THE RELATIONSHIP BETWEEN CAPITAL STRUCTURE AND
FINANCIAL PERFORMANCE OF TOURISM FINANCE
CORPORATION SUBSIDIARIES IN KENYA

BY

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STUDENT’S DECLARATION

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

Signed: ___________________________ Date: ___________________________

Keziah M. Nzeki (ID: 638731)

This Research Project has been presented for examination with my approval as the appointed university supervisor.

Signed: ___________________________ Date: ___________________________

Dr. Amos Njuguna

Signed: ___________________________ Date: ___________________________

Dean, Chandaria School of Business
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ABSTRACT

The purpose of the study was to examine the relationship between capital structure and financial performance of Tourism Finance Corporation (TFC) Subsidiaries in Kenya. The study sought to answer the following questions: what are the components of capital structure? Does debt ratio have any significant effect on the financial performance of Tourism Finance Subsidiaries in Kenya? Does asset tangibility have any significant effect on the financial performance of Tourism Finance Subsidiaries in Kenya? Does asset turnover have any significant effect on the financial performance of Tourism Finance Subsidiaries in Kenya?

The study employed descriptive research design to examine the study purpose and the existing associations between the independent and the dependent variables considered. The study used secondary data which was extracted from the audited financial reports and management accounts acquired from the TFC and the individual finance departments of the subsidiaries. The population of the study comprised of all the five TFC Subsidiaries in Kenya as at 30th June 2016. Data was analyzed by use of time series and regression analysis approaches.

The study found out that debt and equity are the major components of capital structure for the TFC subsidiaries in Kenya. The study has established that there is no statistically significant effect of debt ratio on the financial performance of TFC subsidiaries in Kenya. The study has also found out that there is no statistically significant effect of asset tangibility on the financial performance. Lastly, the study has found out that there is a statistically significant effect of asset turnover on the financial performance of financial performance.

The study recommends a comparative study to be conducted to establish different capital structure components so as to recommend an optimal capital structure. This study recommends the use of other variables such as debt to equity ratio and return on capital employed. Further research can be conducted using primary data. Data over a long period of time (say 10 years) can be considered for a further study on this area covering all the commercial state corporations in Kenya.
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DEDICATION

To my beloved husband, Mr. Nzioki Kiseli and children; Allen, Kate and Khloe Kiseli.
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CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Problem

The importance of financing decisions cannot be over emphasized since many of the factors that contribute to business failure can be addressed using strategies and financial decisions that drive growth and the achievement of organizational objectives (Salazar, Soto & Mosqueda, 2012). A firm’s financial performance is measured by how better off the shareholder is at the end of the period, than he was at the beginning (Roshanak, 2013).

Financing decisions result in a given capital structure and sub-optimal financing decisions can lead to corporate failure. A great dilemma for management and investors alike is whether there exists an optimal capital structure. The objective of all financing decisions is wealth maximization and the immediate way of measuring the quality of any financing decision is to examine the effect of such a decision on the firm’s performance (Mwangi, Makau & Kosimbe, 2014). The choice of investment financing and its link with optimal risk exposure is paramount to financial performance of any firm.

Modigliani and Miller (1958) defines capital structure as a mixture of a variety of long term sources of funds and equity shares including reserves and surpluses of an enterprise. The historical attempt to building theory of capital structure began with the presentation of a paper by Modigliani and Miller in 1958. Modigliani and Miller revealed the situations under which capital structure is relevant or irrelevant to the financial performance of listed companies.

Most of the decision making process related to the capital structure are deciding factors when determining the capital structure, a number of issues, for example, cost, various taxes and rate, interest rate have been proposed to explain the variation in Financial Leverage across firms (Titman & Wessels, 1988). These issues suggested that depending on attributes that caused the cost of various sources of capital, the firms select capital structure and benefits related to debt and equity financing (Pratheepkanth, 2011).
Capital Structure refers to the firm’s financial framework which consists of the debt and equity used to finance the firm. It’s the way a firm finances their assets through the combination of equity, debt, or hybrid securities (Saad, 2010). In short, capital structure is a mixture of company’s debts (long term and short term), common equity and preferred equity. Capital structure is essential on how a firm finances its overall operations and growth by using different sources of funds (San & Heng, 2011). In finance, capital structure refers to the way in which an organization is financed, a combination of long term capital (ordinary shares and reserves, preference shares, debentures, bank loans, convertible loan stock and so on) and short term liabilities such as bank overdraft and trade creditors. A firm’s capital structure is then the composition of its liabilities (Saad, 2010).

A company which has no debt, its capital structure is only equity and different companies have different capital structures (Ahmadpour & Yahyazadehfar, 2010). In reality, the capital structure of a firm is difficult to determine. Financial managers have difficulties to exactly determine the optimal capital structure. A firm has to issue various securities in a countless mixture to come up with particular combinations that can maximize its overall value which means optimal capital structure (San & Heng, 2011).

A firm’s performance is the appraisal of prescribed indicators or standards of effectiveness, efficiency, and environmental accountability such as productivity, cycle time, regulatory compliance and waste reduction (Ngugi & Karina, 2013). Firm performance is a multidimensional construct that consists of four elements (Alam et al. 2011).

Tourism Finance Corporation is the leading Development Financial Institution providing affordable and accessible financial facilities and Business Advisory Services to the tourism industry in Kenya. Its mission is to develop and diversify Kenya’s tourism industry by providing a range of financial services to investors in tourism related enterprises. The Corporation provides Business Advisory Services to private sector enterprises at competitive prices to ensure that they rise to the challenges and leverages the opportunities presented by today's' global economy. These include; preparation of feasibility studies, business evaluations, strategic advice, and research on market trends.
The relationship between capital structure and financial performance is one that has received a considerable attention in the finance literature. Impact of capital structure based on company’s performance will present prove for a company’s performance due to effect of capital structure. There are many variables in a capital structure choice and structure of debt maturity which will affect company’s performance, debt maturity will influence a company’s option of investing (Titan and Zeitun, 2007).

High growth firms will borrow loans and issue new bonds comparing with low growth firms. If the firm decides to issue debt in the future the firm will expose bankruptcy risk by increasing the debt cost leading to reduced firm performance (Ross, 1977). Myer (1977) discussed the role of growth opportunity in effect of the nature and composition of capital structure. High growth firms are most likely to suffer from the debt problem and this will result to risk accompanied with debt of which the firm gives up profitable investment opportunities. In addition, the firm will be relying on the equity sources more than debt sources to face the risk and to finance expected growth opportunities, thus it will reflect positively on firm performance (Hovakimian, Hovakimian & Tehranian, 2011).

Capital structure decisions can have important implications for the value of the firm and its cost of capital. Poor capital structure decisions can lead to an increased cost of capital thereby lowering the net present value of many of the firm’s investment projects. Margaritis and Psillaki (2010) observed that financial leverage (debt ratio) correlated positively and significantly with firm performance. Therefore the capital structure of a firm is expected to have a positive effect on the financial performance.

1.2 Statement of the Problem

Financial performance is the company’s ability to generate new resources, from day-to-day operations over a given period of time and it is gauged by net income and cash from operations. A sound financial performance enables firms to manage credit risk, interest rate risk, liquidity risk, market risk, foreign exchange risk and solvency risk (Sangmi & Nazir, 2010).
Ebaid (2009) carried out a study to investigate the impact of choice of capital structure on the performance of firms in Egypt. Performance was measured using ROE, ROA, and gross profit margin. Capital structure was measured by short-term debt to asset ratio, long-term debt to asset ratio, and total debt to total assets. Multiple regression analysis was applied to estimate the relationship between the leverage level and performance. The study indicated that capital structure has little to no impact on a firm’s performance. These results are inconsistent with other empirical studies such as Hadlock and James (2002) and Ghosh, Nag and Sirmans (2000), which revealed a positive relationship between financial leverage and choice of capital structure. Other studies revealed a negative relationship such as Berger and Bonaccorsi (2006) whereby lower equity capital ratio is associated with higher firm performance. The contradicting results give room for introducing additional variables in new studies.

Kaumbuthu (2011) carried out a study to determine the relationship between capital structure and return on equity for industrial and allied sectors in the Nairobi Securities Exchange during the period 2004 to 2008. Capital structure was proxied by debt equity ratio while performance focused on return on equity. The study applied regression analysis and found a negative relationship between debt equity ratio and ROE. The study focused on only one sector of the companies listed in Nairobi Securities Exchange and paid attention to only one aspect of financing decisions. The results of the study, therefore, may not be generalized to the other sectors. The present thesis covered all non-financial companies listed on the Nairobi Securities Exchange to determine the effects of financing decisions on firm financial performance.

The relationship between capital structure and financial performance is a vital issue which has not been resolved in the finance field. Despite the above observations, there is no study available that systematically explains the effect of capital structure on the financial performance of Tourism Finance Corporation Subsidiaries in Kenya. Both local and global studies have elicited mixed results on the relationship between capital structure and financial performance of firms. This study observes this relationship with the inclusion of efficiency ratios which has not been considered in previous studies: whereby this study attempted to fill this gap. Theoretically, it is expected that the capital structure of a firm to
have a significant effect on the financial performance. This is not consistent in the previous studies done.

1.3 Purpose of the Research

The purpose of this study was to investigate the relationship between capital structure and financial performance of the Tourism Finance Corporation subsidiaries in Kenya.

1.4 Research Questions

The research questions used to achieve the general objective of the study were:

1.4.1: What are the components of capital structure?

1.4.2: Does Debt Ratio has any significance effect on the financial performance of Tourism Finance Corporation subsidiaries in Kenya?

1.4.3: Does asset tangibility has any significance effect on the financial performance of Tourism Finance Corporation subsidiaries in Kenya?

1.4.4: Does asset turnover has any significance effect on the financial performance of Tourism Finance Corporation subsidiaries in Kenya?

1.5 Importance of the Study

This study will fill the knowledge gap on the relationship between ownership and financial performance. The study will benefit the following stakeholders:

1.5.1 Policy Makers in the TFC

The study will be valuable to the Tourism Finance Corporation subsidiaries in Kenya as will bring out the relationship between capital structure and financial performance. This will inform the subsidiaries’ strategy formulation as to whether capital structure is important or not.
1.5.2 Scholars

This study will form a basis for further research. Students and other academic researchers will use this study as a basis to further knowledge and critic it for development of knowledge in the issues involved in this study. This study will be of great importance to both researchers and analysts as it takes the realm of capital financing. It adds to existing literatures to verify the claim of traditional theory of capital structure.

1.5.3 Finance Practitioners

The study will to enhance the knowledge of optimal capital structure and will help companies make efficient financial performance in growing situations. Financial practitioners will make critical decisions for any business organization and to exercise their decision with respect to capital structure decisions and have the ability to deal with the competitive environment.

1.5.4 The Government

The study will enable the government to assess the benefits which accrue to the investments into the subsidiaries through exchequer support. The government will be also able to implement strategies to support the tourism industry in realizing their long terms goals and earning the country revenue to finance other development projects.

1.6 Scope of the Study

The study focused on the TFC subsidiaries in Kenya. The researcher conducted a census survey on all the five subsidiaries. The study was conducted on a period of three months from October 2016 to December 2016. Some of the limitations encountered included un-cooperation of the managers of the subsidiaries in providing the required data for analysis, unavailability of all the requested information due to confidentiality in the subsidiaries and bureaucracy involved in getting the audited financial statements by the office of the Auditor General.
1.7 Definition of Terms

1.7.1 Capital Structure

According to Saad (2010), capital Structure refers to a firm’s financial framework which consists of the debt and equity used to finance the firm. It is the way a firm finances their assets through the combination of equity, debt, or hybrid securities.

1.7.2 Debt

Ross (2001) defined a debt as a liability whereby a firm borrows a certain amount of money at an interest based on agreement with the obligation to pay at a particular time.

1.7.3 Equity

Equity is the contribution that shareholders make to a company in order for it to be operational (Ross, 2001).

1.7.4 Debt to Equity Ratio

Debt equity ratio provides a measure of how much a firm’s capital structure is funded through debt and how much is funded through owner’s equity. In other words, it measures how a firm is leveraged (Aged Care Benchmarking, 2011).

1.7.5 Asset Tangibility

Asset tangibility is the ability of an asset to sustain external financing. Tangibility increases the value that can be captured by creditors in case of default (Almeida & Campello, 2006).

1.7.6 Asset Turnover

Asset turnover is the ratio of sales to total assets. It indicates the extent to which the investment in total assets results in sales (Almeida & Campello, 2006).
1.7.7 Return on Asset

This is the measure of a firm’s success in using assets to generate earnings independent of the financing of those assets (Ross, 2011).

1.7.8 Efficiency Ratios

The efficiency ratios are used to analyze how well a company uses its assets and liabilities internally. An efficiency ratio can calculate the turnover of receivables, the repayment of liabilities, the quantity and usage of equity, and the general use of inventory and machinery (Almeida & Campello, 2006).

1.8 Chapter Summary

The chapter has provided a general overview and the background of the current study. It has detailed the statement of the problem, the purpose of the study, the research questions, significance and the scope of the study. It has also provided the working definitions of terms of this study. The next chapter will endeavor to discuss more literature on empirical studies conducted with respect to capital structure and its effect on financial performance and take a case study of Tourism Finance Corporation in Kenya. Chapter two shall give empirical literature on capital structure effect on financial performance of firms. References shall be made on past studies and academic writings. Chapter three will discuss on the research methodologies used in the study. Chapter four will present the results and findings of the study. Chapter five discusses the findings and also provides a conclusion from the results of the analysis.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

This chapter reviews theoretical and empirical literature on capital structure and how the capital structure could influence the financial performance of Tourism Finance Corporation subsidiaries in Kenya. The chapter explores the components of capital structure and the underlying theories of capital structure. The effect of debt ratio on the financial performance is also reviewed in this chapter. The chapter further looks into the effect of asset tangibility on the financial performance of firms. The effect of asset turnover on the financial performance of firms is explored. This is in the attempt to address the specific research questions and meet the general objective of the study. Lastly, a summary of the chapter is provided.

2.2 Components of Capital Structure

Capital structure is a combination of debt and shareholders’ equity which a company deems efficient as a means to meet its core objectives of existence. A firm can also rely on internally generated funds like the retained earnings to finance its operations. According to Mwangi, Makau and Kosimbei (2014), financing decisions result in a given capital structure and suboptimal financing decisions can lead to corporate failure. A great dilemma for management and investors alike is whether there exists an optimal capital structure. A firm cannot use one source for the financing but a combination of at least two components.

The unending debate on capital structure started in 1958 by Modigliani and Miller. In their original monographs undertaken in the area of capital structure, Modigliani and Miller (1958) and Modigliani and Miler (1963) were discussing on whether the choice of capital structure had an effect on the value of a firm. Modigliani and Miller came up with two propositions to explain their views on capital structure and firm value. They argued that under perfect market condition, the firm value is irrelevant to capital structure. Further, if it were not the case, then arbitrage would occur. This view has changed the financial economics (Grundy, 2001).
Another debate on the capital structure is explained by the trade-off theory. This theory is credited with Kraus and Litzenberger (1973). This theory predicts that managers choose the capital structure that strikes a balance between debt’s tax advantages and its agency costs. Because firms can deduct interest payments from taxable income, more debt leads to lower taxes. However, agency costs of debt rise as borrowing increases. In particular, leverage increases the probability that the firm will encounter financial distress and incur its associated costs. This theory suggests that firms weigh the tax savings of debt against the expected costs of financial distress when choosing their capita structures (Megginson, Smart and Gitman, 2007).

An important purpose of the trade-off theory is that it explains the fact that corporations are usually financed partly with debt and partly with equity. It states that there is an advantage to financing with debt, the tax benefits of debt and there is a cost of financing with debt, the costs of financial distress including bankruptcy costs of debt and non-bankruptcy costs. The marginal benefit of further increases in debt declines as debt increases, while the marginal cost increases, so that a firm that is optimizing its overall value will focus on this trade-off when choosing how much debt and equity to use for financing (Kraus & Litzenberger, 1973).

According to Mahakud (2012), researchers on capital structure studies have tried to estimate the speed at which companies try to reach the optimal or target capital structure. Mahakud argues that the adjustment speed depends on the costs of adjusting the leverage. Further, the research based on the estimation of speed of adjustment to target capital structure has been termed as dynamic trade-off theory which has been quite extensive.

Pecking order theory is also important in the study of capital structure. According to Pandey (2015), this theory is based on the assertion that managers have more information about their firms than investors. This disparity of information is referred to as asymmetric information. Other things being equal, because of the asymmetric information, managers will issue debt when they are positive about their firms’ future prospects and will issue equity when they are unsure. Myers (1984) called it the “Pecking Order” theory since there is not a well-defined debt-equity target and there are two kinds of equity, internal
and external, one at the top of the pecking order and one at the bottom. As a result, investors will place a lower value to the new equity issuance.

Market timing theory is also relevant to this study. This theory was advanced by Baker and Wurgler (2002) to explain the debt-equity choice. They argue that firms time the market by issuing equity when share values are high and by issuing debt when share prices are low. As a consequence, a firm’s capital structure simply reflects the cumulative effects of its managers’ past market-timing activities. Baker and Wurgler find evidence that firms with high leverage are those that raised capital when their stock prices were low, whereas firms with low leverage are those that raised capital when their share prices were high.

According to Gracia and Mira (2008), in their study based on Spanish Small and Medium Sized Enterprises (SMEs), they established that both trade-off and pecking order models are useful in explaining the capital structure. Harris and Raviv (1991) states that these are the most important and most dominant theories of capital structure. This study considers market timing and M&M models.

2.2.1 Debt

Ross (2001) defines debt as the long term and short term borrowing that a firm has. Mostly, the long term borrowing is used to finance the capital structure of a firm and is at an interest which is pegged on to the agreement between the lenders and the firm; on the obligation of the firm to repay at a particular time. When it comes to increased levels of debt by a firm, managers should be very careful so as to mitigate the risk factor which may lead to bankruptcy. According to Leland and Pyle (1977), managers will take debt-equity ratio as a signal, by the fact that high leverage implies higher bankruptcy risk.

As firms grow, they usually have low or high growth opportunities. Due to this, firms require financing mostly through debt. According to Datta, Iskandar and Raman (2005), firms that have high growth opportunities have more debt in their capital structure. Frielinghaus, Mostert and Firer (2005) argued that organizations are like living organisms in that they undergo through various stages of life, from birth to death. At each particular
life stage organizations have typical behaviors. They asserted that more debt should be utilized by firms as they mature from birth. However, they also acknowledged that little has been done to test this theory empirically. Hovakimian, Opler and Titman (2001) also agreed with this theory by stating that firms should use higher debt to fund assets but this should be progressively as the firm matures through its life stages.

According to Grossman and Hart (1982), a number of benefits accrue when using debt, most notable one being on agency conflict whereby bankruptcy is expensive for managers concerned with maintaining control of a firm. This ensures that the firm’s capital structure is effectively used so as to avoid bankruptcy and what ends up in the long run is better financial performance and position of a firm.

The size of the firm determines capital structure on the basis of external financing mostly debt financing. This is due to the fact that large companies have an access to the stock exchange market since meeting the requirements for being listed is easier compared to small firms. The study is in agreement with Sheikh and Wang (2011) study of firms in the manufacturing industry in Pakistan where he argued that large firms have a lower agency cost since they have a lesser volatile cash flow and can easily access the capital markets. Debt offers firms a tax shield, therefore this makes firms to pursue higher levels of debt in order to gain the maximum tax benefit and in the end increase their profitability. On the other hand, high levels of debt increases the possibility of a firm going into bankruptcy (Myers, 2001).

2.2.2 Equity

Ross (2001) defined equity as the contribution of the shareholders that starts up a firm and enables it to be in operation. It is the component of capital derived by total capital minus debt. It is the ownership interest of shareholders that is the ordinary and preferred stockholders. The Accounting Dictionary (2017) also defines equity as the net amount of funds invested in a business by its owners, plus any retained earnings. It is also calculated as the difference between the total of all recorded assets and liabilities on an entity's balance sheet.
Equity funds are obtained by corporations from external sources through capital stock flotations and from internal sources through income retention (Creamer, Dobrovolsky, Borenstein & Borenstein, 1960). Firms have different growth patterns, there are those that have high growth opportunities, others have low or no growth opportunities at all.

According to Jensen (1986) firms with great investment opportunities have lower debt levels meaning that they employ more equity to debt. More equity is required in starting up a firm but as the business growth continues, the ability to access debt financing increases. This is in agreement with a study by Kimki (1997) on the intergenerational succession in small family business: borrowing constraints and optimal timing of success.

The growth of a firm influences the capital structure in terms of the needs of the firm which in turn dictate whether debt or equity is going to be used. Firms with expected growth are not supposed to collateralize their assets hence more equity than debt and this is consistent with a study by Rajan and Zingales (1995) which established that firms with expected growth should be equity financed than debt financed.

From the pecking order theory of capital structure by Myers and Majluf (1984), the equity point of view is that firms follow a pecking order of incremental financing choice that prioritizes internal funds at the top. Internal funds is own equity that includes retained earnings, according to this theory the most important component of capital structure financing is equity debt comes in when equity is not enough.

According to Zender (2010), the tradeoff theory of capital structure predicts that firms will choose their mix of debt and equity to balance the costs and benefits of debt. Tax benefits and control of free cash flow problems are argued to push firms to use more debt. The theory describes a firm’s optimal capital structure as the mix of financing that equates the marginal costs and benefits of debt.
2.2.3 Other Constituents of Capital Structure

2.2.3.1 Retained Earnings

Also referred to as revenue retention, retained earnings can be defined as the portion of a company’s profit that is kept for reinvestment into the business instead of being paid out as dividends (Chasan, 2012).

2.2.3.2 Share Capital

Any firm should have capital in order to finance its activities. This includes the funds raised by issuing shares in exchange of cash and other considerations. When total capital is divided into shares, it is called share capital and it constitutes the basis of the capital structure of a company (Kaur, 2015).

2.2.3.3 Revaluation Reserves

A revaluation reserve arise when the value of an asset becomes greater than the value at which it was previously carried on the balance sheet resulting to the increase of shareholders’ funds (Bermingham, 2016).

2.3 Effect of Debt Ratio on Financial Performance

Profitability of a firm is as a result of the capital structure decisions that a firm comes up, this decisions whether short term or long term affect the profitability of a firm while at the same time increase the risk of the firm investment ventures. This is due to the fact that capital structure comprises of debt and equity, debt increases the risk of future earnings while enabling a firm to expect high returns (Muzir, 2011).

Managers of a firm prefer to use more debt to fund the business operations, according to (Modigliani and Miller, 1963) tax shield due to interest expense is considered to be one of the most important determinant of capital structure decision and is thought to motivate firms to use more debt. However when a firm finances its capital structure by increasing debt, the cost of capital increases and this may bring about cash problems. If the situation aggravates bankruptcy, is bound to happen. This means that the firm has to ensure that its
business operations are bringing higher returns in terms of increased profits which may in turn attract investors (Boodhoo, 2009)

Debt is a resource borrowed with the expectation of paying back after a specified period of time. If the specified time spread over a period of one year then it becomes long term debt and if the expected payment period is less than or equal to one the it becomes a short term debt. The use of debt in a firm’s capital structure has got its benefits. The firm benefits from debt tax shield effect and financial leverage. The firm is required to pay interest to creditors of the costs, exemption from corporate income tax, while dividends paid to shareholders is deducted from the net profit after corporate income tax. If interest rates are appropriate, and earnings before interest and tax are more than business interest, then improvement on the enterprise's debt ratio would increase the tax-free income and the firm’s market value (Kajirwa, 2015).

Nima, Mohammad, Saeed, and Zeinab (2012) did a study on the relationship between capital structure and firm performance of Tehran Stock Exchange Companies for the period between the years 2006 to 2011. Their study utilized three performance indicators which include Gross Profit Margin, Return on Assets as dependent variable and three capital structures including long term debt, short term debt and total debt ratios as independent variable. The study reported a significant relationship between dependent and independent variable, except long term debts with gross profit margin.

A study by Iorpev and Kwanum (2012) examined the impact of capital structure on the performance of 15 manufacturing companies listed in the Nigerian Stock Exchange from 2005 to 2009. Multiple regression analysis was used on performance indicators Return on Asset and Profit Margin, Short-term debt to Total assets, Long term debt to Total assets and Total debt to Equity as capital structure variables. The results established a negative and insignificant relationship between Short term debt to total assets and Long term debt to total assets, and ROA and profit margin. The study also revealed that Total debt to equity was positively correlated with ROA and negatively correlated with profit margin. Short term debt to total assets was significant using ROA while Total Long term debt to total assets is significant using profit margin. The study concluded that statistically, capital structure is not a major determinant of firm performance.
According to Ebaid (2009), capital structure decision has weak-to-no effect on the financial performance of firms. By using return on assets, return on equity, and Gross Margin, the empirical tests concluded that capital structure particularly Short term debts and Total debts have a negative impact on an organization’s performance which is measured by ROA. The study also established that capital structure including short-term debt, long-term debt and total debt had no significant impact on an organization’s performance measured by ROE and gross margin.

Kajirwa (2015) conducted a research on the effect of firm performance on commercial banks listed in the NSE from 2010 to 2014. The study concluded that the use of debt in a firms’ capital structure negatively affects its financial performance though not statistically significant. The ratio of a firm’s total liabilities to total assets negatively affects the financial performance. This implies that an increase in the proportion of debt used by commercial banks results into a decrease in a firms’ financial performance.

Majumdar and Chhibber (1999) examined the relationship between the levels of debt in the capital structure and performance for a sample of Indian firms. Analysis of the data revealed this relationship for Indian firms to be significantly negative. Abor, (2005) examined the relationship between capital structure and profitability of listed firms on the Ghana Stock Exchange (GSE) during a five-year period. The results represented a significantly positive relation between the ratio of short-term debt to total assets and ROE. However, a negative relationship between the ratio of long-term debt to total assets and ROE was found.

2.4 Effect of Asset Tangibility on Financial Performance

Assets Tangibility is the ratio of book value of tangible fixed assets to the book value of total assets (Rajan and Zingales, 1995). Tangibility is the ability of assets to be utilized as collateral. Bond holders will require collateral to protect their interests thus the direct proportional relationship between leverage level and liquidity of a firm. Williamson (1988) observed that high cost of capital leads to costly borrowing hence equity is preferred. It is cheaper to maintain equity capital since once the shares start trading, the firm incurs no borrowing fees and floatation costs. Low cost of capital lead to high firm value.
It is believed that corporations operating with more tangible assets have a higher debt capacity (Byoun, 2008). In addition, agency theory proposes that corporations with high debt financing levels tend to under invest, or invest below their optimal investment levels, and thus transfer wealth away from debt holders to equity holders (Deesomsak, Paudyal and Pescetto, 2004). They argue that these expected behaviors of under investment cause debt holders to require collateral because the use of secured debts can help alleviate this problem. They also argue that the liquidation value of the firm increases with the tangibility of assets and decreases the probability of mispricing in the event of bankruptcy.

Therefore, the existence of tangible assets within the assets of a corporation serves two critical purposes: it enables the corporation to pledge the assets as collateral, thereby reducing the agency costs of debt, like risk shifting; and, at the same time, protects the debt holder in the event of liquidation (Rajan and Zingales, 1995). It means that corporations with difficulties in providing collaterals are prone to pay higher interest, or may be forced to issue equity instead of debt finance, which implies a positive relationship between tangibility of assets and debt financing.

Asset tangibility can also discourage debt financing since a larger proportion of tangible assets in the asset portfolio of a corporation is expected to reduce supply side constraints (Majumdar, 2012). According to Frank and Goyal (2009), the pecking order theory makes opposite predictions since low information asymmetry associated with tangible assets makes equity issuances less costly. Thus, debt financing levels should be lower for firms with higher tangibility.

The trade-off theory predicts tangibility to be positively related to debt levels for two main reasons, namely security and the costs of financial distress. Firstly, tangible assets normally provide high collateral value relative to intangible assets, which implies that these assets can support more debt. Secondly, tangible assets often reduce the costs of financial distress because they tend to have higher liquidation value. In addition to the above two reasons, agency theory provides another two reasons for a positive association between assets’ tangibility and the firm’s debt levels. The first of these reasons relates to the ease by which the variance of the cash flows generated from the asset can be
increased (Manos, 2001). Viswanath and Frierman (1995) note that it is usually more difficult to alter the variance of the cash flows generated from tangible rather than intangible assets. Thus asset tangibility reduces the scope for risk shifting and firms with tangible assets will support more debt.

Harris and Raviv (1990) developed the idea of the role of debt in disciplining management and providing information for this purpose. It is argued that tangible assets have higher value on liquidation, which means that liquidation is often the best strategy when the firm is financially distressed. However it is when liquidation may be the best course of action that managers, due to self-interest considerations, will be most reluctant to provide useful information that can lead to such outcome. Under these circumstances debt can ensure information is available because default on debt obligations, triggers investigation into the firm’s affairs. Thus firms with tangible assets, whose managers tend to conceal information in order to avoid liquidation, will have more debt due to its role in disciplining managers and providing information.

Asset tangibility is found to be priced in the cross-section of equity returns, and this relationship is most evident in the materials industry, which is characterized by irreversible, firm-specific assets (Docherty, Chan & Easton, 2010). Cooper (2006) argues that costly irreversibility means that capital investment remains relatively constant across time. Those firms with physical assets-in-place are more sensitive to aggregate market conditions, given that idle capacity can be employed in boom periods to increase output without the need for costly investment. Firms with a high book-to-market ratio are those that have invested in a larger proportion of installed physical capacity and are therefore more sensitive to aggregate conditions and have high systematic risk. The Zhang (2005) and Cooper (2006) theory is consistent with asset tangibility being priced in the cross section of returns, particularly in industries characterised by investment in irreversible assets-in-place.

Zhang (2005) and Cooper (2006) argue that unproductive physical capacity is costly in contracting conditions, but provides growth opportunities during economic expansions. This provides covariant risk between firms’ investment in tangible assets and market-wide returns. The type of asset held by the firm is important. Almeida and Campello
(2007) found that investment in firms with a high tangibility of assets is not affected by changes in internal funds. Asset tangibility affects the sensitivity of investment to cash flow in financially constrained firms, but does not affect it in financially unconstrained firms. The theoretical basis behind this proposed relationship relates back to what is referred to as the credit multiplier, which means that the firm can extend its credit ability by holding more tangible assets.

Bennett and Donnelly (1993) examine the cross-sectional determinants of capital structure in non-financial UK companies. They found a negative relation between debt and the non-debt tax shield, and a positive relation between tangibility of assets and leverage. Rajan and Zingales (1995) broadened the analysis of the determinants of capital structure choice across the G-7 (Canada, France, Germany, Italy, Japan, United Kingdom, and United States). They focused on four factors that might determine capital structure (tangibility, growth, size, and profitability). Their results showed that the debt level has a positive relation with tangibility of assets in all countries, a negative relationship with growth opportunities, and a positive relationship with size.

2.5 Effect of Asset Turnover on Financial Performance

Asset turnover measures the percent of sales that you are able to generate from your assets. It reflects the level of capital tied-up in assets and how much sales can be squeezed out of assets. Asset Turnover is calculated by dividing Sales by Average Assets. A high asset turnover rate implies that we can generate strong sales from a relatively low level of capital. Low turnover would imply a very capital-intensive organization (Evans, 2000).

Asset turnover ratio is an important financial ratio used to understand how well the company is utilizing its assets to generate revenue. It is imperative for every company to analyze and improve its Asset Turnover Ratio (ATR). Asset turnover ratio determines the ability of a company to generate revenue from its assets by comparing the net sales of the company with the total assets. In other words, it aims to measure sales as a percentage of average assets to determine how much sales is generated by each rupee of assets. Asset turnover ratio shows the comparison between the net sales and the average assets of the company. A higher asset turnover ratio is preferred as it reflects more efficient asset
utilization. However, as with other ratios, the asset turnover ratio needs to be analyzed while keeping in mind the industry standards (eFinance Management, 2016).

Some industries are designed to use assets in a better way than others. A higher asset turnover ratio implies that the company is more efficient at using its assets. A low asset turnover ratio, on the other hand, reflects the bad management of assets by the company. It may also indicate production or management problems. Since asset turnover ratio measures the efficiency of a company in managing its resources to generate its sales, it is very obvious that higher turnover ratios are preferred to reflect a better state of affairs at the company. This ratio gives an insight to the creditors and investors into the internal management of the company. A low asset turnover ratio will surely signify excess production, bad inventory management or poor collection practices. Thus, it is very important to improve the asset turnover ratio of a company (eFinance Management, 2016).

Previous studies have been conducted in relation to how asset turnover affects the financial performance of firms. Pouraghajan, Malekian, Emangholipour, Lotfollahpour, & Bagheri (2012) conducted a study on the relationship between Capital Structure and Firm Performance of companies listed in the Tehran Stock Exchange during the period 2006 to 2010. In their study, variables of return on assets ratio (ROA) and return on equity ratio (ROE) were used to measure the financial performance of companies using multiple regression analysis. Results suggested that there was 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. But the relationship between ROA and ROE measures with the firm age was not significant.

A study done by Gamayuni (2015) concludes that intangible assets have negative but not significant effect on Debt Equity Ratio. Higher investment in intangible assets results to lower debt ratios. This occurs because companies use the funds from retained earnings to invest in intangible asset and reduce debt, because intangible asset are more risky so it has higher debt cost. The higher the intangible assets the higher the dividends are paid, because companies want to give good quality signals for investors. The study found out
that intangible assets have a positive and significant effect on company performance as represented by the ROA. These results support previous research that found that the higher the intangible assets, the higher the ability of companies to return earnings assets. The study also found out that intangible assets have negative but not significant effect on the current ratio and asset turnover. Simultaneously, intangible assets, debt policy, corporate performance (current ratio, ROA, asset turnover) jointly have significant effect on firm value.

Xu and Banchuenvijit (2012) conducted a study on the factors affecting financial performance of firms listed on Shanghai Stock Exchange 50 (SSE 50) excluding financial firms from 2008 to 2012. The dependent variable of the study was return on assets and return on equity, and independent variables were liquidity as measured by current ratio, asset utilization as measured by total asset turnover ratio, leverage as measured by debt ratio, and a dummy variable is the firm size dummy. The research used the quantitative research method. In order to achieve the aims of the study, multiple linear regression analysis was used. The results of the study indicated that current ratio has a positive but insignificant impact both on ROA and ROE, so liquidity positively but insignificantly affects firms’ financial performance. Second, total assets turnover ratio has a positive and significant impact both on ROA and ROE, so assets utilization positively and significantly affects firms’ financial performance.

Mwangi and Birundu (2015) conducted a study to investigate the effect of capital structure on the financial performance of Small and Medium Enterprises (SMEs) in Thika Sub-County for a period of five years from 2009 to 2011. The study used descriptive research design. Multiple regression and correlation analysis were used to determine the nature of significance of the relationship between changes in the response variable and change in the predictor variables. The study concluded that capital structure, asset turnover and asset tangibility do not have significant effects on the financial performance of SMEs. The study therefore concluded that there are other more significant factors which affect the financial performance of SMEs.
2.6 Chapter Summary

Chapter two has broadly introduced capital structure and its effects on the performance of firms both globally and locally. The chapter has analyzed the major components of capital structure that is debt and equity. Other components of capital structure have been examined. The chapter has further presented a critical analysis of the various theories that explain debt and equity and how the two capital structure components relate to the financial performance of firms. The chapter has also analyzed variables under study which are: debt ratio effect on financial performance, asset tangibility effect on performance and asset tangibility effect on financial performance. After Literature review chapter, chapter three describes the research methodology applied on study.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This chapter discusses the research design, the population and sampling design used in the study, the data collection instruments, the data analysis and the model used. The last section gives the summary of the whole chapter.

3.2 Research Design

This study employed descriptive research design. A descriptive study is used to describe or define, often by creating a profile of a group of problems, people or events, through the collection of data and tabulation of the frequencies on research variables or their interaction (Cooper & Schindler, 2011). Descriptive research design was chosen because allowed the analysis and relation of the variables under study.

One of the major goals of the firm is to maximize the wealth of the shareholders. One of the major measures of this goal is the financial ratios (Prashant & Gupta, 2011). The ratios used in the study were calculated from the secondary data acquired from the financial statements of five years period (2011 - 2015) for all the TFC subsidiaries. The financial statements used were obtained from the Tourism Finance Corporation finance department and the individual subsidiary’s finance departments. The study used a framework of Debt ratio, Debt Equity ratio asset tangibility and asset turnover as the independent variables whereas Return on Assets ratio and Efficiency ratio were the dependent variables. After analyzing the relationship among the independent and dependent variables the study has thus provided recommendations that are specific and relevant.

3.3 Population and Sampling Design

3.3.1 Population

Ngechu (2006) defined a population as a complete set of individuals, cases, or objects with some common observable characteristics. A particular population has some
characteristics that differentiate it from other population. He further indicated that a target population is a group of individuals, events or objects which a researcher wants to generalise the findings. The population of the study comprised of all the five Tourism Finance Corporation subsidiaries in Kenya as at 30\textsuperscript{th} June 2016. These Subsidiaries include; Sunset Hotel, Golf Hotel, Kabarnet Hotel, Mount Elgon Lodge Hotel, Kenya Safari Lodges and Hotels Limited.

3.3.2 Sampling Design Sampling Size

3.3.2.1 Sampling Frame
Sampling frame is a list of elements from which the sample is drawn and it is closely related to the population under study. Sampling is selecting a proportionate representation from the total sample size which is the population under study. Sampling enables lower cost, accuracy of results, increased speed of data collection, and availability of population elements (Cooper and Schindler, 2011). A representative sample was drawn from a list of the Tourism state corporations in Kenya. This was to ensure that the sampling frame was current, complete and relevant to the research objectives.

3.3.2.2 Sampling Technique
Sampling technique is a method used in selecting elements from the population that will represent the population (Collins & Hussey, 2009). Descombe 2014 states that the choice of sampling technique depends on how various techniques fit the needs of the researcher and the kind of research he/she proposes to undertake. Descombe further argued that the chosen sampling technique should be both feasible and likely to produce relevant information. This study therefore did adopt the census survey on all the five TFC subsidiaries in Kenya. This technique was chosen because the units analysed were few in number.

3.3.2.3 Sample Size
Sample size is a collection or group of people or units a researcher wants to use to represent the population. Thietart and Raymond (2001) defined a sample size as the set of elements from which data is collected. A good sample size should provide information that is detailed and comprehensive. According to Denscombe (2014), the sample must be
carefully selected to be representative of the population. For this study, the sample size used was five Tourism Finance Corporation Subsidiaries.

3.4 Data Collection Methods

This study relied on secondary data which was obtained from audited annual reports by the Kenya National Audit Office (KENAO) acquired from the Tourism Finance Corporation finance department. The researcher developed a data collection sheet to calculate and capture the capital structure measures of debt ratio, asset turnover and asset tangibility. It also captured the average figures of the efficiency ratios and the room occupancy rate. The data collection sheet helped in calculating the dependent variable (ROA). The period covered by the study was between years 2011 to 2015.

3.5 Research Procedures

The secondary data relied on the research was prepared for analysis by use of data collection sheets after extraction from the financial statements and management reports of the TFC subsidiaries. The data entered in the data collection sheets were for financial performance, debt ratio, asset tangibility and asset turnover. The process produced quantitative data and this led to the use of descriptive research design. The design selected in the study helped to test and describe relationships of the variables considered.

According to Knupfer (1994), descriptive studies report summary data such as measures of central tendency include the mean, median, mode, deviance from the mean, variation, percentage, and correlation between variables.

3.5 Data Analysis Methods

The relationship between the dependent variable and the independent variables was determined by the use of the linear regressions. The data was analysed using Statistical Package for Social Sciences (SPSS) and Microsoft (MS) Excel. According to Denscombe (1998), descriptive statistics involves a process of transforming a mass of raw data into tables, charts, with frequency distribution and percentages, which are a vital part of making sense of the data. The data was presented using tables and graphs to give a clear picture of the research findings at a glance. Given the five year Panel structure of sample
data gathered, regression analysis was conducted to investigate the relationship between capital structure and financial performance of TFC subsidiaries in Kenya. The Regression model was of the form:

\[ Y = c + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon \]

Where:

Y is the financial performance of the subsidiaries represented by ROA and Average of the efficiency ratios for the subsidiaries.

X₁ is the debt ratio (the ratio of total debt to total assets).

X₂ represents the asset tangibility (ratio of net fixed assets to total assets).

X₃ represents the asset turnover (ratio of total sales to total assets).

c- Constant of regression

ε- Error term of the model

The coefficient \( \beta_1, \beta_3 \) is the coefficients as determined by the model. The coefficients were estimated by use of Ordinary Least Squares (OLS) regressions on the population under study.

The significance of capital structure variable as a predictor of financial performance was tested using the t-test in SPSS. The significance of the overall model in explaining performance through the independent variables was measured through the f-test. The coefficient of determination (R²) was used to measure the strength to which independent variables explain variations in the dependent variables. The analysed data was then presented using tables.

3.6 Chapter Summary

The chapter has dealt with research methodology and procedures that helped the researcher in gathering and analyzing data in respect to the research questions. The
chapter has discussed the research design that was appropriate for the study. The population was identified hence the sample and sampling techniques was arrived at. The data collection and analysis methods were identified which suite the study. The regression model chosen was also provided. Chapter four will present the results and findings of the study. Chapter five will present the discussion, conclusions and recommendations of the study.
CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction

This chapter presents the results and findings of the study objective. The different parts discussed in this chapter include: the general information of the study which relates to the nature of the business of the subsidiaries and an analysis of the components considered in capital structure and financial performance. These components include Equity, share capital, total turnover, net income, total assets, total debt, Average efficiency ratios. The chapter also presents the findings of the relationship between debt ratio and financial performance, asset tangibility and financial performance and the relationship between asset turnover and financial performance. Lastly, a summary of the study is presented.

4.2 General Information

4.2.1 Nature of the Business

Table 4.1 shows the nature of business undertaken by each Tourism Finance Subsidiary in Kenya.

Table 4.1 : Nature of Operations

<table>
<thead>
<tr>
<th>Subsidiary</th>
<th>Location</th>
<th>Products</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sunset Hotel</td>
<td>Kisumu</td>
<td>Hospitality products and services, conference facilities for training.</td>
</tr>
<tr>
<td>Golf Hotel</td>
<td>Kakamega</td>
<td>Hospitality services and products, recreation services like swimming and play grounds. A nine-hole golf course for lovers of golf. It also provides conference facilities and outside catering.</td>
</tr>
<tr>
<td>Kabarnet Hotel</td>
<td>Kabarnet</td>
<td>Hospitality products and services, recreation services like swimming and tennis games, bird viewing for both international and local tourists.</td>
</tr>
<tr>
<td>Mount Elgon Hotel</td>
<td>Trans Nzoia</td>
<td>Accommodation and conference facilities for business travelers and tourists, team building and conference facilities.</td>
</tr>
<tr>
<td>Kenya Safari Lodges and Hotel Limited</td>
<td>Mombasa</td>
<td>Premium hotel and lodge accommodation, current conference and business meeting venues, customized beach and safari experiences as well as high value niche products.</td>
</tr>
</tbody>
</table>
4.2.2 Total Turnover

The turnover for the TFC subsidiaries used in the study are shown in Table 4.2 for the period from 2011-2015. Kenya Safari Lodges and Hotels Limited has an average annual turnover of 355.9 million Kenya shillings. Mount Elgon Lodge Limited has an annual average turnover of 293.9 million Kenya shillings while Golf Hotel has an annual average turnover of 107.1 million Kenya shillings. Sunset Hotel has an average annual turnover of 65.8 million Kenya shillings and Kabarnet Hotel has the least average annual turnover of 7.5 million Kenya shillings. It can be concluded that Kenya Safari Lodges and Hotels has the highest average total turnover from the analysis.

Table 4.2: TFC Subsidiaries' Annual Average Turnover (2011-2015)

<table>
<thead>
<tr>
<th>SUBSIDIARY</th>
<th>Averages (KShs '000')</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sunset Hotel</td>
<td>65,786.60</td>
</tr>
<tr>
<td>Golf Hotel</td>
<td>107,090.40</td>
</tr>
<tr>
<td>Kabarnet Hotel</td>
<td>7,489.00</td>
</tr>
<tr>
<td>Mount Elgon Lodge Limited</td>
<td>293,868.48</td>
</tr>
<tr>
<td>Kenya Safari Lodges and Hotels Limited</td>
<td>355,878.80</td>
</tr>
</tbody>
</table>

4.2.3 Net Income

Table 4.3 shows the average net income of the TFC subsidiaries used in the study. It is clear that only Golf Hotel has a positive average net income of 10.4 Million Kenya shillings. All other subsidiaries have reported average losses in the period under study. Mount Elgon Lodge Limited has the highest average loss of 70.7 million Kenya shillings. Kenya Safari Lodges and Hotels Limited has an average loss of 20.6 million Kenya shillings while Sunset Hotel and Kabarnet Hotel have an average loss of 7.9 million Kenya shillings and 3.9 million Kenya shillings respectively.
Table 4.3: TFC Subsidiaries' Average Net Income (2011-2015)

<table>
<thead>
<tr>
<th>SUBSIDIARY</th>
<th>Averages (KShs &quot;000&quot;)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sunset Hotel</td>
<td>(7,994.75)</td>
</tr>
<tr>
<td>Golf Hotel</td>
<td>10,403.50</td>
</tr>
<tr>
<td>Kabarnet Hotel</td>
<td>(3,990.25)</td>
</tr>
<tr>
<td>Mount Elgon Lodge Limited</td>
<td>(70,689.43)</td>
</tr>
<tr>
<td>Kenya Safari Lodges and Hotels Limited</td>
<td>(20,583.25)</td>
</tr>
</tbody>
</table>

4.2.4 Total Assets

The average asset base for the TFC subsidiaries during the period under study are shown in Table 4.4 Kenya Safari Lodges and Hotels Limited have the highest asset base of 867.2 million Kenya shillings. Mount Elgon Lodge Limited has the lowest asset base of 53.6 million Kenya shillings.

Table 4.4: TFC Subsidiaries' Average Total Assets (2011-2015)

<table>
<thead>
<tr>
<th>SUBSIDIARY</th>
<th>Averages (KShs &quot;000&quot;)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sunset Hotel</td>
<td>124,776.00</td>
</tr>
<tr>
<td>Golf Hotel</td>
<td>130,020.80</td>
</tr>
<tr>
<td>Kabarnet Hotel</td>
<td>65,087.60</td>
</tr>
<tr>
<td>Mount Elgon Lodge Limited</td>
<td>53,593.16</td>
</tr>
<tr>
<td>Kenya Safari Lodges and Hotels Limited</td>
<td>867,176.20</td>
</tr>
</tbody>
</table>

4.2.5 Efficiency Ratios

Table 4.5 shows the analysis of efficiency ratios for the TFC Subsidiaries for the period under study. Food efficiency ratio shows the expenses to revenue generated from the food consumption in the hotels. The higher the ratio, the better for the firm. From the analysis, Sunset Hotel has an average efficiency of 0.39 while Golf Hotel has a ratio of 0.36. Kabarnet Hotel has a food efficiency ratio of 0.47. Mount Elgon Hotel Limited and Kenya Safari Lodges have an efficiency ratio of 0.55 and 0.38 respectively. On the beverage efficiency ratios, Kabarnet Hotel and Mount Elgon Lodge have the highest ratio
of 0.70 while Sunset Hotel has the lowest beverage efficiency ratio of 0.40. From the analysis, Golf Hotel has the highest occupancy rate of 0.57 while Mount Elgon Hotel Limited has the lowest room occupancy rate of 0.11. On average, Gold hotel and Kabarnet hotel have the highest efficiency ratios of 0.47. Sunset Hotel and Kenya Safari Lodges and Hotels Limited have the lowest efficiency ratio of 0.36.

Table 4.5: TFC Subsidiaries' Average Efficiency Ratios (2011-2015)

<table>
<thead>
<tr>
<th>SUBSIDIARY</th>
<th>Food Efficiency Ratio</th>
<th>Beverage Efficiency Ratio</th>
<th>Room Occupancy Rate</th>
<th>Average Efficiency Ratios</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sunset Hotel</td>
<td>0.39</td>
<td>0.40</td>
<td>0.28</td>
<td>0.36</td>
</tr>
<tr>
<td>Golf Hotel</td>
<td>0.36</td>
<td>0.49</td>
<td>0.57</td>
<td>0.47</td>
</tr>
<tr>
<td>Kabarnet Hotel</td>
<td>0.47</td>
<td>0.70</td>
<td>0.25</td>
<td>0.47</td>
</tr>
<tr>
<td>Mount Elgon Lodge Limited</td>
<td>0.55</td>
<td>0.70</td>
<td>0.11</td>
<td>0.45</td>
</tr>
<tr>
<td>Kenya Safari Lodges and Hotels Limited</td>
<td>0.38</td>
<td>0.41</td>
<td>0.28</td>
<td>0.36</td>
</tr>
</tbody>
</table>

4.2.6 Asset Tangibility

The average asset tangibility ratio for the TFC Subsidiaries during the period under study are shown in table 4.6. From the analysis, Kabarnet Hotel has the highest asset tangibility ratio of 1.0034 while Golf Hotel has the lowest asset tangibility ratio of 0.5595.

Table 4.6: Asset Tangibility

<table>
<thead>
<tr>
<th>SUBSIDIARY</th>
<th>Asset Tangibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sunset Hotel</td>
<td>0.8634</td>
</tr>
<tr>
<td>Golf Hotel</td>
<td>0.5595</td>
</tr>
<tr>
<td>Kabarnet Hotel</td>
<td>1.0034</td>
</tr>
<tr>
<td>Mount Elgon Lodge Limited</td>
<td>0.9631</td>
</tr>
<tr>
<td>Kenya Safari Lodges and Hotels Limited</td>
<td>0.8441</td>
</tr>
</tbody>
</table>

4.2.7 Asset Turnover

The average asset turnover ratio for the TFC Subsidiaries during the period under study are shown in table 4.7. From the analysis, Mt. Elgon Lodge Limited Hotel has the highest asset turnover ratio of 5.4833 while Kabarnet Hotel has the lowest asset turnover ratio of 0.1151.
Table 4.7: Asset Turnover

<table>
<thead>
<tr>
<th>SUBSIDIARY</th>
<th>Asset Turnover</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sunset Hotel</td>
<td>0.5272</td>
</tr>
<tr>
<td>Golf Hotel</td>
<td>0.8096</td>
</tr>
<tr>
<td>Kabarnet Hotel</td>
<td>0.1151</td>
</tr>
<tr>
<td>Mount Elgon Lodge Limited</td>
<td>5.4833</td>
</tr>
<tr>
<td>Kenya Safari Lodges and Hotels Limited</td>
<td>0.4104</td>
</tr>
</tbody>
</table>

4.3 Components of Capital Structure

4.3.1 Debt

Debt includes both the current and non-current liabilities which the subsidiaries in the study have. The study took into account the long term and short term borrowing and considered the total debt in the analysis. Figure 4.1 shows that Kenya Safari Lodges and Hotels Limited has the highest debt level which has been increasing over the years from 2011 to 2015. Mount Elgon Lodge Limited, Kabarnet Hotel and Golf Hotel has been increasing their debt levels from 2011 to 2013 then the levels remain constant for the other years. Sunset Hotel has the lowest debt levels compared with other subsidiaries.

![Figure 4.1: Debt Levels of TFC Subsidiaries (2011 – 2015)](image-url)
4.3.2 Equity

Equity refers to the capital contributions by the ownership of the subsidiaries. Figure 4.2 shows that Kenya Safari Lodges and Hotels Limited has the highest equity levels. However, these levels have drastically increased from 2011 to 2012 then decreased from 2012 to 2015. Sunset Hotel has the lowest equity level. Golf Hotel’s Equity level has remained constant from 2012-2015. From the figure, it is evident that the equity levels of the TFC Subsidiaries have all been decreasing over the years under study.

![Equity Levels of TFC Subsidiaries (2011-2015)](image)

4.3.3 Other Components of Capital Structure

The study analysed other components of capital structure as discussed in chapter two literature review. These components include share capital, revaluation reserves and retained earnings.

4.3.3.1 Share Capital

Figure 4.3 shows the share capital levels of the TFC Subsidiaries. Kenya Safari Lodges and Hotels Limited has the highest share capital level while Sunset Hotel has the lowest share capital level. All the subsidiaries have maintained a constant share capital from 2011 to 2015.
Figure 4.3: Share Capital of TFC Subsidiaries (2011-2015)

4.3.3.2 Revaluation Reserve

Revaluation occurs when the current and probable future value of a non-current asset is higher than the recorded historical cost. Figure 4.4 shows that Kenya Safari Lodges and Hotels Limited has the highest revaluation reserve levels from 2011 to 2015 which increased from 2011 to 2012 then declined from 2012 to 2015. Sunset Hotel has the lowest revaluation reserve levels over the years under study.

Figure 4.4: Revaluation Reserve Levels of TFC Subsidiaries (2011-2015)
4.3.3.3 Retained Earnings

Figure 4.5 shows the retained earnings of the TFC subsidiaries. In 2011 and 2012, Kenya Safari Lodges and Hotels Limited has the highest retained earnings but in 2013 to 2015, there were no retained earnings and the subsidiary made loses. Golf Hotel has retained earnings for the five years under study which decreased from 2011 to 2013 then increased in 2014 and 2015. All the other three subsidiaries did not have retained earnings for the years under study.

![Retained Earnings for TFC Subsidiaries (2011-2015)](image)

4.4 Effect of Debt Ratio on Financial Performance

4.4.1 Effect of Debt Ratio and Return on Assets

The study sought to determine the causal effect of the individual independent variables upon the dependent variables. A regression and correlation analysis was performed on debt ratio as the independent variable and return on assets as the dependent variable. Table 4.8 shows the average debt ratios and return on asset ratios of the TFC subsidiaries from 2011 to 2016. Kabarnet Hotel has the highest average debt ratio of 0.91 with a negative ROA of -0.06. Mount Elgon Lodge Limited has the lowest average Return on
Assets ratio of -1.32. Golf Hotel has the highest average Return on Assets of 0.08 and an average Debt Ratio of 0.58.

Table 4.8: Average Debt Ratio and ROA of TFC Subsidiaries (2011-2015)

<table>
<thead>
<tr>
<th>Company</th>
<th>Debt Ratio</th>
<th>Return on Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sunset Hotel</td>
<td>0.79</td>
<td>-0.06</td>
</tr>
<tr>
<td>Golf Hotel</td>
<td>0.58</td>
<td>0.08</td>
</tr>
<tr>
<td>Kabarnet Hotel</td>
<td>0.91</td>
<td>-0.06</td>
</tr>
<tr>
<td>Mount Elgon Lodge Limited</td>
<td>0.41</td>
<td>-1.32</td>
</tr>
<tr>
<td>Kenya Safari Lodges and Hotels Limited</td>
<td>0.38</td>
<td>-0.02</td>
</tr>
</tbody>
</table>

Table 4.9 shows the model summary for Debt Ratio and Return on Assets. It provides a values for R and R Square. R is 0.446 which represents a simple correlation between debt ratio and ROA. This therefore indicates that debt ratio and return on assets have a weak but positive correlation. R Square is 0.199. This means that only 19.9% of ROA is explained by debt ratio and that 80.1% is explained by other factors.

Table 4.9: Regression Model Summary for Debt Ratio and ROA

<table>
<thead>
<tr>
<th>Model Summarya</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>.446a</td>
<td>.199</td>
<td>-.069</td>
<td>.60621</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Debt Ratio
b. Dependent Variable: Return on Assets

Table 4.10 shows the regression model coefficients and the statistical significance on the independent variable. The p-value is 0.452 which is greater than Alpha (0.05). This means that the single model is not statistically significant and that debt ratio could not be used to predict financial performance of TFC subsidiaries using Return on Assets as the dependent variable. It also implies that debt ratio does not have a statistically significant effect on financial performance as measured by ROA. The regression constant is -0.966 and the beta coefficient is 1.124. Equation 1 summarizes the regression results.

\[ Y = -0.996 + 1.124X_1 + \varepsilon_1 \]
Table 4.10: Regression Coefficients of Debt Ratio and ROA

<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>(Constant)</td>
<td>-.966</td>
<td>.845</td>
<td>-1.143</td>
<td>.336</td>
</tr>
<tr>
<td>Debt Ratio</td>
<td>1.124</td>
<td>1.304</td>
<td>.446</td>
<td>.862</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Return on Assets

4.4.2 Effect of Debt Ratio on Efficiency Ratios

Table 4.11 shows the results of the regression model summary for debt ratio and efficiency ratios. Efficiency ratio is the average of food efficiency ratio, beverage efficiency ratio and room occupancy rate. From the table, R is 0.197. This means that the correlation between debt ratio and efficiency ratio is very weak but positive. R Square is 0.039. This implies only 3.9% of debt ratio can explain the variability of financial performance of the subsidiaries as measured by the efficiency ratios. The rest of the variability (96.9%) is explained by other factors.

Table 4.11: Regression Model Summary of Debt Ratio and Efficiency Ratios

<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>.197a</td>
<td>.039</td>
<td>-.282</td>
<td>.06474</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Debt Ratio
b. Dependent Variable: Efficiency Ratio

Table 4.12 shows the results of the regression coefficients and the statistical significance of the model. The p-value is 0.751 which is greater than Alpha (0.05). This means that debt ratio does not have a statistically significant effect on financial performance of TFC subsidiaries as measured by efficiency ratios. The regression constant is 0.392 and the coefficient of the regression model is 0.048. Equation 2 summarizes the regression results.

\[ Y = 0.392 + 0.048X_2 + \epsilon \]  

\[ \text{Equation 2} \]
Table 4.12: Regression Coefficients of Debt Ratio and Efficiency Ratios

<table>
<thead>
<tr>
<th>Coefficientsa</th>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>(Constant)</td>
<td>1</td>
<td>.392</td>
<td>.090</td>
<td>.197</td>
<td>4.345</td>
</tr>
<tr>
<td>Debt Ratio</td>
<td>1</td>
<td>.048</td>
<td>.139</td>
<td>.348</td>
<td>.751</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Efficiency Ratio

4.4.3 Trend Analysis of Debt and Financial Performance

4.4.3.1 Debt Ratio and Return on Assets for Sunset Hotel

As shown in figure 4.6, there is an increase in debt ratio from 2011 to 2012. Conversely, ROA has decreased from 2011 to 2012. Debt ratio continues to increase at a decreasing rate from 2012 to 2014 then remains constant in 2015. At the same period, ROA has increased in 2013 and 2014 with a decrease in 2015. It can be deduced that there is no relationship between debt ratio and financial performance of Sunset Hotel as measured by Return on Assets.

Figure 4.6: Trend Analysis of Debt Ratio and Return on Assets for Sunset Hotel
4.4.3.2 Debt Ratio and Return on Assets for Golf Hotel

Figure 4.7 shows the trend analysis of debt ratio and return on assets of Golf Hotel. Both debt ratio and return on assets are decreasing from 2011 to 2012. Thereafter, debt ratio is seen increasing drastically from 2012 to 2013 and at the same time return on assets is still decreasing. It can be deduced that there is no relationship between debt ratio and return on assets for Golf Hotel.

4.4.3.3 Debt Ratio and Return on Assets for Kabarnet Hotel

Figure 4.8 shows the trend analysis of debt ratio and return on assets for Kabarnet Hotel from 2011 to 2015. Return on assets is gently increasing when debt ratio is drastically decreasing from 2011 to 2012. From 2012 to 2014, both return on assets and debt ratios are gently increasing. From 2014 to 2015, return on assets is decreasing when debt ratio is decreasing. This implies there is no relationship between debt ratio and return on assets.
Figure 4.8: Trend Analysis of Debt Ratio and Return on Assets for Kabarnet Hotel

4.4.3.4 Debt Ratio and Return on Assets for Mount Elgon Lodge Limited

Figure 4.9 shows a slight increase of return on assets as debt ratio increases from 2011 to 2012 for Mount Elgon Lodge Limited. From 2012 to 2013, return on assets drastically decreases while debt ratio is constant. Debt ratio drastically increases from 2013 to 2014 when debt ratio slightly increases. This means that there is no relationship between debt ratio and return on assets.

Figure 4.9: Trend Analysis of Debt Ratio and ROA for Mount Elgon Lodge Limited
4.4.3.5 Debt Ratio and Return on Assets for Kenya Safari Lodges and Hotels Limited

Kenya Safari Lodges and Hotels Limited has a decreasing return on assets as debt ratio decreases from 0.53 to 0.26 in 2011 and 2012 respectively as shown in Figure 4.10. Thereafter, return on assets continues to decrease as debt ratio increases. This implies there is no relationship between debt ratio and return on assets.

![Figure 4.10: Trend Analysis of Debt Ratio and Return on Assets for Kenya Safari Lodges and Hotels Limited](image)

4.5 Effect of Asset Tangibility on Financial Performance

4.5.1 Effect of Asset Tangibility on Return on Assets

Table 4.13 shows the regression model summary for asset tangibility and return on assets of TFC subsidiaries. The R value is 0.46 which depicts a weak but positive correlation between asset tangibility and return on assets. The R Square is 0.212 which implies that only 21.2% variation of return on assets is explained by asset tangibility. This means that 78.8% of the variability is explained by other variables.
Table 4.13: Regression Model Summary for Asset Tangibility on Return on Assets

<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>.460&lt;sup&gt;a&lt;/sup&gt;</td>
<td>.212</td>
<td>-.051</td>
<td>.59986</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Asset Tangibility  
b. Dependent Variable: Return on Assets

Table 4.14 shows the regression coefficients of asset tangibility and return on assets. It also shows the statistical significance of the independent variable. The p-value is 0.436 which is greater than Alpha (0.05). This means that the model is not statistically significant and that there is no statistically significant effect of asset tangibility on return on assets of the TFC subsidiaries. The regression constant is 1.033 and the coefficient is -1.548. This can be summarized by equation 3 as shown below.

\[ Y = 1.033 - 1.548X_3 + \epsilon \]  

(3)

Table 4.14: Regression Coefficients of Asset Tangibility and ROA for TFC Subsidiaries

<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</td>
<td>(Constant) 1.033</td>
<td>1.485</td>
<td>.696</td>
<td>.537</td>
</tr>
<tr>
<td>1</td>
<td>Asset Tangibility -1.548</td>
<td>1.726</td>
<td>-.460</td>
<td>-.897</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Return on Assets

4.5.2 Effect of Asset Tangibility on Efficiency Ratio

Table 4.15 shows the regression model summary of asset tangibility and efficient ratios for TFC subsidiaries. The R value is 0.098 which shows that the simple correlation between asset tangibility and efficient ratios is very weak but positive. The R Square is 0.01 which shows the explanatory power of asset tangibility to efficiency ratios. This means that debt ratio explains only 1% of the variability of financial performance of TFC subsidiaries. Further, this means that 99% of the variability is explained by other factors.
Table 4.15: Regression Model Summary of Asset Tangibility on Efficiency Ratio

<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>.098a</td>
<td>.010</td>
<td>-.321</td>
<td>.06572</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Asset Tangibility
b. Dependent Variable: Efficiency Ratio

The regression coefficients and the statistical significance are shown in Table 4.16. The p-value is 0.876 which is greater than Alpha (0.05). This means that the model is not statistically significant to predict the relationship between asset tangibility and efficiency ratio of the TFC subsidiaries. This implies there is no statistically significant effect of asset tangibility on financial performance as measured by efficiency ratios. The regression constant is 0.449 and the coefficient is -0.032. This can be summarized by equation 4 below.

\[ Y = 0.449 - 0.032X_4 + \epsilon \]  

(4)

Table 4.1: Regression Coefficients of Asset Tangibility on Efficiency Ratio

<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</td>
<td>(Constant)</td>
<td>.449</td>
<td>.163</td>
<td>2.760</td>
</tr>
<tr>
<td></td>
<td>Asset Tangibility</td>
<td>-.032</td>
<td>.189</td>
<td>-.098</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Efficiency Ratio

4.5.3 Trend Analysis of Asset Tangibility and Financial Performance

4.5.3.1 Asset Tangibility and Return on Assets of Sunset Hotel

Figure 4.11 shows the trend analysis for asset tangibility and return on assets of Sunset Hotel. From the figure, it is indicated that when asset tangibility increases from year 2011 to 2012, return on assets decreases. From year 2012 to 2014, return on assets increases as asset tangibility remains constant and later decreases. This means there is no relationship
between asset tangibility and financial performance as measured by return on assets of Sunset Hotel.

**Figure 4.11: Trend Analysis of Asset Tangibility and Return on Assets**

### 4.5.3.2 Asset Tangibility and Return on Assets for Golf Hotel

Figure 4.12 shows a decrease in ROA as asset tangibility decreases from year 2011 to 2013. From year 2013 to 2015, ROA increases as asset tangibility slightly increases and stagnate in year 2014 to 2015. This trend could not be said to bring about a relationship.

**Figure 4.12: Trend Analysis of Asset Tangibility and Return on Assets for Golf Hotel**
4.5.3.3 Asset Tangibility and Return on Assets for Kabarnet Hotel

As shown in Figure 4.13, return on assets slightly increases from year 2011 to 2013 as asset tangibility drastically decreases and subsequently slightly decreases. From year 2014 to 2015, return on assets decreases as asset tangibility remains constant. It can be deduced from these trends that there is no relationship between asset tangibility and return on assets for Kabarnet Hotel.

![Figure 4.13: Trend Analysis of Asset Tangibility and Return on Assets for Kabarnet Hotel](image)

4.5.3.4 Asset Tangibility and Return on Assets for Mount Elgon Lodge Limited

Figure 4.14 shows that return on assets is slightly increasing as asset tangibility is slightly increasing from the year 2011 to 2012. The return on assets is drastically declining from year 2012 to 2013 and then drastically increases in year 2015 when the asset tangibility is maintained at a constant level. This trend shows that there is no relationship between asset tangibility and financial performance as measured by return on assets for Mount Elgon Lodge Limited.
Figure 4.14: Trend Analysis of Asset Tangibility and Return on Assets for Mount Elgon Lodge Limited

4.5.3.5 Asset Tangibility and Return on Assets for Kenya Safari Lodges and Hotels Limited

As shown in Figure 4.15, return on assets is decreasing from year 2011 to 2015 when asset tangibility increases and decreased. This means that there is no relationship between asset tangibility and return on assets for the Kenya Safari lodges and Hotels Limited.

Figure 4.15: Trend Analysis of Asset Tangibility and Return on Assets for Kenya Safari Lodges and Hotels Limited
4.6 Effect of Asset Turnover on Financial Performance

4.6.1 Effect of Asset Turnover on Return on Assets

Table 4.17 shows the regression model summary of asset turnover on return on assets for TFC subsidiaries. The R value is 0.981 which shows that there is a very strong but positive correlation between asset turnover and return on assets. The R Square is 0.962 which means that 96.2% of the variability in financial performance as measured by return on assets is explained by asset turnover.

Table 4.17: Regression Model of Asset Turnover on Return on Assets of TFC Subsidiaries

<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>.981*</td>
<td>.962</td>
<td>.949</td>
<td>.13280</td>
</tr>
</tbody>
</table>

*a. Predictors: (Constant), Asset Turnover
b. Dependent Variable: Return on Assets

Table 4.18 shows the regression coefficients of asset turnover and return on assets. The table also shows the statistical significance of the single regression model. The p-value is 0.003 which is less than Alpha (0.05). This means that the single model is statistically significant. This also implies there is a statistically significant effect of asset turnover on the financial performance of TFC subsidiaries as measured by return on assets. The regression constant is 0.099 and the coefficient is -0.255. The model indicated that holding asset turnover constant, return on assets is positive. The regression model can be summarized by equation 5 below.

\[ Y = 0.099 - 0.255X_5 + \epsilon \] ................................................................. (5)

Table 4.18: Regression Coefficients of Asset Turnover on Return on Assets of TFC Subsidiaries

<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</td>
<td>(Constant)</td>
<td>.099</td>
<td>.073</td>
<td>1.345</td>
</tr>
<tr>
<td></td>
<td>Asset Turnover</td>
<td>-.255</td>
<td>.029</td>
<td>-.981</td>
</tr>
</tbody>
</table>

*a. Dependent Variable: Return on Assets
4.6.2 Effect of Asset Turnover on Efficiency Ratio

Table 4.19 shows the regression model summary of asset turnover on efficiency ratio for TFC subsidiaries. The R shows a single coefficient of correlation between asset turnover and efficiency ratio. The R value is 0.271 which indicates a very weak but positive correlation between asset turnover and efficiency ratio. The R Square is 0.073 which means that only 7.3% of variability in efficiency ratio is explained by asset turnover and 92.7% is explained by other factors.

Table 4.19: Regression Model Summary of Asset Turnover on Efficiency Ratio for TFC Subsidiaries

<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>.271a</td>
<td>.073</td>
<td>-.235</td>
<td>.06356</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Asset Tangibility
b. Dependent Variable: Efficiency Ratio

d. The p-value is 0.659 which is greater than alpha (0.05) implying that the model is not statistically significant. Therefore, there is no statistically significant effect of asset turnover on financial performance as measured by efficiency ratios. From the table, the regression constant is 0.412 and the coefficient is 0.007. This can be summarized by the equation 6 below.

\[ Y = 0.007 + 0.007X_6 + \varepsilon \]  

(6)

Table 4.20 shows the regression coefficients and the statistical significance of asset turnover and efficiency ratio. The p-value is 0.659 which is greater than alpha (0.05) implying that the model is not statistically significant. Therefore, there is no statistically significant effect of asset turnover on financial performance as measured by efficiency ratios. From the table, the regression constant is 0.412 and the coefficient is 0.007. This can be summarized by the equation 6 below.

\[ Y = 0.007 + 0.007X_6 + \varepsilon \]  

(6)

Table 4.20: Regression Coefficients of Asset Turnover and Efficiency Ratio for TFC Subsidiaries

<table>
<thead>
<tr>
<th>Model</th>
<th>Coefficientsa</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Unstandardized Coefficients</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>(Constant)</td>
<td>.412</td>
<td>.035</td>
<td>.271</td>
<td>11.711</td>
</tr>
<tr>
<td>Asset Turnover</td>
<td>.007</td>
<td>.014</td>
<td>.488</td>
<td>.659</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Efficiency Ratio
4.6.3 Trend Analysis on the Effect of Asset Turnover on Financial Performance of TFC Subsidiaries

4.6.3.1 Asset Turnover on Return on Assets for Sunset Hotel

Figure 4.16 shows the trend analysis of asset turnover and return on assets for Sunset Hotel. From the figure, when asset turnover declines, return on assets is seen to decrease except for year 2014 to 2015 where return on asset is slightly decreasing when asset turnover is increasing.

![Graph showing trend analysis of asset turnover and return on assets for Sunset Hotel.](image)

**Figure 4.16: Trend Analysis of Asset Turnover on Return on Assets for Sunset Hotel**

4.6.3.2 Asset Turnover on Return on Assets for Golf Hotel

As shown in Figure 4.17, return on assets is decreasing as asset turnover slightly decreases from year 2011 to 2013. Return on assets drastically increases from 0.01 to 0.15 in year 2015. When these trends are happening, asset turnover decreases from 0.82 to 0.79 and then increases to 0.90. This means that there is no relationship between asset turnover and financial performance of Golf Hotel as measured by return on assets.
Figure 4.17: Trend Analysis of Asset Turnover on Return on Assets for Golf Hotel

4.6.3.3 Asset Turnover and Return on Assets for Kabarnet Hotel

Figure 4.18 shows the trend analysis of asset turnover and return on assets for Kabarnet Hotel. As the asset turnover decreases and remains constant in years 2013, return on asset increases. This means that there is no relationship between asset turnover and financial performance as measured by return on assets for Kabarnet Hotel.

Figure 4.18: Trend Analysis of Asset Turnover on Return on Assets for Kabarnet Hotel
4.6.3.4 Asset Turnover on Return on Assets for Mount Elgon Lodge Limited

From Figure 4.19, when asset turnover decreases from 0.04 to 0.01 in year 2011 to 2012, return on assets increases from -0.08 to -0.02. From year 2012 to 2014, asset turnover increases from 0.01 to 15.96. Consequently, return on assets declines to -5.05 in year 2013 and then increases to -0.06 in year 2014. When asset turnover declines from 15.96 to 0.06 in year 2015, return on assets increased from -0.06 to -0.05. This means that there is no relationship between asset turnover and financial performance of Mount Elgon Lodge Limited as measured by return on assets.

Figure 4.19: Trend Analysis of Asset Turnover on Return on Assets for Mount Elgon Lodge Limited

4.6.3.4 Asset Turnover on Return and Assets for Kenya Safari Lodges and Hotels Limited

Figure 4.20 shows the trend analysis of asset turnover and return on assets for Kenya Safari Lodges and Hotels Limited from 2011 to 2015. The figure shows a decreasing trend of asset turnover form 0.78 to 0.37 from year 2011 to 2013. The asset turnover then slightly increased and then decreases in year 2015. As a result, return on assets is decreasing from 0.10 to -0.15 from year 2011 to year 2015. This trend does not show any relationship between asset turnover and return on assets for the Kenya Safari Lodges and Hotels during the years under consideration.
4.7 Chapter Summary

The chapter has analysed and presented the findings of the specific objectives of the study. The specific objectives which were analysed are the objectives enumerated and discussed in the literature review. The chapter has analysed the following: the components of capital structure, effect of debt ratio on financial performance, effect of asset tangibility on financial performance and the effect of asset turnover on financial performance of TFC subsidiaries in Kenya. The techniques adopted in the analyses include ratio analyses, regression analyses and trend analyses of the individual variables for each subsidiary under study to determine the effect. The next chapter presents the discussions, conclusions and recommendations.

The study has established that there is no significant effect of debt ratio on financial performance as measured by both return on assets and efficiency ratio. The study has also found that there is no significant effect of asset tangibility on financial performance as measured by both return on assets and efficiency ratio. Finally, the study had established a significant effect of asset turnover on the financial performance of TFC subsidiaries.
CHAPTER FIVE

5.0 DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

Chapter four has empirically presented the results and findings of the data analysis in an attempt to answer the research questions. Chapter five will discuss the findings and make conclusions from the results of the analysis. This chapter will further suggest recommendations for policy improvement and further studies. The following parts will be detailed in this chapter: summary of the study, discussion on the research questions adopted in the study, conclusions of the study and lastly recommendations for policy improvements and further studies.

5.2 Summary

The purpose of the study was to investigate the relationship between capital structure and financial performance of Tourism Finance Corporation Subsidiaries in Kenya. The following research questions were used as a guide in the study: What are the components of capital structure? Does debt ratio have any significant effect on the financial performance of Tourism Finance Corporation subsidiaries in Kenya? Does asset tangibility have any significant effect on the financial performance of Tourism Finance Corporation subsidiaries in Kenya? Does asset turnover have any significant effect on the financial performance of Tourism Finance Corporation subsidiaries in Kenya?

The study employed causal research design to examine the study purpose and the existing associations between the independent and the dependent variables considered. Secondary data was extracted from the audited financial reports and management accounts acquired from the TFC and the individual finance departments of the subsidiaries. The population of the study comprised of nine Tourism Finance subsidiaries in Kenya as at 30th June 2016. To ensure that the sampling frame was current, a representative sample was drawn from a list of the commercial tourism state corporations in Kenya. The study adopted a census survey since the units analysed were few in number. The data was entered in Microsoft Excel and then ratios (Debt Ratio, Asset Tangibility, Asset Turnover, Return
on Assets and Average Efficiency Ratios) were calculated. Trend analysis was done using Microsoft Excel and regression analysis was done using SPSS Version 21 and presented using line graphs and tables.

The study established that debt and equity are the major components of capital structure for the TFC Subsidiaries. These two components has varied proportions in percentage contribution to the capital structure. After analyses of the TFC subsidiaries, the study found out that debt and equity levels varied from one subsidiary to the other. It is evident from the study that high debt levels are consistent with low financial performance in terms of return on Assets. This is reflected by the performance of Sunset Hotel and Kabarnet hotel.

Other components of capital structure established by the study are share capital, revaluation reserve and retained earnings. From the study, the subsidiaries with the highest share capital have a sound financial performance as opposed to the subsidiaries with low share capital.

From the study, only one subsidiary; Golf Hotel, had retained earnings for each of the five years from 2011 to 2015. Kenya Safari Lodges and Hotels Limited had retained earnings in 2011 and 2012 only. The other years from 2013 to 2015 the subsidiary did not have any retained earnings since it had losses. Sunset Hotel, Kabarnet Hotel and Mount Elgon Lodge Limited did not have any retained earnings for the period of 2011-2015.

The study found out that all the subsidiaries had revaluation reserves for the period of 2011-2015. Kenya Safari Lodges and Hotels Limited had the highest revaluation reserves in that period. Golf Hotel had the lowest revaluation reserves in a spread of the five years under study.

From the statistical analyses, the study established that there is no statistically significant effect of debt ratio on financial performance of the TFC Subsidiaries. However, the study found out that debt ratio has some explanatory strength on the financial performance. This is explained by the use of debt to finance the assets of the subsidiaries.

The study also found out that asset tangibility does not have any statistically significant effect on the financial performance of the TFC Subsidiaries. However, the study
established that all the subsidiaries maintained high asset tangibility ratios. This means that the subsidiaries are able to sustain any external financing if desired.

From the study, it was established that asset turnover has a statistically significant effect on the financial performance of the TFC Subsidiaries. This means that the subsidiaries’ investments in total assets has resulted in the increase in turnover.

5.3 Discussion

5.3.1 Components of Capital Structure

From the study, it has been established that the main components of capital structure are debt and equity. These two components have been adopted by all the five subsidiaries studied. The proportions of the two components has not been established for each subsidiary. This is because all the subsidiaries have different capital structure needs based on their ownership and that there is no ideal capital structure.

The study has established that all the five TFC subsidiaries have debt and equity as their main source of capital. This capital mix is consistent with the view of Cheng (2009). From his study on the effect of financing mix in capital structure on operating performance, He concluded that firms should not solely rely on a single source of financing. Firms are advised to incorporate both debt and equity when raising capital to finance their operations. This is also in agreement with the view of Mwangi et al. (2014) where they concluded that a firm cannot use one source of the financing but a combination of at least two components of capital. This is because financing decisions result in a given capital structure and suboptimal financing decisions can lead to corporate failure.

Modigliani and Miller (1958) argued that debt and equity varies independent of the Trade off and Pecking Order theories of capital structure. This view is consistent with the study findings where, for the period of 2011-2015, all the five subsidiaries used debt and equity each year to finance their capital structure. Kenya Safari Lodges and Hotels Limited used the highest debt levels while Mount Kenya Lodge Limited had the lowest debt levels in its capital structure.
When the retained earnings were compared against the debt levels for the period of 2011-2015, Kenya Safari Lodges and Hotels Limited had the highest debt levels in 2013 to 2015. This translated to the subsidiary exhausting its retained earnings and subsequently making losses. Therefore, the study is consistent with the Pecking Order theory by Myers and Majluf (1984) which states that where firms prioritize internal funds as their main source of funding, which is not sufficient, the firms resolves to use debt as their alternative source of financing.

According to Fama and French (2005), the Pecking Order theory and Trade off theory cannot individually stand alone. The theories have some facts on capital structure which may be of benefit when making decisions on capital structure. The study is consistent with this view. Firms need to do an analysis of the two theories and come up with a balanced strategy on both theories that fit them since they have different capital structures.

### 5.3.2 Effect of Debt Ratio on Financial Performance

From the regression analysis conducted on debt ratio and financial performance indicators in the study, debt ratio does not have a statistically significant effect on the financial performance of TFC subsidiaries in Kenya. This is evident in all the five subsidiaries when the average debt ratio is regressed against the average return on assets and average efficiency ratios for the period of 2011-2015. This is inconsistent with the study by Nima et al. (2012) which reported a significant relationship between total debt ratios and financial performance as measured by return on assets. However, Iorpev and Kwanum (2012) established similar results when they considered debt ratios and return on assets in their study on the impact of capital structure.

The study is also consistent with a study by Ebaid (2009) where capital structure decision is said to have a weak-to-no effect on the financial performance of firms. The ratio of a firm’s total liabilities to assets negatively affect the financial performance (Kajirwa, 2015). This is also evident by the insignificant effect of the debt ratio on the efficiency ratios used. It therefore implies efficiency of the subsidiaries is not driven by the use of debt.
From the study, there is a weak but positive correlation between debt ratio and financial performance although the correlation is not statistically significant. This is both for financial performance as measured by return on assets and efficiency ratios. Usually, assets are used as a collateral to borrow funds by companies.

From the analysis, debt ratio has increased and decreased for the period of 2011-2015 for all the subsidiaries. The increase in the asset base is consistent with the view of Flor (2008). In his study on capital structure and assets, a firm grows its capital structure proportionately with the asset base which represents the face value of the firm. The key to the proportionality is reflected in the effective utilization of a firm’s assets. This ensures that there is capital optimization giving room for debt financing and debt negotiations.

This study is also consistent with a study by Enrol (2011) which found out that the use of more debt in the capital structure increased the use of future earnings while at the same time increasing expectations of high returns. If the risk is not covered by actual returns, the firm is bound to be bankrupt. If it is able to accommodate the risk with high returns, it will have good returns hence attracting major investors. This is evident where the increase in debt has reduced earnings thereby resulting to losses for the subsidiaries.

5.3.3 Effect of Asset Tangibility on Financial Performance

Asset tangibility is the ratio of the book value of tangible fixed assets to the book values of total assets. It is the ability of assets to be utilized as collateral. The study has established that asset tangibility has no significant effect on the financial performance of TFC subsidiaries in Kenya. From the analysis, all the subsidiaries except Golf Hotel had a very high asset tangibility ratios for the period of 2011-2015. This ratio is increasing and decreasing at some years then they become constant. The increase is as a result of the revaluations done to the non-current class of assets which includes buildings and land.

The findings of this study are not consistent with the findings by Rajan and Zingales (1995) which established a significant effect on asset tangibility with financial performance and firm growth indices. However, the study is consistent with the views of Docherty et al. (2010) who argued that asset tangibility is priced in the cross-section of
equity and returns. Cooper (2006) also holds a view consistent with this study that costly irreversibility means that capital investment is relatively constant across time.

From the analysis, there is a weak but positive correlation though not significant between asset tangibility and return on assets and efficiency ratios. This is consistent with the findings of Mwangi and Birundu (2014) where they did a study on the effect of capital structure on the financial performance of Small and Medium Enterprises in Thika Sun-County, Kenya. They found out that the correlation between asset tangibility and return on assets was weak but positive. They also established that the positive correlation was not significant.

### 5.3.4 Effect of Asset Turnover on Financial Performance

The study has established that asset turnover has a significant effect on the financial performance of TFC subsidiaries in Kenya. However, this is only true when Return on Assets is used as a measure of financial performance. This means that there is no significant effect of asset turnover when efficiency ratios were used as measure of financial performance.

The study has also found out that asset turnover could explain most of the variability of the financial performance as measured by return on assets. Similarly, there is a very strong but positive correlation between asset turnover and return on assets. However, the study established a very weak but positive correlation between Asset Turnover and efficiency ratio as a measure for financial performance.

The findings are consistent with the study done by Pouraghajan et al. (2012). In their study, they established that asset turnover has a significant relationship with return on assets. Xu and Banchuenvijit (2012) came up with similar findings in their study on the factors affecting financial performance of firms listed in Shanghai Stock Exchange for the period of 2008-2012. They established that asset turnover ratio had a positive and significant effect on return on assets.

Asset turnover ratio is used to determine the ability of a company to generate revenue from the assets by generating net sales of a firm with total assets. In other words, it shows the comparison between the net sales and the average assets of a firm (eFinance
Management, 2016). The total turnover of the subsidiaries is increasing except for the years between 2012 and 2014 when some of the subsidiaries have decreased turnover. This reduced turnover can be attributed to the effect of the unfortunate travel advisories by foreign governments in Britain and America which brought about reduction in the number of tourists visiting in Kenya. Further, having been an election period, the uncertain political environment prevailing during that period may have also contributed to the reduced turnover.

The total assets have drastically increased from year 2011 to 2015 for the subsidiaries except for Mount Elgon Lodge Limited which has reduce total assets between the period between 2013 and 2015. During the same period, Kabarnet Hotel total assets are also decreasing. This decrease of total assets can be explained by possible reduction in debtors and disposal of some assets.

5.4 Conclusion

5.4.1 Components of Capital Structure

The main components of capital structure are debt and equity. These two components have been adopted by all the five subsidiaries studied. The proportions of the two components has not been established for each subsidiary because all the subsidiaries have different capital structure needs based on their ownership and that there is no ideal capital structure.

Balancing between the tradeoff theory and the pecking order theory is important since they have some good elements in them. For a case in point, from the pecking order theory, companies should use internal finances such as retained earnings. If the retained earnings are not enough, they resolve to use debt financing. This means that internal financing should be a priority over debt financing in capital financing.

5.4.2 Effect of Debt Ratio on Financial Performance

Capital structure decision is said to have a weak-to-no effect on the financial performance of firms. Financial performance of a firm is as a result of the capital structure decisions that a firm comes up, this decisions whether short term or long term affect its profitability
while at the same time increase the risk of the firm investment ventures undertaken by the management.

Debt is a resource borrowed with the expectation of paying back after a specified period of time. If the specified time spread over a period of one year then it becomes long term debt and if the expected payment period is less than or equal to one the it becomes a short term debt. The use of debt in a firm’s capital structure has got its benefits. The firm benefits from debt tax shield effect and financial leverage. A firm pays interest to creditors of the costs. If interest rates are appropriate, and earnings before interest and tax are more than business interest, then improvement on the firm’s debt ratio would increase the tax-free income and the firm’s market value.

5.4.3 Effect of Asset Tangibility on Financial Performance

Asset tangibility is the ability of assets to be utilized as collateral. Bond holders will require collateral to protect their interests thus the direct proportional relationship between leverage level and liquidity of a firm. Corporations operating with more tangible assets have a higher debt capacity. Agency theory proposes that corporations with high debt financing levels tend to under invest, or invest below their optimal investment levels, and thus transfer wealth away from debt holders to equity holders. These expected behaviors of under investment cause debt holders to require collateral because the use of secured debts can help alleviate this problem.

The existence of tangible assets within the assets of a corporation serves two critical purposes: it enables the corporation to pledge the assets as collateral, thereby reducing the agency costs of debt, like risk shifting; and, at the same time, protects the debt holder in the event of liquidation. Asset tangibility can also discourage debt financing since a larger proportion of tangible assets in the asset portfolio of a corporation is expected to reduce supply side constraints.

5.4.4 Effect of Asset Turnover on Financial Performance

Asset turnover reflects the level of capital tied-up in assets and how much sales can be squeezed out of assets. A high asset turnover rate implies that we can generate strong
sales from a relatively low level of capital. Low turnover would imply a very capital-intensive organization. Asset turnover ratio shows the comparison between the net sales and the average assets of the company. However, as with other ratios, the asset turnover ratio needs to be analyzed while keeping in mind the industry standards.

A higher asset turnover ratio implies that the company is more efficient at using its assets. A low asset turnover ratio, on the other hand, reflects the bad management of assets by the company. Since asset turnover ratio measures the efficiency of a company in managing its resources to generate its sales, it is very obvious that higher turnover ratios are preferred to reflect a better state of affairs at the company. This ratio gives an insight to the creditors and investors into the internal management of the company. Thus, it is very important to improve the asset turnover ratio of a company.

5.5 Recommendations

5.5.1 Recommendations for Improvement

5.5.1.1 Components of Capital Structure

Companies should establish a capital structure which they consider optimal. The capital structure should balance between debt and equity in proportions beneficial to the firms. This should include elimination and reduction of costs by application of the Pecking Order theory and Trade-off theory. According to the Pecking Order theory, firms need to first utilize the internally generated sources of funds before considering to have debt. The decision to take debt in the capital structure should be undertaken keeping in mind the applicability of the Trade-off theory which states that firms should consider the costs and benefits of debt.

5.5.1.2 Effect of Debt Ratio on Financial Performance

Firms should come up with proper strategies to ensure that the debt ratio is improved in such a manner that financial performance is increased by use of debt to finance the assets. The long-term assets need to be used as collateral for the acquisition of debt financing at the same time ensuring that there is no compromise to the profitability of the firm. This will ensure that the benefits which accrue by use of debt financing are realized and that
the debt is repaid within the stipulated period of time. Even though firms cannot avoid use of loans in its capital structure, the subsidiaries should try to operate using little amounts of loans compared to equity to avoid higher finance costs which could otherwise be used to invest in other profitable ventures.

5.5.1.3 Effect of Asset Tangibility on Financial Performance

Corporations need to establish a portfolio of more tangible assets in order to boost their debt capacity if required. The existence of tangible assets within the assets of a corporation should enable the firms to pledge the assets as collateral, thereby reducing the agency costs of debt, like risk shifting. Further, this will protect the debt holder in the event of liquidation of the firms. Financial performance of a firm should be improved by considering the increment of asset base and revaluation of the non-current assets.

5.5.1.4 Effect of Asset Turnover on Financial Performance

Due to the significant effect of the asset turnover on the financial performance of the TFC subsidiaries, firms should fully utilize the assets in the generation of revenue. Investments in more hotels and facilities which increase the revenue of the subsidiaries need to be in done. Promotion of the hotel industry should be undertaken to enlighten the citizen on the importance of domestic tourism. The Tourism Finance Corporation should lobby the government to increase its funding on the tourism sector in order to improve the sales of the tourism sector which will have a ripple effect on the subsidiaries.

5.5.2 Recommendations for Further Research

The study recommends a comparative study to be conducted to establish different capital structure components so as to recommend an optimal capital structure. This is because the area on optimal capital structure is still a puzzle in finance research.

The study only considered just few variables on capital structure and financial performance. This study therefore recommends the use of other variables such as debt to equity ratio and return on capital employed. A further research should be done and consider other factors like advertising and promotion.
Secondary data was used in this study for analysis. Further research can be conducted using primary data. Data over a long period of time (say 10 years) can be considered for a further study on this area covering all the commercial state corporations in Kenya.
REFERENCES


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APPENDICES

Appendix I: List of Tourism Finance Corporation Subsidiaries

1. Sunset Hotel
2. Golf Hotel
3. Kabarnet Hotel
4. Mount Elgon Lodge Limited
5. Kenya Safari Lodges and Hotels Limited

## Appendix II: Summary of Data

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### Appendix V: Share Capital in KShs “Millions”

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<th>2015</th>
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### Appendix VI: Revaluation Reserve in KShs “Millions”

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<th>2014</th>
<th>2015</th>
</tr>
</thead>
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### Appendix VII: Retained Earnings in KShs “Millions”

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<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
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