

**INFLUENCE OF FIRM SIZE ON FINANCIAL PERFORMANCE OF FIRMS
LISTED AT NAIROBI SECURITIES EXCHANGE, KENYA**



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INFLUENCE OF FIRM SIZE ON FINANCIAL PERFORMANCE OF FIRMS LISTED AT NAIROBI SECURITIES EXCHANGE, KENYA

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ABSTRACT

The purpose of the study was to establish the influence of firm size on financial performance of listed firms at NSE. The study used a correlation research design. For this study, the target population is represented by a number of companies from different sectors listed on the NSE in Kenya from 2016-2020. The study used data from firms that were consistently listed in NSE from 2016 – 2020 the ones that were delisted and or suspended and that were listed after 2016 were not included, creating a sample size of 55 firms yielding a panel of 275 data points. The study adopted a purposive sampling approach since it satisfied the criteria of the study. The study used secondary data obtained from annual audited financial statements of listed firms using data collection sheets. The study used descriptive statistics; mean maximum, minimum, and standard deviations; inferential statistics; Pearson correlation analysis, and multivariate regression analysis to analyze the data within the panel data framework. Trend results showed firm size of NSE firms was in an increasing trend across 2016 – 2020. According to the results, using ROA, company size had significant and positive effect. However, using ROE, firm size had insignificant positive impact. In conclusion findings demonstrate company size had significant influence using ROA, however results showed also that firm size had no significant influence on financial results using ROE. The study recommended that management of NSE-listed companies take into account their firms' sizes. Due to their market power, a company's size is important because larger firms can perform better than smaller ones because of economies of scale, earning higher returns. Additionally, larger total assets may result in higher returns on assets; consequently, businesses should always aim to increase total assets

Keywords: *firm size, total assets, financial performance*

1.0 INTRODUCTION

Financial performance is a subjective assessment of company capacity to generate and accumulate revenue from its assets. According to Farah et al. (2016), a company's financial performance primarily reflects its outcomes and results, which demonstrate its overall financial stability over time. Wangui (2017) says that a company's financial performance is important to its health and survival because it shows how well it uses its resources to make as much money as possible for shareholders. Muigai (2012) listed firms in Kenya demonstrated a decline in the financials which was attributed to weak corporate governance practices. Onguka, Kaijage, Iraya, & Kisaka, (2019) this is due to increasing firms' financial performance failures being experienced globally, which goes against the assertion well-structured corporate governance practice is necessary for a company's economic and social advancement. According to Fung (2014), stakeholders are becoming increasingly concerned about their businesses' financial performance.

The literature seems to agree that firm size advantages can affect an organization's financial performance. Larger organizations are more competitive than their smaller firms through better access to resources, market power, and economies of scale. Larger companies outperform smaller companies due to economies of scale, but size is relative whether the company is small or large. because it has been evidenced even large firms have performed poorly globally. However, the existing literature reveals conflicting views on whether the size of the firm matters. There are conflicting views on how firm size influences the firm financial performance, some giving positive influence, negative and other no or mixed influence. This has put the literature reviewed into sharp focus and subject of more research due to contradicting results.

Economics of scale and firm agency theory provide a thorough description of the correlation between a company's size and its financial success. It argues that business leaders are biased in favor of the company's bottom line. Managers often seek to expand their companies in order to further their own personal empire building goals. The basic premise is that company executives aim to expand the company's size so they can obtain higher salaries and perks and gain personal status as a result. Managers may be tempted to adopt an aggressive market strategy for their personal gains, such as increased prestige, enhanced amenities, higher compensation, and staff share options, if they are not subject to oversight by shareholders (Muhindi & Ngaba 2018). Investors can accomplish this by appointing management who possess the relevant expertise and abilities. Managers who are not firm owners may operate in a way that is detrimental to the business, as suggested by Jensen and Meckling (2016). As a result, several distinct factors influencing corporate governance and the financial performance of businesses can be explained by this hypothesis.

1.1 Statement of the problem

From 2016 to 2020, the financial results of companies that operate at NSE showed a decline in revenue of Ksh -89.671 billion, a decrease in market capitalization of Ksh-294.91 billion, and a decline in the NSE 20 share index of Ksh -1317.82 billion. In spite of this, Kenya has made great efforts to ensure a favorable business environment, however results of most companies listed at NSE have been mixed, and this has been linked to issues surrounding corporate governance practices, ownership concentration, and firm size. A report from the Capital Markets Authority (2016) confirms a downward trend in financial results of Nairobi securities Exchange firms. Despite the existing literature, no unanimous opinion whether firm size has any impact on firms'

financial performance. Existing results are mixed. Some are positive, some are negative, and some show no effect at all. Such discrepancies warrant further investigation and analysis. Companies registered on Kenya's Nairobi Securities Exchange (NSE) were analyzed to determine the impact that firm size have on financial performance

1.2 Objective of the Study

To establish the influence of firm size on financial performance of listed firms at NSE

1.3 Conceptual Framework

Figure 1 depicts the study's conceptual framework's which attempt to relate firm size to firms' financial performance

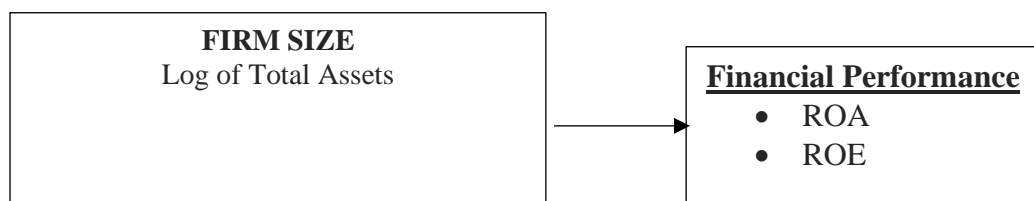


Figure 1: Conceptual framework

2.0 LITERATURE REVIEW

2.1 Theoretical Literature

2.1.1 Theory of Economies of Scale

Marshall's article (1980) attempts to explain increases in returns and competition by expanding on the economies of scale theory. Marshall made an effort to clarify the connection between rising and falling production costs. He thought about how the external and internal economies affected the smaller businesses. The lower cost per unit of production and the more evenly distributed fixed costs that result from increasing output and business size are what economists Borello et al. (2015) mean by the term "economies of scale." Because of economies of scale, expanding businesses are more productive and have lower variable expenses as they expand.

There are many different types of businesses and organizational structures, from individual factories to multinational conglomerates, that can all benefit from economies of scale. The cost per unit of output is anticipated to be lower in large manufacturing facilities than in smaller ones. When all else is equal, companies with multiple locations may have a lower total cost of operation than those with fewer locations (Too & Simiyu, 2018). The economies of scale theory will be used to shed light on the impact that firm size has on bottom-line results in this investigation. In this sense, we can define "economy of scale" as the competitive advantage that larger companies enjoy because of their size and scope both domestically and internationally (Krishnan et al., 2021). The research, production process aggregation, market power, and development efforts of large firms are all factors that contribute to their superior performance. Theories of economies of scale

typically explain the cost advantages that firms achieve through the scale of their operations and production, which allows large firms to more evenly distribute their production costs (Shen et al., 2015).

This theory is useful because it explains why large corporations succeed where small ones fail. This is because large corporations can take advantage of perks like tax breaks, bulk-buying discounts, and economies of scale to boost their bottom line. As a result, they are able to reduce expenses and boost profits. Most large companies can be trusted to deliver on time and in full because they establish strong partnerships with their suppliers. This contributes to the company's credibility and, ultimately, its ability to gain customers' trust (North, 1991).

2.2 Literature Review

Numerous research has examined the effects of firm size. Theoretically, economies of scale are a benefit that larger companies can leverage to improve their bottom line. Due to advantages such as higher market power, economies of scale, and more access to resources, large enterprises appear to be able to create stronger rivalry than their smaller competitors. (Kioko, 2013).

Mule et al, (2015) investigated how Kenya's listed companies' profitability and market value were affected by corporate size. They used information from businesses that were on the NSE from 2010 to 2014. Finding from unit root test demonstrates study elements were stationary at levels and are therefore integrated of order zero ($p=0.000$). They used panel correlation and multiple regression methods. According to their findings, profitability and firm size are positively correlated.

Wayongah, (2019) examined the financial outcome and size of nonfinancial firms trading at NSE. The economic, trade-off, and signaling theories served as the study's foundation. Using a collection sheet, secondary data from 2010 to 2016 were derived from financial reports. The stationarity of the data was verified using the unit root test. The study utilized a sample of 28 companies which created 196 observations over 7 years period. Finding showed company size had insignificant positive impact on business performance composite index (BPCI).

Eyigege (2018) looked into the impact of company size on the stock market performance of Nigerian banks. Taro Yemeni sampling was used to select five deposit money banks as a representative sample of Nigeria's banking sector as a whole. The ROIA was used as the dependent variable in the study. The need to understand what influences the success or failure of Nigerian banks on the stock market prompted this study. The diseconomies of scale, according to the research, cause a negative but negligible effect of firm size on financial outcomes. Getting the most out of economies of scale while keeping expansion costs low was a major recommendation of the study for the manufacturing sector. Additionally, the firm size that indicates insignificant negative effect should be disregarded in favor of other factors that may improve firm financial performance.

Symeou et al. (2018) investigated the connection between financial outcomes and company size. To find out if there was a connection between performance and company size, a descriptive survey design was used. The data were analyzed over a five-year period using a regression model. The results of the analysis indicated that there was a correlation that was positive and significant between the company's financial performance and its size.

Njoroge (2014) investigated impact of size of company on financial results of pension schemes in Kenyan. The audited financial reports of 30 registered Kenyan workplace pension schemes were used to compile the data. and descriptive survey design was used in the study. The results indicates that company size and performance of workplace pension schemes had a significant and positive relationship. Additionally, the NSE index, fluctuations in the interest rates on Treasury Bills, and offshore indices all point to significant market volatility.

Babalola (2013) conducted research on how manufacturing firms at Nigerian Stock Exchange financial performance is affected by company size. A descriptive research design was used, and a panel data set covering nine years, from 2000 to 2009, was used to analyze the data. Profitability of the firm was measured by ROA, while total assets and total income are used as an indicator of company size. Empirical evidence shows that Firm size has been deliberated as an important determinant of firm profitability. The findings demonstrate that manufacturing firms at Nigerian stock exchange benefit financially from firm size.

Mashalaghu and Mutunga (2016) looked into how company size, liquidity, and financial leverage affected the bottom lines of NSE companies that weren't in the financial sector. The research spanned the years 2009-2013 and made use of panel data. The purposes were to examine effect of financial Leverage, company size, Liquidity, Day's accounts receivables and accounts payables and non-financial firms' performance listed on NSEAs financial performance indicators, were ROA and ROE were utilized. Study found financial results of non-financial firms at NSE were positively impacted by company size and liquidity.

The available empirical literature appears to support the idea that a larger company may have greater financial success. Larger businesses have an advantage over their smaller rivals because of their greater market power, economies of scale, and access to resources. Large companies performs better than small companies due to economic of scale but the size whether firm is small or large is relative, because it has been evidenced even large firms have performed poorly globally. However, the existing literature reveals conflicting views on whether the size of the firm matters. There are conflicting views on how firm size influences the firm financial performance, some giving positive influence, negative and other no or mixed influence. This has put the literature reviewed into sharp focus and subject of more research due to contradicting results.

3.0 METHODOLOGY

The study used a correlation research design. For this study, the target population is represented by a number of companies from different sectors listed on the NSE in Kenya from 2016-2020. The study used data from firms that were consistently listed in NSE from 2016 – 2020 the ones that were delisted and or suspended and that were listed after 2016 were not included, creating a sample size of 55 firms yielding a panel of 275 data points. The study adopted a purposive sampling approach since it satisfied the criteria of the study. The study used secondary data obtained from annual audited financial statements of listed firms using data collection sheets. The study used descriptive statistics; mean maximum, minimum, and standard deviations; inferential statistics; Pearson correlation analysis, and multivariate regression analysis to analyze the data within the panel data framework. The hypothesis was tested by regressing independent variables against dependent variables.

4.0 RESEARCH FINDINGS AND DISCUSSIONS

4.1 Descriptive Statistics

Table 1: Descriptive Results

Variable	Obs	Mean	Std. Dev	Minimum	Maximum
ROE	275	0.206	0.216	-0.473	1.628
ROA	275	5.164	6.442	-0.357	27.580
Log of firm size	275	7.223	0.917	5.405	9.054

The results showed that the mean of ROE of firms listed in NSE for the period of 2016 – 2020 was 0.206. In addition, the lowest ROE was -0.473, and the highest ROE was 1.628. The standard deviation is 0.216, implying that the ROE of listed companies is consistent with the mean. However, the results showed that the mean of ROA of firms listed in NSE for the period of 2016 – 2020 was 5.164. Additionally, the lowest ROA was -0.357 and the highest was 27.580. The standard deviation was 6.442 implying that ROA of various listed firms was not varied from the mean.

Firm size is determined based on log of total asset of NSE listed companies. In accordance with previous research, Njuguna and Obwogi, (2015); Ayot, (2011), The ratio of sales to total assets is what determines a company's size, and a value of 1.00 indicates sales equal total assets. Further results showed that the mean of firm size at NSE for the period of 2016 – 2020 was 46.977. This demonstrates that businesses typically have sales that are 47 percent of their total assets. In addition, minimum log of total assets of small firms was 5.405 and largest firms a maximum of 9.054 of assets total. This value is inconsistent with mean value of 1.091 that was obtained by Ayot (2011). The standard deviation was 0.917 implying that log of total assets of various listed firms was not varied from the mean.

4.2 Trend Results

4.2.1 Trend Results for Financial Performance

The trend results for return on assets were shown in Figure 2

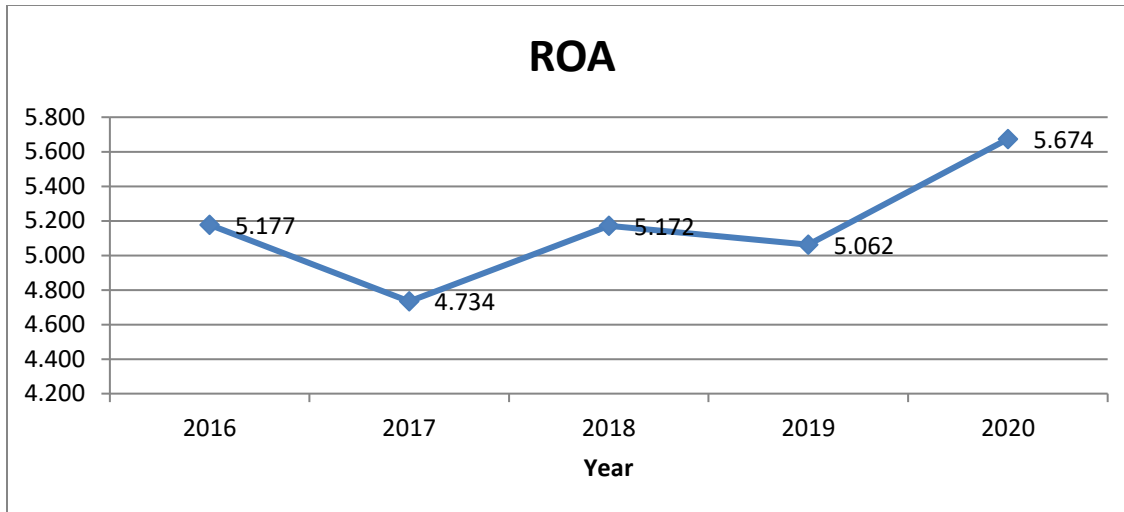


Figure 2: Return on Assets

Source: Field Data, 2022

The 2016 results showed that the average ROA for NSE-listed companies was 5.177 percent. However, ROA as a whole fell to 4.734 in 2017 before rising to 5.172 in 2018. The average ROA fell to 5.062 in 2019, but it is expected to rise to 5.674 in 2020. This indicated that most NSE firms' ROA was erratic between 2016 and 2020.

The trend results for return on equity were shown in Figure 3.

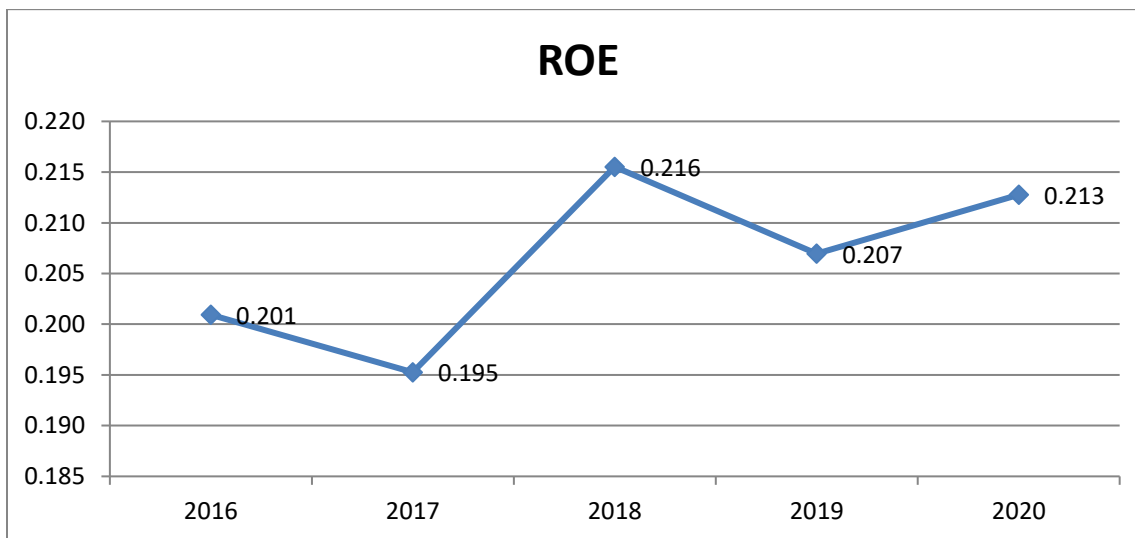


Figure 3: Return on Equity

Source: Field Data ,2022

Results showed that the mean of ROE of firms listed in NSE was 0.201 in the year 2016. However, the mean of ROE of firms listed in NSE declined to 0.195 in the year 2017 but further increased to 0.216 in 2018. Mean of ROE declined to 0.207 in 2019, further increased to 0.213 in 2020. This implied that the ROE of most NSE firms was irregular across 2016 – 2020.

In summary, the findings indicate that the Return on Assets (ROA) for NSE-listed companies fluctuated over the years, with an average of 5.177% in 2016, declining to 4.734% in 2017, rebounding to 5.172% in 2018, dropping to 5.062% in 2019, and showing an expected increase to 5.674% in 2020. This suggests that NSE firms experienced erratic ROA performance between 2016 and 2020.

Similarly, the Return on Equity (ROE) for these firms had an average of 0.201 in 2016, declining to 0.195 in 2017, increasing to 0.216 in 2018, decreasing to 0.207 in 2019, and then rising to 0.213 in 2020. This signifies irregular ROE performance across the same period. The practical implication is that the financial performance of NSE-listed firms exhibited variability during this time frame, and further analysis is needed to understand the factors driving these fluctuations and their impact on corporate governance, ownership concentration, and firm size.

4.2.2 Trend Results for Firm Size

The trend results for log of firm size were shown in Figure 4.

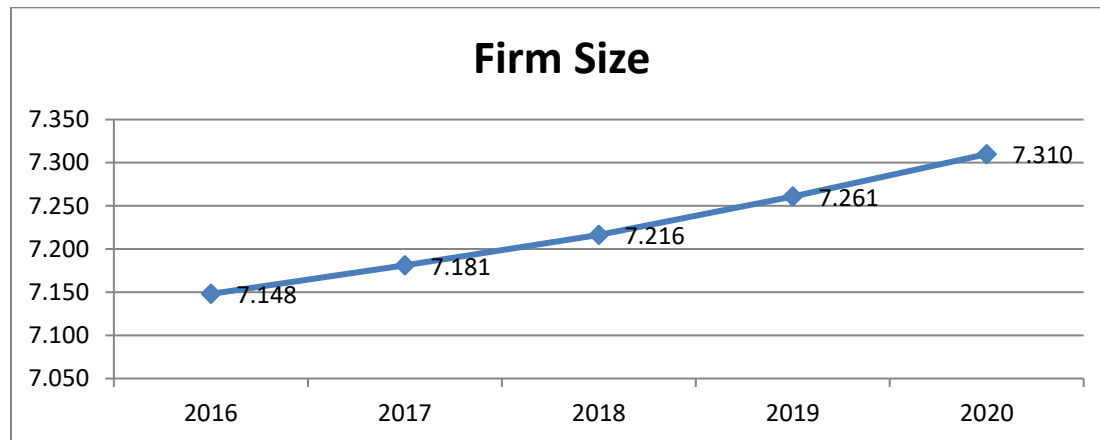


Figure 4: Firm Size

Source: Field Data, 2022

The results show that the average log of total assets of NSE-listed companies was 7,148 in 2016. In the year 2017 the mean of log of total assets increased to 7.181 and further increased to 7.216. In the year 2019 the mean of log of total assets further increased to 7.261 and further increased to 7.310 in the year 2020.

In summary, the practical implication of these findings is that, over the years, NSE-listed companies have experienced a consistent increase in the average log of total assets. This indicates growth in the size and scale of these companies. Such an upward trend suggests expansion and increased economic activities within these firms, which can be seen as a positive sign for their financial health and overall performance. The growth in total assets can be associated with

improved capacity, resource utilization, and potentially enhanced financial performance, making these companies more attractive to investors and stakeholders.

4.3 Correlation Analysis

The researcher carried out the Spearman correlation analysis on firm size and financial performance using ROA and ROE to determine the nature of each pair of variables' statistical relationship.

Table 2: Correlation Matrix Using ROA

	ROA
ROA	1
Firm size	0.008
	0.005

Results also showed that firm size had a positive and insignificant correlation with financial performance ($r=0.008$, $p=0.005$). These findings agreed with Goh and Simanjuntak (2018) who found that firm size has direct positive influence on Firm Value. Combining these concepts, when we say that "firm size had a positive and insignificant correlation with financial performance," we are suggesting that there is a statistical trend that larger firms might tend to have better financial performance, but this relationship is not strong enough to be considered a significant or reliable predictor of financial success. Other factors beyond firm size likely play a significant role in determining a company's financial performance, and variations in firm size do not consistently result in notable changes in financial outcomes.

The study conducted a spearman's correlation analysis for the firm size and financial performance using ROE in order to examine the nature of the statistical relationships between each pair of variables. Table 3 shows the correlation matrix of all the variables.

Table 3: Correlation Matrix Using ROE

	ROE
ROE	1
Firm size	-0.195
	0.001

Further findings showed company size has significant and negative correlation on financial performance (ROE) ($r = -0.195$, $p = 0.061$). This means a positive change in company size does not lead to significant change in ROE. Results of this study are agreeing with Eyigege (2018), that firm size has insignificant and negative effect on firm performance due to diseconomies of scale. Combining these concepts, when we say that "company size has a significant and negative correlation on financial performance (ROE)," we are stating that there is a robust statistical trend indicating that larger companies tend to have lower ROE figures. This suggests that as companies grow in size, their efficiency in generating profits from their shareholders' equity tends to decline.

This could be due to challenges such as increased bureaucracy, reduced agility, and diminishing returns as a company expands.

4.4 Regression Results

Using ROA and ROE, the nature of the relationship between firm size and financial performance was determined by regression analysis. The firm size and ROA regression model are shown in Table 3.

Table 3: Firm Size and ROA

Fixed-effects regression		Number of observations = 275				
Firm variable		Number of firms = 55				
R-sq:						
Within	=	0.330	F(1,203)	=	4.83	
between	=	0.420	Prob>f	=	0.044	
overall	=	0.310				
ROA	Coef.	Std.Err	z	P> z 	(95% conf.interval)	
Firm size	7.424	0.011	686.95	0.000	7.403	7.445
_cons	11.246	6.694	1.680	0.094	-1.938	24.429
sigma_u	6.181					
sigma_e	2.358					
rho	0.873					

Source: Field Data ,2022

Findings in table 3 shows firm size accounted an overall 31% change in return on asset (R-squared coefficient of determination overall= 0.310). This implies 31.0% of the change of ROA is affected by firm size. This result further affirm that company size has significant positive effect on ROA ($\beta=7.424$, $p=0.000$). This was further confirmed by the F statistic of 4.83, $p=0.044$ respectively. The fact that the p-value is less than 0.05 indicates that these values are statistically significant. From these values, we can conclude that a one-unit increase in firm size increases the return on asset. This study's findings are in line with those of Eyigege (2018), who demonstrate that the size of a company has a significant impact on its financial performance, which is attributed to economies of scale.

In summary, the statement is suggesting that firm size explains about 31% of the variation in Return on Assets (ROA), as indicated by the R-squared value of 0.310. Additionally, the analysis found a statistically significant positive relationship between company size and ROA. This means that, on average, larger companies tend to have higher ROA values. The low p-value (0.000) suggests that this relationship is not likely to have occurred by random chance.

Using ROA, the analysis was conducted to test the null hypothesis (H_0) that firm size has no effect on financial performance of NSE-listed companies. Research rejects the null hypothesis and accept the alternative hypothesis. Consequently, one can conclude that the Financial Performance (ROA) of Kenyan listed companies at the Nairobi Securities Exchange was significantly

influenced by firm size. The study agreed with Lee (2009) who established positive influence on financial performance and firm size.

Optimal model

$$Y = 11.246 + 7.424X$$

Where: Y = Financial Performance (ROA)

X = Firm Size

Further analysis on influence of firm size on ROE was carried out. The findings are presented as shown below in Table 4

Table 4: Firm Size and ROE

Fixed-effects regression		Number of observation = 275				
Firm variable		Number of firms = 55				
R-sq:		F (1,203)	= 0.12			
Within	=	0.001	Prob > F = 0.725			
Between	=	0.056				
Overall	=	0.038				
ROE	Coef.	Std.Err	Z	P> z	(95% conf. interval)	
Firm size	0.018	0.051	0.350	0.725	-0.083	0.119
_cons	0.076	0.369	0.210	0.837	-0.651	0.803
sigma_u	0.188					
sigma_e	0.130					
Rho	0.676					

Source: Field Data, 2022

Results in table 4 above indicates size of the firm explains 3.8% of variation in return on equity (overall R-squared= 0.38). This implies firm size contribute 3.8% effect on ROE. This result further supports that firm size had insignificant and positive impact using ROE ($\beta=0.018$, $p=0.725$). This was likewise demonstrated by the F statistics of 0.12, $p= 0.725$. The p-value was greater than 0.05, indicating that these values are not statistically significant. From these values, it implies that unit change in the company's size lead to small changes in ROE.

In summary, the statement is suggesting that the size of the firm explains about 3.8% of the variation in Return on Equity (ROE), as indicated by the R-squared value of 0.038. Additionally, the analysis found a positive relationship between the size of the firm and ROE. However, the statistical analysis did not find strong enough evidence to conclude that this relationship is statistically significant based on the relatively high p-value (0.725). This implies that while there might be a positive trend, the effect of firm size on ROE is not considered reliably significant in this analysis.

Using ROE, the study sought to test the null hypothesis (Ho3) that firm size has no effect on financial performance of NSE-listed companies. Research does not reject the null hypothesis. Thus, it can be concluded that there is no significant effect of Firm size on ROE of listed companies at Nairobi Securities Exchange, Kenya. Findings of this study are consistent with Njoroge (2014) established firm size and financial performance had positive correlation but not significant.

Optimal model

$$Y = 0.076 + 0.018X$$

Where: Y = Financial Performance (ROE)

X = Firm Size

5.0 CONCLUSIONS

Conclusion from third objective is that company size significantly influences financial results of companies at NSE using ROA, consistent with concept of economic of scale theory. This theory predisposes the bigger the company size, the more cost savings with the increase in production. However, there was no significant effect of company size using ROE.

6.0 RECOMMENDATIONS

The study recommended that management of NSE-listed companies take into account their firms' sizes. Due to their market power, a company's size is important because larger firms can perform better than smaller ones because of economies of scale, earning higher returns. Additionally, larger total assets may result in higher returns on assets; consequently, businesses should always aim to increase total assets.

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