STRATEGIC CONFORMITY AND FINANCIAL DISTRESS AMONG LISTED FIRMS IN NAIROBI SECURITIES EXCHANGE

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Abstract

The main purpose of the study was to determine the relationship between strategic conformity measures and financial distress among firms listed firms in Kenya. This study was grounded on trade-off theory. The study employed panel analysis for a period covering ten years from 2006-2015. The target population comprised all 64 listed firms in Nairobi Securities Exchange. Secondary firm-level panel data was gathered from year-end financial reports for the period 2006-2015. Standard multiple regression analysis was used to analyze and test the hypotheses. The study found a positive and significant effect of nonproduction overhead (β=0.914; p<0.05) and financial leverage (β=0.824; p<0.05) on financial distress. The study concluded that nonproduction overhead and leverage accounted for a significant variance on financial distress. This study recommends that the firms should take keen scrutiny of their financial structures. Moreover, firms should utilize the relatively cheap sources of finance since they tend to reduce the probability of firms in facing financial distress. Further research should focus on using different samples like private non-listed firms.

Keywords: Financial Distress, Strategic Conformity, Nonproduction Overhead, Financial Leverage, Firms

INTRODUCTION

Research on financial distress of companies has attracted an increasing attention in the recent past (Liao & Mehdian, 2016, Mselmi *et al.,* 2017). This upsurge in research attention could be attributed to the importance attached to the need of firms to understanding financial dimensions that are revealed in moments of crisis (Pindado *et al.*, 2008). Grice & Ingram (2001) and Agrawal (2015) defined financial distress as the inability of a firm to satisfy its financial obligations as and when they fall due. This is often witnessed whenever the firm's operational cash flows are lower than its financial expenses (Tsun-Siou *et al.*, 2004). Business firms also experience financial distress when they face insufficient liquidity to meet their financial liabilities. Financial distress can be costly to a firm as well as other stakeholders. The indirect costs, such as lost profits and higher costs of capital are incurred by a firm due to financial distress (Agrawal, 2015).

The economic cost of business failures is significant, evidenced by the substantial decline in the market value of the distressed firms prior to their ultimate collapse. This significantly influences the capital suppliers, investors and creditors, the management and the work force (Charitou *et al.,* 2004). Research focusing on financial distress is critical in aiding managers to mitigate the manifestation of failure, aid the stakeholders in examining and choosing companies to partner with or to invest in (Mousavi *et al.*, 2015).

A review of the previous studies shows a trend of changes in the choice of variables in the assessment of financial distress of firms. Efforts have been put in place to include some changing aspects by incorporating data highlighting shifts in the macroeconomic setting, non-financial information and other predictors that change with time (Nouri & Soltani, 2016; Mousavi *et al.* 2015; Tinoco & Wilson, 2013). Tinoco & Wilson (2013) recommend a mix of accounting information, stock market information and alternatives for variants in the macroeconomic setting to clarify financial distress. Corporate financial distress may occur due to a single factor or a mix of factors that can be either external or internal such as errors in management because of failure to change managerial and operational frameworks of the company in line with existing new realities, ineffective or inconsequential corporate policies, the economic setting, variations in legislation and decrease in the sector (Mousavi *et al.*, 2015). The findings of their study indicate that most of the financial distress modeling structures were enhanced in the performance by considering a combination of account-related and market-related data (Mousavi *et al.,* 2015).

Despite the fact that many scholars have analyzed the failure of forecast models using various accounting factors, they did not consider the probable illustrative ability of strategic conformity measures in examining a company's financial distress. According to Ridge *et al.*,

(2014) strategic conformity is the level of a company's strategy in terms of its equivalence to the average strategic profile of its competitors in the sector. The area of organizational strategic conformity has attracted a good deal of attention (Miller *et al.*, 2013). The results of strategic conformity are held by institutional scholars to be certain results which incorporate improved assets (Cohen and Dean 2005, Higgins and Gulati 2006), better securities exchange costs (Zuckerman 2000), and more help from partners (Choi and Shepherd 2005). Since there are no known studies on the relationship between strategic conformity and financial distress, except for the studies that capture financial leverage, a dimension of strategic conformity by Andrade and Kaplan (1998), Fitzpatrick & Ogden, (2011), Kim & Partington, (2014) among others, the current study utilized much theoretical literature from the strategic conformity measures. Financial distress is a global problem affecting both developed and developing economies. Business firms experience financial distress when they face insufficient cash flow to meet their current financial obligations (Jabeur & Fahmi, 2017; Mselmi *et al.,* 2017; Sanz & Ayca, 2006). This phenomenon of financial distress in public companies has been witnessed by a number of corporate failures and the increase in delisting of listed companies. Notable cases of corporate failures and delisting in the past few years include; Enron, World COM, Lehman Brothers, AIG (Shahwan, 2015).

In Kenya, listed firms continue to experience financial distress witnessed by the increase in delisting of companies and the placement of some firms under statutory management. Several firms have been delisted from the stock market which include; Mumias sugar, Eveready, Lonrho East Africa, Pearl dry cleaners, East African Packaging, Uchumi supermarkets, Kenya Corporative Creameries and CMC Kenya Ltd., among others (Gathecha, 2016). In 2008, the financial crisis showed the weaknesses of practices in risk management in the credit setting and assessment of risk at the company level (Tinoco & Wilson, 2013). The fast development of the capital market as well as the incorporation of the world economy have enlarged the number of firms that undergo distress financially (Geng *et al.,* 2015).

According to Purves *et al. (*2016) studies on organizational financial crises have identified the symptoms rather than the causes of financial distress (Altman, 2000; 1968; Charitou *et al.*, 2004; Chen *et al.*, 2013; Huang *et al.*, 2012; Tinoco & Wilson, 2013; Ohlson, 1980; Ooghe & Prijcker, 2008), highlighting the need for alternative approaches A number of studies have examined causes of financial distress such as examination of cash flow information within relevant sections of company financials (Charitou *et al.*, 2004), while others have examined corporate governance practices (Daily & Dalton, 1994; Johnson *et al.,* 2000; Mohd-Mohid, *et al.,* 2004; Fich & Slezak, 2008; Cheng *et al.,* 2009). The review of literature

revealed that there was no known study that specifically focused on the relationship between strategic conformity and financial distress. Thus, the study hypothesized that:

H_{01}: *Nonproduction overhead has no significant effect on financial distress of listed firms in Nairobi Securities Exchange.*

H_{02}: *Financial leverage has no significant effect on financial distress of listed firms in Nairobi Securities Exchange.*

THEORETICAL PERSPECTIVES

The study was underpinned by trade-off theory. The trade-off theory hypothesizes that capital structure is a trade-off between tax savings and distress costs of debt. Therefore, the optimum debt-equity ratio is that which maximizes the tax savings and minimizes the cost of financial distress for the firms (Shyam-Sunder & Myers, 1999) which include maximizing savings and minimizing costs during times of financial distress. Corporate finance theory has long supported the virtues of debt policy which include tax deductibility, mitigation of agency problems and disciplinary role. (Boubaker *et al.,* 2016). Shyam-Sunder & Myers (1999) argue that trade-off predicts a cross-sectional relation between average debt ratios and asset risk, profitability, tax status and asset type, and it also predicts reversion of the actual debt ratio towards an optimum. Several studies have argued that firms need to maximize tax savings and minimize the costs of distress (Myers 1983; Shyam-Sunder & Myers, 1999; Strebulaev, 2007; Kayhan & Titman, 2012). Strebulaev (2007) argues that the trade-off theory captures the dynamics of firms' financing behavior and produces quantitative predictions about leverage ratios. Strebulaev (2007proposes that organizations touch base at their ideal capital structure by adjusting the corporate expense preferred standpoint of obligation against budgetary pain costs. Shyam-Sunder and Myers, (1999) contend that as indicated by the exchange off hypothesis, expenses of trouble diminish with higher profitability and enable firms to expand their tax reductions by expanding influence. Pindado *et al.* (2008) shows that the hypothetical civil argument about money related pain is established in the investigation of capital structure. The consequences of their examination exhibit that the organization's effectiveness in extricating comes back from its benefits, and the exchange off between the method for producing stores and the need to consent to its money related costs amid the monetary year, altogether clarify the financial distress probability. Kayhan & Titman (2007) indicates that firm cash flows, investment expenditures, and stock price histories affect debt. This may in turn affect a firm's financial position and the financial deficit has a stronger effect on capital structure. Hennesey and Whited (2005) contend that organizations consider inside created stores when they pick the strategy for financing. Firms likewise mull over endogenous venture, a wealthier assessment condition, and

more money related decisions. As indicated by Hovakimian et al. (2012) the likelihood of default assumes a focal part in what is for the most part alluded to as the static exchange off hypothesis of capital structure. This hypothesis, which hypothesizes that organizations pick their capital structures by exchanging off the advantages of obligation financing (e.g., impose shields) against the expenses related with budgetary misery and chapter 11, has been tried in the past by relapsing different obligation proportions on firm attributes that intermediary for the expenses of liquidation and the tax breaks of obligation (Hovakimian et al., 2012). In this way, an exchange off model can clarify various exactly watched adapted realities by extending the arrangement of money related decisions accessible to a firm which may help counter budgetary pain circumstances. This makes it important to review the potential relationship between financial leverage and financial distress.

EMPIRICAL REVIEW

Review of research indicates support for a positive relationship between strategic conformity and firm performance. The consequences of conformity held to be positive outcomes include enhanced resources, better stock market prices and more support from stakeholders (Choi & Shepherd 2005; Cohen & Dean 2005, Higgins & Gulati 2006). The above arguments paint a positive picture of strategic conformity for firms (Miller *et al.*, 2013) and this study examines whether strategic conformity will have an effect on financial distress of firms.

The Relationship between Non-production Overhead and Financial Distress

Nonproduction overhead and its effect on firm value have received significant attention in management and finance research (Huang 2006; Baumgarten *et al.,* 2010; Janakiraman, 2010). It can be argued that nonproduction overheads increase with the separation of ownership and control. Managers as the agents of shareholders are inclined to waste the corporate resources to satisfy their exploitative purposes (Li *et al.*, 2008). According to Singh & Davidson (2003) higher levels of selling, general and administrative expenses are a close approximation of managerial pay and perquisite consumption in terms of higher salaries, large office complexes, and other organizational support facilities which may cause a shrink to company resources. Ang *et al.*, (2000) also upheld that agency costs are an alternative for revenue losses because of lack of efficient utilization of assets partly as a result of ineffective investment choices or derived from the avoidance by the management through applying little effort to aid in revenue generation.

Studies interrogating the role of nonproduction overhead have not established a clear link between the level of selling, general and administrative expenses and firm's profitability

(Yükçü & Özkaya, 2011; Anderson *et al.,* 2007). Anderson *et al.* (2007) contented that contrary to the conventional expectation that increase in the ratio of selling, general and administrative costs to sales between two periods was a negative signal about firms future profitability and firm value, an increase in selling, general and administrative costs might signal about the favorable expectations of the managers as managers tended to retain nonproduction overheads when revenues declined only if they believed that revenues would increase in the future (Yükçü & Özkaya, 2011).

Other studies such as Janakiraman (2010), Huang (2006) and Huang *et al.,* (2011) demonstrates that selling, general and administrative expenditure creates intangible assets that have a positive impact on operating earnings. Baumgarten *et al.,* (2010) extended this perspective and argued that intended increase of selling, general and administrative expenditures by management partially represent investments in operating efficiency that significantly enhance future earnings. On the contrary, excessive selling, general and administrative expenditure may indicate loss of managerial control over the selling general and administrative costs that lead to poor operating performance (Janakiraman, 2010). Companies that trim selling, general and administrative costs were found to enjoy far reaching benefits through cost savings and a reduction on corporate overhead as every dollar reduction goes into net income (Lazere**,** 1996). According to Aerts & Van Caneghem (2011) spending on non-production expenditure is often to a significant extent discretionary in nature, while the relationship between this expenditure and revenue is inherently ambiguous.

Scholars such as Anderson *et al.*, (2003) argue that there need not be a proportional relation between the committed resources provided for managerial consumption and the level of activity of the firm. If the committed resources demanded exceed the committed resources provided, the available activity resources will be strained and this may lead to financial distress. Balakrishna & Gruca (2008) further argue that when activity levels decreases, managers face a choice between decreasing the expenditure of resources and delaying cutbacks. Delaying cutbacks might be appealing because of the psychological reasons for avoiding painful decisions and may in turn cause strain on finances of the firm. Increases in the selling, general and administrative cost ratio are treated as evidence that resources are being used less efficiently and that managers are unable to effectively control costs (Anderson *et al.*, 2007). Banker *et al.*, (2011) noted that the extent to which managers react to long-term incentives depends on the future value they can create in their operating context.

An increase in the ratio of selling, general and administrative costs to sales revenue between the previous and current periods is customarily interpreted to be a negative signal about future profitability (Lev & Thiagarajan, 1993). Cappozza & Seguin (1998) found that

higher levels of nonproduction overheads are significantly negatively related to firm value. Consistent with the literature, nonproduction overheads reduce the amount of free cash flow and may lead to a strain in the financial resources of a firm that would have otherwise been used for investment (Siregar *et al.*, 2015). Therefore, it would be necessary to evaluate whether nonproduction overhead has an effect on the financial distress status of firms.

The Relationship between Financial Leverage and Financial Distress

A company is categorized as financially distressed if it defaults its debt payments obligations. This indicates that debt contracts strain financial resources and thus lead to financial distress in firms (Koh *et al.*, 2015). Tsun-Siou & Yin-Hua (2004) argued that on average, the debt ratio of financially distressed companies is higher compared to that of healthy firms. Thus, debt ratio is related to financial distress. In an attempt to examine the factors that drive the sample firms into financial distress, Andrade & Kaplan (1998) found that high control is the sole source of financial distress. High leverage reduces the operating margins of firms that would have otherwise appeared to be healthy.

Scholars such as Chancharat *et al.*, (2010) find that differences exist in the factors which determine whether companies enter different states of financial distress. Specifically, distressed companies have a higher leverage compared to active companies. Of the significant variables, a higher level of financial leverage increases financial distress (Kim and Partington, 2014). Similarly, Tsun-Siou, and Yin-Hua, (2004) argue that debt ratio significantly influences financial distress.

Scholars such as Shumway (2001) have argued that using theoretical frameworks centered on perfect-market suppositions, it can be shown that, ceteris paribus, a company's failure risk increases with increase in leverage. On the contrary, companies time their external financing to equity market environments, and that current capital frameworks highlight the overall effect of equity market timing (Baker and Wurgler, 2002). Hovakimian (2006) extended this perspective and argued that currently, firms have high leverage are also underpriced and if they look for external funding, they are probably going to issue debt. As a result, it is not clear that a company with higher market leverage has a higher risk of failure in the future since the associated underpricing means that they will averagely be more profitable in the future, which, as assumed, will decreased their risk of failure (Hovakimian 2006).

Early studies interrogating the role of financial leverage on firm financial health found varied results. Altman (1968) and Wruck (1990) show that excess debt leads to bankruptcy and generates direct and indirect costs. Chancharat *et al.,* (2007) found that financially distressed companies have higher leverage compared to active companies. Giacomini (2015) found that

levered returns are significantly higher than unlevered returns, suggesting a positive relation between leverage and returns for public real estate firms. Caskey *et al.,* (2012) generally found that leverage positively predicts the probability of distress as firms with high leverage are more exposed to a systematic distress factor.

Graham *et al.,* (2011) found that firms with more debt became financially distressed more frequently during the depression, consistent with the trade-off theory of leverage and the information production role of credit rating agencies. Habib *et al.,* (2013) found a negative coefficient on leverage across the distress measures and argued that this is contrary to expectation because highly-leveraged firms are more likely to manipulate earnings upwards to avoid debt covenant violations. Boubaker *et al.,* (2016) examines whether financial distress risk is systematic risk among French listed firms over the period January 1995 to December 2012. Their findings show that the leverage risk premium is positive for highly lever-aged firms. Shaked & Plastino (2012) further argued that leverage consists of obligations that require mandatory payment and if the company fails to earn enough to satisfy these obligations, the firm may face financial distress.

On the other hand, Di Patti *et al.,* (2015) found that, ceteris paribus, a 10 % point increase in leverage is associated with almost a 1 % point higher probability of default. Tsuruta (2016) found that leverage has a negative effect on average firm performance which shows that highly leveraged firms have a greater probability of financial distress. Opler & Titman (1994) find that highly leveraged firms lose substantial market share to their more conservatively financed competitors in industry downturns. Specifically, firms in the top leverage decile see their sales decline more than do firms in the bottom leverage decile. Therefore, an evaluation of a firm's financial leverage is important in the establishment of financial distress.

RESEARCH METHOD

This study was based on positivism research philosophy. Positivism supports this study since it aims at working with observable social reality (strategic conformity and financial distress of listed firms in Nairobi securities exchange) and that the end product of this research is on causality and law-like generalizations. The hypotheses in this study were examined using panel data regression. This study utilized secondary data which was extracted from a number of secondary sources which include the companies' year-end financial reports in Compustat-Capital IQ, Nairobi Securities Exchange (NSE), and annual reports lodged in the Capital Markets Authority (CMA) library. The data on strategic conformity was drawn from end year financial reports in Compustat-Capital IQ. The dependent variable was calculated based on the

Altman Z-score formula and the data was extracted from the companies' year-end financial reports in Nairobi Securities Exchange (NSE) and Compustat-Capital IQ.

Measurement of Variables

Nonproduction overhead was measured by selling, general and administrative costs divided by sales revenue for firm *i* in year *t*. This measure is more relevant since it captures not only compensation to the senior managers, but also compensation to their staff (Capozza & Seguin, 1998). *Financial leverage* was measured by total liabilities divided by total assets for firm *i* in year *t*. Financial leverage has been associated to the extent of liabilities as compared to total assets in a firm (Das *et al.*, 2009; Munoz, 2013; Kim & Partington, 2014). Financial distress was measured using the Z-score for firm *i* in year *t*, developed and validated by Altman (1968) and reviewed by Altman & Hotchkiss (2006). Altman postulated that companies with a Z-Score <1.10 were likely to experience distress, companies with a Z-score of 1.10 to 2.6 were in a grey zone in which distress may be impending and companies with a Z-Score of >2.60 were likely to be financially sound (Altman & Hotchkiss, 2006). The determined Z-scores are then compared to Altman's predetermined cutoffs. *Firm size* is defined and measured as natural log of total value of firm assets (Back, 2005; Boyd *et al.*, 2005; Agarwal & Taffler, 2008; Brad *et al.*, 2015; Doumpos *et al.*, 2015) for firm *i* in year *t*. *Industry* differences refer to attributes common to an industry (Mauri & Michael, 1998; Lieu & Ching-Wen, 2006; Short *et al.*, 2007). Industry was measured as a dummy variable by assigning "1" to firms in the manufacturing sector and "0" to the rest. This is consistent with the approach used by Barroso *et al.,* (2011) and Plambeck & Weber (2010). *Firm age* is defined and measured as the natural log of the number of years since the firm was first listed (Shumway, 2001; Hovakimian *et al.*, 2011) for firm *i* in year *t*.

Data Analysis and Model Specification

The study used descriptive statistics to summarize and describe the population parameters by the use of mean and standard deviation and presented using tables with the aid of EViews version 7. The descriptive statistics analyzed provided a basis for inferential analysis. To test the correlation of independent and dependent variables, correlation analysis was done using Pearson's Product Moment Correlation Coefficient. Therefore, hypotheses' testing was conducted using hierarchical moderated regression analysis. The study used hierarchical regression models to test the direct effects of strategic conformity dimensions on financial distress. The investigated models are as follows:

$FD_{it} = \beta_{0it} + \beta_{1it}AGE_{it} + \varepsilon_{it}$…………………………............... *Model 1*

$FD_{it} = \beta_{0\,it} + \beta_{1it}AGE_{it\,+}\beta_{4it}NPO_{it} + \alpha\,\beta_{5it}LEV_{it}$ .... *Model 2*

FD_{it} = *Financial distress, measured by Z-score for firm i in year t.*

NPO_{it} = *Nonproduction overhead measured by selling, general and administrative costs divided by sales revenue for firm i in year t.*

LEV_{it} = *Financial leverage, measured by total liabilities divided by total assets for firm i in year t.*

AGE_{it} = *Age of the firm, measured by the natural log of the number of years since the firm first appeared in NSE for firm i in year t.*

$β_0$ = *Constant*

$β_1$ - $β_{12}$ = *Coefficients of Regression*

$ε_{it}$ = *Error terms*

i=Firm

t=Time

FINDINGS

Descriptive and Correlation Statistics

The econometrics techniques require transforming the values of real variables into their logarithmic values (Harlow, 2005). Consequently, some of the real variables were transformed into logarithm form as transformation may reduce the problem of heteroscedasticity. This is because transformation compresses the scale in which the variables are measured, therefore reducing a tenfold difference between two values to a two-fold difference (Harlow, 2005). Thus, all real variables except the dummy variable for industry differences were transformed into logarithmic form for the purpose of this study.

The mean, minimum, maximum and standard deviations of the variables of this study are presented in Table 1 below. The results for Pearson correlations on non-production overhead indicated a positive and significant correlation with financial distress ($p<0.05$). This shows that as non-production overheads go up the chances of firm facing financial distress also rises. The reason could be that when the nonproduction overheads increases it eats up a large portion of profits of the firm which could otherwise be used for investment purposes. Thus, as financial resources get utilized fewer resources are left up for investing hence the firm gets distressed.

The Pearson correlations results on financial leverage was found to have a positive and significant correlation with financial distress ($p<0.01$). This indicates that as financial leverage increases it raises the chances that the firm will face financial distress. The possible reasoning is that an increase in financial leverage is likely to inflict more constraints on the firm's financial resources hence it will be financially distressed.

Table 1. Correlation Analysis Output

N=400	Mean	Std. Deviation	Financial Distress	Firm Age (Log)	Nonproduction Overhead	Financial Leverage
Financial Distress	2.158	1.534	1			
Nonproduction Overhead	1.947	0.831	.228**	1		
Financial Leverage	5.103	0.848	.363**	0.059	1	
Firm Age (Log)	3.039	0.592	-0.096	-0.095	.156**	1

Statistical Tests of Regression Assumptions

Test for normality of error terms Jarque-Bera test was used. The results showed that the significance levels for the Jarque-Bera statistics were greater than the critical p-value of 0.05 implying that the errors were not different from normal distribution (Tanweeer, 2011). This was also confirmed from the normal P-P plots. This study followed white test by regressing the squared residuals by introducing all the regressors, their squared terms and their cross products (Greene, 2003). The results of White test showed R^2 of 0.21. The chi-squared statistic χ2 is therefore tabulated by n×R^2 getting 400 (0.21) =84. The 95 percent critical value of chi-squared with 14 degrees of freedom is 91.541. The results of White test showed non-significant results indicating that heteroskedasticity is not present. Therefore, the assumption of homoscedasticity of variance is supported in the study. The Durbin-Watson test of serial correlations was used to test for independence of error terms. The results in found to be within the acceptable threshold of values between 1.5-2.5, indicating that the error terms were independent for the regression models of Z-score. To test multicollinearity, this study followed the procedure set out by (Gujrati, 2004) that included the use of TOL and VIF. The tolerance statistics were all above 0.10 and VIF values were all below 10 implying that there was no problem of multicollinearity among the predictor variables. This study conducted unit root test for the variables using the Levin-Lin unit root test. Results showed that the p-values for the Levin-Lin -Fisher Chi-square statistic were less than theoretical values of 0.05 for non-production overhead and financial distress. The null hypothesis was rejected implying that the variables do not contain a unit root therefore suitable for modelling and forecasting (Levin *et al.,* 2002). To correct for non-stationarity in financial leverage the first difference of the variables [D (var)] were used in the regression models.

Hypothesis Testing

In this study the random effects model was used in constructing the panel regression models. The decision for using random effects models in this study was based on the Hausman specification test (Wooldridge, 2002; Greene, 2003). Accordingly, the null hypothesis is rejected

when Prob.>χ2 is less than the critical p-value and in such a case the fixed effects regression is appropriate. Hausman test results of these three models are presented along with panel regression results are shown in Table 2. All the models were run on random effects since the significance levels were greater than the critical value of 0.05.

Table 2: Model Specification Test Statistics for Z score

Model	χ2 Statistic	χ2 d.f.	Prob.	Appropriate Model
Model 1	2.548	2	0.846	Random Effects
Model 2	7.643	6	0.657	Random Effects
Model 3	4.314	7	0.997	Random Effects

Random effects regression models were run for all the models and the results are presented in Table 3.

Model 1 presents the results for control variable firm age. The results showed Firm age was found to have a negative and significant effect on financial distress ($β$=-0.177 p<0.001). This implies that older firms are less likely to be financially distressed as compared to recently established firms. Studies of patterns of business failure found that newly founded companies with ineffective control procedures and poor cash flow planning are more vulnerable to financial distress than well-established public firms (Hovakimian *et al.*, 2011).

Hypothesis H_{01} stated that nonproduction overhead had no significant effect on financial distress among listed firms in Nairobi Securities Exchange. The results found a positive and significant effect between nonproduction overhead and financial distress ($β$=0.914; p<0.05). These results therefore reject the hypothesis H_{01}. This implies that nonproduction overhead has significant effect on financial distress of listed firms in Nairobi securities exchange. The probable reasoning could be the likelihood of nonproduction overheads eating into the profits of the firms hence leading to less financial reserves for investment. Thus, firms get strained leading to financial distress the listed firms in NSE. However, the results of this study were contrary to the study by Lazere, (1996) who found that companies that trim selling, general and administrative costs were found to enjoy far reaching benefits through cost savings and a reduction on corporate overhead as every dollar reduction goes into net income. This indicates that the non-production overheads play a significant role in the financial distress status of firms. This finding contradicted prior studies that non-production overhead has unclear link to firm value. This is supported by Yükçü & Özkaya (2011) that studies interrogating the role of nonproduction overhead have not established a clear link between the level of selling, general and administrative expenses and firm's profitability.

Hypothesis H_{02} indicated that financial leverage has no significant effect on financial distress of listed firms in Nairobi Securities Exchange. The results showed that financial leverage has a positive and significant effect on financial distress of listed firms in NSE ($β=0.824$; $p<0.05$). The result therefore means that hypothesis H_{02} is rejected. This means that as financial leverage increases the chances of the firm facing financial distress in enhanced. This finding is consistent with Caskey *et al.,* (2012) which found that leverage positively predicts the probability of distress as firms with high leverage are more exposed to a systematic distress factor. The findings of this study are however contrary to the results by Gupta *et al.,* (2014) whose study ascribed a negative and significant association between use of debt capital and financial distress of Indian listed firms. These results suggested that a higher proportion of financial leverage tend to increase the probability of a firm going into financial distress. It is consistent with past research findings which showed positive relationship between financial leverage and financial distress.

According to a study by Shaked & Plastino (2012) leverage consists of obligations that require mandatory payment and if the company fails to earn enough to satisfy these obligations, the firm may face financial distress. This could lead to an increase in the financial burden (through loan interest payments) to the firm and hence low levels of free cash flow. This finding supports the notion that financial leverage plays a role in influencing a firm's financial soundness. Leverage in the firm affects the firm's debt service coverage and results in financial distress. The financial leverage impacts on firms and leads firms to being unable to pay current financial obligations on scheduled time and may lead to bankruptcy liquidation or reorganization.

Table 3: Regression Analysis Results

Variables	Model 1	Model 2
Constant	0.422 (0.699) **	0.687 (0.810)**
Controls		
Firm Age	-0.177 (-0.175) **	(-0.091(-0.067)**
Predictors		
Non-Production Overhead		0.914 (0.869) **
Financial Leverage		0.824 (2.650) * *
R Square	0.013	0.146
Adjusted R2	0.005	0.045
R2 Change	0.013	0.133
F- Statistic	3.682	3.722
Sig. F-Stat.	0.048	0.122

** Significant at 0.01 level * Significant at 0.05 level

Figures in parenthesis are t-statistics

CONCLUSIONS AND RECOMMENDATIONS

Based on the findings of this study, the following conclusions can be drawn; most importantly, the study concludes that the strategic conformity measures play an important role in the decision making of the firm. The findings of the study indicated that nonproduction overhead had a positive and significant effect on financial distress. This indicates that nonproduction overheads reduces the amount of free cash flow leading to a strain on the financial resources of a firm that would have otherwise been used for investment. This study therefore concludes that companies should trim selling, general and administrative costs so as to enjoy far reaching benefits through cost savings and a reduction on corporate overhead.

Financial leverage was found to have a positive and significant effect on financial distress. Firms with higher leverage level will require a greater cash flow to pay interest and principal of their debt contracts, thereby imposing greater constraints on the firm's financial resources. This study therefore concludes that firms should utilize the relatively cheap sources of finance since they tend to reduce the probability of firms in facing financial distress.

The study found the relationship between financial leverage and financial distress to be positive and significant. This point to the fact that leveraged firms are more likely to get into financial distress compared to unleveraged firms. Therefore, the firms should take keen scrutiny of their financial structures. Hence, the study recommends that the managers should put structures that aid in evaluating the extent of leverage in its capital structure as financial leverage will positively influence financial distress.

This study only incorporated listed firms in Nairobi Securities Exchange. Since strategic conformity is a relatively new construct in financial distress research, the study therefore recommends future research using different samples (e.g. private non-listed firms or Small Market Enterprises) which may provide additional insights and add to the existing understanding of the issues explored in this study.

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