

**DETERMINANTS OF CORPORATE HEDGING PRACTICES USED BY COMPANIES  
LISTED IN NAIROBI SECURITY EXCHANGE: A CASE OF UCHUMI  
SUPERMARKET**

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**ABSTRACT**

Hedging can reduce underinvestment costs since it reduces the probability of financial distress by shielding future stream of cash flows from the changes in the exchange rates. Variability in cash flows will result in variability in the amount of investment. A decrease in planned investment means that the firm is foregoing positive net present value projects and since it has insufficient internal funds the firm is forced to raise costly external finance. The study targeted a population of 300 management employees working at Uchumi Supermarket. Regression models were used to examine how long term debt ratio, growth option, liquidity ratio and cash flow volatility influenced hedging practices used by companies listed in Nairobi Securities Exchange. Questionnaires were used as the main data collection. Descriptive statistics and inferential data analysis method was to analyze the gathered data. The findings indicated that long term debt ratio, growth option, liquidity ratio and cash flow volatility influenced hedging practices used by companies listed in Nairobi Securities Exchange.

**Key Words:** *Hedging, financial distress, investments, Uchumi Supermarket*

## INTRODUCTION

In the presence of a convex corporate tax function the firm's expected tax liability can be reduced by hedging. The more convex the tax schedule the greater the incentive to hedge. The factors that cause convexity in the effective tax function are progressivity in the statutory tax code and tax preference items such as tax loss carry-forwards, investment tax credits and foreign tax credits (Stulz, 2007).

Financial distress is another factor identified by Smith and Stulz (2007) that can justify corporate hedging. They argue that hedging can reduce the expected transaction costs of financial distress by reducing the probability of actually incurring these costs. Most studies use the leverage ratio as an indicator of the likelihood of financial distress to measure expected costs of distress. The leverage ratio, however, fails to allow for the level of cash, or negative debt, held by a firm. This is important because, *ceteris paribus*, a firm with high levels of cash holdings is less financially constrained than a firm with low levels (Trueman & Titman, 2004). Thus, besides the raw leverage ratio, we also use debt net of cash and short-term investments as a proxy for financial distress. To account for the fact that a high level of debt (gross or net) does not necessarily imply a higher probability of financial distress, we use two alternative proxy measures - the interest coverage ratio and a dummy variable indicating whether a firm has net interest payable. As mentioned in the previous footnote the tax loss dummy might be associated with financial distress rather than the corporate tax function. Higher leverage, lower interest cover, net interest payments and tax losses should reflect a higher probability of financial distress (Solomon et al., 2000).

## STATEMENT OF THE PROBLEM

When capital markets are perfect, hedging at the corporate level does not add to firm value and, thus, cannot be justified. The positive theory of corporate hedging developed by Smith and Stulz (2007) shows, however, that when capital markets are less than perfect, circumstances do arise where corporate hedging can add value and, thus, can be justified. The decision of whether and how to hedge then depends on firm-level attributes that determine the benefits derived from hedging that accrue to either shareholders or managers (Fok, Carroll and Chiou, 2006). Hedging against foreign currency exposure is increasingly becoming important because of volatile exchange rates that in one swing turn profit into loss and vice versa as companies settle financing and purchase obligations incurred in various hard currencies (Chalmers, 2001).

Uchumi supermarket having operated for more than 30 years was declared bankrupt on June 2006 (USR 2009). It was put under Specialized Receiver Manager (SRM) and interim management on July 14, 2006 (USL 2009). On February 2007 the government negotiated on URP whose emphasis was to reinvent Uchumi for turnaround. This led to an improved performance due to the implementation of URP in the year 2007/8. The company was relisted at the NSE in June 2010 and made the most from every sale compared to other stock (NSE 2010).

Sales revenue and gross profits grew by 21% and 13% respectively in the year 2008/2009 as compared to the previous year 2007/2008 (NSE 2010). These positive growth results were attributed to focused and redefined business objectives together with operational efficiency, and the re-launched Uchumi brand in line with the URP. Despite that tremendous growth the company has not been able to regain its position as the market leader due to stiff competition from other players (economic survey 2010).

According to Bessembinder, (2006) shareholders in Kenyan firms are losing billions of shillings each year due to directors' failure to shop for appropriate hedging instruments. For instance, throughout the 1990's, Uchumi Supermarkets spearheaded the hypermarket concept in Kenya. Initial restructuring of Uchumi did not forestall the deteriorating performance of the Company and as a result, the Company ceased its operations in the year 2006. Simultaneously, the Capital Markets Authority (CMA) suspended the Company's listing on the Nairobi Stock Exchange (NSE) due to bankruptcy (NSE, 2006). Further, Uchumi Supermarket was put under receivership due to leverage (Ministry of Finance, 2012). According to Otieno (2010), Kenya Airways in the year 2009 reported an annual loss of KES5.6 billion as its fuel-hedging loss ballooned to KES 8.9 billion for the fiscal year ending March 31. This was KQ's first losing fiscal-year after thirteen years of profitability. Kenya Airways lost KES 8.9 billion equivalent to KES 8.8 per share, in the 2009 fiscal year, compared with a profit of KES 6.5 billion, or KES 9.9 per share, a year earlier.

The widespread use of derivatives for hedging is well documented in the corporate hedging literature. Thus, why firms hedge and whether hedging creates value are important questions. Several research studies have been conducted on determinants of corporate hedging practices. Allayannis and Ofek (2001) conducted a study on exchange rate exposure, hedging and the use of foreign currency derivatives; Allayannis and Weston (2001) did a study on the use of foreign currency derivatives and fair market value, Glaum, (2008) conducted a study on the determinants of selective hedging: Evidence from German non-financial corporations and Kiarie (2010) did a study on turnaround strategies adopted by Uchumi supermarket limited under receivership. However, none of these studies was conducted in Kenya on the determinants of corporate hedging practices, research gap. This study aims at filling this research gap by investigating on the determinants of hedging practices used by companies listed in Nairobi Security Exchange.

## **RESEARCH OBJECTIVES**

### **General Objective**

The general objective of this study was investigate on the determinants of hedging practices practices used by Uchumi supermarket limited

## LITERATURE REVIEW

### Real options theory of growth option

Academic interest in real options theory is emerging in the field of strategic management (Adner & Levinthal, 2004; McGrath, Ferrier, & Mendelow, 2004). Behind this emerging interest are the practical concern that strategic investment decisions are often made under uncertainty and the theoretical appeal that real options theory is able to capture managers' flexibility in adapting their future actions to changing market or technological conditions. The broader objective of this dissertation is therefore to improve existing understanding of real options theory's applications in the domain of corporate strategy.

Myers (2003) first coined the term real options to refer to a firm's future investment, or growth opportunities. These growth opportunities can be viewed as real options because their value ultimately depends on the firm's discretion to invest in the future, and whether or not the firm will actually choose to make these investments is contingent on the future states of the world. There is close analogy between real options and financial options (Kogut & Kulatilaka, 2001). Real options are real because the investments are in real (physical or human) assets, as opposed to financial assets in the case of financial options.

Real options theory has generated increased research interest in the strategy field in recent years, and this interest is natural in view of the high degree of uncertainty that firms often confront in making strategic investment decisions (Singh & Upneja, 2007). The appeal of real options theory also rests on its distinctive ability to capture managers' flexibility in adapting their future actions in response to evolving market or technological conditions. While such flexibility has long been recognized and appreciated by managers in an intuitive way, until the publication, seminal work on the pricing of financial options and Myers' (2003) pioneering idea of viewing firms' discretionary future investment opportunities as real options, there had been a lack of formal models of such flexibility.

Over the years, strategy research on real options has used the theory both as a model for financial valuation and as a heuristic for managerial decision-making (Kogut & Kulatilaka, 2001). Many corporate investments have been argued to have option-like features, and a large number of studies have conceptualized or evaluated such investment projects using the real options perspective.

### Free cash flow theory of cash flow volatility

It was argued that firms with a positive cash flow are able to raise their capital and borrow from the capital market, while firms with a negative or insufficient cash inflow are unable to borrow and therefore facing the risk of default. According to this argument, a firm is assumed to go bankrupt (default) whenever the current year profit or cash flow is negative or less than the debt

obligations or whenever the sum of its current year profit and the expected value of equity (without current income) is negative (less than zero). Following this, Pramborg (2005) used the gambler's ruin to develop his framework to predict default risk. The model assumed that the firm's financial state could be defined as its adjusted cash position or net liquidation at any time. According to the gambler's ruin model the time of bankruptcy is based on the inflows and outflows of liquid resources. Pennings (2002) argued that if the current cash flows are able to predict the corporate financial position, then past and present cash flows should be able to determine and predict corporate default.

Firm future cash flows affect its ability to enter the equity market to raise capital, as these cash flows are not directly paid out in a form of dividend they are retained and could be reinvested in profitable projects (Shin & Stulz, 2000). While, shareholders allow managers to retain cash, the managers may misuse the retained cash, i.e., invest in unprofitable or negative projects. Therefore, the potential agency problems exist as a result of a conflict interest between shareholders (principals) and managers (agents).

Kuhn (2007) argued that increased leverage or increased dividends can help to lower the cost of asymmetric information between managers and shareholders, so the free cash flow should be distributed to shareholders as dividends in order to maximize firm value. However, increases the use of debt, moves ownership from equity to debt holders and increasing the firm's probability of default (Nguyen & Faff, 2003). A high proportion of Jordanian companies' capital structure is short-term debt, which could be affected by the banks credits facilities. Regarding the dividends, it has been documented in many studies that Jordanian companies have low dividend ratios. Nevertheless, the retained earnings or cash flows provide the internal source of finance which can be less costly compared with external sources of finance (Othman & Ameer, 2009). The tradeoff between the benefits of free cash flow's as internal finance and the cost of the free cash flow is the main focus of the free cash flow theory. Furthermore, the main Projects with a negative net present value (NPV).

### **Monetary theory of liquidity ratio**

Monetary theory is a set of ideas about how monetary policy should be conducted within an economy. Monetary theory suggests that different monetary policies can benefit nations depending on their unique set of resources and limitations (Minton, Schrand & Walther, 2002). It is based on core ideas about how factors like the size of the money supply, price levels and benchmark interest rates affect the economy. Economists and central banking authorities are typically those most involved with creating and executing monetary policy.

Cash flow ratios determine the amount of cash generated over a period of time and compare that to short-term obligations. This gives a clearer picture if the firm has a liquidity problem in connection with its short-term debt paying ability (Linsley & Shrivs, 2006). Operating cash flow is computed by dividing cash flow from operations by current liabilities.

This shows the company's ability to generate the resources needed to meet current liabilities. Firms with less current assets will having problem in continuing operations while if the currents assets is too much, it shows the return on investment for the company is not in perfect condition.

This concept has a relation with monetary theory because transaction and provision is a main reason in managing cash. In addition, this reason also has an assumption which all the concept of treasury management is in the good judgment of their terms. Cash conversion cycle shows the relation between liquidity and profitability (Lien & Yang, 2008). It is more important to measured profitability compared to if the company is using current ratio. The higher the ratio the higher the comfort level. All of the cash flow ratios are not uniform but vary by industry characteristics. The analyst would then adjust his assumptions accordingly to assess the liquidity of a firm.

Myers (2003) conceptually defines the liquidity ratio as “realizable cash on the balance sheet to short term liabilities.” In turn, “realizable cash” is defined as liquid assets plus other assets to which a haircut has been applied. Ration analysis is one of the conventional way that use financial statements to evaluate the company and create standards that have simply interpreted financial sense (Kuhn, 2007).). A sudden stop in an organization is generally defined as a sudden slowdown in emerging market capital (cash) inflows, with an associated shift from large current account deficits into smaller deficits or small surpluses. Sudden stops are “dangerous and they may result in bankruptcies, destruction of human capital and local credit channels.

## EMPIRICAL REVIEW

There is a lot of literature on determinants of hedging practices in companies all over the world. However, most of these studies have been conducted in the developed countries and very have been conducted in developing countries and more specifically in Africa.

Glaum (2008) conducted a study on the determinants of selective hedging: Evidence from German non-financial corporations. The paper sought to link the discussion on risk management theories more closely to the observed firm behavior. The paper was based on a survey study on the risk management of German non-financial firms. Like previous studies, he found that a majority of firms follow profit-oriented, forecast-based hedging strategies. He adapted the existing hedging theories in order to explain which firms are likely to adopt selective or speculative risk management strategies.

The survey was undertaken in late 2008, early 2004. He surveyed all non-financial German firms listed on the Frankfurt Stock Exchange with a minimum sales volume of DM 400 million in the financial year 2006. Of the 154 companies that met the selection criteria, 74 took part in the survey (response rate: 48 %). Multiple logistic regression analysis was applied in order to test the hypotheses. The proposed model was able to explain the firms' choice of foreign exchange risk



strategies reasonably well. Highly levered firms are less likely to take bets in the currency markets. Secondly, German firms with significant bank ownership are more likely to adopt a profit-oriented risk management strategy. Thirdly, there is a negative correlation between profitability and the likelihood to follow selective hedging. Further, there is a tendency for larger firms to be more inclined to use forecasts in their exchange risk management decisions. The proposed model is not able to explain the choice of the firms' interest rate risk strategies.

Kuhn (2007) conducted a study on corporate Risk Management and Hedging Practice by Medium-Sized Companies in Denmark: An empirical investigation of the determinants of companies' foreign exchange risk management. This thesis presents insight into two corporate risk management areas: Using a questionnaire approach, it presents actual empirical evidence about corporate risk management practice and behavior of industrial, unlisted medium-sized firms in Denmark; and, using regression analysis, investigates the determinants of the usage of derivatives and foreign debt as means to manage foreign exchange rate exposure. These selection and restriction criteria reduced the initial sample from 3561 companies down to a population of 771 Danish medium-sized, industrial corporations with total balance of between 50m and 500m DKK and number of employees of between 20 and 499.

The results indicate that every second company is using derivatives and that the use of foreign debt is even more pronounced among larger companies. In their management of foreign exchange exposure, Danish medium-sized companies mainly hedge contractual commitments and anticipated transactions. Their main concerns when using foreign exchange derivatives or foreign debt is the quantification of underlying exposure and the overall transaction costs involved. Prior findings in this area are confirmed as firm size and foreign exchange exposure are significant indicators for derivative usage. The results also suggest that foreign exchange derivatives and foreign debt are seen and used as substitutes when managing foreign exchange rate exposure.

## CRITICAL REVIEW

Derivatives are an integral part of firms' risk management policy. Market risk is defined as the risk of loss arising from the adverse changes in the market rates and prices such as the interest rates, currency exchange rates, commodity prices, or equity prices (Smith and Stulz, 2007) propose that for value maximizing firms hedging is part of overall corporate financing policy. They suggest that hedging can affect firm value, through changes in tax liabilities, changes in stakeholder contracting costs, or interdependencies between the choice of financial policy and future real investment decisions (Smith and Stulz, 2007). This implies that hedging can increase a firm's value by simultaneously reducing external claims such as taxes paid to government; bankruptcy costs (both direct and indirect); and/or agency costs to align managerial interests with the interests of capital suppliers. Hedging can reduce underinvestment costs since it reduces the

probability of financial distress by shielding future stream of cash flows from the changes in the exchange rates.

According to Froot, Scharfstein, and Stein (2008) hedging ensure that a firm has sufficient internal funds which would enable it to avoid unnecessary fluctuations in either investment spending or external financing and so increases firm value. Froot et al. (2008) argue that variability in cash flows will result in variability in the amount of investment. A decrease in planned investment means that the firm is foregoing positive net present value projects and since it has insufficient internal funds the firm is forced to raise costly external finance. In both Bessembinder (2006) and Froot et al. (2008) analysis the costs of underinvestment will be greater for those firms with more growth options.

Alternatively, firm could lower the likelihood of financial distress by possessing more liquid assets ensuring that funds will be available to pay debt claims. Also firms with higher levels of liquidity will have less need to access costly external financing to fund their investment programme. Nance, Smith, & Smithson (2008), however, posit that corporations can mitigate expected costs of financial distress and agency costs by maintaining a larger short-term liquidity position in terms of having a lower dividend payout ratio or a higher quick ratio. In order to test financial distress cost (underinvestment) and growth option (Nance, Smith, & Smithson, 2008)

Cash flow models of foreign exchange exposure suggest that the foreign exposure should be related to net foreign currency revenues (total revenues minus costs) – higher foreign sales would lead to higher use of currency derivatives. Firms with greater variation in cash flows or accounting earnings resulting from exposure to exchange rate risk have greater potential benefits of foreign currency hedging. The degree to which a firm's cash flows are affected by exchange rate changes should depend on the nature of its activities, such as the level of export and import activity, its involvement in foreign operations, its competitors currencies, and the competitiveness of its input and output markets. Thus, given the exchange rate uncertainty associated with the value of cash flows at a future data that is denominated in the foreign currency can be hedged perfectly in the forward market if the foreign currency value of the cash flow is known with certainty (Nance, Smith, & Smithson, 2008).

It has been argued that if a firm faces a convex tax function, then hedging reduces the volatility of taxable income and the firm's expected tax liability. For a firm facing some form of tax progressivity, when taxable income is low, its effective marginal tax rate will be low; but when income is high, its tax rate will be high. If such a firm hedges, the tax increase in circumstances where income would have been low is smaller than the tax reduction in circumstances where income would have been high, thus lowering expected taxes (Nance, Smith, & Smithson, 2008).

## RESEARCH GAPS

Several research studies have been conducted on determinants of corporate hedging practices. Allayannis and Ofek (2001) conducted a study on exchange rate exposure, hedging and the use



of foreign currency derivatives; Allayannis and Weston (2001) did a study on the use of foreign currency derivatives and fair market value; Glaum, (2008) conducted a study on the determinants of selective hedging: Evidence from German non-financial corporations and Kuhn, (2007) did a study on corporate Risk Management and Hedging Practice by Medium-Sized Companies in Denmark An empirical investigation of the determinants of companies' foreign exchange risk management. However, none of these studies was conducted in Kenya, research gap. This study aims at filling this research gap by investigating on the determinants of corporate hedging practices used by companies listed in Nairobi Security Exchange.

## **METHODOLOGY**

The study adopted a descriptive research design. Descriptive research takes accuracy as a consideration which minimizes bias and maximizes reliability of the evidence collected, (Kothari, 2004). The study population constituted 300 management employees working at Uchumi supermarket since the issue of business capital structure is the activity within this domain and also it's the central command for all the activities of the organization. The primary research data was collected from the employees using a questionnaire. A pilot study was undertaken on fifteen employees to test the reliability and validity of the questionnaire. Data analysis was done with the help of software programme SPSS version 21 which is the most current version in the market and microsoft excel to generate quantitative reports.

## **RESULTS AND FINDINGS**

### **Liquidity Ratio**

The study found out that majority of the respondents indicated that the organization had experienced liquidity problems in the last five years and that liquidity ratio affected the hedging practices of companies listed in NSE to a very great extent. The study also found out that the organization used current ratio in liquidity management to a very great extent.

These findings collate with the literature review where Géczy et al. (2006) argues that liquidity ratios measure a business' ability to meet the payment obligations by comparing the cash and near cash with the payment obligations. If the coverage of the latter by the former is insufficient, it indicates that the business might face difficulties in meeting its immediate financial obligations.

### **Growth Option**

The study further found out that majority of the respondents indicated that growth option affected the hedging practices of companies listed in NSE to a very great extent and that the rate of growth of the organization was steady. The study also found out that the respondents strongly agreed that hedging allowed equity holders to capture a larger portion of the benefits from new investments and that hedging ensured sufficient internal funds for undertaking attractive investment opportunities.

These findings are in line with the literature review where Graham & Rogers (2002) states that hedging allows equity holders to capture a larger portion of the benefits from new investments. Since underinvestment costs are most severe for firms with attractive investment opportunities .

### Cash Flow Volatility

Moreover, the study found out that majority of the respondents indicated that cash volatility affected the hedging practices in the company and that cash volatility affected the hedging practices of companies listed in NSE to a very great extent. The study also found out that the respondents strongly agreed that firms with greater variation in cash flows or accounting earnings resulting from exposure to exchange rate risk had greater potential benefits of foreign currency hedging.

These findings collate with the literature review where Goel and Thakor (2003) suggest that a firm may smooth earnings so as to reduce the informational advantage of informed investors over uninformed investors, and therefore protect these investors who may need to trade for liquidity reasons.

### Long-term debt ratio

Finally, the study found out that majority of the respondents indicated that long term debt affected the hedging practices of companies listed in NSE to a very great extent. The respondents strongly agreed that shortage of long-term finance had a cost in terms of productivity growth and capital accumulation

These findings are in line with Graham and Rogers, (2000) argue that there has been a widespread perception both by domestic and international policymakers that asymmetric information and contract enforcement problems may lead to a shortage of long-term finance and that This shortage is thought to have a cost in terms of productivity growth and capital accumulation and it may justify some form of government intervention. The setting up in most developing countries of long-term credit institutions (development banks) and/or of programs to foster the provision of long-term credit was indeed the policy response to this problem.

### Regression Analysis

#### Model

	<b>R</b>	<b>R Square</b>	<b>Adjusted Square</b>	<b>R Std. Error of the Estimate</b>
1	.836 <sup>a</sup>	.878	.676	.434

Coefficient of determination explains the extent to which changes in the dependent variable can be explained by the change in the independent variables or the percentage of variation in the dependent variable (Hedging practices used by companies listed in NSE) that is explained by all

the 4 independent variables (liquidity ratio, growth option, cash flow volatility and long-term debt ratio).

The four independent variables that were studied, explain 87.8% of variance in hedging practices used by companies listed in NSE as represented by the  $R^2$ . This therefore means that other factors not studied in this research contribute 12.2% of variance in the dependent variable. Therefore, further research should be conducted to investigate the determinants of corporate hedging practices used by companies listed in Nairobi Security Exchange.

#### ANOVA<sup>a</sup>

The F critical at 5% level of significance was 5.44. Since F calculated is greater than the F critical (value = 64.0), this shows that the overall model was significant. The significance is less than 0.05, thus indicating that the predictor variables, ( liquidity ratio, growth option, cash flow volatility and long-term debt ratio). Explain the variation in the dependent variable which is Hedging practices used by companies listed in NSE. Subsequently, we reject the hypothesis that all the population values for the regression coefficients are 0. Conversely, if the significance value of F was larger than 0.05 then the independent variables would not explain the variation in the dependent variable.

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	80.238	5	.167	64.0	.001 <sup>a</sup>
	Residual	10.345	75	.110		
	Total	90.583	65			

a. Predictors: (Constant), liquidity ratio, growth option, cash flow volatility and long-term debt ratio.

b. Dependent Variable: Hedging practices used by companies listed in NSE

#### Multiple Regression Analysis

Where Y is the dependent variable (Hedging practices used by companies listed in NSE),  $X_1$  is liquidity ratio variable,  $X_2$  is growth option variable,  $X_3$  is cash flow volatility variable and  $X_4$  is the long term debt ratio variable.

According to the equation, taking all factors (liquidity ratio, growth option, cash flow volatility and long-term debt ratio) constant at zero, Hedging practices used by companies listed in NSE will be 2.721. The data findings also show that a unit increase in liquidity ratio variable will lead to a 2.453 increase in Hedging practices used by companies listed in NSE; a unit increase in growth option will lead to a 0.233 increase in Hedging practices used by companies listed in NSE; a unit increase in cash flow volatility will lead to a 0.254 increase in Hedging practices used by companies listed in NSE; and a unit increase in long-term debt ratio variable will lead to a 1.967 in Hedging practices used by companies listed in NSE. This means that the most significant factor is liquidity ratio followed by long term debt ratio.

At 5% level of significance and 95% level of confidence, liquidity ratio had a 0.001 level of significance; growth option had a 0.003, cash flow volatility had a 0.002 level of significance while long term debt ratio had 0.004 level of significance implying that the most significant factor is liquidity ratio followed by cash flow volatility.

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error			
1 (Constant)	2.721	.77		5.654	0.000
liquidity ratio	2.453	0.241	0.237	0.567	0.001
growth option	0.233	0.296	0.534	0.256	0.003
cash flow volatility	0.254	0.437	0.356	0.199	0.002
long term debt ratio	1.967	0.656	0.323	0.198	0.004

Source: Research, 2013

## CONCLUSIONS

The study concludes that the organization had experienced liquidity problems in the last five years and that the organization used current ratio in liquidity management to a very great extent. The study also concludes that growth option affected the hedging practices of companies listed in NSE to a very great extent and that the rate of growth of the organization was steady. Moreover, the study concludes cash volatility affected the hedging practices in the company and that cash volatility affected the hedging practices of companies listed in NSE to a very great extent. Finally, the study concludes that long term debt affected the hedging practices of companies listed in NSE to a very great extent and that shortage of long-term finance had a cost in terms of productivity growth and capital accumulation.

## RECOMMENDATIONS

The study recommends that owing to the less cost incurred in obtaining short term loans than long term ones, companies should go for short term loans since despite changing the firm's capital structure to the worse, this will improve their performance as increasing short term debts with a relatively low interest rate will lead to an increase in profit levels. This is more profitable than taking long-term loans as companies are wanted to doing at times.

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