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Effect Of Liquidity On Financial Performance Of Firms Listed In Nairobi Securities Exchange

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Abstract
The performance of listed firms has been steadily declining over the past 10 years according to the NSE reports and these has prompted worry in the industry as to the cause. The signaling of dividends has been touted to be sending wrong signals which scare away investors. Dividend pay-out policy for various firms differs as each company decides on what, how and when to pay dividend to its shareholders. Some firms pay higher dividends and others pay less dividends despite the fact that they operate under same business environment. There is no unified picture regarding dividend pay-out policy and therefore remains one of the most contested disputes within the field of corporate finance. The study sought to investigate the effect of liquidity on financial performance firms listed in Nairobi Security Exchange that covered duration of 10 years effective from 2012 to 2022. Secondary data, which will comprised of audited financial statements, were obtained from the website of the Capital Market Authority. Correlational research design was used to determine the interrelationship among the independent and dependent variables. The population of this study comprised of all firms that are listed in the Nairobi Security Exchange NSE. Purposive sampling technique was applied. Descriptive Statistical methods of mean, percentages and standard deviation were applied in analysis of data. Multiple regression model was applied in analysis to determine the effect of the liquidity on financial performance of listed firms. The results confirm that there was a positive correlation between liquidity and financial performance of these firms and that liquidity had a statistically significant effect on financial performance of firms

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I. Introduction

According to the Nairobi Securities Exchange's end-of-year reports, listed companies' performance has been steadily falling recently (NSE 2017-2018 Investors Handbook). The industry was in a panic due to this tendency, which prompted both industry and academic research. In 2013–2014, the manufacturing sector contributed 12% of the GDP (GOK, 2015). With growth rates of 3.5% in 2015 and 3.2% in 2014, the manufacturing sector which contributed 10.3% of GDP (KNBS, 2016). Yet, manufacturing has often been developing more slowly than the GDP, which grew by 5.6% in 2016. Additionally, growth slowed by 4.7% in 2017 and by a modest 4.2% in 2018. This suggests that, relative to the total economy, manufacturing's GDP share has been declining over time (Too & Simiyu, 2019). Other businesses, like agriculture, telecommunication, forestry and fishing, transportation, and construction, do not operate in this manner. When compared to regional and worldwide productivity levels, Kenya's manufacturing industry does very poorly financially. Due to subpar performance, several industrial companies have had to close since 2015, while others have been compelled to move their facilities abroad. Additionally, several businesses have reduced their production capacity.

In advanced economies a decision is made whether to pay profits or keep the income in the care of both investors and managers (Laurence & Jun, 2015). Many studies such as Gizelle, Marcus, Allen and Shelton (2013) on the dividend distribution policy have provided experimental evidence with regard to dividends. However, there is no interpretation that cannot affect the profit policy. Why companies pay dividends from their income, still remain unclear. It is known as the payout tube of financial literature as per Hussein, Shamsabad and Richard, 2016. Many hypotheses were ready to shade light on this puzzle, but the problem still exists

Since it goes back to almost 4 centuries, there is no doubt that the distribution of dividend of the company is not new. Dividends, which are distributed in the form of reward for investment are subjects to this discussion according to Pandey 2004. In the field of finance and business, many scientists have put forth all efforts to find financing decision-making alternatives that are directed by dividend guidelines in the last 50 years. Lintner in

1956, Modigliani and Miller's article of 1961 and, Musiko et al., 2013 are some of the studies that have emphasized financing decisions.

Nissim and ZIV (2001) recognized that the administration of any company is bestowed with an important task to design the right dividend policy, a tool instrumental in shedding light and directing a firm as to how it will share dividends in the current as well as in future years. However, managers must exercise great care and caution when making sublime decisions about whether or not a company should pay dividends. In 1983 Alli et al. noted that a company should ensure that it has sufficient funds to facilitate the payment of dividends. This argument explains why most companies should pay dividends and distribute surpluses to investors after making large profits to handle their internal day-to-day operations. Ultimately, however, any reasonable investor expects a company to issue dividends after a successful final year, as evidenced by empirical studies that indicate that there is a strong and positive relationship between profitability and a company's behavior when it comes to paying dividends.

Available literature points out that factors such as profit, profitability, liquidity, property, scalability, and business risk are demonstrated empirically, to be the common independent variables concerning dividend pay-out (al-Kuwari, 2009, ESA. et al. , 2012, Kartal, 2015, Nishijima, 2015). Nyamosi, 2016, Ikunda et al. ,2016). Khan and Ahmad (2017) while investigating pharmaceutical companies in Pakistan affirmed that dividend pay-out was significantly influenced by profitability, liquidity ,growth opportunities and audit type. However, for the analysis of banking sector of Lebanon, profitability was the least significant consideration in dividend pay-out (Anupam, 2012, Maladjian, and Khoury, 2014). Baker and Gandhi 2007 show that different companies have different budget plans for how they spend their revenues in terms of profitability. Therefore, in this context, it is not important to generalize that increasing profitability translates directly into dividends.

Thus, it is prudent for management to evaluate its ability to access quick financing as it weighs out on options to pay shareholders dividend. Previous studies have pointed out that large firms have easy access to credit facilities due to the fact that they have collateral besides minimal risk levels to default, which positively contributes to their consistency in dividend pay-out (Mehta (2012). In year 2000 Maina points out that external finance is expensive due to interest charges and risks of ultimate loss in the event of default in servicing the mortgage. In this context he advocates that firms ought to utilize internal sources of funding which are cheaper besides cautioning the firm from high leverage that can result into liquidation. This concept forms the basis of transactional cost theory, thus entities that rely heavily on external funding are constrained financially as a result of costs linked to loans. This explains why most of them do have inadequate funds to pay dividends as empirically shown that firms that are tied up on loans do have an inverse relationship towards dividend pay-out.

One of the authors of the Dividend Irrelevancy theory, which was first proposed in a 1961 paper by Modigliani and Miller, contends that in a perfect market with free information flow between participants and no transaction costs or taxes, dividend payments are pointless and do not add value to the company. The theory concludes that shareholders have the power to control dividends and can buy or sell their shares whenever they choose. It also suggests that when a company pays out dividends, the value of the company decreases proportionately, which can be reversed by issuing new shares of a similar quantity (Brigham and Houston, 2011).

According to signaling theory, Lintner in 1956, asserted that a company's dividend payments are an indication of its financial stability, growth, and improved performance. This attracts more investments into the company, increasing its capital and share price. Asquith and Mullins in 1983 and Bhattacharya ,1979 both supported and empirically supported these findings. Although the market environment is primarily full of unpredictable, volatile events that are bound to occur, Gordon and Walter's 1963 Bird in Hand Theory asserts that investors prefer dividends today rather than in the future because they are assured of what they can possess rather than putting money back in the hopes of better future rewards. This depreciates the dividend per share value.

On the basis of the Tax Priority Principle, which was espoused in Brawan 1970, some investors may, nevertheless, prefer their dividends because of the taxing effect of applying cash dividends in opposition to capital benefits.

Asness and Arnett in 2003 noted that managers are hesitant to reduce dividends because there is a strong correlation between dividend payout and future earnings growth. Businesses with a high dividend payout ratio show that management is confident in the stability and growth of future earnings, while those with a low ratio show that management is not so sure about the sustainability of earnings growth or stability.

Anijesushola and Jimoh article in 2012 looked into the relationship between listed companies' dividend payments and financial performance in Nigeria. The factors that were used were dividend payments, ownership structure, and firm size. For the fifty chosen companies, the primary sources of data were the years 2004–2009. According to the study, the dividend distribution and the performance of the sampled Nigerian enterprises are significantly positively correlated. The analysis showed that a company's size and ownership structure had a big influence on how much it pays out in dividends. Compared to the mature capital markets, the dividends in Poland serve as a less significant signal.

Nairobi Securities Exchange

Stock trading in Kenya began informally during British colonial rule in the 1920s, mostly involving British settlers and a few Asian merchants. No formal market or rules governed the transactions. In 1954 The Nairobi Stock Exchange was formally constituted as a voluntary association of stockbrokers and it was registered under the Societies Act. Operations started under the regulation of the London Stock Exchange, as Kenya had no capital markets authority at the time. In 1963 the government began to Africanize the economy, encouraging local ownership of businesses. Later in 1988 the first privatization via the NSE took place with the sale of 20% of Kenya Commercial Bank (KCB) shares to the public through the exchange. Regulatory and Institutional Reforms started in 1990 with establishment of the Capital Markets Authority (CMA) to regulate and develop capital markets in Kenya.

This market moved to electronic trading through the Automated Trading System (ATS) in 1994 and in 2001 the exchange became a company limited by guarantee. In 2011 the Nairobi Stock Exchange changed its name to the Nairobi Securities Exchange (NSE) to reflect its broader role in the capital markets, including equity, debt, derivatives, and other instruments. This market has seen developments over time culminating to the launch of the Derivatives Market (NEXT) which enabled trading of equity index and single-stock futures. Between 2020-2024 there were digital transformations and mobile platforms that expanded retail investor access. This was through introduction of Real Estate Investment Trusts (REITs) and Green Bonds to diversify investment options. Ongoing efforts to attract cross-border listings and integrate regional markets under the East African Capital Markets Infrastructure (EACMI).

The NSE is a member of the African Securities Exchanges Association (ASEA) and is classified as a Frontier Market by MSCI. As of 2024, the NSE listed over 60 companies and had multiple trading segments: Main Investment Market Segment (MIMS), Alternative Investment Market Segment (AIMS), Growth Enterprise Market Segment (GEMS), and Fixed Income Securities Market Segment (FISMS).

II. Literature Review

Bird in Hand Theory

Gordon in 1959 introduced bird in hands, based on an argument on the inability to predict market because of volatility. The theory portents that current dividends are preferred to long term capital gains in terms of increase in share prices. Therefore, on the basis of this subject, obtaining cash profits to investors and re-investment in fixed assets such as land is able to appreciate the time to replace any decrease responsible for inflation. If the principle agrees to its predecessors, in addition to most companies, managers are overrated in their financing policies, so profits will be determined based on the payment report on future profits.

Contributors like to maintain actions that generate gains or waive these risks exceeding the agency's control, so the best options will be paid today. There is no doubt in the wide capital required by manufacturing companies that have to face payment barriers from profits and managers to create the opportunity costs. Essentially, stakeholders should have a final decision on how to distribute profits. Apparently, all the powers are vested in the agency that writes the dividend policy. However, on the other hand, investors have used traditional means such as selling holdings to force the agency to give up their claims, which has allowed management to understand what type of investors they have and consider their preferences over dividends.

This study will leverage on the fact that firms in the manufacturing sector may be willing to pay dividends later than today. It will be of interest to see how these firms pay their dividends; if they pay in shares repurchases or even give cash dividends. This theory also may highlight that investors value the time of value crux that money today is better even it means more tomorrow.

Agency Theory

Jensen and Meckling 1976 study described agency theory as a cost that arises between the principals (Shareholders) and agents (managers) in a process whereby Shareholders delegate the obligations of managing business affairs to managers referred to as the agent and grants them powers to enforce rules and regulations geared towards achieving the goals and mission of the entity. Several cases have been documented subject to vice of misappropriation of funds by agency in form of exorbitant perks, high remuneration beyond financial capacity of the firm not forgetting negative net present value projects that do not benefit the company in the long run.

Majority of investors are unprofessional and a few who might have the relevant knowledge lack time to commit in daily transactions of the business. This grants the agency a blanket cheque to diligently plan and execute their fraud. The only weapon at shareholders disposal is to ensure that part of them are positively involved in policy making to put stringent internal and external controls that could include external auditors who are independent and report to the board directly. It's only through such controls that mischief can be unravelled, and necessary remedies applied rather than reacting to aftermath losses .Raheja study in 2005 shades light on the two main ways in which dividend payment can be applied to mitigate agency costs; First, it is critical to distinguish between ownership of an entity and control or management, according to him if the two are tide-up then there is

a likelihood of managers to take advantage and invest in negative NPV which could be at their own benefit. Secondly, dividend pay-out is a signal that a firm is performing better hence chances of issuing new securities in the near future are high, as a result it is subject to scrutiny by the capital market authorities thus enhancing accountability and transparency in operations besides reducing cash exposure to misappropriation.

Empirical Literature Review

Liquidity and Financial Performance

The effect of liquidity management on commercial banks' performance was ascertained by Majakusi (2012). The study used a descriptive research design and ran from 2010 to 2014. CBK reports provided the data. The impact of the factors was measured using regression analysis. The analysis found that although capital adequacy and liquidity management showed consistent increase, financial performance fluctuated. According to the study, there is a positive correlation between ROA and liquidity management. According to the study, 34% of the variations in financial performance can be explained by liquidity management. The results are consistent with previous empirical research (Olongo, 2013; Wanjohi, 2013; Kavale, 2016). Nevertheless, the results run counter to those of Vintila and Nenu (2015), Molefe and Muzindutsi (2016), and Bassey (2015).

Chembe and Xi (2016) conducted an explanatory research of the banking industry from 2008 to 2017 on the effect of liquidity on profitability. The goal of the study was to define how liquidity affected profitability in the normal course of business, in a multi-geographical context, and over a mid- to long-term time horizon. A quantitative analysis of a research sample consisting of 50 banks that are located in three geographical regions—Asia, Europe, and North America—and that rank among the top 100 banks globally in terms of asset size was carried out. Ten years, or from 2008 to 2017, were taken into consideration. In order to measure the variables, the quantitative data for these banks was compiled. The liquidity proxies were the loan to deposit ratio (LDR), deposit to asset ratio (DAR), and cash and cash equivalents to deposit ratio (CDR), while the profitability proxies were return on equity (ROE) and return on assets (ROA). These five factors led to the development of six hypotheses, which were then applied to ascertain how liquidity affected profitability. According to the study's findings, only DAR has a meaningful impact on profitability as measured by ROE; the other hypotheses were all found to be inconsequential. Because banks had a large amount of liquid assets in the post-crisis period, DAR was not shown to have a substantial impact on ROA. ROE was not observed to be significantly impacted by either LDR or CDR. ROA as a result of high lending rates, large liquid asset holdings, and high interest payed on deposits. As a result, it was determined that, in general, liquidity had little bearing on banking industry profitability.

Vaita (2017) aimed to investigate how liquidity affected Kenyan tier one listed commercial banks' financial performance. The research design used was descriptive. The survey included a sample of 31 respondents selected from 6 banks. The Central Bank of Kenya, the Kenya National Bureau of Statistics, the regulator, and the websites of each individual bank were the sources of the secondary data. The data was analyzed using descriptive and inferential statistics. According to the study's findings, the liquidity coverage ratio significantly increased ROA while having no discernible impact on ROE. A higher liquidity coverage ratio results in a higher ROA and a lower ROE.It was concluded that in order to achieve the intended financial performance while keeping the minimum necessary liquidity ratio, commercial banks must operate appropriately.

Kaodui Lil et al. (2020) used panel evidence from non-financial companies listed on the Ghana Stock Exchange to examine the relationship between liquidity and firms' financial performance. The purpose of this study was to determine the relationship between Ghanaian quoted non-financial establishments' viability and liquidity. The study used panel data derived from 15 entities' published annual reports covering the years 2008–2017. Initial tests were conducted for causality, heteroscedasticity, serial correlation, unit root, cross-sectional dependency, and co-integration. The results demonstrated that there is no cross-sectional dependence and that the input variables are co-integrated, stationary, and free of serial correlation and heteroscedasticity.

Estimates from the random effects generalized least squares (GLS) regression revealed that, when represented by the cash flow ratio, liquidity had a negligible positive impact on ROE but a large negative impact on the firm's ROE. Lastly, a test based on causalities revealed that no additional causal affiliation was found among the other variables, except for the current ratio and ROE, which are bordered by bidirectional liaison.

Madegwa, Ndung'u, and Nyamira (2024) aimed to ascertain the connection between Kenyan listed commercial banks' financial performance and liquidity. Explanatory research methodology was used in the study. 11 Kenyan listed commercial banks were the focus of the five-year study, which ran from 2019 to 2023. All eleven of Kenya's listed commercial banks were surveyed for the study. The necessary secondary data was extracted and compiled by the researcher using a data collection sheet. Both descriptive and inferential statistics were employed in the investigation. The results showed a statistically significant negative relationship between Kenyan listed commercial banks' financial performance and liquidity. The liquidity ratio and the financial performance of Kenya's listed commercial banks are statistically significantly correlated. The cautious approach to preserving liquid assets may result in poorer short-term profitability for banks with greater liquidity ratios.

The impact of liquidity on the financial performance of real estate and property firms listed on the Indonesia Stock Exchange was examined by Hendrilensio Sanga et al. in 2023. Techniques: The relationship between the liquidity and financial performance of real estate and property companies was measured using a quantitative approach with a descriptive and causal design. Using a census that included all businesses in this industry, secondary data was gathered from the 2023 annual financial statements of companies listed on the IDX. While the Quick Ratio had no influence on ROA, the Current Ratio significantly reduced ROA. In contrast, the F-Statistic value demonstrated that financial performance was unaffected by liquidity. The investigation came to the conclusion that optimizing sufficient liquidity is necessary without compromising the possibility of profitable investment.

Kim, Thi Hang Nga, and Nguyen (2024) calculated the effect of liquidity on the profitability of companies listed on the Ho Chi Minh City Stock Exchange (HSX) in Vietnam. Six determinants influencing the firms' performance from 2012 to 2021 were found using a quantitative research method (the feasible generalized least squares method, or FGLS): COVID-19, the liquidity ratio, company age, firm size, tangible assets, and gross domestic product growth. The detrimental and substantial impact of liquidity on businesses' performance during the pandemic has been particularly underlined in this research. As a result, the study's conclusions show that manufacturing companies with strong liquidity during COVID-19 miss out on revenue growth since their working capital funds aren't available to support operations according to the theory of trade-offs. Additionally, high liquidity raises the opportunity cost for the business, which lowers profitability.

In summary both arguments raised both pro and against liquidity are fundamental above all they have been supported by empirical evidence which cannot be ignored.

Research Gap

Majakusi (2012) studied the effect of liquidity management on performance of commercial banks and used a descriptive research design. The current study adopted correlational research design. Vaita (2017) study on effect of liquidity on financial performance of tier one listed banks in Kenya. The scholar adopted descriptive research design, used a sample size of 31 respondents from the respective banks and measured performance using ROE and ROA. The current study will adopt correlational research design, secondary data from firms listed in NSE for the period of 10 years 2012-2022 and financial performance was measured by use of Return on Assets (ROA).

Moses, Tobias and Margaret (2018) adopted a census approach for the 135 deposit taking Saccos in their study of effect of liquidity on financial performance of deposit taking Saccos in Kenya. The current study will employ stratified and random sampling techniques.

III. Research Methodology

Research Design

Maxwell (2013) define a research design to be strategy that leads to gathering and analysis of data and maps away in which research is carried out. This study used correlational research design to determine the nature and strength of the relationship between the independent variable and dependent variable according to Sekaran and Bougie, 2011. According to Creswell 2005 correlational research design can be effectively used to predict the outcome for a cause effect relationship.

Study Area

The study will be carried out. Nairobi Securities Exchange is located in the capital city of Kenya. This area was appropriate in measuring the variables adopted in this research as it provides sufficient and more relevant information for analysis. NSE is an exchange that deals with capital and money markets for both primary and secondary players in the Kenyan economy.

Target Population

According to Kothari 2003, target population constitutes the total number of subjects which could be people, things or environment of interest to the researcher. The population of this study comprised of 62 firms that are listed in the Nairobi Security Exchange NSE as at December 2024. However, specifically the research focused on firms that had consistently traded for the period 2015-2024 and having data on the variables of the study. These firms totalled to 62 obtained across all sectors of the economy which are classified it 13 sectors at the NSE/

Sampling and Sample Size
Sample Size

A sample is a smaller group that has the characteristics of the larger group that is the target population. It therefore represents the behavioral patterns of the population. Yamane (1967) formula was applied to determine the sample size in this study

$S = N/1-N(e)^2$

Where S is sample size, N is target population; e-margin of error

Therefore the sample for the target population of 62 was 53 firms listed in the NSE

Sampling Design

Purposeful sampling was used in the case of sections where the firm is only one. Random sampling was applied in all other sectors where firms were more than 3.

Data Collection

Document analysis schedule was used collect data for the period of 2012-2022. The range in period mitigated prejudice that may be caused by economic unpredictability such as inflation and political volatility, whose footprints can result into brief reactionary changes in the results in a situation where period of study is 1 to 2 years. In this study, only controlled annual financial statement accepted by the capital market, and whose correctness is above the bar stipulated by (Steppingstones, 2004; Kothari, 2005) were used.

Instrumentation

The Document analysis schedule was designed according to the indicators of the variables of the study in order to pick the requisite information. The expert opinion of the University supervisors verified the accuracy of the constructs adopted in the study.

Data Collection Procedures

The researcher will be given an introduction letter from Kisii University which will be used to apply for the NACOSTI permit that will allow the researcher to collect data. The study will use secondary data which will be obtained from financial statements of listed manufacturing companies.

Data Analysis and Presentation

The data analysis is the process in which the researcher undertakes to derive interpretation and inferences on the findings as per Bogdan and Taylor, 1975. Data will be analysed using descriptive statistical methods of minimum, maximum, mean, standard deviation and percentages. Inferential statistical methods of correlation and regression analysis will also be adopted to draw inferences on the findings. Panel multiple regression analysis shall be the preferred regression technique for adoption

The Regression will adapt the following model: $Y_{it} = \beta_0 + \beta_1 x_{1it} + \beta_2 x_{2it} + \beta_3 x_{3it} + \beta_4 x_{4it+}\acute{\varepsilon}$

Where from,

Y_{it} is Performance of Manufacturing Firms

X_1 – liquidity; X_2 – leverage; X_3-Firm Size

$\beta 0$, β_1, β_2 and β_3, are the y intercept and coefficients of independent variables

At 95% confidence level, The F-Test will be used to determine the significance of the variables while the coefficient of determinants R^2 will be used to determine how much variation in Y is explained by X.

Testing of Regression Assumptions

Test for Normality

Normality of the data will be tested using Kolmogorov Smirnov-Shapiro Wilk test. If the p values obtained for every variable will be higher than .05 significance then the data will be considered normally distributed and if less than .05 then data will not be considered normally distributed.

Test for Multicollinearity

According to Grewal, Cote and Baumgartner 2004 multicollinearity will occur in a situation where at least two predictors which are independent variables are two correlated to provide redundant information about the response. Tolerance values and variance inflation factors will be used to determine existence of multicollinearity. If VIF will be greater than 10 and tore lance levels less than .01 then multicollinearity is said to exist.

Test for Heteroscedasticity

Heteroscedasticity means that the variance of errors will not be the same across all levels of the independent variable. The study will adopt the use of p-p plot of the standardized predicted value.

Ethical considerations

The researchers will seek for an introduction letter before starting research from post graduate office at Kisii University. This will be used to apply for a research permit from the national science and technology and innovation (NACOSTI). The information obtained in the study will be strictly for the purpose of the study. All ideas of various scholar shall be appropriately referenced both in text and in the reference list.

IV. Results

Response Rate

Out of the 53 firms sampled data was obtained from 42 firms which had complete information for the period of study. This represented 79.25% of the targeted response from the firms. According to Babbie 2010 a response rate of 50% is considered adequate, 60% is good, and 70% or more is very good. This implies that the response of 79.25% is considered to be very good hence low sampling bias. On the other hand, Dillman, Smyth, & Christian in 2014 emphasized the importance of survey design in increasing response rates. They argued that with personalized and well-structured surveys, response rates of 50–60% can be reasonably achieved. This study also supports the response rate in this study.

Descriptive Statistics

Liquidity

Descriptive statistical methods of minimum, maximum, mean and standard deviations were used to characterize the study variables. Liquidity which was measured by using current assets, current liabilities and liquidity ratio revealed the results in table 4.1

Table 4.1 Liquidity

	N	Minimum	Maximum	Mean	Std. Deviation
CA	420	6917	1718000000	96426389.30	239352745.043
CL	420	7951	1468376068	64108790.83	167026772.470
Liquidity	420	.60	2.77	1.7367	.50833
Valid N (listwise)	420				

Source: Field Data 2025

The descriptive statistics in Table 4.1 provide an overview of the financial position of the firms in terms of current assets, current liabilities, and liquidity. The average current assets stand at approximately KES 96.4 million, with a wide dispersion (SD = KES 239.4 million) and a range stretching from KES 6,917 to KES 1.72 billion, suggesting significant disparities in firm size. Current liabilities show a similar pattern, averaging KES 64.1 million with a standard deviation of KES 167 million, ranging from KES 7,951 to KES 1.47 billion. The liquidity ratio, calculated as the ratio of current assets to current liabilities, averages 1.74, indicating that most firms can meet their short-term obligations. However, the range from 0.60 to 2.77 reflects variability in liquidity positions, with some firms potentially at risk of liquidity shortfalls, while others maintain strong financial cushions.

Financial Performance

To determine the trend of financial performance the researcher established the minimum, maximum, mean and standard deviation. Financial performance was measured using net profit after tax, total assets and return on assets. The results are as indicated in table 4.5

Table 4.5 Financial Performance

	N	Minimum	Maximum	Mean	Std. Deviation
NPAT	420	-3680373889	175147355	-3885739.45	180603659.94
Total Assets	420	4605566	46091409	589421.28	50861512.44
ROA)	420	-.78	15.81	8.1066	2.85924
Valid N (listwise)	420				

Source: Field Data 2025

The descriptive statistics show substantial variability in the financial performance and size of the firms analyzed. The average net profit after tax (NPAT) is negative at KES. –3.89 million, suggesting that a majority of firms in the sample are incurring losses. This is supported by the extremely large standard deviation, reflecting wide performance gaps across firms. Total assets range from KES. 4.6 million to KES. 46.1 million, with a high standard deviation, indicating a diverse firm size distribution. The average return on assets (ROA) is 8.1%, which shows that firms are generally able to generate modest returns from their asset bases. However, the spread of ROA values, including some negatives, implies mixed financial efficiency across the sample.

Diagnostic Tests

Test for Normality Normality was tested using a visual histogram of standardized residuals for financial performance. The results are as indicated in figure 2.

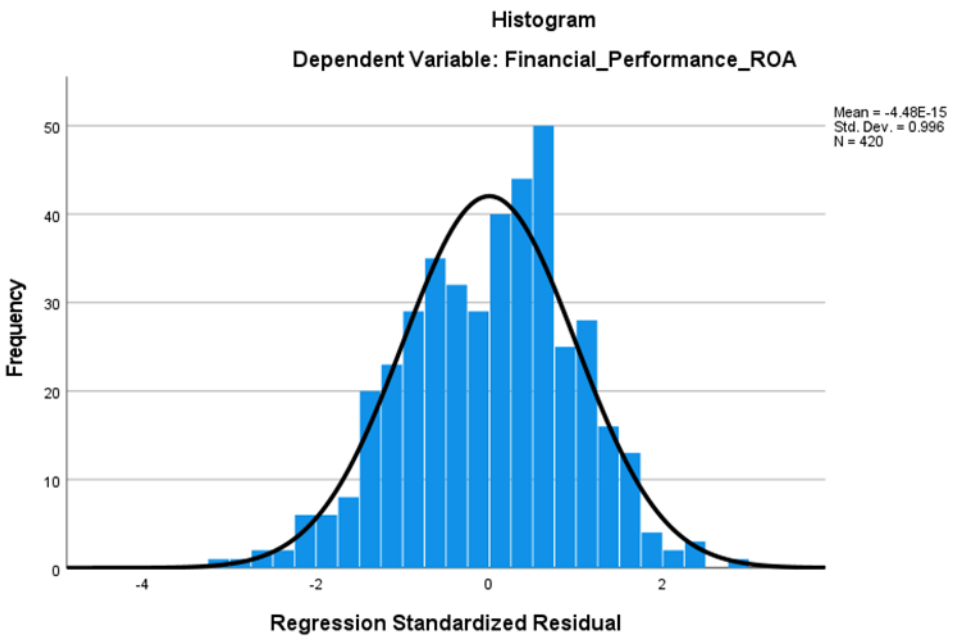

Figure 2: Normality Histogram

This histogram shows the distribution of standardized residuals for regression with Financial Performance (ROA) as the dependent variable. The histogram follows a bell-shaped curve, closely aligned with the normal distribution line (black curve). The distribution is approximately symmetrical, centered around 0, with no extreme skewness. The mean of the standardized residuals is -4.48E-15, which is effectively zero. This is ideal, as regression assumptions require the residuals to be normally distributed with a mean of zero. The standard deviation of residuals is approximately 0.996, very close to 1. This confirm the residuals are standardized properly and the scale is consistent. A sample of 420 observations were included in this regression analysis, which is a robust sample size to assess normality visually. These results suggest that the assumption of normally distributed residuals is satisfied. This means the data supports use of OLS regression. Normality of residuals is a key assumption because it increases confidence in statistical tests like t-tests and F-tests used in the regression output.

Test for Multicollinearity

According to Grewal, Cote and Baumgartner 2004 multicollinearity would occur in a situation where at least two predictors which are independent variables are two correlated to provide redundant information about the response. Tolerance values and variance inflation factors were used to determine existence of multicollinearity. If VIF is greater than 10 and tolerance levels less than .01 then multicollinearity existed.

Table 4.6 Multicollinearity

	Tolerance	VIF
Liquidity	.983	1.017

Source: Field Data 2025

Values below 0.1 would suggest problematic multi collinearity. The value in table 4.5 are greater than 0.1 and close to 1 which indicates that there is no multicollinearity. VIF quantifies how much the variance of a regression coefficient is inflated due to multicollinearity. All VIFs are well below 10 indicating no multicollinearity concerns.

Test for Homogeneity

To test for homogeneity of the variables the researcher used Levene's test of equality of error variances. The findings are represented in table 4.7

Table 4.7 Levene's Test of Equality of Error Variances

	Levene Statistic	df1	df2	Sig.
ROA	1.793	9	410	.068
Liquidity	.343	9	410	.960

Source: Field Data 2025

The null hypothesis was that the variances across groups are equal with alternate that at least one group has a different variance. If $p > 0.05$ then fail to reject null hypothesis and equal variances is assumed. If $p < 0.05$ then null hypothesis is rejected and unequal variances (heteroscedasticity) is assumed. The results show that all p-values > 0.05, In the case of ROA, $p = .068$ and equal variances is assumed while for liquidity $p = .960$ and equal variances were strongly supported. Therefore, Levene's Test indicates that the assumption of homogeneity of variances was met for variable under analysis. The non-significant p-values (all > .05) suggest that variance across the groups is statistically equal, supporting the validity of subsequent ANOVA or regression analyses that rely on this assumption.

Autocorrelation Test

To test for serial correlation of the variables Durbin Watson coefficient was used and the findings are presented in table 4.8. The threshold for the acceptable range is between 1.5-2.5, which show non-existence of autocorrelation.

Table 4.8 Autocorrelation Test

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.639[a]	.408	.404	2.2078531	1.846

Source: Field Data 2025

R is .639 which is the multiple correlation coefficient between the observed and predicted values of ROA. It shows a moderate to strong positive relationship. R Square (R^2) 0.408 indicates that 40.8% of the variation in ROA is explained by the model which constitutes of the independent variable of Liquidity. Adjusted R Square 0.404 Adjusts for the number of predictors and it indicates that 40.4% of the variance in ROA is explained after accounting for model complexity. It confirms the model's goodness-of-fit remains strong. Standard Error of 2.208 show the average distance that the observed values fall from the regression line. A lower value is better; in this case, it's reasonably acceptable given the ROA scale. Durbin-Watson 1.846 These tests for autocorrelation in residuals (values range 0–4). A value close to 2 suggests no autocorrelation, so the residuals are independent, which satisfies a key regression assumption.

Correlation Analysis

To establish the nature and strength of the relationship between liquidity and financial performance of listed firms Karl Pearson coefficient of correlation was employed. Correlation was determined using a two tailed significance level of .01. The results are presented in table 4.9

Table 4.9 Correlation Analysis

		Liquidity	ROA
Liquidity	Pearson Correlation	1	.533**
	Sig. (2-tailed)		.000
	N	420	420
ROA	Pearson Correlation	.533**	1
	Sig. (2-tailed)	.000	
	N	420	420

**. Correlation is significant at the 0.01 level (2-tailed)

Source: Field Data 2025

The data reveals that liquidity has the strongest and most positive correlation with financial performance ($r = 0.533$, $p < .01$), suggesting that firms with stronger short-term financial positions tend to perform better.

Regression Analysis

Liquidity and Financial Performance

The first objective sought to determine the effect of liquidity on financial performance of listed firms. Table 4.10 shows the values of R and r square**.**

Table 4.10 a) Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.533[a]	.284	.282	2.42271

Source: Field Data 2025

R (Correlation Coefficient) 0.533 Indicates a moderate to strong positive relationship between liquidity and ROA, meaning firms with higher liquidity tend to exhibit better financial performance. R Square (R^2) 0.284 indicate that 28.4% of the variance in financial performance is explained by liquidity alone. Adjusted R Square 0.282 depicted adjustment for model simplicity. Since R is close to R square it means that the model is efficient even with one predictor. Standard Error of 2.423 show the average distance that the observed ROA values fall from the predicted values; a smaller value implies better fit.

To test for the prediction model fitness the researcher used p-values and in this case if p<.05 then the model was deemed fit but if p>.05 then the model was considered unsuitable to predict financial performance. The results are presented in table 4.10 b).

Table 4.10 b) ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	971.973	1	971.973	165.596	.000[b]
	Residual	2453.463	418	5.870		
	Total	3425.437	419			

Source: Field Data 2025

There was a very high of calculated F value, indicating that the model explains a significant portion of the variance in ROA compared to a model with no predictors. The p-value of .000 means the model is statistically significant at the 5%, and 10% levels ($p < 0.01$), strongly rejecting the null hypothesis that Liquidity has no effect on Financial Performance. Therefore, liquidity has a statistically significant influence on ROA (Financial Performance). The model fits well, and the ANOVA test confirms the relationship is statistically significant.

Further the coefficients table was generated to explain the influence of liquidity on financial performance and establish whether its statistically significant. Table 4.10 c) shows the findings.

Table 4.10 c) Coefficients

		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
Model		B	Std. Error	Beta		
1	(Constant)	2.903	.421		6.891	.000
	Liquidity	2.996	.233	.533	12.868	.000

Source: Field Data 2025

Unstandardized Coefficient for Liquidity (B = 2.996) means that for every 1-unit increase in Liquidity, the ROA increases by 2.996 units, holding other factors constant. Standardized Coefficient (Beta = 0.533) indicates the strength of Liquidity's effect on ROA in standard deviation units. A Beta of 0.533 is moderately strong, showing that Liquidity has a substantial positive influence on financial performance.

The t-value = 12.868 with $p < 0.001$ show very high t-value and extremely small p-value confirming that the effect of liquidity on ROA is statistically significant. The Constant or Intercept of 2.903imply that when liquidity is zero the expected ROA is 2.903.

Hypothesis Testing

The hypotheses of this study were tested using the p-values as indicated in the hypothesis summary table 4.14. These were obtained from table 4.13(c)

Table 4.14. Summary of Hypothesis Testing

Hypothesis	Criteria/ Statistics	Decision
H_{01}: Liquidity has no statistically significant effect on financial performance of manufacturing firms listed in NSE	B = 3.110, t = 14.536, p = 0.000 Since p<0.05-Positive statistically significant effect	Reject Null

V. Conclusion

Liquidity ratios among firms varied widely (0.60 to 2.77), with an average of 1.74, suggesting that most firms are liquid enough to meet short-term obligations. Large disparities in current assets and liabilities point to heterogeneity in firm size and financial capacity. Liquidity has a strong and statistically significant positive correlation with ROA ($r = 0.533$, $p < 0.01$). Regression results show that liquidity explains 28.4% of the variance

in ROA ($R^2 = 0.284$, $p < 0.001$), and a 1-unit increase in liquidity results in a 2.996. Liquidity is a major determinant of financial performance. Firms with stronger liquidity positions are significantly more profitable, underscoring the importance of maintaining adequate short-term financial assets to meet operational needs and invest in opportunities.

VI. Recommendations

Policy Recommendations

The study recommends Mandatory liquidity disclosures in annual reports to enhance transparency for investors and regulators. Setting minimum liquidity thresholds for listed firms to safeguard short-term solvency and prevent operational disruptions.

Recommendations for Practice

Firms should maintain optimal liquidity levels (liquidity ratio above 1.5) to meet obligations and avoid financial strain. Regular liquidity stress testing should be implemented to prepare for unexpected cash flow shocks.

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