THE EFFECTS OF CAPITAL STRUCTURE ON PROFITABILITY OF MANUFACTURING AND ALLIED COMPANIES LISTED IN KENYA CAPITAL MARKET

BY

EMILY OREGE

UNITED STATES INTERNATIONAL UNIVERSITY – AFRICA

FALL 2016
THE EFFECTS OF CAPITAL STRUCTURE ON PROFITABILITY OF MANUFACTURING AND ALLIED COMPANIES LISTED IN KENYA CAPITAL MARKET

BY

EMILY OREGE

A Project Report Submitted to the Chandaria School of Business in Partial Fulfilment of the Requirement for the Degree of Masters in Business Administration (MBA)

UNITED STATES INTERNATIONAL UNIVERSITY-AFRICA

FALL 2016
STUDENT'S DECLARATION

I, the undersigned, declare this my original work and has not been submitted to any other college, institution or university other than United States International University-Africa in Nairobi for academic credit.

Signed __________________________  Date: _________________________

Emily Orege (ID No: 645928)

This project report has been presented for examination with my approval as the appointed supervisor.

Signed __________________________  Date: _________________________

Mr. Francis Gatumo

Signed: __________________________  Date: _________________________

Dean, Chandaria School of Business
COPYRIGHT

© Copyright by Emily Orege, 2016
All rights reserved. No part of this project may be produced or transmitted in any form or by any means, electronic, mechanical, including photocopying, recording or any information storage without prior written permission from the author.
ABSTRACT

The purpose of the study was to assess the effects of capital structure on profitability of manufacturing and allied companies listed in the Kenya capital market. The study was led by the following research questions; what is the influence of equity financing on profitability of firms in the manufacturing sector in Kenya? What is the effect of debt on profitability of firms in the manufacturing sector in Kenya? What is the impact of the preference share financing on profitability of firms in the manufacturing sector in Kenya?

The study assumed a descriptive research design in collecting, analyzing, inferring, and presenting data. The descriptive research design helped in focusing on the direction and strength of the relationship between net profits and capital structure of listed manufacturing companies. The study used secondary data that was obtained from the Capital Markets Authority (CMA) data bank. The study used census technique whereby all nine (9) manufacturing and allied companies trading on the Nairobi Securities Exchange were used in the study. The study assumed descriptive and inferential statistics in data examination, analysis and interpretation. The data was presented using tables and figures.

The study examined how equity financing influences profitability of firms in the manufacturing and allied sector. The study found that equity financing contributes to a significant change to the net profits of Kenyan listed manufacturing and allied companies. The study reveals that through the sale of shares of a company, the company raises capital for its business operations in a process known as equity financing. In equity financing, the study found that an organization can either issues new shares of stock or reinvest in new assets the profits generated by its existing assets. When a company generates profits, it may hold the cash in reserve for future investments or it may pay the cash back to the shareholders. The study found that when a business organization pays the cash back to its shareholders, it reduces it net profits that would be used to expand or rather diversify the business operations. The study found that the correlation coefficient (r) was 0.526, beta (β) which is the slope was -0.526 and R² was 0.467, which means that 46.7% of net profits can be explained by equity financing.

The study revealed how debt financing affects net profits in Kenyan listed manufacturing and allied companies. From the study, linear regression analysis was used to determine
the relationship between the level of leverage and organizational performance. The study found that through debt financing in manufacturing and allied companies are able to enhance their profitability. The study revealed that manufacturing companies have strategies of choosing capital structure that enhance their profitability. The study found that the successful selection and use of the debt-to-equity ratio is one of the key elements of firms’ financial strategy. The study revealed that profitable manufacturing companies borrow more as they greatly shield income from corporate tax and enhance net profits. It was found from the study that a company’s profit performance is a good indicator of its fundamental health and competitive position. The study confirms that profit margin indicates whether a company can sustain its present cash accruals. The study revealed that the correlation coefficient (r) was 0.792, β which is the slope was 0.792 and R² was 0.627, which means that 62.7% of net profits can be explained by debt financing.

The study examined the effect of preference share financing on net profits of Kenyan listed manufacturing and allied companies. The study shows that like bonds, preferred shares are rated by the key credit-rating institutions. The study established that usually, preferred stock has preference in paying dividends. The preference doesn’t warranty the disbursement of dividends, but the business organization must pay the assured dividends on preferred stock ahead of paying any dividends on common stock. The study found that preferred stock resembles debt in that it promises pre-determined levels of dividends. It was also revealed that preferred dividends aren’t tax-deductible to the issuing companies like interest on debt. From the research, it was demonstrated that many issuers of preferred stocks are industrial companies or rather firms. The study illustrated that it is profitable for manufacturing and allied firms to issue preference shares in place of debt, hence meeting regulators' equity limitations. The study also reveals that manufacturing and allied companies that issue preference shares can pass their costs on to the consumers and hence are less affected by the tax disadvantages of preferreds. From the study, it is clear that the correlation coefficient (r) was 0.780, β which is the slope was 0.780 and R² was 0.609, which means that 60.9% of net profits can be explained by preference mode of financing.

The study concludes that there is a positive relationship between equity financing and net profit. Maximizing wealth for the shareholders require perfect combination of debt and equity and that cost of capital is negatively correlated and therefore to be reduced to
minimum level. From the study it is concluded that debt financing enhances net profits of manufacturing and allied companies. The study concludes that preference share financing is a very important method of enhancing net profits of manufacturing and allied companies.

The study recommends the manufacturing companies to use equity to finance their operations as equity financing enhances net profits. The management of manufacturing companies should develop techniques of determining how capital structure should be divided. The study recommends a successful selection and use of the debt-to-equity ratio as it is one of the key elements of firms’ financial strategy. The study recommends the use of preference shares because preferred dividends are not tax-deductible to the issuing firms and that omission of dividends will not result in bankruptcy.
ACKNOWLEDGMENT

I would like to acknowledge my supervisor Mr. Francis Gatumo for his guidance and support during the course of this project. I am also grateful to my parents and siblings for their support over the course of my studies. Finally, I would like to thank God for the gift of life and health.
# TABLE OF CONTENTS

**STUDENT’S DECLARATION** .............................................................................................................. ii  
**COPYRIGHT** ................................................................................................................................. iii  
**ABSTRACT** ........................................................................................................................................ iv  
**ACKNOWLEDGMENT** ....................................................................................................................... vii  
**LIST OF TABLES** .............................................................................................................................. x  

## CHAPTER ONE ................................................................................................................................. 1  
### 1.0 INTRODUCTION ....................................................................................................................... 1  
#### 1.1 Background of the Study .......................................................................................................... 1  
#### 1.2 Statement of the Problem ......................................................................................................... 6  
#### 1.3 General Objective .................................................................................................................... 7  
#### 1.4 Specific Objectives .................................................................................................................. 7  
#### 1.5 Significance of the Study .......................................................................................................... 7  
#### 1.6 Scope of the study ..................................................................................................................... 8  
#### 1.7 Definition of Terms .................................................................................................................. 9  
#### 1.8 Chapter Summary .................................................................................................................... 10  

## CHAPTER TWO ............................................................................................................................... 11  
### 2.0 LITERATURE REVIEW ............................................................................................................ 11  
#### 2.1 Introduction ............................................................................................................................ 11  
#### 2.2 The Influence of Equity Financing on Profitability ............................................................... 11  
#### 2.3 The Effects of Debt Financing on Profitability ....................................................................... 15  
#### 2.4 The Impact of Preference Share Financing on Profitability ...................................................... 20  
#### 2.5 Chapter Summary .................................................................................................................... 25  

## CHAPTER THREE ........................................................................................................................... 26  
### 3.0 RESEARCH METHODOLOGY ............................................................................................... 26  
#### 3.1 Introduction ............................................................................................................................ 26  
#### 3.2 Research Design ...................................................................................................................... 26  
#### 3.3 Population and Sampling Design ............................................................................................ 26  
#### 3.4 Data Collection Methods ......................................................................................................... 28  
#### 3.5 Research Procedure ................................................................................................................ 28  
#### 3.6 Data Analysis Methods ............................................................................................................ 28  
#### 3.7 Chapter Summary .................................................................................................................... 29
CHAPTER FOUR .................................................................................................................. 30
4.0 RESULTS AND FINDINGS .......................................................................................... 30
4.1 Introduction ................................................................................................................. 30
4.2 Reliability Statistics ................................................................................................... 30
4.3 Equity Financing and Net Profits ............................................................................... 30
4.4 Debt Financing and Net Profits .................................................................................. 32
4.5 Preference Share Financing and Net Profit ............................................................... 34
4.6 Chapter Summary ..................................................................................................... 36

CHAPTER FIVE .................................................................................................................. 37
5.0 DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS .................................. 37
5.1 Introduction ................................................................................................................ 37
5.2 Summary .................................................................................................................... 37
5.3 Discussion .................................................................................................................. 39
5.4 Conclusions ............................................................................................................... 45
5.5 Recommendations ................................................................................................... 46

REFERENCES .................................................................................................................. 49
APPENDIX I: Gross Domestic Savings to GDP Ratios in Selected Countries and Years .......................................................................................................................... 57
APPENDIX II: Declining Profits of Manufacturing and Allied Sector in Kenya .... 58
APPENDIX III: Manufacturing and Allied ..................................................................... 59
APPENDIX IV: Capital Structure Table ........................................................................ 60
LIST OF TABLES

Table 4.1: Descriptive Statistics for Equity Financing .................................................................30
Table 4.2: Correlation of Equity Financing and Net Profit .........................................................31
Table 4.3: Model Summary of Equity Financing and Net Profit ..............................................31
Table 4.4: Coefficients Variation of Equity Financing and Net Profits ......................................32
Table 4.5: Descriptive Statistics for Debt Financing .................................................................32
Table 4.6: Correlation between Debt Financing and Net Profit ...............................................33
Table 4.7: Model Summary of Debt Financing and Net Profit ..................................................33
Table 4.8: Coefficients Variation of Debt Financing and Net Profit ..........................................34
Table 4.9: Preference Share Financing .........................................................................................34
Table 4.10: Correlations between Preference Share Financing and Net profit .......................35
Table 4.11: Model Summary of Preference Share Financing and Net Profit .........................35
Table 4.12: Coefficient of Variation of Preference Share Financing and Net Profit ...............36
CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Study

Capital structure decisions (Ebaid, 2009) are vital for the financial safety of a firm. Financial misery, bankruptcy and liquidation are the eventual consequences lying ahead if any main misjudgment ensues following any financing decision of an organization’s activity. One of the strategies an organization should look into is to reduce the weighted cost of capital. This will enhance net economic return, which in the long run increases the firm’s value. Hence, maximizing the firm’s value is the focus of every financing decision made by the management of a company. The management of an organization operating in the very uncertain world has a tough task ahead in achieving the best capital structure (Goyal, 2013).

Nevertheless, the key to choosing acceptable and appropriate level of financial leverage is still debatable by the top management of an organization (Chechet & Olayiwola, 2014). Several theories and much empirical evidence in providing the most favorable capital structure exist in the real world. Until now, this is still an overcast area and with no definite guidelines to help financial officers in reaching an efficient combination of equity and debt. Therefore, only calculated judgment and clues plus some understanding of financial theory are probable tools to be applied in making easy how the financing mix affects the firm’s value and its stock price (Farhad & Aliasghar, 2013).

From the emerging markets of South-East Asia, there are a number of studies that provide evidence on the capital structure determinants (Pandey, 2001; Pandey, Chotigeat, & Ranjit, 2000; Annuar & Shamsher, 1993). The focal point of corporate finance empirical literature has been to identify some ‘stylized’ aspects that determine capital structure. Modigliani and Miller (1958) instigated the theory of capital structure in their prominent seminal work on the effects of capital structure on the firm’s value. They demonstrated and finally concluded that the ‘capital structure is an irrelevance’ in an ideal financial market, bearing in mind the no-tax case in the ‘pie model,’ which literally means that the firm’s value is independent of its financing or financial structure. They argue that the size of the pie depends only on the level and risk of its future cash flows and not on how it is sliced. Modigliani and Miller (1963) still demonstrated how firms should make use of all debt financing, because interest is deductible for tax purpose. This ‘tax shield’ permits
firms to pay less taxes than they should if equity financing is used, thus achieving optimal capital structure through tax saving. Shockingly, regardless of all the controversial issues and criticism arising from the Modigliani and Miller (M&M) proposition, the empirical work by Hatfield, Cheng, and Davidson (1994) supports the M&M theorem. As time moved on, and with current developments in the corporate world, more researches have examined in greater depth the concept of capital structure.

The trade-off theory of capital structure comes at a later stage, which is concerned about the corporate finance choices of organizations, and is widely argued. Its rationale is to describe the fact that firms are usually financed by some proportion of debt and equity. It proposes the principle that a firm’s target leverage is driven by tax-shields, bankruptcy costs of debt and agency conflicts (Hauswald & Marquez, 2005). Under the trade-off theory, it affirms the advantages of using debt because the firm can gain a tax shield by using some proportion of debt in financing the company. The tax shield comes from the interest payment as a tax deductible item, which means that the higher the interest payment on debt employed, the lower will be the taxes paid by the firm (Mahira, 2011). However, as companies decide to use more debt; this will put companies in the position of financial distress due to the possibility of the firm being in default in meeting its liabilities obligations. Financial distress will include bankruptcy and non-bankruptcy cost.

In conclusion, the trade-off theory suggests that optimal capital structure can be attained. Nonetheless, firms should take appropriate actions in balancing between the tax benefits of higher debt and the greater possibility of financial distress costs, while aiming to optimize their overall profits and value. Early empirical evidence on the trade-off theory by Bradley, Jarrell and Kim (1984) reported mixed results.

Debt is an effective tool to lessen the agency costs, and eventually optimal capital structure can be derived from the balance between the costs of debt against the benefits of debt (Jensen & Meckling, 1976). In viewing the conflicts between shareholders and bondholders, covenants will protect the bondholders’ position so that they can mitigate the risk of default payment. However, the agency costs only arise when the risk of defaults payment exists. Even though the agency costs of debt are burdensome, they are the solution towards obtaining external funds at a lower rate. According to Yuanxin and Jing (2009) through the information of insiders, the preference of capital structure takes signals to outside investors. Managers (the insiders), according to Ross (1977) are very
much aware of the true sharing of organizations’ returns, but investors don’t. If managers decide to add more debt into capital structure, investors interpret this as a signal of high future cash flows and the firm is committed towards its contractual obligation. Thus, this will show a higher level of confidence that the management has towards the firm’s prospect in the near future. However, if managers decide to finance the firm by issuing new equity, this signals that management is lacking in confidence towards future prospects of the firm. Consequently, Myers and Majluf (1984) wrap up that shareholders take bigger levels of debt as an indication of superior quality and that leverage and profitability are thus positively related.

The profitability is the key element to determine the capital structure. The firms may have their retained earnings to increase their capital structure. Capital structure is an important topic in corporate finance for practitioners and academic researchers (Ebaid, 2009). In the recent years, several capital structure theories have been proposed to elucidate the disparity in debt ratios across companies. Capital structure theory suggests that firms determine what is often referred to as a target debt ratio; which is based on various trade-off between the costs and benefits of debt versus equity. The modern theory of capital structure was established by Modigliani and Miller (1958). Following on from this pioneering work of Modigliani and Miller on the capital structure, three conflicting theories of capital structure have been developed. They are namely: static trade-off theory (Bradley et al., 1984), pecking order theory (Myers & Majluf, 1984), and agency cost theory (Jensen & Meckling, 1976).

To understand how firms in developing countries finance their operations, it is necessary to examine the determinants of their financing or capital structure decisions. Company financing decisions involve a wide range of policy issues. At the macro level, they have implications for capital market development, interest rate and security price determination, and regulation. At the micro level, such decisions affect capital structure, corporate governance and company development (Green, Murinde, & Suppakitjarak, 2002).

Singh and Hamid (2006) and Singh (2005) used data on the largest companies in selected developing countries. They found that firms in developing countries made significantly more use of external finance to finance their growth than is typically the case in the industrialized countries. They also found that firms in developing countries rely more on
equity finance than debt finance. These findings seem surprising given that stock markets in developing countries are invariably less well developed than those in the industrial countries, especially for equities. However, in an Indian study, Cobham and Subramaniam (1998) used a sample of larger firms and found that Indian firms use substantially lower external and equity financing. In a study of large companies in ten developing countries, Booth, Aivazian, Demirguc-Kunt, and Maksimovic, (2001) also found that debt ratios varied substantially across developing countries, but overall were not out of line with comparable data for industrial countries.

Voulgaris, Asteriou and Agiomirgianakis (2013) investigated the determinants of capital structure of large size enterprises (LSEs) in the Greek manufacturing sector. The findings suggest that asset utilization, gross and net profitability and total assets growth has a significant effect on the capital structure of LSEs. They have also suggested that in order to improve their capital structure, Greek manufacturing LSEs need to achieve higher asset utilization and profit margins through economies of scale by increasing exports. They have also suggested that governments should focus on alleviating taxation, reducing bureaucratic burdens, minimizing market imperfections and subsidizing applications of new technology.

Mesquita and Lara (2013) have studied the relationship between capital structure and profitability of the Brazilian Firms. They are of the view that there is a difficult decision that whether company should use debt or equity and this decision become more difficult when a company is operating in unstable environment and this problem occur largely in Brazil. They examined the effects of debt or equity on profitability. Ordinary least squares method was used to examine the effect of short and long term financing on return on equity. On the other hand, the market also interprets this as a positive sign that the company is anticipating more returns so resultantly the price of the share goes up. This is because if a firm needs resources in the short term then it tries to take a loan and has no intention to raise equity due to the cost of raising equity which is greater than the debt. Due to high interest rates in Brazil, in the long run debt becomes more costly as compared to the equity (Osteryoung, Constand, & Nast, 2012).

In Kenya, the manufacturing sector is the fourth biggest sector after agriculture, transport and communication and wholesale and retail trade. Although Kenya is the most industrially developed country in East Africa, the manufacturing sector in Kenya
constitutes 70 per cent of the industrial sector contribution to GDP. Kenya Vision 2030 identifies the manufacturing sector as one of the key drivers for realizing a sustained annual GDP growth of 10 per cent (World Bank, 2007). The manufacturing sector has high, yet untapped potential to contribute to employment and GDP growth. Industrial activity, concentrated around the three largest urban centers of Nairobi, Mombasa, and Kisumu is dominated by food-processing (Oyuke, 2012). As an important sector in the overall economic growth, manufacturing sector requires in depth analysis at industry as well as firm level. However, there are a few studies with reference to Kenya on working capital management and firm profitability, especially in the manufacturing and construction sectors.

After a long period of virtual stagnation the Kenyan economy went through a strong phase over the period 2003-2007, as the rate of economic growth accelerated up to 7 per cent. During the same period total factor productivity (TFP) in manufacturing increased by as much as 20% (World Bank, 2007). Aggregate capital formation increased up to 19.5 per cent, which is high by Kenyan standards, but of course pales in comparison with those of its Asian competitors. And it is a long way away from the long-term target of investments of 30% of GDP. The positive development was (temporarily) halted by the post-election conflicts in 2008. Manufacturing growth followed more or less the same pattern as GDP, which meant that its share of GDP remained at slightly below 10 per cent of GDP. There has thus not been any major take-off for manufacturing production in Kenya (Kenya Economic Report, 2013).

According to World Economic Forum (2007), challenges facing the sector include shrinking demands for locally manufactured goods due to rising poverty levels and reduced exports resulting from general economic slump after the recent global recession. In addition, the high cost of inputs resulting from poor infrastructure has led to high prices for final products leading to underutilization of capacity. Other challenges include security issues, arbitrary charges levied by regulatory and local authorities and high cost of securing financial facilities from the banks. Due to the above challenges, the industry is facing decrease in production and net profits. This also affects how the companies in the industry choose the mixture of their capital structure.
1.2 Statement of the Problem

World Bank (2012) found that despite Kenya’s financial system development and numerous efforts by the Republic of Kenya, domestic savings have still been decreasing with time. This is depicted in Appendix I, where Kenya’s gross domestic savings is seen to be declining over years from 1980 through 2011. According to Ngugi, Amanja, and Maana (2012), the decrease in savings has caused many institutions in Kenya including business enterprises to access foreign sources of finance to fund for business activities. The foreign sources of finance bear higher costs of financing compared to the domestic sources and these costs are charged as interest rates. Deesomsak, Paudyal, and Pescetto (2011) further noted that interest rates also incorporate inflation expectations and, therefore, corporations could be expected to change from equity to debt financing when interest rates are increasing. In this case, the degree of interest rates is anticipated to be positively correlated to leverage. Deesomsak, et al. (2011) asserts that more borrowings reduce profits by deducting interest payments. Ngugi, et al., (2012) state that due to the shortage of equity, manufacturing firms borrow more which enhances the leverage, but increases the interest expense. The increase of interest expense reduces the profits. The authors found that the reduction in profits results in less addition to equity.

According to Kenya National Bureau of Statistics (2012) the manufacturing sector in Kenya has been registering a steady decline in profitability. In Appendix II, the study by the Kenya National Bureau of Statistics (2012) reveals that the profits realized from manufacturing and allied sector has been declining for several years from 1980 to 2010. The progressive decline in Kenya’s economy is caused by various reasons varying from; choice of inappropriate development strategies; collapse of infrastructure; unstable macroeconomic environment; uncertain institutional and political environment and poorly managed policy transition. These have caused Kenyan manufacturing and allied sector to perform poorly. The lack of capital is a major constraint to economic growth and development. This in turn relates to low incomes, which do not allow for substantial savings, hence the unavailability of credit. A stable macroeconomic environment allows for industrial production and the subsequent creation of jobs that give fair wages to enable for savings to be mobilised for increased investment. As it is shown in appendix II, profits in the Kenyan manufacturing and allied sector have been declining over time and this has been due to less capital available for investment (Singh & Hamid, 2006). As indicated in
appendix I, the decreasing level of savings has caused the inadequacy of capital in the capital market.

The manufacturing sector has been identified as one of the key sectors to support the Kenya Vision 2030 strategy. According to the Economic Survey (2012) compared to a revised growth of 4.5% in 2010, the manufacturing sector contribution to GDP worsened from 9.6% in 2011 to 9.2% in 2012, while the growth rate deteriorated from 3.4% in 2011 to 3.1% in 2012. According to the Global Economic Report of 2012 – 2013, surviving firms have significantly less debt outstanding than ailing firms. Yet, the average ratio of total debt to total assets is still very high at 87.68% in the surviving firms, with a median value of 81.10%. On average 36.90% of the assets of surviving firms are financed by means of bank debt (World Economic Forum, 2013).

1.3 General Objective

The main objective of the study was to establish the effects of capital structure on profitability of firms in the manufacturing sector in Kenya

1.4 Specific Objectives

1.4.1 What is the influence of equity financing on profitability of firms in the manufacturing sector in Kenya?

1.4.2 What is the effect of debt on profitability of firms in the manufacturing sector in Kenya?

1.4.3 What is the impact of the preference share financing on profitability of firms in the manufacturing sector in Kenya?

1.5 Significance of the Study

1.5.1 Manufacturing and Allied Companies

The information from this study benefits manufacturing and allied companies. The companies would use the information from this study in understanding the impact of profitability on their capital structure hence make good decisions concerning capital structure.
1.5.2 Other Companies on the NSE

This study is intended to benefit other companies from different sectors that are trading on the Security Exchange. The firms benefits by understanding and reacting proactively to the effects of profitability to the capital structure. This makes them develop strategies to minimize the impact of profitability on capital structure.

1.5.3 Scholars and Future Researchers in Colleges and Universities

For scholars, the study gives full proof that exercising good capital structure mix is essential for the continued existence of organizations. The study also is useful to researchers in providing an in-depth understanding of capital structure and profitability.

1.5.4 Policy Makers

This study informs policy makers on the need to make and implement good policies that would help different companies to access to different capital for their businesses.

1.5.5 Shareholders

This study helps shareholders understand the importance of the perfect mix of capital structure in relation to net profits.

1.6 Scope of the study

The study focused on manufacturing and allied companies listed on the Nairobi Securities Exchange (NSE) and the Capital Markets Authority (CMA) in Kenya. The study assessed the effects of capital structure on the net profits of manufacturing and allied companies listed on Nairobi Securities Exchange for the year 2015. The study aimed to research on all nine (9) manufacturing and allied firms listed on Nairobi Securities Exchange Kenya. The study used financial statements of the companies from the year 2015 to extract data from and use for analysis. The research went on for a period of three months starting from October 2016. The study experienced a limitation of obtaining relevant data from the relevant authorities. To mitigate this challenge, the researcher used two institutions; the Nairobi Securities Exchange and the Capital Markets Authority. The data the researcher could not obtain from the Nairobi Securities Exchange, she obtained from the Capital Markets Authority.
1.7 Definition of Terms

1.7.1 Profitability

According to Brealey, Myers and Allen (2011), profitability is the ability of a business to earn a profit. A profit is what is left of the revenue a business generates after it pays all expenses directly related to the generation of the revenue, such as producing a product, and other expenses related to the conduct of the business activities.

1.7.2 Net Profit

Net profit is the number of sales dollars remaining after all operating expenses, interest, taxes and preferred stock dividends (but not common stock dividends) have been deducted from a company's total revenue (Taani, 2013).

1.7.3 Capital Structure

Saad (2010) define capital structure as how an organization finances its operations by utilizing different sources of funds. This includes owners’ equity, long-term debts and preference shares.

1.7.4 Debt Financing

Debt Financing is when a firm raises money for working capital or capital expenditures by selling bonds, bills, or notes to individual and/or institutional investors (Yuanxin & Jing, 2009).

1.7.5 Equity Financing

Equity financing is the process of raising capital through the sale of shares in an enterprise or an organization (Anup & Suman, 2010).

1.7.6 Equity Financing

Preference shares, more commonly referred to as preferred stock, are shares of a company's stock with dividends that are paid out to shareholders before common stock dividends are issued. If the company enters bankruptcy, the shareholders with preferred stock are entitled to be paid from company assets first (Pandey, 2009).
1.8 Chapter Summary

Chapter one presents the background information about profitability and capital structure. The research questions of the study, the implication of the study, consequence and the scope of the study as well as the definitions of specific terms used in the research is also outlined in this part. The literature which is guided by the research questions recognized in chapter one is reviewed in chapter two. Chapter three presents research methods while chapter four and five present research findings, discussions, conclusion and recommendations.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

The chapter provides the literature review on the effects of capital structure on net profits of manufacturing companies listed on the Nairobi Securities exchange (NSE) Kenya. The chapter is separated into different parts starting with part 2.2 that depicts the influence of equity financing on profitability of firms in the manufacturing sector. Part 2.3 presents a discussion on the effect of debt on profitability of firms in the manufacturing sector. Part 2.4 discusses the impact of the preference share financing on profitability of firms in the manufacturing sector. Finally, part 2.5 is the summary of the whole chapter.

2.2 The Influence of Equity Financing on Profitability

2.2.1 Theoretical Review

How do firms finance their operations? How should firms finance their operations? What factors influence these choices? How do these choices affect the rest of the economy? These are important questions of long standing. At one time, the complexity of the problem was thought by many to be so great as to defy the development of reasonable theories. Half a century ago Weston (1955) even felt the need to argue that it was possible to develop reasonable theories about these matters. Since then, a remarkably large number of ideas and theories have been proposed to answer these questions.

The theory of business finance in a modern sense starts with the Modigliani and Miller (1958) capital structure irrelevance proposition. Before Modigliani and Miller, there was no generally accepted theory of capital structure. They start by assuming that the firm has a particular set of expected cash flows. When the firm chooses a certain proportion of debt and equity to finance its assets, all that it does is to divide up the cash flows among investors. Investors and firms are assumed to have equal access to financial markets, which allows for homemade leverage. The investor can create any leverage that was wanted but not offered, or the investor can get rid of any leverage that the firm took on but was not wanted. As a result the leverage of the firm has no effect on the market value of the firm.
The term trade-off theory is used by different authors to describe a family of related theories. In all of these theories, a decision maker running a firm evaluates the various costs and benefits of alternative leverage plans. Often it is assumed that an interior solution is obtained so that marginal costs and marginal benefits are balanced. The original version of the trade-off theory grew out of the debate over the Modigliani-Miller theorem. When corporate income tax was added to the original irrelevance proposition (Modigliani and Miller, 1963) this created a benefit for debt in that it served to shield earnings from taxes. Since the firm’s objective function is linear, and there is no offsetting cost of debt, this implied 100% debt financing.

The pecking order theory stems from Myers (1984) who in turn was influenced by the earlier institutional literature including the book by Donaldson (1961). Myers (1984) argues that adverse selection implies that retained earnings are better than debt and debt is better than equity. This ranking was motivated with reference to the Myers and Majluf’s (1984) adverse selection model. The ordering, however, stems from a variety of sources including agency conflicts and taxes.

2.2.2 Equity Financing

Equity financing is the process of raising capital through the sale of shares in an enterprise. Equity financing essentially refers to the sale of an ownership interest to raise funds for business purposes. Ross (2003), states that a corporation can raise funds from either lenders or shareholders. If the corporation borrows, the lenders contribute the funds and the corporation promises to pay back the debt plus a fixed rate of interest. If the shareholders put up the funds, they get no fixed return, but they hold shares of stock and therefore get a fraction of future profits and cash flow. The shareholders are equity investors, who contribute equity financing. The choice between debt and equity financing is called the capital structure decision. Capital refers to the firm’s sources of long-term financing (Brealey, et al., 2011).

Corporations raise equity financing in two ways. First, they can issue new shares of stock. The investors who buy the new shares put up cash in exchange for a fraction of the corporation’s future cash flow and profits. Second, the corporation can take the cash flow generated by its existing assets and reinvest the cash in new assets. In this case the
corporation is reinvesting on behalf of existing stockholders. No new shares are issued (Farhad & Aliasghar, 2013).

What happens when a corporation does not reinvest all of the cash flow generated by its existing assets? It may hold the cash in reserve for future investment, or it may pay the cash back to its shareholders. When the business pays the cash back to its shareholders, it reduces its net profits that would be used to expand or rather diversify the business operations. Business is inherently risky. The financial manager needs to identify the risks and make sure they are managed properly. For instance, debt has its advantages, but too much debt can land the company in bankruptcy (Brealey, et al., 2011).

Financing arrangements determine how the value of the firm is sliced up. The firm can determine its capital structure. That is, the firm might initially have raised the cash to invest in its assets by issuing more debt than equity; now it can consider changing that mix by issuing more equity and using the proceeds to buy back some of its debt. Financing decisions like this can be made independently of the original investment decisions. The decisions to issue debt and equity affect how the pie is sliced and this helps to save on the net profits that would be paid out to debtors as interests earned (Ross, 2003).

2.2.3 Net profits

Net profit, also referred to as the bottom line, net income, or net earnings is a measure of the profitability of a venture after accounting for all costs. It is the actual profit without inclusion of working expense in the calculation of gross profit (Brealey, Myers, & Allen, 2011). In a survey of nearly 200 senior marketing managers, 91% responded that they found the "net profit" metric very useful. In accounting, net profit is equal to the gross profit minus overheads minus interest payable for a given time period, usually accounting period. (Farris, Neil, Phillip, & David, 2010)

According to Farris, et al. (2010) a common synonym for "net profit", when discussing financial statements which include a balance sheet and an income statement, is the bottom line. This term results from the traditional appearance of an income statement which shows all allocated revenues and expenses over a specified time period with the resulting summation on the bottom line of the report. In simplistic terms, net profit is the money
left over after paying all the expenses of an endeavor. In practice this can get very complex in large organizations or endeavors. The bookkeeper or accountant must itemize and allocate revenues and expenses properly to the specific working scope and context in which the term is applied (Anup & Suman, 2010).

2.2.4 Profit Efficiency

In Nigeria for instance, Oke and Afolabi (2011) investigated the impact of equity financing on industrial performance as far as net profit is concerned. Oke and Afolabi (2011) took five listed companies into account with equity financing, debt financing and debt to equity financing as stand-in for capital structure whereas profit efficiency a proxy for performance. For debt to equity and equity finances, a positive correlation existed but a negative correlation between debt financing and performance.

Anup and Suman (2010) found out that the impact of capital structure on the value of firm in the context of the Bangladesh industrial sector by gathering secondary data of publicly listed companies traded in Dhaka Stock Exchange (DSE) and Chittagong Stock Exchange (CSE) using share price as a proxy for firm's value and different ratios for capital structure decision. It was found that maximizing wealth for the shareholders require perfect combination of debt and equity and that cost of capital is negatively correlated and therefore to be reduced to minimum level. The findings implied that equity financing is beneficiary to business as it increases net profits and enhances value of the organization.

Ong and Teh (2011) examined the relationship between capital structure and organization performance of construction firms for a period of four years (2005-2008) in Malaysia. Debt to asset, debt to capital, Long term debt to capital, debt to common equity, debt to equity market value, long term debt to common equity were used as surrogates as the independent variables (capital structure) whereas net profits, return on capital, earnings per share, return on equity, operating margin were used to surrogate the corporate performance. The result reveals that there is a correlation between corporate performance and capital structure. The study found a positive relationship between net profits and equity financing. The study concluded that for an organization to enhance value there should be a perfect combination between equity and debt financing whereby equity should assume the highest proportion.
Researchers generally agree that an association among capital structure and firm performance exist (Ai, 1997; Hung, Albert, & Eddie, 2002). Akintoye (2008) in a study of the sensitivity of performance to capital structure confirms that the performance indicators (earnings before interest and taxes, earnings per share and dividend per share) used in his study were significantly sensitive to the capital structure in most of the companies. According to Jensen (1986), argument of free cash flow predicts that higher leverage might raise financial performance due to the reason that managers of such firms are lesser able to initiate with projects showing negative net present value (NPV). Margaritis and Psillaki (2009) in checking the association among capital structure, firm performance and equity ownership, found supporting results for the centre forecast of the Jensen and Meckling (1976).

2.2.5 Cash Dividends and Net Profits

When a company declares a cash dividend on its shares, its retained earnings are reduced and its current liabilities (Dividends Payable) are improved. When the cash dividend is paid out to shareholders, the Dividends Payable account is reduced and the company's cash account is minimized.

The net consequence of the announcement and disbursement of the dividend is that the company's stockholders' equity and assets have reduced. Particularly, the statement of financial position accounts retained earnings and cash are reduced. The income statement is not affected by the announcement and disbursement of cash dividends on common stock. The cash dividends on preferred stock are subtracted from gross income to arrive at net income obtainable for common stock. The cash dividends are reported as a use of cash in the financing activities section of the cash flow statement (Stulz, 2008).

2.3 The Effects of Debt Financing on Profitability

2.3.1 Debt Financing

Profit margin is a way of measuring how well a company is doing, regardless of size of the organizations. The capital structure is how a firm finances its overall operations and growth by using different sources of funds (Taani, 2013). The successful selection and use of the debt-to-equity ratio is one of the key elements of firms’ financial strategy. The
profit margin is a key element to determine the capital structure. The firms may have their retained earnings to increase their capital structure (Pandey, 2009).

The profitability is the key element to determine the capital structure. The firms may have their retained earnings to increase their capital structure. Capital structure is an important topic in corporate finance for practitioners and academic researchers. A variety of capital structure theories have been proposed in the recent years to extrapolate the disparity in debt ratios across organizations (Yogendraajah & Thanabalasingam, 2010). Since Modigliani and Miller (1958), a large amount theoretical work has been done. Among the theories, no reliable forecasts have been reached of the correlation between capital structure and profitability. Tax-based models suggest that profitable firms should borrow more, ceteris paribus, as they have greater needs to shield income from corporate tax. Pecking order theory, however, recommends firms to use retained earnings initially as investment funds, then move to bonds and new equity so long as it is necessary. Profitable firms, in this case, tend to have less debt. Agency-based models also give us conflicting predictions. On the one hand Jensen (1986) defines debt as a discipline device to ensure that managers pay out profits rather than build empires. For firms with free cash flow, or high profitability, high debt can restrain management discretion. On the other hand Chang (1999) shows that the optimal contract between the corporate inside and outside investors can be interpreted as a combination of debt and equity, and profitable firms tend to use less debt.

A research to examine the effect of capital structure choice on the performance of companies in Egypt was carried out by Ebaid (2009). Net profit margin was used to evaluate performance. Short-term liability to asset ratio, fixed liability to asset ratio, and total liability to total assets were used as capital structure. Multiple regression analysis was used to ascertain the relationship between the leverage level and performance. The study revealed that capital structure has little or no effect on an organization’s performance. These findings are contradictory to other empirical studies such as Hadlock and James (2002), which established a positive correlation between choice of capital structure and financial leverage. Other studies confirmed a negative correlation such as Booth, et al. (2001) and Gleason, Mathur and Mathur (2000) a whereby higher firm performance is related to lower equity capital ratio.
Profit margin broadly indicates both a company’s competitive position in an industry, and the industry’s characteristics in terms of the strength of competition, pricing flexibility, demand - supply scenario, and regulation (Chechet & Olayiwola, 2014). A company’s profit performance is a good indicator of its fundamental health and competitive position. Profit margin, observed over a period of time, also indicates whether a company can sustain its present cash accruals. A profitable company exhibits the ability to generate internal equity capital, attract external capital, and withstand business adversity. From a rating point of view, the profit after tax (PAT) margin, that is, the ratio of PAT to operating income is the most important profitability ratio. Although other ratios such as operating profit before depreciation, interest, and tax (OPBDIT) to operating income, or operating profit before tax (OPBT) to operating income, are also evaluated, these ratios tend to be influenced by industry specific characteristics, and hence, do not lend themselves to comparison across industries. A high PAT margin offsets, to some extent, the effect of business risk and the corresponding financial risk. However, when used in evaluating low value added industries such as trading, the PAT margin also tends to have industry specific characteristics. This is appropriately factored in while analyzing such industries (CRISIL, 2012). In contrast to theoretical studies, most empirical studies show that Capital structure is negatively related to profitability. Friend and Lang (1988), obtain such findings from US firms. Taani (2013) finds that debt financing is negatively related to profitability in both the US and Japan. Brealey, et al. (2011) even claims that “profitability has the largest single effect on debt/asset ratios.” Quite a large strand of theoretical and empirical research has focused on the area of determinants of capital structure. Titman and Wessels (1988) investigated that the determinants of capital structure choice using data from United States from 1974 to 1982. They reported that debt levels are negatively related to the “uniqueness” of a firm’s line of business. They found out that firms can potentially impose high costs on their customers, workers, and suppliers in the event of liquidation have lower debt ratios. They conclude that transaction costs may be an important determinant of capital structure choice.

Gau and Wang (2003) in their study were amongst the first to apply the theory of capital structure directly to real estate investment decisions at the project level. Based on a sample of 1,423 apartment and commercial property transactions in Vancouver between 1971 and 1985, they observed that the level of debt employed in a property acquisition is
directly related to the cost of the investment and inversely to the size of its depreciation tax shield, expected costs of financial distress and market interest rates.

Jean (2004) developed a preliminary study to explore the determinants of capital structure of Chinese-listed companies using firm-level panel data. The findings reflect the transitional nature of the Chinese corporate environment. Different financial authors suggest that some of the ideas from contemporary finance theory of capital structure are transferable to China in that certain firm-specific issues that are pertinent for explaining capital structure in developed economies are also key in China. However, neither the trade-off model nor the Pecking order hypothesis derived from the Western settings provides convincing explanations for the capital choices of the Chinese firms. The capital choice decision of Chinese firms seems to follow a “new Pecking order”—retained profit, equity, and long-term debt. These important institutional distinctions and financial restrictions in the banking sector in China are the issues influencing companies’ leverage decision and they are in any case as important as the firm-specific factors (Nirajini & Priya, 2013).

In the study of Yogendrarajah and Thanabalasingam (2010), the effect of profit margins on capital structure on listed manufacturing companies on Colombo Stock Exchange was examined. The study found out that company’s profit margin did not strongly related to capital structure. The study also confirmed that in manufacturing firms of Sri Lanka, profit margin of the companies was not significant in bringing about any changes in their capital structure. The capital structure of the companies was established by other factors such as equity financing, working capital and debt capital. The study, further, showed that most companies that finance their investment activities by retained earnings are more profitable than those that finance their activities through borrowed capital. The reason for this was that, if firms finance their operations from borrowed capital then they will have to impose interest costs then the financial burden to be on them (Osteryoung, et al. 2012).

Yuan and Kazuyuki (2011) carried out a study on the impact of the debt ratio on firm investment. Using a sample of Chinese listed companies showed that total debt ratio had a negative impact on fixed investment. A firm with a high debt ratio will channel most of its income to debt repayments thereby forgoing investment using internal funds. As more debt is employed in the capital structure of a firm, the business risk also increases. Yuan and Kazuyuki argued that creditors will be reluctant to lend more funds to a highly
indebted firm which can result in underinvestment. Firm operations will be affected if insufficient investment is undertaken.

Pouraghajan, Malekian, Emamgholipour, Lotfollahpour and Bagheri (2012) investigated on the impact of capital structure on the financial performance of companies listed in the Tehran Stock Exchange. The study tested a sample of 40 firms among the companies listed in the Tehran Stock Exchange. Results suggest that there is a significant negative relationship between debt ratio and financial performance of companies, and a significant positive relationship between asset turnover, firm size, asset tangibility ratio, and growth opportunities with financial performance measures.

Ahmad, Abdullah and Roslan (2012) carried a study in Malaysia which sought to investigate the impact of capital structure on firm performance by analyzing the relationship between return on assets (ROA), return on equity (ROE) and short-term debt and total debt. The study established that short-term debt and long-term debt had significant relationship with ROA. It was also established that ROE had a significant relationship with short-term debt, long-term debt and total debt.

2.3.2 Net Profit Margin

The Gross Operating Margin is a measure of profitability. It is an indicator of the efficiency of the operation of production (Puwanenthiren, 2011). A firm with a fairly higher percentage of gross margins is well on the way to higher percentage of operating profit. The gross operating margin is influenced by rate of change in cost of production and rate of change in selling price. A stable or declining trend in the rate of change in cost of production would help a firm to achieve a higher gross operating margin hence higher net profit (Chechet & Olayiwola, 2014). On the other hand, an increasing trend in cost of production would cause a reduction in gross operating margin and net profit. The variability in sales may also affect gross operating margin. If the sales revenue is fairly stable, then the firm’s profit would be stable. Such stability paves the way either for going in for a higher level of debt or for lessening the proportion of debt in the capital structure (Kinsman & Newman, 1999).

Net profit measure how much amount earned by the firms. A low profit margin indicate that larger risk decline in sales will reduce profit and at the end in a net loss. Net profit
margin provide the information to the firms pricing policies that cost structure and production efficiency. Different product mixes strategies use because the net profit margin to different among different companies (Agarwal & Elston, 2001). Net profit margin is indicating that how efficient a firms is and how it well control its costs. The larger the margin is the more effective the firms are in converting income into actual earning. Net profit margin is usually used to firms compare expense over time. To compare the net profit margin between firms in the same industry might have low meaning. That not effect by the firms that it is not efficient than other company. The operating profit margin gives the opportunity that the business owner a lot of important information about the company profitability, so particularly with regard to control cost. It indicates that how much cash is thrown off after the most of the expense are achieve. A large profit margin means that the firms has good cost control and or that sales are improving faster than costs, which is the optimal situation for the firms (Chiou, Cheg, & Wu, 2006).

Korajczyk and Levy (2003) assert that gross profit margin reveals the percentage of a firm’s sales revenue would be left after taking away the cost of goods sold. This is vital as it helps to establish whether the organization would still have sufficient funds to cover operating costs such as lease payments, advertising, employee benefits, and many more. An organization’s gross profit margin may also be viewed as a measurement of production efficiency. A firm with a gross profit margin more than that of its competitors, or the industry average, is believed to be more efficient and is for that reason preferred (Nirajini & Priya, 2013).

2.4 The Impact of Preference Share Financing on Profitability

2.4.1 Preferred Stock

Preferred stock (also known as preference shares, preferred shares, or just preferreds) is a type of stock that have any mixture of characteristics not owned by common stock including properties of both debt and equity instrument, and is usually regarded as a hybrid instrument. Preference stocks are higher ranking to common stock, but lesser to bonds in terms of claim or rights to their share of the assets of the company and have precedence over common stock or rather ordinary shares in the reimbursement of dividends and upon insolvency. Terms of the preference stock are illustrated in the articles of association (Brealey, Myers, & Allen, 2011).
Fooladi and Roberts (1986) found that like bonds, preference stocks are rated by the main credit-rating firms. The rating of preference shares is by and large lower than for bonds since dividends accrued from preference shares do not carry the same warranties as interest payments from bonds and because preference stock holders’ claims are subordinate to those of all creditors.

Preference share is an extraordinary class of stock which may have any mixture of traits not possessed by common stock. The following characteristics are typically associated with preference stock: preference in assets, preference in dividends, in the event of insolvency, ability to be redeemed before it matures, convertibility to common stock, at the option of the company and nonvoting (Heinkel & Zechner, 2009). Generally, preference stock has first choice in dividend payments. The preference does not guarantee the payment of dividends, but the firm must pay the proposed dividends on preference stock before paying any dividends on common stock. Preferred stock can be noncumulative or cumulative. A cumulative preferred needs that if a firm fails to pay a dividend or pays less than the proposed rate, the firm must make up for it at a later time. Dividends accrue with each passed dividend period (which might possibly be quarterly, semi-annually or annually) (Linn & Pinegar, 2008). Passed dividend is a dividend not paid in time. All passed dividends on a cumulative stock constitute a dividend in arrears. A stock lacking this attribute is known as a straight preferred stock or noncumulative; any dividends passed are lost if not declared (Heinkel & Zechner, 2009).

2.4.2 Preferred Business Financing

Preferred stock has been used as means of financing for a long time, yet the existing literature provides few convincing explanations for issuing this security by non-regulated firms. Preference stock bears a resemblance to debt in that it guarantees pre-determined levels of dividends. Unlike interest on debt, however, preference dividends are not tax-deductible to the issuing companies. On the other hand, omission of dividends will not result in bankruptcy (Mesquita & Lara, 2013). According to Masulis (2006), empirical studies reveal that when a company repurchases equity and increases the percentage of preference shares on the capital structure, the impact of the stock price is similar but of a lesser degree than that resulting from retiring equity so as to enlarge debt. Preferred stock, in other words, appears to be observed as a partial substitute for debt.
According to the study done by Brealey, et al. (2011) the traditional literature suggests two motives for issuing preferred stock by utilities. First, preference stock is regarded as equity by the regulators, but offers a prototype of payments similar to that of debt. For that reason, it is profitable for firms to issue preference as opposed to debt, thus meeting regulators’ equity constraints. Second, firms can pass their costs on to the customers hence are less affected by the tax disadvantages of preference stock (Copeland & Weston, 2009).

Most issuers of preference stocks are, nonetheless, industrial firms (Houston & Houston, 1990). Thus, explaining what motivates such firms to issue preferred stock is quite important. Issuing preference shares by non-regulated organizations can be substantiated by clientele effects. Seventy percent of dividends received by corporations (85 percent according to the former U.S. tax law) are tax-exempt. Thus companies are better off receiving dividends of preference stock other than interest on capital gains or debt. Linn and Pinegar (2008) find that issuance of preferred stock by frequent issuers, such as utilities was anticipated by the market and hence provided no new information; issuance by financials provided tax benefits; and issuance by industrials conveyed new, and negative, information regarding the firm’s prospects.

Since 1993 some firms (in particular, Enron and Texaco) were issuing a new type of preferred stock: “Structured Preferred Stock” (also referred to as monthly income preferred stock, MIPS). Firms that issue MIPS create subsidiaries that raise money via preferred shares. That money is then loaned to the original company. The latter pays interest to the subsidiary. The subsidiary in turn passes the cash through to investors as preferred dividends (Irvine & Rosenfeld, 2000). MIPS are treated as preferred stock for financial statements and as debt for tax purposes. Practitioners attribute the popularity of this instrument to the fact that it lowers the debt-equity ratios, providing the issuer with better credit ratings with some credit rating agencies (Engle, Erickson, & Maydew, 1999). However, ever since its inception, the favorable tax treatment of this hybrid has been called into question by the government and the IRS2. In the aftermath of the Enron bankruptcy in 2002 it seems MIPS may indeed by on the way out. Also, clearly, MIPS can be treated analytically as preferred stock for one firm and debt for the other.
2.4.3 The Utility of Preferred Stock

In most situations, investors prefer enforceable legal rights over mere promises. However, the inability for fixed-claim financers to force liquidation can be efficient and lead to higher overall returns for firms with highly variable or unpredictable cash flow." Over time, these firms can be highly profitable, but only if they can survive their lean years-periods during which they lose money, exhaust their liquid assets, and are unable to pay the yield on their fixed-claim financing." In such cases, debt financing renders the firm and its investors vulnerable to opportunistic creditors, who can force the company into a bankruptcy and seize its equity during reorganization." This costly and ex ante inefficient process can be avoided by financing with preferred stock, since the company cannot be forced into default." It can simply wait out the lean years by suspending its dividend, resuming it (and paying arrears) upon regaining profitability. It is for this reason that venture capitalists rely so heavily on preferred stock financing (Copeland & Weston, 2009).

In this sense, preferred stock acts as a type of firm-level "automatic stabilizer." In macroeconomics that term refers to fiscal policies with naturally counter-cyclical effects; for instance, when workers are laid off as an economy begins to slide into recession, the payment of unemployment benefits or provision of food stamps immediately provides a fiscal stimulus to slow the recession's progress." Preferred stock works analogously at the level of the firm: as liquidity decreases, financing commitments automatically loosen so as to prevent a liquidity failure." By contrast, debt is pro-cyclical. A faltering debtor firm is likely to breach a maintenance covenant, and trigger creditors' control rights-rights that can be used to push the firm into a bankruptcy event." By reducing expected bankruptcy costs, preferred stock should increase investor yields, as compared to debt, for risky companies (Masulis, 2006).

Sadly, the automatic stabilizing feature has a significant downside: its issuance signals to the market that management believes the firm's expected bankruptcy costs to be high." Otherwise, the firm would simply finance with a lower-yield instrument like debt. An adverse selection feedback loop thus arises: by issuing preferred stock, firms signal that they are uncertain of their future prospects, which in turn causes investors to demand an even higher yield. The result is that preferred stock, though low-cost in theory ends up
being a high-cost financing mechanism for companies with uncertain outlooks (Stulz, 2008).

2.4.4 Usage of Preferred Stock

Preference shares offer a firm a different form of financing, for example through pension-led funding. In some cases a firm can postpone dividends by going into arrears with small punishment or risk to its credit rating, though; such action might have a negative effect on the firm meeting the terms of its financing contract. With traditional debt, payments are required; a neglected payment might put the firm in default (Annuar & Shamsher, 1993).

Occasionally firms use preference shares as means of stopping hostile takeovers, creating preference shares with a poison pill or conversion traits or forced-exchange which are practiced upon a change in control. Some firms have provisions in their charters permitting the issuance of preference stock whose terms and conditions are decided by the board of directors when issued. These "blank checks" are frequently used as a takeover resistance; they may be allotted very high liquidation value that must be converted in the event of a change of control, or may have immense super-voting powers (Engle, et al., 1999).

When a firm goes bankrupt, there might be sufficient money to reimburse holders of preference issues known as "senior" but not adequate money for "junior" issues. Therefore, when preference shares are first issued their overriding document may have protective requirements preventing the issuance of new preference shares with a senior claim. Individual series of preference shares might have a senior, pari-passu (equal), or junior correlation with other series issued by the same firm (Margaritis & Psillaki, 2009).

2.4.5 Benefits of Preferred Stock

Mesquita and Lara (2013) revealed that a business organization is not bound to pay a dividend on preferred shares if its returns in a certain year are inadequate. It can defer the dividend in case of cumulative preferred shares. No permanent burden is made on its finances. In general, preferred shares do not carry voting rights. Hence, a firm can raise finances without dilution of control. Equity shareholders hold exclusive control over the firm. The rate of dividend on preferred shares is predetermined. Therefore, with the
increase in its earnings, the firm can offer the benefits of trading on equity to the equity shareholders. Preferred shares do not form any charge or mortgage on the assets of the firm. The firm can keep its permanent assets free for raising loans in future. Oke and Afolabi (2011) put forward that various types of preferred shares can be issued basing on the needs of investors. Convertible preferred shares or participating preferred shares may be issued to attract enterprising and bold investors.

2.5 Chapter Summary

In this chapter, the study was about the effects of capital structure on profitability of manufacturing and allied companies listed on Nairobi Securities Exchange Kenya. The study has discussed the effects of equity financing, debt financing and preference share financing on net profits. The next chapter, research methodology, explores the methodology adopted by the researcher.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This chapter illustrates the research methodology and procedures that were used to conduct the study. The population and sampling design are also illustrated in this chapter. Sampling frame, sampling technique, sample size and research procedures are defined under sampling design. Described also in the chapter are data collection and analysis techniques to be employed.

3.2 Research Design

The nature of the study is quantitative geared on positivism paradigm. This provides the framework to be used as a guide in collecting and analyzing data (Cooper & Schindler, 2008). The research design that was adopted in this study is descriptive in nature. Descriptive studies describe features related to the subject population (Cooper & Schindler, 2014). Descriptive design helps in finding out and measuring the relationships among variables. The study utilised the descriptive research design to gather in depth information about the population under study therefore provide recommendations that are explicit and pertinent. The dependent variable for the study is profitability while the independent variable is capital structure.

3.3 Population and Sampling Design

3.3.1 Population

Population, according to Cooper and Schindler (2008), is the total compilation of elements at which inferences are made. The larger set of observation is called the population whereas the smaller set is known as the sample. This study therefore focused on the nine (9) manufacturing and allied companies listed on Nairobi Securities Exchange (NSE) Kenya. A list of manufacturing and allied companies listed on Nairobi Security Exchange is shown in appendix III. BOC Kenya Limited is a Kenya-based company, primarily engaged in the chemical industry. BAT is engaged in the manufacture and sale of cigarettes and tobacco. Carbacid produces natural, certified food grade carbon dioxide for the beverage and brewery industries, where it is used to carbonate water, soft drinks and alcoholic beverages. East African Breweries Limited is involved in the marketing,
production and distribution of a collection of brands that range from beer, spirits and adult non-alcoholic drinks. Eveready East Africa is a Kenyan manufacturer and marketer of battery brands. Mumias Sugar Company Limited is a sugar manufacturing company in Kenya. Unga Group Limited is a Kenyan based holding company with its investments in the business of flour milling and manufacturing of a human nutrition products and animal feeds. Kenya Orchards Limited engages in processing and selling of fruits, vegetables, and other food products in Kenya. The ninth company on the list is Flame Tree Group Holdings Ltd. Flame Tree is a leading regional manufacturing group that operates in fast moving consumer goods (FMCG), plastics and trading.

3.3.2 Sampling Design

Saunders, Lewis, and Thornhill (2012) found that a sample is a group from the population that represents the entire population. Sampling design is a method used in choosing a proportionate representation from the total sample size which is the population under study. Sampling enables: accuracy of results, lower cost, availability of population elements, and increased speed of data collection.

3.3.2.1 Sampling Frame

A list of elements from which the sample is actually drawn is called sampling frame. It is closely related to the population under study (Salikind, 2012). The list could be of geographical areas, institutions, individuals, or other units. In this study the list came from the Capital Markets Authority (CMA).

3.3.2.2 Sampling Technique

The method used in selecting elements from the population that represents the population is known as sampling technique (Bryman & Bell, 2011). In most cases, a researcher is required to describe how he/she would arrive at a sample size that would be used in the study. Given that the study adopted census technique, all manufacturing and allied firms listed on the Nairobi Securities Exchange was used in this study. McMillan and Schumacher (2006) define a census as a study where all members of the population take part in a study. Census increases the level of accuracy and reliability of a study.
3.3.2.3 Sample Size

A sample size is a number of units (persons, animals, patients, and specified circumstances) in a population to be studied (Cooper & Schindler, 2014). Because this study is a census; therefore, all the nine (9) manufacturing and allied companies trading on the Nairobi Securities Exchange (NSE) were used.

3.4 Data Collection Methods

Data collection method is defined as the systematic process that a researcher utilizes to collect either primary or secondary data for a study (Mugenda & Mugenda, 2012). The study used secondary data to obtain the needed data to complete the study. The study utilised financial statements of manufacturing and allied firms listed on the Nairobi Securities Exchange Kenya. The study collected from the financial statements data about profitability, debts, equity and preference shares of the manufacturing and allied companies listed on the NSE. The study used a checklist to collect secondary data from the nine listed manufacturing and allied companies. The researcher obtained values of equity, long term debts and preference shares from the financial statements of the manufacturing and allied companies.

3.5 Research Procedure

The researcher started by seeking authority letter from the research office for permission to carry on the study. The researcher presented the letter to the Capital Markets Authority (CMA) for them to release relevant information (audited financial statements) to the researcher. The data on profitability (net profit), equity, long term debts and preference shares was sampled for analysis.

3.6 Data Analysis Methods

A research method for the objective, systematic and qualitative description of the obvious content of a communication is referred to as data analysis (Cooper and Schindler, 2008). Quantitative method of data analysis was used in order for research quality in this study.
According to Cooper and Schindler (2008) descriptive statistics entails a process of converting a mass of raw data into charts and tables, with frequency distribution and percentages, which are a fundamental part of making sense of the data. The data for research was analyzed using Statistical Package for Social Sciences (SPSS) program and presented using tables to give a clear picture of the research findings at a glance.

Correlation was the statistic that was useful in describing the degree of relationship between variables used. The study also utilized measures of central tendency. Regression analysis was applied in testing the causal relationship in this study where the equation was $y = \alpha + \beta x_i$. Data was subjected to the Shapiro-Wilk test for normality. The researcher used a 0.05 level of significance.

3.7 Chapter Summary

Chapter three has depicted the methodology and procedures that was employed in carrying out the study. It started with a brief introduction highlighting the general methodology and structure of the chapter. The chapter also highlighted the method that was used to conduct the research and its use justified. The population was defined and the sampling technique, and sample size illustrated. Finally, the data collection techniques and research procedures to be used have been discussed. The next chapter that follows is Chapter four that talks about the results and findings of the study.
CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction

This chapter depicts the analyzed results and findings of the study on the effects of capital structure on profitability of manufacturing and allied companies listed on the Nairobi Securities Exchange. The first part is about the reliability of the data as provided by the Capital Markets Authority. The second part deals with equity financing and net profits. The third part is about debt financing and net profits. The fourth part is on the preference share financing and net profits and the final section is the summary of the whole chapter.

4.2 Reliability Statistics

The data that was used in this study was obtained from the Capital Markets Authority (CMA) hence it is very much reliable for the outcome of the study.

4.3 Equity Financing and Net Profits

The first objective of the study was to examine the influence of equity financing on profitability of firms in the manufacturing sector in Kenya for the financial years 2015.

4.3.1 Descriptive Statistics for Equity Financing

Table 4.1 shows the descriptive statistics of the manufacturing and allied companies. The descriptive statistics used in the study are mean, median, mode and standard deviation. The study reveals that the mean of the equity is 752.70 million Kenya shillings, the median is 254.85 million Kenya shillings and standard deviation is 0.100.

<table>
<thead>
<tr>
<th>Descriptive Statistics</th>
<th>Equity Financing</th>
</tr>
</thead>
<tbody>
<tr>
<td>N</td>
<td>9</td>
</tr>
<tr>
<td>Mean</td>
<td>752.70</td>
</tr>
<tr>
<td>Median</td>
<td>254.85</td>
</tr>
<tr>
<td>Std. Deviation</td>
<td>0.100</td>
</tr>
</tbody>
</table>
4.3.2 Correlation of Equity Financing and Net Profit

In social science research situations, a correlation is considered significant when its significance level (p) is less than 0.05 (p = 0.013<0.05). Table 4.2 reveals a negative relationship between equity financing and net profits. From the table it is shown that equity financing correlates with net profits at (r= -.526*, P<0.05, N= 9). The p-value for the study is 0.013 therefore, the relationship is statistically significant. The study clearly reveals that there is relationship between equity financing and net profits.

Table 4.2: Correlation of Equity Financing and Net Profit

<table>
<thead>
<tr>
<th>Equity Financing</th>
<th>Pearson Correlation</th>
<th>Sig. (2-tailed)</th>
<th>N</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Profits</td>
<td>-.526*</td>
<td>.013</td>
<td>9</td>
</tr>
</tbody>
</table>

4.3.3 Regression Analysis of Equity Financing and Net Profit

To determine relationship between equity financing and net profits regression was done between equity financing as a predictor variable against the net profit achieved in the manufacturing and allied industry in the year 2015.

The R² of the model was 0.437. This means that 43.7 percent of the variations in the net profits is explained by equity financing of the firms in the manufacturing and allied industry. The 56.3 percent difference is due to factors not predicted in this model symbolized by the error term. Given this model, the study tested whether there is a strong empirical ground to conclude that equity financing significantly enhances net profits.

Table 4.3: Model Summary of Equity Financing and Net Profit

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.526(^a)</td>
<td>.467</td>
<td>.437</td>
<td>.414</td>
</tr>
</tbody>
</table>

\(^a\) Predictors: (Constant), Equity Financing

The standardized coefficient (β) is -0.526 and p value is 0.013. The study used linear regression model to test the relationship between equity financing and net profits in the
manufacturing and allied industry. The results from the table above mean that a unit change in equity financing causes a change of -0.526 in net profits in manufacturing and allied industry.

\[ y = \alpha + \beta x \text{ hence } y = 1556.46 - 0.526x, \text{ where } y \text{ is the net profits, } x \text{ is equity financing.} \]

### Table 4.4: Beta Coefficients of Equity Financing and Net Profits

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
</tr>
<tr>
<td>1</td>
<td>(Constant)</td>
<td>1556.46</td>
</tr>
<tr>
<td></td>
<td>Equity Financing</td>
<td>-0.333</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Net Profit

#### 4.4 Debt Financing and Net Profits

The second objective of the study was to assess the effect of debt financing on net profits of firms in manufacturing and allied industry.

##### 4.4.1 Descriptive Statistics for Debt Financing

Table 4.5 shows that mean, median and standard deviation were the descriptive statistical tools used in the analysis. From the study, the mean for debt financing for the listed manufacturing and allied companies is 3,094.13 million Kenya shillings, median is 360.79 million Kenya shillings and standard deviation is 0.802.

### Table 4.5: Descriptive Statistics for Debt Financing

<table>
<thead>
<tr>
<th>Descriptive Statistics</th>
<th>Debt Financing</th>
</tr>
</thead>
<tbody>
<tr>
<td>N</td>
<td>9</td>
</tr>
<tr>
<td>Mean</td>
<td>3094.13</td>
</tr>
<tr>
<td>Median</td>
<td>360.79</td>
</tr>
<tr>
<td>Std. Deviation</td>
<td>0.802</td>
</tr>
</tbody>
</table>
4.4.2 Correlation of Debt Financing and Net Profit

In social science research situations, a correlation is considered significant when its significance level (p) is less than 0.05 (p = 0.011<0.05). The study in Table 4.6 reveals the correlations between Debt financing and net profit. The study found that the debt financing correlates positively with net profit at (r= .792*, P< 0.05, N= 9). The p-value is 0.011 which is less than 0.05 hence the relationship is statistically significant. The study means that there is a significant relationship between debt financing and net profit.

Table 4.6: Correlation between Debt Financing and Net Profit

<table>
<thead>
<tr>
<th>Net Profit</th>
<th>Pearson Correlation</th>
<th>Sig. (2-tailed)</th>
<th>N</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt Financing</td>
<td>.792*</td>
<td>.011</td>
<td>9</td>
</tr>
</tbody>
</table>

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

4.4.3 Regression Analysis of Debt Financing and Net Profit

The study sought to statistically test whether debt financing significantly affects net profits of firms in the manufacturing and allied industry. This was tested using the debt financing as a predictor variable against the net profit achieved in the manufacturing and allied sector.

The adjusted R² from this test is 0.573 meaning that 57.3 percent of the variation in net profit is explained by debt financing.

Table 4.7: Model Summary of Debt Financing and Net Profit

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.792a</td>
<td>.627</td>
<td>.573</td>
<td>25380.48</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Debt Financing

The study used linear regression model to test the relationship between debt financing and net profit in the manufacturing and allied industry. Table 4.8 depicts the results of the model.
The study means that a unit change in debt financing causes a change of 0.792 in net profits of companies in manufacturing and allied sector.

\[ y = 120.48 + 0.792x \]

where \( y \) is the net profit, \( x \) is the debt financing.

**Table 4.8: Coefficients Variation of Debt Financing and Net Profit**

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>1 (Constant)</td>
<td>120.48</td>
<td>91.40</td>
<td>.132</td>
<td>.899</td>
</tr>
<tr>
<td>Borrowings</td>
<td>.383</td>
<td>.112</td>
<td>.792</td>
<td>3.427</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Net income

**4.5 Preference Share Financing and Net Profit**

The objective of the study was to examine the effects of preference share financing on net profit in Kenyan manufacturing and allied companies.

**4.5.1 Descriptive Statistics for Preference Share Financing**

The study in Table 4.9 shows that mean, median and standard deviation were the descriptive statistical tools used in analysis. From the table, it is clearly demonstrated that the mean for preference shares for listed manufacturing companies is 287.65 million Kenya shillings, the median is 25.54 million Kenya shillings and standard deviation is 0.057. The study reveals that preference share financing is critical in enhancing net profit.

**Table 4.9: Preference Share Financing**

<table>
<thead>
<tr>
<th>Descriptive Statistics</th>
<th>Preference shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>N</td>
<td>9</td>
</tr>
<tr>
<td>Mean</td>
<td>287.65</td>
</tr>
<tr>
<td>Median</td>
<td>25.54</td>
</tr>
<tr>
<td>Std. Deviation</td>
<td>0.057</td>
</tr>
</tbody>
</table>
4.5.2 Correlation of preference Share Financing and Net Profit

In social science research situations, a correlation is considered significant when its significance level (p) is less than 0.05 (p = 0.022<0.05). Table 4.10 reveals the correlation between preference share financing and net profit of companies in manufacturing and allied sector in Kenya. The study found that preference share financing correlates positively to net profit at (r=0.780*, p<0.05, N=9). The p-value is positive 0.022 which is less than 0.05 hence the relationship is statistically significant.

The implication of the study is that manufacturing companies that finance their operations through offering of preference shares enhance their net profits.

Table 4.10: Correlations between Preference Share Financing and Net profit

<table>
<thead>
<tr>
<th></th>
<th>Preference Shares Financing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Profit</td>
<td>Pearson Correlation</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
</tr>
<tr>
<td></td>
<td>N</td>
</tr>
</tbody>
</table>

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

4.5.3 Regression Analysis of Preference Share Financing and Net Profit

Table 4.11 shows that the coefficient of determination for the relationship between preference share financing and net profit was 0.544 and this means that 54.4 percent of net profit was explained by preference mode of financing.

Table 4.11: Model Summary of Preference Share Financing and Net Profit

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.780*</td>
<td>.609</td>
<td>.544</td>
<td>27991.19</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Preference share Financing

Table 4.12 shows the beta coefficients of preference share financing. The beta coefficient of preference share financing was positive meaning that a unit change in the offering of preference share causes a positive change in the enhancing net profit. The study hence
concluded that preference share financing has a significant influence on manufacturing organizations’ enhancement of net profits.

The regression equation shown above indicates that a unit change in the offering of preference shares causes an increase of 0.780 in net profits.

\[ y = 77.06 + 0.780x \]

where \( y \) is the net profit, \( x \) is the preference mode of financing.

**Table 4.12: Coefficient of Variation of Preference Share Financing and Net Profit**

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>1 (Constant)</td>
<td>77.06</td>
<td>10.80</td>
<td>0.780</td>
<td>3.056</td>
</tr>
<tr>
<td>Preference Share Financing</td>
<td>5.490</td>
<td>1.797</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Dependent Variable: Net Profit

**4.6 Chapter Summary**

In this chapter, the results and findings of the study have been presented. These results and findings were constructed basing on the secondary data as provided in the financial reports of manufacturing and allied companies listed on the Nairobi Securities Exchange. The chapter showed Pearson correlation coefficient of equity and net profits, debts and net profits and preferreds and net profit. The beta coefficients were also analysed. The next chapter presents the summary, discussions, conclusions and recommendations.
CHAPTER FIVE

5.0 DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter provides the discussion, conclusions and recommendations of the study. The summary of the study is presented in the first part. In part two and three, the discussion and conclusion of the study are presented respectively. Part four displays the recommendations.

5.2 Summary

The purpose of the study was to assess the effects of capital structure on profitability of manufacturing and allied companies listed in the Kenya capital market. The study was led by the following research questions; what is the influence of equity financing on profitability of firms in the manufacturing sector in Kenya? What is the effect of debt on profitability of firms in the manufacturing sector in Kenya? What is the impact of the preference share financing on profitability of firms in the manufacturing sector in Kenya?

The study assumed a descriptive research design in collecting, analyzing, interpreting, and presenting data. The descriptive research design helped in focusing on the direction and strength of relationship between net profits and capital structure of listed manufacturing companies. The study used secondary data that was obtained from Capital Market Authority (CMA) data bank. The study used census technique whereby all nine (9) manufacturing and allied companies trading on Nairobi Securities Exchange was used in the study. The study assumed a descriptive and inferential statistics in data examination, analysis and interpretation. The data was presented using figures and tables.

The study examined how equity financing influences profitability of firms in the manufacturing and allied sector. The study found that equity financing contributes to a negative change to the net profits of Kenyan listed manufacturing and allied companies. The study reveals that through the sale of shares of a company, the company raises capital for its business operations in a process known as equity financing. In equity financing, the study found that an organization can either issues new shares of stock or reinvest in new assets the profits generated by its existing assets. When a company generates profits, it
may hold the cash in reserve for future investments or it may pay the cash back to the shareholders. The study found that when a business organization pays the cash back to its shareholders, it reduces its net profits that would be used to expand or rather diversify the business operations.

The study revealed how debt financing affects positively net profits in Kenyan listed manufacturing and allied companies. Linear regression analysis was used to determine the relationship between the debt level and performance. The study found that through debt financing the manufacturing and allied companies are able to enhance their profitability. The study revealed that manufacturing companies have strategies of choosing capital structure that enhance their profitability. The study found that the successful selection and use of the debt-to-equity ratio is one of the key elements of firms’ financial strategy. The study revealed that profitable manufacturing companies borrow more as they greatly shield income from corporate tax and enhance net profits. It was found from the study that a company’s profit performance is a good indicator of its fundamental health and competitive position. The study confirms that profit margin indicates whether a company can sustain its present cash accruals.

The study examined how preference share positively affects financing on net profits of Kenyan listed manufacturing and allied companies. The study shows that like bonds, preferred shares are rated by the key credit-rating institutions. The study established that usually, preferred stock has preference in paying dividends. The preference doesn’t warranty the disbursement of dividends, but the business organization must pay the assured dividends on preferred stock ahead of paying any dividends on common stock. The study found that preferred stock resembles debt in that it promises pre-determined levels of dividends. It was also revealed that preferred dividends aren’t tax-deductible to the issuing companies like interest on debt. From the research, it was demonstrated that many issuers of preferred stocks are industrial companies or rather firms. The study illustrated that it is profitable for manufacturing and allied firms to issue preference shares in place of debt, hence meeting regulators’ equity limitations. The study also reveals that manufacturing and allied companies that issue preference shares can pass their costs on to the consumers and hence are less affected by the tax disadvantages of preferreds. From the study, all the variables; equity, debts and preferreds were statistically significant.
5.3 Discussion

5.3.1 Equity Financing and Net Profits

The study analyzed the effect of equity financing on net profits of Kenyan listed manufacturing and allied companies. The study found that equity financing of manufacturing companies has a significant impact on net profits. The study supports the findings of Ross (2003) who argues that financing arrangements determine how the value of the firm is sliced up. Ross found that the decisions to issue debt and equity affect how the pie is sliced and this helps to save on the net profits that would be paid out to debtors as interests earned. In their study, Oke and Afolabi (2011) found a positive relationship between equity financing and net profits. This according to Oke and Afolabi means that companies that issue shares to finance their operations ends up gaining on net profits.

The study found that equity financing negatively affects net profits and decreases value of the manufacturing and allied companies when dividends are paid out. Anup and Suman (2010) confirm that maximizing wealth for the shareholders require perfect combination of debt and equity and that cost of capital is negatively correlated and therefore to be reduced to minimum level. Ong and Teh (2011) examined the capital structure and company performance of construction firms and found that there is a relationship between capital structure and firm performance. The study found a positive relationship between net profits and equity financing. Margaritis and Psillaki (2009) revealed that for an organization to enhance value there should be a perfect combination between equity and debt financing whereby equity should assume the highest proportion. Akintoye (2008) confirms that the performance indicators like earnings before interest and taxes, earnings per share and dividend per share, are significantly sensitive to the capital structure in of most companies.

The study revealed that when a firm declares a cash dividend on its share, its retained earnings are reduced and its current liabilities are enhanced. The dividends payable account is decreased when the cash dividend is paid, and the company's cash account is decreased. The net result of the announcement and disbursement of the dividend is that the corporation's stockholders' and assets equity have reduced. Stulz (2008) affirms that when dividends are paid, the balance sheet accounts cash and retained earnings are decreased. The profit and loss account is not affected by the dividend announcement and payment of
cash dividends on common stock. Margaritis and Psillaki (2009) assert that the cash dividends on preference shares are subtracted from gross income to arrive at net income obtainable for common stock. The cash dividends are accounted for as a use of cash in the financing activities section of the cash flow statement.

From the study, it is well demonstrated that when the manufacturing companies do not reinvest all of the cash flow generated by its existing assets, they may hold the cash in reserve for future investment, or they may pay the cash back to its shareholders inform of dividends. Brealey, et al. (2011) assert that when the business pays the cash back to its shareholders, it reduces it net profits that would be used to expand or rather diversify the business operations. Farhad and Aliasghar (2013) found that business organizations are inherently risky hence the financial manager needs to identify the risks and make sure they are managed properly. Brealey, et al. (2011) believe that debt has its advantages, but too much debt can land the company in bankruptcy, hence it is appropriate for business organizations to have a perfect mix of capital structure.

The study found that manufacturing companies issue shares to shareholders to finance their day to day operations. Farhad and Aliasghar (2013) found that corporations raise equity financing in two ways. First, they can issue new shares of stock. The investors who buy the new shares put up cash in exchange for a fraction of the corporation’s future cash flow and profits. Second, the corporation can take the cash flow generated by its existing assets and reinvest the cash in new assets. In this case the corporation is reinvesting on behalf of existing stockholders. No new shares are issued. Ross (2003), states that a corporation can raise funds from either lenders or shareholders. If the corporation borrows, the lenders contribute the funds, and the corporation promises to pay back the debt plus a fixed rate of interest. If the shareholders put up the funds, they get no fixed return, but they hold shares of stock and therefore get a fraction of future profits and cash flow. The author found that when corporations use more of equities to finance their operations that more of debts, the corporations end up in enhancing the value of retained earnings which grow the wealth of a firm. The study found that equity financing is statistically significant.
5.3.2 Debt Financing and Net Profit

The study found that the successful selection and use of the debt-to-equity ratio is one of the key elements of firms’ financial strategy. Yogendrarajah and Thanabalasingam (2010) revealed that a variety of capital structure theories have been proposed in the recent years to illustrate the variation in debt ratios across companies. Taani (2013) affirm that the capital structure is how a firm finances its overall operations and growth by using different sources of funds. On the other hand, Chang (1999) shows that the optimal contract between the corporate inside and outside investors can be interpreted as a combination of debt and equity, and profitable firms tend to use less debt. The findings of this study contradicts the findings of Ebaid (2009) who believe that much theoretical work has been done since Modigliani and Miller but no consistent predictions have been reached of the relationship between profitability and capital structure.

The study found a positive relationship between debt financing and net profit. From the study, it is found that net profit margin was used to evaluate performance. Ebaid (2009) conducted a research to examine the effect of capital structure choice on the performance of companies. Ebaid (2009) using multiple regression analysis to establish the correlation between the leverage level and performance found that capital structure has little or no effect on an organization’s performance. The findings of Ebaid contradict the findings of other empirical studies such as Hadlock and James (2002), which established a positive correlation between choice of capital structure and financial leverage. Contrary, Booth, et, al. (2001) confirmed a negative correlation financial leverage and organizational performance.

From the study, it is confirmed that companies that are using debt financing generates profits hence enhance the value of net profit. To support the study, Oke and Afolabi (2011), investigated the impact of capital structure on industrial performance and found debt finance has a positive relationship to the performance of the organizations. In addition, Yogendrarajah and Thanabalasingam (2010) found that for debt to equity and equity finances, a positive correlation exists but an inverse relationship between leverage financing and performance. Mathur and Mathur (2000) in their study revealed that higher firm performance is related to lower equity capital ratio.
The study reveals that profit margin broadly indicates both a company’s competitive position in an industry, and the industry’s characteristics in terms of the strength of competition. Chechet and Olayiwola (2014) confirm that a company’s profit performance is a good indicator of its fundamental health and competitive position. Chechet and Olayiwola believed that profit margin, observed over a period of time, indicates whether a company can sustain its present cash accruals. Brealey, et al. (2011) assert that a profitable company exhibits the ability to generate internal equity capital, attract external capital, and withstand business adversity. From a rating point of view, CRISIL (2012) found that the profit after tax (PAT) margin, that is, the ratio of PAT to operating income is the most important profitability ratio. The study by CRISIL (2012) revealed that a high PAT margin offsets, to some extent, the effect of business risk and the corresponding financial risk.

Even though the study found that there is a positive relationship between debt financing and net profit, most empirical studies show that capital structure is negatively related to profitability. Taani (2013) finds that debt financing is negatively related to profitability in both the US and Japan. Brealey, et al. (2011) even claims that “profitability has the largest single effect on debt/asset ratios. Titman and Wessels (1988) investigated the determinants of capital structure choice using data from United States from 1974 to 1982. The authors reported that debt levels are negatively related to the “uniqueness” of a firm’s line of business. Titman and Wessels (1988) found out that firms can potentially impose high costs on their customers, workers, and suppliers in the event of liquidation have lower debt ratios.

The study found that a proper mix of capital structure is essential for manufacturing companies to enhance profitability. Gau and Wang (2003) in their study observed that the level of debt employed in a property acquisition is directly related to the cost of the investment and inversely to the size of its depreciation tax shield, expected costs of financial distress and market interest rates. Osteryoung, et al. (2012) showed that most companies that finance their investment activities by retained earnings are more profitable than those that finance their activities through borrowed capital. They believe that the reason for this was that, if firms finance their operations from borrowed capital then they will have to impose interest costs then the financial burden to be on them. Yuan and Kazuyuki (2011) revealed that a firm with a high debt ratio will channel most of its
income to debt repayments thereby forgoing investment using internal funds. As more debt is employed in the capital structure of a firm, the business risk also increases. Yuan and Kazuyuki argued that creditors will be reluctant to lend more funds to a highly indebted firm which can result in underinvestment. The study found that the relationship between debt financing and net profit is statistically significant.

### 5.3.3 Preference Share Financing and Net Profits

The study confirms that preference share financing has a positive relationship to the profitability of manufacturing companies. Masulis (2006) confirms that preferred stock has been used as means of financing for a long time. Unlike interest on debt, Mesquita and Lara (2013) assert that preference dividends to the issuing firms are not tax-deductible. On the other hand, Masulis (2006) asserts that the omission of dividends will not result in bankruptcy. Masulis (2006) depicts that when a company repurchases equity and enhances the percentage of preference shares on the capital structure, the stock price effect is alike but of a lower degree than that ensuing from retiring equity so as to raise debt. Preference stock, according to Masulis (2006) appears to be observed as a partial substitute for debt.

The study confirmed a positive relationship between preferreds and net profit. The study found that preference stock is regarded equity by the regulators, but offers a model of payments similar to that of debt. Brealey, et al. (2011) in their study show that manufacturing companies can easily pass their costs on to the customers and hence are less affected by the tax disadvantages of preference shares. Houston and Houston (1990) established that most issuers of preference shares are industrial firms. Linn and Pinegar (2008) assert that companies are better off receiving dividends of preference shares rather than interest on capital gains or debt.

The study found that companies have developed strategies in issuing preference shares. Irvine and Rosenfeld (2000) confirm that some firms issue a new type of preferred stock called structured preferred stock or monthly income preferred stock (MIPS). They found that firms that issue MIPS create subsidiaries that raise money via preferred shares. That money is then loaned to the original company. The latter pays interest to the subsidiary. The subsidiary in turn passes the cash through to investors as preferred dividends. Engle, et. al. (1999) found that MIPS are treated as preferred stock for financial statements and
as debt for tax purposes. Linn and Pinegar (2008) attribute the popularity of this instrument to the fact that it lowers the debt-equity ratios, providing the issuer with better credit ratings with some credit rating agencies.

From the study, it was confirmed that preferred stock acts as a type of firm-level "automatic stabilizer. To support the findings, Copeland and Weston, (2009) found that preferred stock works analogously at the level of the firm: as liquidity decreases, financing commitments automatically loosen so as to prevent a liquidity failure. Masulis (2006) found that a faltering debtor firm is likely to breach a maintenance covenant, and trigger creditors' control rights—rights that can be used to push the firm into a bankruptcy event. By reducing expected bankruptcy costs, preferred stock should increase investor yields, as compared to debt, for risky companies. Stulz (2008) found that the automatic stabilizing feature has a significant downside: its issuance signals to the market that management believes the firm's expected bankruptcy costs to be high. Otherwise, the study found that the firm would simply finance with a lower-yield instrument like debt.

The study exposed that preference shares offer a firm another type of financing. Annuar and Shamsher (1993) revealed that a firm can postpone payments of dividends by going into arrears with minimal risk or penalty to its credit rating, though, such action can have a negative effect on the firm meeting the terms of its financing contract. With traditional liability, payments are necessary; a missed payment would lead the firm in default. Engle, et al. (1999) argue that companies use preference stock as means of avoiding hostile takeovers, creating preference stock with a poison pill which are practiced upon a change in control.

The study found that a company issuing preferred stock can raise cash for the business without dilution of control. Mesquita and Lara (2013) found that a firm isn’t not held accountable to pay a dividend on preferred stock shares if the company’s incomes in a certain year are inadequate. It can defer the dividend in case of cumulative preferred stock. The authors found that companies using preference share financing has no fixed burden created on its finances. Oke and Afolabi (2011) revealed that various categories of preferred stock are issued depending on the requirements of investors. Still Oke and Afolabi (2011) found that convertible preference shares or participating preference shares are issued to attract the attention of enterprising and bold investors. The study revealed a statistical significant relationship between preferreds and net profit.
5.4 Conclusions

5.4.1 Equity Financing and Net Profits

The study concludes that there is a negative relationship between equity financing and net profit. Maximizing wealth for the shareholders requires a perfect combination of debt and equity and that cost of capital is negatively correlated and therefore to be reduced to minimum level. The study concludes that equity financing is beneficiary to business as it increases net profits and enhances value of the organization. The performance indicator (net profit) used in this study was significantly sensitive to the capital structure in most of the companies. The study also concludes that the performance indicators (earnings before interest and taxes, earnings per share and dividend per share) used in this study were significantly sensitive to the capital structure in most of the companies. The net result of the declaration and payment of the dividend is that the corporation's assets and stockholders' equity have decreased. Specifically, the balance sheet accounts of cash and retained earnings are decreased hence cash dividends negatively affects net profits. The study concludes that for an organization to enhance value there should be a perfect combination between equity and debt financing whereby equity should assume the highest proportion.

5.4.2 Debt Financing and Net Profit

From the study it is concluded that debt financing positively affects net profits of manufacturing and allied companies. The study concludes that the capital structure is how a firm finances its overall operations and growth by using different sources of funds. The successful selection and use of the debt-to-equity ratio is one of the key elements of firms’ financial strategy. The study concludes that the optimal contract between the corporate inside and outside investors can be interpreted as a combination of debt and equity, and profitable firms tend to use less debt. Profit margin broadly indicates both a company’s competitive position in an industry, and the industry’s characteristics in terms of the strength of competition. The study also concludes that a firm’s profit performance is a good indicator of its fundamental health and competitive position. Profit margin also indicates whether a company can sustain its present cash accruals. It is concluded from the study that a profitable firm exhibits the ability to generate internal equity capital, attract external capital, and withstand business adversity.
5.4.3 Preference Share Financing and Net Profit

The study concludes that preference mode of financing positively affects net profits of manufacturing and allied companies. To the issuing firms, dividends of preference shares are not tax-deductible and that exclusion of dividends won’t result in liquidation. The study concludes that preference shares seem to be observed as a partial substitute for debt. Preference stock is regarded as equity by the regulators, but presents a model of payments similar to that of debt. The study also concludes that preferred stock acts as a type of firm-level automatic stabilizer. Preferred stock works analogously at the level of the firm: as liquidity decreases, financing commitments automatically loosen so as to prevent a liquidity failure. From the study, it is concluded that by reducing expected bankruptcy costs, preferred stock should increase investor yields, as compared to debt, for risky companies. Preference stocks present a firm an optional form of financing and that a firm can postpone dividends by going into arrears with minimal risk or penalty to its credit rating.

5.5 Recommendations

5.5.1 Recommendation for Improvement

5.5.1.1 Equity Financing and Net Profit

The study recommends the manufacturing companies to use equity to finance their operations as equity financing enhances net profits. The management of manufacturing companies should develop techniques of determining how capital structure should be divided. The decisions to issue debt and equity affect how the pie is sliced and this helps to save on the net profits that would be paid out to debtors as interests earned. The study recommends organizations to maximize wealth for the shareholders and this according to the study requires perfect combination of debt and equity. The study recommends the use of equity to finance the operations of the business as it was found that equity financing is beneficiary to business as it increases net profits and enhances value of the organization. The study recommends the elements of capital structure should be combined in a way that it enhances performance of the company. For an organization to enhance value there should be a perfect combination between equity and debt financing whereby equity should assume the highest proportion.
5.5.1.2 Debt Financing and Net Profit

The study recommends a successful selection and use of the debt-to-equity ratio as it is one of the key elements of firms’ financial strategy. The profit margin is a key element to determine the capital structure. The firms may have their retained earnings to increase their capital structure. The study recommends the organizations to use some of the capital structure theories as they will help in correctly matching between debts and equity. Tax-based models suggest that profitable firms should borrow more, ceteris paribus, as they have greater needs to shield income from corporate tax. The organizations should enhance their profit performance as it is a good indicator of its fundamental health and competitive position. Profit margin, observed over a period of time, indicates whether a company can sustain its present cash accruals.

5.5.1.3 Preference Share Financing and Net Profit

The study recommends the use of preference shares because preferred dividends are not tax-deductible to the issuing firms and that omission of dividends will not result in bankruptcy. Preference stock is regarded as equity by the regulators, but offers a pattern of payments similar to that of debt. The study recommends the use of preference shares as the issuing firms pass their costs on to the clients or rather customers hence are less affected by the tax disadvantages of preference stock. Structured Preferred Stock lowers the debt-equity ratios, providing the issuer with better credit ratings with some credit rating agencies. Preference stock is recommended because it works analogously at the level of the firm: as liquidity decreases, financing commitments automatically loosen so as to prevent a liquidity failure. Preference shares provide a firm an optional type of financing and that a company can postpone payments of preference dividends by going into arrears with minimal risk or penalty to its credit rating.

5.5.2 Recommendation for Further Research

The study was only carried in companies from one industry (manufacturing and allied industry). Further researches about effects of capital structure on net profits should be carried out in other industries like the Banking and Agricultural industries. The study encourages future scholars to assess the factors that contribute to the perfect combination of organizations’ capital structure.
The study recommends future scholars to conduct multiple regression on the effects of equity, debt and preferreds on net profits. The study recommends a combination of all three variables; equity, debt and preferreds to see the effect on net profit. The equation will be $y = \alpha + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3$, where $\beta_1 x_1$ = equity, $\beta_2 x_2$ = debt and $\beta_3 x_3$ = preference shares. The study also recommends scholars to determine the optimal capital structure.
REFERENCES


51


<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Angola</td>
<td>-</td>
<td>28.30</td>
<td>29.70</td>
<td>-</td>
<td>39.60</td>
<td>41.20</td>
<td>32.10</td>
<td>33.10</td>
</tr>
<tr>
<td>Argentina</td>
<td>23.80</td>
<td>23.10</td>
<td>19.70</td>
<td>17.50</td>
<td>15.60</td>
<td>27.00</td>
<td>25.30</td>
<td>24.90</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>2.10</td>
<td>8.60</td>
<td>9.60</td>
<td>12.60</td>
<td>17.80</td>
<td>18.10</td>
<td>17.80</td>
<td>16.40</td>
</tr>
<tr>
<td>Botswana</td>
<td>26.70</td>
<td>38.00</td>
<td>42.60</td>
<td>37.50</td>
<td>43.80</td>
<td>43.10</td>
<td>22.50</td>
<td>26.20</td>
</tr>
<tr>
<td>Brazil</td>
<td>21.10</td>
<td>24.40</td>
<td>21.40</td>
<td>20.50</td>
<td>20.00</td>
<td>25.00</td>
<td>19.20</td>
<td>19.00</td>
</tr>
<tr>
<td>China</td>
<td>35.00</td>
<td>34.40</td>
<td>39.90</td>
<td>44.10</td>
<td>37.50</td>
<td>49.00</td>
<td>52.10</td>
<td>52.50</td>
</tr>
<tr>
<td>India</td>
<td>15.50</td>
<td>21.20</td>
<td>22.60</td>
<td>25.30</td>
<td>24.00</td>
<td>29.70</td>
<td>31.70</td>
<td>29.00</td>
</tr>
<tr>
<td>Indonesia</td>
<td>38.00</td>
<td>29.70</td>
<td>32.30</td>
<td>30.60</td>
<td>32.80</td>
<td>26.60</td>
<td>34.30</td>
<td>34.20</td>
</tr>
<tr>
<td>Ireland</td>
<td>12.70</td>
<td>19.60</td>
<td>25.60</td>
<td>29.90</td>
<td>38.70</td>
<td>38.80</td>
<td>30.60</td>
<td>32.80</td>
</tr>
<tr>
<td><strong>Kenya</strong></td>
<td><strong>18.10</strong></td>
<td><strong>20.50</strong></td>
<td><strong>18.50</strong></td>
<td><strong>15.30</strong></td>
<td><strong>9.40</strong></td>
<td><strong>9.30</strong></td>
<td><strong>7.50</strong></td>
<td><strong>4.30</strong></td>
</tr>
<tr>
<td>Malawi</td>
<td>10.80</td>
<td>12.90</td>
<td>13.40</td>
<td>(0.30)</td>
<td>3.80</td>
<td>(5.50)</td>
<td>10.40</td>
<td>5.60</td>
</tr>
<tr>
<td>Malaysia</td>
<td>29.80</td>
<td>29.90</td>
<td>34.50</td>
<td>39.70</td>
<td>47.30</td>
<td>43.50</td>
<td>40.30</td>
<td>39.50</td>
</tr>
<tr>
<td>Namibia</td>
<td>38.40</td>
<td>18.10</td>
<td>18.20</td>
<td>15.50</td>
<td>13.40</td>
<td>19.80</td>
<td>13.90</td>
<td>12.20</td>
</tr>
<tr>
<td>Nigeria</td>
<td>31.40</td>
<td>12.60</td>
<td>29.40</td>
<td>18.40</td>
<td>42.30</td>
<td>38.80</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Pakistan</td>
<td>6.90</td>
<td>5.90</td>
<td>11.10</td>
<td>15.80</td>
<td>16.10</td>
<td>12.20</td>
<td>9.70</td>
<td>8.00</td>
</tr>
<tr>
<td>Poland</td>
<td>-</td>
<td>29.20</td>
<td>32.80</td>
<td>20.90</td>
<td>18.40</td>
<td>18.70</td>
<td>19.70</td>
<td>-</td>
</tr>
<tr>
<td><strong>South Africa</strong></td>
<td><strong>37.90</strong></td>
<td><strong>29.40</strong></td>
<td><strong>23.20</strong></td>
<td><strong>18.90</strong></td>
<td><strong>18.90</strong></td>
<td><strong>17.50</strong></td>
<td><strong>19.10</strong></td>
<td><strong>19.10</strong></td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>11.20</td>
<td>10.20</td>
<td>13.80</td>
<td>15.30</td>
<td>17.40</td>
<td>14.60</td>
<td>19.30</td>
<td>15.40</td>
</tr>
<tr>
<td>Thailand</td>
<td>22.90</td>
<td>25.50</td>
<td>33.80</td>
<td>35.40</td>
<td>31.50</td>
<td>30.10</td>
<td>33.40</td>
<td>31.20</td>
</tr>
<tr>
<td>Zambia</td>
<td>19.30</td>
<td>14.10</td>
<td>16.60</td>
<td>12.20</td>
<td>3.50</td>
<td>21.60</td>
<td>34.40</td>
<td>34.00</td>
</tr>
</tbody>
</table>

Source: World Development Indicator, 2012
APPENDIX II: Declining Profits of Manufacturing and Allied Sector in Kenya

<table>
<thead>
<tr>
<th>Year</th>
<th>Profitability in Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>9.10%</td>
</tr>
<tr>
<td>1990</td>
<td>6.30%</td>
</tr>
<tr>
<td>2000</td>
<td>4.80%</td>
</tr>
<tr>
<td>2010</td>
<td>3.00%</td>
</tr>
</tbody>
</table>

**APPENDIX III: Manufacturing and Allied**

<table>
<thead>
<tr>
<th></th>
<th>Company Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>B.O.C Kenya Limited</td>
</tr>
<tr>
<td>2</td>
<td>British American Tobacco Kenya Limited</td>
</tr>
<tr>
<td>3</td>
<td>Carbacid Investments Limited</td>
</tr>
<tr>
<td>4</td>
<td>East African Breweries Limited</td>
</tr>
<tr>
<td>5</td>
<td>Eveready East Africa Limited</td>
</tr>
<tr>
<td>6</td>
<td>Mumias Sugar Company Limited</td>
</tr>
<tr>
<td>7</td>
<td>Unga Group Limited</td>
</tr>
<tr>
<td>8</td>
<td>Kenya Orchards Ltd</td>
</tr>
<tr>
<td>9</td>
<td>Flame Tree Group Holdings Ltd</td>
</tr>
</tbody>
</table>
## APPENDIX IV: Capital Structure Table

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Equity (Kshs, 000)</th>
<th>Debt (Kshs, 000)</th>
<th>Preference Share (Kshs, 000)</th>
<th>Net Profit (Kshs, 000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 B.O.C Kenya Limited</td>
<td>97,627.00</td>
<td>606,850.00</td>
<td>2,554.00</td>
<td>148,600.00</td>
</tr>
<tr>
<td>2 British American Tobacco Kenya</td>
<td>1,000,000.00</td>
<td>1,227,600.00</td>
<td>2,300.03</td>
<td>4,976,256.00</td>
</tr>
<tr>
<td>3 Carbacid Investments Limited</td>
<td>254,852.00</td>
<td>244,575.00</td>
<td>2,700.26</td>
<td>393,316.00</td>
</tr>
<tr>
<td>4 East African Breweries Limited</td>
<td>1,581,547.00</td>
<td>24,469,236.00</td>
<td>1,691,151.00</td>
<td>9,423,375.00</td>
</tr>
<tr>
<td>5 Eveready East Africa Limited</td>
<td>210,000.00</td>
<td>54,071.00</td>
<td>667,004.00</td>
<td>587,823.00</td>
</tr>
<tr>
<td>6 Mumias Sugar Company Limited</td>
<td>3,060,000.00</td>
<td>725,139.00</td>
<td>1,955.58</td>
<td>(4,644,801.00)</td>
</tr>
<tr>
<td>7 Unga Group Limited</td>
<td>378,535.00</td>
<td>360,785.00</td>
<td>73,148.00</td>
<td>621,866.00</td>
</tr>
<tr>
<td>8 Kenya Orchards Ltd</td>
<td>58,228.75</td>
<td>56,271.93</td>
<td>493.42</td>
<td>28,915.65</td>
</tr>
<tr>
<td>9 Flame Tree Group Holdings Ltd</td>
<td>133,540.08</td>
<td>102,609.43</td>
<td>152,450.45</td>
<td>219,834.01</td>
</tr>
</tbody>
</table>