International Journal of Economics, Commerce and Management
United Kingdom ISSN 2348 0386 Vol. 14, Issue 10, Oct 2026

https://ijecm.co.uk/

FINANCIAL LEVERAGE, CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE OF NON FINANCIAL FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE

Mulwa Pauline
Student, University of Nairobi, Kenya
lynmulwa001@gmail.com

Herick Ondigo
University of Nairobi, Kenya

Onesmus Mutunga
University of Nairobi, Kenya

Abstract

This study aimed to establish the relationship among Financial Leverage, Corporate Governance, and financial performance of firms listed in the Nairobi Securities Exchange. The study first explored the relationship between Financial Leverage and financial performance. The study then explored the intervening variable on this relationship. Financial Leverage is operationalized by debt equity ratio, Corporate Governance was measured by Board independence and Board size while Financial Performance had ROE as an indicator. A positivist philosophy guides this study, which relies on existing theory to generate and test quantitative hypotheses. Data was analyzed using descriptive statistics and panel data analysis. The study relied on secondary data gathered from the published annual reports and financial statements from the selected firms between 2019 and 2023. The study collected data from 32 non-financial firms listed at the Nairobi Securities Exchange. The study established that the financial leverage had a positive but a statistically insignificant effect on financial performance. The outcome further established that corporate governance did not intervene in the correlation between financial leverage and financial performance.

Keywords: Financial Leverage, Corporate Governance, Financial performance, Nairobi Securities Exchange

Licensed under Creative Common

INTRODUCTION

The ratio between an organization's debt and equity is called leverage. This ratio denotes proportion of debt and the equity applied in funding purchase of firm resources. An unlevered firm utilizes owner's equity to finance its operations while a levered firm is that which uses the mixture of equity and debt to fund its operations. Financial leverage might either be a loan or borrowed capital. Debt acquisition costs and interest payments are recouped by the reinvestment of financial leverage proceeds (Cheng & Tzeng, 2014).

Financial leverage is measured using financial ratios. The ratios reflect a firm's ability to serve the varied stakeholder interests and quantify a firm's debt. The information applied in deriving the ratios is pulled out from the financials. Additionally, the statements are used in the assessment of the ability of the firms to make fixed payments related to the firm's debts. Several studies adopted different measures of financial leverage which include; the Long-Term Debt Ratio (LTDR), Debt to Equity Ratio (DTER), Short Term Debt Ratio((STDR), Interest Coverage Ratio Collins, Sitienei & Masinde 2025; Nduru 2023; Aderemi 2024).

According to Kithandi and Kithandi (2020) debt ratio, D/E ratio, are important metrics for measuring financial leverage since they directly impact the financial performance of a firm. The debt ratio is derived by dividing total liabilities by total assets. D/E ratio is calculated through division of a firm's total liabilities by total equity held by stockholders of same company. D/E ratio shows the percentage of debt financing relative to shareholder's equity. The ratio reflects the balance between shareholders' and creditors' claims on the firm's assets. Debt financing can magnify returns when returns on borrowed funds exceed financing costs and can erode ROE when debt servicing obligations reduce profitability. This study employs D/E ratio in conformity with previous research (Kithandi & Kithandi, 2020).The ratio allows for comparison across firms and years using audited statements financial data.

Corporate governance encompasses the age distribution of the management team, the CEO's attributes, the board's structure or composition, and the management team's acts and inactions(Ozili, 2021).Corporate governance is a structure aimed at enhancing the effectiveness of board members while also addressing issues related to agency conflicts (Areneke, Khlif, Kimani, & Soobaroyen, 2022). As firms assume higher levels of debt, creditors often demand stronger governance structures to safeguard their investments. This pressure may lead firms to enhance board oversight, enhance monitoring and improve accountability. Consequently, these governance improvements can influence managerial decisions, reduce agency conflicts and hence improve financial performance.

Corporate governance structures are centered on how duties are delegated amongst a company's stakeholders, including the managers, board of directors and shareholders; it

Licensed under Creative Common

additionally includes the requirement for well-defined policies and guidelines guiding corporate choices. Establishing a corporate governance framework is essential for organizations as it maintains ownership and control distinct from management. This raises the possibility that the company will be handled by experts with the requisite experience and in-depth business understanding enhancing firm performance. Board independence is the ability of the board to make decisions without insiders in an organization interfering. Throughout the study period, listed companies continued to be guided by the Capital Markets Authority's Code of Corporate Governance Practices for Issuers of Securities to the Public 2015.

Board size is a key aspect of board composition because it determines the board's ability to monitor managers, provide expertise and improve organizational oversight (Oruke, Iraya, Omoro & Otieno, 2020). Studies measure corporate governance differently. McCahery and Vermeulen (2014) measured corporate governance with board composition, board independence and ownership structure. The CMA 2015 code says the board size should balance the need for expertise with the need for effective interaction. The current study will use board size and board independence (Kyere & Ausloos, 2021).

Board size reflects the breadth of skills, advice and monitoring capacity while non-executive director representation reflects independence in board oversight. (Bui and Krajcsák, 2024).Board size and Board independence reflect two complementary board-level dimensions; the capacity of the board to provide expertise and monitoring, and the independence required for objective monitoring of the management. The CMA 2015 code addresses appropriate board size and non-executive representation and the board should have a majority non-executive directors and at least one third independent directors. The code describes board composition and independence as part of mandatory requirements for issuers.

As indicated by Metcalf and Titard (1976)**,** financial performance is carrying out of financial activities to attain financial goals within a particular time. It can be used to compare the performance of identical firms in an aggregated industry or sector. It also poses a great concern for professionals in business in diverse operating institutions because of the implications that it has on an entity's general health and survival. When an entity records a high performance, that is an indication of the efficacy in the usage of the resources in a company and ultimately it contributes to the economy. Short term financial performance reflects the firm's ability to generate returns from its resources within one year while long term performance reflects the ability to sustain profitability, growth over several years.

Accounting measures are the commonly used measures of financial statements and they rely on income statement data and balance sheet data. ROA is a financial performance indicator which measures the management efficiency in generating revenues from the assets

Licensed under Creative Common

they have at their disposal however, the numerator employed in the ratio is not clearly defined as operating income is applied by certain firms and other firms use net income. As a result, making comparisons between enterprises with varying business models can be misleading. ROE is a measure applied in evaluating the profitability of a firm's investment from its stockholders. however, a company's ROE cannot be compared to other companies with a positive ROE if it has a net loss or negative shareholders' funds. Various studies employ either the ROA or ROE to evaluate the financial performance of a firm (Zelalem, 2020). The study utilized ROE in line with previous researchers (Wayongah & Ochieng, 2019).

Research Problem

Decisions on financing are complex and differ between companies. The performance of the company will suffer if funding is made with the incorrect mix of debt and equity. Adding more debt might increase the risk for shareholders, though if the conditions are favorable, it might significantly boost their profits(Aziz & Abbas, 2019) .For firms listed at the NSE, sound financial decisions are expected to protect shareholder wealth, sustain dividend payments and maintain confidence in the wider market while corporate governance is expected to ensure that financing choices are made prudently and in the interest of shareholders .However ,there are listed non-financial firms which have failed to meet these expectations.

Concerns over corporate governance procedures have been connected to the inconsistent financial results that companies listed on the NSE have seen over the last few years (Kiruga, Ombok, & Adoyo, 2023). The recent wave of corporate scandals in several organizations like Uchumi supermarket, Mumias Sugar, Kenya Airways, among others caused regulators, academics and researchers to be interested on the corporate governance instruments of the organizations. This study seeks to answer the question; What is the intervening effect of corporate governance on the relationship between financial leverage and financial performance of non-financial firms listed in Nairobi Securities Exchange?.

LITERATURE REVIEW

Abid, Zhang, Xiongyuan and Aneela (2024) studied the connection between Financial Leverage and financial performance and the possible moderating role of corporate governance. The study period was 2016 to 2023. A total of 23 businesses in Pakistan's food and personal care sector were the subject of the study. The ratio of total debt to total assets was used to quantify leverage, while ROA was used to evaluate financial success. The results showed that leverage significantly harmed business performance, and that the negative link was strongest between companies with stricter governance practices and those with less severe governance

Licensed under Creative Common

requirements. However, the findings might not apply to other economic sectors because the study was restricted to the food and personal care industry.

Bui and Krajcsák (2024) aimed to study the correlation between financial performance and corporate governance for the listed firms trading under the Vietnam Stock Exchange, for the period between 2019 and 2021. The researchers also employed the GMM. Financial performance was evaluated using Tobin Q, ROE, and ROA. A positive correlation between financial performance and transparency disclosure; corporate governance and firm size were found to be positively correlated.

Kholilah and Solikhah (2024) sought to look into relationship between financial success, leverage, and good corporate governance. Banking firms that were quoted on the Indonesia Stock Exchange comprised the research's population. The study was conducted between 2018 and 2021. There were twenty-three banks in the sample. Multiple linear regression was used for analysis. The audit committee's size was determined by the number of its members, whereas corporate governance was evaluated by the makeup of the board of directors. The debt-to-asset ratio served as a stand-in for leverage. The findings indicated that effective corporate governance had a significant positive effect on financial performance, while leverage moderated the association amongst corporate governance and firm performance.

Research Hypotheses

H_1: There is no significant relationship between financial leverage and financial performance among non-financial firms listed on the Nairobi Securities Exchange.

H_2: There is no significant intervening effect of corporate governance on the relationship between financial leverage and financial performance of non-financial firms listed in Nairobi Securities Exchange.

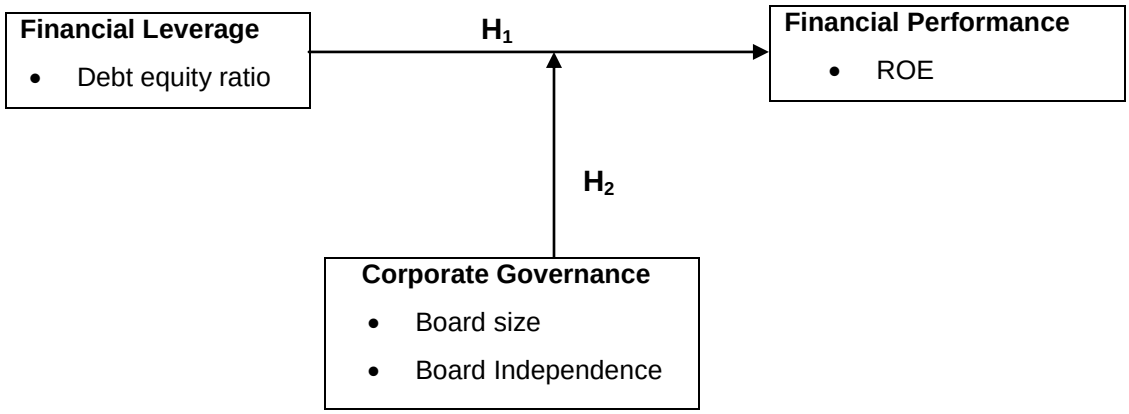


Figure 1: Conceptual Framework

Licensed under Creative Common

RESEARCH METHODOLOGY

This study adopted descriptive research design. Quantitative data on the variables of the study was obtained from published annual reports and financial statements. The study relied on secondary data gathered from the published annual reports and financial statements from the selected firms between 2019 and 2023. The study collected data from 32 non-financial firms listed at the Nairobi Securities Exchange.

Descriptive statistics were used to summarize the data and provide an overview of the characteristics of the variables while panel data analysis was employed to examine variations across firms and over time. In addition, it utilized the inferential statistics methodology to examine the proposed relationships.

To determine the relationship between Financial Leverage and financial performance the following model was used.

$FP=\alpha+\beta_1 DER_{it}+\varepsilon_{it}$

Where;

α=Constant

ε_{it}=Error term

β=Beta

FP=Financial Performance

For the second Hypothesis **(H_2)** the following model was used

$FP_{it}=\alpha+\beta_1 FL_{it}+\varepsilon_{it}$

2.$CG_{it}=\alpha+\beta 2FL_{it}+\varepsilon_{it}$

3.$FP_{it}=\alpha+\beta 3CG_{it}+\varepsilon_{it}$

4.$FP_{it}=\alpha+\beta 4FL_{it}+\beta 5CG_{it}+\varepsilon_{it}$

Where;

FP=Financial performance

FL=Financial Leverage

CG=Corporate Governance

α=Constant

ε_{it}=Error term

ANALYSIS AND FINDINGS

Based on the table 1, Debt equity ratio has a mean of 0.0002211 and a standard deviation of 0. 998593. According to the findings, nearly all the non-financial firms have a debt equity ratio of 0. 000221. Non-executive to Total Directors ratio has a min -2.15388 and max

Licensed under Creative Common

1.708735 ROE had a mean of 0.0106061 standard deviation of 0. 972216, minimax of -1.708735 and maximax of 2.734369. On average, the firms show a very low return on equity (1.06%), with a wide dispersion (high standard deviation). Mean = 0.0106: On average, the firms had a low return on equity, indicating relatively modest profitability among non-financial firms on the NSE. Some firms are significantly unprofitable (up to -170.87% ROE), while others are highly profitable (up to 273.44%). The mean ROE is slightly positive, implying low average profitability among NSE-listed firms. The broad range indicates that while some firms are very profitable, others have experienced substantial losses. The high variability suggests inconsistent performance across firms.

Table 1: Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
ROE	160	0.0106	0.9722	-1.7087	2.7344
DERATIO	160	0.0002	0.9986	-2.7344	2.7344
Nonexecutives	160	-0.0071	0.9632	-2.1539	1.7087
Boardsize	160	2.8025	0.5160	1.4142	4.2426

Correlation Analysis

This section outlines the results of correlation analysis of the research variables. It was undertaken through use of the Pearson's product moment correlation. The table below demonstrates a detailed information on correlation analysis carried out.

Table 2: Correlation Analysis

	DERATIO	Nonexecutives	Board size	ROE
DERATIO	1.000			
Non-executives	0.0873	1.000		
	0.2726			
Board size	0.0787	0.4781	1.000	
	0.3224	0.0000		
ROE	0.2055	0.0795	0.0198	1.000
	0.0091	0.3174	0.8035	

Financial Performance and Financial Leverage

The table above depicts the association amongst the response variable Financial Performance, operationalized by ROE and the Predictor Variable which is Financial Leverage, and indicator DERATIO. From the above table, DERATIO and ROE were positively correlated

Licensed under Creative Common

and the relationship was weak (r=0.2055). This means that when DERATIO increases the return on equity also increases.

Financial Performance and Corporate Governance

Table above shows the relationship between Financial Performance that was indicated by ROE and the intervening variable Corporate Governance operationalized by board size and the ratio of nonexecutive directors. From the correlation analysis, ROE and Board size were positively correlated and the relationship was weak (r=0.0787). When board size increases, DERATIO increases and vice versa. DERATIO and Nonexecutive directors' ratio were positively correlated, (r=0.0873). This means a rise in nonexecutive directors ratio results in an increase in DERATIO.

Financial Leverage and Corporate Governance

The table above shows the association amongst Financial Leverage which was the predictor variable, operationalized by DERATIO and Corporate Governance the intervening variable which was operationalized by nonexecutive directors' ratio. The correlation analysis shows ROE and nonexecutive directors were negatively correlated r=0.0795 indicates a weak positive relationship between nonexecutive directors' ratio and ROE. ROE and board size were positively correlated r =0.0198 hence they had a weak positive relationship.

DISCUSSION

The findings showed a positive and statistically insignificant association between financial leverage and ROE. This shows that, changes in financial leverage do not significantly influence the profitability (ROE) of the firms in the sample. The regression results revealed non-significant negative relationship between DERATIO and the non-executive directors' ratio. This indicates that changes in financial leverage do not significantly explain variations in board composition with respect to non-executive members. Corporate governance was found not to indirectly connect Financial Leverage to Financial Performance. The findings of this research were inconsistent with the findings of (Affes and Jarboui, 2023) that found a positive connection amongst corporate governance and financial performance .The findings were also inconsistent with the outcomes of Shahzad, Zulfiqar, Hassan, Mathkur, and Ahmed (2022) research that found mixed results on the connection amongst Corporate governance and financial performance.

Licensed under Creative Common

CONCLUSION

The first conclusion, drawn from the objective of examining the relationship between financial leverage and financial performance of non-financial firms listed on the NSE, revealed that although the debt-to-equity ratio had a positive effect on ROE, the relationship was statistically insignificant. This led to the conclusion that no significant association exists between financial leverage and financial performance in the sampled firms. The findings further indicated that corporate governance did not exert an intervening effect on the relationship between financial leverage and financial performance among non-financial firms listed on the NSE

REFERENCES

Abid, K., Zhang, D., Xiongyuan, W., & Aneela, I. I. (2024). Impact of leverage on firm financial performance: Evidence from Pakistan. *International Journal of Economics, Business and Management Research, 8*(5), 63–80. https://doi.org/10.51505/IJEBMR.2024.8506

Aderemi, O. A. (2024). Leverage and financial performance of quoted consumer goods in Nigeria. *Nigerian Journal of Management Sciences, 25*, 1b.

Affes, W., & Jarboui, A. (2023). The impact of corporate governance on financial performance: A cross-sector study. *International Journal of Disclosure and Governance*, 1.

Areneke, G., Khlif, W., Kimani, D., & Soobaroyen, T. (2022). Do corporate governance codes matter in Africa? In *Research handbook on corporate board decision-making* (pp. 273–301). Edward Elgar Publishing. https://www.elgaronline.com/edcollchap/book/9781800377189/book-part-9781800377189-23.xml

Bui, H., & Krajcsák, Z. (2024). The impacts of corporate governance on firms' performance: From theories and approaches to empirical findings. *Journal of Financial Regulation and Compliance, 32*(1), 18–46.

Cheng, M.-C., & Tzeng, Z.-C. (2014). Effect of leverage on firm market value and how contextual variables influence this relationship. *Review of Pacific Basin Financial Markets and Policies, 17*(1), 1450004. https://doi.org/10.1142/S0219091514500040

Collins Sitienei, D. J. N., & Masinde, J. (n.d.). *The effect of financial leverage on financial performance of non-financial firms listed in the Nairobi Securities Exchange, Kenya*. https://ijebmr.com/uploads/pdf/archivepdf/2025/IJEBMR_1672.pdf

Kiruga, A. M., Ombok, D. B., & Adoyo, D. P. O. (n.d.). *Influence of corporate governance practices on financial performance of listed firms in Nairobi Securities Exchange, Kenya*.

Kithandi, C., & Kithandi, C. (2020). Financial leverage and financial performance of the energy and petroleum sector companies listed in the Nairobi Securities Exchange. *International Journal of Scientific and Research Publications, 10*, p9972. https://doi.org/10.29322/IJSRP.10.03.2020.p9972

Kholilah, K., & Solikhah, R. N. (2024). Good corporate governance and financial performance: Does leverage matter? *Jurnal Akuntansi Terapan Dan Bisnis, 4*(1), 59–66.

Kyere, M., & Ausloos, M. (2021). Corporate governance and firms' financial performance in the United Kingdom. *International Journal of Finance & Economics, 26*(2), 1871–1885. https://doi.org/10.1002/ijfe.1883

Metcalf, R. W., & Titard, P. L. (1976). *Principles of accounting*. Saunders.

Nduru, M. (2023). *Financial leverage and performance of insurance firms listed at the Nairobi Securities Exchange, Kenya* [Doctoral dissertation, Kenyatta University]. Kenyatta University Institutional Repository. https://ir-library.ku.ac.ke/bitstream/handle/123456789/26587/Financial%20Leverage%20and%20Performance%20of%20Insurance%20Firms.pdf?sequence=1

Oruke, O., Iraya, C. M., Omoro, N. O., & Otieno, L. O. (2020). Board structure and firm performance: Evidence from state-owned enterprises in Kenya. *Research Journal of Finance and Accounting*. https://doi.org/10.7176/RJFA/11-16-04

Ozili, P. K. (2021). *Financial inclusion: The globally important determinants* [SSRN scholarly paper]. https://doi.org/10.2139/ssrn.3998152

Licensed under Creative Common

Shahzad, A., Zulfiqar, B., Hassan, M. ul, Mathkur, N. M., & Ahmed, I. (2022). Investigating the effects of capital structure and corporate governance on firm performance: An analysis of the sugar industry. *Frontiers in Psychology, 13*. https://doi.org/10.3389/fpsyg.2022.905808

Wayongah, D., & Ochieng, W. (2019). *Analysis of firm size, leverage and financial performance of non-financial firms in Nairobi Securities Exchange, Kenya* [Doctoral dissertation, Maseno University].

Zelalem, D. (2020). The impact of financial leverage on the performance of commercial banks: Evidence from selected commercial banks in Ethiopia. *International Journal of Accounting, Finance and Risk Management, 5*(1), 62–68.

Licensed under Creative Common