THE RELATIONSHIP BETWEEN CAPITAL STRUCTURE AND PROFITABILITY OF LISTED NON FINANCIAL FIRMS IN KENYA: A CASE STUDY OF NAIROBI SECURITIES EXCHANGE.

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ABSTRACT

The profitability of every business is always determined by the type of capital structure decision it employs. It has always become very difficult to determine a firm's capital structure, and in the process of doing this there are several antagonistic factors to tackle like risk and profitability. In a more disturbing situation is when the economic environment in which the business is operating is volatile and unstable, the decision will be difficult to make. This has always led to corporate failures, and to revive the ailing enterprises that have faced liquidity problems we must focus solely on financial restructuring. A great dilemma for management and investors alike is whether there exists an optimal capital structure and how various capital structure decisions, both short-term and long-term, influence business performance. A review of empirical works reveals that there exists conflicting results about the relationship between capital structure and profitability of firms. This study therefore investigated the relationship between capitals structures on the performance of non-financial companies listed in the Nairobi Securities Exchange (NSE), Kenya over 5 year period from 2008 to 2012 after the financial crisis of 2007. It's a descriptive research study with a population focus of 40 listed non-financial firms in NSE. The source of data is mainly secondary data extracted from annual financial reports and financial statements of listed non-financial companies. The data were extracted from the Nairobi Securities Exchange hand books for the period 2008-2012. The data were analysed using regression analysis technique. The study showed long-term liability to equity had an inverse relationship to profitability of -5.7% and adjusted coefficient of determination of 9.80%. It further found that there was a positive correlation of 18.1% between the firm's profitability measured by ROA and of the short term debt, and also at 56.2% for long-term debt. The research therefore concludes that there's a negative relationship between capital structure and profitability. The research was done in line with pecking order theory and information asymmetrical theory and recommends that firms should aim to attain a debt/equity ratio so as to minimize the cost of capital and increase profitability.