

**A Survey of Strategies used to cope with Financial Distress:
A case study of Quoted Companies in the Nairobi Stock Exchange
(1995-1999).**

By:

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Administration (MBA) of Kenyatta University.**

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strategies used to*



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DECLARATION

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

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Education

to my loving wife Mrs. Jane Naitore Mwirigi for moral support and financial support that you gave me continuously in the course of my study.

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TABLE OF CONTENT

| | Page |
|-----------------------|--------|
| Declaration | (i) |
| Dedication | (ii) |
| Acknowledgement | (v) |
| List of abbreviations | (vi) |
| Definition of terms | (vii) |
| List of tables | (viii) |
| List of figures | (ix) |
| Abstract | (x) |

CHAPTER ONE

| | | |
|------|-----------------------------|---|
| 1.0 | Introduction | 1 |
| 1.1 | The background to the study | 1 |
| 1.2 | Statement of the problem | 4 |
| 1.3 | Purpose of the study | 5 |
| 1.4 | Objectives of the study | 5 |
| 1.5 | Research questions | 5 |
| 1.6 | Hypothesis | 6 |
| 1.7 | Significance of the study | 6 |
| 1.8 | Scope of the study | 6 |
| 1.9 | Assumptions of the study | 7 |
| 1.10 | Limitations of the study | 7 |

CHAPTER TWO: LITERATURE REVIEW

| | | |
|-----|-------------------------------------|----|
| 2.0 | Introduction | 9 |
| 2.1 | General literature review | 9 |
| 2.2 | Characteristics of the company | 10 |
| 2.3 | Critical review of the major issues | 17 |
| 2.4 | Conceptual framework | 19 |
| 2.5 | Summary | 24 |

CHAPTER THREE: RESEARCH METHODOLOGY

| | | |
|-----|--|----|
| 3.0 | introduction | 25 |
| 3.1 | research design | 25 |
| 3.2 | Target population | 25 |
| 3.3 | Sampling design | 25 |
| 3.4 | Data collection procedures and instruments | 26 |
| 3.5 | Data analysis | 27 |
| 3.6 | Expected output | 29 |

CHAPTER FOUR: DATA ANALYSIS AND INTERPRETATION

| | | |
|-----|---|----|
| 4.0 | Introduction | 30 |
| 4.1 | Descriptive results | 30 |
| 4.2 | Findings based on the size of the company | 32 |
| 4.3 | Findings based on leverage | 35 |
| 4.4 | Findings based on the sector | 39 |
| 4.5 | Hypothesis testing | 43 |

CHAPTER FIVE: CONCLUSIONS AND RECOMMENDATIONS

| | | |
|-----|--------------------------------------|----|
| 5.0 | Introduction | 45 |
| 5.1 | Conclusions | 45 |
| 5.2 | Recommendations for further research | 46 |

REFERENCES

| | |
|--------------|----|
| Appendix I | 51 |
| Appendix II | 53 |
| Appendix III | 54 |
| Appendix IV | 55 |

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ABBREVIATIONS

| | | |
|------|---|---|
| PBT | - | Profit Before Taxes |
| NSE | - | Nairobi Stock Exchange |
| SR | - | Short Run |
| LR | - | Long Run |
| SHS | - | Shillings |
| DIV | - | Dividends |
| NBK | - | National Bank of Kenya |
| KCB | - | Kenya Commercial Bank |
| ROA | - | Return on Assets |
| EPS | - | Earnings per share |
| SPSS | - | Statistical package for social sciences |

Definition of Terms

- Financial distress** - It's a situation where the company has inadequate assets to meet the current requirements of its hard contracts.
- Financial leverage** - It's the process of magnifying the shareholders return through the use of debts. Also referred to 'gearing' or 'trading on equity'.
- Dividends** - Money earned as profit by a company and divided among the owners or the shareholders.
- Shares** - Each of equal parts into the ownership of the company or corporation.
- Rationalization** - The act or fact of being reasonable.
- Mismatch** - To match badly or unsuitably.
- Strategy** - These are action plans set by the management.
- Looming** - To appear as dimly or vaguely, appear as large and dangerous.
- Formal** - Done with proper forms, clear and definitions.
- Informal** - Not done in any prescribed or regular manner.
- Liquidator** - An agent appointed to sell the assets of the company to pay creditors.

List of Tables**Page**

| | | |
|---------|-------|----|
| Table I | ..... | 28 |
| Table 2 | ..... | 29 |
| 2 (i) | ..... | 30 |
| 2 (ii) | ..... | 31 |
| 2 (iii) | ..... | 31 |
| Table 3 | ..... | 32 |
| 3 (i) | ..... | 33 |
| 3 (ii) | ..... | 34 |
| 3 (iii) | ..... | 35 |
| Table 4 | ..... | 35 |
| 4 (i) | ..... | 37 |
| 4 (ii) | ..... | 37 |
| 4 (iii) | ..... | 38 |
| Table 5 | ..... | 39 |

Figure: 2.1 19

Abstract

Financial distress is usually experienced by quoted companies when there is a mismatch between the assets and the financial obligations of the business. This makes it necessary for companies to use response actions to cope with financial distress.

Of importance to this study is the fact that quoted companies used different response actions to minimize financial distress. This is because of different characteristics such as the size, sector and the leverage of the company.

The study design used a cross sectional sampling. A total of 80 respondents were randomly selected followed by stratification. The data were gathered using questionnaires, interviews and observations. The data were analyzed using the Statistical Package for Social Sciences (SPSS). Descriptive and multiple regressions were used.

Based on the results of the survey, it was found that response actions taken by quoted companies to cope with financial distress were successful in respect of the characteristics of the company.

CHAPTER ONE

1.0 Introduction

A firm is financially distressed when it finds itself with inadequate liquid assets to meet the current requirements of its hard contracts [John and John (1993)]. Financial distress is an outcome of a mismatch between the current available assets and the current obligations of a Company's hard financial contracts. This mismatch causes companies to experience serious operational problems, which if not checked could result to the worst being put under receivership and ultimately being liquidated.

Any company which finds itself financially distressed will result to one action or another to employ mechanisms for managing the financial distress so that it can be able to rectify the mismatch between its current available liquid assets and the current obligations of its "hard" financial contracts [Hart and Moore (1989)].

The Nairobi Stock Exchange was established in 1954 to assist transfer of shares by the quoted companies and raise the capital. Currently, the number of quoted companies is 53. The Nairobi stock exchange monitors the progress of these companies and some experienced financial distress. (Appendix vi).

1.1 The Background to the study

The indicators of financial distress includes retrenchments, change of operations, branch closures, replacement of top management, dividends cuts, diversification, selling –off the debt s, mergers and the last resort receivership and bankruptcy. Since financial distress results from a mismatch between the current obligation of companies," hard" financial contracts rectify this mismatch by either restructuring the assets or restructuring the financial contracts or both.

In case financial distress is not addressed, it leads to disinvestments from the company by the existing shareholders, decline in the share value, delisting from the

stock exchange, potential investors reluctant to invest and the last resort may lead into bankruptcy proceedings.

Total market capitalization declined from Kshs 137 billion to Kshs 99 billion as at the end of December 1995 (CMA, Annual Report 1996). There has been a further decline in terms of share turnover and foreign investor activity of 22.8% and 14.5 in 1999 and 2000 respectively (CMA, Annual Report 2001). The profit volume dropped from Kshs 22 billion to Kshs 8 billion (NSE Handbook 1995-1999).

The expansion of the scope of foreign investment by introduction of incentives for capital market in 1998 yielded less. This included the setting up of the tax free capital funds, removal of capital gains tax on insurance companies, investment allowances of beneficial ownership by the foreigners in local stockbrokers and envisaged licensing of dealings firms to improve market liquidity. Nevertheless the NSE did not perform well, with the NSE 20 share index failing below 3000 index mark.

The Unga Group Ltd. made a loss before tax for the 1998 financial year of Kshs 708.24 million. This disappointing performance was due to the depressed and uncertain economic conditions which prevailed in Kenya during this period coupled with problems related to change policy programmes. The sales turnover recorded a partly increase of 1.6% to Kshs 9.42 billion (Chairman Annual Report November, 1998).

The company in April 1998 made a decision to close down Elianto Ltd. and dispose off most of its assets and brands, also it made a radical change programme decision to re-engineer and restructure all the operations of the group to bring them more into line with modern business practices and to focus more closely on its core business.

At the same period, the group drastically down sized the workforce, which was bloated for the years.

During the year ended September 1998, the Lonhro Motors East Africa Limited made a (loss) of Kshs 29,775 million compared to the previous year 1997 of kshs 4,099 million. The turnover during the year declined 15.5% on the previous year, in line with other new vehicles market, which declined 20% for the year. The truck segment of the market was down by 30%.

The company had plans to place greater emphasis upon core competencies of regional franchise, the expansion of dealer network and increasing absorption after market growth. Further rationalization and consolidation actions were being considered given the depressed market conditions and in which no early up turn was anticipated (Chairman Report 1998).

Companies take different remedies and survival tactics and some have succeeded in turning themselves round while others have failed to achieve the desired positive results.

The financially distressed companies take some of the following operational activities:

- 1) Changing the asset structures by selling assets, diversity, division and discontinuing unprofitable operations (Brown et al 1991).
- 2) Changing the size and scope of the operations by consolidating production facilities and laying off employees (John and Zonth (1992).
- 3) Changing the top-management (Glison 1990).
- 4) Restructuring debt corrections (Gilson 1990).
- 5) Dividend cuts (Smith & Warner 1979).

It's possible to find companies that have similar characteristics in terms of size, leverage, operating in the same industry and structure of ownership, among others taking different actions in response to financial distress.

In the late 1990s many companies listed in the Nairobi Stock Exchange (NSE) performed poorly and as a consequence, their share values declined tremendously. Those companies had a good performance record in the past and share values. The profits before tax (PBT) among the listed companies grew slightly between 1995 and 1997, but lost by over 50% in the following two years. The poor financial performance, which has persisted for some companies, has led to such firms being unable to meet their financial obligations as and to when they fall due, hence leading to financial distress.

1.2 Statement of the Problem

In 1997, the economic crisis hit operations of most of the companies, this is the year which was characterized by declining growth rate, stringent monetary policies on inflation, the absence of significant productive investments, the el Nino effect which damaged infrastructure had a pervasive impact on trade, industry and agriculture. (Daily Nation 1998).

The behaviour of quoted firms is characterized as a vector of outcomes (output prices, input prices, efficiency, profitability etc), some of which are of interest to each of the pressure groups (Barbara Grosh 1991). The firm's behaviour will depend on the relative strength of the different pressure groups. These include:- consumers who press for low prices, suppliers of inputs, who press for high prices and procurement from themselves, competitors, who press for the firm to charge high prices and restrict services offered, employees, including management, who wish to ensure that the firm generates a continuing, stream of surplus from which it can

appropriate portion either directly or indirectly and shareholders who press for firms to earn profit. These interest groups exert pressure through the variety of means and this causes financial distress to the firm. The financial distress had such companies to change their policy options so as to change the undesirable situation to better position. No research has been carried out in Kenya on the measures taken by companies in response to financial distress or poor performance. The close research carried out were investment decision on securities (Kipsang K.A 2003), the dividend decisions (Kirugumi J.M. 2003.), Corporate Restructuring on shareholders value (Muthama K.W. 2000) and determination of appropriate earning per share, EPS (Cheruiyot P.R. 1998).

In the light of these developments, it becomes extremely important to study to what extent were the response actions such as employee layoffs, change of top management, dividend cut, debt restructuring, and consolidation of production lines succeeded in coping with financial distress?

1.3 The Purpose of the Study

This was a descriptive survey of the strategy used by the companies to cope with the financial distress and the response action taken.

1.4 Objectives of the study

The general objective of the study was to survey the financial distress on quoted companies. The study specifically set to;

- i) Identify the response actions taken by the companies.
- ii) Identify the response action which succeeded in turning round the companies.

1.5 Research Questions

- i) Did quoted companies listed in the stock exchange experience financial distress?
- ii) What response actions did quoted companies adopt?
- iii) Were the response actions success in turning round the companies?

1.6 Hypothesis

The response actions taken by quoted companies in the Nairobi Stock Exchange to cope with financial distress were successful irrespective of characteristics such as size of the company, leverage and the sector of the company.

1.7 Significance of the study

The study can assist the following:

The government may be able to learn so useful lessons to influence the formulation of policies to the public sector.

Scholars will also use this study to build upon their knowledge and in addition to carry out further research on action taken by financially distressed companies in Kenya and make a comparative study with other countries.

The existing investors both local and foreign will like to know if the financial distress is a short-term phenomenon so they can decide whether to disinvest to other companies and also the potential investors will be reluctant to invest in those companies.

From this research, managers of various companies will obtain information on what short-term action should they take when companies they run get into financial distress.

1.8 The Scope of the study

This project examined only the companies, which are quoted in the Nairobi Stock Exchange, which experienced financial distress and located within the Nairobi City Council and the periphery (Appendix v). These were used to generalize the results.

1.9 Assumptions of the study

- i) The companies used similar response actions to cope with financial distress
- ii) The response actions were successful in dealing with financial distress.
- iii) There was no influence from the pressure groups such as trade unions, government, creditors, debtors and shareholders.
- iv) Capital and money market are efficient in that the prices are free to move in such a way that they will reach equilibrium when the supply and demand for each security are equal.

1.10 Limitations of the study

The following limitations may affect the reliability and validity of the study

- (i) The samples may be too small and they may not be a representative of the population.
- (ii) The concept may be poorly defined
- (iii) The respondents may be unusual for example some may be uncooperative and dishonest.
- (iv) Respondents may not be oneself, one may be stressed and may not respond to the questions well.
- (v) Respondents may be influenced by people around them especially those who are in open office may discuss how to answer the questions
- (vi) The respondents may be influenced by the environmental factors such a lot of work in the office and may give little attention to the questionnaire.
- (vii) The questionnaire may have wrong questions, which may not match with research questions.

- (viii) The data may be wrongly entered by the respondents.
- (ix) The respondents may answer questions wrongly and this can lead to wrong analysis.
- (x) The samples may be badly chosen.
- (xi) The questions in the questionnaire may not be enough.

The above limitations can be minimized by

- i) Pre-testing of the test instruments before the actual data collection.
- ii) Use of triangulate sources of information such as observation, asking manager questions and other people what they feel.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

The review of literature is about previous research conducted on the topic being researched, to provide a framework for establishing the importance of the study. To highlight the gaps in existing studies and to provide a bench mark for comparing the findings with previous discoveries.

2.1 Types of Financial Distress

The Financial contracts of a firm may be categorized into two; the “hard” and the “soft” contracts. The “hard” contract specifies periodic payments by the firm to the claimholders. If the payments are not made on time, the firm is regarded to be in violation of the contract and the claim holders may take specified or unspecified legal actions to enforce the contract. Examples of this type of contracts are; coupon debt contracts, contracts with suppliers and also contracts with employees.

The “soft” contracts are those type of contracts that even though claim holders have expectations of receiving current pay-outs from the firm in addition to their ownership rights, the level and frequency of these payouts are directed by policy decisions made by the firm. Examples include contracts as common stock and preference stock.

During hard financial times firms with contracts react financially, through debt restructuring and bankruptcy filings [Gilson et al (1990)].

2.1.1 Signals of Financial Distress

The first signal of financial distress is a tremendous decline in financial performance in a company. This is the beginning of financial problems, assuming that the company had sound Working Capital Management. Immediately a company experiences a serious decline in its financial performance, such a firm is supposed to

initiate actions to contain the situation, unless such decline in financial performance can be accounted for under circumstances of being extraordinary and therefore, the company would be back to its normal trend of good financial performance in the subsequent years.

2.2 Characteristics of companies

Where different companies have taken different actions in order to rescue themselves, in the same industry, they may have had different characteristics. Such characteristics have differentiated them and probably this could justify for different actions they adopted.

Some of the characteristics that differentiate the companies are:

- (i) Level of leverage
- (ii) Some firms performing poorly in relation to the industry.
- (iii) Size of the company.
- (iv) Structure of the ownership.

2.2.1 Financial leverage and financial distress

Financial leverage refers to the financial ratios which are calculated from financial statements. These financial ratios include: debt ratios, coverage ratios, activity ratios, component ratios and profitability ratios. The financial ratios allow the management to zero in on areas of the business that may need attention. Most of the estimates of predictive power of financial ratios are based on the analyst's past experience with them (Van Horne 2002).

Beaver was the first to use statistical techniques to predict financial distress. He found that financial ratios for financially distressed companies deteriorated markedly as failure approached. In a similar type of study Altaman employed multiple discriminant analysis to predict bankruptcy using various financial ratios. He found

out that five financial ratios were able discriminate rather effectively between bankrupt and non-bankrupt companies (Elijah W. Khakame 2004), beginning up to five years prior to the bankruptcy event.

The Z-score models used the following equation.

$$Z = 1.2 X_1 + 1.4 X_2 + 3.3 X_3 + 0.6 X_4 - 1 - 1.0 X_5$$

Where

| | | |
|-------|---|---|
| X_1 | = | Working capital total asset |
| X_2 | = | Cumulative retained earning to total assets |
| X_3 | = | Earning before interest and taxes to total assets |
| X_4 | = | Market value of equity to book value of total liabilities |
| X_5 | = | Sales to total assets |

The Z ratio is the overall multiple discriminant function (Van Horne 2002). Altaman found that companies with Z-scores below 1.81 (including negative amount) always went bankrupt, whereas scores above 2.99 represented health firms. Firms with Z scores were sometimes misclassified, so this represented an area of gray. On the basis of these cut-offs, Altaman suggests that one can predict whether a company is likely to go bankrupt in the near future or not.

According to Harris and Raviv (1990) and Ofek (1991), default will cause a positive relation between leverage and many other operational actions which lead to a firms increase in value. The types of leverage are as follows;

(i) High leveraged firms

According to Jensen (1989), highly-levered firms will respond faster to a decline in firm's value than the less-leveraged firms, because a small decline in value can easily result to a default in the repayment of the debt and hence get into bankruptcy status.

(ii) Low leveraged firms

If a firm is low-leveraged, it is less likely to respond to short-term operational distress. Of course, default of servicing the hard contracts will occur if losses continue moving the firm's value below the pre-distress level. This will be another issue that this study sought to establish.

The logic implies that a highly levered firm is more likely to restructure its operations and its financial claims quickly, in order to preserve its going-concern value. This is one of the issues that this study attempted to establish whether financial distress is due to internal and external shocks.

It is also indicated that a positive relation exists between leverage and actions that generate short-term cash flow [Jensen (1989) and Stulz (1990)]. This means that the debt service obligations will cause the poorly performing firms to sell assets and divest operations.

Firms that experience poor performance respond either operationally through carrying out changes in top management [Gilson (1989)] or by changing the organizational strategy and structure [Wruck (1990)]. Others act on their debt, by restructuring it or by filing bankruptcy proceedings for themselves [Gilson et al (1990)].

Typical responses to short period or poor performance include asset restructuring, employee layoffs and management replacement [John et al (1992)]. There are several ways of taking leverage-based actions as detailed below. The company can take general and specific methods of handling financial leverage.

2.2.2 General methods

A company can take the following general methods of coping with financial distress

a) Changing the top management

Firms experiencing poor performance may respond operationally, by making changes in top management [Gilson(1989)]. This is with the hope that if they inject new managerial skills, the new team would employ new strategies to turn around the company.

b) Changes in organizational strategy and structure

Companies will change their strategies and their organization structures in order to respond to a looming financial distress [Wruck (1990)]. This is a sign of a financial distress.

2.2.3 Management of financial distress by restructuring assets

The hard assets could, either wholly or partially, be liquidated to generate additional liquid assets in order to enable the firm to meet the current obligations. It should be noted that, premature liquidations of hard assets lead to the destruction of the firms going concern value. If this option is used to contain financial distress, the value lost due to the premature liquidation of assets represents the cost of managing financial distress.

The integrated model of assets and debt restructuring according to John and Vasudevan (1992) examines how the cost of asset sales, the current liquidity position of the firm and the option value of its equity determine the choice between a private workout (with or without some asset sales) and filing for bankruptcy proceedings. They found that, when the combined costs of assets liquidations are high, the firm will prefer to seek bankruptcy and hence seek new financing under debtor-in-possession financing, which has a priority over existing debt. They also found that:

- i) Successful completion of debt workouts should result to increased stock prices and increased firm value.
- ii) Asset sales by distressed firms to make debt payments have a favourable effect on stock price.

(a) Asset restructuring

A lot of evidence has been presented on the firms that can be able to use asset restructuring as a way of managing financial distress as detailed by Brown et al (1991). The researchers present that asset sale are frequently used by financially distressed firms. Firms, which sell assets, are distinguished by multiple division or multiple subsidiary operations. Conversely, most firms, which do not sell assets, operate only a single division.

It has also been found that the announcement of asset sales elicits insignificant abnormal stock returns; but the announcement of avoidance of bankruptcy by firms leads to positive results to such firms. According to Lang et al (1994), and Stulz (1994) the abnormal return is higher for sellers who use the proceeds from assets sales to retire the firms debts.

One way of dealing with financial distress is to restructure the asset side of the balance sheet to raise enough money to meet the requirement of the “hard” contracts. This is done either in piecemeal or in their entirety. The selling could also be done privately or through court-process either during bankruptcy reorganization or under liquidation process. Each of the alternatives has different costs attached to them and whether asset restructuring is actually used as a solution to financial distress depends on its costs relative to those of financial restructuring [John and John (1992)].

According to Shliefer and Vishny (1992), the price received in a distress sale may have large liquidity discounts if the entire industry is in a downturn. In an illiquid

secondary market, the cost of assets restructuring are likely to be high and financial restructuring therefore offers a better way of dealing with financial distress.

(b) Raising additional current assets using cashflow

It's the process of raising additional current liquidity by issuing new financial claims against future cash flows generated by assets. This enables avoidance or reduction of premature liquidation of assets.

Although the original "hard" contract is left unaltered, the structure of financing claims is altered by the new financing undertaken. If the new claims issued have a softer contract or longer maturity, the new package of financing claims are less onerous on the firm than before and hence resolves financial distress.

2.2.4 Management by restructuring the debts

Companies can cope with financial distress by restructuring the financial obligations as follows:

a) Dividend cuts

A company could change the amount of total annual regular dividend paid and reduce it in order to respond to financial distress [Warner (1990)].

b) Debt restructuring

Companies could also take financial actions aimed at restructuring their debts, so that the debt covenants are softened in their favour. Besides, if the situation is found to be very severe, such companies could file for bankruptcy in order to secure for themselves a court protection. [Gilson et al (1990)].

Debt restructuring is the process whereby an existing debt contract is renegotiated and replaced by a new contract with:

- (i) A lower interest or principal repayments

- (ii) Period of maturity extended
- (iii) Placement of equity securities with creditors

Private debt restructuring occurs when informal re-organization of Corporate Financial Structure is done via debt restructuring and private workouts used to “soften” the hard contracts which caused the firms to experience financial distress. The firm may reduce or defer payment on its debt contracts or replace debt with soft securities, which have residual rather than fixed payoffs.

According to Haugen and Senbet (1978) capital Markets mechanisms can be used to deal with hard contracts and replace them with a “softer” mix. They indicate that it is cheaper to use these “private” mechanisms

c) Employee lay offs

This is also a common action for short-term period of poor financial performance. The employees are laid off and once the company improve performance, it may go ahead and re-hire more employees to match its new work pressure requirements [John et al (1992)].

2.2.5 Future Action

After the companies have coped with financial distress, they can use the following actions in future,

a) Retained earning

The company can retain some of the profit earned, rather than declaring dividends to shareholders. This will be held as reserve.

b) Proforma financial statement

These are projected future ratios. The comparison of current or past ratios with the future ratios shows the firm’s relative strengths and weaknesses in

the past and in the future. If future ratios indicate weak financial positions, corrective action should be initiated.

2.3 Critical review of major issues

The following are the impediments of the response actions:

- i) Managerial holdings
- ii) Conflict among different groups of creditors
- iii) Holder problems
- iii) Informational asymmetries

2.3.1 Managerial holdings

Managerial holdings refer to shares of the firm's equity held by the management.

According to Jensen (1989), where as leverage is highly related to a firm's response to trouble, managerial holdings also appear to play a role. He argues that the larger the share of the firms equity held by management, the lower the probability of such a firm taking operational actions which do not generate cash inflow, such as replacing management, laying off employees, and discontinuing operations.

Jensen and Meckling (1976), found that the market for corporate control, which disciplines and replaces inferior managers, had less effect on firms with large managerial holdings. It is difficult to sack poorly performing managers in such firms and to discipline them as they grant themselves exorbitant salaries and other benefits which reduce the value of the firm.

Jensen and Meckling (1976), explain that "free" cash flow may lead managers to pursue projects with negative Net Present Value (NPV) projects. Stulz (1990), assumes that managers value investments because their perquisites increase with investments, whether they have positive or negative Net Present Values (NPV). The argument implies that entrenched managers are likely to avoid actions that reduce the

firm's investment such as changes that reduce assets, employees or market share under management control.

2.3.2 Coalitions and conflicts

If a firm has a complex capital structure, where there are several groups of claimants of different classes, the issue of conflict of interest arises. This may lead to distortions in investments (such as under investment, over investment and excessive continuation or liquidations) Bulow and Shoven (1989).

2.3.3 Information asymmetry

Corporate insiders and management know more about the firm than outside investors. Therefore, creditors are not in a position to evaluate new package being proposed in a workout. They believe that the debtor management may misrepresent the value of the firm and therefore, they may reject mutually beneficial private restructuring for a court-imposed proposal; regardless of the attendant deadweight costs. According to Brown et al (1993), on the other hand shows that where there is a symmetric information setting, equilibrium always results to a successful private workout.

2.3.4 Holder problems

This is encountered when a firm's debt is held by a large number of different creditors. Therefore, achieving an agreement among creditors outside the formal bankruptcy process is difficult, especially if some of the debt is held by private and public persons.

A unanimous consent is required of every bondholder to change the maturity, principal or coupon rate for interest in the bond or debenture. Where the debt is held by public entities, most often, an exchange offer is pursued, where bondholders take the option to exchange their old bonds for a package of new securities with an objective of swapping existing "hard" contract for a "softer" mix.

Since participation is optional, individual bondholders choose to “hold out” in the expectation that their bonds would be more valuable in the stock exchange less distressed firms, than the new package of securities. Since all bondholders have similar incentives, assuming that they don’t collude, the exchange offer is then likely to fail.

The items of the new packages of securities are usually set to coerce participation, since the corporation aims at implementing a successful exchange offer, which is accompanied by modification of the covenants of the original bonds. The change or elimination of existing debt covenant is done through voting by tendering bondholders. Once majority votes are obtained in favour of the change, then the modification is approved.

The consent of solicitation is designed in such a way that those who opt for the exchange securities gain more than those who choose to stick to the old bonds. It has been noted that when bondholders act each on their own, that is the best time to use coercive solicitations, but otherwise, bond prices may increase if bondholders collude and act coherently in the face of coercive consent solicitations Kahan and Tuckman (1993).

2.4 Conceptual framework

This describes what the research means by the concept. The dependent variables are first identified, defined, followed by major independent and the test variables.

There are two main ways in which a firm experiencing a looming financial distress may react in order to save itself.

- i) Formal approach
- ii) Informal approach

2.4.1 Formal response to financial distress

Through this approach, a company will take deliberate actions of operational nature or financial nature in order to change its poor performance trend. The operational actions include; making changes in top management, changes in organizational strategy and structures or by taking financial actions such as debt restructuring, dividends cuts and bankruptcy filings. Other actions could be asset restructuring and employee lay offs [Ofek (1992)].

2.4.2 Informal response actions

The distressed company can choose not to take any action but continue with its operations as usual.

The creditors' debts will go unserviced and therefore such creditors will take court actions either for specific damages or where it was not explicitly provided for in the contractual terms and conditions, for appropriate damages. If the Company is not able to pay the damages as adjudged by the court, then the creditors will move in and file for "Involuntary winding up". In this case, the company is assumed to have taken an informal action by not taking any concrete step to contain financial distress.

The above can be summarized by the figure below:

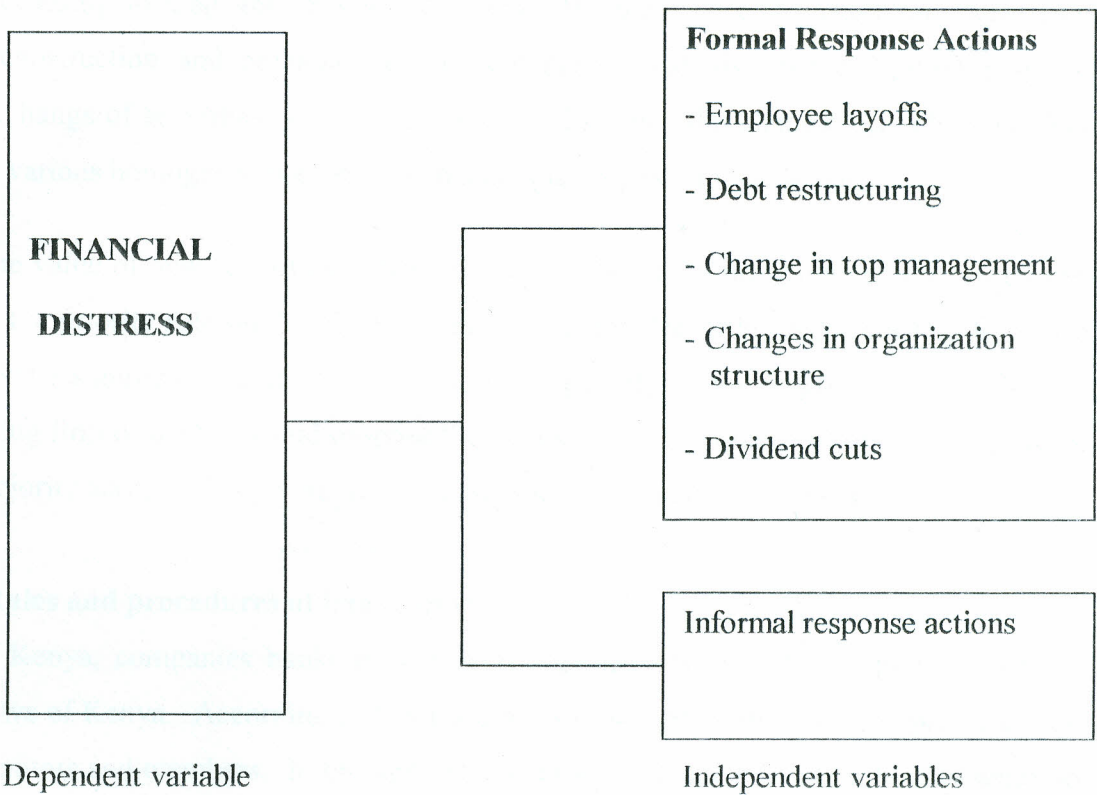


Figure 2.1: Conceptual framework.

Source: Researcher

The mathematical formula is as follows:

$$Y = \alpha_0 + \alpha_1 x_1 + \alpha_2 x_2 + \alpha_3 x_3 + \alpha_4 x_4 \dots \alpha_n e.$$

Where:

Y = Dependent variable

α = Constant coefficient

x = Independent variable

e = Error rate

2.4.3 Financial distress and the laws of Kenya (Cap 486)

According to Cap 486, Section 209 and 210, there is a provision for facilitating reconstruction and amalgamation of companies and also reorganization plan on exchange of securities is formally agreed on in which the plan clusters claim holders in various homogeneous classes with a unique proposal for each class.

The value of new securities distributed to any class is in principle determined by use of the priority rule on the claims against the firm. Nevertheless, according to Weiss (1990) significant deviations from absolute priority occur in practice. Usually, the filing firm or debtor would propose the firm's plan. Acceptance of the plan requires a majority acceptance by vote by the claim holders in each affected class.

2.4.4 Rules and procedures of bankruptcy

In Kenya, companies bankruptcy proceedings are governed by chapter 486 of the Laws of Kenya. According to this Law, a distressed company may compromise with creditors and members. In the same statute procedures are set out on how to wind-up the company.

2.4.5 Corporate default and debt restructuring

To avoid default of servicing its debt, a firm must restructure the terms of its debt contracts. The firm may either file for bankruptcy or attempt to renegotiate with its creditors privately.

The result could be a relief to the firm if the creditors consent to exchange their impaired claims to new shares in the firm or when the debt contracts are modified [John and Vasuderan (1992)]. According to this the survey, if the firm finds that there are legal and institutional constraints of bankruptcy process, then they would prefer an out of court settlement.

2.4.6 Creditors filing for bankruptcy

Filing for bankruptcy is not always the exclusive right of stockholder. Creditors may file an “Involuntary” Petition, as long as they can explicitly show a case of the firm having been delinquent in making payments on its debt.

2.4.7 Determinants of choice of bankruptcy and private renegotiations

- (a) Stockholders and creditors collectively benefit from settling out of court because private renegotiations generates lower costs than bankruptcy. Under this lower cost alternative, the resulting value of the firm is higher and each claimant would end in a better position. However, this lower cost alternative would be adopted only if claimants can agree on how to share the cost savings, therefore, such, private settings fail occasionally.
- (b) If individual creditors have stronger incentive to obtain more favourable treatment under the debt-restructuring plan.

John and Vasudaven (1992), found that financially distressed firms successfully restructured their debt outside of the U.S. Chapter 11. Financial distress was found to be more likely to be resolved through private renegotiations when more of the firm’s assets were intangible, and if relatively more debt was owed to banks. Out of the study, it was also found that cumulative stock returns were significantly higher when debt was restructured privately and therefore on average, stockholders would prefer it to bankruptcy.

2.4.8 Court intervention

Occasionally, deadlocks arise and the court is called upon to intervene. However, according to John & Vasudaran (1992) the deadlocks are rare, because it is in the joint interest of all classes to avoid it, as applications of fair and equitable standard requires the court to determine the firms liquidation value and going concern value in a special hearing. The hearings are considered extremely time- consuming.

2.4.9 Liquidation

According to Section 234 of Cap 486 of Laws of Kenya, the court is granted powers to appoint a liquidator or liquidators to liquidate a company after a winding up petition has been determined. Once the petition is before the court, the court may also appoint a receiver before the case is determined so that a liquidator is appointed as indicated above. The same law stipulates how the liquidation is supposed to be done. Liquidation is the last resort after all other remedial actions have failed to revert a company into a good performance after financial distress sets in. Indeed, liquidation brings to an end the life of a company.

2.5 Summary

Although studies had been carried out on companies' response to financial distress in other countries, no such a study had been carried out in Kenya to date. Nevertheless, the response actions taken by companies in other countries when financially distressed as detailed in the literature review, in our view are good corrective measures. We think similar actions to have been taken by companies in Kenya, which experienced financial distress.

Altogether, with globalization, some of the companies may not have been able to turn themselves round even when they took the corrective actions, because of the immense competition which set in the country in the late nineties.

The findings of this research will be useful in giving guidelines on the actions taken by the Kenyan quoted companies that have been financially distressed and to what extent these response actions were successful.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This chapter describes the methodology used in the study, that is, data collection, the sample and sampling technology, research instruments as well as data collection.

3.1 Research Design

This research was conducted on a cross-section of companies quoted in the Nairobi Nairobi Stock Exchange (Appendix VI). This is because the item has advantages of isolation and homogeneity which are disadvantages of longitudinal.

3.2 Target Population

All the companies listed in the Nairobi Stock Exchange (NSE) during the period of study, constituted the population, from which the samples were based. It should be noted that a number of the listed companies fluctuated between 54 to 48 over the years due to delistings and currently the number is 48. Data were collected on the number listed through the period under review.

3.3 Sampling Design

A sample is a number of items, which are selected from the population and examined from where the inferences about the whole population can be drawn. The study used cluster sampling. This involves selection of an intact group. The groups on the clusters were randomly selected and not individuals or cases. It is assumed that clusters were similar in characteristics, where the clusters are similar to a very high degree, validity is said to exist. It also involves less time and it's convenient.

Probability sampling was used where 16 companies were taken as samples, out of these 13 companies, 5 respondents were selected each from the quoted company

which gives the total items, examined to be equal to 80. This gives a sampling error of 05 % and the resulting confidence level was 95%.

3.4 Data collection procedures and instruments

The researcher adopted two main sources mainly:

- i) The secondary data
- ii) The primary data

The secondary data were collected from the Nairobi Stock Exchange (NSE) handbooks on companies performance for the year 1995 to 1999, Newspaper cuttings, journals and magazines. The respective companies annual statements and reports were thoroughly scrutinized for evidence of financial distress and response actions taken by each such as:

- Employees layoffs
- Change of top management
- Asset restructuring
- Dividend cuts
- Debts restructuring

The primary data were collected through observation and communication methods. The researcher used participant observer method. This is where the researcher observed the procedures as they were being carried out.

The communication method used the questionnaire as the instrument of collecting the data. The questionnaire contained both the structured or closed-ended and unstructured or open-ended set of questions, which the respondents were required to answer (appendix II). The questionnaire was self administered. The combining of the observation and communication methods ensures the validity of the data.

3.5 Data analysis

The financial statements were scrutinized for evidence that any of the actions, was taken. In the presence of evidence, the action was scored positively. The data collected were presented in a distribution table indicating the number of accuracies.

Based on Return on Assets (ROA), all companies listed in the stock exchange were ranked according to their performance. 1995 is the first year to be considered and was regarded as the base year (T) . Then companies were ranked according to the performance in year 1996 (T + 1). Companies that appear to have performed well in 1995 but declined in 1996 in terms of ROA ranking were picked as items for the study. The response actions they took in 1997 (T + 2) and 1998 (T + 3) were analyzed with regard to their characteristics. The above process was repeated for the years 1996, 1997, 1998 and 1999 each being held as the base year at a time.

Only companies that experienced poor performance and rapid decline in value were selected for the sample and the sampling procedure was random. The decline is defined as a drop in Return on Assets (ROA) from the top 40 percentile in the base year to the bottom 40 percentile in the distress year.

To avoid including companies in the study that did not react to the distress, the study was restricted to reactions within the two years after the financial distress set in, [i.e. (T + 2) and (T + 3)]. This made it possible to select companies with one year of poor performance to ensure identification of responses to short-term distress, making it possible to evaluate the speed at which the companies reacted to a decline in value.

In addition, using a shorter period of poor performance avoids bringing in to the sample companies that became highly leveraged and financially distressed due to the

continuing poor performance to which such companies did not do something about. The companies were analyzed according to the following

3.5.1 Size of the companies

Under this classification, the data were summarized on the basis of large, medium and small companies. The sizes of the companies were determined on the basis of market capitalization computed as an average of the two years of response actions [i.e. (T + 2) and (T + 3)].

3.5.2 Leverage of the company.

Companies' actions were recorded on the basis of level of leverage at the end of each base year. Companies were divided into three classifications of either highly (65%), moderately (45 - 65%) and lowly leveraged (45% and below).

3.5.3 Data by sector

Data were collected and recorded on the basis of the sector the distressed companies operated in.

3.5.4 Companies that turned themselves round

Data were also collected on the companies that turned themselves round to establish whether they took similar response actions.

Qualitative methods such as giving an insightful description of the response obtained in the data collection. The descriptions objectively relay the information contained in the quantitative analysis. This implies that the quantitative and the qualitative methods of data analysis are complementary.

The data were edited to ensure accuracy, uniformity, consistency and completeness.

The data collected were analyzed using quantitative and qualitative techniques such as averages, percentages, graphs and pie charts. Then a computer package SPSS version for data analysis was used. This established reliability coefficient, frequency distribution of value, descriptive statistics and Pearson Correlation Matrix.

3.6 Expected output

We expected most of the response actions to have been effective in assisting the companies to cope with financial distress.

CHAPTER FOUR

DATA ANALYSIS AND INTERPRETATION

4.0 Introduction

This chapter gives a systematic and comprehensive analysis of the data collected during the study. The study's major concern was to survey the response actions (Independent Variables) influence financial distress (Dependent Variable). An attempt, is therefore made to tie the interpretation to the research question that guided this study, as specified in section 1.5.

A total of 80 questionnaires were administered to 16 quoted companies, which experienced financial distress during the period between 1995 – 1999. However, the total questionnaires collected were 65 representing 81.3% return rate.

4.1 Descriptive results

Sixteen companies listed in the Nairobi Stock Exchange were found to have been financially stressed in one year or another in the period between 1995 and 1999.

One of the companies, Dunlop Kenya Ltd, was delisted from the list of quoted companies in the year 1998 and therefore, this reduced the number of companies to be 15.

The main response action taken by companies to cope with financial distress were as follows:

- i. Employee layoff
- ii. Change of top management
- iii. Assets restructuring
- iv. Dividend cut
- v. Debt restructuring

The above findings were consistent with the findings on studies carried out by Gilson (1989), Wruck (1990), Gilson et al (1990), Warner (1990) and John et al (1992).

Table 1: Frequency of response actions taken by financially distressed companies

| Response Action | Frequency | Percent |
|--------------------------|------------------|----------------|
| Employee lay off | 9 | 60% |
| Change of top management | 12 | 80% |
| Assets restructuring | 15 | 100% |
| Dividend cut | 4 | 27% |
| Debt restructuring | 13 | 86% |

Source: Own data analysis

This table shows the frequency of actions taken by 15 companies and each of the response actions. The most popular response action was asset restructuring which was taken by 100% of the companies, followed by debt restructuring 86%, change in top management 80%, employee lay off 60% and the least popular was dividend cut with 27%.

4.2 Findings based on the size of the company

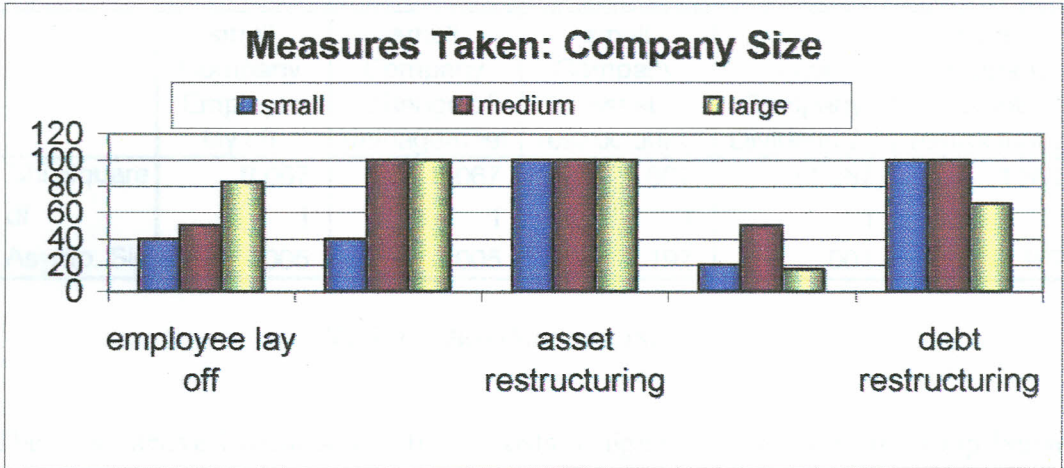
Table 2: Summary of response action based on market capitalization

| Company size by market capitalization | Company Name | Response action taken | | | | |
|---|----------------------|-----------------------|----------------------------------|--------------------------|-----------------|-------------------------|
| | | Employee Layoff | Change of top man- agement | Asset rest- ructuring | Dividend cut | Debt Re- structuring |
| Below Ksh 0.5 bn (Small companies) | Eaagards Ltd | 0 | 0 | 1 | 1 | 1 |
| | A Bauman & Co Ltd. | 1 | 1 | 1 | 0 | 1 |
| | E.A. Packaging Ltd | 1 | 0 | 1 | 0 | 1 |
| | Standard Newspaper | 0 | 1 | 1 | 0 | 1 |
| | Crown Berger Ltd | 0 | 0 | 1 | 0 | 1 |
| Ksh.0.5-1.0bn (Medium) | E.A. Portland Cement | 0 | 1 | 1 | 0 | 1 |
| | Kenya National Mills | 1 | 1 | 1 | 1 | 1 |
| | George Williamson | 0 | 1 | 1 | 0 | 1 |
| | Sasini | 1 | 1 | 1 | 1 | 1 |
| Over Ksh 1.0bn (Large) | Unga Group Ltd | 1 | 1 | 1 | 1 | 1 |
| | Lonroh Motors Ltd | 1 | 1 | 1 | 0 | 1 |
| | Bamburi Cement Ltd | 1 | 1 | 1 | 0 | 1 |
| | E.A. Breweries Ltd | 1 | 1 | 1 | 0 | 0 |
| | KPLC Ltd | 1 | 1 | 1 | 0 | 0 |
| | Kakuzi | 0 | 1 | 1 | 0 | 1 |

Source: Own data analysis

The above table shows the action taken by 15 companies in their respective capitalization levels.

Chart 1: Response Action Taken vs. Company Size



Source: Own data analysis

Analysis by size

Small companies: 40% of the laid off staff, 40% changed their top management, 100% restructured the assets, 20% cut dividends and 100% restructured the debts.

Medium sized Companies: 45% laid off staff, 100% changed top management, 100% restructured the assets, 60% cut dividend and 100% restructured the debts.

Large Companies: 82% laid off employees, while 20% cut dividend. Those that changed top management and restructured assets were 100% in each category. 65% restructured the debts.

Chi square Test

Testing at 95% significance level.

Table 2(i): small companies**Test Statistics**

| | small Company :Employee lay off | small Company :Change of managemnet | small Company :Asset restructuring | small Company :Dividend cut | small Company :Debt restructuring |
|-------------|--|--|---|-----------------------------------|--|
| Chi-Square | 8.067 | 8.067 | 1.667 | 11.267 | 1.667 |
| df | 1 | 1 | 1 | 1 | 1 |
| Asymp. Sig. | .005 | .005 | .197 | .001 | .197 |

Source: Own data analysis

The table above indicates that there exists a highly significant relationship between employee layoff, change of top management, dividend cut and small companies. But there is no relationship between asset restructuring and debt restructuring in the small companies.

Table 2(ii): medium companies**Test Statistics**

| | medium Company :Employee lay off | medium Company :Change of managemnet | medium Company :Asset restructuring | medium Company :Dividend cut | mediumCo mpany :Debt restructuring |
|-------------|---|---|--|------------------------------------|--|
| Chi-Square | 8.067 | 3.267 | 3.267 | 8.067 | 3.267 |
| df | 1 | 1 | 1 | 1 | 1 |
| Asymp. Sig. | .005 | .071 | .071 | .005 | .071 |

Source: Own data analysis

There exists a relationship between employee layoff, dividend cut and medium size companies ($\chi^2 \leq 5\%$). But there is no relationship between change of top management, asset restructuring and debt restructuring.

Table 2(iii): large companies

Test Statistics

| | large Company :Employee lay off | large Company :Change of managemnet | large Company :Asset restructuring | large Company :Dividend cut | large Company :Debt restructuring |
|-------------|---------------------------------|-------------------------------------|------------------------------------|-----------------------------|-----------------------------------|
| Chi-Square | 1.667 | .600 | .600 | 11.267 | 3.267 |
| df | 1 | 1 | 1 | 1 | 1 |
| Asymp. Sig. | .197 | .439 | .439 | .001 | .071 |

Source: Own data analysis

The table above indicates a significant relationship between large companies and dividend cut. There is however no significant relationship between employee lay-off, change of top management, asset and debt restructuring.

4.3 Response Action vs. Leverage

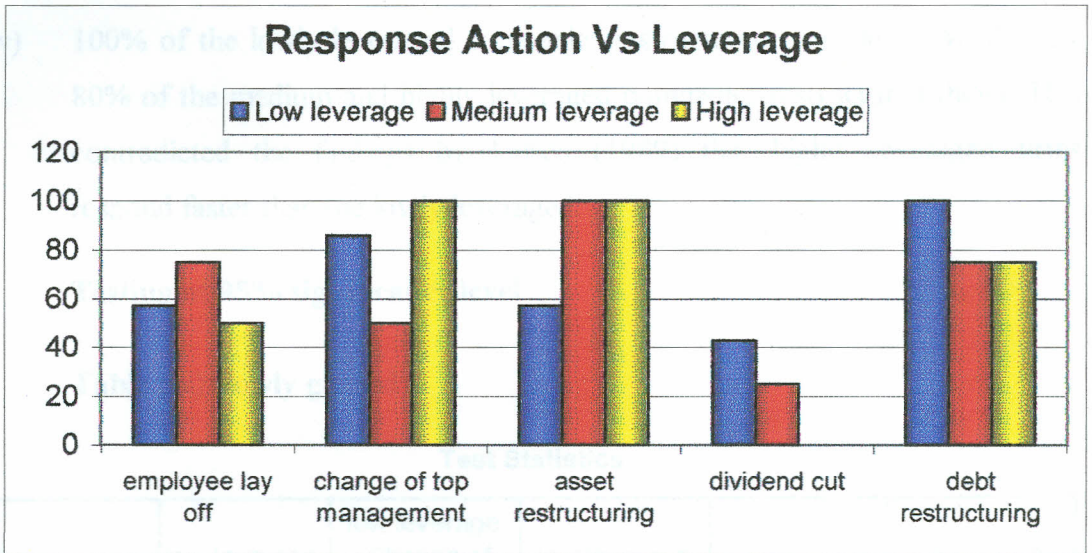
Table 3: Summary response action based on leverage

| Company size Leverage | Company Name | Response action taken | | | | |
|------------------------------|--------------------|-----------------------|--------------------------|---------------------|--------------|--------------------|
| | | Employee Lay off | Change of top management | Asset restructuring | Dividend cut | Debt Restructuring |
| Below 45% (Low geared) | Unga Group Ltd | 1 | 1 | 1 | 1 | 1 |
| | Eaagards Ltd | 0 | 0 | 1 | 1 | 1 |
| | A Bauman & Co Ltd. | 1 | 1 | 1 | 0 | 1 |
| | Bamburi Cement Ltd | 1 | 1 | 1 | 0 | 1 |
| | Kakuzi | 0 | 1 | 1 | 0 | 1 |
| | George Williamson | 0 | 1 | 1 | 0 | 1 |
| | Sasini | 1 | 1 | 1 | 1 | 1 |

| | | | | | | |
|------------------------------|----------------------|---|---|---|---|---|
| 45%-65% (Medium geared) | Kenya National Mills | 1 | 1 | 1 | 1 | 1 |
| | E.A. Packaging Ltd | 0 | 0 | 1 | 0 | 1 |
| | Crown Berger Ltd | 1 | 1 | 1 | 0 | 0 |
| | E.A. Breweries Ltd | | | | | |
| | | | | | | |
| Over 65% (highly geared) | Lonroh Motors Ltd | 1 | 1 | 1 | 0 | 1 |
| | KPLC Ltd | 1 | 1 | 1 | 0 | 0 |
| | E.A. Portland Cement | 0 | 1 | 1 | 0 | 1 |
| | Standard Newspaper | 0 | 1 | 1 | 0 | 1 |
| | | | | | | |

Source: Own data analysis

Chart 2: Response Action vs. Leverage



Source: Own data analysis

- (i) Based on leverage, 57% of the low-geared companies laid off their staff, while 75% of those with medium gearing took the same action. Only 50% of the highly geared companies laid off their staff. These findings are not fully

consistent with the findings by Harris & Raviv (1990) and Ofek (1991), which show that companies with the highest leverage reacted faster in order to save them from impending bankruptcies.

- (ii) It was found that, 85% of the low geared companies changed their top management while 50% of the medium leveraged companies took the same action, as 100% of the high the highly geared did the same. This is in line with Harris & Raviv (1990) and Ofek (1991) that highly geared companies react faster.
- (iii) For companies with low gearing, 45% reduce dividends paid while 25% of the companies with medium gearing reducing theirs. None of the highly geared companies reduce dividend paid to their shareholders. This contradicts the findings by Smith and Warner (1979) that leverage is positively and significantly related with the probability of dividend cuts.
- (iv) 100% of the lowly leveraged companies restructured their debts. While only 80% of the medium and highly leveraged companies restructured theirs. This contradicted the findings by Jensen (1989) that highly leveraged firms respond faster than the lowly leveraged.

Testing at 95% significance level

Table 3(i): lowly geared

Test Statistics

| | low leverage :Employee lay off | low leverage :Change of top managemnet | low leverage :Asset restructuring | low leverage :Dividend cut | low leverage :Debt restructuring |
|-------------|--------------------------------------|---|---|-------------------------------|--|
| Chi-Square | 3.267 | .600 | 3.267 | 5.400 | .067 |
| df | 1 | 1 | 1 | 1 | 1 |
| Asymp. Sig. | .071 | .439 | .071 | .020 | .796 |

Source: Own data analysis

The table above illustrates that there exists a highly significant relationship between dividend cut and low leveraged companies. There was however no significant relationship between employee lay offs, change in top management, asset and debt restructuring with low leverage.

Table 3(ii): Medium geared

Test Statistics

| | medium leverage :Employee lay off | medium leverage: Change of top managemnet | medium leverage :Asset restructuring | mediumlever age :Dividend cut | medium leverage :Debt restructuring |
|-------------|-----------------------------------|---|--------------------------------------|-------------------------------|-------------------------------------|
| Chi-Square | 5.400 | 8.067 | 3.267 | 11.267 | 5.400 |
| df | 1 | 1 | 1 | 1 | 1 |
| Asymp. Sig. | .020 | .005 | .071 | .001 | .020 |

Source: Own data analysis

It is observable from the table above that employee layoff, change in top management, dividend cut and debt restructuring are all significantly related to medium leveraged companies while asset restructuring is not.

Table 3(iii): Highly geared

Test Statistics

| | high leverage :Employee lay off | high leverage :Change of top managemnet | high leverage :Asset restructuring | high leverage :Debt restructuring |
|-------------|---------------------------------|---|------------------------------------|-----------------------------------|
| Chi-Square | 8.067 | 3.267 | 3.267 | 5.400 |
| df | 1 | 1 | 1 | 1 |
| Asymp. Sig. | .005 | .071 | .071 | .020 |

Source: Own data analysis

There exists a highly significant relationship between employee layoff and high leveraged companies, same as debt restructuring. There is however no significant relationship between such companies and assets restructuring or change of top management.

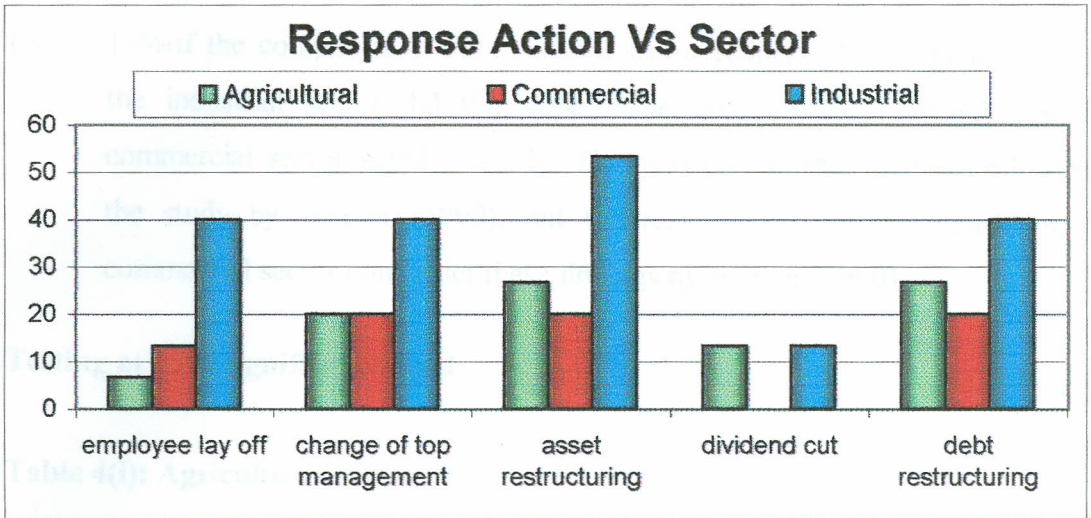
4.4 Response Action Based on Sector

Table 4: Summary of response based on sector

| Sector | Company Name | Response action taken | | | | |
|---------------------|----------------------|-----------------------|--------------------------|---------------------|--------------|--------------------|
| | | Employee Layoff | Change of top management | Asset restructuring | Dividend cut | Debt Restructuring |
| Agricultural sector | Eaagards Ltd | 0 | 0 | 1 | 1 | 1 |
| | Kakuzi | 0 | 1 | 1 | 0 | 1 |
| | George Williamson | 0 | 1 | 1 | 0 | 1 |
| | Sasini | 1 | 1 | 1 | 1 | 1 |
| Commercial Sector | A Bauman & Co Ltd. | 1 | 1 | 1 | 0 | 1 |
| | Lonroh Motors Ltd | 1 | 1 | 1 | 0 | 1 |
| | Standard Newspaper | 0 | 1 | 1 | 0 | 1 |
| Industrial sector | Unga Group Ltd | 1 | 1 | 1 | 1 | 1 |
| | Kenya National Mills | 1 | 1 | 1 | 1 | 1 |
| | E.A. Packaging Ltd | 1 | 0 | 1 | 0 | 1 |
| | Bamburi Cement Ltd | 1 | 1 | 1 | 0 | 1 |
| | Crown Berger Ltd | 0 | 0 | 1 | 0 | 1 |
| | E.A. Breweries Ltd | 1 | 1 | 1 | 0 | 0 |
| | KPLC Ltd | 1 | 1 | 1 | 0 | 0 |
| | E.A. Portland Cement | 0 | 1 | 1 | 0 | 1 |

Source: Own data analysis

Chart 3



Source: Own data analysis

- (i) 25% of the companies in the agricultural sector and 20% of commercial sector restructured their debts while only 40% of those in the industrial sector took this action. The action taken by the companies are in line with the findings by Gilson et al (1990), that companies take financial actions so that they can obtain softer debt covenants in their favour to cope with financial distress.
- (ii) In the agricultural sector, only 15% of the companies laid off staff, while 18% of the companies in the commercial and 40% in the industrial sectors responded similarly. The actions taken are in line with the findings by John et al (1992) that financially distressed companies lay off staff but if the situation improves, they may re-hire more in order to get adequate capacity to meet its manpower demands. This action is conforming to the findings by Gilson et al (1989).

- (iii) 20% of companies in the agricultural sector and commercial sectors changed their top management while 40% in the industrial sector did.
- (iv) 15% of the companies in the industrial sector reduced dividends and 15% in the industrial sector did the same while none of the companies in the commercial sector acted similarly. This partly conforms to the results from the study by Warner (1990), but the reactions by the companies in the commercial sector contradict these findings by Warner (1990).

Testing at 95% significance level

Table 4(i): Agricultural Sector

Test Statistics

| | agricultural :Employee lay off | agricultural :Change of top managemnet | agricultural :Asset restructuring | agricultural :Dividend cut | agricultural :Debt restructuring |
|-------------|--------------------------------------|--|---|-------------------------------|--|
| Chi-Square | 11.267 | 5.400 | 3.267 | 8.067 | 3.267 |
| df | 1 | 1 | 1 | 1 | 1 |
| Asymp. Sig. | .001 | .020 | .071 | .005 | .071 |

Source: Own data analysis

The table above indicates that there is a highly significant relationship between employee lay off, change of top management and dividend cut with the agricultural sector. However, there is no relationship between assets and debt restructuring with the sector.

Table 4(ii): Commercial Sector**Test Statistics**

| | commercial :Employee lay off | commercial :Change of top managemnet | commercial :Asset restructuring | commercial: Debt restructuring |
|-------------|------------------------------------|--|---------------------------------------|--------------------------------------|
| Chi-Square | 8.067 | 5.400 | 5.400 | 5.400 |
| df | 1 | 1 | 1 | 1 |
| Asymp. Sig. | .005 | .020 | .020 | .020 |

Source: Own data analysis

As evidenced by the table above there exists a highly significant relationship between the commercial sector and the response actions, though there was no reduction in dividend.

Table 4(iii): Industrial Sector**Test Statistics**

| | industrial :Employee lay off | Industrial :Change of top managemnet | industrial :Asset restructuring | industrial :Dividend cut | industrial:Deb t restructuring |
|-------------|------------------------------------|--|---------------------------------------|-----------------------------|-----------------------------------|
| Chi-Square | .600 | .600 | .067 | 8.067 | .600 |
| df | 1 | 1 | 1 | 1 | 1 |
| Asymp. Sig. | .439 | .439 | .796 | .005 | .439 |

Source: Own data analysis

It can be seen that only dividend cut is significantly related with the industrial sector companies. The rest: employee lay off, change of top management, asset and debt restructuring are not.

4.4 Hypothesis testing using the outcomes on the Chi-square computations under the various company characteristics

Table 5

| | Response action taken | | | | |
|----------------------------|-----------------------|-------------------|---------------------|--------------|--------------------|
| | Employee Layoff | Change of top mgt | Asset Restructuring | Dividend Cut | Debt restructuring |
| Size of Company | | | | | |
| Below Ksh0.5 bn | 0.005 A | 0.005 A | 0.197 R | 0.001 A | 0.197 R |
| Between Ksh 0.5-1.0 bn | 0.005 A | 0.071 R | 0.071 R | 0.005 A | 0.071 R |
| Above Ksh1.0 bn | 0.197 R | 0.439 R | 0.439 R | 0.001 A | 0.071 R |
| Leverage of company | | | | | |
| Less than 45% | 0.071 R | 0.439 R | 0.071 R | 0.020 A | 0.796 R |
| 45%- 65% | 0.020 A | 0.005 A | 0.071 R | 0.001 A | 0.020 A |
| Over 65% | 0.005 A | 0.071 R | 0.071 R | | 0.020 A |
| Sector | | | | | |
| Agricultural | 0.001 A | 0.020 A | 0.071 R | 0.005 A | 0.071 R |
| Commercial | 0.005 A | 0.020 A | 0.020 A | | 0.020 A |
| Industrial | 0.439 R | 0.439 R | 0.796 R | 0.005 A | 0.439 R |

Source: Own data analysis

The hypothesis that “the response actions taken by quoted companies in the Nairobi Stock Exchange to cope up with financial distress were successful irrespective of characteristics such as the size of the company, leverage and the sector of the company”.

From the above summary of computation outcomes, it can be seen that the response action taken by quoted companies to cope with financial distress were successful in respect to characteristics such as size of the company, leverage and the company sector. Therefore, the hypothesis is rejected.

The hypothesis that “the response actions taken by quoted companies in the Nairobi Stock Exchange to cope up with financial distress were successful irrespective of characteristics such as the size of the company, leverage and the sector of the company”.

From the above summary of computation outcomes, it can be seen that the response action taken by quoted companies to cope with financial distress were successful in respect to characteristics such as size of the company, leverage and the company sector. Therefore, the hypothesis is rejected.

CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

5.0 Introduction

This chapter represents conclusions and recommendations derived from the findings of the study

5.1 Conclusions

The study was aimed at surveying the response actions used by quoted companies to cope with financial distress. Based on the results of the survey, it was found that:

All the companies that experienced financial distress took one action or another to respond to financial distress. The financially distressed companies responded by either one or a combination of actions of laying off staff, replacing top management, restructuring their assets, reducing dividends and restructuring their debts.

The analysis of the primary data shows that 100% of the companies studied restructured their assets, 75% carried out debt restructuring while 80% changed their top management. 60% of the companies laid off employees while only 25% reduced dividends paid.

Restructuring of assets was the most popular response action taken. This was done through either disposing all or part of the existing fixed assets and or acquiring new ones. This action could be seen to have been aiming at reducing operational costs, increasing efficiency, acquiring new technology and new methods of production so that the companies' performance could be improved.

The next most popular response actions were debt restructuring and change of top management. Employee layoff was fairly popular and was taken by 60% of the companies.

The least frequent response action taken by the companies was the dividend cut. Companies reacted differently on this particular aspect. Some of them increased dividends, which is viewed as unconventional under circumstances of financial distress.

The companies with the highest market capitalization, highest leverage and those in the industrial sector show a X^2 of around 4.00 which is generally higher than the X^2 computed under the other characteristic situations. This is an indication that these three characteristics could be tending to determine the response actions that the companies took compared to the rest of the other characteristics. But it is not consistent, especially when the small and the large companies exhibit this outcome whereas the medium companies do not.

Whereas there is no clear consistency on the response actions taken by the companies that were able to record the best improvements in their Return On Assets (ROA), one of the companies, George Williamson, which is among the companies that improved well, was noted to have taken some unique actions such as recruiting more staff at a time when it ought to have taken a conventional action of laying off staff. It is also noted that this company increased dividends at this critical time. The Eaagards company did not also take the conventional action of laying off staff and changing top management, just like Crown Berger which took no other action except asset restructuring.

5.2 Recommendations for Further Research

The following are some of the recommendations and suggestions: Whereas financially distressed companies should take conventional response actions in order to improve their performance, it is important that such companies should take into consideration their individual characteristics.

There is need to carry out further study separating labour intensive from the capital labour intensive companies in order to establish whether the action of laying of staff is uniformly taken or whether some companies will prefer to restructure their assets instead of laying of staff.

Another study could be done on the change of top management with an objective of establishing whether major shareholders who have substantial voting powers, who therefore, cannot be removed from the Board by minority shareholders, accepted on their own volition to quit their Boards when the company got into financial distress.

Further study can be carried out on other response actions which can be used to cope with financial distress such as issue of new shares to improve the financial liquidity of the company.

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1. Which of the following best describes your company?

| | Strongly disagree | Disagree | Neutral | Agree | Strongly agree |
|----------------------------|-------------------|----------|---------|-------|----------------|
| Dividend out | 1 | 2 | 3 | 4 | 5 |
| Employee layoff | 1 | 2 | 3 | 4 | 5 |
| Asset restructuring | 1 | 2 | 3 | 4 | 5 |
| Debt restructuring | 1 | 2 | 3 | 4 | 5 |
| Change of top management | 1 | 2 | 3 | 4 | 5 |
| Fail or miss or they apply | 1 | 2 | 3 | 4 | 5 |

2. What is the leverage of your company?

| | Strongly disagree | Disagree | Neutral | Agree | Strongly agree |
|--------|-------------------|----------|---------|-------|----------------|
| Low | 1 | 2 | 3 | 4 | 5 |
| Medium | 1 | 2 | 3 | 4 | 5 |
| High | 1 | 2 | 3 | 4 | 5 |

APPENDIX I

THIS QUESTIONNAIRE IS IN PARTIAL FULFILLMENT FOR A MASTERS OF BUSINESS ADMINISTRATION OF KENYATTA UNIVERSITY.

This questionnaire is in partial fulfillment for a Masters of Business Administration of Kenyatta University.

You have been selected by Kenyatta University to participate in the research on effective strategies used to cope with financial distress in companies quoted in the Nairobi Stock exchange. The question ask about the business and yourself. This will help people to better understand their work. Your company has been chosen as a part of the small sample. All what is required is to tick the questions in the questionnaire and this will take about 20 minutes of your busy schedule.

1. In what category is your business in the stock exchange

| | | | |
|--------------|---|---|---|
| Agricultural | 1 | 2 | 3 |
| Commercial | 1 | 2 | 3 |
| Industrial | 1 | 2 | 3 |

2. Did your company experience financial distress during the period 1995-1999?

| | | |
|----------|---|---|
| Agree | 1 | 2 |
| Disagree | 1 | 2 |

3. Which of the following response actions were undertaken during the period 1995-1999 financial years?

| | Strongly Disagree | Disagree | Agree | Strongly agree |
|--------------------------|----------------------|----------|-------|-------------------|
| Dividend cut | 1 | 2 | 3 | 4 |
| Employees layoff | 1 | 2 | 3 | 4 |
| Asset restructuring | 1 | 2 | 3 | 4 |
| Debt restructuring | 1 | 2 | 3 | 4 |
| Change of top management | 1 | 2 | 3 | 4 |

Tick as many as they apply

4. What is the leverage of your company

| | Strongly Disagree | Disagree | Agree | Strongly agree |
|--------|----------------------|----------|-------|-------------------|
| Low | 1 | 2 | 3 | 4 |
| Medium | 1 | 2 | 3 | 4 |
| High | 1 | 2 | 3 | 4 |

Tick as many as they apply

5. How many years did response actions take to succeed?

1. 1 yr 2. 2 – 3 yrs 3. 3 – 4 yrs
4. Above 5 yrs

6. For how many years have you been in the company?

1. Less than 10 2. 10 -30 3. 30- 50
4. Above 50

7. What is the number of your employees?

1. Less than 500 2. 500-1000 3. Above 1, 000

8. What is the total amount of your assets in shillings

1. Less than 500 million 2. 500m – 1 billion 3. Above 1 billion

9. What is your level of education?

1. Certificate 2. Diploma 3. Degree
4. Degree and above

10. What is your age in years?

1. below 30 2. 30 – 35 3. 35 – 40
4. 40 and above

11. The question does not embrace all the questions, not comprehensive and therefore you may not have been afforded the opportunity to say all about your work and yourself. Please below make any other recommendations.

.....

.....

.....

APPENDIX II

Pre-Contact Letter

Dear respondent

I am an MBA student in the institute of open learning Kenyatta University. I am carrying out a research on financial distress experienced by companies quoted in the stock exchange during the period between 1995 to 1999.

The purpose of this questionnaire is to gather the response action taken by these companies. Since you are an active player at the stock exchange, you are in a position of providing the researcher with the necessary data for the study. You have been selected as one of the respondents in this study. The information supplied will be treated confidentiality and will be used strictly for academic purposes only.

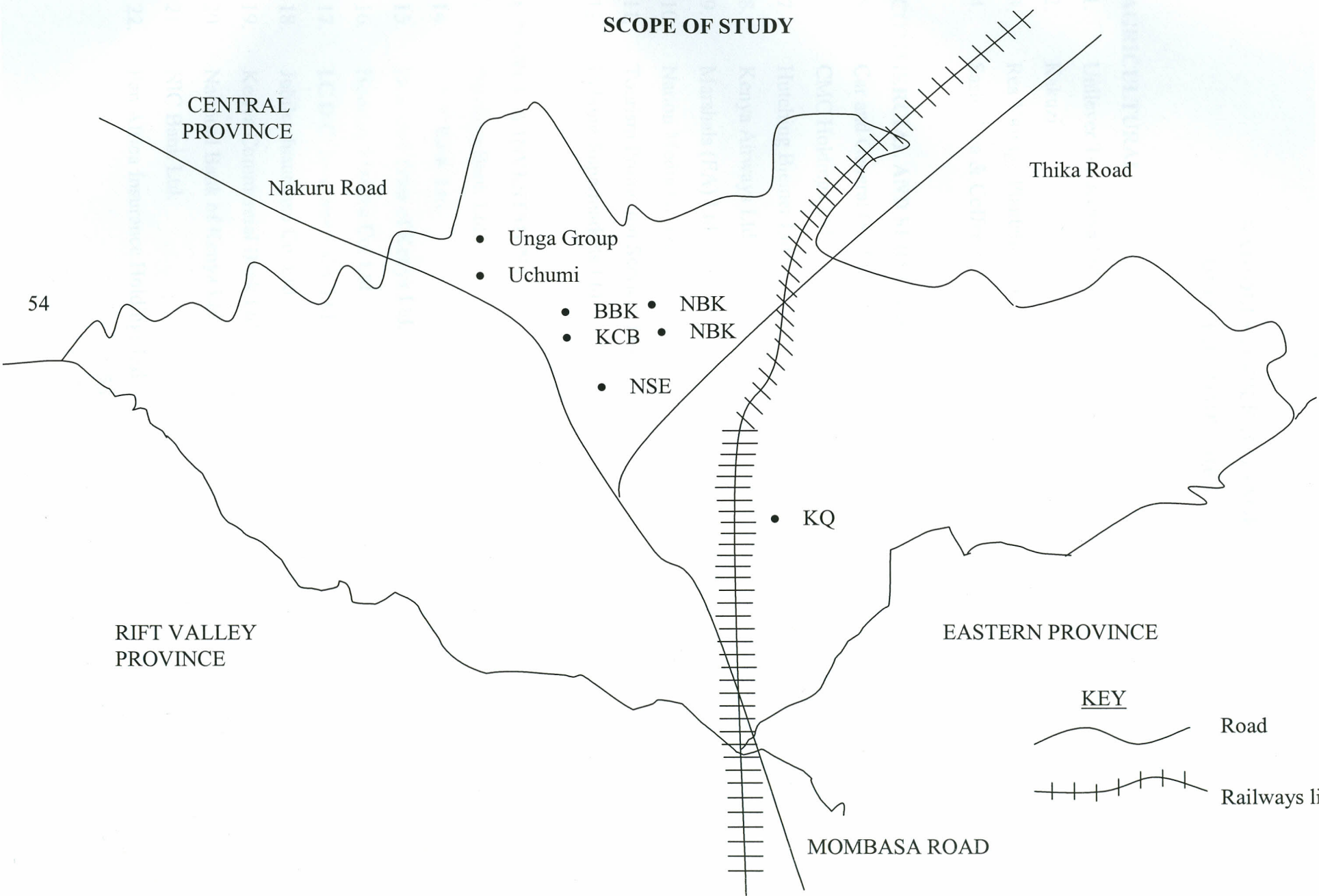
Your co-operation will be highly appreciated.

Thank you in advance.


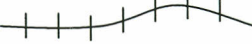
Yours researcher.

MAC MWIRIGI M. JOHN

APPENDIX III
NAIROBI PROVINCE
SCOPE OF STUDY



KEY

-  Road
-  Railways li

MOMBASA ROAD

NAIROBI STOCK EXCHANGE
QUOTED COMPANIES

AGRICULTURAL

1. Unilever Tea Kenya Ltd.
2. Kakuzi
3. Rea Vipingo Plantation Ltd.
4. Sasini Tea & Coffee Ltd.

COMMERCIAL AND SERVICES

5. Car and General (K) Ltd.
6. CMC Holdings Ltd.
7. Hutching Biemer Ltd
8. Kenya Airways Ltd.
9. Marshals (EA) Ltd.
10. Nation Media Group
11. Tourism Promotion Services Ltd.
12. Uchumi Supermarkets Ltd.

FINANCE & INVESTMENT

13. Barclays Bank Ltd.
14. C.F.C Bank Ltd.
15. Diamond Trust of Kenya Ltd.
16. Housing Finance Co. Ltd.
17. I.C.D.C. Investment Co. Ltd.
18. Jubilee Insurance Co. Ltd.
19. Kenya Commercial Bank Ltd.
20. National Bank of Kenya Ltd.
21. NIC Bank Ltd.
22. Pan Africa Insurance Holdings Ltd.

23. Standard Chartered Bank Ltd.

INDUSTRIAL AND ALLIED

24. Athi River Mining
25. BOC Kenya Ltd.
26. Bamburi Cement Ltd.
27. British American Tobacco Kenya Ltd.
28. Carbacid Investments Ltd.
29. Crown Berger Ltd.
30. Olympia Capital Holdings Ltd.
31. E.A. Cables Ltd.
32. E.A. Portland Cement Ltd.
33. East African Breweries Ltd.
34. Sameer Africa Ltd.
35. Kenya Oil Co. Ltd.
36. Mumias Sugar Co. Ltd.
37. Kenya Power & Lighting Co. Ltd.
38. Total Kenya Ltd.
39. Unga Group Ltd.

ALTERNATIVE MARKET SEGMENT

40. A. Baumann & Co. Ltd.
41. City Trust Ltd.
42. Eaagads Ltd.
43. Express Kenya Ltd.
44. Williamson Tea Kenya Ltd.
45. Kapchorua Tea Co. Ltd.
46. Kenya Orchards Ltd.
47. Limuru Tea Co. Ltd.
48. Standard Group Ltd.