RELATIONSHIP BETWEEN DEBT FINANCING AND FINANCIAL SOUNDNESS OF NON-FINANCIAL COMPANIES LISTED IN NAIROBI SECURITIES EXCHANGE, KENYA

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Abstract

Since independence, Kenya has witnessed many cases of corporate failure among listed companies. In addition, instances of operational but financially struggling corporations have been numerous. This has not only resulted to erosion of confidence in the capital market but has also led to loss of investors' wealth. Although subsequent investigative reports conducted by government agencies have attributed this phenomenon to aggressive financing by the firms that take up excessive debt to finance their assets, analysts and members of public alike have discredited these explanations on grounds of political expediency and lack of scholarly underpinning. This study therefore investigated the effects of debt financing on financial soundness of non-financial companies listed in the Nairobi Securities Exchange (NSE), Kenya. The study employed quantitative research design. A census of the 40 non-financial companies listed as at 31st December 2013 was taken. The study used secondary panel *data extracted from the published annual reports and financial statements of listed non-financial companies for the 10 years period from 2004 to 2013. The study estimated the specified the panel regression model for random effects as supported by the Hausman test results. Feasible Generalized Least Square (FGLS) regression results revealed that total debt is negatively and significantly related with financial soundness of non-financial firms listed in NSE. Further, long term debt had a positive and significant relationship with financial soundness. The study also found that short term debt was negatively and significantly related with financial soundness of non-financial firms. On the basis of these empirical findings, the study recommended that managers of listed non-financial companies should use debt financing sparingly in an effort to promote the level of financial soundness. Where debt financing must be utilized, long term debt should be employed as it increases the financial soundness of non-financial firms listed in NSE.*

Key words: Corporate failure, Debt financing, financial soundness, Long term debt, Non-financial Companies