

FIRM AGE AND LONG TERM DEBT OF FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE, KENYA

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Abstract: Companies need more finance as they grow since increased operating expenditures are a result of this growth. Since debt obligations provide tax advantages, financing a corporation through them is regarded as being less expensive than using equity. A tax shield connected with debt financing has advantages, and debt financing has information costs that are significantly lower than those associated with the issuance of new shares. However, debt issues have plagued the majority of NSE companies. Therefore, the study sought to investigate the effect of firm age on long term debt of Nairobi Securities Exchange, Kenya. The study was anchored on pecking order theory and agency theory. The study utilized descriptive research design. The study utilized secondary data from annual accounting report of quoted firms on Nairobi securities exchange from 2007 to 2011. Data analysis was performed in order to convert obtained data into a format that can be used for interpretation and conclusion. Because the study was based on panel data, the analysis was based on panel regression. Result demonstrated a negative and significant effect between firm age and long term debt. The study recommended that firms should find alternative ways of financing than having long term debt.

Keywords: Agency Theory, Firm Age, Long Term Debt, Pecking Order Theory.

1. INTRODUCTION

A component of the financial system is long-term debt. Long-term debt entails strong binding contracts between the company and the debt issuers, which is typically accompanied by substantial agency and financial distress costs (Tailab, 2018). A substantial amount of long-term debt makes it more likely that the company may go bankrupt, which makes it difficult for the company to operate effectively. High levels of debt raise interest rates, which could make the company's liquidity levels unviable. Long-term obligations divided by total assets is used to calculate long-term debt (Koila, 2018). Long-term debt is money owed to creditors for a period longer than a year from the current balance sheet date. According to their asset base, widely recognized business organizations prefer long-term debts over other types of debt financing, and numerous banking institutions that accept deposits also need collateral (Foyeke, Olusola, & Aderemi, 2016). Long term debt enables companies to invest in initiatives that provide returns over a lengthy time span, long-term debt funding is expected to have a favourable impact on financial return and performance for organizations who need it. The managers' incentives may be distorted by long-term finance, which would hurt investment and business performance.

In the United States, from 49% in 1976 to 21% in 2000, long-term debt as a percentage of total debt has decreased for businesses. This denotes a drop-in debt maturity brought on by small businesses operating in the marketplaces (Bannerman, 2019). The United States owes 3139 billion dollars in long-term debt as of 2019, and 3373 billion dollars as of 2020. In the United Kingdom, the long-term debt pile of firms increased to over 100% of the existing income in 2023 obtained annually for the very first time ever since 1961 (Schomberg, 2023). As at 2022, the total debt incurred amounted to 27.6 billion pounds which tallies to 4.4% of GDP. In Russia, the long-term debt is equivalent to 19.6% of the country's GDP (Office of National Statistics, 2023).

In Africa, many African governments implemented a variety of actions to lessen the COVID-19 pandemic's effects on the economy and society, which had a substantial impact on the continued existence of debt. In Ghana, in the aftermath of the Covid-19 outbreak, the deterioration of financial markets worldwide, and the war in Ukraine, fiscal and external situations have substantially worsened. Public and external debt has increased in most enterprises as a result of all of these external shocks, in addition to pre-existing fiscal and long-term debt concerns. Late in 2021, Ghana lost access to international markets, and by 2022, its economic health had deteriorated significantly due to substantial declines in international reservations, a dramatic devaluation of the currency, and skyrocketing inflation (Dadi, Francisco & Fedelino, 2023). In Uganda, the drop in the price of coffee globally made it harder for the economy to earn foreign currency, which negatively impacted Uganda's ability to pay its debts and hastened the accumulation of arrears. The debt outstanding and paid out is estimated to be 105 % of GDP, with a debt-service ratio of almost 80 percent. This is a significant impediment to the revival of the economy and future growth of Uganda (Barunge & Atungi, 2018).

In Kenya, the COVID-19 shock's escalation has been blamed for the large long-term debt. The gross public debt increased from 48.6% of GDP at the end of 2015 to a projected 69% of GDP at the end of 2020, reflecting high deficits that have been partially fuelled by historical spending on large infrastructure projects and the 2020 Covid-19 global shock. Approximately half of Kenya's debts are owed to foreign creditors. By the end of 2020, the domestic public sector debt had increased to 33% (Fedelino, Kaufman & Estevao, 2021).

An important factor in identifying a company's foundation is the firm's age (Kartorningsih, 2020). The age refers to the age of a corporation at the time of analysis; as a company gets older and gains economies of scale, it may create a product for less money. Nevertheless, established companies need to adapt their procedures to the fresh setting to compete with their rivals (Chinaemerem & Anthony, 2018). Managers' risk and decision-making inclinations are influenced by a firm's age-uniqueness, particularly in situations that involve risk and rapid change. Tangibility is one of the key elements that determine capital structure (Imtiaz, 2018)

The Nairobi Securities Exchange (NSE) was founded in 1954. NSE is vital to Kenya's financial system's growth since it encourages saving and investing whilst also making it easier for local as well as international businesses to get suitable funding. The NSE is subject to scrutiny by the Kenyan Capital Markets Authority. The Nairobi Securities Exchange lists mainly financial and non-financial enterprises. Non-financial firms encompass those which do not engage in the industry of aiding financial service providers (NSE, 2018).

Statement of the Problem

Companies need more finance as they grow since increased operating expenditures are a result of this growth. Since debt obligations provide tax advantages, financing a corporation through them is regarded as being less expensive than using equity (Pandey, 2018). A tax shield connected with debt financing has advantages, and debt financing has information costs that are significantly lower than those associated with the issuance of new shares. However, debt issues have plagued the majority of NSE companies. Due to lenders, including banks, Kenya Airways is one of the companies with the highest debt problems among those traded on the Nairobi Securities Exchange. This is because its total asset balance is only Sh17.00 billion, while its total debt is Sh20.80 billion. The net worth of the shareholders was wiped out, making an unfavourable Sh 23.00 per share or total Sh 33.80 billion (NSE, 2019). The stock, which is currently trading at Sh 4.4 per piece (NSE, 2018), has dropped by 55% in just the last year. In exchange for a capital infusion of Sh5 billion shares in the form of shares or converted debt, Uchumi supermarket investors, who paid 0.03 shares per share as dividend in 2014, will transfer ownership of Uchumi to a strategic investor. Additionally, the retailer borrowed money to fund its growth both nationally and internationally, which looks to have been at best reckless.

2. THEORETICAL REVIEW

Pecking Order Theory

Myers (1984) suggested this view. This argument is predicated on the idea that company managers have greater knowledge or information about their company than do investment specialists. It is implied that the information discrepancy is asymmetrical. When management is confident in their company's future prospects, they will raise money through debt, all other things being equal and considering knowledge asymmetry. On the other hand, when managers foresee an uncertain future, they will issue equities and make a commitment to repay debt holders in the form of premium and principal, demonstrating that the company anticipates consistent cash flow (Myers, 2001). In a similar vein, this shows that businesses consistently use internal financial resources when available and choose debt over new stock issues

when additional funding is needed. Since there was no clear equity-debt target and internal and external equity existed, with the former being at the top of the pecking order theory and the latter at the bottom, Myers termed it the pecking order theory.

Agency Theory

According to agency cost in the capital structure, an optimal capital structure will be attained by minimizing costs associated with disputes between the company's management and shareholders. According to Jensen and Meckling (1976), agency costs play a significant role in financing decisions because of potential conflicts of interest between shareholders and debt holders. Investors may compel management to take steps that will transfer money from debt holders to equity holders if a company is going toward issues connected to the financial crisis. Holders of complex obligations will then demand a greater rate of return on their assets if there is a chance of wealth transfer (Jensen & Meckling, 1976). Managers are concerned about the possibility of losing their jobs, so they likely run the business successfully in order to fulfil the compensation of interest while aligning their actions with the shareholders' wealth maximization goal. If the management does not work to make interest repayments when they become due, debt owners have legal recourse.

Empirical Review

Afey and Warui (2019) investigated the effect of firm age and size on the financial leverage of companies listed at the NSE, Kenya. The study used secondary data derived from company financial statements and considered businesses that have been listed on the NSE over the previous fifteen years. The time frame considered was 2003 to 2017. Only 32 lean enterprises were included in the sample size. To construct the pertinent ratios, secondary information from financial statements of companies listed on the NSE was employed. Descriptive statistics were used to analyse the panel data as well as panel regression, correlation, and analysis. The study discovered that financial leverage had a detrimental and substantial association with business age and firm size. Afey and Warui (2019) investigated the effect of firm age and size on the financial leverage, which found a negative effect between firm age and financial leverage.

Mallinguh, Wasike and Zoltan (2020) evaluated firm age and its performance on financial leverage in the business sector. The research looked at 146 medium-sized businesses (MEs). The findings demonstrated that, aside from ownership, company industry, firm age, the percentage of foreign ownership, and financial leverage have a substantial impact on performance. Foreign ownership, but not leverage, significantly influences the relationship between firm age and performance. The association between the business sector and financial performance is not significantly moderated by either foreign ownership or leverage.

Yilun (2020) sought to reveal the effects of firm age and size on the profitability of firms in China. With the aid of data from public industries in China market from 2008 to 2018 on stock, the study adopted the use of fixed effect model for the examination of the various relationships. Profitability served as the dependent variable while firm age was used as the independent variant. At the end of the study, the study findings revealed that a negative relationship exists between firm age and the profitability of the selected firms in China.

In a study by Solanke and Mohammed (2022), firm age and size was used to assess the leverage of listed financial firms in Nigeria. The study looked at how the leverage of listed financial firms in Nigeria relates to firm size and listing age. Information taken from 49 financial firms' annual reports over a 12-year period (2008–2019). A firm's size, listing age, and leverage are estimated using descriptive data as well as inferential statistics. According to the study, the firm's leverage and firm size are negatively and strongly correlated. Age has a favourable and considerable impact on the financial sector's leverage. According to the survey, businesses frequently use loan financing to take advantage of accessible tax shelters, eventually boosting profitability.

Firm age and financial performance of manufacturing consumer goods firm in Nigeria was studied by Ahmad, Hassan and Ladon (2022). Fifteen (15) consumer goods of the selected manufacturing consumer goods firms were examined with the means of a panel dataset from 2004 to 2020. The analysis of the data was performed using the fixed and random regression effects. The findings of the study depicted that firm age statistically affected the performance of the selected consumer goods manufacturing firms in Nigeria.

Rwakihembo, Aryatwijuka, Kalinda and Nimusiima (2023) examined the influence of firm age on the financial performance of private limited companies in Uganda. The study used a cross-sectional design and a positivist paradigm. To collect quantitative information from purposefully chosen Accountants, Auditors, CEOs, and Board Members, a standardized self-administered questionnaire was used. A sample of 394 private businesses in Central and Western Uganda were taken. Standard regression analysis methods and Pearson correlation were both used to evaluate the association. According to the study, there is a strong correlation between business age and financial performance.

3. RESEARCH METHODOLOGY

The study chose to adopt a descriptive study design which sought to examine the effect of firm age on total debt of firms listed on NSE. The population of interest was comprised of all firms that are listed on the NSE between 2007-2011. The study opted to undertake a census because of the small number of firms listed on the NSE. It was therefore possible to collect data from all the firms.

The study utilize to use secondary data from the annual financial statements of the firms listed on the NSE. 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 include.

Data analysis was performed in order to convert obtained data into a format that can be used for interpretation and conclusion. Because the study was based on panel data, the analysis was based on panel regression. As a result, the panel regression technique was utilized to test hypotheses, and conclusions was drawn after. The 0.05 significance level, or 95 percent confidence interval, was used to guide the test of hypotheses. The fixed effects model is as follows;

$$Y_{it} = \alpha_i + \beta X_{it} + \mu_{it}$$

Where μ_{it} = error term

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

X_{it} = Firm Age

β = Coefficientsr

4. RESEARCH FINDINGS AND DISCUSSIONS

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

Table 1: Panel Regression result

Fixed Effect Model				F(9,459)	=	2.99
corr(u_i, Xb) = -0.7970				Prob > F	=	0.0018
Long term debt	Coef.	Std. Err.	t	P>t	[95% Conf.	Interval]
Age	-0.0060479	0.0023729	-2.55	0.011	-0.0107110	-0.0013847
_cons	0.2372819	0.1329253	1.79	0.075	-0.0239356	0.4984995
sigma_u	0.22047758	(fraction of variance due to u_i)				
sigma_e	0.05951692					
rho	0.9320789					
F test that all u_i=0:		F(51, 459) =	31.14	Prob > F = 0.0000		

From the above table, firm age is significantly as well as negatively related to the Long term debt. This means that a point increase in firm age will reduce Long term debt by 0.0060 and over time there will be a reduction in long term debt. Long term debt will reduce over time as the principle is repaid. Ahmad *et al.* (2022) reported that firm age statistically affected the performance of the selected consumer goods manufacturing firms in Nigeria. Similarly, Rwakihembo *et al.* (2023) documented that there is a strong correlation between business age and financial performance.

5. CONCLUSION AND RECOMMENDATION

Age was found to be having a negative relationship that was significant with long term debt. With time firms will use low level of long term debt. This meant that older firms employ significantly lower levels of long term debt. This was to be expected because such firms were able to finance their activities from the funds that were internal which they must have been accumulating over time. Such firm also have long term assets which can be disposed of to finance their activities and therefore do not need to go for the long term debt. This result was contrary to the pecking order theory that had suggested a relationship that was positive between age and leverage.

The study highlighted that firm age significantly affected long term debt. From the analysis firm age were significantly and negatively related with long term debt. Since firm age has a negative effect on long term debt, it is management of firms should continue to finance internally and also other forms of financing can be utilized within firms. Management should ensure that there is a more stable and predictable cash flows which can be utilized to fund operations instead of relying on debt. While long term debt might indicate financial strength, it is important that companies can manage unforeseen events within the economy, risk management tactics are important to help mitigate risk.

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