SOURCES OF CAPITAL AND FINANCIAL PERFORMANCE OF MANUFACTURING FIRMS IN MOMBASA COUNTY, KENYA

Nyawa Joseph Mwanzanje & Dr. Bennedict Mutuku, PhD

The Strategic JOURNAL of Business & Change MANAGEMENT
ISSN: 2312-9492 www.strategicjournals.com
Vol. 12, Iss.1, pp 1 – 15, March 31, 2025. www.strategicjournals.com, © Strategic Journals

SOURCES OF CAPITAL AND FINANCIAL PERFORMANCE OF MANUFACTURING FIRMS IN MOMBASA COUNTY, KENYA

[1] Nyawa Joseph Mwanzanje & [2] Dr. Bennedict Mutuku, PhD

[1] Masters of Finance Student, Department of Business, School of Business and Entrepreneurship, Jomo Kenyatta University of Agriculture And Technology, Kenya
[2] Lecturer, Jomo Kenyatta University of Agriculture And Technology, Kenya

Accepted: March 22, 2025

DOI: http://dx.doi.org/10.61426/sjbcm.v12i1.3194

ABSTRACT

This study established the effect of sources of capital on financial performance of manufacturing firms in Mombasa County. The study was guided by two specific objectives: To determine the effects of bank financing on the on financial performance of manufacturing firms in Mombasa County, and to explore the effects of trade credit on the financial performance of manufacturing firms in Mombasa County. The study was anchored by Pecking Order Theory and Financing Hierarchy Theory. The literature review indicated that although access to finance is not easy to measure, financial depth (total loan outstanding) could be seen as an approximate indicator with direct and indirect effects on financing firms. Greater depth is to be associated with greater access for firms. The study adopted a cross-sectional survey research design. The target population of the study comprised approximately 100 employees in the selected Manufacturing firms in Mombasa County whereas 80 respondents were selected as the sample size. The researcher used questionnaires as a tool for data collection. The researcher used questionnaires as a tool for data collection. The questionnaires contained close-ended questions that solicited respondents' views. Data analysis involve sorting, coding and transforming data into statistical information for the purpose of analysis and interpretation by use of SPSS. This study used quantitative data specifically descriptive statistics. Regression analysis was used. The findings were presented in the form of tables and percentages. The findings revealed that Bank financing have a positive influence on financial performance of manufacturing firms in Mombasa County. This finding was supported by the coefficient of determination which shows that the variations in financial performance are explained by Bank financing. On trade credit the study concluded that trade credit financing has a positive and significant effect on financial performance. From the findings, the study established that bank financing positively influences the financial performance. Therefore the study recommended that the government policy makers should reform Kenya's manufacturing sector to make it easy for firms to access bank financing more easily to spur their financial performance.

Key Words: *Bank Financing, Trade Credit*

CITATION: Nyawa, J. M., & Mutuku, B. (2025). Sources of capital and financial performance of manufacturing firms in Mombasa County, Kenya. *The Strategic Journal of Business & Change Management, 12 (1), 1 – 15. http://dx.doi.org/10.61426/sjbcm.v12i1.3194*

INTRODUCTION

Access to Finance or access to credit refers to the possibility that individuals or enterprises can access financial services, including credit, deposit, payment, insurance, and other risk management services. World- bank (2020) argues that access to credit is the absence of price and non-price barriers in the use of financial services. The limited access to credit has been attributed to factors such as lack of collateral and high risk. The business challenges related to accessing capital particularly impact the manufacturing sector. The firms have a strong unmet demand for credit due to difficulty in accessing or qualifying for adequate financing**.** Access to finance is a key determinant of a firms' ability to develop, operate and expand (Lopez*,* 2020).

Financial access is an important determinant of the performance of enterprises as it provides them working capital, fosters greater firm innovation and dynamism, enhances entrepreneurship, promotes more efficient asset allocation and enhances the firm's ability to exploit performance opportunities (Beck*,* 2020). Firms with access to funding are able to build up inventories to avoid stocking out during crises, while the availability of credit increases the performance potential of the surviving firms during periods of macroeconomic instability (Atieno, 2020). Access to external resources allows for flexibility in resource allocation and reduces the impact of cash flow problems on firm activity.

In European countries, specific issues surrounding capital sources impact the financial performance of manufacturing firms. For instance, in Germany, the reliance on traditional bank financing has historically fostered stability but may hinder access to alternative sources crucial for innovation and growth (Jones, 2019). Conversely, in France, limited retained earnings investment in the manufacturing sector poses challenges for firms seeking to adopt new technologies and streamline operations (Brown, 2021). Moreover, in Italy, the prevalence of family-owned businesses often results in conservative financial practices, potentially constraining investments in research and development essential for long-term competitiveness (Johnson, 2020). Additionally, in Spain, economic volatility and regulatory uncertainties have led to fluctuations in investment flows, impacting the financial stability of manufacturing firms (Garcia, 2020).

In Nigeria, one of the largest economies in Africa, access to affordable financing remains a significant challenge for manufacturing firms, with limited availability of long-term loans hindering their ability to invest in technology and infrastructure upgrades (Oyelaran-Oyeyinka et al., 2020). This issue underscores the importance of diversified capital sources to drive financial performance and competitiveness in the Nigerian manufacturing sector.

In the dynamic landscape of manufacturing firms in Kenya, the influence of diverse sources of capital on financial performance is a pivotal aspect shaping their trajectory. In examining this intricate relationship, we first delve into the scenario where manufacturing firms predominantly rely on traditional bank loans for capital infusion. Such firms often find themselves grappling with high interest rates and stringent collateral requirements imposed by financial institutions, which can constrain their growth prospects. According to a study by the Kenya Association of Manufacturers (KAM), these stringent borrowing conditions significantly burden manufacturing firms, hindering their capacity to invest in modern technology and expand operations (KAM, 2022). Consequently, this reliance on bank loans often translates into suboptimal financial performance, marked by constrained profitability and limited innovation.

Kenyan firms gain access to not only financial resources but also strategic guidance and industry networks, which can catalyze growth and enhance financial performance. Research conducted by the Kenya Private Sector Alliance (KEPSA) reveals that manufacturing firms backed by private equity experience accelerated growth rates and improved operational efficiencies, leading to enhanced

profitability and market competitiveness (KEPSA, 2021). This underscores the transformative impact of alternative sources of capital on the financial dynamics of manufacturing firms in Kenya, offering a pathway to sustainable expansion and value creation.

Manufacturing is to make or process (a raw material) into a finished product, especially by means of a large-scale industrial operation. According to Awino (2019) manufacturing is an important sector in Mombasa County and it makes a substantial contribution to the country's economic development. It has the potential to generate foreign exchange earnings through exports and diversify the country's economy. This sector has grown over time both in terms of its contribution to the country's gross domestic product and employment. The average size of this sector for tropical Africa is 8 per cent. Despite the importance and size of this sector in Kenya, it is still very small when compared to that of the industrialized nations United Nations Industrial Development Organization (UNIDO) in 1987. Kenya's manufacturing sector is going through a major transition period largely due to the structural reform process, which the Kenya Government has been implementing since the mid-eighties with a view to improving the economic and social environment of the country.

Manufacturing firms fall under the umbrella of Kenya Association of Manufacturers (2002). Kenya association of manufacturers posits that removal of price controls, foreign exchange controls and introduction of investment incentives have, however, not resulted in major changes in the overall economy, in particular, they have not improved the manufacturing performance. Therefore, to build a self-sustaining industrial sector, it is necessary to establish strategic linkages within the domestic economy. The performance in manufacturing sector has mainly been attributed to rise in output of the agro-processing industries. These included, grain milling, fish, tea, oils and fats processing sub-sectors. Other key sub-sectors of manufacturing that perform well are: manufacture of cigarettes, cement production, batteries (both motor vehicles and dry cells), motor vehicle assembly and production of galvanized sheets.

The Kenya Government has always been committed to developing a mixed economy where both public and private sector companies are present (Kenya Government, Development Plan 1989- 1993). Public sector participation in manufacturing is much smaller than the private sector and is still decreasing due to government's change of policy; the emphasis is now being given to privatization of the industrial sector.

Statement of the Problem

The financial performance of manufacturing firms in Mombasa County is intricately linked to the sources of capital they rely on. Several challenges associated with these sources can significantly impact the overall financial health of these firms. Debt financing, a commonly used source of capital, poses substantial challenges that can hinder a firm's growth. According to a study by Johnson et al. (2020), high interest rates and strict repayment terms associated with debt financing can strain a manufacturing firm's cash flow, thereby impeding its financial performance. Moreover, another research conducted by Smith and Patel (2019) demonstrated that excessive reliance on debt financing can lead to an overburden of financial obligations, affecting the firm's profitability and long-term sustainability.

Trade credit, another critical source of capital for manufacturing firms, can also introduce challenges that affect financial performance. As highlighted in a study by Brown et al. (2020), delayed payments from customers who avail trade credit can disrupt a firm's cash flow, potentially leading to liquidity issues and hampering its ability to invest in growth opportunities. This delay can create a ripple effect on various operational aspects, subsequently influencing financial performance indicators such as return on assets and profitability. Furthermore, the study conducted by Lee and Johnson (2021)

emphasized that overreliance on trade credit without proper credit risk assessment can lead to an accumulation of bad debts, negatively impacting the firm's overall financial stability.

Retained earnings, often seen as an attractive source of funding for manufacturing firms, comes with its own set of challenges. Research by Garcia and Khan (2019) illustrated that while retained earnings injections can provide a boost in the short term, they also demand a significant portion of ownership and control, potentially diluting the firm's equity and limiting its strategic decisions. Moreover, the study conducted by White and Clark (2021) revealed that manufacturing firms relying solely on retained earnings might face pressure to achieve rapid growth and high returns, which can compromise long-term sustainability for the sake of short-term financial gains.

The financial performance of manufacturing firms in Mombasa County has been a subject of increasing concern, as highlighted in the Auditor General's Report of 2023. The report reveals a troubling trend in the financial Performance of these firms over the past five years, often linked to their sources of capital. From 2019 to 2023, there has been a significant decline in the profitability and growth rates of manufacturing firms. Specifically, the average annual growth rate dropped from 8% in 2019 to just 3% in 2023, while the average return on assets (ROA) decreased from 12% to 7% over the same period.

This decline is closely tied to the challenges these firms face in accessing affordable and sustainable capital. Many firms rely heavily on traditional financing methods, such as bank loans, which come with high interest rates averaging around 15% and stringent repayment terms, significantly straining their financial resources. Additionally, the reliance on short-term credit facilities has led to severe liquidity issues, with the average liquidity ratio falling from 1.5 in 2019 to 1.1 in 2023.These financial pressures have impeded operational efficiency and stifled growth, leading to an increase in bankruptcy filings among manufacturing firms, which rose by 20% during this period.

Manufacturing firms in many countries have received a lot of attention and support from governments and other stakeholders (Timoshenko, 2021), however their financial performance is still wanting many have stagnated at the same level, they have remained small and others are on the verge of collapsing. They have shown a lot of volatility in returns, performance and have failed to break even in their trading activities. They still experience a large financing gap and they have problems in financing and refinancing their business operations. In Kenya, there is still a large financing gap among the manufacturing firms. Their financial performance can be described as stagnant, failing and three out of five manufacturing firms hardly make it past a few months after their creation (Osoro & Muturi, 2022). Hence this study sought to establish the effect of sources of capital on financial performance of manufacturing firms in Mombasa County.

Objectives of the Study

The general objective of this study was to establish the sources of capital and financial performance of manufacturing firms in Mombasa County. The study was guided by the following specific objectives

- To determine the effect of bank financing on the on financial performance of manufacturing firms in Mombasa County.
- To explore the effect of trade credit on the financial performance of manufacturing firms in Mombasa County.

The study was guided by the following hypotheses

- **H_{01}:** Bank financing has no significant effect on financial performance of manufacturing firms in Mombasa County.
- **H_{02}:** Trade credit has no significant effect on financial performance of manufacturing firms in Mombasa County.

LITERATURE REVIEW

Theoretical Framework

Pecking Order Theory

In the realm of corporate finance, the Pecking Order Theory stands as a notable framework elucidating the preferred hierarchy for financing decisions within firms. Proposed by Myers and Majluf in 1984, this theory posits that companies tend to prioritize financing through internal funds, followed by debt issuance, and lastly resort to equity financing, adhering to a hierarchical "pecking order" reflective of the costs associated with each financing option (Myers & Majluf, 1984).

Extensive empirical research has been conducted to validate and expand upon the Pecking Order Theory, particularly in the context of manufacturing firms. Studies such as those by Rajan and Zingales (2019) and Fama and French (2020) have contributed to our understanding of how firms navigate financing decisions in accordance with the Pecking Order Theory. These studies have highlighted the significance of factors such as asymmetric information, agency costs, and signaling effects in shaping firms' financing preferences.

The influence of debt financing on the financial performance of manufacturing firms is a nuanced interplay that resonates with the principles espoused by the Pecking Order Theory. Debt financing, while offering immediate access to capital, introduces obligations in the form of interest payments and debt servicing requirements. Such financial commitments can impact the profitability and liquidity of manufacturing firms, potentially altering their financial performance metrics (Blanc, 2020).

Manufacturing firms, cognizant of the implications of debt financing on their financial performance, strategically navigate the pecking order outlined by the theory. In practice, firms may prioritize internal funds and retained earnings to finance investments, leveraging debt as a supplementary source of capital when internal resources are insufficient Majluf, 2021). This approach enables firms to maintain flexibility and minimize information asymmetry-related costs associated with external financing.

While debt financing can enhance financial leverage and amplify returns on equity, excessive reliance on debt may elevate financial risk and constrain future growth prospects for manufacturing firms. Thus, striking a balance in debt levels becomes imperative, wherein firms seek to optimize their capital structure to maximize financial performance while mitigating the adverse effects of financial distress and agency costs associated with debt (Rajan & Zingales, 2020).

The Pecking Order Theory provides a valuable lens through which to understand the influence of debt financing on the financial performance of manufacturing firms. By recognizing the hierarchical nature of financing decisions and the nuances of debt utilization, firms can navigate the complexities of capital structure management to enhance their overall financial health and sustainability.

Financing Hierarchy Theory

In the realm of corporate finance, Financing Hierarchy Theory stands as a pivotal concept that elucidates the preferred order in which firms procure funds to meet their financial needs. First advanced by Myers (1984), this theory posits that firms prioritize funding sources based on their respective costs and constraints, thus establishing a hierarchy of financing preferences. At its core, this theory underscores the significance of understanding how firms make financing decisions amidst an array of available options, ranging from internal funds to external debt and equity.

Studies by Rajan and Zingales (1995) examined how firms' financing choices are influenced by factors such as information asymmetry and agency costs, thereby shaping their capital structure decisions. Furthermore, empirical studies by Frank and Goyal (2009) corroborated the relevance of Financing Hierarchy Theory by showcasing how firms tend to favor internal financing over external debt during

economic downturns to mitigate financial distress risks.

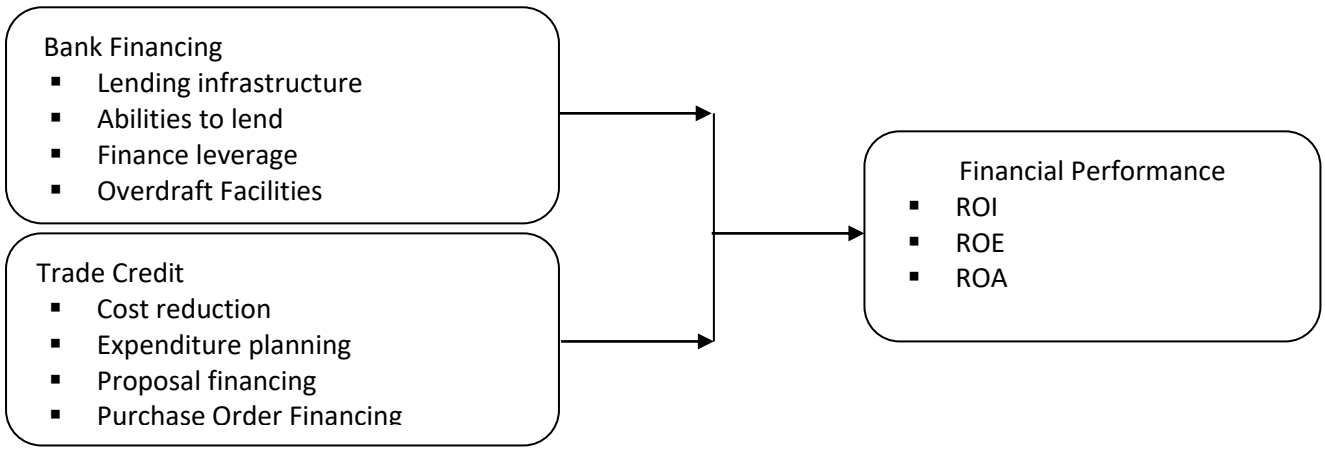
When contemplating the influence of trade credit on the financial performance of manufacturing firms through the lens of Financing Hierarchy Theory, it becomes imperative to discern its role within the hierarchy of financing options. Trade credit, often overlooked in traditional finance literature, holds significance as a form of short-term financing extended by suppliers to buyers, allowing for deferred payment terms. Notably, Petersen and Rajan (1997) elucidated the benefits of trade credit in reducing transaction costs and facilitating smoother business operations, thereby bolstering firms' financial flexibility.

Within the framework of Financing Hierarchy Theory, trade credit assumes a notable position, particularly as a source of short-term financing that complements internal funds. By leveraging trade credit effectively, manufacturing firms can optimize their working capital management, thereby enhancing liquidity and operational efficiency (Nguyen et al., 2020). Moreover, research by Mateut et al. (2013) underscored the significance of trade credit in mitigating financing constraints, especially for small and medium-sized enterprises (SMEs), thus underscoring its integral role within the broader spectrum of financing options.

The interplay between trade credit utilization and financial performance among manufacturing firms unveils intriguing insights into the practical implications of Financing Hierarchy Theory. Empirical evidence suggests that judicious management of trade credit can contribute positively to firms' profitability and sustainability (Shin and Soenen, 1998). Moreover, the strategic deployment of trade credit enables firms to maintain smoother cash flow cycles and optimize capital allocation, thereby fostering resilience in the face of economic uncertainties (Deloof, 2019).

The integration of Financing Hierarchy Theory with the influence of trade credit on the financial performance of manufacturing firms elucidates a multifaceted relationship that transcends conventional financing paradigms. By recognizing trade credit as a pivotal component within the hierarchy of financing options, firms can navigate financial complexities adeptly, thereby fortifying their competitive positioning and ensuring long-term viability in dynamic market environments.

Conceptual Framework



Independent Variables **Dependent Variable**

Figure 1: Conceptual Framework

The Strategic Journal of Business & Change Management. ISSN 2312-9492 (Online) 2414-8970 (Print). www.strategicjournals.com

Review of Study Variables

Bank Financing

Firms need capital in their operations. They can finance their operations using internal funds, debt and equity. Debt finance is raised by borrowing from financial institutions. Most literature states that differences in the financial institution structure and lending infrastructure affect the availability of funds to manufacturing firms (Berger & Udell, 2019). These differences may significantly affect the availability of funds to manufacturing firms by affecting the feasibility with which financial institutions may employ the different lending technologies (be it transaction lending or relationship lending) in which they have comparative advantage to provide fund to different businesses. Transaction lending technologies are primarily based on "hard" quantitative data such as the financial ratios calculated from certified audited financial statement among others. Relationship lending on the other hand is based on "soft" qualitative information gathered through contact overtime with manufacturing firms. This soft information may include the character and reliability of the manufacturing firms owner based on direct contact overtime by the financial institution. Also by lending infrastructure, they were talking about the rules and conditions set up mostly by governments that affect financial institutions and their abilities to lend to different potential borrowers.

Literature uses different measure for the calculation of financial leverage through accounting measures, which includes short term debt, long term debt and total debt as a ratio of total assets (Abor, 2020). Debt/Equity ratio is an important tool of financial analysis to evaluate the financial structure of a firm. According to Khan and Jani (2019), D/E ratio gives the creditors and owners of a firm a very important viewpoint to the implication of the business, since it indicates the relative proportion of debt and equity in financing the assets of the business. Ever since manufacturing firms are not trading in the financial markets book values are used to measure their financial performances. Using the book value measure, book value of debt is divided by book value of equity. Book value of debt is calculated as total debt plus accrued interest. The second ratio that is often used for the measure of financial leverage is total debt to total assets also called a capital ratio, which is computed as the ratio of book value of total debt to total assets. Companies use leverage to finance their needs because of the tax shield which generates savings.

Trade Credit

Trade credit is a crucial aspect of financial management for manufacturing firms, playing a significant role in shaping their financial performance. In essence, trade credit refers to the arrangement wherein suppliers provide goods or services to buyers on credit terms, allowing the buyers to pay at a later date, typically within a specified period, after the receipt of the goods or services. This form of financing is prevalent across industries, enabling firms to manage their cash flows effectively and maintain smooth operations (Petersen & Rajan, 2019). For manufacturing firms, which often face fluctuations in demand and working capital needs, trade credit serves as a flexible source of short-term financing, facilitating their day-to-day operations and supporting growth initiatives.

Research has extensively examined the relationship between trade credit and the financial performance of manufacturing firms. One key aspect that emerges from these studies is the impact of trade credit on liquidity management. By allowing firms to defer payment for inputs, trade credit aids in preserving cash reserves, thereby enhancing liquidity levels (Deloof, 2019). This liquidity buffer is crucial for manufacturing firms, especially during periods of economic uncertainty or when faced with unexpected expenses, as it provides a cushion to meet short-term obligations and maintain operations without resorting to costly external financing.

The Strategic Journal of Business & Change Management. ISSN 2312-9492 (Online) 2414-8970 (Print). www.strategicjournals.com

Financial Performance

Financial performance is a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. It is the process of measuring the results of a firm's policies and operations in monetary terms (Mwangi, 2020). It identifies the financial strengths and weaknesses of a firm by establishing relationships between the items of the financial position and income statement. The term is also used as a general measure of a firm's overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. There are many different ways to measure firms' performance, but all measures should be taken in aggregation. Line items such as revenue from operations, operating income or cash flow from operations can be used, as well as total unit sales (Njeru, 2019).

Quantitative measures of firm performance include profitability measures such as gross margin, net margin for example return on sales, return on equity, economic value added, return on equity less cost of equity and return on capital employed. Other measures of performance include cash flow measures such as free cash flow over sales and growth measures for example historical revenue growth. Ideally, forward-looking measures such as expected profitability, cash flow and growth should be used to measure a firm's performance (Kiaritha, 2020).

Empirical Review

This section presents review of global and local empirical literature on the effect of bank financing on the financial performance of manufacturing firms

Rainhart and Rogoff (2020) argued that debt impact positively to the growth of a firm only when it is within certain levels. When the ratio goes beyond certain levels financial crisis is very likely. The argument is also supported by Stern Stewart and Company which argues that a high level of debt increases the probability of a firm facing financial distress. Cecchetti et al. (2019) studied the effects of debt on firms and concluded that moderate debt level improves welfare and enhances growth but high levels can lead to a decline in growth of the firm. Over borrowing can lead to bankruptcy and financial ruin (Ceccetti et al., 2019). High levels of debt will constrain the firm from undertaking proposal that are likely to be profitable because of the inability to attract more debt from financial institutions.

Ahmad, Abdullar and Roslan (2020) carried a study in Malaysia which sought to investigate the impact of capital structure on firm performance by analysing the relationship between return on assets (ROA), return on equity (ROE) and short-term debt and total debt. The study established that short-term debt and long-term debt had significant relationship with ROA. It was also established that ROE had significant relationship with short-term debt, long-term debt and total debt.

Soumadi and Hayajneh (2020) studied the relationship between capital structure and corporate performance on Jordanian shareholdings firms. The study used multiple regression models by least squares (OLS) to establish the link between capital structure and corporate performance of firms over a period of 5 years. The results showed that capital structure was associated negatively and statistically with the performance of the firms in the sample. Another finding from the study was that there was there was no significant difference to the impact of financial leverage between high financial leverage firms and low financial leverage firms in their performance. The study also concluded that the relationship between capital structure and firm performance was negative for both high growth firms and low growth firms.

Maritala (2020) examined the optimal level of capital structure which enabled a firm to increase its financial performance. The study found that there was a negative relationship between the firm's debt ratio and financial performance measured by return on assets and return on equity

Atieno (2019) found that manufacturing firms in Kenya that participate in business associations have better access to bank loans. In addition, membership to associations is important for manufacturing firms as they facilitate access to financial services. Thus institutions, such as associations, which support the manufacturing firms capacity to access financial services, become an important avenue for strengthening manufacturing firms.

Namusonge, Mairura and Karanja (2020) in their survey on the role of financial intermediation in the growth of manufacturing firms in Kenya, showed that the financial intermediaries played a significant role by offering banking services and extending credit facilities to SME businesses. Other support offered by financial intermediaries included; advisory services, training and financing the start of businesses. The existing evaluation procedures adopted by financial intermediaries were a big hindrance to credit access because they were stringent and bureaucratic was further revealed by the study. Finally they also found out that evaluation procedures made it difficult for businesses to access support from financial institutions because the procedures wasted a lot of business time and made financial intermediaries' services inaccessible to most businesses

Osoro and Muturi (2020) conclude that accessibility to credit affects financial performance of small and medium enterprises positively. The easier it is to access credit, the higher the financial performance of the Small and medium enterprises. However, They also indicate that access to credit is not that easier from the financial institutions considering the many requirements one has to meet before the credit is approved to the entrepreneur for use in the business. There is evidence that as credit becomes more available, the financial performance of business becomes better and hence a chance for business growth (Osoro and Muturi, 2020).

Muriuki and Wachira (2021) conducted a study on the influence of equity financing on the financial performance of manufacturing firms in Nairobi County, Kenya. The study utilized a panel data approach to analyze the financial statements of selected firms over a period of five years. The findings indicated that equity financing, particularly through retained earnings and equity issuance, had a significant positive impact on the firms' return on equity (ROE) and return on assets (ROA). The study concluded that firms with higher reliance on equity financing tend to have better financial performance due to lower financial distress and interest obligations compared to debt-financed firms.

Ngugi and Njiru (2022) explored the effects of venture capital as a source of financing on the growth and financial performance of technology-based startups in Kenya. The study found that firms that secured venture capital financing showed higher growth rates in terms of revenue and market share compared to those relying solely on traditional bank loans. Moreover, the study revealed that venture capital not only provided financial resources but also strategic management support, which contributed to improved financial performance and accelerated business growth.

Wang and Zhang (2020) analyzed the impact of debt financing on the financial performance of manufacturing firms in China. The study used a sample of 100 publicly listed manufacturing firms and examined the relationship between various debt ratios and financial performance indicators such as ROA, ROE, and net profit margin. The results showed a significant negative relationship between high levels of long-term debt and financial performance, highlighting the risks associated with excessive borrowing. However, the study also found that moderate levels of short-term debt could enhance liquidity and operational efficiency, leading to better financial outcomes.

Mburu and Kinyua (2023) investigated the role of internal financing through retained earnings in the financial performance of manufacturing firms in Kenya. The study employed a mixed-methods approach, combining quantitative analysis of financial data with qualitative interviews with firm managers. The findings revealed that firms that

prioritized reinvesting profits back into the business rather than distributing them as dividends experienced higher growth in assets and profitability over time. The study emphasized the importance of internal financing in sustaining long-term financial health and reducing dependency on external debt.

METHODOLOGY

This study used descriptive research design. The study population consisted of selected 100 employees of manufacturing firms in Mombasa County in which their designations are General managers, finance managers, operations managers and Risk managers. The sampling frame of this study was senior management employees from manufacturing firms in Mombasa County. The study employed stratified sampling technique by using a sample comprising of 100 senior management staff from manufacturing firms in Mombasa County. Thus the sample size for the study comprised of 80 respondents.

This study used quantitative data which was collected by use of a questionnaire. The researcher used questionnaire method to acquire or solicit data. Secondary data was obtained from already existing sources which included library books, documents, published journals and manufacturing firms' reports. Questionnaires were administered to the target respondents. The questionnaires were reformulated through pilot test which were undertaken to confirm their reliability and validity.

Quantitative methods of data analysis was used to analyze the data. Quantitative information was analyzed through statistical procedures. Multiple regression analysis was used because it provides estimates of net effects and explanatory power. The statistical package for social sciences, SPSS version 29 was used for data analysis.

The regression model was as follows:

$Y= \alpha +\beta_1X_1 +\beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \varepsilon$ Where:

Y = is the dependent variable; which was financial performance.

α = Constant term

β_1, β_2 and β_3 are the coefficients of the predictor variable and

X_1= Bank financing

X_2= Trade credit

ε = Error term

FINDINGS

Descriptive Analysis of Objectives

In the research analysis the researcher used a tool rating scale of 5 to 1; where 5 were the highest and 1 the lowest. Opinions given by the respondents were rated as follows, 5= Strongly Agree, 4= Agree, 3= Neutral, 2= Disagree and 1= Strongly Disagree. The analyses for mean, standard deviation was based on this rating scale.

Bank Financing on the Financial Performance

Table 1: Bank Financing

	N	Mean	Std. Deviation
differences in the financial institution structure and lending infrastructure affect the availability of funds to manufacturing firms	68	3.74	1.353
rules and conditions set up mostly by governments that affect financial institutions and their abilities to lend to different potential borrowers	68	4.01	.718
Companies use leverage to finance their needs because of the tax shield which generates savings	68	3.77	1.441
Valid N (listwise)			

The first objective of the study was to establish the effects of bank financing on the financial performance of manufacturing firms in Mombasa County. Respondents were required to respond to

The Strategic Journal of Business & Change Management. ISSN 2312-9492 (Online) 2414-8970 (Print). ww.strategicjournals.com

set questions related to bank financing and give their opinions. The statement that differences in the financial institution structure and lending infrastructure affect the availability of funds to manufacturing firms had a mean score of 3.74 and a standard deviation of 1.353. The statement that rules and conditions set up mostly by governments that affect financial institutions and their abilities to lend to different potential borrowers had a mean score of 4.01 and a standard deviation of 0.718. The statement that Companies use leverage to finance their needs because of the tax shield which generates savings had a mean score of 3.77 and a standard deviation of 1.441

Study findings are in line with Berger & Udell, (2019) who observed that bank finance is raised by borrowing from financial institutions. Most literature states that differences in the financial institution structure and lending infrastructure affect the availability of funds to manufacturing firms. These differences may significantly affect the availability of funds to manufacturing firms by affecting the feasibility with which financial institutions may employ the different lending technologies (be it transaction lending or relationship lending) in which they have comparative advantage to provide fund to different businesses.

Trade Credit on the Financial Performance

Table 2: Trade Credit

	N	Mean	Std. Deviation
Usage of this funding line reduces transaction costs for manufacturing firms	68	3.87	1.143
manufacturing firms has time to plan for repayment/expenditure accessibility hence maintaining continuous production schedule	68	3.92	1.220
Manufacturing firms are able to finance more projects enhance increasing returns.	68	3.62	.993
Valid N (listwise)			

The second objective of the study was to establish the effects of trade credit on the financial performance of manufacturing firms in Mombasa County. Respondents were required to respond to set questions related to trade credit and give their opinions. The statement that Usage of this funding line reduces transaction costs for manufacturing firms had a mean score of 3.87 and a standard deviation of 1.143. The statement that manufacturing firms has time to plan for repayment/expenditure accessibility hence maintaining continuous production schedule had a mean score of 3.92 and a standard deviation of 1.220. The statement that Manufacturing firms are able to finance more projects enhance increasing returns had a mean score of 3.62 and a standard deviation of 0.993.

The study findings are supported by Ayadi, (2018) who observed that trade credit was ranked as the primary financing source above bank and other debt financing. Indeed, for a considerable number of manufacturing firms, trade credit was a more important source of working capital than bank loans. The reason is that trade credit is easily accessible even under conditions of slow growth or recession when banks become more reluctant to lend.

Correlation Analysis

To establish the relationship between the independent variables and the dependent variable the study conducted correlation analysis which involved coefficient of correlation and coefficient of determination.

Table 3: Pearson Correlation

	Financial performance	Bank financing	Trade credit
Financial performance	1		
	68		
Bank financing	.768**	1	
	.000		
	68	68	
Trade credit	.741**	.710**	1
	.000	.000	
	68	68	68

In trying to show the relationship between the study variables and their findings, the study used the Karl Pearson's coefficient of correlation (r). This is as shown in Table 4.12 below. According to the findings, it was clear that there was a positive correlation between the independent variables, bank financing, trade credit and the dependent variable financial performance. The analysis indicates the coefficient of correlation, r equal to 0.768, 0.741, for bank financing, and trade credit respectively. This indicates positive relationship between the independent variable and the dependent variable financial performance.

Multiple Regression Analysis

To assess the research model, a confirmatory factors analysis was conducted. The four factors were then subjected to linear regression analysis in order to measure the success of the model and predict causal relationship between independent variables (Bank financing, Trade credit and Venture capital), and the dependent variable (Financial performance).

Table 4: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.904[a]	.817	.809	1.06178

a. Predictors: (Constant), Trade credit, Bank financing

The model explains 81.7% of the variance (Adjusted R Square = 0.809) on Financial performance. Clearly, there are factors other than the three proposed in this model which can be used to predict Financial performance. However, this is still a good model as Cooper and Schinder, (2020) pointed out that as much as lower value R square 0.10-0.20 is acceptable in social science research.

This means that 81.7% of the relationship is explained by the identified two factors namely Bank financing, and Trade credit. The rest 18.3% is explained by other factors in the financial performance not studied in this research. In summary the three factors studied namely Bank financing, and Trade credit, or determines 81.7% of the relationship while the rest 18.3% is explained or determined by other factors.

Table 5: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	477.258	2	238.629	144.799	.000[b]
	Residual	107.102	65	1.648		
	Total	584.360	67			

a. Dependent Variable: Financial performance

b. Predictors: (Constant), Trade credit, Bank financing

The study used ANOVA to establish the significance of the regression model. In testing the significance level, the statistical significance was considered significant if the p-value was less or equal to 0.05. The significance of the regression model has P-value of 0.00 which is less than 0.05. This indicates that the regression model is statistically significant in predicting factors of organizational performance. Basing the confidence level at 95% the analysis indicates high reliability of the results obtained. The overall Anova results indicates that the model was significant at F = 144.799, p = 0.000.

Table 5: Multiple Regression

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	1.464	1.306		3.194	.001
	Bank financing	.455	.071	.435	6.451	.000
	Trade credit	.914	.098	.809	9.275	.000

a. Dependent Variable: Financial performance

The regression equation was:

$Y = 1.464 + 0.455\mathbf{X_1} + 0.914\mathbf{X_2}$

Where;

Y = the dependent variable (Financial performance)

X_1 = Bank financing

X_2 = Trade credit

The regression equation above has established that taking all factors into account (Financial performance as a result of Bank financing, and Trade credit) constant at zero Financial performance will be 1.464. From the table we can see that the predictor variables of Bank financing, and Trade credit got variable coefficients statistically significant since their p-values are less than the common alpha level of 0.05

Discussion of Key Findings

The first objective was to explore the effect of bank financing on financial performance of manufacturing firms in Mombasa County, Kenya. The regression results showed a positive and significant effect of bank financing and financial performance (β=0.455, p<0.05). The findings presented also shows that taking all other independent variables at zero, a unit increase in Bank financing will lead to a 0.455 increase in the scores of Financial performance. On hypothesis testing, since p-value is less than 0.05, the null hypothesis that bank financing has no significant effect on financial performance is, therefore, rejected.

The second objective sought to examine the effect of trade credit on financial performance of manufacturing firms in Mombasa County, Kenya. The regression results showed a positive and significant effect of trade credit and financial performance (β=0.914, p<0.05). The findings presented also shows that taking all other independent variables at zero, a unit increase in Trade credit will lead to a 0.914 increase in Financial performance. On hypothesis testing, since p-value is less than 0.05, the null hypothesis that trade credit has no significant effect on financial performance is, therefore, rejected.

CONCLUSION AND RECOMMENDATION

On banks financing the study concluded that financing has a positive effect on financial performance and this effect is statistically significant in predicting financial performance. Firms that use commercial loan financing will expand their business operations and experience significant increase in their profitability. The effect is moderate as these gains are dependent on the tradeoff (Joeveer, 2018) between high returns and costs including financing costs.

On trade credit the study concluded that Trade credit financing has a positive and significant effect

on financial performance. It therefore follows that trade credit is a significant predictor of financial performance. Fims that use trade credit in financing their operations are likely to see their output and revenues increase thus increasing their level of profitability.

From the findings, the study established that bank financing positively influences the financial performance. Therefore the study recommends that the government policy makers should reform Kenya's manufacturing sector to make it easy for firms to access bank financing more easily to spur their financial performance.

Manufacturing firms should come together to form larger groups in order to access bigger commercial loans from banks, microfinance institutions and other lenders which are cheaper to source as they carry lower transaction costs.

Suggestion for Future Research

This study could be further developed by including more independent variables to the model and increasing the sample size. The researcher further recommends research in related areas in both the private and public sector.

REFERENCES

Admati, AR., and Pfleider, P. 1994) Robust financial contracting and the role of retained earningsists. *Journal of Finance*, 49(2), 371-402.

Amit, R., Brander, J. and Zott, C. (2019). Why retained earnings firms do exists? Theory and Canadian evidence. *Journal business Venturing*, 13, 441-466.

Amjed, S. (2011). Impact of Financial Structure on Firm's Performance: A Study of Pakistan's Chemical Sector. *Society of Interdisciplinary Business Research (SIBR) Conference on Interdisciplinary Business Research*.

Berger, A.N.., and Udell, G.F. (2019). The economics of small business finance; The roles of private equity and debtmarkets in the financial growth cycle. *Journal Banking and Finance*, 22(6-8), 613-673.

Bronwyn, A. (1995). Retained earnings Funding. Paper prepared for presentation at The President's Conference onSmall Business. South Africa.

Cooper, D.R. & Schindler, P.S. (2019), *Business Research Methods*, New York: McGraw-Hill/Irwin.

Diamond, D (1991) Monitoring and reputation: the choice between bank loan and directly placed debt. *Journal of political Economy*, 99 (4), 689-721.

Dooley D. (1995). *Social Research Methods*. Prentice Hall, New Delhi. Eisenhardt, K.M. (1989). Agency Theory: An Assessment and Review. *Academy of Management Review*, 14(1), 57-74

European Retained earnings Association, 1987-1997, EVCA Yearbook (European Retained earnings Association, Zaventem, Belgium.

Fluck, Z., D. Holtz–Eakin and Rosen, H.S (2019). Where does the money come from? The Financing of Small Entrepreneurial Enterprises. New York University.

Frear J. and Sohl J.E (2002). The Characteristics and Value Added Contributions of Private Investors to Entrepreneurial Ventures. *Journal of Entrepreneurial Finance.* 6(1), 84-103.

Gompers, P.A. (1995). Optimal Investment, Monitoring, and the Staging of VentureCapital. *Journal of Finance*, 50(5), 1461-1489.

Government of Kenya. (2005). *Sessional Paper No. 2 of 2005 on Development of Micro and Small Enterprises forwealth and Employment Creation for Poverty Reduction*, Nairobi Government Printers.

Hisrich D.R. and Peters P.M. (2002). *Entrepreneurship*, McGraw – Hill Publishing Co. Ltd, New York.

Keushnigg, C. (2019). *Retained earnings A case for Investment Promotion*, Discussion Paper No 1887. London: Centre for Economic Policy Research.

Lerner, J. (1999). The government as retained earningsist: the long –run impact of the SBIR program. *Journal ofBusiness*. 72(3), 285-318.

Mallick, S. and Yang, Y. (2011). Sources of capital, Profitability and Productivity: First Evidence from Matched Firms. Financial Markets, *Institutions & Instruments*, 20 (5), 221 – 252.

Memba, S.F., Gakure, W.R., & Karanja, K. (2019). Retained earnings (V C): It's Impact on Growth of Small and Medium Enterprises inKenya. *International Journal of Business and Social Science*, 3(6), 32 – 38.

Modigliani, F. and M. Miller (2020) The cost of capital, corporation finance and the theory of investment. *American Economic Review*, 48, 261-297.

Mugenda, A. &Mugenda, O. (2019). *Research Methods; Quantitative and Qualitative Approaches*. Africa Center for Technology (ACTS), Nairobi Kenya.

Republic of Kenya (2005). Sessional Paper No. 2 of 2005 on Development of Micro and small Enterprises for wealthand Employment Creation for poverty Reduction. Government Printers, Nairobi