ranked it as high contributor to the overall cost of credit, 43% as average and none of the users of bank overdrafts ranked it as low contributor. This may be because of the short term nature of this type of credit making it even more popular with the lenders due to the low risk of default. Commercial papers were the least used with only 7% of the respondents using it and none of the users ranked it as high contributor to the overall level of credit. Other types of credit identified were government loans, directors' loans, convertible bonds, preference shares and finance lease. These types of credit were rarely used by the majority of firms.

Table 4.2.1: Types of Credit and their Rankings

<table>
<thead>
<tr>
<th>Types</th>
<th>Number Respondents</th>
<th>Percentage</th>
<th>High</th>
<th>Average</th>
<th>Low</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank borrowings</td>
<td>7</td>
<td>50.0%</td>
<td>42.8%</td>
<td>21.4%</td>
<td>35.7%</td>
</tr>
<tr>
<td>Bank overdrafts</td>
<td>10</td>
<td>70.7%</td>
<td>57.1%</td>
<td>42.9%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Commercial papers</td>
<td>1</td>
<td>7.1%</td>
<td>0.0%</td>
<td>20.3%</td>
<td>79.7%</td>
</tr>
<tr>
<td>Trade credit</td>
<td>14</td>
<td>100.0%</td>
<td>35.7%</td>
<td>57.1%</td>
<td>7.1%</td>
</tr>
<tr>
<td>Others</td>
<td>1</td>
<td>7.1%</td>
<td>21.4%</td>
<td>35.7%</td>
<td>42.8%</td>
</tr>
</tbody>
</table>

Source: Research Data

The respondents were required to identify the various determinants of the cost of credit or elements that make up the cost of credit and rank them. The ranking was in the order of their contribution to the overall cost of credit for each specific type of credit identified earlier in Table 4.2.1. From the
findings presented in Table 4.2.2, interest rate was identified as the key element in the cost of credit with all the respondents coming into agreement. In addition, all the respondents ranked it as a major contributor to the overall cost of credit with none ranking it either as average or low. It was noted that even those firms that did not use those types of credits where interest rate was an element of the cost still perceived it as a major element of their cost of credit. This shows the great impact the interest rates have on the business community in respect to financing of business activities. However, it was observed that 28% of the respondents see the loss of cash discounts as contributing highly to the cost of credit while 42% see it as low determinant. Other costs elements identified included the extra cost charged on goods purchased on credit, indirect cost of the time the management uses to negotiate the credit facilities as well as the extra manpower that goes by the use of credit.

Table 4.2.2: Determinants of the Cost of Credit and their Rankings

<table>
<thead>
<tr>
<th>Types</th>
<th>Number of Respondents</th>
<th>Percentage</th>
<th>High</th>
<th>Average</th>
<th>Low</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest rates</td>
<td>14</td>
<td>100.0%</td>
<td>100.0%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Processing fees to acquire credit</td>
<td>1</td>
<td>7.1%</td>
<td>7.1%</td>
<td>71.4%</td>
<td>21.4%</td>
</tr>
<tr>
<td>Loss of discount on cash payments</td>
<td>1</td>
<td>7.1%</td>
<td>28.5%</td>
<td>28.6%</td>
<td>42.9%</td>
</tr>
<tr>
<td>Penalties for defaulting payments</td>
<td>2</td>
<td>14.2%</td>
<td>7.1%</td>
<td>35.7%</td>
<td>57.1%</td>
</tr>
<tr>
<td>Others</td>
<td>1</td>
<td>7.1%</td>
<td>21.4%</td>
<td>35.7%</td>
<td>42.8%</td>
</tr>
</tbody>
</table>

Source: Research Data

The cost of credit for the period 1998-2002 varied from firm to firm. This may be explained by the varying level of borrowings that firms adopted during this period as shown in appendix B. From
Table 4.2.3, 21% of the respondents recorded increasing credit cost for the period, 28% decreasing, 28% stable and 21% recorded fluctuation in the cost over the same period. The data in appendix B reinforces the sentiments from the respondents. From this data, it can be observed that the average cost of credit for the entire industry remained stable for the first three years 1998 to 2000 but decreased marginally in year 2002. A mixed reaction is reflected from one firm to the other.

Table 4.2.3: Firms Cost of Credit Trend: 1998-2002

<table>
<thead>
<tr>
<th>Performance Trend</th>
<th>Number of Respondents</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increasing</td>
<td>3</td>
<td>21.4%</td>
</tr>
<tr>
<td>Decreasing</td>
<td>4</td>
<td>28.6%</td>
</tr>
<tr>
<td>Stable</td>
<td>4</td>
<td>28.6%</td>
</tr>
<tr>
<td>Fluctuating</td>
<td>3</td>
<td>21.4%</td>
</tr>
<tr>
<td>Total</td>
<td>14</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Research Data

4.3 Relationship-Financial Performance and Cost of Credit

This section compares the study findings on the firms’ financial performance with the findings on the cost of credit. A derivation of any relationship that may have existed is also done through the use of chi-square method of statistical test. The field survey findings on the trends of both the financial performance and the cost of credit for the five-year period are used to derive any relationship. Trend analysis is used due to its ability to show the direction taken by each of the measurement for the
period under study. Financial data collected from NSE in appendix B is also incorporated in order to reinforce the findings of the field survey.

4.3.1 Chi-Square Test

A chi-square test of independence was carried out to test the hypothesis that there is no relationship between the cost of credit and financial performance of manufacturing firms. The null and alternative hypotheses were:

Ho: There exists no relationship between the cost of credit and financial performance of manufacturing firms.

H1: There exists a relationship between the cost of credit and the financial performance of manufacturing firms.

Correlation of data collected from NSE on financial performance and cost of credit was summarized in 3 x 3 contingency tables detailed below. The threshold cut-off points for financial performance and cost of credit were set as follows:

**Table 4.3.2: Financial Performance and Cost of Credit Threshold Cut-off Points**

<table>
<thead>
<tr>
<th>Financial Performance</th>
<th>Cost of Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Good</td>
<td>Above 90%</td>
</tr>
<tr>
<td>Average</td>
<td>50% - 90%</td>
</tr>
<tr>
<td>Poor</td>
<td>Below 50%</td>
</tr>
</tbody>
</table>
The data collected as to the various attributes was then cross-tabulated with corresponding attribute for each of the five years under study. The column totals and the row totals were multiplied and divided by the grand total to get the expected values for each cell as reflected in appendix C.

The Pearson's chi square ($x^2$) value was then computed for each year. The $x^2$ value obtained compared to the critical value as well as the decision to reject or accept the null hypothesis for each year is detailed below.

### Table 4.3.3: Chi – Square Test Results

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>$x^2$ value</td>
<td>5.040</td>
<td>6.519</td>
<td>1.667</td>
<td>4.245</td>
<td>9.798</td>
</tr>
<tr>
<td>Reject / fail to reject</td>
<td>Fail to reject</td>
<td>Fail to reject</td>
<td>Fail to reject</td>
<td>Fail to reject</td>
<td>Reject</td>
</tr>
</tbody>
</table>

The level of significance was set at five percent and with $(3-1) (3-1)$ that is four degrees of freedom. $X^2_{0.05,4} = 9.488$. The decision rule was therefore to reject the null hypothesis if $X^2 > 9.488$ and not to reject the null hypothesis if $X^2 < 9.488$.

From the table, the null hypothesis was only rejected on the test results of the year 2002 while the other four years test results failed to reject the null hypothesis. The null hypothesis can therefore be retained on this basis and a conclusion that no relationship exists between the cost of credit and the financial performance of manufacturing firms made.

To reinforce the results of the data collected from the NSE, a test was done on the data from the field survey. The computed Pearson's chi square $x^2$ value from the cross tabulated data in appendix B was 11.91 with 9 degrees of freedom and 5% confidence level. This is less than the related critical value.
of 16.919, so we fail to reject the null hypothesis and conclude that there exists no relationship between the financial performance and the cost of credit of manufacturing firms.

4.4 Issues Relating to the Use of Credit

This section deals with other issues that are related to the use of credit facilities in consideration of the financial performance of firms. It identifies the various reasons that would make firms use credit facilities in respect to the other sources of finances to finance their operations. It also identifies the various hindrances that encountered by firms in their efforts to secure credit facilities from the providers.

Table 4.4.1: Reasons for Using Credit Facilities in Financing Firms Operations

<table>
<thead>
<tr>
<th>Reasons</th>
<th>Number of Respondents</th>
<th>Percentage Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low interest rates</td>
<td>13</td>
<td>92.9%</td>
</tr>
<tr>
<td>Relaxed requirements in acquiring credit</td>
<td>1</td>
<td>7.1%</td>
</tr>
<tr>
<td>Total</td>
<td>14</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Source: Research Data

From the table, 93% of the respondents felt that if the interest rates were reduced, they would be able to use credit facilities more than the other sources of finances. 7% of the respondents would wish that requirements for acquiring credit facilities were relaxed.
Table 4.4.2: Hindrances Encountered when Securing Credit

<table>
<thead>
<tr>
<th>Types</th>
<th>Number of Respondents</th>
<th>Percentage</th>
<th>High</th>
<th>Average</th>
<th>Low</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unstable cash flows to repay</td>
<td>4</td>
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<td>42.9%</td>
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Source: Research Data

In order to establish the reasons why firms could not utilize credit facilities to the maximum, respondents were asked to identify the various hindrances they encountered when trying to acquire credit facility. From the table, 28% of the respondents felt that their firm’s unstable cash flow hindered it from acquiring credit. Among this respondents 35% ranked this hindrance very highly in comparison to the other hindrances, 43% felt it was average while 21% ranked it lowest. Overall, high cost of credit was observed to be the highest hindrance with 57% of the total respondents picking it. Further 78% of these respondents ranked it as the highest hindrance in comparison to the others, 21% ranked it average and no respondent felt that it was the least hindrance compared to the other hindrances.

4.4.3 Financial Data

The table in appendix B analyses the percentage of the firm’s borrowings in relation to its turnover as well as the firm’s financial performance having factored in the cost of credit. From the appendix, a generalization can be made with regard to the level of borrowings that significantly affect the firms’ financial performance. Borrowings of less than 10% of the total turnover generate a financial performance of 90% and more while borrowings of more than 10% of the total turnover significantly
affected the financial performance of firms negatively. This negative impact varies from firm to firm and from year to year in case of the same firm hence the difficulty in establishing the exact optimal level of borrowing from this data. The appendix also shows that the industry’s average financial performance varied significantly from as low as negative 20% to 67%.

The appendix further analyses the percentage level of trade credit in relation to the total turnover. The average percentage for the industry remained fairly stable over the period of study. The implication from these findings is that across the industry firms maintained a stable level of trade credit.

4.4.4 Problems Faced by Firms in the Use of Credit.

The study established various problems that faced firms in the use of credit. It was found out that these problems arose from the very initial stages of acquiring the credit to the final stages of servicing the credit. Problems were found to be:

i) There were many requirements and restrictions in the process of acquiring the credit as well as during the usage of the acquired credit.

ii) Due to the high cost that went by the credit, there were difficulties in repaying the borrowings hence firms were forced to renegotiate the repayment periods and amounts.

iii) Use of credit when firms were experiencing low turnover resulted in very poor cash flow and very tight controls.

iv) Fluctuating interest rates, which affected cash flows.
4.4.5 Benefits accrued to the firms in the use of credit

Despite the above problems being experienced in the use of credit, it was however established that there were benefits that accrued. These benefits include:

i) Firms were able to deduct tax exemption for the credit cost paid hence a reduction of their overall corporate tax charge.

ii) Use of credit enabled firms to finance their working capital requirements hence the smooth running of their operations.

iii) Credit was used by firms as an alternative when the firms had unhealthy cash flows.

iv) Use of trade credit enabled firms to acquire raw materials on credit and pay after the products had been sold.

v) Firms using credit were able to beat competitors by having advantage of available financial resources for utilization when need arose.

vi) Past good performance in terms of debt repayment and large scale production by the majority of firms made them popular with lenders hence, giving them somewhere to bank on in times of financial crisis at an advantage to their competitors.

4.5 Summary and Discussions

The study has revealed in detail the varying impact of the cost of credit on the financial performance of manufacturing firms. This is due to the different credit policies adopted by firms. These policies determined the level of borrowings, the types of credit facilities to be taken as well as the time period.

In one extreme firms that adopted conservative credit policy and had very low borrowings or no borrowings at all in some cases. Such firms only utilized trade credit as the only credit facility; hence
they could not enjoy the tax benefit from borrowings. These firms adopted such policies in their efforts to minimize financial risk, provide financial flexibility and give independence from the financial institutions. This they did it at the expense of enjoying the benefits that would accrue from the use of credit facilities in their operations. However, the majority of these firms had healthy cash flows hence they would more or less require no credit facilities in their financing. Though trade credit was perceived to be extremely cheap in comparison with the other credit facilities, its usage could not give firms tax advantage. This opportunity cost when factored in makes trade credit cost compare favorably with the other credit facilities in terms of costs. Therefore, firms that majored in using credit facilities as their main credit facilities incurred as much costs as the other firms though their financial performance looked relatively good.

On the other extreme were firms that were non-conservative in the use of credit facilities. These firms used very high percentage of borrowings to turnover in total disregard of their financial performance. Such firms adopted such policies to overcome their cash flow problems as well as guaranteeing their normal operations. The cost of credit for these firms was therefore relatively high hence affecting their financial performance significantly. The accumulation of credit on these firms and their poor financial performance exposed them to high charges on credit facilities advanced to them by financial institutions. This is an attempt by these financial institutions to cover for the risk should these firms default their repayments.

However, most firms studied used prudent credit policies with an aim of optimizing the benefits of using credit facilities in corporate financial management. This was achieved by acquiring a manageable level of borrowings as well as having the right credit mix. These policies enabled these firms to enjoy the use of credit facilities in their operations. It was noted therefore that although
firms would be subjected to relatively the same percentage cost of specific credit facilities, the overall cost of the firms cost of credit was significantly determined by the mix adopted.

From the above indications the study found out that there exists a relationship between the cost of credit and the financial performance of manufacturing firms in the two extremes. A very low cost of credit resulted in very high financial performance while on the other hand very high cost of credit resulted in very low financial performance. In general, the statistical test from the field survey as well as the NSE data derived no relationship between the cost of credit and the financial performance of manufacturing firms. This was due to the effect of the large number of firms in the study that were not affected by the cost of credit due to their prudent use of credit facilities.

The study also identified the elements that made up the cost of credit and their relative contribution to the overall cost of credit. It established that interest charges formed the bulk of the cost of credit in almost all the available credit facilities. However, their impact also varied from one type of credit facility to the other due to the different interest rates applied to the respective credit facilities. Notably, commercial papers, preference shares, government loans and long term loans attracted very low interest rates; firms that exploited such facilities accrued very low credit costs despite having huge amounts of credit facilities in their books as measured by their percentage level of borrowings to turnover. The significance of interest rates in the cost of credit explains why the rate of interest rates charged by the banks and other financial institutions is a major barometer of financial costs and to a lesser extent the economic growth. Consequent to these observations, interest rates formed the major hindrance to the use of credit facilities in firm’s financing. It, therefore, emerged they are willing to optimize their use of credit facility as long as interest rates were reduced to favorable levels.
The low average financial performance and its stability throughout the period of study reconfirmed the impact the cost of credit had on the financial performance from a general perspective of the entire manufacturing industry. This was an indication of the high interest rates charged on the loans advanced to businesses coupled with the low economic recession experienced in the same time period.

However, the study found out that despite the cost of credit contributing to the financial performance at varying degrees and dimensions, a multiplicity of other factors whose details were beyond this study played a significant role in the financial performance and trend of specific firms as well the entire manufacturing industry.
5.1 Conclusion

This study derived no existence of relationship between the cost of credit and the financial performance of manufacturing firms quoted in the Nairobi Stock Exchange. However, it found out that the impact of the cost of credit on the financial performance though significant, was both varying and in different dimensions. The level of borrowings was identified as one of the contributor to this variation. However, no level of borrowing was identified as having the lowest cost of credit but rather a ceiling of the highest level of borrowings that would have a negative impact was determined. The findings, therefore, supported the expressions of (Ndirangu, 1992) who contend that when more and more debts are added, the present value of these costs rise at an increasing rate but there is no way of determining the exact optimal level of borrowings for any particular firm. The study refutes the Modigliani and Miller (1963), who suggested that firms should choose the maximum debt possible.

The study identified the various sources of credit and their relative cost. In the process it identified trade credit as the most popular source of credit for the firms based on the questionnaires filled by the respondents and the final accounts and balance sheets of the firms. More importantly, the source of credit greatly affects this cost as indicated by the choice of source of credit by firms.

From all indications and given the foregoing, the use of credit, though beneficial and necessary for the healthy operations of the firms, should be used with a lot of caution. Proper corporate policies need to be implemented to guide firms in their use of credit so as to reap the benefits. Other
government policies guiding the operations of lenders and other financial institutions would also
play a great role in increasing the benefits accrued. Moreover, such policies are
not only financial performance but economic development in general, a central objective of credit
advancement efforts.

From the foregoing, it is clear that there is an urgent need of financial reforms, the strengthening of
the regulatory and legal framework as well as the establishment of clear guidelines to the conduct of
lenders and financial institutions in general which are the drivers of the interest rates and the cost of
credit in general.

5.2. Recommendations

Further to the research findings and the related discussions, the researcher recommends the following:

i) Banks and other lenders should relax the requirements that firms are required to give when acquiring credit.

ii) Interest rates being the highest determinant of the cost of credit should be reduced across the board so as to act as an incentive for firms to borrow to encourage investments hence economic growth. It is worth noting that the government has already initiated the first step towards interest rates reduction by the resent policy pronouncements made during this year’s budget.

iii) Measures should be put in place to bring checks and balances in the already liberalized interest rate regime to prevent over-exploitation of borrowers by financial institutions.

iv) The regulatory and legal framework in relation to lending and borrowing should be strengthened to enhance discipline, trust, and stability in the market. In this regards the Central Bank of Kenya is mandated to be the regulatory body.
5.3 Limitations of the Study

The study was undertaken amidst several limitations that are worth noting. These were:

- Some financial data for some firms could not be traced in the NSE since the firms had not been listed in those respective years or had not yet published their accounts. The study could not therefore cover those firms for those particular years.

- Some of the respondents did not complete the questionnaires arguing that their corporate policy did not allow the release of information. Efforts to explain that the information was purely academic and that the information was to be treated with utmost confidentiality did not change their perception.

- It was very difficult to determine the cost of trade credit as a source of credit since there was no record that could be used to derive the cost in numerical figures. The determination of this cost was, therefore, somewhat subjective.

5.4 Suggestions for Further Study

- This study focused on the relationship of only one factor that affects financial performance. Further study can be done to determine the relationship of the other factors that affect firm's financial performance.

- The scope of the study was also limited to only those manufacturing firms that are quoted for the period 1998 to 2002. Further study can be done on a bigger scope of all the manufacturing firms or on the other sectors of the economy covering other periods.
APPENDIX A

LIST OF MANUFACTURING FIRMS LISTED IN THE NAIROBI STOCK EXCHANGE

1. ATHI RIVER MINING LTD
2. B.O.C. KENYA LTD
3. BAMBURI CEMENT
4. BRITISH AMERICAN TOBACCO
5. CARBACID INVESTMENTS LTD
6. CROWN BERGER
7. DUNLOP KENYA LTD
8. EAST AFRICAN CABLES
9. EAST AFRICAN POTLAND
10. EAST AFRICAN BREWERIES
11. FIRESTONE EAST AFRICA LTD
12. KENYA OIL COMPANY LTD
13. MUMIAS SUGAR
14. KENYA POWER AND LIGHTING COMPANY LTD
15. TOTAL KENYA LTD
16. UNGA GROUP LTD
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</tr>
<tr>
<td>2000</td>
<td>GROSS TURNOVER</td>
<td>551,941</td>
<td>6,565,948</td>
<td>7,710,000</td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td></td>
<td>OPERATING PROFIT</td>
<td>73,413</td>
<td>292,881</td>
<td>888,000</td>
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<td></td>
<td>FINANCE COST</td>
<td>355</td>
<td>16,916</td>
<td>269,000</td>
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<tr>
<td></td>
<td>P.A.F.C.</td>
<td>73,260</td>
<td>275,965</td>
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<tr>
<td></td>
<td>TRADE CREDITS</td>
<td>34,812</td>
<td>345,825</td>
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<td></td>
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<td></td>
<td>TOTAL BORROWINGS</td>
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<td>2,123,000</td>
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<td></td>
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### Source
- Calculated from Financial Data

### Appendix B: Financial Data
### Table 1: Performance * Cost Cross Tabulation-1998

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<tr>
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<td>0</td>
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<tr>
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<td>.9</td>
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<tr>
<td>Average Count</td>
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<td>1</td>
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<tr>
<td>Expected Count</td>
<td>1.6</td>
<td>.8</td>
</tr>
<tr>
<td>Poor Count</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Expected Count</td>
<td>.5</td>
<td>.3</td>
</tr>
<tr>
<td>Total Count</td>
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<tr>
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### Table 2: Financial * Cost Cross Tabulation-1999

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</tr>
</thead>
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<td></td>
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</tr>
<tr>
<td>Good Count</td>
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</tr>
<tr>
<td>Expected Count</td>
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<tr>
<td>Average Count</td>
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<td>2</td>
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<tr>
<td>Expected Count</td>
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<td>1.0</td>
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<td>Poor Count</td>
<td>1</td>
<td>1</td>
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<tr>
<td>Expected Count</td>
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<td>1.0</td>
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<tr>
<td>Total Count</td>
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<td>5</td>
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<tr>
<td>Expected Count</td>
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<td>5.0</td>
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### Table 3: Performance * Cost Cross Tabulation-2000

<table>
<thead>
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<tr>
<td>Expected Count</td>
<td>1.2</td>
<td>2.8</td>
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<tr>
<td>Average Count</td>
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<td>1.2</td>
<td>2.8</td>
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<tr>
<td>Poor Count</td>
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<tr>
<td>Expected Count</td>
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Table 4: Performance * Cost Cross Tabulation-2001

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<td>Average</td>
</tr>
<tr>
<td>Good</td>
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<td>3</td>
</tr>
<tr>
<td>Expected Count</td>
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<td>2.6</td>
</tr>
<tr>
<td>Average</td>
<td>2</td>
<td>3</td>
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<tr>
<td>Expected Count</td>
<td>1.3</td>
<td>2.6</td>
</tr>
<tr>
<td>Poor</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Expected Count</td>
<td>.4</td>
<td>.8</td>
</tr>
<tr>
<td>Total</td>
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<td>6</td>
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<td>Expected Count</td>
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</table>

Table 5: Performance * Cost Cross Tabulation-2002

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</tr>
</thead>
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<td></td>
<td>High</td>
<td>Average</td>
</tr>
<tr>
<td>Good</td>
<td>0</td>
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</tr>
<tr>
<td>Expected Count</td>
<td>.6</td>
<td>1.8</td>
</tr>
<tr>
<td>Average</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Expected Count</td>
<td>.3</td>
<td>.8</td>
</tr>
<tr>
<td>Poor</td>
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<td>0</td>
</tr>
<tr>
<td>Expected Count</td>
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<td>.4</td>
</tr>
<tr>
<td>Total</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Expected Count</td>
<td>1.0</td>
<td>3.0</td>
</tr>
</tbody>
</table>

Table 6: Trend of Financial Performance * Cost of Credit Five Year Period

<table>
<thead>
<tr>
<th>Trend of financial Performance 5 years period</th>
<th>Trend of cost of credit facilities 5 years period</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Increasing</td>
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<tr>
<td>Increasing Count</td>
<td>1</td>
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<tr>
<td>Expected Count</td>
<td>.6</td>
</tr>
<tr>
<td>Decreasing Count</td>
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<tr>
<td>Expected Count</td>
<td>.4</td>
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<tr>
<td>Stable Count</td>
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</tr>
<tr>
<td>Expected Count</td>
<td>.2</td>
</tr>
<tr>
<td>Fluctuating Count</td>
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</tr>
<tr>
<td>Expected Count</td>
<td>1.7</td>
</tr>
<tr>
<td>Total Count</td>
<td>3</td>
</tr>
<tr>
<td>Expected Count</td>
<td>3.0</td>
</tr>
</tbody>
</table>
APPENDIX D:

INTRODUCTION LETTER

Dear respondent,

I am a student at Kenyatta University pursuing a Masters Degree in Business Administration.

I am carrying out a research on “Relationship between cost of credit and financial performance of manufacturing firms listed in the Nairobi Stock Exchange”

This questionnaire is aimed at eliciting information, which will be useful in the above-mentioned research as a part of Masters of Business Administration Degree requirements.

You have been selected as one of the respondents in this study. The information supplied will be used strictly on academic purposes only and will be treated with utmost confidentiality.

Your cooperation will be highly appreciated.

THANK YOU

Stephen M. Mwaura.
APPENDIX E

SURVEY QUESTIONNAIRE

Sector: ________________________________

Location: ________________________________

Name of firm: ________________________________

Person to contact: ________________________________

1. When did your firm begin production? ________________________________

2. What is the main product of the firm? ________________________________

3. What is the major secondary product of the firm? ________________________________

4. Is the establishment a part or a branch of a parent enterprise?
   Yes [ ] No [ ]

5. What is the ownership structure of the firm? (tick only one)
   - Private owned by Kenyans only [ ]
   - Private owned by foreigners only [ ]
   - Private owned by Kenyans and Foreigners [ ]
   - Public and Private owned by Kenyans [ ]
   - Public and Private owned by Foreigners [ ]
   - Public and Private owned by Kenyans and Foreigners [ ]

6. Has the enterprise shifted some of its portfolios from manufacturing into other activities such as trading, purchase of treasury bills, government bonds, etc?
   Yes [ ] No [ ]
7. If the answer to (6) is yes, why the shift?

- To reduce the firms exposure to risks. [ ]
- To increase profitability. [ ]
- To fully utilize the firms available resources. [ ]
- To expand as a result of growth. [ ]
- Other(s)(specify) ____________________________

8. How has your firm been performing financially in the last five years (1998 – 2002)?

- Very well [ ]
- Well [ ]
- Average [ ]
- Bad [ ]
- Very bad [ ]

9. What has been the trend of your firm’s financial performance in the last five years?

- Increasing [ ]
- Decreasing [ ]
- Stable [ ]
- Fluctuating [ ]

10. (a) Did your firm make after tax profit in the last financial year?

   Yes [ ]   No [ ]
(b) Did your firm make after-tax profit in the immediate past quarter of the current financial year?

Yes [ ] No [ ]

11. In comparison to the growth in the manufacturing industry, how would you rate your firm’s performance in the last five years (1998 – 2002)?

- Consistently above average [ ]
- Consistently average [ ]
- Consistently below average [ ]
- Fluctuating between above average and below average [ ]
- No change [ ]

12. (a) Among the factors listed below, which one(s) have negatively affected your firm’s financial performance

- Cost of credit [ ]
- Cost of labor [ ]
- Cost of power [ ]
- Taxes on raw materials [ ]
- Other(s)(specify) 

(b) Indicate the extent to which the factors in 12 (a) above have negatively impacted on your firm’s financial performance.

55
<table>
<thead>
<tr>
<th>Item</th>
<th>Not at all</th>
<th>Moderate</th>
<th>Major</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of credit</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>Cost of labor</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>Cost of power</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>Taxes on raw materials</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>Other(s)</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
</tbody>
</table>

13. (a) Which type of credit do you use in your firm?

- Bank borrowings [ ]
- Bank overdrafts [ ]
- Trade credit [ ]
- Bonds issue [ ]
- Commercial papers [ ]
- Other(s)(specify)

(b) Rank the sources of credit in 13 (a) above in order of their percentage contribution to financing your firm’s operations.

<table>
<thead>
<tr>
<th>Source</th>
<th>Very high</th>
<th>High</th>
<th>Average</th>
<th>Low</th>
<th>Not at all</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank borrowings</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>Bank overdrafts</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>Trade credit</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
</tbody>
</table>
14. Why do you use the credit facilities you indicated in 13 (a) to finance your firm's operations?
   - Lack of stable cash flow from the firm's operations [ ]
   - To take advantage of tax effect [ ]
   - Low cost of the credit [ ]
   - Unavailability of other credit facilities [ ]
   - Other(s)(specify)


15. What has been the trend of the cost of credit to your firm in the last five years?
   - Increasing [ ]
   - Decreasing [ ]
   - Stable [ ]
   - Fluctuating [ ]

16. What do you think of the rate of interest you are charged on credit taken?(Tick one only)
   - Very high [ ]
   - High [ ]
   - Average [ ]
   - Low [ ]
17. What would encourage your firm to use credit to finance its operations instead of other forms of finance?

- Low interest rates
- Removal of processing fees when acquiring credit
- More relaxed requirements when acquiring credit
- Easier accessibility to credit
- Other(s)(specify)

18. What are the determinants of the cost of credit in your firm?

- Interest rates
- Penalties for defaulting payments
- Processing fees to acquire credit
- Loss of discounts on cash payments
- Other(s)(specify)
19. State the extent to which the determinants listed in (18) determine the cost of credit.

<table>
<thead>
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<th>Determinant</th>
<th>Not a determinant</th>
<th>Moderate</th>
<th>Major</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest rates</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>Penalties for defaulting payments</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>Processing fees to acquire credit</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>Loss of discounts on cash payments</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>Other(s)</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
</tbody>
</table>

20. For what purpose were the last major credit facility/facilities received by your firm intended?

- Working capital only [ ]
- Investment to expand business [ ]
- Working capital and investment [ ]
- Investment to start business [ ]
- Other (please specify)

21. (a) Among the following hindrances, which one(s) have you encountered in securing credit?

- High cost of credit [ ]
- Unstable cash flow to repay the borrowings [ ]
- Poor organization performance [ ]
- Unavailability of credit [ ]
- Other(s)(specify) [ ]
(b) What has been the level of the hindrance you have highlighted in 21 (a)?

<table>
<thead>
<tr>
<th>Hindrance</th>
<th>High</th>
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<th>Not a hindrance</th>
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</thead>
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<td>High cost of credit</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>Unstable cash flow to repay the borrowings</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>Poor organization performance</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>Unavailability of credit</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>Other(s)</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
</tbody>
</table>

22. What are the obstacles that deter your firm’s investment?

- Uncertainty about the economy (uncertainty about the interest rates, exchange rates, demand for products, etc) [ ]
- High level of taxes [ ]
- Difficult in obtaining credit [ ]
- High interest rates [ ]
- Lack of demand for products [ ]
- Lack of raw materials [ ]
- Poor infrastructure [ ]
- Other(s) (specify)
23. How can the obstacles highlighted in (22) be solved?

- Using other sources of finances other than credit
- Negotiating for lower interest rates with the providers of credit
- Reduction of interest rates in the market across the board
- Reduction of taxes by the Government
- Diversifying the firms' investment portfolios
- Other(s)(specify)_____________________________

24. State the extent to which the obstacles listed in (22) above deter your firms investment.

<table>
<thead>
<tr>
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<th>Not at all</th>
<th>Moderate</th>
<th>Major</th>
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</thead>
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<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>High level of taxes</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>Difficult in obtaining credit</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>High interest rates</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>Lack of demand for products</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>Lack of raw materials</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>Poor infrastructure</td>
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</tr>
<tr>
<td>Other(s)</td>
<td>[ ]</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
</tbody>
</table>
25. How has your firm benefited from the use of credit to finance its operations?


26. Which problems have your firm encountered in the use of credit to finance its operations?


Thank you very much for your efforts in completing this questionnaire.
BIBLIOGRAPHY


