DOES FINANCING POLICY DECISION INFLUENCE FIRM PERFORMANCE A KENYAN PERSPECTIVE

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Abstract

The relationship between financing policy and firm performance in Kenya needs to be studied. There is need to establish finance management decision influences the corporate performance of listed companies in Kenya. Using correlation research design, the study sought to investigate the relationship between financing policy and firm performance among listed companies in 2009 to 2013. Specifically the study sought to establish the relationship between leverage and firm performance among listed companies in NSE. To determine the relationship between working capital policy and firm performance among listed companies in NSE. To find out the relationship between dividend policy and firm performance among listed companies in NSE. To establish the relationship between investment policy and firm performance among listed companies in NSE. The target population of this study was all the 64 listed companies in Kenya. The study was based on secondary data which was collected from the published annual reports for listed companies spanning five years (2009-2013). Both Microsoft excel and E views 8 will be used to analyse the data. Descriptive statistics such as mean, median and standard deviation will be used to summarize the data. Inferential statistics such correlation analysis will be used to test the strength of the relationship between financing policies and firm performance while regression analysis will be used to test the nature of the relationship between financing policies and firm performance.

Key words: firm performance, Dividend, Investment, Leverage.

1.0 Introduction

A corporate finance organization is mostly concerned with profit and wealth maximisation. In order to increase an organization profit there are key financial policies which the finance manager must deliberate on. The four key policies which a finance manager is mostly involved on are capital structure or leverage decision, working capital decision, investment decision and dividend decisions. These decisions will have individual or collective influence on shareholders wealth as well as companies profit. Corporate organization firm performance is influenced by several factors among them leverage decision due to debt covenants, dividend decision which can determine the

retained earnings which influence future company's growth, investment decision which will determine whether investors wealth increases or decreases as well as working capital decisions which will determine the foregone benefits associated with particular amount held in current assets such as work in progress.

Loof and Heshmati (2008) investigated the relationship between investment decision and financial performance among Swedish companies. Results of the study showed a positive significant relationship between investment decision and firm performance. Grazzi, Jacoby and Treibich (2013) analysed the dynamics of investment and firm performance. Comparative evidence from manufacturing industries; in France and Italy. Results of the study showed a positive relationship between investment decision and firm performance. Ayaydin and Karaaslan (2014) found a positive relationship between investment decision and firm performance. Uwuigwe, Jafari and Ajayi (2012) investigated the relationship between dividend payout and firm performance a Nigerian case, results of the study showed a positive significant between dividend payout ratio and firm performance. Ajanthan (2013) showed that dividend payout ratio have a significant positive influence on profitability of companies listed in Tourism and hospitality. Iavorskyi (2013) investigated the impact of capital structure: evidence from Ukraine, results of the study showed a negative significant relationship between leverage and firm performance. Ali (2014) showed a negative significant impact on leverage and firm performance among non-financial firms listed in Nairobi Securities Exchange. Coricelli *et al,* (2011) showed a negative significant relationship between optimal leverage and firm performance.

According to Block and Hirt (2000) working capital is the management of current assets and liabilities; since they change instantaneously wise decisions should be made on how much should be spent on current assets such as inventory as such to minimize opportunity cost associated with them. Block and Hirt argued that working capital decisions have implications on whether a firm can position it in effective strategies which influences the attainment of their long term goals. Past studies on the relationship between working capital and firm performance for example Waithaka (2012) showed a negative significant relationship between average credit collection period and firm performance among firm listed in Agricultural segment in NSE. Lingesia and Nalini (2013) showed a negative significant relationship between inventories, debtors and firm performance among manufacturing companies listed in Sri Lanka. Vural, Sokmen and Cetenak (2012) showed that the shortening of the credit collection period had a positive significant relationship with firm performance. Moreover, the study showed a positive significant relationship between cash collection period and firm performance among the companies listed in Turkey.

1.2 Statement of the Problem

There are always competing needs in an organization despite the limited resources being exposed to finance manager. In a corporate organization the finance manager has four key policies which are financing decisions, investment decision, dividend decision and working capital management decision. As a result of the limited resources the finance manager must make decision which will lead to organization positive growth. Emphasis have been made on the need to spend at least 60% of finance managers time on working capital management since holding excessive amount of current assets and few current liabilities may expose an organization to low returns due to opportunity costs foregone on resources held in current assets. There are different sources of finance

which will have different cost attachment, the finance manager should choice between aggressive versus conservative financing policy. The choice of mix between debt and equity capital are associated with cost, the choice of debt will lead to cost savings due to interest tax shield benefits and consequently decrease the overall cost of capital which increases the chances of accepting projects with positive net present value and consequently increase shareholders wealth.

Although several past studies have evaluated the relationship between independent finance policies and firm performance. There has been a consistent result showing the influence of each finance decision (Waithaka, 2012; Uigwe *et al*., 2012; Treibich, 2012) whereby investment decision and pay-out ratio has positive significant relationship with firm performance while working management and leverage has inverse relationship with firm performance. The current study seeks to find the relationship between financing policy and firm performance. The current study will consider companies listed in Nairobi Securities Exchange for a period of five years, most of them have used ordinary least squares method to evaluate the relationship though the data was panel. The current study seeks to investigate the relationship using panel data regression analysis and fill this gap.

1.3 Objectives of the Study

The main purpose of the study is to investigate the relationship between financing policy and firm performance among companies listed in Nairobi Securities Exchange. Specifically the study will be guided by the following objectives:

i. To establish the relationship between leverage and firm performance among listed companies in NSE

ii. To determine the relationship between working capital decisions and firm performance among listed companies in NSE

iii. To find out the relationship between dividend decisions and firm performance among listed companies in NSE

iv. To establish the relationship between investment decisions and firm performance among listed companies in NSE

2.0 Review of Literature

This section analyses literature related to the determinants of financial policies. The main source of literature is past studies and a detailed study of the four objectives which include: to establish the relationship between leverage and firm performance, to determine the relationship between working capital decision and firm performance, to find out the relationship between dividend decision and firm performance and to establish the relationship between investment decisions and firm performance. Moreover, the chapter will have theoretical review, conceptual framework, research gaps and summary of reviewed literature.

2.1 Theoretical Framework

2.1.1 Agency Theory

The agency theory is based on the relationship between the principal (owners) and the agent (managers). The separation of ownership from management in modern corporations provides the context for the function of the agency theory. Modern organizations have widely dispersed ownership, in the form of shareholders, who are not normally involved in the management of their companies. In these instances an agent is appointed to manage the daily operations of the company. This distinction between ownership and control creates the potential for conflict of interests between agents and principals, which result in costs associated with resolving these conflicts (Jensen & Meckling, 1976). The most important basis of agency theory is that the managers are usually motivated by their own personal gains and work to exploit their own personal interests rather than considering shareholders' interests and maximizing shareholder value. For example, managers may be attracted to buying lavish offices, company cars and other extravagant items, since the cost is borne by the owners. Thus, the key predicament indicated by agency theory is ensuring that managers pursue the interests of shareholders and not only their own interests. The theory is appropriate for the study since if the management are more motivated by their personal gains then there will be little amount which will be spent on profitable investment since the higher the amount spent to motivate the management the higher the expenses and consequently the amount of profit available to the shareholders will be limited.

2.1.2 Risk Return Trade off Theory

The concept of risk and return trade off assumes that there is exists an efficient and no riskless profit that can be earned. Most investors are motivated by the anticipated return from all investments which they engage in but they should be ready to meet the cost which will minimize the level of return, (Krantz and Zhnag, 2013). For example the ordinary shareholders are always motivated by the future dividend and capital gains they will receive from their current investment. The theory is appropriate for the study since the management ought to make investment decision which will be motivate the anticipated returns they expect. All investment decision are exposed to different risk levels and the management can be composed of different with varying levels of risk attitude; risk averse, risk neutral and risk seekers. Therefore, if the management is composed of risk seekers then there are high chances of good return and vice versa.

2.2 Conceptual Framework

A conceptual framework is a diagrammatic representation of the study variables showing their relationship. In the current study the dependent variable will be return on assets and the independent variables will be leverage as measured by the ratio of long-debt to total assets, working capital decision which will be measured as the difference between current assets minus current liabilities, dividend decision will be measured by the total amount of dividend paid and investment decision will be measured by amount incurred on capital projects within the same period.

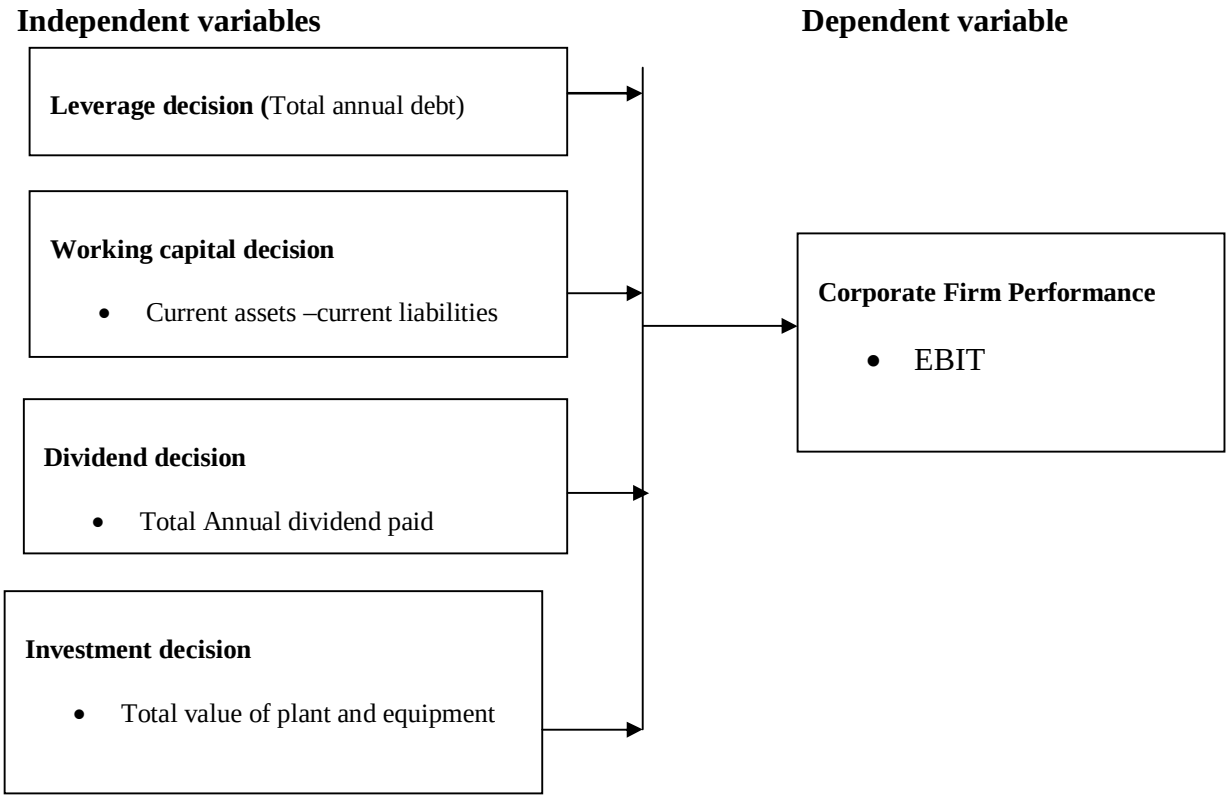

Figure 2.1 Conceptual Framework

2.3 Empirical Review

2.3.1 Leverage Decision and Firm Performance

Hasan *et al.,* (2014) investigated the influence of capital structure on firm performance using four firm performance measures which were return on assets, return on equity, earnings per share and Tobin's Q, while capital structure was measured using three ratio which were short term debt ratio, long term debt ratio and total debt ratio. Purposive sampling was used to select 36 firms which were listed in Dhaka securities exchange on condition that there were actively trading in 2007 to 2012. Panel pooled regression analysis was applied to analyse the data. Results of the study found a positive and significant relationship between short term debt and EPS and negative significant relationship between long term debt and EPS. Moreover, there was a negative significant relationship between ROA and capital structure in contrast there was no significant relationship between both ROE and Tobin's and capital structure. The choice of purposive sampling technique was appropriate since the study elaborated the inclusion criteria as being limited to only those firms listed and actively trading. Pooled panel regression analysis was the most appropriate analysis method since the data was panel because the 36 firms were observed for a five year period. Akeem *et al.,* (2014) investigated the effects of capital structure on firm performance among Nigerian

manufacturing companies. The sample was drawn for a period in 2003 to 2012. Firm performance was measured using ROI and ROA. Capital structure was measured as ratio of total debt to total assets, long term debt to total assets and debt to equity ratio. The study applied pooled, fixed and random effects regression analysis though Hausman test results were not reported. The study found that there was a negative but significant relationship between total debt ratio and ROI while both DE and long term debt ratio had negative but insignificant relationship with ROI. Moreover, the study showed negative insignificant relationship between total debt ratios to ROA, in contrast there was a positive significant relationship between DE and ROA but long term debt ratio had a positive insignificant relationship with ROA. The choice of pooled, fixed or random effects regression analysis was appropriate since the data was panel in nature. Ogobe, Orinya and Kemi (2013) investigated the impact of both macroeconomic indicators and capital structure on firm performance using fixed effects panel regression analysis. Results of the study found a significant negative relationship and ROI among listed firms in 2000 to 2010. The results were in support of the traditional capital structure theory. From the findings the study recommended that firms should be financed more using equity capital as such to minimize the leverage risks. Soumadi and Hayajneh (2008) revealed a negative significant relationship between financial leverage and ROE as well as with Tobin's Q using Ordinary Least Squares (OLS) regression analysis with a sample of 76 firms for the period 2001 to 2006 listed in Jordanian securities exchange. Since the data was panel in nature OLS was not the appropriate regression analysis method since the study did not consider both cross sectional and time effects thus the most appropriate method would have been pooled, fixed or random effects regression model upon testing their appropriateness using Hausman test. Umar *et al,* (2012) investigated the impact of capital structure on firm performance in Pakistan. The study used purposive sampling to draw top 100 performing companies within four years between 2006 and 2009. Exponential regression analysis was used to test the impact. The study found a negative but significant relationship between capital structure as measured by short term debt ratio, long term debt ratio and total debt ratio with firm performance as measured by EBIT, ROA, EPS and net profit margin. Moreover, there was a negative significant relationship between short term debt ratio, long term debt ratio with price earnings ratio and a negative but insignificant relationship between total debt ratio with firm performance. Mwangi, Makau and Kosimbei (2014) investigated the relationship between capital structure and firm performance among non-financial firms listed in NSE. A census approach was applied to select 42 firms which had been actively trading in 2006 to 2012. Radom effects regression analysis was applied. Results of the study showed a negative but significant relationship between capital structure and firm performance as measured by ROE and ROA.

2.3.2 Working Capital and Firm Performance

Mousavi and Jari (2012) investigated the relationship between working capital and firm performance among companies listed in Iran. A sample of 56 companies trading in 2003-2007 was purposively drawn. Both correlation and OLS regression analysis were applied. The study found a positive significant relationship between net working capital and firm performance as measured using ROE, ROA and market value to book value. The choice of OLS was not appropriate since the data was panel in nature thus the most appropriate model would have been pooled, fixed or random effects upon testing their appropriateness using Hausman test. Vural, Sokmen and Cetenak (2012) tested the effects of working capital management on firm performance among firms listed in

Turkey. A sample of 75 manufacturing trading in 2002-2009 was purposively selected. Dynamic panel regression analysis was used to analyse the data. The study found an inverse significant relationship between cash conversion cycle and accounts receivable collection period. Thoa and Uyen (2014) tested the relationship between working capital management and firm performance among firms listed in both Ho Chi City securities exchange and Hanoi securities exchange in 2006 to 2012. Purposive sampling was used to select a sample of 208 firms which had homogeneous accounting cycle, had no missing data and were actively trading in the seven years under investigation. Both generalised least squares and fixed effects model were applied to analyse the panel data. The study found a negative but significant relationship between cash conversion cycle, inventory conversion period, receivables conversion period, payable conversion period and gross profit. Both purposive sampling and panel data analysis method were appropriate. Ebenezer and Asiedu (2013) investigated the relationship between working capital management and firm performance among firms listed in Ghana. Secondary data was collected from annual financial statements of manufacturing firms for a period of 2007 to 2011. Data was analysed using OLS. Results of the study showed that there was a negative insignificant relationship between both accounts payable periods and inventory period and firm performance. Moreover, there was a positive but insignificant relationship between cash conversion cycle and firm performance. The choice of OLS was not appropriate since the data was panel in nature. Lingesiya and Nalin (2012) analysed the effect of working capital management on manufacturing firm performance in Malaysia. Secondary was collected for a period of 2006-2010 for 30 listed manufacturing firms. Pooled panel regression analysis was applied to analyse the data. Results of the study showed an inverse significant relationship between both inventories and accounts payables with firm performance. The choice of panel data regression analysis was appropriate since the data was panel in nature.

2.3.3 Dividend Decision and Firm Performance

Murekefu and Ouma (2013) used regression analysis to examine the relationship between dividend payout and firm's performance among selected companies in Kenya. They found out that dividend payout has a strong and significant impact on firms' profitability and concluded that dividend payout was a major factor affecting firm's performance. Moreover, Similarly, Murekefu and Ouma identified positive relationship between current dividend payout and future earnings growth. Azeez and Latifat (2013) used OLS to investigate the relationship between dividend policies and firm performance among oil companies. Oil companies were selected purposively and secondary was retrieved from annual financial statements for the period covering 1999 to 2013. Results of the study showed a positive significant between dividend policy and firm performance. From the findings it was concluded that dividend policy is a critical factor on firm performance. The choice of OLS was not appropriate since the data was panel thus both time and cross sectional ought to have been considered. Uwuigbe, Jafaru and Ajayi (2012) applied regression and correlation analysis to correlation analysis to examine the relationship between dividend policies and firm performance among Nigerian listed companies in 2006 -2010. Judgemental sampling was used to select 50 high performing firms in Nigeria. The selection criteria was availability of the data, firms asset size and market capitalization. Results of the study showed a positive significant relationship between dividend policy and profitability. Moreover, there was a significant positive relationship between both firm size and ownership structure and dividend policies. The choice of OLS was not

appropriate since the data was panel thus both time series and cross sectional effects ought to have been considered thus the most appropriate model ought to have been pooled, fixed or random effects. Salehnezhad (2013) used fuzzy regression analysis to study the relationship between firm performance and dividend policy among listed firms in Iran. Results of the study found that there is a positive and significant relationship between dividend policy and firm performance. In contrast there was a negative but significant between economic value added and firm performance. Similarly, there was a significant positive effect for controlling the firm size in relation to the dividend policy. Ajanthan (2013) used regression and correlation analysis to examine the relationship between dividend payout and profitability among listed hotels and restaurants in Sri Lanka. Results of the study found that there is a positive significant relationship between dividend payout and firm performance. From the findings it was concluded that finance managers ought to pay attention and devote adequate time on dividend policies decision. Velnampy, Nimalthasan and Kalaiarasi (2014) applied regression and correlation analysis to examine the relationship between dividend policies and firm performance among manufacturing companies listed in Colombo securities exchange in 2008-2012. The study found that both dividend payout ratio and earning per share have positive but insignificant relationship with firm performance. The choice of OLS was not appropriate since the data had both time series and cross sectional effects thus the most appropriate model would have been pooled, random or fixed effects regression model upon applying Hausman test to test the most appropriate model.

2.3.4 Investment Decision and Firm Performance

Grazzi, Jacoby and Treibich (2013) argued that though there is a significant relationship between investment policies and economic growth. There are mixed findings on its relationship with specific firm performance. Grazzi *et al.,* carried out a comparative analysis to investigate the relationship between dynamic investment and firm performance in France and Italy. Results of the study showed an inverse relationship between branch expansion and firm performance though it associated with increased sales and employment. Maherani, Ranjbar and Fathi (2014) used OLS and correlation analysis to investigate the relationship between earning quality, firm performance, and investment decision among companies listed in Tehran stock exchange. Systematic sampling was used to select 63 companies actively trading in 2002-2010. The inclusion criteria was that: " Fiscal year should end in March, fiscal year may not be changed during the period under study, the firm should not be among investment firms or banks, the information should be available during the period under study and the firm should be profitable during the study period". Results of the study showed a positive significant relationship between investment decision and earnings quality. The choice of OLS was not appropriate since the data was panel in nature thus the study ought to have used pooled, fixed or random effects regression model.

2.6 Research Gaps

In summary firms should evaluate their financing policies fully to ensure that they reap the maximum benefits at the least possible cost. There are different sources of financing which are either internal or externally generated funds. These sources have associated costs which must be borne by firm and consequently affect its performance. There is documented empirical evidence of the influence of each independent financing policy though none of the study has considered them

collectively within NSE. For companies to benefit fully from the financing policies it must consider the cost benefit analysis and mix the policies in the most effective way.

Conclusively, the forgoing literature has exhaustively reviewed issues associated with the relationship between financing policies and firm performance. This chapter tried to review some scholars' general overview of the relationship between financing policies and firm performance on both public and private firms in the whole world but very little information has been explained in relation to NSE. The chapter helped to show case the drawbacks associated with the choice of data analysis methods in different studies owing to panel data type. Several theories have been discussed in relation to financing policies the theories posits that financing policies have significant or no significant influence on firm performance.

3.0 Research Methodology

3.1 Research Design

A research design is a step by step systematic approach showing how the study objectives will be achieved (Kothari, 2011). In the current study we will use correlation design which is important when the study seeks to find out the causal relationship between the dependent and independent variables (Kothari, 2011). The design was appropriate since similar studies such as (Githira & Nasieku, 2015; Tarus & Omandi, 2013) used the same design where the former sought to investigate the determinants of capital structure in East Africa securities exchange while the later sought to examine Kenyan case of corporate governance among listed companies.

3.2 Sampling Procedure and Sample Size

According to Kothari (2007) sampling procedure is the process followed to select a subset from the total population. In the current study judgemental sampling will be used those companies which are listed and actively trading in the past five years in 2009-2013, the firm ought not to be listed in banking or insurance segment owing to their balance sheet structure, the firm ought not to have been suspended or delisted in the past five years and the firm should have data for the five years. The choice for five years was guided by past studies such as Velampy *et al.*, 2014, Uwuigbe *et al.*, 2012 and Githira & Nasieku, 2015 among others.

3.3 Data Collection Instruments

According to Kothari (2011) there is need for developing a data collection instrument which will assist in primarily meant to measure, quantify and measure the items under investigation. In the current study a document check index (DCI) will be used as a guide for data collection from the annual statement of listed companies in NSE. DCI had been previously applied by Tarus (2013) to collect secondary data among listed companies in East Africa the former and the later in NSE. The instrument will have five sections seeking to collecting information for every study variable.

3.4 Data Analysis

The current study seeks to investigate the relationship between financing policy and corporate performance among companies listed in NSE. The study will use both descriptive and inferential

statistics. Descriptive statistics will include both measures of central tendency such as mean and median and measurers of dispersion such as standard deviation, minimum and maximum. Inferential statistics will included both correlation to measure the strength of the relationship between dependent and independent variables and regression analysis to measure the nature of the relationship between dependent and independent variables. Normality test will tested using Jarque-Berra test and if the p value will be less than 0.05 then the data will not be normally distributed and thus data transformation such as logarithm transformation will be carried out. Since the data is panel in nature Hausman test will be used to test the most appropriate model among pooled, fixed or random effects will be used to show the relationship between dependent and independent variables.

Table 3.1 Measurement of Variables

	Variables	**Measures**
Y	Firm performance	Annual Net profit
X_1	Leverage decision	Total annual debt
X_2	Working capital decision	Current Asset-Current liabilities
X_3	Dividend decision	Total annual dividend paid
X_4	Investment decision	Net plant and equipment per annum

The study model will be of the form:

$$y_{i,t}=\alpha+\beta_1 x_{1i,t}+\beta_2 x_{2i,t}+\beta_3 x_{3i,t}+\beta_4 x_{4i,t}+\acute{\varepsilon}_{i,t}$$

y= firm performance, x_1= Leverage decision, x_2= Working capital decision, x_3= Dividend decision, x_4= Investment decision, $\acute{\varepsilon}_{i,t}$= error term.

4.0 Results and Interpretation

4.2 Descriptive Statistics

Results in Table 4.1, shows the descriptive statistics for the overall data set. Measures of central tendency; mean was used to summarise the data while standard deviation tested the degree of variation among the variables under investigation. Jarque-Berra test was used to test the normality of the data. The variables under investigation were normally distributed since there Jarque Berra test had a p value > 0.05. On average the firm performance averaged at Kshs 2352843 per annum, the firm leverage levels differed as accounted by standard deviation of 8.7E+07. All companies had differing financial needs which averaged at Kshs 22142362 per annum.

Table 4.1 Descriptive Statistics

	Firm performance	Leverage	Working capital	Dividend	Investment
Mean	2352843	35642680	18412900	701989	22142362
Std. Dev.	4628569	8.7E+07	4.6E+07	3E+07	4.7E+07
Skewness	2.28745	1.94542	2.22984	-0.7051	3.20246
Kurtosis	1.56976	2.27045	2.30591	5.82717	1.63803
Jarque-Bera	14.21	5.11401	7.72419	8.3414	7.65934
Probability	0.56	0.48	0.59	0.68	0.45

4.2.1 Correlation Analysis

Correlation analysis was carried out to examine the presence of multicollinearity and strength of the relationship between variables. The study findings showed negative significant relationship between firm performance and leverage (rho = -0.459, p value <0.05). This implies that an increase in leverage decreased listed company's firm's performance. Secondly, there was a positive significant relationship between working capital and firm performance among companies listed in NSE, (rho=0.491, P value <0.05). This implies that a unit increase in working capital increases firm performance by 49.1%. Thirdly, there was a positive significant relationship between annual dividend paid and firm performance among companies listed in NSE (rho=0.151, p value <0.05). This implies that a unit change in annual dividend paid increases firm performance. Finally, the study findings showed that there was a strong positive significant relationship between annual investment and firm performance among companies listed in NSE, (rho=0.501, P value < 0.05). A close scrutiny of the correlation analysis revealed that an increase in leverage influenced investment positively. Since the two variables had a correlation coefficient of 0.795, it implies that they were related and capital intensive projects were mostly financed using long terms or short term debt.

Table 4.2 Correlation Analysis

	Firm performance	Leverage	Working capital	Dividend	Investment
Firm performance	1				
Leverage	-.459**	1			
	0.000				
Working capital	.491**	.524**	1		
	0.000	0.000			
Dividend	.151**	0.083	0.087	1	
	0.022	0.21	0.188		
Investment	.501**	.795**	.156*	0.092	1
	0.000	0.000	0.018	0.164	

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

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

4.3.1 Diagnostic Test

In the current section the researcher reports panel data diagnostics tests. In this section the results for serial correlation, heteroskedasticity, Hausman test and time fixed effects tests were carried out. Breusch Pagan LM test was used to test the appropriate model between pooled effects regression and random effects regression model. Since the P value was less than 0.05, there was significant difference on firm performance among listed companies thus pooled effects regression modelling was not appropriate for the study

Table 4.3 Chi-Square values for the Breusch-Pagan LM Test

Model	Dependent variable	χ^2-value	p-value
1	Firm performance	25.58	.0000

Results in Table 4.4 shows the test results for time fixed effects. The findings showed no significant time effects thus, therefore it was not appropriate to fit a two way or introduce dummy variables in the panel regression models.

Table 4.4 Test Results for Time Fixed Effects

Model	Dependent variable	F- value	p-value
1	Firm performance	0.11	0.9791

Heteroskedasticity former was tested using modified Wald test while serial correlation was tested using Wooldridge Drukker test. Results in Table 4.5 revealed that there was no heteroskedasticity. Moreover, there was no evidence for serial correlation among the panels since the (p value > 0.05).

Table 4.5 Result for Heteroskedasticity and Serial Correlation tests

		Test for heteroskedasticity		Serial Correlation	
Model	**Dependent variable**	**χ^2-value**	**p-value**	**F-value**	**p-value**
1	Firm performance	4.45	0.1256	1.5896	0.415

The secondary data collected had both cross sectional and time series characteristics, through Breusch Pagan LM test showed pooled effects model was not appropriate for the study. Due to this the most appropriate model for the study was panel regression model which could either be random effects (RE) or fixed effects (FE). FE regression modelling is more appropriate when the study seeks to examine the effect of independent variables over time. More so the independent entity should be having a relationship with the independent variables. In contrast RE assumes that independent variables have no collinearity with independent entities. In addition, it assumes that there are random variations across the error terms and both independent variables and specific's entities are also treated as independent variables. Since the p value is less than 0.05 fixed effects(FE) regression model is more appropriate as shown in table 4.6.

Table 4.6 Hausman Test Results

Variables	**b (fe)**	**B (re)**	**b-B (difference)**	**SE**
Leverage	-.0282209	-.0281973	-.0000236	.0007491
Working capital	.0642383	.0642419	-3.64e-06	.000978
Dividend	.0097845	.0098644	-.0000799	.0013148
Investment	.0799171	.0798724	.0000447	.0013018
Chi square = 39.85, Prob > chi^2 =0.000				

After the Hausman test hypothesis testing was tested using fixed effects regression modelling as shown in Table 4.11. Regression analysis was used to test the study hypothesis as stated in chapter one. The within r-squared is 48.50% which means that 48.50% of the variations within the variables were explained by the model. The between r-squared is 87.13% which means that 87.13% of the variations between the variables were explained by the model. The overall R squared of 48.80%

shows that 48.80% of the changes in firm performance can be explained by leverage, working capital and investment decision jointly while the remaining percentage can be explained by other factors which were excluded in the model. The F statistics was used to test whether the model was significant and if at least one of the beta coefficient was non-zero, since the F statistics = 52.02 and p value was <0.05. Then firm performance was explained jointly by leverage, working capital, dividend and investment decision which were made within listed companies.

The first objective of the study stated that there was no significant relationship between leverage and firm performance. Results of the study indicated that there was a negative and significant relationship between firm performance and leverage (β=-0.0282209, p value <0.05). This implies that a unit increase in leverage decreased firm profitability by 2.822%.

Secondly the study hypothesised that there was no significant relationship between working capital and firm performance among the companies listed in Nairobi securities exchange. The study findings revealed that there was a positive and significant relationship between working capital and firm performance (β = 0.0642383, p value <0.05). This implies a unit increase in working capital management increase firm profitability by 6.423%.

Thirdly, the study hypothesised that there is no significant relationship between dividend policy and firm performance. The study revealed a positive and significant relationship between dividend policy and firm performance among the companies listed in NSE, (β= .0097845, p value <0.05).

The fourth hypothesis of the study stated that there was no significant relationship between investment decision and firm performance among the companies listed in Kenya. Results of the study showed a positive and significant relationship between investment decision and firm performance (β=.0799171, p value <0.05). Thus, a unit increase in investment decision increased company's financial performance.

Table 4.7 Fixed Effects Regression Effects on Firm Performance

Fixed-effects (within) regression		**Number of obs = 230**
Group variable: Company		Number of groups = 5
R-sq:	within = 0.4850	Obs per group: min = 46
	between = 0.8713	avg = 46.0
	overall = 0.4880	max = 46
		F(4,221) = 52.02
	corr(u_i, Xb) = 0.0031	Prob > F = 0.0000

Variable	Coefficient	Std. Err.	t	P>t	[95% Conf.	Interval]
Leverage	-.0282209	.005705	-4.95	0.000	-.0394641	-.0169776
Working capital	.0642383	.0066582	9.65	0.000	.0511166	.0773599
Dividend	.0097845	.0074977	2.31	0.00	-.0049916	.0245606
Investment	.0799171	.0090542	8.83	0.000	.0620736	.0977607
_cons	413211.5	262119.2	1.58	0.116	-103361.5	929784.5
sigma_u	164361.53					
sigma_e	3368044.4					
rho	.00237581					

5.0 SUMMARY CONCLUSION AND RECOMMENDATIONS

5.1 Summary

The current study was meant to examine the relationship of financing policy and firm performance. To achieve this, the study aimed at testing the hypothesis that there was no significant relationship between leverage and firm performance, there was no significant relationship between working capital and firm performance, there was no significant relationship between dividend policy and firm performance and there was no significant relationship between investment decision and firm performance. Secondary data retrieved from annual audited financial statements was used to test the study hypothesis. Fixed effects regression analysis was used to answer the research questions. Generally, 48.8% of the variations in firm performance can be explained jointly by leverage, working capital, dividend and investment financing policy decisions. Since the p value =0.00 for the F statistics (52.02, p value <0.05) then the four variables had significance influence with firm performance. The results revealed that there was an inverse significant relationship between leverage and firm performance. This implies an increase in interest liability decreased the prospect of good performance among companies which were listed in Nairobi securities exchange. Secondly, there was a positive relationship between working capital management policy and firm performance. This implies that the working policy adopted by companies listed in NSE were efficient since they increased the chances of more returns among the listed companies. Thirdly, there was a positive and significant relationship between dividend amount paid and firm performance. This implies that an increase in annual dividend paid to the shareholders increased their prospects of making more profits therefore listed companies ought to pay more dividends as such to ensure that the shareholders are reaping the maximum benefit. Lastly, there was a positive

and significant relationship between investment expenditure and firm expenditure. From the findings it can be deduced that an increase in finance expenditure increased the prospects of generating more returns among the companies listed in East Africa.

5.2 Conclusion

There is need to monitor the levels of leverage among the companies which are listed in Nairobi securities exchange. Corporate organization debt levels are associated with increased expenses especially in relation to interest expenses. The management should consider using debt capital if the return on investment will be higher than the periodic interest payment. All quoted companies should examine their working capital and look for means to make it more efficient as such to increase the benefits associated with it in relation to firm performance. There is need to hasten the debtor repayment period and improve inventory management strategies and evaluate on the ways of benefiting from extended credit period. There is need to evaluate the dividend patterns as well as examine the composition of the shareholders from which the investors can benefit fully on their investment. More so the companies should devise unique dividend policy aimed at reaping the optimal return for the shareholders. The amount of capital expenditure per annum should be evaluated to ensure that there are maximum benefits and only those projects which are having positive net present value are invested in. More so the management should examine the investment policy to ensure that there are profitable to operate and the maintenance costs are within the set levels.

5.3 Recommendation

Based on the study findings the researcher recommends that listed companies should evaluate their leverage policy. Through this evaluation the firms ought to examine their credit rating, predict their chances of bankruptcy and examine their current credit financing policy so as to reap the maximum benefits. Secondly, the firms should evaluate the working capital decision so that they can adapt the optimal working capital cycle. More so the companies should increase the creditor's period and decrease the debtors and inventory turnover periods. The management should devise mechanisms in which the working capital decision is customised for every industry sector in NSE. Thirdly, the dividend policy adopted by listed companies should be tailored to meet the unique needs of all investors within an organization to maximize investors' confidence. There is need to sensitize investors on how they can benefit through retention rather than cash dividend only. There is need to increase the amount of capital expenditure incurred per annum as such to increase the net plant and equipment. Although, capital expenditure increased firm's profitability there is need for companies to evaluate all projects independently and eliminate those projects whose maintenance costs is so high.

5.4 Suggestion for Further Studies

There is need to evaluate the effect of specific determinants of financing polices for example through the use of structural equation modelling, working capital is influenced by debtors, inventory, cash and cash equivalent and current liabilities which include creditors, there is need to combine all of them and measure jointly their impact on firm performance as well as their

individual contribution on firms performance. The financing decisions may have either positive or negative impact there is need to evaluate the chances of increasing or decreasing the firm performance among the listed companies. In addition, there is need to examine the effect of financing decision on performance among those companies which are listed in East Africa securities exchange.

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