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THE ROLE OF FIRM GROWTH AS INTERVENING ON THE RELATIONSHIP BETWEEN CAPITAL STRUCTURE AND VALUE OF NONFINANCIAL FIRMS LISTED ON THE NSE, KENYA

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Abstract

The aspiration of this paper is to investigates the influence of firm opportunity growth as intervening variables on the association amid capital structure and firm relative worth have long been critical with regard to corporates' financial decision making around the world of business. The greater the firm growth, the more assignable resources there is, and the higher is the firm value. The study used secondary data collected from audited financial statements for nonfinancial companies registered at the NSE, Kenya between 2015 to 2019. This research adopted stepwise regression analysis to explore the intervening consequence of firm growth on the relationship between capital structure and firm relative worth. The results of the study

revealed that firm growth has strong intervening influence on the connection amidst capital structure and value of nonfinancial entities' registered at the NSE, Kenya. The management and regulators or policy-makers will find these results useful in their daily management of companies registered at the NSE. This will assist them in policy modeling to avoid delisting of entities due to nonperformance.

Keywords: Capital Structure, Firm growth, Firm value, Trade-off Theory of capital structure

INTRODUCTION

In the field of corporate finance, capital structure decision making process is an important step in the composition of the financial structure. This is made up of two things, that is debt and equity. The combination of those two is called financial leverage which is differs from firm to firm. Capital structure is an important aspects of financial management goals of the company in any market. This research therefore ought to examined the intervening inspiration of corporation growth on the link amidst financial structure and the relatives wealth of nonfinancial corporations registered at the Nairobi Securities Exchange.

The other theories of capital structure after the inspirational paper of Modigliani and Miller (1958) that support relevancy of leverage on value of firms includes Pecking Order Theory, Agency Cost Theory, and Trade-off theory as they real world market is imperfect as opposed by MM theorem. This view was also supported by other researchers like De Angelo and Masulius (1980), Myers (1984), Leland (1994), Horakimian, Opler and Titman (2002), McConnel and Servaes (1990), Titman (1984), Robichek and Myers (1965), Berger, Banaccorsi (2006), Lee, and Hsieh, (2013).

The aim of this study is to examined whether the intervening variable has direct effect on the linking amidst financing choice and nonfinancial entities registered at the Nairobi Stock Market value in Kenya. Does firm growth has any mediating impact on the connection amid capital structure and the business value? This study drive support to the present literature by helping finance managers, investors and policymakers on the ideal optimum corporate capital structure that maximize the market value of the firms and minimize the cost of capital as well the cost of financial distress.

THEORETICAL AND EMPIRICAL STUDIES

There are numerous theories and analyses on the effect of capital structure on the value of firms. As the seminal paper of MM theorem (1958) stated that capital structure decision is

irrelevance to the company net worth. The MM theorem was based on some assumptions which includes no taxes, no transaction costs and no information asymmetry.

Mugo, Kerosi and Kalul (2018) explored the association amidst structure of capital and profitability of nonfinancial entities registered at the NSE.. They used the longitudinal research design with the used of secondary data obtained from the nonfinancial firms annual financial reports from 2010-2015. The results revealed that profitability was statistically significant and positively related to the internal equity.

Kodongo, et al., (2014) examined the association concerning leverage and financial performance of companies registered in Kenya. The results indicated that leverage has substantial and inverse impact on the profitability of entities quoted in capital market and they further stated that leverage has no substantial inspiration on the net worth of entities quoted at the Nairobi Securities Exchange. For favorable condition to prevail in Kenya, the private sector and government must avail more resources to attract investors locally and internationally (Mwangi et al., 2014). As the case, firm will be able to raise funds and performance exceedingly well due to favorable market environment.

The study carried out by Ogbulu and Emeni (2012) investigated the influence of capital structure of entities registered relative worth employing data from Nigerian market. The results of study revealed that, Nigeria as emerging economy, corporate capital structure as part of corporate financial planning does have influences on the market value of entities or companies registered in Nigeria.

The study conducted by Babalola (2012) examined the correlation amid corporate capital structure and Return on Equity (ROE) using sample of ten companies in Nigeria, 2000 - 2009, and pointed out that a positive linear link that exist amidst the debt-to-asset ratio and return on equity. The outcome of the study support the notion of Trade-off theory by considering the used of debt as an important tool companies should use to increase the firm value and reduce financial distress through the use of debt financing. In fact, debt financing bring tax benefits advantage to the entities as company's financial performance as the results of debt financing as the company meet its daily obligation when they fall due. This is also supported by studies conducted by Yong and Christos (2013) and Lei, and Song, (2013),

Hirdinis (2019) conducted a research by scrutinizing the relationship between capital structure and company size moderated by profitability using 43 stock listed in the mining sector. The study adopt secondary data obtained from the annual financial reports 2013-2018. Based on the investigates outcomes of the study which was concluded that capital structure has a significant positive effect on firm value while company specific factors has a significant negative

influence on entity value. Profitability has no significant consequence on firm value, whilst company level has a significant positive impact on profitability.

RESEARCH METHODOLOGY

The sample used in this study was 36 nonfinancial firms listed at the Nairobi securities Exchange as at 31st December 2019. The nature of data adopted for this research is panel data for 5 years (2015 – 2019) and 36 nonfinancial firms, therefore composed of both time series and cross-sectional data. The main purpose of utilizing panel data is to add up number of observation (sample frame). The study used cross-section and time series data to scrutinize the consequence of firm opportunity growth as intervening variable on the association amid leverage and the business net worth. The research adopted secondary data obtained using annual reports from the NSE website. The regression analysis method was employed to analyze the results of the study. The Ordinary Least Square method was implemented meanwhile it is a fitting procedure since our focus was to test the affiliation amid the business value and their capital structure.

The study employed multivariate ordinary Least Square (OLS) regression to analyses the influence of mediating variable on the connection amid capital structure and the net wealth of nonfinancial corporations registered on the NSE, Kenya. The Linkage among variables was examined as follows.

$FV = \alpha 0 + \beta 1\ STD + \beta 2\ LTD + \beta 3 DE\ Ratio + \mu t$ ----------3.1

$FG = \alpha 0 + \beta 1\ STD + \beta 2\ LTD + \beta 3 DE\ Ratio + \mu t$ ----------3.2

$FV = \alpha 0 + \beta_1 FG + \mu t$ ----------3.3

$FV = \alpha 0 + \beta 1\ STD + \beta 2\ LTD + \beta 3 DE\ Ratio + \beta 4 FG + \mu t$ ----------3.2

α0, β1, and β0 are constraints to be assessed

The a priori expectation is as follows

β1 > 0, β2 > 0 Where FV is the value of the firm, Equity represent the sum total of all equity instruments, Debt is the summation of all the debt instruments used in financing a bank and μt is the error term.

ANALYSIS AND RESULTS

This paper was based on the second objective of the thesis. The objective stated that firm growth has intervening impact on the link amidst capital structure and value of nonfinancial corporations registered at the NSE. The first step was performed regressing dependent variables on independent variables ignoring intervening variables. The first was performance using the leverage choice and company net worth without intervening variables.

This analysis followed the four steps suggested by Baron and Kenny (1986) to analyses the mediating effects of firm growth rates on the relationship amid capital structure and firm value. Thus the first step analyses regression model to conduct the assessment on the connection concerning capital decisions and business network without considering the mediator (firm growth rate). The model was statistically significant at 0.05 as bestowed in the Table 1 below. The stepwise regression analysis resulted in the adjusted R^2 of 0.534, 57.87(0.000). This mean that capital structure explained 53.40 per cent in the variance in firm value.

The second step assessed association between firm growth rate (intervening variables) and capital structure (independent variables) excluding firm value (dependent variable) measured by Tobin Q. The model in this step was statistically significant at 0.05 as bestowed in the Table 1 below. The adjusted R square 0.075 , F = 8.234 and PV <0.05. Meaning that capital structure explained 7.5 of variation in firm growth rate. The coefficient of capital structure with -0.281 and statistically significant with PV of 0.008. This shows that capital structure is a predictor variable at p <0.05, hence there exist a connection amidst capital structure and firm growth rate.

In the third step of the intervention process, the analysis was carried out by analyzing the connection between firm growth and value of the without considering capital structure (independent variable). The regression model was statistically significant as indicated in Table 1. The stepwise regression model produced adjusted R square of 0.186, F = 4.028 and PV <0.05. This shows existing link concerning company opportunity growth rate and the firm value is significant. This outcomes from study analysis indicated that there is a relationship between firm growth rate and Tobin Q as a measure of firm value in the model specifications and therefore the relationship is statistically significant. When the test of the slope was conducted, the regression coefficient of capital structure (CS) was negative 0.435 with 0.0260 level of significant. As a result, there exist a relationship amidst firm growth rate and the value of the firm.

Table 1: Regression Results for the Mediating Effect (Dependent Variable: TQ)

	CS & FV	CS & FGR	FGR & FV	CS, FGR & FV
Cons-	0.165 (0.025)	4.073(0.000)	0.713(0.000)	0.2019(0.689)
CS	0.187(0.000)	-0.281(0.008)	-0.435(0.0260)	0.207(0.000)
FGR				0.053(0.024)
Adjusted R^2	0.534	0.075	0.186	0.4034
F	57.87(0.000)	8.234(0.007)	4.028	28.986(0.000)

(P – values in parenthesis, Dependent variable: Firm Value; Dependent Variable: Firm Growth Rate; Dependent Variable: Firm Value; Dependent Variable: Firm Value).

The mediation process conducted in step four was to analyze the association among CS, FG rate and value of nonfinancial corporations registered in Kenya. The Table 1 above indicated that regression model of this step was statistically significant at 0.05. The adjusted R^2 produced by the stepwise regression model was 0.4034, F = 28.986, P-Value <0.05. Firm growth and capital structure explained 40.34 per cent of the variation in the value of nonfinancial corporations registered at the NSE, Kenya. The assessment of the slope revealed that the coefficient of capital structure was 0.2070 with significant level of 0.024. This shows that capital structure and firm growth are important predictor factors of firm value at 0.05 and therefore, there exist a correlation among capital structure, firm growth and firm value. As the firm growth significantly predict firm value even when capital structure was measured at 0.05 level of significant, firm growth has mediating influence on the connection amidst capital structure and firm value.

CONCLUSION

This paper explored the intervening impacts of firm opportunity growth on the connection amid financing structure and the net worth of nonfinancial corporations registered in Kenya as the context of the current research paper. The study investigated contribution of the theories of capital structure. The research paper was grounded on the tradeoff theory as it advocates for firms to have ideal capital structure through the external sources of financing due to their tax shield advantage. The outcomes of the study indicated that firm growth has intervening consequence on the link concerning capital structure and corporation net worth. This implied that nonfinancial companies in Kenya should always pay attention to the firm growth to clearly made decisions concerning the link concerning capital structure and firm value.

The contribution of this paper to the current empirical works is that, there is no direct bond amid capital structure and firm value but rather mediated by the firm growth. This could be explained by other scholars who have conducted studies by testing the impact of capital structure and firm value with the conclusion that arrived to the controversy as shown in the following studies (Leland, 1994; Babalola, 2012; Mwangi, et al., 2014; Mugo, et al., 2018). This research paper has revealed that the impact of capital structure on firm value can be well explained by taking into account how capital structure influences firm growth first and after that the effects of firm growth as intervening variable on the value of nonfinancial organizations registered in Kenya.

The current research recommends that nonfinancial firms should endeavour to maintain optimal mix of debt and equity that maximize the value of the firms and shareholders wealth.

SUGGESTION FOR FURTHER RESEARCH

The sample study can be duplicated in some years to come to examined the impact of firm growth as intervening variable on the influence of leverage choice and net worth of nonfinancial organizations registered at the NSE, Kenya. This is because change in time and advancement in technology the extend in which businesses are carried out could have improved and there needs to ascertain the influence of leverage choices on the net worth of companies. Further research could be done using financial sector or taking subsection of each sector expand the period of the study and may be using both primary and secondary data for the analysis. Further studies should be made across countries on determinants of firm growth in order to obtain vivid understanding about whether and to what extent macroeconomic conditions influence firm value of nonfinancial firms in Kenya.

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