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A CRITICAL REVIEW OF LITERATURE ON ASSET STRUCTURE AND PROFITABILITY OF FIRMS LISTED UNDER MANUFACTURING AND ALLIED SECTOR AT THE NAIROBI SECURITIES EXCHANGE, KENYA

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Abstract: **The study sought to carry out a critical review of literature on asset structure and profitability of the manufacturing and allied firms listed in Nairobi Securities Exchange, Kenya. It was found that several studies have been done with respect to asset structure and profitability. However, these studies are characterized by various research gaps. Some of the studies were centered on other countries and not Kenya. Notably, different countries are guided by varying regulatory frameworks as such the findings of the previous study cannot be directly applicable to the Kenyan context. The study recommends that rather that focus on financial performance, profitability which is a narrow and key aspect of financial performance can be explored. Moderation effects of inflation on the relationship between asset structure and profitability can be considered while focusing on manufacturing and allied firms listed at the Nairobi Securities Exchange, Kenya.**

Keywords: **Asset Structure, Property, Plant and Equipment, Current Assets, Intangible Assets, long term investments and Profitability.**

1. INTRODUCTION

1.1 Background of the Study

Across the World, the manufacturing sector has played an important role in driving economic development by stimulating and sustaining high productive growth, boosting employment opportunities for semi-skilled labour and building country competitiveness through exports. According to the Economic Survey (2019), manufacturing sector, which is under the economic pillar, is expected to support social economic development through job creation, wealth generation and attracting foreign direct investment. As outlined under the Big Four Agenda in Kenya, a competitive manufacturing industry is key for economic prosperity of any country through employment, wealth creation and consequently poverty reduction.

The Vision 2030 aims to transform Kenya into a newly-industrializing, middle-income country providing a high quality of life by 2030. The industrial sector has been identified as key to addressing incidences of high poverty levels, unemployment, disparities in regional development, and meagre foreign exchange earnings from exports of primary or semi-processed agricultural produce. This vision is shaped by President Uhuru Kenyatta's Big Four agenda – food security, manufacturing, affordable housing and healthcare. The aim is to increase competitiveness and consumption of locally produced goods and services.

In order to achieve vision 2030, KAM called for greater interventions such as supporting SME development through the provision of affordable credit; increasing the resilience of the manufacturing sector by ensuring long-term policy stability; improving the ease of doing business and development of regional value chains to minimize exposure from external shocks and much more.

In Kenya, listed firms have a common characteristic in that they are more professionally managed, bigger in size with very high turnover and asset values as compared to unlisted firms (Ayot, 2013). Listed firms contribute in many ways to the economy of Kenya. They provide employment in the firms thus reducing unemployment problems. They also pay tax to the government which is utilized to provide the necessary products and services to the citizen of the country. Furthermore, they contribute to the research and development thus increasing innovation. A number of listed firms have been experiencing declining fortunes and some have even been delisted from the NSE over the last decade and Significant efforts to turn around such companies or even liquidating them have focused mainly on financial restructuring (Ayako *et al*., 2015).

Koralun-Bereźnicka (2013) described asset structure as a combination of the various asset components which was identified as: financial fixed assets; tangible fixed assets; current assets; and current investments and cash in hand and at bank. A similar definition was taken by Schmidt (2014), where asset structure is described in terms of: current assets; long term investments and funds; Property, Plant and Equipment; intangible assets; and others assets. The manufacturing companies depending on the structure of assets consist of two types of assets, fixed and current assets.

Profitability relates to the ability of firms to generate returns on assets management within a particular period (Saleh, Priyawan & Ratnawati, 2015). Profitability entails the generation profits by firms within a given level of assets, sales as well as certain share capital. Profitability relates to the end outcome of several decisions and policies undertaken by firms which serve as an indication of effectiveness and efficiency of firms. Firms which achieve maximum profitability over a certain period will have the ability of distributing dividends every year which in turn will attract investors into buying of company shares (Mutua & Atheru, 2020). The achievement of high profits will be a source of attraction to investors to channel funds to such company so it can be a funding source in relation to business development (Olatunji & Tajudeen, 2014).

1.2 Statement of the problem

Kenya, like many other developing countries, has not managed to develop a robust manufacturing sector and growth has stagnated over the last ten years to an average of 10% from 2007 to 2016 contribution to GDP. The country has thus experienced a premature deindustrialization as evinced by the decline in GDP contribution by the manufacturing sector which was at a paltry 8.4% in 2017. Despite the government effort to boost outcomes in the manufacturing, the sector has remained stagnant. In order to curb further job losses, decline of the industrial sector's contribution to the economy and deteriorating standards of living on majority of Kenyans, the National Economic and Social Council (NESC) was established and mandated to develop a National Policy Agenda on Industrialization to reverse the declining trend and make recommendations that will fast track the industrialization process. The government has also developed the 2019 Manufacturing Priority Agenda (MPA), themed at closing the manufacturing gap through the Big 4 Agenda for shared prosperity. It outlines immediate action plans that will yield tangible results in the short term, which will see Kenya's manufacturing sector close the current gap of 6.6% by 2022 to attain the 15% GDP target under the Big 4 Agenda. The government's goal is to increase the manufacturing sector's contribution to the Gross Domestic Product (GDP) to 15 per cent by 2022 (currently at 8.4% per cent), create jobs annually, increase foreign direct investment and improve ease of doing business.

The Vision 2030, the Kenya Industrial Transformation Programme (KITP) and most recently Big 4 Agenda have all been designed by the Government to revamp the manufacturing sector. Of the Big Four Agenda pillars, Manufacturing is the only one that is guaranteed to create jobs and enhance its contribution to GDP in the short to medium term. Despite the government effort to revive manufacturing sector several companies, however, are experiencing declining performance and some have even been delisted from the NSE in the last decade. This is contrary to the expectations of their stakeholders who span across shareholders, employees, consumers, and government among others. This sector was considered to be the most ideal for the study compared to the other sectors because during the period of study, some of the firms in this category had been experiencing financial difficulties.

Profitability is viewed as the key objective of asset structure management and as such firms engage in asset transformation with the aim of yielding profitability as well as asset preservation simultaneously. This study sought to carry out a critical review of literature on asset structure and profitability of the manufacturing and allied firms listed in Nairobi Securities Exchange, Kenya.

1.3 Objective of the Study

This study sought to carry out a critical review of literature on asset structure and profitability of the manufacturing and allied firms listed in Nairobi Securities Exchange, Kenya.

2. LITERATURE REVIEW

2.1 Theoretical Review

Pecking Order Theory was advanced by Donaldson in 1961 and in 1984 by Myers. Largely applied in Corporate Finance, the theory holds the assertion that firms prioritize their finance sources in line with the finance costs, with preference in raising equity finance means of last resort. It is based on the concept of information where retained earnings are considered first in the financing pecking order because they are cheaper and are rarely affected by asymmetry of information. Second, debt is considered next since it carries low asymmetry which serves as a monitoring device against wasteful spending by the management. Finally, external equity is used as a last option because of its adverse selection effect (Ayot, 2013).

The value of tangible assets affects the capital structure according to the pecking order theory of debt, as these assets are pledged as collateral, meaning that the larger their share, the higher the leverage. Redeployability of tangible assets has also been cited as a key determinant of firm capital structure. As such, firms which hold higher value of collateral assets hold higher likelihood of having access to bank loans unlike firms that largely hold intangible assets (Koralun-Bereźnicka, 2013). In view of the notion that assets are used as collateral and as such, firms with high levels of tangible assets have high accessibility to debts which can in turn impact of profitability and financial performances in general.

Trade-Off Theory was brought forth by Kraus and Litzenberger in 1972 holds the view that a firm decides how much debt and equity finance it wants to utilize through having a balance between the cost and benefits. It was then expanded by Myers in 1984, by introducing adjustment costs, including those stemming from asymmetric information and agency problems (Frank et al., 2011) It states that there is an advantage to financing with debt, the tax benefits of debt and there is a cost of financing with debt, the costs of financial distress including bankruptcy costs of debt and non-bankruptcy costs (Ayot, 2013). Researches on the nexus between asset structure and capital structure came to the conclusion that the higher the collateral, the higher the potential leverage.

In view of this notion, the theory links asset structure and profitability. Firms having sufficient assets stand in a better position of utilizing assets which in translates to improved profitability. The assumption is also based on the findings of various scholars that: the higher the collateral, the higher the potential leverage; the higher the share of current assets the greater the long term assets; and the higher the share of current assets, the lower the short-term debt (Koralun-Bereźnicka, 2013). In view of this theory and in relation to this study, sufficient assets bring about the likelihood of reduced risk as well as bankruptcy cost, thereby increasing profitability and performance at large.

2.2 Empirical Review

2.2.1 Property, Plant, Equipment and Profitability

Mawih (2014) studied the effect of assets structure (based on current assets and fixed assets) on financial performances of listed manufacturing companies in Muscat Securities Market (MSM). The period 2008 to 2012 was covered where asset structure was assessed using current assets turnover and fixed assets turnover. The indicators for financial performance were return on assets and return on equity. In overall, it was found that asset structure had insignificant effects on profitability (ROE). Only fixed assets had significant on ROE unlike ROA. Findings show that in the petro-chemical sector, asset structure had significant impact on ROE.

Mwaniki and Omagwa (2017) analyzed the relationship between property, plants, equipment and financial performance for listed firms in the commercial and services sector at the Nairobi securities exchange, Kenya. The results from the regression analysis reveal that property, plants and equipment had significant relationship with financial performance. It was recommended that available resources with respect to property, plant and equipment should be utilized effectively.

Omondi (2018) examined asset structure effects on financial performance with emphasis on listed firms in the NSE, Kenya. The research used lifecycle theory, agency theory as well as static trade off theory to underpin the nexus between the study variables. While measuring financial performance with the use of ROE and ROA, asset structure was assessed using current asset turnover and fixed asset turnover. 17 firm cutting across commercial and service sector and energy and petroleum sectors were covered for the time frame 2011 to 2017. It was established that fixed assets is significant in predicting financial performance. The research concluded that asset structure had significant positive effect financial performance. The study recommended the prudent utlization as well as management of assets fpr purposes of increasing the value of the firm.

Ngunya and Mwangi, (2018) investigated the nexus between asset structure and financial performance for listed manufacturing and allied Companies in Kenya. While using casual research design, eight (8) companies were considered. Multiple panel regression model was used based on panel data. While using panel regression (random effect) analysis, it was found that tangible fixed assets had negative insignificant effect on financial performance. It was established that intangible fixed assets had positive insignificant effect on performance. It was recommended that management of manufacturing and allied listed firms should reconsider their composition of current and fixed assets.

Okoro and Charles (2019) examined fixed assets revaluation and profitability relationship based on a cross sectional approach with focus on commercial Banks in the context of Nigeria. Fifteen (15) listed banks were considered for the time frame 2013 to 2017. Profitability (return on assets) was expressed as a function of revaluation of land, revaluation of building as well as revaluation of equipment. With the use of panel regression, it was established that revaluation of buildings and land both exert negative insignificant effect on profitability whereas revaluation of equipment had positive insignificant effect on profitability. It was concluded that fixed assets revaluation had significant effects on bank profits in Nigeria.

2.2.2 Current Assets and Profitability

A study was done by Mawih (2014) on the effect of assets structure (based on current assets and fixed assets) on financial performances of listed manufacturing companies in Muscat Securities Market (MSM). The period 2008 to 2012 was covered where asset structure was assessed using current assets turnover and fixed assets turnover. Financial performances assessed through return on assets and return on equity. Current asset had insignificant effects on profitability. Only fixed assets had significant on ROE unlike ROA. Findings show that in the petro-chemical sector, asset structure had significant impact on ROE.

Mwaniki and Omagwa (2017) sought to establish the effect of current asset on financial performance of listed firms under the category of commercial and services sector at the Nairobi securities exchange, Kenya. Current assets denoted the independent variable while the outcome variable was financial performance as measured using return on equity, earning per share, return on sales (profit margin) and return on assets. The results indicated that current assets had insignificant effect on financial performance. It was recommended that companies should strive towards increasing resource allocation for purposes of long term investments.

Ngunya and Mwangi, (2018) examined the nexus between asset structure and financial performance of listed manufacturing and allied Companies in Kenya. While using casual research design, a census of eight (8) companies was done. With the use of panel data, multiple regression technique was applied. It was found that current assets had positive significant effect on financial performance as captured by ROA in the context of manufacturing and allied sector in Kenya. It was recommended that the management should relook at the existing fixed assets and current assets composition of the firm.

Omondi (2018) researched on the effect of current assets on financial performance while focusing on listed firms in the NSE, Kenya. The study used lifecycle theory, agency theory to explain the relationship between asset structure and financial performance. Financial performance was measured using ROE and ROA while current asset turnover was the independent variable. 17 firm cutting across commercial and service sector and energy and petroleum sectors were covered for the time frame 2011 to 2017. Current asset was established to exert significant in effect on financial performance of listed firms at NSE. The study recommended that companies should employ cash for purposes of meeting their intended obligations while and ensure smooth operations. Diligence is needed in spending resources towards economic benefits.

2.2.3 Intangible Assets and Profitability

Mwaniki and Omagwa (2017) did an assessment of intangible assets and financial performance nexus in the context of commercial and services firms listed at the NSE, Kenya. The research made use of secondary data and other variales used were current assets, property, plants and equipment and long term investments where financial performance was the dependent variable as indicated by return on equity, earning per share, return on sales (profit margin) and return on assets based on a composite index. The output of the multiple regression analysis reveals that asset structure had a significant nexus with financial performance of firms. It was found that intangible had no significant significance in predicting financial performance.

Ngunya and Mwangi, (2018) analyzed asset structure and financial performance relationships for the case of listed manufacturing and allied Companies in Kenya. Casual research design was used and a census of eight (8) companies was done. Panel data was used which was analyzed using multiple panel regression model. While using panel regression (random effect) analysis, it was found that tangible fixed assets had negative insignificant effect on financial performance. It was established that intangible fixed assets had positive insignificant effect on performance. Out of the different asset classes, the study concluded that performance in the context of manufacturing and allied sector in Kenya is dependent on the current assets. The study recommended managers to reconsider their holdings of fixed and current assets.

Utami *et al*. (2020) investigated asset structure effects on profitability of companies. The study focused on Indonesia Stock Exchange while covering the period 2015 to 2019. Twelve (12) companies were considered through the use of purposive sampling method. Asset structure was assessed using tangibility asset while profit was measured using return on assets. The study applied panel regression analysis and found that asset structure (tangibility assets) positively affects profitability of companies. The study has contributed to existing literature on asset structure and profitability, however, the context was Indonesia Stock Exchange.

2.2.4 Long-Term Investments and Profitability

Mwaniki and Omagwa (2017) assessed the nexus between asset structure and firm financial performance. The study was focused on listed firms under the category of commercial and services sector at the Nairobi securities exchange, Kenya. The research made use of secondary data where asset structure was considered in terms of current assets, property, plants and equipment, long term investments and funds as well as intangible assets while the outcome variable was firm financial performance which was assessed using return on equity, earning per share, return on sales (profit margin) and return on assets as computed by a composite index. The output of the multiple regression analysis reveals that asset structure had a significant nexus with financial performance of firms. The recommendation was that firms ought to increase resource allocation towards long term investments and funds.

Omondi (2018) examined asset structure effects on financial performance with emphasis on listed firms in the NSE, Kenya. The research used lifecycle theory, agency theory as well as static trade off theory to underpin the nexus between the study variables. While measuring financial performance with the use of ROE and ROA, asset structure was assessed using current asset turnover and fixed asset turnover. 17 firm cutting across commercial and service sector and energy and petroleum sectors were covered for the time frame 2011 to 2017. It was established that long term investments are significant in predicting financial performances in the context of listed firms at NSE. It is important to note that listed firms at NSE, Kenya cut across various sectors.

Mutua and Atheru (2020) studied long term investments and financial

performance while considering firms in the Manufacturing and Allied Sector listed at Nairobi Securities Exchange in Kenya. The study focused on all eight (8) firms listed under manufacturing and allied sector. Descriptive research design was applied and multiple regression was used in the data analysis. The study documented that long term debt positively affected financial performance (return on equity). It was recommended that the board of firms under the manufacturing and allied category should revamp their policies through the adoption of strategies which will ensure optimum utilization of resources.

3. FINDINGS AND CONCLUSIONS

The study sought to carry out a critical review of literature on asset structure and profitability of the manufacturing and allied firms listed in Nairobi Securities Exchange, Kenya. It was found that several studies have been done with respect to asset structure and profitability. However, these studies are characterized by various research gaps. Some of the studies

were centered on other countries and not Kenya. Notably, different countries are guided by varying regulatory frameworks as such the findings of the previous study cannot be directly applicable to the Kenyan context. Also, key aspects of asset structure such as property plant and equipment, current asset and long term investments were not considered. Despite some of the studies focusing on the manufacturing sector, moderation effects of inflation on the relationship between asset structure and profitability were not considered**.**

4. RECOMMENDATIONS

Several studies were done with respect to asset structure and profitability. As concluded, several research gaps exist within this area of study. The recommendations of this study are therefore in view of these research gaps which have been established. The study recommends that rather that focus on financial performance, profitability which is a narrow and key aspect of financial performance can be explored. Moderation effects of inflation on the relationship between asset structure and profitability can be considered while focusing on manufacturing and allied firms listed at the Nairobi Securities Exchange, Kenya.

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