

Abstract

Managers strive to maximise shareholder wealth by making rational financing decisions regarding optimal capital structure which would minimise its cost of capital. In attempt to magnify the return to shareholders, managers employ the use of debt. When excessive debt financing is employed by a firm, it increases the cost of financing and the financial risk of the firm leading to decreasing the return on equity as a result of financial distress. Do the various debt equity ratio levels lead to different financial performance when compared for high levered and low levered firm, high growth and low growth firm or large and small firms? A causal research design was used to establish the cause and effect relationship between financial leverage and the financial performance of the firms. The target population was 61 listed firms on the Nairobi securities exchange by December 2013. Purposive sampling was used to select 38 non-financial companies. Financial companies were eliminated because the company's capital structures have specific characteristics affected by industry regulatory requirements. Secondary data was obtained from published financial statements of the sampled companies for the six year period from 2008 to 2013. Ordinary Least Square method was used to establish the cause effect relationship among variables; Hypotheses were tested at 5% significance level using t-statistic. The study found that there was no significant difference in financial performance between highly levered and lowly levered firms and that there existed a negative relationship between Leverage and firm's performance. There were also no significant differences in financial performance between high growth levered firms and low growth levered firms and that there existed a negative relationship between a firm's growth opportunity and financial leverage ratio. There was no significant difference in financial performance between large levered firms and small levered firms. The findings of this study may act as a policy guideline to finance managers involved in managing firms on the contribution of financial leverage and its association with return on equity to maximise shareholder wealth.