EFFECTS OF FIRM SPECIFIC VARIABLES ON CAPITAL STRUCTURE CHOICE OF NON FINANCIAL FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE

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ABSTRACT

This study investigates the effect of firm specific variables on capital structure choice of non-financial firms listed at the Nairobi Securities Exchange. Capital structure choice is considered as resulting from financial characteristics of the firm, the environment and the decision-makers' choice; particularly insiders and significant owners that both influence decision making in the firm. Two theories on capital structure changes considered relevant in guiding this study are signaling theory and pecking order theory. The study specifically tested the effect of insider holdings, ownership concentration, market capitalization, growth opportunities, firm size and profitability on debt to equity ratio, as proxy for capital structure choice. The study developed balanced short panel data derived from published financial statements and NSE Handbook 2013, in respect 28 non-financial firms out of the 57 firms listed at the Nairobi Securities Exchange as at 31st December 2012. The data was for the ten year period, 2003 to 2012, providing a total of 280 observations. The data series were subjected to panel unit root tests to establish their stationarity conditions and were found to be stationary at level. The data was then analysed using descriptive statistics, panel data methodology and Ordinary Least Square (OLS). The study established evidence of a statistically significant effect on capital structure choice, of four out of the six explanatory variables studied namely; market capitalization, growth opportunities, firm size and profitability. A positive association with capital structure choice is observed in market capitalization and firm size while a negative correlation is observed with growth opportunities and profitability. It can be inferred that the variables have influence on capital structure choice of non-financial firms listed at the NSE. However, insider holding and ownership concentration are not statistically significant to explain variations in capital structure choice which implies a higher extent of information asymmetry at the NSE. The results are consistent with existing empirical findings that capital structure is not homogeneously used as a signaling tool, and that it is not always the case that capital structure contains signaling values. The study is expected to provide useful insights to managers, investors and policy makers to help them better understand and interpret firms' capital structure signals. It will also contribute to studies in corporate finance, and more specifically capital structure and support further research.

Key words : Capital Structure, Debt-to-equity ratio (D/E), firm-specific variables, Signaling theory, Pecking order Theory and Asymmetric Information

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