

COMMERCIAL TRADE POSITION AND SHORT TERM DEBT OF FIRMS QUOTED ON THE NAIROBI SECURITIES EXCHANGE, KENYA

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Abstract: The critical economic transformation of Kenya's economy has been blueprinted at the ideal level of short-term liabilities. Financial stability has resulted from the effects of achieving equity and liability balance. Debt on the short term is essential to a company's performance when it has a strong trade position. The company makes the most of its trading position to make money. Additionally, borrowing in the short term is essential when investing in projects with a positive net value. The study sought to evaluate the effect of commercial trade position on short term debt on companies listed on Nairobi securities exchange. The study was anchored on pecking order theory and risk and return theory. The study utilized descriptive research design. The study targeted all fifty four firms that were listed on Nairobi securities exchange from 2007 to 2011. The study collected secondary data from annual accounting report of quoted firms on Nairobi securities exchange. Data analysis was performed in order to convert obtained data into a format that can be used for interpretation and conclusion. The study was based on panel data, the analysis will be based on panel regression. Result demonstrated a negative and significant effect between commercial trade position and short term debt. The study recommended inter-firm trade should therefore be encouraged as this is a form of internal financing.

Keywords: Commercial Trade Position, Panel Regression, Pecking Order Theory, Risk and Return Theory, Short Term Debt.

1. INTRODUCTION

Consumer trading position is a crucial aspect of business financing since it has an immediate effect on the availability of funds as well as profit (Khalaf 2012). This additionally implies that only one of the crucial factors that need to be carefully taken into account prior to deciding money-related choices is working capital. This is why it is a crucial component of the investment and directly affects the company's fiscal condition and solvency. Trading positions include short-term funding and investments, but they are never taken into consideration in regards to economic choices. Additionally, because it doesn't contribute to return on equity, it hinders the business's results (Namasake, 2018).

Trading position makes sure a business has sufficient funds to cover its immediate debt payments and everyday costs. A suitable amount of financing for many businesses that operate across different industries may optimize their financial position (Rathirane 2017). The operation of working capital, according to Ramesh, Hamad, and Tammam (2017), constitutes one of the key financial tasks and refers to the sum of funding that a business invests to fund its daily activities.

This positioning in trade is crucial given the current, extremely difficult corporate environment, which requires effective resource usage. According to earlier studies, a company's profitability is significantly influenced by how its financing

operates (Adamu & Hussaini 2015). Ineffective operation of position capital lowers profit and over time may cause a company's suffering and financial difficulties in addition to reducing profit. According to Akinyomi and Tasié (2016), it is critical that the funds used in trade positions are utilized effectively because they are frequently significant relative to the overall assets utilized.

The operation of working capital, that seeks to keep each of a company's four functional components—cash, inventories, receivables, as well as payables—in an ideal condition of equilibrium, is an essential aspect of the company's general value-creation method and a key source of competitive advantage (Waema & Nasieku 2016). Maintaining enough liquidity for regular business operations is essential to working capital management since it helps the company run smoothly and fulfill its duties.

Debt that is due soon is a component of the financial system. According to Kumah (2013), financial structure refers to how a company funds its assets using an assortment of equity and debt that it believes suitable to improve its ability to operate. To decide the extent to which money ought to be loaned and the ideal balance of equity and debt needed for financing company operations, it is essential to determine the company's optimum financial framework. Thus, the decision of the optimal debt to equity ratio might impact the company's worth alongside profitability (Shikumo, Oluoch & Wepukhulu, 2020).

In overall, funds and debts that are going to be employed, liquidated, grow older or paid off under a period of time are referred to as short-term assets and liabilities. Assessment of choices that influence current assets and current liabilities is the main focus of the short-term approach. Short-term liabilities divided by total assets is used to calculate short-term debt. The likelihood of a company's expansion has a positive association with its debt that is short-term. According to personal experience, short-term loan finance and economic success are positively correlated (Yazdanfar & Hman, 2015).

Short-term debt obligations have maturities of one year or less and call for prompt repayment within 90 to 120 days. Short-term term loans make it easier to finance short-term needs without making long-term commitments (Peavler, 2014). Short-term debt servicing costs are less onerous for the company. The interest rates for short-term loans are often lower, and the majority of lenders do not start charging interest until the whole credit allowance term has passed (Kahl, Shivdasani & Wang, 2015).

One of the continent of Africa's most robust capital markets is the Nairobi Securities Exchange. When the nation was still a British colony in the 1920s, the Nairobi Securities Exchange was established. The NSE has been through a number of adjustments throughout time to improve its efficacy and react to shifting trends in the business climate, interest from investors, and technological advancements. Listed companies have the chance to gain from greater access to financing, a raised worldwide profile, and access to liquidity thanks to the NSE as a secondary market (Namasake, 2018).

The critical economic transformation of Kenya's economy has been blueprinted at the ideal level of short-term liabilities. Financial stability has resulted from the effects of achieving equity and liability balance. Any company's ability to survive is largely dependent on its short-term debt load. There are not many studies that have focused on short-term debts, despite the fact that they are important, account for more than 50% of all business funding, and create more than 70% of all jobs (KNBS, 2020).

Debt on the short term is essential to a company's performance when it has a strong trade position. It illustrates the business's liquidity. The company makes the most of its trading position to make money. Additionally, borrowing in the short term is essential when investing in projects with a positive net value. Periodically allocating more funds to improve businesses has helped the government spur economic growth (SMEA, 2021). However, a lot of the negatives the corporation placed under statutory management faces are greatly caused by a few small short-term financial decisions (Kiprotich, 2022). This state of things has caused investors who participate in the Kenyan stock market to lose trust as well as wealth. A request for in-depth inquiry is made by results that are either substantial or insignificant in addition to positive, negative, and neutral results.

2. REVIEW OF LITERATURE

Theoretical Review

Pecking Order Theory

According to Myers and Majluf (1984), the POT require a structured and logistical plan because of the category of asymmetric information and agency problems. By holding onto earnings to put toward initiatives, the preposition gives internal money priority. In the second category, secured debts are used to finance the investment; following that, the

company can turn to risky borrowing or equity, if appropriate. Financial managers receive information from the flotation cost of stock and the transaction cost of borrowing. The theory has limitations in terms of the methods and factors that can be used to finance a firm, among other things. The hypothesis ignores investment capital and incentives. In addition, the POT has failed to adequately address the necessary scientific comparison among the risk and benefits. The approach promotes financial health by making effective utilization of assets in a particular priority sequence. Yet it does not provide an option in circumstances where the method of obtaining funds is costly.

Accurate empirical evaluation and methodical financial sources free from haphazard and expensive processes are relevant theory support. The notion seeks to conserve resources for the company. Although providing credible evidence on serious consequences resulting from asymmetric information, POT offers important guidelines. Additionally, it describes and ranks the costs related to funding in order to help the accounting professionals make wise decisions. It points the company in the direction of the important financing path. Short-term debts have both advantages and disadvantages for company. The use of financing to achieve positive net value is the main factor to be taken into account (Kiprotich, 2022).

Risk and Return Theory

A firm with a high working capital liquidity will have a low risk of defaulting on its obligations and poor profitability at the same time, according to Zariyawati *et al.* (2009) theory of risk and return. To put it another way, the firm is less risky the more NWC it has, and the more liquid the firm is, the less probable it is to become technically insolvent. Lower NWC and liquidity, on the other hand, are linked to higher levels of risk. According to Zariyawati *et al.* (2009), the link between liquidity, NWC, and risk is such that if each of these variables increases, the firm's risk will also reduce.

Empirical Review

Kioko and Sitienei (2015) looked at how working capital management affected the profitability of Kenyan cement manufacturing enterprises. Secondary data from the audited financial accounts of the cement manufacturing enterprises for the years 2000–2014 was used in the study. Karl Pearson correlation and multiple linear regressions were used to analyze the data collected. They discovered that the average receivables duration had a positive, negligible link with profitability while the inventory conversion period had a positive, significant relationship with profitability. The study's findings also showed that profitability and average payables period had a strong inverse relationship.

Debt financing versus performance was examined by Aziz and Abbas (2019). Pakistan was the country that led the study. The goal of the study was to show how the performance of non-financial enterprises and diverging finance are related. The information was put together using auxiliary methods. Short-term debts were determined to be inversely and significantly linked with ROA for the population of 14 companies. The study took a close look at quoted Pakistani companies whose business, geography, and socioeconomic status varied from those of SMEs in Kenya.

Narang (2018) looked at the effects of capital structure on performance. India was the key location, and the goal was to model the current relationship after true propositions. The short-term debt, LTD, and TD on ROA provided the finest expression of the capital structure. The focus of the study was on publicly traded Indian companies. 20 companies' 5-year data were included in the study. The investigation placed special emphasis on the relationship between short-term indebtedness and ROA.

Nguyeu (2020) investigated the relationship between the capital structure and profitability. Non-financial listed firms were included in the study's scope. Vietnam businesses were the study's key region. It also focused on 488 businesses while using secondary sources for data. The time frame for the study was from 2013 to 2018. The results showed that CS has a considerable negative impact on profitability.

3. METHODOLOGY

A descriptive case research design was used in the study. Given deadlines, the researcher selected the technique. The goal of this descriptive case study was to gather in-depth data addressing the impact of commercial trade position on short-term debt. Seeking out who, what, where, and why of an occurrence was the focus of a descriptive investigation (Ngechu, 2004). The descriptive study design was selected since it allowed the researcher to accurately extrapolate the results to a wider range of people. For the purpose to better understand and analyze the findings, the study's main emphasis was on quantitative data. Descriptive studies, according to Coopers and Schindler (2004), are more systematic and frequently designed with distinct objectives.

The population of interest was comprised of all fifty four firms that were listed on the NSE between 2007-2011. The study used census sampling method, thereby capturing all the intended audience. The study chose to use secondary data from the semi-annual as well as the annual financial statements of the firms listed on the NSE for a period of five years. This data allowed for the calculation measures relevant to this study. The data constituted a mixed of cross-sectional as well as time series data and was therefore treated as panel data. The use panel data has advantages over both cross sectional and time series data. The Ms-Excel and STATA were used to clean, explore and analyze that data. Data was analyzed using panel regression methods. This is because neither cross sectional data or time series data analysis could not give out the best result because of the combined variation in both the firms and time.

Panel data is used to increase data observations and therefore very helpful in looking at change dynamics. The data was initially analyzed using pooled ordinary least squares (OLS) regression model. Panel data regression models that were used in the analysis of the data included random effects. Random effects model separates the differences across components (panels) and individual are random and uncorrelated with the independent variable. Hence error term thus captures the random effects due to the panels and the random errors. Random effects are treated as unique errors, for each panel, that have a distribution that is normal with zero mean as well as variance σ^2 . The random effects method needs you to specify the individual characteristics which may or may not in any way influence the independent variables. There is however a problem where some variables may not be available in the analysis leading to the omitted variables bias in the model. It also allows generalization beyond the sample in the model. The random effect model:

$$Y_{it} = \alpha + X_{it}\beta + \varepsilon_{it} + \mu_{it}$$

Where

ε_{it} = within entity error term

μ_{it} = between entity error term

Y_{it} = Short term Debt for i^{th} firm in t^{th} year.

X_{it} = Commercial trade position (Difference between Receivables and Liabilities divided by Total Assets)

β = Vector of Coefficient

4. RESEARCH AND RESULT DISCUSSION

Presentation of findings from panel data analysis of secondary data procured from NSE quoted companies. Panel data analysis thus provided result as follows

Panel Regression on Short term Debt

| | | | | | | |
|---------------------------|--------------------|-----------------------------------|--------|------------------------|------------|------------|
| Group variable: Company | | | | Number of groups = 52 | | |
| R-sq: | within = 0.3345 | | | Obs per group: min = 2 | | |
| | between = 0.2292 | | | avg = 10.0 | | |
| | overall = 0.2359 | | | max = 10 | | |
| | | | | F(9,459) = 25.64 | | |
| corr(u_i, Xb) = -0.1377 | | | | Prob > F = 0.0000 | | |
| Short term debt | Coef. | Std. Err. | T | P>t | [95% Conf. | Interval] |
| Commercial trade position | -0.4500228 | 0.032040 | -14.05 | 0.000 | -0.5129861 | -0.3870594 |
| _cons | 0.5774872 | 0.1326202 | 4.35 | 0.000 | 0.3168691 | 0.8381053 |
| sigma_u | 0.21772789 | (fraction of variance due to u_i) | | | | |
| sigma_e | 0.05938035 | | | | | |
| rho | 0.9307692 | | | | | |
| F test that all u_i=0: | F(51, 459) = 15.59 | | | Prob > F = 0.0000 | | |

From the table, the overall r-squares is 23.59% which means overall 23.59% of the variations in short term debt were explained as shown by independent variable. The within r-squared is 33.45% which means that 33.45% of the variations within variables were explained as shown by model. The between r-squared is 22.92% which means that 22.92% of the variations between the variables were explained as shown by model. Result showed that commercial trade position was

significant and negatively related to the Short term debt This meant that a point increase in Short term debt would reduce commercial trade position by 0.45. Commercial trade position will decrease as these short term debts are paid within a short period of time

5. CONCLUSION, RECOMMENDATIONS AND SUGGESTIONS FOR FURTHER STUDIES

Commercial trade position was found to have a significantly and negatively related to short term debt. This means that a higher level of commercial trade position will result to a significant decrease in the use of the short term debt hence reducing total debt and vice versa. Commercial trade position is as a result of firms owing each other in the process of trading. These are short term debts from trading which cancel each other out and hence it is expected that as the firms trade with each other there will be a reduction in short term debts. However, these firms will increasingly continue to use long term debts. This is because the firms will continue to require the use of long term debt for the purpose of financing their activities. These firms will borrow long term to invest and enjoy the intercompany transactions in financing some operational activities and forfeit short term debt. The results shows that short term debts are consistent with pecking order theory which suggests a relationship that is negative because commercial trade position is accepted as an internal fund.

From the study, commercial trade position had a significant and negative connection with short term debt. Inter-firm trade should therefore be encouraged as this is a form of internal financing. The policies that are prepared for trading firms should therefore encourage inter-firm trading and the extension of credit among firms. Further studies can be carried out on commercial trade position on listed banking establishments and listed insurance companies.

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