THE ROLE OF CORPORATE TAX ON THE RELATIONSHIP BETWEEN FINANCING SOURCES AND PROFITABILITY OF MANUFACTURING FIRMS LISTED AT NAIROBI SECURITY EXCHANGE IN KENYA

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ABSTRACT

The study assessed the role of corporate tax on the relationship between financing sources and Profitability of manufacturing firms listed at Nairobi Securities Exchange in Kenya. The specific objective was to assess the effect of debt financing on Profitability of manufacturing firms. The study was based on Simulation theory. The descriptive and cross sectional research design were employed in the study. The population of the study was 9 manufacturing firms with Purposive sampling technique used to arrive at 8 firms. Published financial statements were used to collect secondary data. Researchers 'supervisors' opinion tested validity. Descriptive statistics and multiple regression analysis were used to analyze data. Based on the findings, the study concluded that both short term debts and long term debts were used by manufacturing companies listed in NSE, Kenya. The study also concluded that debt financing was negatively correlation effect and statistically significant on profitability. Finally corporate tax had a positive correlation effect and was not significant on financing sources and profitability. Based on correlation analysis, the study recommended that companies to look for better means of reducing their debt financing since it was found to affect profitability negatively. The study recommended for tax relief clams to be put in place to improve on the relationship between corporate tax and Profitability.

Key Words: *corporate tax, financing sources, profitability, manufacturing firms, Nairobi Security Exchange, Kenya*

INTRODUCTION

Finance is the lifeblood of the manufacturing industry. The need for manufacturing financing arose during the industrial revolution in 1800's in Europe and America due to the need to provide improved products to the growing number of people who moved to urban areas in search of jobs. The investors therefore started approaching financing institutions such as banks in search of finances to finance the growth in demand products. With urbanization spreading throughout the world with time, the desire for quality products and finances has made manufacturing financing an important aspect of study (Ge, 2010).

Manufacturing industry is the leading indicator of development in any economy and is used to measure the economic growth and health of a country. Access to finance has always been an issue of debate within the circle of finance scholars for a long time. This is more so for manufacturing businesses. Sources of finance and its success has been an issue of debate for a long time. The informal financing sources have been opposed to the formal type of financing. Accordingly, manufacturing firms in China do not enjoy sufficient support from their financial system. It has been shown that the main reason for the manufacturing financing constraint in China is the issue of information asymmetry where these firms are either completely unaware of the options available or are reluctant to explore new sources due to the classical corporate infrastructure that limits them to opt for other sources of financing (Ezimuo, 2014).

Financing sources available to manufacturing firms are many. The Islamic religious aspect in the country has however led to the development of Islamic banking, and this phenomenon is found out to be extensively successful in making its way as a prime source of finance for the manufacturing business across the country. The Islamic Banking or (interest- free banking) caught the spotlight in 1975 with the establishment of Dubai Islamic bank. That is the world's first Islamic bank operating on the Islamic principles. Islamic banking refers to the doctrine of zero interest over the short term and long term loans. According to the research, it has been found out that the main source of finance for the manufacturing firms in Pakistan comprises of external finance out of which banking industry dominates. On the other hand, other financing options including share capital, leasing, supplier credit and development banks also provide finance (Peng and Pang, 2007).

The main sources of financing manufacturing firms are share capital, loan capital, debt funding and use of debentures as the sources of finance for real estate. While the state of manufacturing growth has been shown to be on the increase, it has further been indicated that the various financing sources have different impacts on property growth in Nigeria with Debt financing having the greatest positive significant impact and share capital the least, (Ezimuoet al., 2014).

Debt financing takes many forms. The essence of debt is that the borrower must repay the funds along with agreed-upon service charges such as interest and loan origination fees. If the money is not repaid as promised, the lender can start collection proceedings. This process can become very uncomfortable for the entrepreneur, who could stand to lose the business and any non-business assets pledged to secure the loan According to Tirole (2006). A long-term debt usually has a payback period between one and five years. Depending upon the deal negotiated, these loans are normally secured (collateralized by assets) and guaranteed by the entrepreneurs. Rates and terms on long-term loans vary greatly based on the lending institution's policies and the business's age and financial status (Bichsel& Blum, 2005).

Debt financing in USA and Australia, bring more opportunities than risks. The financial institutions that provide financing to manufacturing investors have equally experienced a tremendous growth as the number has increased significantly. People therefore take chance to invest in firms and reap the benefits thereof by use of debt finance (Mugo, 2013).

Debt financing is one of the factors affecting Profitability of firms in Australia. The more firms are leveraged the less profitable it becomes as an investment. The lower the debt the more profitable a firms is. Thus managers of firms should minimize public debt levels (Chikolwa, 2009).Debt financing plays a very important role in giving small scale investors access to large funds for investments in Ghana. The diversification and professional management of the trust gives investors an added advantage as an investment tool. Firms' form a regular income stream to the investor informs of dividends paid out regularly. The benefits of firms far outweigh the risks involved and stakeholders should carry out public education to all members of the public on the

benefits of firms. The government should also streamline the processes involved in the ownership of firms (Sada, 2016).

Corporate tax is also called company tax which is imposed on income generated by the company or corporations registered as a legal entity. Corporate taxes may be taxed at national level, county level and at local levels. In United Kingdom, the government announces corporation tax legislation using tax rates on all profits at 19%. Corporate taxes are the expenses incurred to an organization's cash flows since it levied by the relevant authorities; it represents other firm's sources of income not taxed or imposed tax on individuals such employees' wages or salaries. The United Kingdom states the lowest tax rates starting with Hungary having corporation tax rates of 9.0%, Ireland with 12.5% and Lithuania with 15.0%. This indicates that most of European nation's corporate tax rates range from 19.0 to 25% (Charles, 2017).

Corporate tax in South Africa is the tax imposed by the jurisdiction on income of a corporation. Corporate income is subject to corporate tax often determined by the amount of taxable income from individual taxpayers generally imposed on incomes. In other jurisdiction the rule of taxing corporation differs from company rules to the existing tax rates for individual tax payers under certain company act. In case of tax exempt, the corporation may be exempted from taxation where the states pay dividend, individual tax is required. Dividend distribution is taxed under withholding tax before shareholder dividend is paid. The taxes imposed in all corporation income are given with the same tax rates but provides with different corporate rates of taxing individual based on the generated incomes level of the corporation (Arulampalam, 2012).

In Uganda, corporate tax is chargeable on income of a corporation or income of a foreign corporation is taxed at 30 percent after deduction all allowable expenses subject to tax. Further in any extra corporate tax is charged at tax rate of 15 percent repatriated on the income of the financial year. Corporate taxable income is on all gross income that is sales income plus other generated income subtracts cost of goods sold with tax deductions. Standard deduction is applicable to allowable deductions requires different principles identifying incomes and deductions from timing of incomes and deductions. A tax exemption is given on certain incomes and disallowances of certain tax deduction to be disclosed under considerable corporation details (Bittker, 2018). Kenya National Bureau of Statistics indicate that manufacturing firms' Profitability in Kenya is low due to several reasons including low demand, high Debt costs and high taxes. The role of financing sources on Profitability of the manufacturing has however not been established (KIM, 2014).

STATEMENT OF THE PROBLEM

Profitability of manufacturing businesses has been on the decline. If the sources of finance by debt financing is significantly managed in financial management would improve profitability of firms. In the recent years however, For instance, in the year 2016, statistics indicated that average Profitability from the manufacturing businesses was 31% while in 2017 it dropped to an average of 21.4% (KBS 2018). Oyesora (2013) studied the relationship between sources of finance and

Profitability, an empirical analysis of listed companies in Nigeria. The study aimed at investigating the influence of bank loans, share capital and debt on Profitability of quoted companies in Nigeria. The study did not incorporate debt financing as the current study did. Debt financing is one of the financing sources that have not been established. Based on these gaps, the present study investigate the role of corporate tax on the relationship between financing sources and Profitability of manufacturing firms listed at Nairobi Security Exchange in Kenya.

OBJECTIVE OF THE STUDY

The objective of the study was to assess the role of corporate tax on the relationship between financing sources and Profitability of manufacturing firms listed at Nairobi Security Exchange in Kenya.

THEORETICAL REVIEW

The study was anchored by the simulation theory which was proposed by Laibson in 2007 and examines the extent to which markets enable the provision of housing finance across a wide range of countries. Manufacturing is a major purchase requiring long-term financing, and the factors that are associated with well-functioning housing finance systems are those that enable the provision of long term finance. The theory further states that countries with stronger legal rights for borrowers and lenders (through collateral and bankruptcy laws), deeper credit information systems, and a more stable macroeconomic environment have deeper manufacturing finance systems. These same factors also help explain the variation in sources of finance across emerging market economies such as Kenya. Across developed countries, which tend to have low macroeconomic volatility and relatively extensive credit information systems, variation in the strength of legal rights helps explain the extent of financing (Kioko, 2014).

The theory is based on the assumption that the chances we are living in a virtual world made by an advanced civilization is infinitely greater than the chance we are living in the real world. Living in what we already know about our world and that we wonder if we might be living in a simulation only because we can create realistic simulations ourselves (Saleem and Abideen, 2011).

Simulation theory however can be criticized by that it can’t be disapproved nor proven which means it is not a scientific hypothesis. Physicists have gone ahead and made assumptions about simulation, leading to a testable model, then proven it's wrong. But that doesn't disprove the whole paradigm, just their model. It is just a smoke-screen, a stalking horse, hiding the God hypothesis. Finally, they claim there's no indication that the universe is simulated. Where are the glitches, the round-off errors, and so forth? But there are plenty of odd facts physics has discovered about the inner workings of reality that fit the simulation hypothesis (Poudel, 2012).

It applicable to this study as it is based on a statistical comparison of debt financing in terms of loan-to-value and loan-to-income ratios that can provide a good indication of the risks those

entrepreneurs run in financing their own businesses. At the same time, this kind of comparison ignores the causes of the risks, namely the volatility or uncertainty of future interest rates, share prices and changes in earnings. It also disregards the main debt characteristics, the cost of taking out a debt, and the direct and indirect subsidies, including interest deductibility, factors that have a big influence on the costs and risks for manufacturers.

EMPIRICAL REVIEW

Debt Financing on Profitability

Ngige (2017) conducted a study the effect of debt financing on Profitability of firms in the Kenyan stock market. In her work she sought to explain how the introduction of manufacturing investment trusts has had an impact on performance of the stock market. In order to achieve her objective, she employed an exploratory research design and used a census comprising of all 64 firms listed on the NSE. The data collected was secondary data and in her analysis of the data she discovered that the introduction of firms did not affect stock performance. The investors were indifferent to the introduction of firms to the Kenyan stock market. The study recommended that the government involves all stakeholders before coming up with fiscal policies regarding firms.

Kebewar (2017) studied the effect of debt on corporate Profitability evidence from French service sector. The study aims to provide new empirical evidence on the impact of debt on corporate Profitability. This impact can be explained by three essential theories: signaling theory, tax theory and the agency cost theory. Using panel data sample of 2240 French non listed companies of service sector during 1999-2006. By utilizing generalized method of moments (GMM) econometric technique on three measures of Profitability ratio (prof1, prof2 and Profitability), we show that debt ratio has no effect on corporate profitability, regardless of the size of company (MSES, SMES or less).

Sada (2016) reviewed the introduction and development of Debt in Kenya. The purpose of her work was to understand the benefits investors had due to the introduction of firms in Kenyan stock market and also the risks inherent therein. The study adopted a census design since the target population of 117 that comprised of all management firms in Kenya was small. The findings show that firms serve a very important role in giving small scale investors access to large manufacturing investments. The diversification and professional management of the trust gives investors an added advantage as an investment tool. Firms' form a regular income stream to the investor informs of dividends paid out regularly. From her findings she concluded that the benefits of firms far outweigh the risks involved. She recommends that major stakeholders should carry out public education to all members of the public on the benefits of firms. The government should also streamline the processes involved in the ownership and sale of land and also issuance of title deeds.

Chol (2017) studied the effects of Debt on manufacturing industry in Kenya and focused mainly in the Uasin Gishu region. The purpose of his work was to understand how population growth rates

and house prices affect the profitability manufacturing industry. The study area was Eldoret, Kenya. The research covered the Uasin Gishu area in Eldoret. The data was collected via questionnaires handed out to respondents. A population of 109 respondents was targeted. This entailed registered property companies and government officials in charge of planning. A descriptive research method was employed in the analysis and presentation of findings. The findings of the research proved that an increase in demand lead to an increase in Profitability of the manufacturing industry. Firms can take advantage of the fact that an increase in income and an increase in population leads to more business in the manufacturing industry. Population increase leads to an increase in demand for residential buildings. This is true especially for small to medium earners.

Kajirwa (2016) Effects of Operating Debt Finance on Financial Performance of Parastatal Sugar Manufacturing Firms in Kenya. This study analyses the effect of operating debt finance on financial performance of Parastatal sugar firms in Kenya. The specific objectives were to: find out the effects of operating debt finance on financial performance, determine the relationship between operating debt finance and financial performance. The study used a retrospective research design in collection of data. A target population of all the 4 Parastatal sugar firms was considered in the study. Secondary data was the main source of data. The data was then analyzed using multiple linear regression models and Pearson product moment correlation. The study found that operating debt finance negatively affects ROA although not statistically significant (β -.451, $p<0.05$). Operating debt finance was strongly related to financial performance as measured by ROA. The conclusions of the study were that operating debt finance negatively affects firm performance although not statistically significant. The study recommended that Parastatal sugar firms should reduce the proportion of operating debt finance in their capital structure as it negatively affects financial performance.

Kirui (2016) studied the effect of Debt financing on performance of developing market in Nairobi, Kenya, the objective of the study was to determine the effect of Debt financing on performance of manufacturing market in Nairobi. This study adopted a descriptive research design. The population of the study entailed 69 manufacturing firms registered by Kenya Property Developers Association (KPDA). The study sample comprised of use of online publications such as journals, Debt institutions surveys and CBK documentations on Debt loans. The data was analyzed by multiple regression models by use of The Statistical Package for Social Sciences (SPSS). The study revealed that the number of Debt loans, amount of Debt loans balances, GDP growth and inflation rate have a negative effect on the manufacturing market in Kenya. The study concluded that there is a positive and significant effect between Debt financing and manufacturing market performance which was supported by a coefficient of correlation of 0.746 that was obtained. The researcher further recommended that the government through the Central Bank and Debt lending firms should execute policies that ensure that low interest rates is charged on Debt finance.

Muumbi (2010) established the effects of debt financing on the financial performance of companies listed in Nairobi Securities Exchange. The population under study comprised of companies' annual financial reports for the companies listed in Nairobi Securities Exchange that use debt financing as a means of acquiring equipment's. The period of study was seven years (2007 to 2013). The study found that there is a positive significant relationship between debt financing and Return on Share capital. This shows that debt financing has a positive influence on a firm's efficiency in generating profits from every unit of shareholders' share capital. Debt financing is positive when it is used to generate a return on assets that is higher than the before-tax cost of debt, thereby enhancing the return on share capital. This results in Profitability and wealth maximization. According to the findings, there is a positive correlation between debt financing and Return on Share capital.

Obiero (2014) studied effects of debt financing on the financial performance of companies listed on Nairobi securities exchange. The aim was to establish effects of debt funding on the monetary act of corporations registered at NSE. The research assumed descriptive study plan in defining the noteworthy effects of debt financing on performance in financial perspective. The study population consisted all the 65 registered companies at NSE. All firms listed at NSE had not reported use of debt, but only 33 firms which had reported use of debt financing and their secondary data for the period between the years 2011 –2015 was obtained from annual financial reports of the firms. The gathered secondary statistics from the annual reports and financial statements was evaluated using Statistical Package for Social Science version 20. A reversion examination was carried out on the data set to regulate the significant effect of debt business on the ROA(measure of financial performance) for firms listed at NSE. The results from regression analysis showed, debt financing and liquidity having positive effects on ROA whereas size and leverage had negative effects on ROA.

Ndida (2014) studied the effect of Debt financing on performance of manufacturing market in Kenya. His objective was to establish the effect of Debt financing on performance of manufacturing market in Kenya. His study considered a population of 19,177 outstanding Debt loans drawn from 35 Debt and financial institutions. The study used a sample size of 392 Respondents. The study revealed that positive relationship exists between Debt financing and performance of manufacturing market in Kenya. The study concluded that Financial institutions provide adequate information to potential homeowners thus there is flow of information hence reduction in cases of moral perils and adverse selection.

Asiya (2017) studied the effects of Debt financing on financial performance of commercial banks in the study the researcher's main objective was to determine the effect of Debt financing on financial performance of commercial banks. The study employed descriptive research design and all commercial banks in Kenya were used as target population. The study used census technique where secondary data was collected from the financial reports of the commercial banks as well as CBK annual reports. Both descriptive and inferential methods of analysis were used since the data

collected was quantitative. The study findings revealed that there is a positive significant effect of amount of Debt offered on financial performance. The researcher also noted that interests charged on Debt have a positive and significant effect on financial performance of the commercial banks. The study concluded that an increase in the log of amount of Debt offered as well as other activities that augment the total value of Debt loans extended by the commercial banks leads to a significant improvement in financial performance of commercial banks.

Wafula and Weche (2018) carried out a study on effects of Debt financing on financial performance of manufacturing investment firms in Nakuru town in Kenya. The main objective of the study was to examine the effects of Debt financing on financial performance of manufacturing investment. The study population consisted of 80 manufacturing developers and census research design was employed. The statistical package for social sciences version 24 programme was used for data analysis. The findings of the study revealed that asset-to-loan ratio significantly affected the financial performance of the manufacturing investments firms in Nakuru town. The study concluded that a substantive proportion of financial performance of the stated firms could be attributed to Debt financing as depicted by the ratio of assets and loans. The researcher thus recommended that the manufacturing investment firms should minimize their reliance on the assets already owned by the borrowers as one of the major conditions for extending applied loans to them.

Corporate Tax and Profitability

Mutsotso (2017) studied the influence of taxation on the financing of companies quoted on the NSE. The study targeted 11 companies with a sample of 91 employees. The research used a descriptive study design and primary data was collected using questionnaires and used regression to analyze the data. The study found that interest taxation was positively related to debt financing. He observed that tax policy has an important effect on the financing decisions of companies.

Mutwiri and Okello (2015) studied the effects of tax advantages on decisions of funding of companies listed in NSE; Kenya. The study adopted descriptive research design and correlation design the study collected data using structured questioner from eighty employees. They established that there is significant relationship between tax incentives and funding. They also concluded that tax incentives were not enough to encourage investors. It recommended that local tax be reviewed to spur investment and call for more research on effect of tax on financial decision of listed companies.

High debt tax shield cause increase in debt and the higher debt tax shield the higher tax advantage from debt interest to the company. Malenya at al (2016), studied Influence of Tax on financing of Private Manufacturing Companies in Kenya. The main objective of the study was to determine the influence of tax on finance sources of private manufacturing companies in Kenya. The measure of tax for this research is corporation tax on interest debt. Ascertaining and attaining an optimal funding for many companies is not an easy task. In Kenya any manufacturing companies are

struggling to operate while others have been compelled to shut down. Under descriptive statistics percentages of responses and means of items was computed. In quantitative analysis Karl Pearson's correlation, multiple linear regressions, ANOVA and E -Views were used. In addition, the results revealed that with high tax rate, the company uses more debt and has more income to shield from tax.

METHODOLOGY AND MATERIALS

This study adopted descriptive survey and cross sectional research design. According to Gay (1992), a descriptive and cross sectional research design attempts to describe or define a subject, often by creating a profile of a group of problems, people or events through a collection of data, analysis and interpretation of findings. The study focused on 8 manufacturing listed firms comprised of B.O.C Kenya Ltd, British American Tobacco Kenya Ltd, Carbacid Investment Ltd, East African Breweries Ltd, Mumias Sugar Co. Ltd, Unga Group Ltd, Eveready East Africa Ltd and Kenya orchards ltd.

RESULTS AND FINDINGS

The study focused on the moderating role of corporate tax on the relationship between financing sources and Profitability of manufacturing firms listed in NSE, Kenya. Mainly the study sought to assess the effect of the following sources; debt financing on Profitability. Profitability was measured by return on asset.

Debt Financing

The study sought to examine the influence of debt financing on Profitability of manufacturing companies listed in NSE from 2014-2018 under short term liabilities, long term liabilities and total liabilities. The study examined the extent of usage of short term debts by the 8 listed companies in NSE during the study period. The study revealed that in terms of short term liabilities B.O.C Kenya Ltd had a mean of 508774.6 and Standard Deviation of 30083.46, British American Tobacco Kenya Ltd had a mean of 6120897.2 and Standard Deviation of 646059.74, Carbacid Investment Ltd had a mean of 63887.6 and Standard Deviation of 69294.78, East African Breweries Ltd had a mean of 17719951.2 and Standard Deviation of 3693623.92, Mumias Sugar Co. Ltd had a mean of 14757086 and Standard Deviation of 4637610.62, Unga Group Ltd had a mean of 3258640.6 and Standard Deviation of 538256.68, Eveready East Africa Ltd had a mean of 429644.8 and Standard Deviation of 240143.79 while Kenya orchards ltd had a mean of 25354.6 and Standard Deviation of 9553.22. This showed that East African Breweries Ltd had the highest mean while Kenya orchards ltd had the lowest mean.

The study also measured the aspect of long term liability consumption by the manufacturing companies. The study results showed that B.O.C Kenya Ltd had a mean of 0.000 and Standard Deviation of 0.000, British American Tobacco Kenya Ltd had a mean of 3230710.4 and Standard Deviation of 175574.91, Carbacid Investment Ltd had a mean of 18146.8 and Standard Deviation

of 13038.313, East African Breweries Ltd had a mean of 24785421.60and Standard Deviation of 3976394.704, Mumias Sugar Co. Ltd had a mean of 5283391.60 and Standard Deviation of 3552319.580, Unga Group Ltd had a mean of 995905.00 and Standard Deviation of 171069.111, Eveready East Africa Ltd had a mean of 43982.60 and Standard Deviation of 56769.059 while Kenya orchards ltd had a mean of 56332.80 and Standard Deviation of 135.953. This implied that East African Breweries Ltd had the highest mean while B.O.C Kenya had the lowest mean.

In addition, the study sought to find out the level of total debt usage. The study revealed that B.O.C Kenya Ltd had a mean of 508774.60 and Standard Deviation of 30083.462, British American Tobacco Kenya Ltd had a mean of 9351607.60 and Standard Deviation of 598818.226, Carbacid Investment Ltd had a mean of 82034.40 and Standard Deviation of 73888.514, East African Breweries Ltd had a mean of 42505372.80 and Standard Deviation of 4717348.947, Mumias Sugar Co. Ltd had a mean of 20040477.60 and Standard Deviation of 6970352.890, Unga Group Ltd had a mean of 4254545.60 and Standard Deviation of 465204.898, Eveready East Africa Ltd had a mean of 473627.40and Standard Deviation of 274014.521 while Kenya orchards ltd had a mean of 81687.40 and Standard Deviation of 9483.176. It was revealed that Kenya orchards ltd had the lowest mean while East African Breweries Ltd had the highest mean.

Regression Analysis Financing Sources and Profitability

A regression analysis was conducted to test the significance levels in the relationships between the financial sources and Profitability of manufacturing companies listed in NSE from 2014-2018 and the results was as follows. The study carried out a model summary to determine the relationship between study variable. The results were as shown in table 1.

Table 1: Model Summary for Financing Sources and Profitability

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.797[a]	.635	.603	14.442

a. Predictors: (Constant), share capital, Debt, Retained Earnings

Table 1 shows a regression coefficient of 0.797 which implies a strong relationship between financial sources and Profitability. Financing sources under study explain 63.5% of the listed manufacturing companies' profits as shown by R square of 0.635. This meant that 36.5% of Profitability is determined or can be explained by other factors outside the scope of this study.

An analysis of variance was conducted to determine the goodness of fit for the regression model and the result was as shown in table 2.

Table 2: ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	12672.768	3	4224.256	20.254	.000[b]
	Residual	7299.898	35	208.569		
	Total	19972.667	38			

a. Dependent Variable: profitability
b. Predictors: (Constant), Debt financing

At 95% confidence level, F was 20.254 p<.05. The model was statistically significant and fit in predicting the relationship between the study variable since the F calculated is greater than critical F and the p<.5.

Regression coefficients were generated to develop the equation and test the study hypothesis. The results were as shown in table 3.

$$\mathbf{Y = 8.873 - 9.276X_2 + \varepsilon}$$

The regression equation revealed that holding independent variables constant at zero, profitability was 8.873. An increase in debt financing by a unit led to a decrease in profitability by 9.276 units and was statistically significant

Table 3: Coefficients[a] for Financing Sources and Profitability

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	8.873	3.358		2.642	.012
	Debt	-9.276	.000	-.588	-4.054	.000

a. Dependent Variable: profitability

In support to these findings for debt financing, Kerubo (2018) concluded that profitable companies borrow little. Chikolwa (2009) studied debt financing as one of the factors affecting Profitability of firms in Australia. The study concluded that the more firms are leveraged the less profitable they become. The lower the debt the more profitable a firms is. Thus managers of firms should minimize public debt levels. For this reason, higher dividends are paid in stable, low-growth industries. Rajan&Zingales, (2015) indicated that high-growth companies with lots of investment opportunities are likely to pay low dividends because they have profitable uses for the capital. So, growth is likely to place a greater demand on internally generated funds. Higher growth firms use less debt.

Regression analysis was conducted to test the significant levels of the moderating variable (corporate tax) in the relationship between financing sources and Profitability and the result was as shown in table 4 shows the result.

Table 4: Model Summary with the Moderating Variable

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.806[a]	.649	.604	14.884

a. Predictors: (Constant), Corporate Tax

As indicated in table 4, the regression coefficient R, was .806 which implies a strong relationship between finance sources and corporate tax on Profitability. R Square indicated that 64.9% of Profitability of manufacturing companies was explained by financing sources while 35.1% can be attributed to corporate tax factors under this study while the remained can be explained by other variables away from this study.

ANOVA was conducted to test the goodness of fit for the model and the result was as indicated in table 5.

Table 5: ANOVA[a] with the Moderating Variable

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	12706.976	4	3176.744	14.340	.000[b]
	Residual	6867.330	31	221.527		
	Total	19574.306	35			

a. Dependent Variable: profitability

b. Predictors: (Constant), Corporate Tax, Debt financing

ANOVA result indicated that, at significance level of .05 the model was statistically significant and fit for use (p value .000). This enabled the research to predict the moderating role of corporate tax in the relationship between finance sources and Profitability.

The regression model showing the moderating role of corporate tax in the relationship between financing sources and Profitability was as shown in table 6. The following regression equation was established:

$$Y = 7.767 + 2.343 - 9.725X_2 + \varepsilon$$

The equation shows that; holding independent variables constant profitability was at 7.767. A unit increase in corporate tax as a moderating variable increases profitability by 2.343 units; a unit increase in debt financing led to a decrease in profitability by 9.725 units and was statistically

significant at 5%. This is in line with the hypothesis that debt financing had t values of t= -3.964: p<.05. This led to the rejection of the stated null hypothesis. Corporate tax has no significant moderating role on the relationship between debt and Profitability of manufacturing firms listed in NSE, Kenya. At .05 significance level t= .738 with a p value .466>5%, hence the stated null hypothesis is accepted.

Table 6: Coefficients for Moderating Variable

Model		UnStandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	7.767	3.742		2.076	.046
	Debt	-9.725E-007	.000	-.611	-3.964	.000
	Corporate Tax	2.343E-006	.000	.113	.738	.466

a. Dependent Variable: profitability
b. Predictors: (Constant), Corporate Tax, Debt financing

CONCLUSION

The study sought to establish the role of corporate tax on the relationship between financing sources and Profitability of manufacturing companies in Kenya from 2014-2018. The following conclusions were arrived. The study concluded that both short term debts and long term debts were used by manufacturing companies listed in NSE, Kenya. Correlation analysis concluded that debt financing negatively relations with profitability and was statistically significant

RECOMMENDATIONS

Based on correlation analysis, the study recommended that companies to look for better means of reducing their debt financing since it was found to affect profitability negatively. The study measured the role of corporate tax paid by manufactured companies listed in NSE from 2014 to 2018. The study recommended for tax relief clams to be put in place to improve on the relationship between corporate tax and Profitability.

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