EFFECT OF FIRM LEVEL FINANCIAL CHARACTERISTICS ON CORPORATE LEVERAGE OF MANUFACTURING FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE

REUBEN MUTINDI MUTEGI

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DECLARATION AND RECOMMENDATION

Declaration

This thesis is my original work and has not been presented for an award of diploma or conferment of degree in this or any other University

Signature____________________ Date 14/10/2024

Reuben M. Mutegi
CM11/19101/15

Recommendation

This thesis has been examined, passed and submitted with our approval as the university supervisors

Signature____________________ Date 16/10/2024

Prof. Gilbert M. Miriti
Chuka University

Signature____________________ Date 15/10/2024

Dr. Nebat Galo
Chuka University

DEDICATION

This thesis is dedicated to my parents and my son for their encouragement and prayer. May God almighty keep them safe and bless them unconditionally.

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ABSTRACT

Manufacturing firms often use debt in financing their day to day operations. However, what constitutes optimal debt level is a subject of debate among researchers. Prior studies often associate firm specific characteristics with firm leverage. Despite efforts to employ qualitative, quantitative and triangulation approaches in conceptualization of study variables, the available evidence is however not conclusive. It is in this context that the present study set out to establish the effect of firm level financial characteristics on corporate leverage of manufacturing firms listed at the NSE. Specifically, the study tested the effect of asset tangibility, firm growth and firm liquidity on corporate leverage of manufacturing firms listed at the NSE. To provide more insight on the context of the variables, the study considered trade-off theory, pecking order theory, agency-cost theory and the simple linear regression model. This study employed causal research design and longitudinal research design in an attempt to explain the cause-effect relationship between the variables for the years 2018-2022. Secondary data from published audited financial statements of the listed manufacturing firms at the NSE for a period of five years 2018-2022 was considered. A target population of 23 manufacturing firms listed at the NSE was employed. The research data was pooled over a five-year period across the 23 firms yielding 115 observations. The data was summarized in MS-Excel and later analyzed using Statistical Package for Social Sciences (SPSS) version 28. Analysis of data included descriptive and inferential statistics. Hypotheses were tested at 5% level of significance using t-statistics and p-values. Results of the analysis showed that asset tangibility negatively affects corporate leverage since firms that generate relatively high internal funds tend to avoid debt funding ($\beta_1 = -0.141$, t = -3.66, p=0.000 <0.05). This is consistent with the pecking order theory that explains that the use of retained earnings to finance firm's operations comes with the minimum possible cost and managers would prefer to choose retained earning first before debt and equity. Firm growth had a negative effect on corporate leverage ($\beta_2 = -0.001$, t = -2.285, p=0.024 < 0.05). Firm liquidity was also observed to have a significant negative effect on corporate leverage ($\beta_3 = -0.087$, t = -3.356, p= 0.023< 0.05). The slope to predict corporate leverage from firm level characteristics does not differ significantly between the levels of firm age ($\beta_3 = -0.130$, t = -2.301, p= -0.130 <0.05). Results of joint analysis showed that asset tangibility and firm liquidity have a negative effect on corporate leverage whereas firm growth does not affect corporate leverage. The interaction between firm age and firm level financial characteristics was not significant ($\beta_1 = 0.01, \beta_2 = -0.03, \beta_3 = 0.00$, t =0.983, p=0.328>0.05). This implies that the effect of firm level financial characteristics on corporate leverage does not depend on the firm age. The outcome of the study will be of value to investors, managers and shareholders in making choices aimed at maximizing shareholders' wealth and in enhancing firm value. The study is also significant to academicians in broadening their knowledge on the nexus between firm level financial characteristics and corporate leverage of manufacturing firms.