

ABSTRACT

Various firm stakeholders have interest in the financial health of their firms. Efforts to increase financial performance of companies have focused on financial restructuring. The effectiveness of this strategy has however not been empirically proven since the studies have also produced mixed results. Despite aggressive strategies, firms still encounter financial distress as evidenced by liquidity and bankruptcy problems. The purpose of this study was to determine the effect of debt financing on financial performance of non-financial firms listed at the Nairobi securities Exchange. The specific objectives of the study were to establish the effect of debt to equity ratio of non financial firms listed at the Nairobi securities exchange on their return on equity, to establish the effect of interest coverage ratio of non financial firms listed at the Nairobi securities exchange on their return on equity and to establish the controlling effect of firm size of non financial firms listed at the Nairobi securities exchange in the relationship between debt financing and financial performance of non-financial firms listed at the Nairobi securities exchange. This study was based on the stakeholder theory. The study used a correlation research design. The target population were the 64 firms listed at the Nairobi Securities Exchange. The study period was six years from 2011 to 2016. The research used secondary data collected from the Capital Markets Authority and from individual firms' financial reports; data analysis by multiple regression. The findings were as follows: With respect to the effect of debt to equity ratio on return on equity, the regression findings revealed a p-value of (0.000) and a beta value of (0.999), With respect to effect of interest coverage ratio on return on equity the regression results indicates a p-value of (0.620) and a beta value of 0.001 and With respect to the effect of firm size on return on equity, the regression finding revealed a p-value of (0.419) and a beta value of 0.002. The study concluded that there is need for efficient management of debt as a source of capital. The study recommends that firms should use debt as much as possible so that they benefit from positive effect of borrowing, which includes interest deductibility of debt and reduction of agency costs. Special consideration should also be taken to ensure that the assets financed by the borrowed funds bring in a higher return than the interest the firms are paying for the debts. The study is of significance to the stakeholders of the companies such as managers, potential investors, shareholders, debt holders, the government and researchers in the field of finance.