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UNDERSTANDING CASH FLOW HOLDINGS ON FINANCIAL
PERFORMAMNCE OF LISTED NON-FINANCIAL FIRMS IN KENYA

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ABSTRACT

Non financial firms in Kenya are characterized by a decline in performance with low market price of the shares. Literature available shows that financial performance is known variable on Listed Non financial firms in developed economies. This study sought to establish the effects of Cash holdings on financial performance of listed non-financial firms in Kenya. The objective of the study was to establish the effects of Cash holdings on the financial performance of listed non-financial firms in Kenya The study also adopted supporting theory for the study objectives which was the Trade-off theory. The study used causal research design and the target population constituted 42 listed non - financial firms at the NSE under different categories.

The study used secondary panel data contained in the annual reports and financial statements of listed non-financial companies from the NSE Hand Book 2009-2013. A regression model was used to analyze the objectives the results were presented using descriptive statistics and inferential analysis such as Student t test. The results of statistical tests show that cash flow holdings have positive effect corporate financial performance (ROA).

Key words: Cash flow holdings, student t test, Financial Performance and NSE Hand Book 2009-2013

1.0 INTRODUCTION

The importance of financing decisions cannot be over emphasized since many of the factors that contribute to business failure can be addressed using strategies and financial decisions that drive growth and the achievement of organizational objectives. The finance factor is the main cause of financial distress. Financing decisions result in a given financial structure and suboptimal financing decisions can lead to corporate failure. To understand how firms in developing countries finance their operations, it is necessary to examine the effect of financial structure decisions. Company financing decisions involve a wide range of policy issues. At the macro level, they have implications for capital market development, interest rate and security price determination, and regulation. At the micro level, such decisions affect short term funding and capital structure, corporate governance and company development.

Business success depends heavily on the ability of financial managers to effectively manage the components of working capital. The level of cash holdings a firm holds was a point of concern addressed in this study against the firm's performance. Non-financial companies which are listed in Nairobi Stock Exchange have not been performing well and some actually records huge losses. Its against this background that the study was based

1.1 Global Perspective of Cash flow holdings and Performance of Listed Non-Financial Firms

Financing structure is critical to the company's performance. The equity financing ratio and operating performance of non - financial sectors listed companies in China has been found to have a significant positive correlation; no significant linear relationship between the endogenous financing ratio and corporate performance; the debt financing ratio and operating performance is negatively correlated Yan-ru Hui & Liang, (2014). Allen, Chakrabarti and De (2008) assert that while a large number of firms (e.g., in India and Hybrid Sector firms in China) do not use much bank finance, the reason behind their choice is unclear. Is it because these firms are unable to secure bank credit (e.g., credit rationing, low credit quality) even though they prefer bank credit to alternative finance, or does this financing pattern reflect an interior optimal choice rather than a corner solution. Alternative finance may actually be the preferred form of finance over bank finance because the effective (as opposed to nominal) cost of alternative finance (average over a long period of time) may be lower due to some of its special beneficial features, such as renegotiation flexibility and the advantage of an extended network with the providers of capital. Due to long dated economic policies, the cost of capital is much higher than in more developed countries and many firms suffer from credit constraints Terra, (2003). Also, the debt market in Brazil is less mature when contrasted to US or European markets, with less transactions and lower liquidity (Cheng, R, 2002). Because emerging economies tend to have higher interest rates when compared to more developed economies N, & S, (2012), the opportunity cost of holding cash is higher.

1.1.1 Financial Performance of Listed Non-Financial Firms in Kenya

After a long period of virtual stagnation the Kenyan economy went through a strong phase over the period 2003-2007, as the rate of economic growth accelerated up to 7 per cent. During the same period TFP in manufacturing increased by as much as 20% World Bank, (2007). Aggregate capital formation increased up to 19.5 per cent, which is high by Kenyan standards, but of course pales in comparison with those of its Asian competitors. And it is a long way away from the long-term target of investments of 30% of GDP.

Kaumbuthu (2011) determined the relationship between capital structure and return on equity for industrial and allied sectors in the Nairobi Securities Exchange during the period 2004 to 2008 and found a negative relationship between debt equity ratio and ROE. The study focused on only one sector of the companies listed in Nairobi Securities Exchange and paid attention to only one aspect of financing decisions. Maina and Kondongo (2013) investigated the effect of debt-equity ratio performance of firms listed at the Nairobi Securities exchange and found a significant negative relationship between capital structure and all measures of performance. Otieno (2013) explored the financial structure of listed financial firms in Kenya based on a sample of 29 non financial firms listed on the Nairobi Securities Exchange during the period 2004-2012 and revealed that firm specific factors affecting the capital structure of listed firms in Kenya are asset tangibility, firm's profitability, size of the firm, firm's growth opportunities and finally liquidity of a firm's assets while the macroeconomic factors are economic growth and corporate tax rate.

1.2 Statement of the Problem

Business success depends heavily on the ability of financial managers to effectively manage the financial structure components (Filbeck & Krueger, 2005). Studies from developed countries show that non financial firms are experiencing declining performance and data shows that non financial firms have been delisted from the Stock exchange in the last decade Zeitun, Tian, G (2007). Documented evidence available from the World Bank (2014) shows that non financial firms in Kenya are characterized by a decline in financial performance for example, Kenya Airways made a loss of Sh3.4 billion after tax by March 2014, down from Sh7.8 billion it made in 2013 Wahito, (2014). Further statistics from the Capital market Authority reveals that market price of the shares declined in the year 2007 – 2013 CMA, (2013). More evidence available in Kenya for example Furniture firm Hutchings Biemer which was listed on the commercial and services sector, had been suspended for over ten years before being de-listed from the Nairobi Stock Exchange in 2006 Wandera, (2006). Reports from the Republic of Kenya (RoK) reveal that the low financial performance is a major hindrance in the realization of Vision 2030 leading to a lower economic development and loss of jobs in Kenya which is associated with social injustices (RoK, 2014).

Information available from the foregoing background reveals that momentous efforts to revive the ailing and liquidating companies have focused on financial restructuring. However managers and practitioners still lack adequate guidance for attaining optimal financing decisions Kibet, Tenei & Mutwol, (2011) yet many of the problems experienced by the companies put under statutory management were largely attributed

to financing Chebii, Kipchumba & Wasike, (2011). This situation has led to loss of investors' wealth and confidence in the stock market. Studies on the relationship between various financing decisions and financial performance have produced mixed results hence determination of optimal capital structure is a difficult task that go beyond many theories though many researchers agree that the economic and institutional environment in which the firms operate significantly affect the capital structure of a firm Owolabi & Inyang, (2013). Appropriate financing/capital structure should be profitable to the firm to enable it meet its obligations. It is against this background that this study was carried out.

1.3 Research Objectives

The main objective of the study was to establish the effects of Cash holding on the financial performance of listed non-financial firms in Kenya.

1.3.1 Specific Objective

The specific objectives were:

To explore the effects of Cash holdings on financial performance of listed non-financial firms in Kenya.

1.4 Research Hypothesis

The research hypothesis was;

H_0 Cash holding does not affect financial performance of listed non-financial firms in Kenya.

2.0 Theoretical Review

Good theories and models provide causal accounts of the world and allow one to make predictive claims under certain conditions, bring conceptual coherence to a domain of science and simplify our understanding of the world Mouton, (2001).

2.1 The Trade-off Theory

Like debt, cash holding generates costs and benefits; and is very important in financing the growth opportunities of the firm. The principal benefit of holding cash is that it constitutes a safety buffer Levasseur (1979) which allows firms to avoid the costs of raising external funds or liquidating existing assets and which allows firms to finance their growth opportunities. In fact, since companies operate in an imperfect market, they either have difficulty accessing the capital markets or bear a very important external financing cost. Moreover, the principal characteristic of their environment is uncertainty. Thus, insufficient amount of cash forces firms to forgo profitable investment projects or to support abnormally high costs of financing. Two principal costs are associated to cash holdings. These costs depend on whether managers maximize shareholders wealth or not. If managers' decisions are in line with shareholders' interests, the only cost of cash holdings is its lower return relative to other investments of the same risk. If managers don't maximize shareholders' wealth, they increase their cash holdings to increase assets under their control and so to be able to increase their managerial discretion. In this case, the cost of cash holdings will increase and include the agency cost of managerial discretion. Thus, we can apply the idea of trade-off theory to determine the optimal level of cash.

According to Keynes (1936), firms need liquidity to face their current expenses. Thus they have to raise funds in capital markets or liquidate existing assets. However, capital markets are imperfect and there are transaction costs which can be avoided by holding a sufficient cash level. Thus, the firm can avoid the situations where it is forced to forgo its profitable investments, to cut its dividend payments or to liquidate its assets. And this is one of the principal benefits of holding a sufficient cash level. This theory instigated the research hypothesis: H_0 : Cash flow holdings do not affect financial performance of listed non-financial firms in Kenya.

2.3 Conceptual Framework

In a broad sense a conceptual framework can be seen as an attempt to define the nature of research (Gay, 1992). This study seeks to establish the effects of financial structure on financial performance of listed non-financial firms in Kenya. The independent variables in this study are capital adequacy, leverage, cash flow holdings and liquidity with firm size as the moderating variable. This study will therefore establish the impact of the independent variables on the dependent variable which is financial performance of listed non-financial firms.

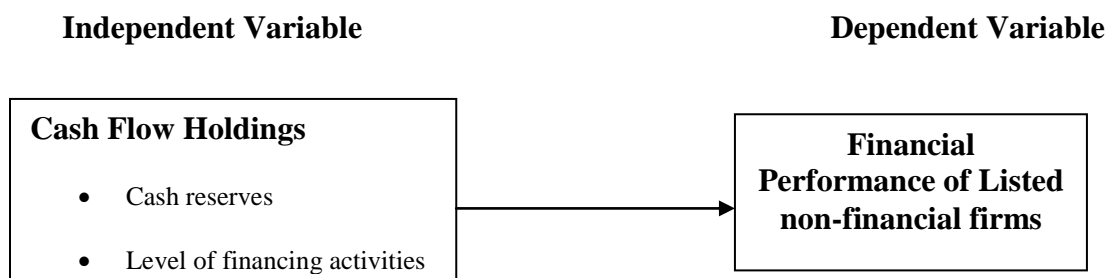


Figure: 2. 1: Conceptual Framework

2.4 Empirical Review

2.4.1 Financial Performance of Listed Non Financial Firms

Financial goals drive higher profits, but non-financial company objectives also aid in improving the company as a whole. The non-financial improvements help round out the company's strengths in areas like customer service, production quality and employee satisfaction. These areas create a stronger company as a whole that is able to perform better in the market, increasing profits. A study by Frost (2010) observed that focusing on employee satisfaction allows firms to create a workforce of engaged, loyal employees. With increased employee morale often comes better attendance and effort. By aiming to improve the workplace for employees, firm management should show employees that the firm cares about more than simply making money. The study also found that the quality of work produced by the firm affects reputation and amount of business you receive. When a firm offers consistently high-quality products or services, the firm gains a positive reputation that potentially leads to more business and repeat customers. Frost (2010) revealed that making customers feel valued encourages them to give your company additional business in the future. Improved customer service is possible through employee training and high expectations. The study concluded that improving the way the general public views the company can mean increased business and stronger relationships with the community (Frost, 2010).

2.4.1 Cash Flow Holdings

A study by Benoit (2004) observed that although rapid developments have considerably enriched our understanding of the factors driving firms' cash holdings,

the literature has paid little attention to whether cash policy has a real effect on firms' day-to-day operations. A cash-rich firm can use its war chest to finance competitive strategies. The study also found that a firm can rely on a strong balance sheet to hurt rivals' bottom lines and prospects through aggressive pricing. More generally, a firm may use its cash reserves to fund a number of alternative competitive policies such as the location of stores or plants, the construction of efficient distribution networks, advertising targeted against rivals, or even the employment of more productive workers. From a different perspective, the study concluded that a firm's stock of cash can signal the possibility of aggressive behavior, thereby distorting competitors' actions in the product market. Accordingly, one can view cash holdings as a preemptive device that may affect, for instance, rivals' entry or capacity expansion decisions (Benoit, 2004).

Ferreira and Vilela (2004) investigated the determinants of corporate cash holdings using an empirical investigation from a sample of publicly traded firms from 1987 to 2000 in EMU countries which included Germany, France, Netherlands, Italy, Spain, Finland, Belgium, Austria, Ireland, Luxemburg, Greece and Portugal. The results suggested that cash holdings are positively affected by the investment opportunity set and cash flows and negatively affected by asset's liquidity, leverage and size. Bank debt and cash holdings are negatively related, which supports that a close relationship with banks allows the firm to hold less cash for precautionary reasons. Firms in countries with superior investor protection and concentrated ownership hold less cash, supporting the role of managerial discretion agency costs in explaining cash levels.

Capital markets development has a negative impact on cash levels, contrary to the agency view Ferreira & Vilela, (2004).

Table 2.1 Summary of findings Related to the Determinants of Corporate Cash Holdings

Author(s)	Findings Related to the Determinants of Corporate Cash Holdings	Country(ies)
Ferreira and Vilela (2004)	Found that cash holdings are positively affected by the cash flows and negatively affected by asset's liquidity, leverage and firm size.	EMU
Nguyen (2005)	Found that cash holdings decrease with the firm size and debt ratio, and increase with its dividend payout ratio.	Japan
Saddour (2006)	Found that cash levels negatively affected by high leverage, firm size, level of liquid assets.	France
Afza and Adnan (2007)	Found negative relationships between i) market-to-book ratio, net working capital, leverage, dividends, and cash holdings, and ii) positive relationships between i) firm size, cash flow, and cash holdings	Pakistan
Drobetz and Grüninger (2007)	Found a negative relationship between firm size and corporate cash holdings. □ Found positive relationships between dividend payments, operating cash flows, and cash holdings. □ Found a positive relationship between i) CEO duality and corporate cash holdings, and ii) a non-significant relationship between board size and corporate cash holdings.	Switzerland
Hardin III <i>et al.</i> (2009)	Found negative relationships between funds from operations, leverage, and cash holdings.	USA
Meggison and Wei (2010)	Found negative relationships between debt, net working capital, and cash holdings.	China
Kim <i>et al.</i> (2011)	Found positive relationships between firm size, dividend payments, and cash holdings.	USA
Alam <i>et al.</i> (2011)	Found positive relationships between cash flow, market-to-book ratio, and cash holdings. □ Found negative relationships between net working capital, leverage, and corporate cash holdings.	Pakistan

2.5 Critique of the existing literature

Benoit's (2004) study which observed that although rapid developments have considerably enriched our understanding of the factors driving firms' cash holdings,

the literature has paid little attention to whether cash policy has a real effect on firms' day-to-day operations, has also aided the current study in guiding the researcher in what to expect. However, the study was conducted a decade ago and a more recent study is of paramount importance so as to reflect the current perspective of the prevailing phenomenon in a developing country like Kenya.

Table: 3. 1 Operationalisation and Measurement of Study Variables

Variable	Name of Variable	Operationalisation	Measurement	Hypothesis Testing
Independent	Cash	Cash reserves	Operating cash flow divided by the sum of capital expenditure and cash dividends	Student t-test and 2-tail test
	Flow	Level of financing activities		
	Holdings	Level of Investing activities		

4.0 RESULTS AND DISCUSSION

4.1 Descriptive Statistics

Secondary data collection method was used for the study. Data collected were used to calculate the variables used in the analysis. Table 4.1 gives the summary descriptive statistics of the dependent and independent variables of the sample.

From the findings as indicated in table 4.1, The ratio of Operating cash flow and sum of capital expenditure and cash dividends (Cash flow holdings) for 42 observation

showed a mean of 37.6382, a standard deviation of 143.67090 and a maximum and minimum of 880.17 and .79 respectively.

Table 4. 1: Descriptive Statistics 2009-2013

	N	Minimum	Maximum	Mean	Std. Deviation
Cash holdings	42	.79	880.17	37.6382	143.67090

4.2 Regression Results

$$Y = c + \beta_3 \text{CFH} + \varepsilon$$

Where: c is the constant,

β_3 shows the change in the dependent variable for a unit change in cash flow holdings (CFH) and,

ε is the error term.

4.2.1 Cash flow Holdings

According to Jensen (1986), managers are restrained when external financiers withhold cash for new investment. On the other hand, managers become free to make new investment when there is increased cash flow. Ozkan and Ozkan (2004) provide evidence that cash flow and growth opportunities have a positive impact on the level of cash holdings in their UK sample. They also find that ownership structure plays an important role. Guney, Ozkan and Ozkan (2007) provide empirical evidence that there exists a non-linear relationship between cash holdings and leverage, more specifically; cash is negatively related to leverage for firms with low leverage and positively related in the more levered firms.

4.2.2 Model Summary

From the findings Cash-flow variable explain a significant proportion of the performance as represented by the R^2 value of 56.8%. This therefore means that there are other factors not studied in this research that majorly contributes to the firms' performance.

The value of the Durbin-Watson statistic ranges from 0 to 4. As a general rule of thumb, the two variables are uncorrelated since the Durbin-Watson statistic is approximately 2. A value close to 0 indicates strong positive correlation, while a value of 4 indicates strong negative correlation.

The value of Durbin-Watson is 1.974, approximately equal to 2, indicating no serial correlation.

Table: 4. 2 Model Summary

Model	R	R Square	Adjusted Square	R	Std. Error of the Estimate	Durbin-Watson
1	.754 ^a	.568	.557		1.16595	1.974

a. Predictors: (Constant), Cash holdings

b. Dependent Variable: Performance ROA

4.3 Anova

The F critical at 5% level of significance was 4.0847. Since F calculated is greater than the F critical (value =52.616), this shows that the model was significant as shown by significance level of 0.000.

Table: 4. 4 ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	71.528	1	71.528	52.616	.000 ^b
1	Residual	54.377	40	1.359		
	Total	125.905	41			

a. Dependent Variable: Performance ROA

b. Predictors: (Constant), Cash holdings

From the hypothesis:

H₀: Cash flow holdings do not affect the Performance of listed non-financial firms in Kenya.

Since F calculated is greater than the F critical (value =52.616), we reject the null hypothesis and conclude that Cash flow holdings affects the Performance of listed non-financial firms in Kenya.

4.4 Simple Regression Model

From the findings the result indicated a significant positive association between cash flow holdings and ROA shown by the Unstandardized Coefficients.

4.5 Simple Regression model 2013-2009

From the findings in the data year 2013-2009 the relationship between cash holdings and performance is found to be positive. A unit increase in cash flow leads to a 0.162 increase in the performance of a firm. The relationship is significantly positive since p-value = 0.000 is less than the 5% level of significance used.

The tolerance value (VIF) is 1 and since the closer to 1 is a variable, the stronger the relationship between the variable and the other predictor variables therefore cash flow has a strong relationship with performance.

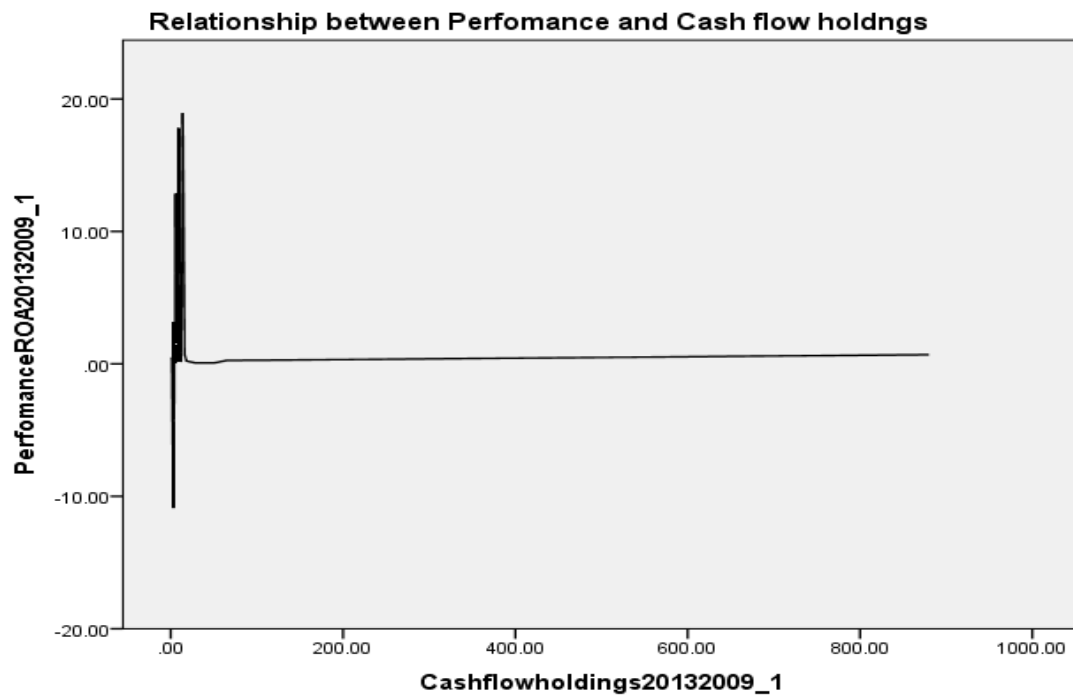
The study findings conquer with those of Myers and Majluf (1984) who discuss how cash and deposits provide firms with financial slack, which allows them to manage operations without costly external funding. If there is a large asymmetry of information between borrowers and lenders, firms with large agency costs from the asymmetry of information tend to reserve more liquid assets instead of using external funding.

Table 4.5: Cash Holdings Simple Regression model 2009 - 2013**Coefficients^a**

Model	Unstandardized		Standardized	t	Sig.
	Coefficients				
	B	Std. Error	Beta		
1					
	(Constant)	3.203	.312		10.280.000
	Cash holdings	.162	.022	.754	7.254 .000

a. Dependent Variable: Performance ROA

The graph below further shows the relationship between Performance and cashflow.

**4.6 Hypothesis Testing**

From the hypothesis:

H₀: Cash flow holdings do not affect the Performance of listed non-financial firms in Kenya. Since F calculated is greater than the F critical (value =188.787), we reject the null hypothesis and conclude that Cash flow holdings, does affects the Performance of listed non-financial firms in Kenya.

Table 4.6: ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	121.279	5	24.256	188.787	.000 ^b
	Residual	4.625	36	.128		
	Total	125.905	41			

a unit increase in Cash flow holdings will lead to a 0.052 increase in Firms' performance. The VIF is greater than one showing a strong relationship of the independent variable and depended variable.

Table 4.7: Multiple regressions

Model	Unstandardized Coefficients		Standardized Coefficients Beta	t	Sig.
	B	Std. Error			
(Constant)	.800	.420		1.904	.065
¹ Cash holdings	.052	.011	.243	4.728	.000

4.7 Correlation Analysis

Table below shows the correlation among the 2 variables that were studied. Coefficient correlation lies between -1 and +1. The more positive the coefficient is the more the variables are positively correlated. The more negative the coefficient is the more negative the variables are negatively correlated to each other. Pearson correlation (2-tail) was used to draw the correlation matrix. The study reveals that the variables were significantly (0.000) Cash holdings variable showed negative correlation as shown below.

Table 4.8: Correlations between independent and explanatory variable (N=42)

Correlations						Cash holdin gs
Cash holdings	Pearson	-.051	-.031	-.175	-.074	1
	Correlation					
	Sig. (2-tailed)	0.000	0.000	0.000	0.000	
	N	42	42	42	42	42

5.0 SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary of findings

From the findings as indicated in table 4.1: Descriptive Statistics 2009-2013; Combined. The ratios of Operating cash flow and sum of capital expenditure and cash dividends (Cash holdings) for 37 observations showed a mean of 7.5276, a standard deviation of 28.73417 and a maximum and minimum of 176.03 and 16 respectively.

Cash flow/Net investment had a mean value 0.0527 and standard deviation of 0.1207 and a minimum and maximum value of .20 and 8.00.

5.2 Conclusion

5.2.1 Multiple regression results

Cash holdings have a positive and significant relationship with performance of ROA. A unit increase in cash flow leads to a 0.162 increase in the performance of a firm. The relationship is significantly positive since p-value = 0.000 is less than the 5% level of significance used.

The tolerance value (VIF) is 1 and since the closer to 1 is a variable, the stronger the relationship between the variable and the other predictor variables therefore cash flow has a strong relationship with performance.

5.3 Recommendations

Based on study findings on the variable firm size; it was established that there was positive relationship between the size of the firm and its performance hence it is highly recommended for firms to have optimum cash holding reserves. There for efforts to be made by management to increase the value of the company through the funding policy,

the provision of incentives to managers in the form of bonus shares, and improve company performance.

5.4 Areas for further Research

The study findings show that the R^2 was only 0.568. This means the variables explained 57% of factors influencing the financial performance of the firm, therefore there are other factors that should be research on to establish the causes of financial performance in non financial firms in Kenya.

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