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**FIRM FINANCING ON FINANCIAL PERFORMANCE OF
UNIT TRUST FIRMS LISTED IN NAIROBI SECURITIES
EXCHANGE, KENYA**

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FIRMS LISTED IN NAIROBI
SECURITIES EXCHANGE, KENYA**

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Abstract

Purpose: The study seeks to establish the effect of firm financing on financial performance of Unit trust firms listed in Nairobi Securities Exchange in Kenya.

Materials and Methods: Desktop methodology was adopted for the study. This refers to secondary data collection from existing data resources which include approved websites, online journals, and library. This technique is considered a low-cost in comparison to primary data collection which required field visit. Thus, the study relied on already published studies, audited financial reports and statistics.

Results: The results revealed that the studies done had conceptual framework gap. The study also found out that the study had geographical gap because they were not conducted in Kenya and also had different periodic scope.

Unique contribution to theory, practice, and policy: The findings from the study will be used by various regulators (CMA) in different jurisdictions to improve on their financial performance. The findings of this study will assist the Unit Trust firms to monitor the key financial variables and understand; the extent to which firm financing can affect performance. Information acquired from this study will help the investors and customers understand key variables that affect financial performance. This study sought to fill the gap that existed in the literature concerning the effect of firm financing on performance of Unit Trust firms in Kenya. The finding will add to already existing body of knowledge in the field of firm financing. The information acquired from the study will be useful to policymakers in the Investment services and especially Unit Trust Firms in Kenya

Keywords: *Firm Financing, Financial Performance, Unit Trust Firms*

INTRODUCTION

Firm financing involves the resourcing of funds to support the financial operations that includes meeting capital expenditure obligations and firm financial choice to either use debt and or equity are the key challenges that face firm management. According to (Myers, 2001) firm financing involves the process through which companies raise funds for their operations by either utilizing internally generated resources; and or external financing. This can be through internal financing which includes utilization of retained earnings from returns, leverage/debt and equity through publicly sale of shares. The existence and running of a business revolve around the strong financing of its working capital needs and supporting financing of fixed assets that generate income without which, the business will not be a going concern venture. The return of a firm is hence anchored on the firm financing structure decisions which therefore means that firm management must invest appropriately on fixed asset. For companies to increase returns and optimize shareholders wealth requires that proper attention and maximum support be given while making firm financing decisions (Arulraj & Annamalai, 2020)

Firm financing theories and their connection with company returns and company value have been a considered issue for a long time. According to (Vuong et al., 2017) proven that there is insignificant relationship between financial leverage and cost of capital, and it was further proven that there is no evidence on the impact of leverage and dividend policy on the cost of firm financing function. As stated by (Autoridad Nacional del Servicio Civil, 2021) where inefficient market, firm value is immaterial to firm financing choice adopted. One of the most quoted theories in firm structure is MM (1958) where it's postulated that firm value is independent of the fraction of its financing regardless of whether is financed through debt or equity or a combination. The theorem was anchored on the assumption that there are no taxes (Vuong et al., 2017). The choice on the source of firm financing is a vital and delicate decision to make and greatly affect how competitive a firm becomes in the eyes of other peers in a similar sector. Hence, firms need to select the best financial structure mix that will optimize financial performance (Tanko et al., 2021).

The necessity of retain earnings and its influence on financial performance of a firm is important. This is since retain earnings forms an imperative part in the development and improvement of corporations (Li et al., 2020). Proper administration of company resources is crucial because it ensures that there is adequate earnings for the business to accomplish their immediate financial needs without default. Retained earnings has been described as the residual net income or profit after tax which is not distributed as dividends to the shareholders but is reinvested in the business. Typically, the net profit earned by firm is either distributed as dividend to shareholders or is retained in the business for its growth and expansion, (Li et al., 2020). Retained earnings can be used by firms to meet various business operations which includes, meeting the fixed and working capital needs of the firms, providing funds for growth and expansion, funding for new assets, paying off external loans, providing for mergers and acquisition, funding share repurchase and withstanding economic downturns (Tanko et al., 2021).

According to (Felix & Nairobi, 2019), capital markets are crucial part of financial sector in a modern economies and more so developing economies. They provide a platform for substitute savings instruments to investors and non-bank sources of financial resourcing for businesses. Therefore, capital markets aid in economic advancement through increased savings marshaling. It was concluded that a well grown capital market enhance development

through expanded savings, easy access to foreign savings, diversification of financial risks, assist the government of the day finance budgetary deficit. In 2001, the Capital Market Authority issued guidelines towards the growth of Collective Investment Schemes (CIC) this was geared towards deepening the market access by investors as reported from (Nairobi Securities exchange, 2020). Collective Investment Schemes is an interconnecting link between individual investors to facilitate them benefit from professional finance management, maximize on economies of scale and to grow to higher levels of expansion to different sectors that would not have been possible individually.

The composition of CIS includes Unit Trust, Mutual Funds both open and close and Special Interest Collective Investment Schemes. Unit Trust according to (Tesco PLC, 2015) are means of participation in security, bond and other money market traded by investors or otherwise called unit holders that they would not have been able to invest in individually due to capacity, time the money or the required expertise necessary for successful trading. Unit Trust are ideal investment vehicle that investors seeking to get exposure on financial markets across the spectrum require. This can be from individual to pension finances, firms, and government institutions. Unit Trust are medium to long term financial investments that can be for a minimum of three to five years which allows fluctuations period to smoothen out. Equity, bonds both corporate and government and money markets securities are the portfolio that form Collective Investment Schemes. As noted by (Autoridad Nacional del Servicio Civil, 2021) unit trust are part of Collective Investment Schemes in which investors with like-minded investment objectives put money together. The assets are put in the custody of the control of trustees for benefit of investors. Fund managers are responsible for daily running of unit Trust which are open ended where units can be bought from managers who in turn create new units for them or otherwise sell back their units for liquidation by managers.

Firm financial structure

Firm financing is a snapshot of how companies fund their assets using the available resources (Tanko et al., 2021). There are several ways of financing firm assets which can be done through internal financing like retained earnings from returns, equity, long term loaning, short term loaning or any other short term financial liabilities (ibrar, 2020). Companies can also finance firm assets using permanent short term loans, long term loans, preferred stock and others common equity which describe company capital structure (ibrar, 2020).

The various financial structure variables include leverage, liquidity, and firm equity these constitute the study variables. Leverage is ratio of debt to total assets of a given firm and it shows the extent to which total assets are funded through debt (Arulraj & Annamalai, 2020). Higher leverage ratio indicates dependence of firm on debt. High debt portfolio leads to high interest payments, this negatively affect the firm performance and hence lower earnings per share. Even though increasing financial leverage will enable a company to increase its value by getting returns through tax shield on debt there are financial distress cost that come along either direct or indirect which therefore reduce on firm value. Cost of debt impact on firms cost of funding its operations and hence impact on its financial performance (Tanko et al., 2021). In this case therefore, the higher the financial cost of leverage the lower the company profitability because interest that relates to debt is an allowance cost against firm returns. Firm management uses debt since it offers potential to grow the volume of operations and hence grow the average return on equity and return on assets by way of tax savings (Bradshaw et al., 2017). Being credit worthy, requires that creditor who intends to lend to the company will always be concern whether the company can be able to repay interest and

principal amount. This is because highly leveraged firm exposes the company to a lot of financial risks and therefore creditors would want to play safe to ensure that they lend to firms that can adequately and promptly service their debts (Lanka & Lanka, 2017).

Firm Financial Performance

Financial performance has been defined by different scholars in the world. According to (Omollo et al., 2018), define financial performance in terms of the change in the general business environment, change in business internal controls, change in business strategy that can be an increase or a reduction over a given period of time. Therefore, it's a measure of how well the stated variables have adjusted since the last review. Financial performance can also be stated as a measure of how healthy a firm has utilized its available capital in the production of better shareholders returns. The results of this performance review can be utilized by firm management to make financial decisions and comparison on how the firm is financially performing in relation to competitors of similar sector (Olusuyi & Araoye, 2017). According to (Akombo, Millicent, Edwins Baraza, 2020), financial performance gives an avenue through which a determination of firm activities are made in an objective monetary manner. It gives an indication of how well off a shareholder is at the end of a financial period as compared with the beginning of the period. The financial measures can be done by utilizing the financial ratios calculated from the firm financial books or otherwise through use of market share prices. According to (Al-matari, 2014) , puts it that the main objective of a company is to optimize shareholders wealth and hence performance measurement support in assessing whether the shareholder has been made richer as a result of financial investments decisions through a given period of time. A close look at the literature of corporate governance and firm performance reveals that different measures have been used by the researchers to measure the performance. They classified those measurements into accounting-based and market-based indicators. Performance measurement has great significance in effective management of an organization and in the enhancement of the processes since only measurable things is manageable. Hence, the enhancement of the organizational performance requires some measurements to determine the impact of the level of organizational effectiveness upon business performance (Al-matari, 2014).

Unit trust firms listed at Nairobi Securities Exchange

Unit trust funds are unincorporated mutual funds that whose business is to trade on carefully selected financial securities to satisfy a given group of potential investors goal. Unit Trust Funds are collective investment schemes that pool funds from many different investors and are managed by professional fund managers. the fund managers invest the pooled funds in a portfolio of securities with the aim of generating returns in line with the specific objectives of the fund (Autoridad Nacional del Servicio Civil, 2021). Investors willing to invest usually lacks resource capacity to build a portfolio and also expertise, understanding and lack of time needed to manage their portfolio (Namu Nthimba et al., 2021a). Unit trust firms give potential investors opportunity to invest in a diversified securities without assuming the threat of managing the securities.

Nairobi securities exchange is publicly owned market where trading of securities of publicly listed firms in Kenya takes place. The market is regulated through Capital Market Authority (CMA). The market started in 1954 as a voluntary association of individuals or otherwise called brokers working under a society act and were responsible for growth of security markets and guidelines of trading activities. The Nairobi securities Exchange has gone

through numerous changes since inceptions including establishment of trading regulations, central depository system, marketing automation and stocking from mutual firm to firm limited by shares (Securities et al., 2017). NSE has been ranked the fourth largest in terms of traded shares and fifth in market capitalization measured in percentage of GDP (Pavone, 2019).

Nairobi Securities Exchange is currently licensed, supervised and monitored by Capital Market Authority being the security market approving authority in Kenya. The authority has the role of ensuring that there is good governance among the listed firms and growth of efficient markets (Securities et al., 2017). There are currently 64 listed companies at the Nairobi securities Exchange which have been distributed among the various sectors of the economy among which 30 firms falls under investment, and investment services where unit trust firms sit being the chore of this study. Since inception in 1954, Nairobi Securities Exchange has been using NSE 20-share to measure general performance of 20 blue-chip firms. However there was a review of this measure of performance where Nairobi Securities Exchange change to the measure from NSE all share index(NASI) where it measure performance of the market by incorporating traded shares per day (I. Report & Statements, 2018).

It has been noted that listed firms at the Nairobi Securities have gradually increased using leverage funding on their firm financial structure as they sort after more financial muzzles for firm operations (*Taking off Together Nairobi Securities Exchange Integrated Report and Financial Statements 2020*, 2020). According to (ibrar, 2020), large, listed companies seems to easily raise debt to equity ratio but small companies fall short of this. The choice in whether to take debt financing or equity remained the confines of management and board of directors but financial analysts argued supporting and take debt financing as an appropriate means of or increasing firm value so long as they are acquired at suitable market rate and returns utilize for good operations (Makeni, 2018). This study seeks to investigate whether leverage/debt financing do have any impact on the financial performance of the unit trust firms listed at NSE.

Statement of the problem

The unit trust funds in many developed countries are driving their economies upwardly. The performance of Unit trust in Kenya has been poor as compared to the counterparts in the rest of the world. The poor performance is a discouragement to investors both individuals and corporate besides affecting the realization of financial stability as per Kenyan Vision 2030 (Namu Nthimba et al., 2021b).The general performance of Unit trust has not been so much in upward trajectory due to various factors and some could be attributed to firm financing among others. Statistically Unit trust funds contributes approximately 0.80% to the country's GDP, (Capital Markets Authority report, 2020).

Economies that started Unit trust financial markets with Kenya in early 2000 are well ahead and grown. Globally, Peru and Turkey are some examples with a total value of USD 6.1 billion and USD billion respectively. In Africa, Morocco started with Kenya but doing well supporting its economies with a total value of USD 275.3 million. While in Kenya there has been a sluggish growth in the sector. The performance of the sector in Kenya for the last five years has been ups and down. In 2017, the sector registered Kes 155.55 billion which was a decline of 13.19% as compared to 2016 financial year (CMA Report & Statements, 2019). In 2018 Unit trust fund performance was Kes 197.89 billion registering a 27.22% increase. In

2019 the sector registered Kes 146.53 billion which was 25.95% lower than the previous year. While in 2020, the sector performance was Kes 158.9 billion, which was 8.43% improvement from the previous year (CMA Report, 2020). The statistics therefore is a clear indication that the Unit trust fund performance in Kenya has not been steady pausing a lot of concerns to the country, investors, and other stakeholders. This reflect poor understanding of the markets by investors or the fund managers in general are doing well enough to woo investors. This kind of performance leads to poor investor confidence and depletion of investors wealth in the Unit trust fund (Namu Nthimba et al., 2021a).

On the relationship of firm financing and financial performance of unit trusts, researchers have shown mixed results. Currently, there is no clear documentation in the researches carried out on a particular connection between the financial performance of unit trust funds and firm financing. Investigations carried out in Kenya have not exhaustively addressed the link amongst financial performance of unit trusts funds and the firm financing. Disparities in results on the same subject matter, in consequence, informed the present study. The objective of this research is to explore the effect of firm financing on financial performance of unit trust funds in Kenya using panel data for five years and, also investigate the moderation effect of firm size on the relationship between firm financing and financial performance of unit trusts funds in Kenya.

Research Objectives

General Objective

The general objective is to establish the effect of firm financing on the financial performance of unit trust firms listed in Nairobi Securities Exchange.

Specific Objective

- i. To establish the effect of leverage/debt on financial performance of unit trust firms listed in Nairobi Securities Exchange
- ii. To determine the effect of retained earnings on the financial performance of unit trust firms listed in Nairobi Securities Exchange
- iii. To determine the effect of equity on the financial performance of unit trust firms listed in Nairobi Securities exchange.
- iv. To establish effect of firm size on the financial performance of unit trust firms listed in Nairobi Securities Exchange.

Research Hypotheses

H₀₁: Leverage/debt has no significant effect on the financial performance of unit trust firms listed in Nairobi Securities Exchange

H₀₂: Retain earnings has no significant effect on the financial performance of unit trust firms listed in Nairobi Securities Exchange

H₀₃: Equity has no significant effect on financial performance of unit trust firms listed in Nairobi Securities Exchange.

H₀₄: Firm size has insignificant moderating effect on the financial performance of unit trust firms listed in Nairobi Securities Exchange.

Scope of the study

The purpose of this study is to establish firm financing and financial performance of unit trust fund in Kenya. The research study will cover all 30-unit trust firms listed in Nairobi securities exchange regulated by the Capital Market Authority. The unit trust firms in Kenya will form unit of analysis in this research study while observations will be from the annual audited financial statements for unit trust firms in operation as at close of 31st December 2020. The data collection will cover five-year period 2016 to 2020, the five-year period of study selected to determine the changes in unit trust firms over time and base analysis on current data as much as possible.

This will also be important because capital market regulations for investment and investment services institutions have been put in place while there are challenges in firm financing that can affect the financial performance of investment and investment service institutions. The study will focus on firm financing that have been used by earlier scholars and those harmonious with existing theories and can be identified from unit trust firms in Kenya. The specific objectives that will be used in the study includes Leverage/debt, retained earnings, Equity and Firm size as moderating variable while financial performance will be measured using; Return on equity (R.O.E) and return of assets (R.O.A). The study will utilize secondary data from audited financial statements. The study will be anchored on various theories that are relevant to the firm financing which include the signaling theory, trade-off theory, pecking order theory and the market timing theory.

Theoretical Literature review

Theories in firm financial structure discussed will provide the basis for selection of research variables. The various theories are herein reviewed.

The Signaling theory

This theory was authored by two professors, Poterba and Summers (1985) to explain information asymmetry between company's managers and their shareholders. According to the proponents, managers have a lot of information in their possession. If the managers of a company strongly believe that the company is undervalued, they will borrow more externally and later issue equity. Similarly, if the managers believe that their companies are overvalued, they will issue equity first followed by debt. Hence according to Ross (1977), managers' choice of capital structure will signal information to the market. As a result, increase on a firm's leverage may be a positive sign towards the future earnings of a company. Failure to repay debt could lead to bankruptcy and hence firms with high levels of debt depict a positive signal of their capability of having sufficient cash flows to service the debt, Jensen & Meckling, (1976). Dividend announcement by a company is a signal of a prospective future as an organization suffering from distress and bankruptcy costs mostly likely cannot announce dividend pay outs.

Trade-off Theory

The trade-off theory suggests firm's selection of leverage between benefits and costs of debt and the trade-off costs and benefit of borrowing while keeping firm's assets in lieu as a factor of a firm's maximum debt ratio (Gungoraydinoglu & Öztekin, 2021). Hence, trade-off can be seen as summing up balance of different benefits and costs that pertains debt for maximum capital structure. In addition, a firm adjusted optimum leverage ratio, cost and lags commonly known as adjustment costs, which is therefore called optimal capital structure of a company (Gungoraydinoglu & Öztekin, 2021).

It's suggested that firm's management should stress favorable liquidity position to level out the costs and benefits of cash holdings. Cost of cash holdings being the low yield liquid assets since liquidity premium and tax disadvantages (Tarus et al., 2014). Enterprises must keep liquidity risk premium in understanding keep secure competitive level in market while using outside resources to maintain liquid assets portfolio. According to (Frank & Goyal, 2007), all the theories of trade-off is an assessment of the cost and benefits of substitute capital structure strategy. According to trade-off theory it suggests an inverse relationship between liquidity and firm earnings that is central to the cost and benefit of every choice made. Where else pecking order theory suggests the optimistic relationship between liquid assets and firm performance, trade-off theory views the different compositions of firm financial structure and recommend that there is need to view the cost benefit evaluation and make a choice on the best mix of firm financial structure choices. This therefore means that study variables need to be investigated to determine their contributions to company performance financially and would inform future capital structure choices. Though this, future financial structure choices would be informed which aim at acquiring maximum firm financial structure where cost of capital is reduced and performance financially enhanced. Therefore, trade-off theory is key in the study since the theory highlight expected connection between liquidity of firm level and financial performance of firm which is key consideration by firm funding managers when making funding choices.

Pecking Order Theory

According to Stewart & Myers, (1984) developed the theory to explain the corporate financial behavior of firm structure choices. Where the major points firms' managers need to adhere to and which is highly relevant to firm capital structure choices are fund managers wants to uphold sustainable shareholder returns over a given period of time despite variation in earnings, investment opportunities sand share prices. Fund managers prefer internal funding as compared to external financing. Therefore, they opt for less risky option to start with before much riskier financing (Gunarsih, 2017). Securities are normally ranked based on their viewed risk the leverage on one hand to common shares on the other hand.

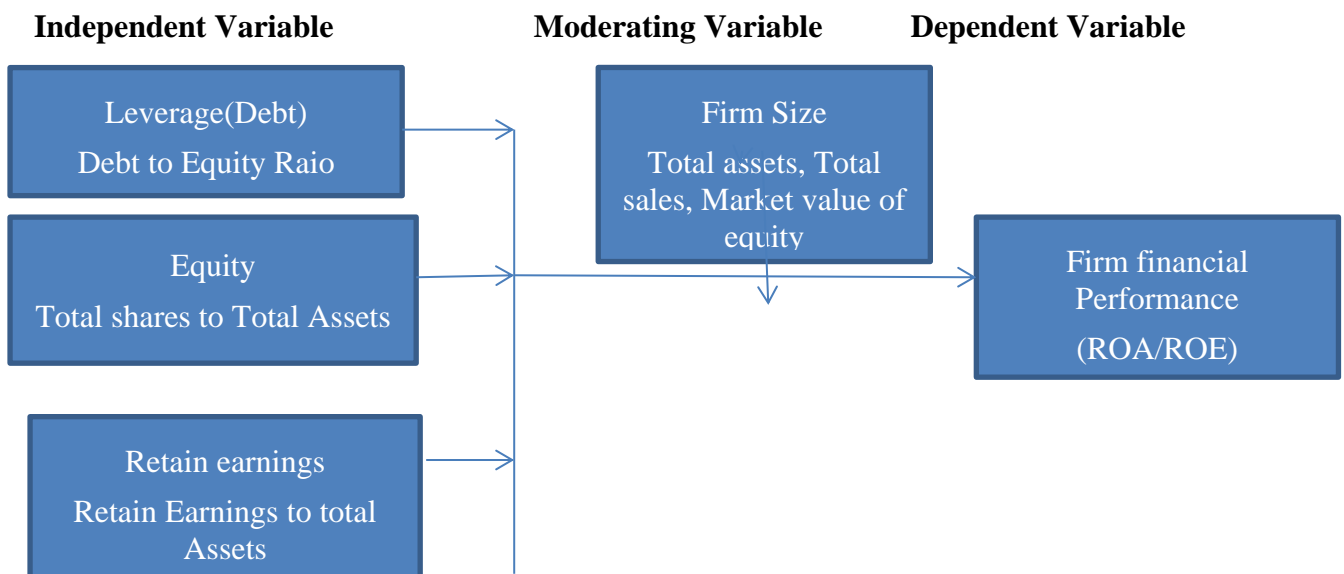
Myers (1984), he posits that while designing firm capital structure, enterprises should make use of internally generated finances, the followed by external which includes debt and lastly the external equity. Internal financing is regarded as cheap and is not subject to outside interference while external debt being less costly since restrictions are less in comparison to issuing of equity. The theory hence assumes that fund managers understand their firm's status better and they would possibly do everything to ensure existing shareholders benefit (Qureshi, 2015). The managers are also keen to keep firm's exclusive information classified because using internal financing allows managers keep away from making public disclosures concerning firm investment opportunities and earning potentials on investment. According to Myers and Majluf (1984), project with positive Net present value could easily be rejected because it requires issue of new equity which would give value of projects to new shareholders. This is assumed if the view is held to safeguard the interest of existing shareholders. But Fama and French (2005) in their study supported preference for equity over leverage against this theory. The scholars argued that firms can avoid information costs or the adverse choice through issuing of equities which are less subject to asymmetric information like equity issues to employees in their compensation strategy or the existing shareholders through rights issue. While making financing choices, there is need to review leverage and equity funding and suggest an optimal financial structure. As suggested by pecking order

theory, firms need to use leverage(debt), equity and liquidity in their financial structure to meet firms' operations in the order of their cost to the firm where cheaper financing structure are considered first. The three components of firm funding structure make up study variables and therefore need to evaluate how they impact on financial performance of unit trust firms. According to the theory, debt financing influences performance positively because it's cheaper. But the theory doesn't have any preference for use of equity since its most expensive and risky due to the possibility of loss of control and hence a review of the connection between equity and firm financial performance will be done since firms are also funded through equity. The connection between liquidity and firm financial performance will also be evaluated in the research study because pecking order recommend for optimistic relationship between liquid and firm financial performance.

The Market Timing Theory

Market timing theory introduces a way to answer the traditional question of firm's decision whether to finance their investments via debt or equity. Market timing hypothesis explains that selection of specific fraction of debt and equity in capital structure is dependent upon mispricing of these instruments in financial markets at timing the firm financing needs for investment. In other words, the theory contrasts the explanation of trade-off theory and pecking order theory, market timing theory interpret that firms does not care about whether to finance with debt or equity but just choose any form of financing that appears to be overvalued by financial market at that point in time. The firm issue equity when stock prices are overvalued (Huang & Ritter, 2005). Market timing theory of capital structure" assumes that firm picks the financing source that is most cost efficient at the point in time fund is required. Hence, managers can increase current shareholder's wealth by timing the issue of securities meaning that firms sell new stocks when the stock price is perceived to be overvalued and buying back own shares of stocks when they are undervalued. Therefore, stock price variation is a deciding factor that affects firm's capital structures decision.

Market timing theory of firm capital structure argues that companies time equity issues in the understanding that the issue new shares when the share price is regarded to be overvalued and buy back their own shares when there is underpriced. Accordingly, variation in share prices affects firms' capital structure (Hasan, 2017). The market timing theory stressed that a company prefer equity funding when the regarded cost of equity is low and hence prefer leverage financing when cost of funding is low.

Conceptual framework**(Researcher, 2021)****METHODOLOGY**

Desktop methodology was adopted for the study. This refers to secondary data collection from existing data resources which include approved websites, online journals, and library. This technique is considered a low-cost in comparison to primary data collection which required field visit. Thus, the study relied on already published studies, audited financial reports and statistics.

RESULTS

The results have been grouped into various research gap categories namely as conceptual, , contextual, and geographical, methodological.

Conceptual Gaps

Studies by Ahmed et al (2018), Mohamed (2013), Kithandi & Katua (2020), Abu-Abbas et al (2019), Mwangi Gathara et al (2018), Omai & Memba (2018), Stephen (2012), Amaka et al (2019), Yemi et al (2018), Viet et al (2020), Bala et al (2020), Thurair (2014), Akombo et al (2020); Hossain & Said (2019) had conceptual framework gap. Besides, all the mentioned studies did not establish the effect of firm financing on financial performance of unit trust firms in Kenya. The research did not clearly outline the relationship between independent and dependent parameters. Hence the current study seeks to address these conceptual gap.

Contextual and Geographical Gap.

Studies by Andred et at (2018), Abu-Abbas et al (2019), Demigure (2016), Yushana Kong, Moh, Isaiah, Ogunabade (2020), Hossain (2015) were not conducted within Kenyan borders and hence geographic gap. It therefore implies that the results might not be applied in Kenya since the social economic environment of Kenya differs to that of other jurisdictions. The current study therefore seeks to address this gap.

Methodological Gap

Studies by Ahred et al (2018)-Abbaset et al (2019), Kithandi Katma (2020), Mwangi Cathir (2018), (Omai & Memba 2018), Stephen 2(012,) Demigures 2(016), Yushona Kong Moh, Isaiah Ogunabade (2020), Akenga (2017), Waswa et al (2018), Nahiu (2017), Akombo (2016), Hossain 2015, Amaka et al (2019), Yemi et al (2018), Viet et al (2020), Bala et al (2020), Thurairi (2014) differs in time scope. The current study seeks to cover upto 2021.

CONCLUSIONS AND RECOMMENDATIONS

The findings from the study will be used by various regulators Capital Market Authority (CMA) in different jurisdictions to improve on their financial performance.

The findings of this study will assist the Unit Trust firms to monitor the key financial variables and understand; the extent to which firm financing can affect performance.

Information acquired from this study will help the investors and customers understand key variables that affect financial performance.

This study sought to fill the gap that existed in the literature concerning the effect of firm financing on performance of Unit Trust firms in Kenya. The finding will add to already existing body of knowledge in the field of firm financing.

The information acquired from the study will be useful to policymakers in the Investment services and especially Unit Trust Firms in Kenya.

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