FACTORS AFFECTING FINANCIAL STABILITY OF FINANCIAL SERVICE COMPANIES LISTED IN NAIROBI SECURITY EXCHANGE

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ABSTRACT

The purpose of the study was to examine the factors affecting financial stability of financial service companies listed in Nairobi securities exchange. The specific objectives of this study were: to establish the effect of macroeconomic factors on financial stability of financial service companies listed in Nairobi Securities Exchange and to examine the effect of savings on financial stability of financial service companies listed in Nairobi Securities Exchange. The population of the study consisted of all the 17 financial service companies consistently listed at the Nairobi Securities Exchange as at 27th July 2016. The research data was collected using a secondary data guide. Inferential statistics was used to analyze the relationship between independent and depended variables using linear regression. The study found that there was a strong positive correlation between financial stability of financial service companies and Macro-economic factors. The study revealed that macro-economic factors significantly affected financial stability of financial service companies. The study found that there was strong correlation between financial stability of financial service companies and savings. The study established that savings had positive significant effect on financial stability of financial service companies. The study recommended that there was need for the management of financial service companies listed in the NSE to factor macro environment factors when making in decision on financing. There was need for management of financial service companies listed in the NSE to use more of retained earnings in their investment.

Keywords: Macroeconomic Factors, Savings, Financial Stability, Financial Services, Nairobi Security Exchange
INTRODUCTION

Distinction between ownership and control in firm management result in sufficient work effort with clear focus on value maximization (Berger & Bonaccorsi di Patti, 2006). According to Ebaid (2009), the approach behind this distinction and focus on maximization of a firm’s value is Capital Structure (CS) theory. For their contribution on the same Razak, Ahmad and Aliahmed, (2008) argued that capital Structure is the way a firm finances its assets through a combination of equity and debt. Berger & Bonaccorsi di Patti (2006) focused their assertion on the theory of capital structure advanced by Modigliani and Miller in 1958 and its relationship with financial performance of non-financial firms even though it has been a controversial issue in corporate finance. The financial decision set by management of any firm is very important in determining the optimal capital structure, which in turn has an influence of its stability. According to Razak, Ahmad and Aliahmed, (2008), management of the firms have to set their capital structure in a way to maximize firm’s value. Maximization of firms’ value aims at improving stability in terms of profitability, tax Liability and asset growth. However, many firms have different levels of stability; there is a need to ascertain the influence of capital structure on the same. Capital structure is the proportion of debt instruments, preferred and common stock on a firm’s statement of financial position. On his part Ebaid (2009), noted that capital structure is the mixture of a firm's debt and equity, is important because it costs company money to borrow. Further Kouki (2012), argued that capital structure matters because of the different tax implications of debt vs. equity and the impact of corporate taxes on a firm’s stability. In essence according to Pratheepkanth (2011) firms must be prudent in their borrowing activities to avoid excessive risk and the possibility of financial distress or even bankruptcy to enhance stability. In recognition of the vital role of capital structure in determination of firms’ stability, it is imperative to adopt best practices in respect to investment decisions. Scholars have come to recognize the significance of capital structure in investment decision as it has an impact on shareholder return and risk. In this study on capital structure an attempt will be made to explain the macro-economic factors; savings; turn over growth; and debt financing used by companies towards achieving financial stability through investment in firms listed in Nairobi Security Exchange (NSE). Specifically, this study aims to examine empirically the relation between macro-economic factors such as inflation rate, exchange rate and interest rate; savings factors like dividend payout and retained earnings; turn over growth in terms of growth in revenue, growth in income, asset growth; and debt financing such as short term debt and long term debt on financial stability of firms listed in NSE.

Many studies on the US, the UK and other advanced countries, have attempted to establish the relationship between security Performance and economic indicators (Patra and Poshakwale, 2006; Wongbangpo and Subhash, 2002; Liow, 2006; Al-Jafari, 2011). The importance of establishing these relationships for investors is extremely important given that the risk faced by investors may be traced to the changing values of these economic factors. Several empirical studies have tested these relationships using the APT on US data such as Flanney and Protopadakis, (2002) and Humpe and Macmillan, (2007); and their results show that the theory has the potential for explaining Performance in the US capital markets. Capital markets of US, UK, Australia, Turkey and Japan among others have attracted the attention of many researchers in the past due to their size and prominence in the world capital markets (Kaplan, 2014).
Kaumbuthu (2011) carried out a study to determine the relationship between capital structure and return on equity for industrial and allied sectors in the Nairobi Securities Exchange during the period of 2004 to 2008. The study applied regression analysis and found a negative relationship between debt equity ratio and ROE. The study focused on only one sector of the companies listed in Nairobi Securities Exchange and paid attention to only one aspect of financing decisions. Locally, many researchers have reviewed various aspects of capital structure in the Kenyan context: Mwangi (2010) examined the relationship between capital structure and financial performance of firms listed in NSE and found out that there was a strong positive relationship between leverage and return on equity and return on investment.

The Nairobi Securities Exchange (NSE, 2011) was established in 1954 as a voluntary association of stock brokers with the objective to facilitate mobilization of resources to provide long term capital for financing investments. The NSE is regulated by Capital Markets Authority (CMA, 2011) which provides surveillance for regulatory compliance. The exchange has continuously lobbied the government to create conducive policy framework to facilitate growth of the economy and the private sector to enhance growth of the stock market (Ngugi, 2005). The NSE is also supported by the Central Depository and Settlement Corporation (CDSC) which provides clearing, delivery and settlement services for securities traded at the Exchange. It oversees the conduct of Central Depository Agents comprised of stockbrokers and investment banks which are members of NSE and Custodians (CDSC, 2004). These regulatory frameworks are aimed to sustain a robust stock market exchange that supports a cogent and efficient allocation of capital allowing price discovery to take place freely based on the market forces

Statement of the Problem

Macroeconomic pressures such as currency depreciation, fiscal deficits and rising sovereign debt levels, along with a spate of high valuations and profit warnings in the first half of 2015 led to a decline in the NSE, all Share Index; an indication of capital structure challenge (Muigai, 2016). This made the equity index which had peaked at 176.82 in February 2016 before ending September at 146.92, down 10% from 162.89, where it started the year; posing a big challenge of meeting capital requirements in these firms; and having an influence on their stability. Capital structure and financial stability are linked in a variety of mutually interacting ways. It is evident that risks to financial stability, to the extent that they require strategic thinking on capital structure which in itself is dependent on several factors. Most studies on listed firms in NSE have argued that several capital related factors contribute to performance with little regard to financial stability. For example, Kodongo, Mokoaleli-Mokoteli, and Maina (2014) in a study on capital structure, profitability and firm value of listed firms in Kenya concluded that it has no effect on indicators of financial distress, but didn’t mention financial stability. This in itself is a contradiction and is puzzling and provides a need to carry out an incisive investigation of effects of capital structure on financial stability. Secondly, Mwangi, Muathe, and Kosimbei (2014), studying relationship between capital structure and performance of non-financial companies listed in the Nairobi Securities suggested that asset tangibility, sales growth and firm size are important determinants of profitability; and with no mention of financial stability. In a surprise turn they also noted that asset tangibility consistently has a negative relationship with profitability. Study on factors affecting financial stability enabled listed firms including those in NSE to appreciate how related factors influence stability (Magara, 2012). A
number of such factors which include macro-economic factors such as inflation rate, exchange rate and interest rate; savings factors like dividend payout and retained earnings; turn over growth in terms of growth in revenue, growth in income, asset growth; and debt financing such as short term debt and long term debt affect financial stability of firms. These as capital structure related factors contribute towards profitability, tax liability and asset growth all of which are measures of financial stability. The questions that demand answers are how financially stable are listed companies in Nairobi Security Exchange and to what extent does macro-economic factors, savings, turnover growth and debt financing affect financial stability of companies listed in the NSE. This study sought to fill the existing research gap by conducting a study to establish factors affecting financial stability of financial service companies listed in Nairobi Security Exchange.

Research Objective

The objective of the study was to examine factors affecting financial stability of financial service companies listed in Nairobi security exchange. The specific objectives of this study were:

- To establish the effect of macroeconomic factors on financial stability of financial service companies listed in Nairobi security exchange.
- To examine the effect of savings on financial stability of financial service companies listed in Nairobi security exchange.

LITERATURE REVIEW

Theoretical Review

Trade off Theory

San and Heng (2011) noted that according to trade off theory propounded by Modigliani and Miller in 1958, if firms are more profitable they prefer debt financing as compared to equity for the sake of profit. According Raheman, Zulfiqar and Mustapha (2007) this posture is driven by three forces. First, more debt in a firm’s capital structure allows for more tax benefits as their tax liabilities become lower and even in some cases it is waved off. Secondly, if a firm has a low profit than there exist greater chances of bankruptcy. So, if the firm takes more debts there are chances that it is bankrupt and as a result of this, investors cannot have trust on it. And thirdly, the agency cost which has to be borne by investors is a cost in form of interest rate because creditors always check the position of the company and monitor the management. So, if a firm has a good image that it can get loan at a lower cost because creditors are not worried about bankruptcy and their agency cost is very low, it can acquire more debts. Generally, a firm’s optimal capital structure involves the trade-off among the effects of corporate and personal taxes, bankruptcy costs and agency costs, etc. The Tradeoff Theory defines the capital structure in terms of how much debt and equity finance should be chosen by the company to use by balancing the costs and benefit (Frank & Goyal, 2009). The capital structure can sometimes also lead to the bankruptcy and subsequent negative and adverse effect on the performance of the firm if not properly utilized. Tradeoff theory was used to establish the effect of macroeconomic factors on financial stability of firms listed in Nairobi Security Exchange.

Pecking Order Theory

Pecking order theory articulated by Myers and Majluf in 1984, state that firms having high profits tend to attain low debt profile because when firms are more profitable their first priority is to generate financing through retained earnings (R. Es) because they maximize the value of the existing shareholders. If retained earnings are not sufficient, the firms can then go for debt and if further financing is required they issue new equity. The
retained earnings are preferred because it almost has no cost, but if the external resources are used for financing like issuance of new shares it may take very high costs. The pecking order theory is as a result of information asymmetries existing between insiders of the firm and outsiders’ liquidity (Uremadu, 2009). The model leads to managers to adopt their financing policy to minimize these associated costs. It means that they will prefer internal financing to external financing and very risky debt to equity. Different shades of conceptual views on the effect of capital mix on corporate performance therefore exist, but the central issue before a financial manager is to determine the appropriate mix between equity and debt for his firm (Okafor and Harmon, 2005). The mix of debt and equity is known as the firm’s capital structure. A financial manager must strive to achieve an optimum mix or the optimal capital structure for his or her firm; that is, the capital structure which would maximize the market value of the firm’s shares and at the same time assure adequacy in capital. Criticizing pecking order theory, Naidu (2011) argued it is based on the costs of obtaining financing. Pecking order theory was used in this study to examine the effect of savings on financial stability of firms listed in Nairobi Security Exchange.

Conceptual Framework

<table>
<thead>
<tr>
<th>Macro-Economic Factors</th>
<th>Financial Stability</th>
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<tr>
<td>• Inflation rate</td>
<td>• Profitability</td>
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<td>• Exchange rate</td>
<td>• Liquidity levels</td>
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<td>• Interest rate</td>
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<td>• Retained earnings</td>
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Independent Variables          | Dependent Variable
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Figure 1: Conceptual Framework

Macro-Economic Factors

Macroeconomic uncertainty, volatility and risk on financial services firms are having an effect on their profitability and especially in developing countries. Financial factors such as inflation rate, high interest rates and increasing exchange rates are some of the factors in the current business environment that are affecting the profitability of financial services firms. According to Demir (2009) increasing exchange rate and capital flow volatility are also found to raise inflation uncertainty and encourage financial investments while discouraging fixed investments. In addition, despite comprehensive reform programs, persistent capital market imperfections and high real interest rates in developing countries continue to hurt firms’ profitability. Moreover, despite large capital inflows, financial services firms continue to face strict credit rationing and are forced to finance their investments mostly from internal sources or short-term borrowing. Inflation means rising prices and it shows the increase in cost of living. In economics, inflation is explained as rise in the general level of prices of goods and services in an economy over a period of time. With the rise in price levels a unit of currency will buy fewer goods and services. As a result, the purchasing power of money will be reduced with inflation. In other words, the real value of money will be lost day by day along with inflation. Ebaid (2009) in his work on the impact of capital structure choice on firm performance in Egypt noted that low inflation rate is beneficial to a country and zero or negative inflation is considered as bad. This can destabilize markets creating unnecessary shortages. High inflation redistributes the income of people. The fixed income earners and those lacking bargaining power will become relatively worse off as their purchasing power falls. Trade unions may demand for higher wages at times of high inflation. During a high inflation period, wide fluctuations in the inflation rate make it difficult for business
organizations to predict the future and accurately calculate prices and returns from investments. Therefore, it can undermine business confidence. When inflation in a country is more than that in a competitive country, the exports from former country will be less attractive compared to the other country (Montiel & Serven, 2004). This means there will be less sales for that country’s goods both at home and abroad and that will create a larger trade deficit. High interest rates are likely to curb business investments and innovation. Rising interest rates could also increase loan defaults in the banking system and bank vulnerability, drive the cost, push inflation due to medium term increase in prices associated with higher costs of business financing (CBK, 2012). When banks make borrowing more expensive, companies might not borrow as much and will pay a higher rate of interest on their loans. Less business spending can slow down the growth of a company, resulting in decreases in profit. Securities of firms making continuous losses usually suffer from price decline.

Savings

Many of these studies have used national saving and investment figures while only few focused on private saving and investment. Further, policies that are geared to raise the level of saving and investment generally focus on these two aggregates. Unfortunately, no attempt has been done so far to estimate the saving and investment functions for Namibia. Several briefing papers on the historical trends of savings and investment have been prepared so far but none of these papers have used econometric tools to estimate the determinants of saving and investment. The absence of earlier work presents a challenge to this study, as there are no existing results against which a comparison could be made. The inclusion of macroeconomic stability factors in the saving and investment models is done on recognition that these factors have significant influences on saving and investment. This includes, the rate of inflation, the standard deviation of inflation, the overall budget deficit as a ratio of GDP.

Stability of Companies Listed in NSE

A company’s financial performance, in the view of the shareholder, is measured by how better off the shareholder is at the end of a period than he or she was at the beginning and this can be determined using ratios derived from financial statements; mainly the balance sheet and income statement, or using data on stock market prices (Berger & Patti, 2002). These ratios give an indication of whether the company is achieving the owners’ objectives of making them wealthier, and can be used to compare a company’s ratios with other companies or to find trends of performance over time. Severin (2002), states that an adequate stability measure ought to give an account of all the consequences of investments, on the wealth of shareholders. The main objective of shareholders in investing in a business is to increase their wealth. Thus, the measurement of financial stability of the business must give an indication of how wealthier the shareholder, has become as a result of the investment over a specific time. Asset growth is form of investment in which the company management adds value to shareholders’ wealth. This lucrative investment strategy is emerging to be the normative idea for many firms. It is also common knowledge for the management of a company to expect that an asset bought now as an investment will perform better in the future. However, the management has to assess the derivative impact of investing heavily on assets in relation to (long) term effect stock return if it is a listed company. There is an indication that Kenya Stock market financial listed companies are inefficient in allocating capital and valuing investment opportunities since the negative asset growth effect on stock returns exist. Numerical
instructions on the Kenyan listed firms’ data were performed which supports the theoretical analysis.

Empirical Review

Macro-Economic Factors

World Bank (2000) estimates that reducing consumption volatility may create welfare gains in the order of 4%-10% of consumption in 20 Latin American countries (with an overall mean of 20% and median of 7.7%) though such gains would be 1.2% on average in developed countries. In addition, despite comprehensive reform programs persistent capital market imperfections and high real interest rates in developing countries continue to hurt firms’ profitability. Moreover, despite large capital inflows, financial services firms continue to face strict credit rationing and are forced to finance their investments mostly from internal sources or short-term borrowing. Khan (2012) in a study on capital structure, equity ownership and firm performance in India found out that inflation continues to be a fact of economic life in most countries. His study involved pooling of twenty-one listed firms on the Indian Stock Exchange over the period of 2005-2010 and agreed with Babalola (2014) that high inflation rates have seriously eroded monetary values in most developing countries over the past two decades, and have brought forth new patterns of economic behavior. Inflation means rising prices and it shows the increase in cost of living. In economics, inflation is explained as rise in the general level of prices of goods and services in an economy over a period of time. With the rise in price levels a unit of currency will buy fewer goods and services. As a result, the purchasing power of money will be reduced with inflation. In other words, the real value of money will be lost day by day along with inflation. Ebaid (2009) in his work on the impact of capital structure choice on firm performance in Egypt noted that low inflation rate is beneficial to a country and zero or negative inflation is considered as bad. His research was based on panel estimation covering the periods 2003-2008 and modelled on the Return on Assets, return on Equity and firm’s Tobin’s Q, to proxy firm’s performance, concurred that a high inflation is harmful to an economy and it affects an economy in many ways. High inflation distorts consumer behavior. Because of the fear of price increases, people tend to purchase their requirements in advance as much as possible. This can destabilize markets creating unnecessary shortages. High inflation redistributes the income of people. The fixed income earners and those lacking bargaining power will become relatively worse off as their purchasing power falls. Trade unions may demand for higher wages at times of high inflation. During a high inflation period, wide fluctuations in the inflation rate make it difficult for business organizations to predict the future and accurately calculate prices and returns from investments. Therefore, it can undermine business confidence. When inflation in a country is more than that in a competitive country, the exports from former country will be less attractive compared to the other country (Montiel & Serven, 2004). This means there will be less sales for that country’s goods both at home and abroad and that will create a larger trade deficit. In their study on capital structure and financial performance in Kenya, Maina and Ishmail (2014) and using evidence from firms listed at the Nairobi Securities Exchange, noted that interest rate has a wide and varied impact upon the economy. Their study employed an explanatory non-experimental research design. A census of 42 non-financial companies listed in the Nairobi Securities Exchange, Kenya was taken. The study used secondary panel data contained in the annual reports and financial statements of listed non-financial companies. The data were extracted from the Nairobi Securities Exchange hand books for the period 2006-2012. The study applied panel data models (random effects) When it is raised, the
The general effect is to lessen the amount of money in circulation, which works to keep inflation low. High interest rates are likely to curb business investments and innovation. Rising interest rates could also increase loan defaults in the banking system and bank vulnerability, drive the cost, push inflation due to medium term increase in prices associated with higher costs of business financing (CBK, 2012). When banks make borrowing more expensive, companies might not borrow as much and will pay a higher rate of interest on their loans. Less business spending can slow down the growth of a company, resulting in decreases in profit. Securities of firms making continuous losses usually suffer from price decline. The drop in the rates promote borrowing and spending (Saunders and Cornett, 2008). The lower interest rates give companies an opportunity to borrow money at lower rates, which allows them to expand their operations and also their cash flows. In a low interest rate regime, companies are able to increase profitability by reducing their interest expenses. However, in a rising interest rate regime, since interest expenses rise, profitability is lowered.

**Savings**

Many of these studies have used national saving and investment figures while only few focused on private saving and investment. In his study on financial leverage and firm value in South Africa Rayan (2010), noted that it is of great importance to determine factors that influence changes in private saving and investment, as these are the main components of aggregate saving and investment in many countries. Further, policies that are geared to raise the level of saving and investment generally focus on these two aggregates. Unfortunately, no attempt has been done so far to estimate the saving and investment functions for Namibia. Several briefing papers on the historical trends of savings and investment have been prepared so far but none of these papers have used econometric tools to estimate the determinants of saving and investment in Namibia. The absence of earlier work presents a challenge to this study, as there are no existing results against which a comparison could be made. Several studies have estimated the saving and investment function in developing countries, particularly on sub-Saharan Africa. For example, Magara (2012) in study on capital structure and its determinants at the Nairobi Securities Exchange. His study adopted a correlational research design and targeted all the companies listed and active at the NSE from January 2004 to August 2010. Regression model was used to examine the effect of the macroeconomic environment on the stock market returns at the NSE. He gave a generalization that a number of macroeconomic variables have been included in the saving and investment models to account for the effects of monetary, fiscal and exchange rate policies. The inclusion of macroeconomic stability factors in the saving and investment models is done on recognition that these factors have significant influences on saving and investment. This includes, the rate of inflation, the standard deviation of inflation, the overall budget deficit as a ratio of GDP. Production costs are expenses, such as materials and labor that a company incurs in the course of producing the product to sell to consumers and from incomes are expected. Pratheepkanth (2011), in a study on capital structure and financial performance from selected business companies in Colombo Stock Exchange Sri Lanka, noted that the lower the production cost, the higher the profit, or the amount left over after subtracting expenses from sales revenue. However, low production costs do not necessarily guarantee a high profit. A business may have unsustainably high fixed costs, such as rent, or may cut production costs of producing an inferior product that nobody wants.
METHODOLOGY

The nature of this study was a causal study. Causal designs are used to show the impact of one variable on another. The population of the study consisted of all the 17 financial services firms consistently listed at the Nairobi Securities Exchange as at 27th July 2016. The financial institutions’ sector comprised 11 banking service providers and 6 insurance firms. Secondary data was collected for this study.

RESULTS AND DISCUSSION

Descriptive Statistics

The study present the research finding on the descriptive statistic in the data collected.

Table 1: Descriptive Statistics

<table>
<thead>
<tr>
<th></th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
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<tbody>
<tr>
<td>Economic Factors</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Inflation rate</td>
<td>85</td>
<td>5.63</td>
<td>14.37</td>
<td>8.31</td>
<td>.6372</td>
</tr>
<tr>
<td>Exchange rate</td>
<td>85</td>
<td>80.79</td>
<td>110.41</td>
<td>100.37</td>
<td>.8781</td>
</tr>
<tr>
<td>Interest rate</td>
<td>85</td>
<td>8.42</td>
<td>13.42</td>
<td>10.12</td>
<td>.7821</td>
</tr>
<tr>
<td>Savings</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividend payout</td>
<td>85</td>
<td>.67</td>
<td>3.27</td>
<td>2.40</td>
<td>.49977</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>85</td>
<td>.23</td>
<td>.87</td>
<td>.4119</td>
<td>.15574</td>
</tr>
<tr>
<td>Financial stability</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profitability</td>
<td>85</td>
<td>.02</td>
<td>.34</td>
<td>.1371</td>
<td>.08046</td>
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<tr>
<td>Liquidity levels</td>
<td>85</td>
<td>.78</td>
<td>2.59</td>
<td>1.5596</td>
<td>.45603</td>
</tr>
</tbody>
</table>

From the findings on the economic factors the study found that the mean for the inflation rate was 8.31 with standard deviation of 0.6372, exchange rate had mean of 100.37 and standard deviation of 0.8781, interest rate was found to have a mean of 10.12 and standard deviation of 0.7821. On the study findings on saving the study found that dividend payout had a mean of 2.40 and standard deviation of 0.49977, retained earning had mean of 0.4119 and standard deviation of 0.15574.

Correlations Analysis

The study carried out correlation matrix analysis to examine factors affecting financial stability of financial service companies listed in Nairobi security exchange.

Effect of Macroeconomic Factors on Financial Stability

The results of Pearson Moment Correlation analysis illustrated that there was a strong positive correlation $r = 0.897$ between financial stability of financial service companies and Macro-economic factors, statistically significant ($P=0.00<0.05$) at 95% confidence level. The study findings were in agreement with the finding of Demir (2009) increasing exchange rate and capital flow volatility was also found to raise inflation uncertainty and encouraged financial investments while discouraging fixed investments.

Effect of Savings on Financial Stability

The study found that there was strong correlation ($r=0.779$) between financial stability of financial
service companies and savings, statistically significant (P=0.00<0.05) at 95% confidence level. The study findings were in agreement with the findings of Rayan (2010) who revealed that it is of great importance to determine factors that influence changes in private saving and investment, as these were the main components of aggregate saving and investment in many countries.

**CONCLUSION AND RECOMMENDATIONS**

From the finding the study found that there was a strong positive correlation between financial stability of financial service companies and macro-economic factors. The study findings were in agreement with the finding of Demir (2009) increasing exchange rate and capital flow volatility were also found to raise inflation uncertainty and encourage financial investments while discouraging fixed investments. The study revealed that macro-economic factors were significantly affecting financial stability of financial service companies. This was an indication that a unit increase in macro-economic factors led to an increase in financial stability of financial service companies. The study findings were in agreement with the findings of Demir (2009), who found that an increasing exchange rate and capital flow volatility are also found to raise inflation uncertainty and encourage financial investments while discouraging fixed investments.

The study found that there was strong correlation between financial stability of financial service companies and savings. The study findings were in agreement with the findings of Rayan (2010) who revealed that it is of great importance to determine factors that influence changes in private saving and investment, as these are the main components of aggregate saving and investment in many countries. The study revealed that saving significantly explained financial stability of financial service companies. This implied that saving had positive significant effect on financial stability of financial service companies. This was an indication that a unit increase in saving led to increases in financial stability of financial service companies. The study findings were in agreement with the findings of Rayan (2010) who revealed that it is of great importance to determine factors that influence changes in private saving and investment, as these are the main components of aggregate saving and investment in many countries.

**Conclusion**

The study found that there was a strong positive correlation between financial stability of financial service companies and Macro-economic factors. The study revealed that macro-economic factors significantly affected financial stability of financial service companies. From the finding the study concluded that those macroeconomic factors positively affected the financial stability of firms listed in Nairobi Securities Exchange.

The study found that there was strong correlation between financial stability of financial service companies and savings. The study revealed that saving significantly explained financial stability of financial service companies. This study established that saving had positive significant effect on financial stability of financial service companies. From the findings the study concluded that savings positively affected the financial stability of firms listed in Nairobi Securities Exchange.

**Recommendations**

The study recommended that there is need for the management of firms listed in the NSE to factor macro environment factors when making in decision on financing as the study found that macroeconomic factors positively affect the

There was need for management of firms listed in the NSE to use more of retained earnings in their investment as the study found savings has positive effects on financial stability of firms listed in Nairobi Security Exchange.

Areas For Further research

The study sought to examine the effect of capital structure on financial stability of companies listed at the Nairobi Securities Exchange. The study recommended that an in-depth study should be done on determinants of capital structure among companies listed at the Nairobi Securities Exchange.

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