

**LEVERAGE, LIQUIDITY AND PROFITABILITY OF BANKS AND INSURANCE
FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE****By Opuodho Dorothy Otunge¹ and Nixon O Omoro²****University of Nairobi, SoB****Abstract**

Purpose: Banks and Insurance firms keep the finances of other firms and investors. Therefore the study sought to establish the relationship between leverage and liquidity on profitability and determine the effect of leverage and liquidity on profitability of Banks and Insurance firms listed at the Nairobi Securities Exchange.

Methodology: A census study was done on all the seventeen Banks and Insurance firms listed at the NSE for a six year period beginning the year 2010 to the year 2015. Secondary data was collected from NSE handbooks and individual firms published financial statements for the respective years. Data was analyzed using correlation analysis and General linear models including ANOVA and regression analysis.

Findings: Findings show that a positive relationship exists between leverage and profitability expressed in terms of ROA and a negative relationship exists between leverage and profitability expressed in terms of ROE. Liquidity showed a negative relation with profitability when expressed in terms of ROA whereas a positive insignificant relation exists between liquidity and profitability expressed in terms of ROE.

Implication: The study recommends that managers need to gauge the appropriate leverage and liquidity levels to use for firms given their unique circumstances.

Value: These findings form the basis of argument and support for proposition that liquidity effects on profitability varies when different measures of profitability are applied. Combining leverage and liquidity aspects to determine probable joint effects on profitability brings about opposite observations on firm profits.

Keywords: leverage, liquidity, profitability

Introduction

Financial firms obtain leverage in order to purchase assets. Firms shift risks to financial intermediaries due to debt when prices of assets increase, this reduces their liquidity and debt servicing capacity and with high leverage economic activity is heightened, when there is low leverage there is less economic activity (Geanakoplos, 2010). Liquidity of assets is affected by the entrenchment of leverage and how severe there is asset shock. Adrian and Shin (2010) posit that liquidity is the rate of growth of aggregate balance sheets and leverage reduces when financial firms have surplus capital. Tarus, Chenuos and Biwott (2014) observe that capital structure influence profitability thus affecting firm's return on investment. They noted that leverage distribution is endogenous to future expectations. Liquidity is connected to firm's operational requirements. Low liquidity exposes firms to bankruptcy threats thus affecting profitability, whereas surplus liquidity portrays presence of idle funds not put into use to enhance profitability. Kahraman and Tookes (2014) state that when hedge funds and other financial firms do intermediaries role and supply liquid assets to markets, their ability to get leverage influences their liquidity supply. They show that decline in use of leverage reduces both liquidity and profitability.

A firm needs to choose its debt- equity mix and leverage to attain desired financing. Modigliani and Miller (1958, 1961, and 1963) propose that a firm can mix its debt and equity to achieve desired value. They use pie model that views taxes and bankruptcy costs as claims on cash of the firm, thus ignoring tax relevance to firm value. Trade off theory emerged due to debate on Modigliani and Miller theory because of taxes. Tax was added to the irrelevance proposition (Modigliani and Miller, 1963) bringing about tax benefit for debt. The theory posits that leverage has benefits in a capital structure to a certain level beyond which bankruptcy occurs. Risk return theory explains how leveraged finance entails the possibility that if costs of borrowing could be more than returns from investment then realization of losses could occur and profits would be earned if returns are more than costs of borrowing. This study focuses on the risk return theory.

Financial firms in Kenya hold non- performing loans exposing them to credit and leverage risks (Wangai, Bosire & Gathogo 2012). Non- performing loans reduce profitability of these institutions. Onuonga (2014) observes that bank profitability is declining as profits before tax (PBT) is below 20% on average since size of bank, capital base, ownership, operating expenses and expansion influence bank profitability. Insurance industry in Kenya contributes a percentage of 2.08% to gross domestic product (Mwangi and Murigu, 2015). They advise

that insurers in Kenya need to increase leverage and equity capital to perform better. Financial firms face credit risk due to leverage and their liquidity is affected by difficulty to get borrowers.

Leverage

Adrian and Shin (2010) defined leverage as the ratio of total assets to equity saying that it relates inversely to total assets. Adongo (2012) defines it as the use of a fairly little investment or less debt to make profits. Geaneakoplos (2010) defines it as the ratio of the asset value to cash needed to acquire it. Therefore incorporating all the definitions, this study defines leverage as the ratio of core capital to resources supplied by the owner then measures leverage as a ratio calculated by tier one capital to adjusted assets.

Leverage comprises of borrowed money used for acquisition of assets. Where the ratio of equity capital to debt capital in a company's capital structure is big there is conservative financing. Adrian and Shin (2010) established that leverage is high when total assets are many. There are three types of leverage namely; balance sheet leverage based on balance sheet concepts, economic leverage based on market dependent future cash flows and embedded leverage based on market risk. The most recognized leverage is the balance sheet leverage that occurs when a firm's assets exceed its equity base. A firm with debt pays interest as a liability. When the balance sheet side of asset is unchanged, more debt reduces equity.

High leverage induces the probability of having bankruptcy and financial costs thus lowers profits as equity holders want high returns on investments due to high chance for risk of default. A high debt to equity proportion points to the fact that a company is keen on financing its assets acquisition with debt. Leverage use does not always lead to profitability and the risk of excessive loss is more if there is high leverage.

Liquidity

Maina (2011) defines liquidity as cash and cash equivalents of a firm including cash inflows and outflows of the assets. Kimathi, Galo and Akenga (2015) relate firm liquidity to meeting of its short-term obligations. More cash indicate that the business can meet its obligations. Therefore, liquidity shows the ability of an economic agent to do exchange Kleopatra (2009). This study defines liquidity as the ability of a firm to meet its obligations as they occur.

Owino (2011) argues that leverage and liquidity being positively related slows growth of firms. He observes that firms choose high liquidity levels to survive during recession hindering investments in viable opportunities. He notes that incomplete markets and asymmetric information lead to liquidity risk existing in financial systems. Trade off theory suggests that liquid firms venture into promising projects hence increasing their value. Sibilkov (2007) works out asset liquidity, by computing the liquidity index derived by value of corporate transactions in an industry standardized by the total book value of assets. A firm becomes bankrupt if it cannot meet its obligations. Lack of cash and its equivalents can lead to loss of profitable business ventures. This results to high production cost that eventually affects profitability.

Profitability

Profit is derived by deducting all business obligations in a year from its earnings. Profitability is therefore the capacity to make profit (Ngwili, 2014). Olalekan and Adeyinka (2013 pp 89) define profitability as the ability of a given investment to earn a return from its use. Nishanthini (2013) defines profitability as the final surplus of a large number of policies and decisions. This study defines profitability as the ability to generate income on owner-supplied resources.

Ngwili (2014) states that profitability ratios comprise of net profit margin, ROA, ROE, and payout ratio. Net profit margin is arrived at by net income divided by revenues. Profit margin compares similar industries. High profit indicates that a business manages its costs and is profitable. ROA is derived by dividing yearly earnings by average of total assets. It measures firm performance and indicates profitability of a firm relative to its total assets. ROE is derived by dividing net income by average stockholders' equity and measures a firm's profitability with regard to how much return it makes from investments. Payout ratio is realized when dividends is divided by earnings and measures earnings paid out as dividends. In this study, profitability will be measured by return on assets, and return on equity.

Leverage, Liquidity and Profitability

Levered firms hold assets that are liquid or easy to convert into cash as a precautionary measure to enable them pay interest charges of debt when they arise (Tarus et al. 2014, Owino, 2011.). A high leverage level subjects a firm into liquidity problems as it finances interests thus reducing profitability. Where leverage ratios are fixed, financial institutions limit their liquidity levels. They do this by minimizing cash and its equivalents that they maintain on their balance sheets, thus becoming risky. When a firm maintains high liquidity it

points to possibility of having idle funds not invested to generate profits. However low liquidity also destroys firm credit rating and may lead to compulsory liquidation of assets. Sibilkov (2007) notes the relation between asset liquidity and leverage as being stronger for firms having more noncurrent assets relative to debt and a high chance of default. When firms use cash to settle liabilities, they reduce their leverage ratio. However if firms use cash to meet short-term obligations their liquidity is not affected, but if they use cash to meet long-term needs they tend to have low levels of liquidity.

Kahraman and Tookes, (2014) observe that stock volatility increases due to use of leverage and level of risk, which in turn increases return at an ideal level of leverage. A firm's return on equity thus increases. Over-leveraged firms experience decrease in return on equity. Kaya (2014) found that trade firms that are highly levered suffered in terms of liquidity. High debt level of the oil sector led to great financial distress and induced retrenchment (Domanski, Kearns, Lombardi and Shin, 2015).

Financial Firms Listed at the NSE

Financial firms listed at the Nairobi stock exchange (NSE) include banks and insurance companies among other financial firms. There are seventeen listed Banks and insurance firms and they make about twenty five percent (25%) of firms listed at the NSE. This is a relatively lower proportion given that there are many Banks and Insurance firms not listed but they carry out their operations as per their mandate in Kenya. This study focused on listed banks and insurance firms. Some financial firms including banks and insurance firms are not listed because they are individual or family owned and they are conservative in diluting ownership and control. These could have an effect on their leverage, liquidity and eventually profitability.

Banks and Insurance firms have reported fluctuations in profits over the past decade, with some reporting high profits at times and decline in profits in other periods. In September 2015, Imperial bank went under receivership followed by Chase bank in April 2016 and there is need to establish whether these occurred due to debt or liquidity issues. Mergers are also common in banks that may indicate need to have a strong capital base among financial firms. Few researches have been done on financial performance in terms of effect of leverage and liquidity on profitability of financial and non-financial firms listed at the NSE. Again, in studying leverage and liquidity effects on profitability there is need to determine whether separation of financial firms from non-financial firms would lead to different observations due to variation in nature of operations and economic circumstances. This prompted this

study to try to establish whether leverage and liquidity aspects affect profitability of financial firms and determine the extent to which Nairobi Securities Exchange market data of financial firms reflects on matters of liquidity, leverage and profitability.

The Research Problem

A firm that uses more debt in its capital structure employs more leverage. High leverage subjects owners' profits to risk but leverage may not affect the cost of capital at times. If a firm's ability to use leverage declines, its liquidity reduces. Leverage is necessary but is linked to risk of bankruptcy costs. Various researchers find conflicting results on profitability, leverage and liquidity. Kimathi et al. (2015) conclude that high profitability encourages use of internal financing and lowering debt level whereas Mwangi and Murigu (2015) found profitability to be positively related to leverage. Owino (2011) observes that scholars argue on the relationship between liquidity and leverage differently leading to conflicts in findings on effect on returns. This study tries to establish leverage and liquidity implications on profitability.

Financial firms in Kenya have reported fluctuations in earnings with both profits and losses being reported at varying periods. In 2013, nine insurance companies reported losses in earnings due to price undercutting. The putting under receivership of Dubai bank in June 2015, Imperial bank in September 2015, Chase bank in April 2016 and National bank of Kenya having financial problems in April 2016 brings about the question as to whether debt and liquidity factors played a role that calls for credit and liquidity regulation. Some financial institutions opted for mergers and partnerships like Chase bank and Stima Sacco partnered on October 12, 2015 by securing a long-term bond but Chase bank still went under receivership raising concern on its debt and liquidity position. This made it necessary to determine whether firm mergers and partnerships increased capital base due to debt financing in order to enhance liquidity or it exposed them to financial constraints. It is also not certain as to whether financial firms in Kenya prefer to finance their operations through leverage with the hope of venturing into profitable activities but unforeseen events or high risk appetite of managers makes them end up in high debts with low liquidity leading to bankruptcy costs. In addition, the question as to why and how much debt firms should use persists (Otieno, 2015).

A number of local and international studies conducted across the listed firms have concentrated much on non-financial firms leaving out financial firms because of the nature of their balance sheets (Adongo, 2012, Kodongo, Mokoaleli-Mokoteli and Maina, 2014, Kaya, 2014, Shubita, 2012). Only a few studies have been done on financial firms with respect to leverage, liquidity and profitability, yet the two variables are not jointly studied as evident in

Ngwili, 2014, whose study focused on the relationship between liquidity and profitability of insurance companies in Kenya. Mwangi and Murigu, 2015, researched on determinants of financial performance of insurance companies in Kenya, Kebewar, 2013, looks at effect of debt on corporate profitability of French service sector while Velnampy and Niresh, 2012, dealt with the relationship between capital structure and profitability of Srilankan banks. This research bridges the gap by studying the variables jointly to establish the relationships. In addition, financial firms in the banking sector reported increase in non-performing loans (NPLs) to a level of 8.16 % by April 2016 increasing their credit risks and lending risks leading to decline in profitability. It is not clear as to whether debt secured by assets was used to obtain funds (liquidity) issued and now standing as NPLs thereby reducing their profitability thus the reason for this study. Since firms follow different leverage and liquidity policies it is wanting to determine whether this affects their profitability. Also firms use different ways of managing working capital thus affecting their liquidity and eventually profitability calling for need to study this aspect. Some studies have used leverage and liquidity as dependent variables (Tarus et al. 2014), this study uses leverage and liquidity as independent variables and tries to answer the question; Does leverage and liquidity affect profitability of Banks and Insurance firms listed at the Nairobi Securities Exchange?.

Research Objectives

- i. Establish the relationship between leverage and profitability of financial firms listed at the NSE.
- ii. Establish the relationship between liquidity and profitability of financial firms listed at the NSE.
- iii. Determine the effect of leverage and liquidity on profitability of financial firms Listed at the NSE.

Empirical Studies

Owino (2011) examined liquidity and leverage relationships of quoted companies at the NSE. He studied thirty companies out of forty-seven quoted firms for the years 2006 to 2010. Data was analyzed using multivariate regression analysis that tests for cause- effects but not relationships and test whether this could have led to results realized. Findings are in agreement with other studies done in developing countries revealing a negative insignificant relationship between liquidity and leverage such as Tarus et al. (2014) and Awan (2014). This study used multiple correlation/general linear models to determine variable relationships of financial firms.

Otieno (2015) investigated the relationship between capital structure, performance, and replacement of CEO in firms listed on the NSE. He sampled 37 firms for the period 1990 to 2012, analyzed data using canonical correlation technique, general linear model, and generalized estimating equation to assess effects on the variables. He found a bidirectional relationship between capital structure and debt capital. He says managers need not be passive in choosing between equity and debt capital. This can be compared with the study in Owino (2011) that does not give direction as to what ought to be done. This research used correlation analysis and general linear models to examine the direction of leverage and liquidity relationship of financial firms and how these variables relate to profitability.

Tarus et al. (2014) studied the effect of profitability, firm size and liquidity on capital structure of 34 firms listed on the NSE for the period 2006 to 2012 excluding commercial banks. They used Pearson correlation coefficient and multiple regression models to test variable relationships and found profitability and liquidity as negatively and significantly related to capital structure. This study used correlation and general linear models to determine variable relationships and Pearson correlation coefficient to test for linearity of variables and confirm validity of findings. Ngwili (2014) tested liquidity and profitability relationship of insurance companies in Kenya. He studied 49 registered insurance companies with IRA as at December 31, 2013. Data was collected for the periods 2009 to 2013, analyzed using descriptive statistics and multiple linear regressions. He found a negative but significant relationship between loss ratio and profitability of insurance industry in Kenya. This study uses correlation/general linear model to examine the relationship among variables and explain decline in profits of financial firms. Mwangi and Murigu (2015) examined factors that affected profitability of general insurers in Kenya for the period 2009-2012. They used multiple linear regressions for analysis and found profitability to be positively related to leverage, equity capital, management competence index but negatively related to size and ownership structure. This study used correlation and general linear model to examine whether the extent of use of leverage and liquidity levels influence profitability of financial firms.

Kimathi et al. (2015) studied the effect of leverage on performance of firms listed at the NSE using causal research design and ordinary least square to determine variable relationships. They used a population of 61 listed firms by December 2013 and found no big difference in financial performance between large levered firms and small-levered firms. And profitability. This study used correlation research design to examine the relationship between leverage, liquidity. Adongo (2012) studied the effect of financial leverage on profitability and risk of a sample of thirty firms (excluding banks and insurance firms) listed at the NSE for the period

2007 to 2011. Data collected was analyzed by time series, regression and correlation analysis to determine the nature and strength of relationship between variables and found no relation among variables. Results are not inclusive of financial firms yet they play a role of funds distribution and current reports of financial crises called for the need for this study to examine variable relations.

Kodongo et al. (2014) investigates the relationship between leverage and financial performance of listed firms in Kenya. They use correlation analysis to do diagnostic tests of data for the period 2002 to 2011 and find leverage to be negatively, affecting profitability of firms. This is in agreement with the findings of Adongo (2012). This study sought to determine the strength of leverage and liquidity relation on profitability by use of similar research design. Kahraman and Tookes (2014) examined leverage constraints on market liquidity of listed securities on NSE of India as at December 2012. Regression design was used and they observe liquidity as high when stocks are eligible for margin trading and decrease with ineligibility. This concurs with findings of Geanakoplos (2010) that capital constraints drive market liquidity. This study used correlation analysis to determine whether NPLs issued from levered funds by financial firms adversely influence liquidity hence low profitability due to credit risks.

Kaya (2014) studies U.S. trade firms for the period 2000-2005 to determine whether firm leverage explains profitability and liquidity values. He uses descriptive statistics and non parametric tests to analyze the variables. Findings show highly levered firms to suffer in terms of liquidity. This research investigated the negative relation between the variables among firms. Kebewar (2013) studied debt impact on corporate profitability. He sampled 2240 French non listed companies of service sector during 1999-2006, collected data and analyzed it using generalized method of moments (GMM) econometric technique on three measures of profitability ratio. He found debt ratio to have no effect on corporate profitability in agreement with Kodongo et al. (2014).

The Conceptual Model

Independent variables

Dependent variables

Leverage

Leverage ratio

Profitability

- i. Return on Assets
- ii. Return on Equity

Liquidity

Liquidity ratio

Adrian and Shin (2010) argue that when firms have surplus funds (high liquidity) their asset prices increase (hike) thus reducing leverage. This occurs because firms have cash to use in carrying out routine operations as well as invest in profit

Methodology

Research Design

The study adopted correlation research design that assesses the relationship or covariance among variables in a group or data set and general linear models including ANOVA and regression that assess effects among variables. These designs fit the study, since they relate and determine the relationships among variables and gauge the effect of relationship in liquidity and leverage variables to profitability thus helps to determine the extent of relationship. Otieno, (2015), Kodongo et al., (2014), Shubita and Alsawalhah, (2012) and Velnampy and Niresh, (2012), have successfully used these research designs. This design was therefore used in the study to establish whether there is correlation and effects between the dependent and independent variables.

Population

The study comprised of seventeen financial firms listed at the Nairobi Securities Exchange as at the year 2016. These financial firms consist of insurance companies and banks. Listed banks and insurance firms are seventeen in number and therefore the entire population will be taken for study. The entire population was studied and as it is less than thirty, thus a census study was done.

Data Collection

This study used secondary data captured from Capital Markets Authority reports, individual firm's financial reports and Nairobi Securities Exchange handbooks for listed companies and annual reports for the period 2010 to 2015. Secondary data comprised of data from published financial statements of the listed category of firms.

Data was collected using secondary data capture form appendix II for the period 2010 to 2015. Leverage measures were derived from the statements of financial positions of

individual firms, Liquidity and profitability measures were calculated using information from both statements of incomes and statements of financial positions.

Data Analysis

Pearson correlation and General linear models were used to establish the relationship between leverage and profitability, liquidity and profitability and the effect of leverage and liquidity on profitability. The results were tested for normality, linearity, homoscedasticity and multicollinearity using F-tests, Confidence interval at 5% level of significance, scatter plots, Pearson coefficient and ANOVA. Profitability is the dependent variable while leverage and liquidity are independent variables. Therefore, the proposed analysis model is as follows:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \epsilon_i \dots \dots \dots 3.1$$

Where; Y = the dependent variable (Measured by ROA and ROE)

β_0 = Constant

$\beta_1 \dots \beta_3$ = correlation coefficients

$X_1 \dots X_2$ = Independent variables

X_1 = Liquidity Ratio

X_2 = Leverage Ratio

ϵ_i = Error term

Leverage ratio is a measure of leverage mostly used for regulatory purposes. The ratio is expressed as Tier 1 capital as a proportion of total adjusted assets where, Tier 1 capital is the sum of capital and reserves minus some intangible assets such as goodwill, software expenditure and deferred tax assets.

Liquidity ratio is derived by division of total assets by the difference between total liabilities and conditional reserves. Insurance companies and other financial institutions use this ratio for analysis and. It measures a company's ability to settle liabilities with its assets.

Return on Asset (ROA) is a measure of profitability which measures returns in terms of the gains realized on an asset from trading in a given financial period and leads to increase in asset value as compared to cost of acquisition or amount invested. It is measured by dividing net income by total assets.

Return on Equity (ROE) is a measure of profitability which measures returns in terms of shareholders return on equity in any year of trade. It is measured by net income after interest

and tax less distributions due to preference shareholders if any divided by total outstanding shareholders equity.

Results and Discussion

Response Rate

Secondary data was collected from all the seventeen firms comprising of Banks and Insurance companies listed at the NSE for a six-year period in between the years 2010 to 2015. Two insurance firms; Britam and Liberty Holdings were not operational in the year 2010, thus there was no data collected for them in that year.

The banking and insurance sectors provides mediums through which money flows in and out of an economy and enables distribution and circulation of finances. These firms' activities show the general operations and performance of all listed firms in the named sectors with regard to leverage and liquidity matters. These have both direct and indirect effects in a total economy as non-financial firms depend on financial firms for leverage and liquidity engagements.

All components of independent and dependent variables were collected and compiled for entry and analysis.

Descriptive Statistics

This summarizes details of ROA, ROE, Leverage Ratio, Liquidity Ratio and Profitability variables. The numbers of observations were 102, drawn from seventeen banks and insurance firms for a consecutive time period, beginning the year 2010 to 2015 for each of the firm. The table below shows the descriptive statistic summary for the variables. The results however, show 101 observations indicating the likelihood of non usage of one row. There were no entries in the year 2010 for Britam and Liberty Holdings.

Table 1: Descriptive Statistics

Variable	N	N*	Mean	Std Dev	Minimum	Q1	Median	Q3	Maximum
ROA	101	1	3.74	2.421	-5.81	2.71	3.48	4.71	11.78
ROE	101	1	19.013	9.044	-17.42	15.08	20.24	25.13	37.45
Lev Ratio	101	1	0.177	0.1244	0	0.1228	0.1378	0.1658	0.6061
Liq Ratio	101	1	0.873	2.424	-9.422	1.325	1.428	1.544	3.35

Relationship between Leverage and Profitability of Banks and Insurance firms listed at the NSE

The first objective intended to determine the relationship between Leverage and Profitability of financial firms. The study conducted entailed use of correlation for analysis of the variables to determine the relationship. Results are shown in table 2 as follows:

Table 2: Correlation Results

	ROE	ROA
ROA	0.460	
	0.000	
Lev Ratio	-0.165	0.705
	0.098	0.000

This study used Pearson correlation to determine relationships at 95% significance level and derived the correlation between ROA and ROE as 0.460 and statistically significant hence a significant relationship between the measures of profitability. The correlation between ROA and leverage ratio is 0.705 and statistically significant thus showing that a significant relation exists between leverage ratio and ROA. There is an insignificant relationship between Leverage ratio and ROE since the p-value is 0.098 and statistically insignificant. The relationship between ROA and Leverage ratio is presented in table 3.

The leverage ratio has a p-value of 0.000 in ANOVA analysis indicating that the model estimated by the regression equation is significant at an alpha level of 0.05. This implies that there is a 95% confidence level that leverage ratio significantly explains the changes that occur in ROA.

The Variance Inflation Factor (VIF) is near 1.00, suggesting that the causal variables are uncorrelated. The coefficients are properly estimated, stable and can adequately be interpreted. The R² value in ANOVA analysis results above indicates that leverage ratio explain 49.63% of the variance in ROA. The adjusted R² is 49.13%, and is also close to R-square, hence indicating model fitness... Other factors account for changes in ROA besides leverage for the remaining percentages. The predicted R² value is 47.48% and is near the value of R² and adjusted R² value, the model seems to be fit

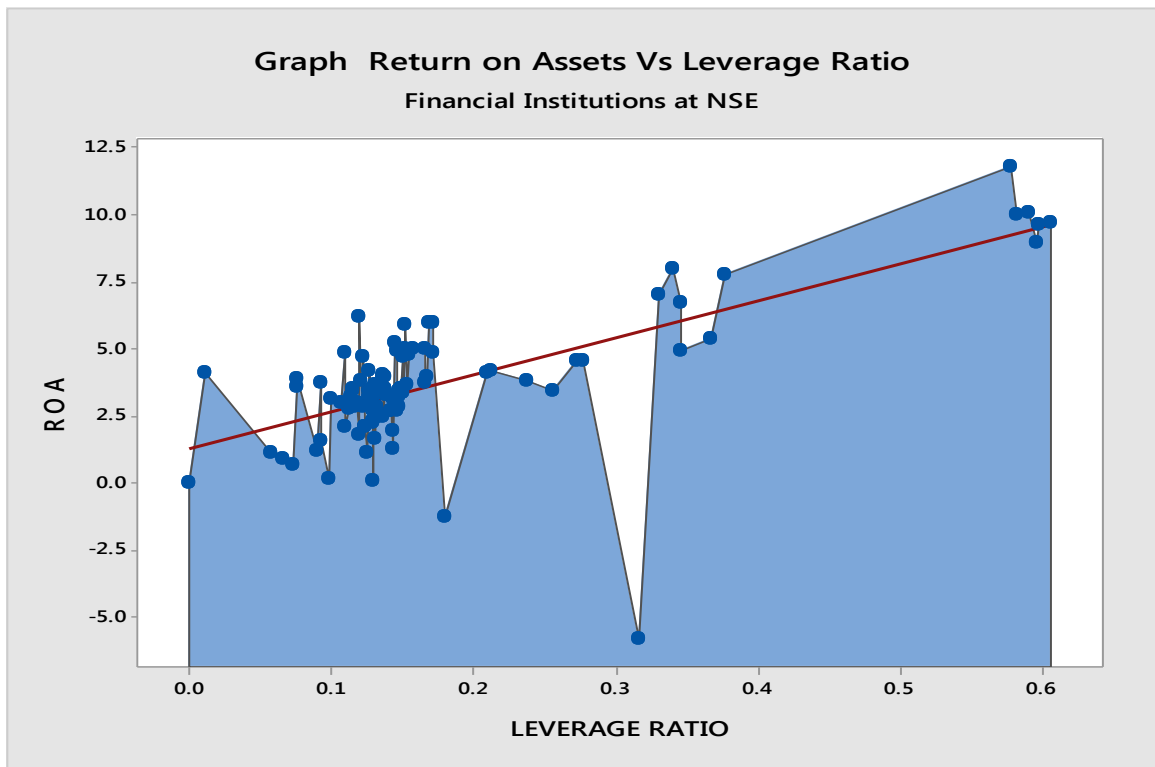
and capable of giving appropriate predictions. The T-value of 9.88 and a p-value of zero (0.000) indicate that the model has predictive ability; leverage thus, explains changes in ROA.

Table 3: Analysis of variance in ROA and Leverage Ratio

Data Source	Degree of Freedom	Adj Sum of Squares	Adj Mean Square	F-value	P-value
Leverage Ratio	1	290.8	290.836	97.56	0.000
Error	99	295.1	2.981		
Total	100	586.0			
Model Summary					
S	R-sq	R-sq(adj)	R-sq(pred)		
1.72656	49.63%	49.13%	47.48%		
Coefficients					
Term	Coef	SE Coef	T-Value	P-Value	VIF
Constant	1.312	0.300	4.38	0.000	
Leverage Ratio	13.71	1.39	9.88	0.000	1.00
Regression Equation					
ROA= 1.312 + 13.71 LEVERAGE RATIO					
Fits and Diagnostics for Unusual Observations					
Observation	ROA	Fit	Residual	Std Resid	
68	-5.810	5.660	-11.470	-6.72R	
72	-1.300	3.786	-5.086	-2.96R	
85	8.940	9.479	-0.539	-0.33X	
86	10.030	9.298	0.732	0.45X	
87	11.780	9.231	2.549	1.57X	
88	10.110	9.417	0.693	0.43X	
89	9.750	9.623	0.127	0.08X	
90	9.650	9.511	0.139	0.09X	

A number of observations are identified as not usual because the absolute values of the residuals are higher than 2. This shows that they are outliers. There seems to be a non clear pattern in the fits and diagnostics for residuals in the analysis of data between leverage ratio and ROA in table 3 in terms of values and sign directions implying that the data set is random, hence suggesting fitness of model.

Figure 1: Graph of Leverage Ratio plotted against ROA



The Graph shows the relationship between leverage ratio and ROA. Most observations are closer to the line of fit. However some observations are quite far from the straight line and show presence of outliers.

The ANOVA analysis between ROE and Leverage ratio is shown in table 4.

Table 4: Analysis of Variance

Source	DF	Adj SS	Adj MS	F-value	P-value
Leverage Ratio	1	223.7	223.74	2.78	0.098
Error	99	7955.3	80.36		
Total	100	8179.0			
Model Summary					
S	R-sq	R-sq(adj)	R-sq(pred)		
8.96417	2.74%	1.75%	0.00%		
Coefficients					
Term	Coef	SE Coef	T-Value	P-Value	VIF
Constant	21.14	1.56	13.58	0.000	
Leverage Ratio	-12.03	7.21	-1.67	0.098	1.00
Regression Equation					
ROE = 21.14 - 12.03 LEVERAGE RATIO					
Fits and Diagnostics for Unusual Observations					
Observation	ROE	Fit	Residual	Std Resid	
68	-17.42	17.33	-34.75	-3.92	R
72	-5.71	18.97	-24.68	-2.77	R
77	-15.60	17.86	-33.46	-3.76	R
85	14.58	13.98	0.60	0.07	X
86	16.61	14.14	2.47	0.29	X
87	19.17	14.20	4.97	0.59	X
88	14.41	14.03	0.38	0.04	X
89	15.69	13.85	1.84	0.22	X
90	15.74	13.95	1.79	0.21	X
91	0.00	21.14	-21.14	-2.39	R
100	37.45	19.32	18.13	2.03	R
102	0.72	19.58	-18.86	2.12	R

The leverage ratio has a p-value of 0.098, indicating a non-significant relation to ROE at a significance level of 0.05. This implies that there is a 95% confidence level that leverage ratio does not explain much of the changes that occur in ROE. A negative relationship exists

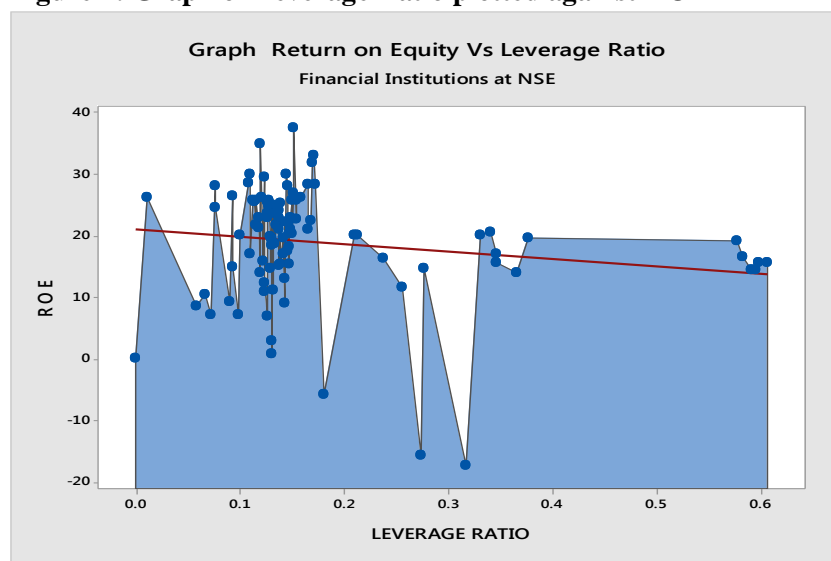
between leverage ratio and ROE in the regression equation since one unit change in leverage ratio reduces ROE by -12.03.

It suggests that the leverage ratio is not very different from zero and even though there is a negative relation between leverage ratio and ROE in the regression equation, not much explanation is seen. The VIFs are low at 1.00, and show stability in the regression coefficients, properly estimated and can valuably be interpreted. The results thus show that leverage coefficients are properly estimated and are uncorrelated.

The R-square value indicates that the leverage ratio explain 2.74% of the variance in ROE. The adjusted R-square is 1.75% accounting for predictability level of the model. The two values show that the model explains 2.74% in R-square and 1.75% of adjusted R-square of the percentage of the response variable variances. This implies that only 2.74% change in the leverage ratio explains the change in ROE and other factors could be involved in determining the remaining percentage of the results. The predicted R-square value is 0.00% thus the model is not able to predict any new variation on response and the model may need improvement.

T-value is low at -1.67 whereas the p-value is 0.098 for the coefficients indicating leverage ratio is insignificant on ROE. The observed T-value of -1.67 and a p-value of zero (0.098) indicate that the model may not have precise predictive ability; the leverage ratio, does not explain much of the changes observed in ROE. Some observations are depicted as outliers since their residuals are greater than 2, indicating that they are outliers.

Figure 2: Graph of Leverage Ratio plotted against ROE



The observations in figure 2 show that there are unusual observations and outliers far from the line of fitness.

Relationship between Liquidity and Profitability of Banks and Insurance firms listed at the NSE

The relationship between liquidity, ROA and ROE are presented in table 5.

Table 5: Correlation Results

	ROE	ROA
ROA	0.460	
	0.000	
Liquidity Ratio	0.098	-0.421
	0.332	0.000

The researchers used Pearson correlation to establish relationships at 95% significance level and derived the correlation between ROA and ROE as 0.460 and thus a significant relationship exists between the variables. There is a significant negative relation between ROA and liquidity ratio at -0.421. An insignificant relationship is found between the liquidity ratio and ROE.

Table 6 presents regression analysis between ROA and liquidity ratio

Table 6: Regression Analysis

Analysis of Variance

Source	DF	Adj SS	Adj MS	F-value	P-value
Liquidity Ratio	1	103.9	103.863	21.33	0.000
Error	99	482.1	4.870	-	-
Total	100	586.0	-	--	-
Model Summary					
S	R-sq	R-sq(adj)	R-sq(pred)		
2.20672	17.73%	16.89%	7.61%		
Coefficients					
Term	Coef	SE Coef	T-Value	P-Value	VIF
Constant	4.107	0.234	17.59	0.000	
Liquidity Ratio	-0.4204	0.0910	-4.62	0.000	1.00
Regression Equation					
ROA = 4.107 - 0.4204 LIQUIDITY RATIO					
Fits and Diagnostics for Unusual Observations					
Observation	ROA	Fit	Residual	Std Resid	
31	1.300	8.068	-6.768	-3.41	R X
37	2.440	7.433	-4.993	-2.44	X
68	-5.810	2.869	-8.679	-3.97	R
72	-1.300	3.338	-4.638	-2.11	R

73	7.800	2.698	5.102	2.34 R
75	8.010	2.992	5.018	2.29 R
85	8.940	7.119	1.821	0.88 X
86	10.030	7.375	2.655	1.30 X
87	11.780	7.347	4.433	2.16 R X
88	10.110	6.627	3.483	1.65 X
89	9.750	6.339	3.411	1.61 X
90	9.650	6.480	3.170	1.50 X

Durbin-Watson Statistic = 1.35812

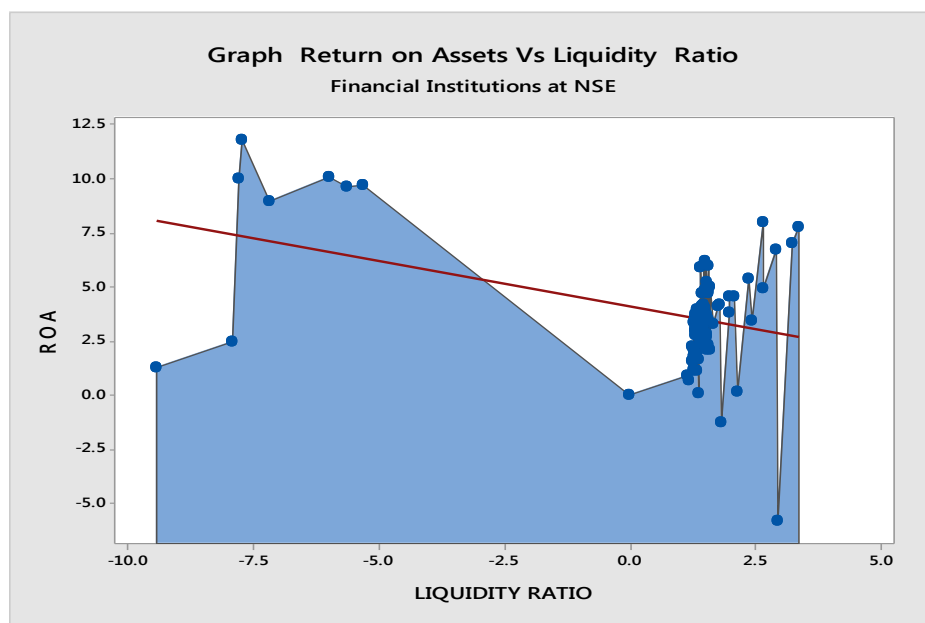
The liquidity ratio has a p-value of 0.000, indicating that it is significantly related to ROA at an alpha level of 0.05. This implies that there is a 95% confidence level that liquidity ratio significantly explains the changes that occur in ROA. Liquidity ratio thus explains profitability of firms. There is a negative relationship between liquidity ratio and ROA as one unit change in liquidity ratio causes a -0.4204 change in ROA.

The VIFs are near to 1.00, indicating no co-linear relation among the predictors. The R-square value in the model summary in table 4.6 indicate that the liquidity ratio explain 17.73% of variance in ROA. The adjusted R-square is 16.89% indicating the percentage at which the predictors explain the observations seen in the model. The values indicate that the model fits the values by the stated percentages. Other factors also explain the observations in ROA. The predicted R-square is 7.6% and since it has predictive ability the model does not appear to be over fit. The value of the predicted R-square shows that the model can predict new observations in the model.

T-value is -4.62 while p-value is 0.000 for the coefficients indicating significance of liquidity ratio on ROA. Some observations are shown as outliers since the standardized residuals are greater than 2. There is an unclear pattern in the fits and diagnostics for residuals in the analysis of data between liquidity ratio and ROA above implying that the data set is random, hence suggesting the fitness of the model.

Durbin Watson statistic is 1.35812 which suggests that there is no autocorrelation in the data used. The data collected for the various financial firms are not related to each other over successive time periods even for the same firm.

Figure 3: Graph of Liquidity Ratio plotted against ROA



Extreme values far from the line of fit in figure 4.3 indicate presence of outliers.

Regression analysis of Liquidity ratio on ROE is presented in table 4.7

Table 4.7: Regression Analysis

Analysis of Variance

Source	DF	Adj SS	Adj MS	F-value	P-value
Regression	1	77.87	77.87	0.95	0.332
Leverage Ratio	1	77.87	77.87	0.95	0.332
Error	99	8101.15	81.83		
Total	100	8179.02			
Model Summary					
S	R-sq	R-sq(adj)	R-sq(pred)		
9.04598	0.95%	0.00%	0.00%		
Coefficients					
Term	Coef	SE Coef	T-Value	P-Value	VIF
Constant	18.696	0.957	19.53	0.000	
Liquidity Ratio	0.364	0.373	0.98	0.332	1.00
Regression Equation					
ROE = 18.696 + 0.364 LIQUIDITY RATIO					
Fits and Diagnostics for Unusual Observations					
Observation	ROE	Fit	Residual	Std Resid	
31	9.00	15.27	-6.27	-0.77 X	
37	15.29	15.82	-0.53	-0.06 X	

68	-17.42	19.77	-37.19	-4.15 R
72	-5.71	19.36	-25.07	-2.79 R
77	-15.60	19.41	-35.01	-3.89 R
85	-14.58	16.09	-1.51	-0.18 R
86	16.61	15.87	0.74	0.09 X
87	19.71	15.89	3.28	0.39 X
88	14.41	16.51	-2.10	-0.24 X
89	15.69	16.76	-1.07	-0.12 X
90	15.74	16.64	-0.90	-0.10 X
91	0.00	18.70	-18.70	-2.08 R
100	37.45	19.21	18.24	2.03 R
102	0.72	19.19	-18.47	-2.05 R

Durbin-Watson Statistic = 1.37277

The estimated p-value of the liquidity ratio is 0.332 in ANOVA analysis and is insignificantly related to ROE at alpha level 0.05. There is a 95% probability that the actual value of the liquidity ratio is equal to zero. This implies that changes in liquidity ratio do not lead to observable responses in changes in ROE. It further suggests that the liquidity ratio can be done away with without significantly changing the results.

The Effect of Leverage and Liquidity on Profitability of Banks and Insurance firms listed at the NSE.

Regression analysis of leverage ratio and liquidity ratio on ROA is presented in Table 8

Table 8: Regression Analysis

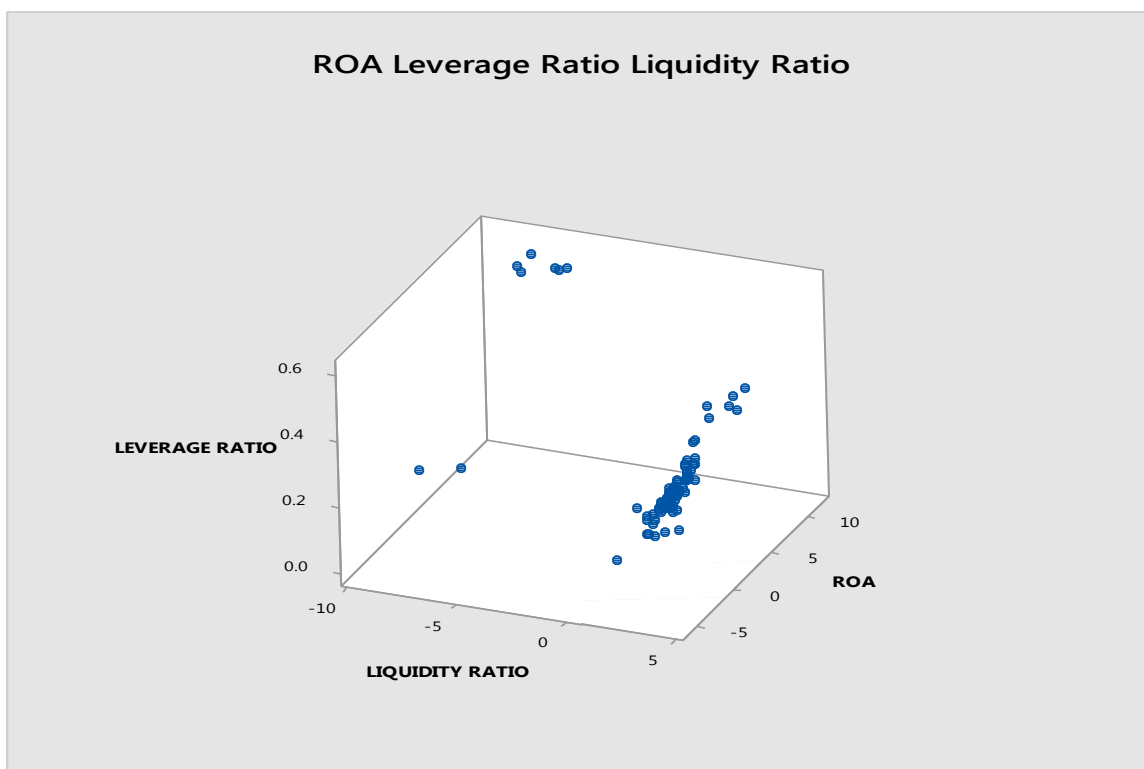
Analysis of Variance Source	DF	Adj SS	Adj MS	F-value	P-value
Regression	2	291.447	145.724	48.49	0.000
Leverage Ratio	1	187.584	187.584	62.42	0.000
Liquidity Ratio	1	0.611	0.611	0.20	0.653
Error	98	294.509	3.005		
Total	100	585.956			
Model Summary					
S	R-sq	R-sq(adj)	R-sq(pred)		
1.73355	49.74%	48.71%	44.58%		
Coefficients					
Term	Coef	SE Coef	T-Value	P-Value	VIF
Constant	1.421	0.386	3.68	0.000	
Leverage Ratio	13.29	1.68	7.90	0.000	1.46
Liquidity Ratio	-0.0389	0.0863	-0.45	0.653	1.46
Regression Equation					
ROA = 1.421 + 13.29 LEVERAGE RATIO - 0.0389 LIQUIDITY RATIO					
Fits and Diagnostics for Unusual Observations					
Observation	ROA	Fit	Residual	Std Resid	

31	1.300	3.689	-2.389	-1.64 X
37	2.440	3.550	-1.110	-0.73 X
68	-5.810	5.520	-11.330	-6.72 R
72	-1.300	3.747	-5.047	-2.93 R
73	7.800	6.294	1.506	0.91 X
85	8.940	9.614	-0.674	-0.91 X
86	10.030	9.463	0.567	0.36 X
87	11.780	9.394	2.386	1.50 X
88	10.110	9.509	0.601	0.37 X
89	9.750	9.682	0.068	0.04 X
90	9.650	9.586	0.064	0.04 X

Durbin-Watson Statistic = 1.68781

The p-value for the leverage ratio in the equation is significantly related to ROA. Changes in the leverage ratio elicit responses in the value of ROA. The p-value for the liquidity ratio on the other hand is 0.653 implying that it is insignificantly related to ROA at an alpha level of 0.05. Thus changes in liquidity ratio do not explain responses observed in the value of ROA. When the two variables are combined to study effects, leverage ratio elicits responses in ROA while liquidity ratio does not thus a negative insignificant relation exists among the variables. The R-square value indicates that both the leverage ratio and liquidity ratio together explain 49.74% of the variance in ROA while the adjusted R-square is 48.71%, a figure that is close to R-square value contributing to the percentage that explains the changes observed in ROA. The two values imply that the model fits the data well and accounts for the number of predictors in the model.

Figure 4.4: Scatter diagram showing effects of Liquidity Ratio and Leverage Ratio on ROA



The scatter diagram shows the effect of Leverage ratio and Liquidity ratio on Return on Assets. It shows presence of outliers or factors that may have brought about the observed outcomes.

Table 9 presents regression analysis of leverage ratio and liquidity ratio on ROE.

Table 9: Regression Analysis

Analysis of Variance	DF	Adj SS	Adj MS	F-value	P-value
Regression	2	224.04	112.019	1.38	0.256
Leverage Ratio	1	146.17	146.168	1.80	0.183
Error	98	7954.98	81.173		

Total	100	8179.02			
Model Summary					
S	R-sq	R-sq(adj)	R-sq(pred)		
9.00962	2.74%	0.75%	0.00%		
Coefficients					
Liquidity Ratio	1	0.30	0.300	0.00	0.952
Term	Coef	SE Coef	T-Value	P-Value	VIF
Constant	21.07	2.01	10.49	0.000	
Leverage Ratio	-11.73	8.74	-1.34	0.183	1.46
Liquidity Ratio	0.027	0.448	0.06	0.952	1.46
Regression Equation					
ROE = 21.07 - 11.73 LEVERAGE RATIO + 0.027 LIQUIDITY RATIO					
Fits and Diagnostics for Unusual Observations					
Observation	ROE	Fit	Residual	Std Resid	
31	9.00	19.13	-10.13	-1.34	X
37	15.29	19.24	-3.95	-0.50	X
68	-17.42	17.43	-34.85	-3.98	R
72	-5.71	19.00	-24.71	-2.76	R
73	19.63	16.74	2.89	0.34	X
77	-15.60	17.91	-33.51	-3.77	R
85	14.58	13.88	0.70	0.08	X
86	16.61	14.02	2.59	0.31	X
87	19.17	14.08	5.09	0.62	X
88	14.41	13.97	0.44	0.05	X
89	15.69	13.81	1.88	0.22	X
90	15.74	13.90	1.84	0.22	X
91	0.00	21.07	-21.07	-2.40	R
100	37.45	19.33	18.12	2.02	R
102	0.72	19.58	-18.86	-2.11	R

Durbin-Watson Statistic = 1.44561

The leverage ratio has a p-value of 0.183 while the liquidity ratio has a p-value of 0.952 in respect of ROE in the regression model in the Analysis of variance table which shows that the model estimated by the regression procedure is insignificant at an alpha level of 0.05. These values indicate that the coefficients of these ratios could be zero. This suggests that the changes in the variables do not explain much of the responses in the dependent variable. These results are in agreement with that of Adongo (2012) which found no relation in effect of leverage on profitability measured in terms of ROE.

Discussion

The analysis of findings show that there is a positive relationship between leverage and profitability expressed in terms of ROA as seen in the significant Pearson correlation values,

However insignificant Pearson correlation value between leverage ratio and ROE show that there is a negative relation between leverage and profitability expressed in terms of ROE. The significant relationship between profitability expressed in terms of ROA and leverage ratio is explained by the Pecking order theory, where managers prefer to use leverage instead of equity since it involves lower risk and between leverage ratio and ROE is -0.165 and statistically insignificant where use of leverage reduces what is available to equity holders due to finance costs of servicing debt. When firms use high leverage, equity declines given the authorized level of capital at the point of incorporation and vice versa. The balance sheet either expands or contracts on the equity and capital side depending on level of leverage or liquidity use. These findings are in agreement with Otieno (2015) who found a bilateral relationship between capital structure and debt capital. Leverage or debt is positively related to ROA, while it is negatively related to ROE. High leverage level used to finance acquisition of assets generates returns on assets whereas high leverage costs leaves firms with little cash to pay equity holders' dividends. ANOVA analysis values show that change in leverage ratio leads to positive change in profitability expressed in terms of ROA, thus increase in leverage level by firms leads to increase on return on assets. This could be due to increase in leverage level by firms to acquire assets used for productive purposes thereby enhancing profitability on acquired assets. On the other hand increase in leverage leads to decrease in profitability expressed in terms of ROE in agreement with findings by Shubita and Alsawalhah (2012). Increase in leverage reduces return on equity available to equity holders. The higher the leverage level the lower the return on equity and vice versa as a unit change in leverage level determines return on equity. This could be due to increase in costs of financing debt in terms of both the interest costs and principal amounts reducing distributable profits due to equity holders. However as return on assets increase, return on equity decrease as funds borrowed are immediately used to acquire assets used for production and productivity increases, on the other hand profits generated are used to service the costs of debt thereby reducing distributable funds to shareholders. On one hand high levels of leverage expose the firms to probabilities of bankruptcy or liquidation when returns dwindle in economic recessions making it difficult for them to meet compulsory debt financing costs while on the other hand high leverage leads to increase in productivity in good economic times availing funds to finance debt costs and leaving high returns for re-injection into business and for distribution to equity holders. Hence the agreement, with the Risk- Return theory, that states that the higher the risk the higher the return and vice versa.

Liquidity has a significant negative relationship with profitability expressed in terms of ROA as shown in the correlation values whereas there is an insignificant relationship between

liquidity and profitability expressed in terms of ROE. High liquidity is synonymous with low returns on assets due to lack of investments whereas high liquidity does not show significant relations with distribution of equity holders dividends. Analysis of Variance of effect of liquidity on profitability indicates that there is a negative relation between liquidity and ROA. This shows that as liquidity levels increase, return on assets decrease because funds held in liquid form are not put into productive purposes such as asset acquisition to generate returns in agreement with findings in Ngwili (2014). There is a positive relation between liquidity ratio and ROE. This shows that as liquidity levels increase, return on equity increase too since there is free circulation of liquid funds at disposal to meet short term obligations as they occur. Also there is money available for distribution to shareholders; hence the higher the liquidity levels the higher the returns available for distribution to equity holders.

When leverage ratio and liquidity ratio are jointly regressed to observe probable joint effect on profitability, they show opposite effects on profitability variables. The leverage coefficient indicates that increase in leverage level leads to increase in ROA, whereas liquidity ratio does not, thus a negative insignificant relation exists among the variables. This is in the Risk-Return theory component, that high leverage has premium costs due to inherent risks, thus in boom times high returns on assets could be realized while in recession periods agreement with findings in Owino (2011) which showed a negative insignificant relationship between liquidity and leverage. The coefficient of leverage ratio is high in the equation explaining debt costs surge and may plunge firm into bankruptcy or even liquidation. The leverage ratio has a p-value of 0.183 while the liquidity ratio has a p-value of 0.952 in respect of ROE in the regression model in the Analysis of variance table which shows that the model estimated by the regression procedure is insignificant at an alpha level of 0.05. These values indicate that the coefficients of these ratios could be zero. This suggests that the changes in the variables do not explain much of the responses in the dependent variable. These results are in agreement with that of Adongo (2012) which found no relation in effect of leverage on profitability measured in terms of ROE. The insignificant effects could have occurred due to non-linear effects or other factors in the model.

Conclusion

The study confirms the Risk-Return theory that states that when leverage is high, there are implications of finance costs and if economic times are favorable firms' reap in high profits, whereas when economic times are deplorable firms easily plunge into bankruptcy or even liquidation when they employ high leverage levels. Also the study alludes to need by financial

firms to hold certain levels of cash balances to meet both recurring liquidity needs as well as long term financial requirements. If leverage is high while liquidity is low Banks and Insurance firms face the likelihood of being rendered bankrupt or being deemed into liquidation as they struggle to meet financial obligations.

This study provides new evidence on the relationship between leverage and liquidity to profitability and the effects of the predictor variables on profitability when combined in an equation to provide joint observations. Previous research works show that there is either positive relation or negative relation of leverage to profitability. This study found out that the results of leverage relationship to profitability and the effects of the explanatory variable to profitability varies depending on which measure of profitability is applied for use in the course of study or during firms' choice on leverage level and financial reports as strategy for making investment decisions or dividend distribution, this not leaving out the short-term financial needs. Findings show that there is a positive relationship between leverage and profitability expressed in terms of ROA and a negative relation between leverage and profitability expressed in terms of ROE as different measures of profitability. Liquidity has a negative relation with profitability when expressed in terms of ROA whereas there is a positive insignificant relation between liquidity and profitability when expressed in terms of ROE. Change in leverage ratio leads to positive change in profitability expressed in terms of ROA, hence increase in leverage use by firms increase return on assets. This happens when firms increase leverage level to acquire assets employed to generate returns. When returns increase as a result of new asset acquisitions, there is increase in profitability in form of return on assets (ROA). Again increase in leverage leads to decrease in profitability expressed in terms of ROE thus reducing return on equity available to equity holders. These occur because interest costs and repayment of principal amount involved in servicing debt reduce available profits for distribution to equity holders. Observations from analysis of leverage effects on profitability using the two different measures are opposite.

Similarly increase in liquidity levels leads to decrease in profitability when expressed in terms of ROA whereas when there is increase in liquidity position by firms' there seems to be unclear observations in profitability when expressed in terms of ROE due to insignificant variable relations and regression results. The observations seen in reduction in ROA could be attributed to non-acquisition of investment assets to generate returns hence high liquidity but low returns. These findings form the basis of argument and support for proposition that liquidity effects on profitability varies when different measures of profitability are applied.

Combining leverage and liquidity aspects to determine probable joint effects on profitability brings about opposite observations on firm profits. When leverage and liquidity variables are combined leverage effects are felt more than liquidity on profitability measured in terms of ROA whereas insignificant effects are observed in profitability measured in terms of ROE when the two variables are combined.

Recommendations

This study brings on board additional findings and contributes in building the body of knowledge by focusing on leverage use by banks and insurance firms that for a long time have been left out in study of debt implications with proponents saying that banks are lenders only and do not engage in leverage while insurance companies receive premiums and do not engage in leverage activities. This study confirms that all financial firms including banks and insurance firms engage in leverage activities and since they create the means through which all other firms including non financial firms distribute, allocate, stores and use finances for investments they form the basis of operations in economic activities. Their engagement in leverage and liquidity aspects, are paramount to a nations economic well being and thus academicians can encourage further fact finding in this area to help build on the existing literature.

Managers practicing in different skill areas are advised to determine whether use of leverage in financing asset purchase will be tenable in light of economic situations and whether the decision to acquire the asset will be desirable in terms of leverage costs. Managers are encouraged to gauge the appropriate leverage and liquidity levels to use for firms given their unique circumstances. This will see firms seeking to maintain appropriate debt levels while avoiding situations that may lead to bankruptcy costs and have liquidity to sustain operations. Firm managers should establish the relation between liquidity of asset and leverage and their effects on profitability especially when assets are used as collateral for securities. They need to understand the effect of liquidity of asset on leverage and vice versa if assets are applied as collaterals so as to enable them make appropriate decisions when they have discretion to either dispose or not to dispose assets. This will help protect the interests of lenders to the firms. Managers should to be informed and be restricted on use of assets. Managers need to be aware of advantages of managing firm assets instead of selling to meet liquidity needs in order to gain from avoiding costly assets sales.

Policy makers need to put in place policies that specify beneficial effects on firms' leverage levels and liquidity levels. Tax implications are felt by levered firms in terms of finance costs and liquidity aspects thus appropriate tax rates need to be used to enable firms not to sacrifice

too much thus minimizing what is left for investment opportunities while at the same time enabling tax authorities to collect enough revenue for economic advantage. Also policy makers should in addition to specifying the regulatory requirements for banks and insurance firms, put in place mechanisms for monitoring their operations to ensure full compliance with minimum requirements. This should also be applied to non listed banks and insurance firms due to their contributory nature of operations affecting whole economy. In addition they need to fix and alter interest rates as appropriate depending on economic times. Flexible interest rates and different interest rates for corporations and individuals need to be considered for use to enable all parties to benefit from economic activities bearing in mind their financial abilities.

Limitations of the Study

The study concentrated only on listed banks and insurance firms due to difficulties in obtaining data from these categories of non-listed firms thus conclusions are a representation of banks and insurance firms and are not fully applicable to all financial firms in the specified sectors in the country.

Secondary data was used and during the period of study beginning the year 2010 to the year 2015, different inflation rates prevailed and could have affected interest rates thereby affecting liquidity, leverage and profitability levels. The observed results for the period of study may bear these significant components.

Classification of reserves as obtained from financial statements was not quite distinct for some firms with regard to disclosure or non-disclosure instead there was general statement of reserves. Where it was unclear as regards this and in computation of Tier 1 capital total reserves were included.

Suggestions for further Research

Some firms were declared bankrupt during the period of study, future further study could be designed to determine whether only leverage or liquidity aspects played a role to inform their distress situations or whether some other factors like management decisions in terms of choices of leverage and liquidity levels contributed to this.

Only seventeen listed banks and insurance firms were studied. Non-listed categories of these firms were left out because of difficulties in obtaining their data. In future if more listing of these firms is done or if some means could be used to obtain their data further research could

be done to determine findings, since the larger the sample or use of population for study the more valid the findings become.

Some findings showed insignificant relationships and negative values or effects thus other non-linear models could be employed to determine fit of model or further incorporate other variables that are likely to influence responses to establish whether they contribute to results observed.

Insurance firms receive premiums from policy holders which they invest in assets such as real estates, marketable securities, if they do these without some minimum liquidity retention ratio they end up in liquidity problems and fail to repay both the policy holders interests as well as the principal sum when they become due for repayment. This is an area of study that could be explored in future to help inform authorities of regulatory agencies in this sector on best practices as regards their unique nature of operations as well as provide managers of these firms' with valuable insights on courses of actions that can be adopted for effective results.

Non- Performing loans were identified as a factor that curtail the maximization of profits by Banks and even lead to realization of losses, but by the end of this research it was not clear as to whether these loans were eventually recovered or whether they were written-off as bad debts. Future research can follow up on this matter to determine their aftermath in order to give favorable recommendations.

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