The Impact Of Liquidity On The Financial Performance Of The Nonfinancial Firms Quoted On The Nairobi Securities Exchange
ABSTRACT

Liquidity and profitability of businesses are imperative concern in the development and continued existence of a company and the capability to hold the substitution involving the two is of immense importance for the management. This research examined the impact of liquidity on financial performance of the nonfinancial companies quoted on the Nairobi Securities Exchange (NSE). The research used the descriptive research design that permitted the researcher to significantly explain a distribution of measurements. The research included 39 quoted nonfinancial companies in NSE in Kenya. Investigation was based on data extracted from audited annual accounts of quoted nonfinancial companies for a period of five years from year 2010 to 2014. Correlation and regression analysis were used to identify the impact of liquidity on financial performance of the companies quoted in the NSE. The ROA was used as an alternate for financial performance and the liquidity was calculated using the current ratio, quick ratio and the cash ratio. Control variables used were Firm size, sales growth and firms’ leverage. Findings established a significant positive relationship between liquidity and profitability of nonfinancial companies quoted on Nairobi Securities Exchange. Quoted companies should uphold the most favorable liquidity point in order to maximize company’s profitability and shareholders’ wealth. Nonfinancial companies are therefore required to trail return maximization and by this will improve on liquidity of the firm.

Keywords: Current Ratio, Quick Ratio, Cash Ratio and financial performance

1. INTRODUCTION

1.1 BACKGROUND OF THE STUDY

The significance of liquidity and its effects on business financial performance in business nowadays cannot be over accentuated (Apuoyo, 2010). Proper administration of current assets and current liabilities is essential in maintaining liquidity in day-to-day functions to guarantee the proper operation and meeting obligation as they become due (Eljelly, 2004). Liquidity plays an important function for a thriving performance of nonfinancial companies. A business ought to make sure it has sufficient liquidity to meet up its immediate obligation. A research of liquidity is of key substance to analysts and other users of financial statements due to the immediate survivor of a business (Bhunia, Khan and Mukhuti, 2011). Problem in liquidity administration is to realize preferred substitution involving liquidity and financial performance of a business (Nasr and Raheman, 2007).

Every business is mainly apprehensive with its financial performance. Profitability is related to the goal of shareholders of wealth maximization, and investments in current assets are made only if an adequate return is obtained. While liquidity is needed for a company to continue business, a company may choose to hold extra current assets than desirable for functional requirements or for preventive or contemplative motives. Indefensible excess investment in working capital would influence the return on assets negatively (vishnani and shah, 2007).
Two measures of company financial performance ratios which are based on sales and investments were identified. Gross profit margins (GPM), net operating margin (NOM), rate of return on assets (ROA), rate of return on owners fund (equity) (ROE) and rate of return on resources employed (ROCE) are the main measures of financial performance. Therefore, profit is an absolute measure and financial performance is a relative measure of effectiveness of the operations of a business. Nonfinancial companies need to earn profit to survive and develop. Earnings are fundamental for survival of businesses, but concern should also be given to other stakeholders of a business like the consumers, government, creditors, employees and the society (Janglani and Sandhar, 2013)

1.2 STATEMENT OF THE PROBLEM
The development and continued existence of a company generally relies on the earnings the business is capable of making. Excellent financial performance of the business will positively throw in to the profitable growth of the country by means of making available further employment and taxation. Besides, it contributes to the earnings of the business owners by paying dividends (Aremu et al, 2013). Business liquidity affects financial performance; liquidity problems may lead to loss of customers to competition and may cause the company to be wound up(Mwangi, Muathe and Kosimbei, 2014)

1.3 RESEARCH OBJECTIVE
This study sought to pursue the following objectives:
- To establish the impact of liquidity on financial performance of the nonfinancial companies quoted at the NSE.
- To determine the relationship between current ratio and financial performance of the nonfinancial companies quoted at the NSE.
- To determine the relationship between acid-test ratio and financial performance of the nonfinancial companies quoted at the NSE.

1.4 SIGNIFICANCE OF THE STUDY
The study will enable the managers to establish optimal liquidity levels and adopt better working capital management policies. The research will enable the policy makers to devise standards in establishing an appropriate level of liquidity for firms and come up with more effective methods of managing liquidity levels of a company. The study will also enable the investors to know the kind of information to be disclosed by firms on the financial statements as pertains to liquidity and profitability. Finally, the study will be of importance to academics and scholars. The study will add to the theories on the liquidity and how liquidity impact on financial performance. The study is also of importance to the management of companies as they will be able to use the information as a base for making decisions, understand its importance and observe the trend of the impact of liquidity on profitability.
2. LITERATURE REVIEW

2.1 EMPIRICAL REVIEW
This section gives evidence of what other researchers have observed and the findings in their research relating to the impact of liquidity and financial performance.

Shin and Soenen (1998) investigated association involving a measure of the cash gap and company financial performance in their study of a large sample of listed American businesses for a twenty year duration starting from 1975 to 1994; the results indicated a negative relationship. This shows that shareholders wealth is maximized by reducing the cash conversion cycle.

Obida and Owolabi (2012) carried out a study of manufacturing companies quoted on the Nigerian stock exchange on the effects liquidity have on company financial performance, using descriptive research they found that liquidity as measured in terms of cash conversion cycle, cash flows and credit policy have a significant effect on company financial performance and they concluded that financial performance as measured by profits may be improved by having short cash conversion cycle, employing good credit policy and having an efficient cash management policies.

Apuoyo (2010) examined the association linking the policies put in place in the management of working capital and business profitability for companies quoted at the NSE using a sample of 19 listed joint stock entities for a five year duration and the findings were that company’s profitability as measured by ROA increases with firm’s size, efficient working capital and with a lesser aggressiveness of the asset management. Thus, contrary to the traditional theory of asset management, where a conservative policy is expected to sacrifice profitability at the cost of liquidity, the research study found a positive association amid a conservative management of current asset and current liabilities and the financial performance of firms quoted at the NSE.

2.2 CONCEPTUAL FRAME WORK

- **LIQUIDITY RATIOS**
  - Current Ratio (C.R)
  - Quick Ratio (Q.R)
  - Cash Ratio (L.R)

- **CONTROL VARIABLES**
  - Sales Growth (S.G)
  - Firm Size (LnT.A)
  - Debt Ratio (D.R)

- **PROFITABILITY**
  - Return on Assets (R.O.A)
3. RESEARCH METHODOLOGY

3.1 STUDY BLUEPRINT
A descriptive research design was adopted for the study. This enabled the investigator to significantly explain various dimensions using a variety of information (Mugenda and Mugenda, 2003).

3.2 POPULATION OF THE STUDY
Mugenda and Mugenda (2003) define a population as the entire group of individuals, events or objects having a common observable characteristic. The population elements comprised the 39 nonfinancial firms quoted in the NSE. Firms in the financial segment were disqualified from the research due to the uniqueness of the environment of their operations and to do away with any abnormality allied with this segment which is vastly under regulation by the Central Bank of Kenya central on matters of liquidity, core capital and allowance for bad and doubtful debts in addition to other dynamics (Mwangi et al. 2014).

3.3 DATA COLLECTION
The researcher used secondary source of data. Data comprising of time series and cross sections was used in the study. Financial performance and liquidity data was obtained from the audited financial reports of the quoted nonfinancial companies at the NSE. The period of data collection was from 2010 to 2014 covering five years. The specific data collected for the five years period is in form of annual profit before tax, current assets, current liabilities, non-current assets, accounts receivable, prepayments, cash and bank balances, short term investments, sales/turnover, noncurrent liabilities and inventory for each year of study.

3.4 DATA ANALYSIS
Data was analyzed through the use of descriptive statistics, correlation analysis and multiple linear regression analysis. The multiple linear regression models were used to estimate the causal relationships between ROA and the independent variables and control variables. SPSS version 20 software was used for the analysis of the different variables in the study.

3.4.1 ANALYTICAL MODEL
Multiple linear regression was employed in examining the impact of liquidity and the financial performance of the nonfinancial firms quoted on the Nairobi securities exchange.

The study used the following conceptual model:

\[ \text{ROA} = \beta_0 + \beta_1 \text{(CR)} + \beta_2 \text{(QR)} + \beta_3 \text{(LR)} + \beta_4 \text{(LnTA)} + \beta_5 \text{(SG)} + \beta_6 \text{(DR)} + \varepsilon \]

Where;
ROA\_it = Assets return of a firm i at time t;

Bo = the intercepts of equation (the constant);

\( \beta_i \) = Coefficients of independent variables of company i which measures the change in ROA for a unit change in independent variable;

t =Time in years; 1, 2… 5 years;

i = 1….n, where n is the total number of companies; n = 39;

CR = Current Ratio;

QR = Quick Ratio;

LR = Cash/Liquid Ratio;

LnTA = Natural Logarithm of Total Assets;

SG = Sales Growth;

DR = Debt Ratio;

\( \varepsilon \) = the error term (residual).

### 3.4.2 VARIABLES AND VARIABLE MEASUREMENT AND SELECTION

The dependent variable was defined as the profitability of the firms. The independent variable was interpreted as the commonly used liquidity ratios. The ratios used are chosen from those utilized by Bhunia et al. (2011) and Janglani & sandhar (2013). The dependent variable that was used is ROA. The researcher considered ROA as the best measure of profitability since it measures the return on all assets utilized in generating the profit for the period. ROA is computed by dividing the profit before interest and tax by the book value of total assets multiplied by 100. The research utilized the following independent variables; current ratio (CR) obtained by dividing current assets by current liabilities; acid test ratio or quick ratio (QR) obtained by dividing current assets net of inventories by current liabilities and the cash ratio (LR) obtained by dividing cash plus short term investments by current liabilities.

The control independent variables identified by the researcher in the study of the impact of liquidity on financial performance of nonfinancial firms quoted at the NSE included the following; Size of the firm, growth in sales and the debt ratio. Control variables are those variables that are likely to influence the research results (Mugenda and Mugenda, 2003). The control independent variables were calculated as follows: firm size was the natural logarithm of total assets (LnTA); sales growth (SG) = [(this year's sales - previous year's sales)/previous year's sales] multiplied by 100 and the debt ratio (DR) was determined by dividing the total liabilities by the total asset multiplied by 100.

### 3.4.3 TEST OF SIGNIFICANCE

Since this study sought to ascertain the impact of liquidity on financial performance of the nonfinancial firms quoted at the NSE, a correlation design was used for the in the research. A correlation analysis attempts to
determine the extent and course of association amid variables under the study. In a multivariate distribution, if the variables have the cause and effect relationship, they have high degree of correlation between them. Regression analysis was used to identify how the predictor variables are correlated to the dependent variable, and to discover the forms of these relationships. Significance of coefficient values at 5% and 1% levels of significance was tested using the $R^2$, Analysis of Variances (ANOVA, the $t$ and the $F$ statistics. $R^2$ was used to measures the deviation in the dependent variable (ROA) which is explained by the deviation in the predictor variables. $F$ Statistic is a statistic which essentially compares Sum of Square due to Regression to Sum Square due to Error. It enabled a hypothesis test to be carried out on the significance of the regression model. The $t$ statistic was used to measure how well a particular independent variable predicts the dependent variable if all other predictors are not included or are assumed constant.

4. DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 DESCRIPTIVE STATISTICS

Table 4.1 shows the descriptive statistics presenting the mean, standard deviation, maximum values and minimum values of the different variables used in the study.

<table>
<thead>
<tr>
<th>Variable</th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA</td>
<td>195</td>
<td>-22.3135</td>
<td>65.9032</td>
<td>12.183594</td>
<td>12.1640197</td>
</tr>
<tr>
<td>CR</td>
<td>195</td>
<td>0.2015</td>
<td>22.492</td>
<td>2.240736</td>
<td>2.8733322</td>
</tr>
<tr>
<td>QR</td>
<td>195</td>
<td>.0998</td>
<td>22.4394</td>
<td>1.723136</td>
<td>2.8526450</td>
</tr>
<tr>
<td>LR</td>
<td>195</td>
<td>.0032</td>
<td>7.8824</td>
<td>.562260</td>
<td>1.1564354</td>
</tr>
<tr>
<td>LnTA</td>
<td>195</td>
<td>11.1409</td>
<td>19.0555</td>
<td>15.634317</td>
<td>1.7387710</td>
</tr>
<tr>
<td>DR</td>
<td>195</td>
<td>3.8647</td>
<td>109.0048</td>
<td>47.738163</td>
<td>20.5471161</td>
</tr>
<tr>
<td>SG</td>
<td>195</td>
<td>-65.6763</td>
<td>221.4526</td>
<td>13.063250</td>
<td>35.0893238</td>
</tr>
<tr>
<td>Valid N</td>
<td>195</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Research Findings

Table 4.1 above shows the mean, standard deviation, minimum values and maximum values for 39 companies listed on Nairobi Stock Exchange for years 2010 to 2014. The descriptive statistics show that over the duration of the research, financial performance as calculated by the assets rate of return has a minimum -22.31% with a maximum of 65.9% and an average ROA of 12.18% with a 12.16% standard deviation. Furthermore, the minimum current ratio was 0.20 and a maximum of 22.45. The minimum quick ratio was 0.1 and a maximum of 22.44 and the minimum cash ratio was 0.00325 with a maximum of 7.88. The average current ratio was 2.24 with a standard deviation of 2.87, the mean value of quick ratio was 1.72 with a standard deviation of 2.85 and the mean value of cash ratio was 0.56 with a 1.156 standard deviations. These ratios as used to measure companies liquidity shows a health liquidity position of the companies listed on the NSE. These ratios were in line with those of standard conventional rule of 2:1 for current ratio and 1:1 acid test ratio.
4.2 QUANTITATIVE ANALYSIS

Pearson’s correlations are calculated for all the variables used in the study and the results are as shown in table 4.2 below. The Table presents correlation co-efficient for the variables used to measure liquidity whereas financial performance is measured by return on total assets.

Table 4.2: Carl Pearson’s Correlation Coefficients breakdown

<table>
<thead>
<tr>
<th></th>
<th>ROA</th>
<th>CR</th>
<th>QR</th>
<th>LR</th>
<th>LnTA</th>
<th>DR</th>
<th>SG</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA</td>
<td>Pearson Correlation</td>
<td>.294**</td>
<td>.286**</td>
<td>.229**</td>
<td>-.039</td>
<td>-.319**</td>
<td>.169*</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.000</td>
<td>.001</td>
<td>.590</td>
<td>.000</td>
<td>.018</td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
</tr>
<tr>
<td>CR</td>
<td>Pearson Correlation</td>
<td>.985**</td>
<td>1</td>
<td>.500**</td>
<td>-.321**</td>
<td>-.429**</td>
<td>-.018</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.803</td>
</tr>
<tr>
<td>N</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
</tr>
<tr>
<td>QR</td>
<td>Pearson Correlation</td>
<td>.516**</td>
<td>.288**</td>
<td>1</td>
<td>-.018</td>
<td>-.414**</td>
<td>-.001</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.992</td>
</tr>
<tr>
<td>N</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
</tr>
<tr>
<td>LR</td>
<td>Pearson Correlation</td>
<td>.039</td>
<td>-.321**</td>
<td>-.288**</td>
<td>.018</td>
<td>1</td>
<td>.090</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.590</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.806</td>
<td>.000</td>
<td>.063</td>
</tr>
<tr>
<td>N</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
</tr>
<tr>
<td>LnTA</td>
<td>Pearson Correlation</td>
<td>-.319**</td>
<td>-.429**</td>
<td>-.414**</td>
<td>.090</td>
<td>1</td>
<td>-.048</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.211</td>
<td>.503</td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
</tr>
<tr>
<td>DR</td>
<td>Pearson Correlation</td>
<td>.169*</td>
<td>-.018</td>
<td>-.001</td>
<td>.133</td>
<td>.119</td>
<td>-.048</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.018</td>
<td>.803</td>
<td>.992</td>
<td>.063</td>
<td>.097</td>
<td>.503</td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
<td>195</td>
</tr>
</tbody>
</table>

** Correlation is significant at the 0.01 level (2-tailed).
* Correlation is significant at the 0.05 level (2-tailed).

Source: Research Findings

Correlation investigation was employed to determine the strength and course of the linear association among the variables in concern (Table 4.2). The outcome points out that all the predictor variables to be precise: current ratio (CR), quick ratio (QR), cash ratio (LR) has positive but weak relationship with profitability as measured by Return on Asset (ROA). The correlation coefficients of CR, QR and LR with ROA is 0.294, 0.286 and 0.229 respectively are found to be significant statistically at 1% level with ROA. ROA is positively correlated with sales growth (SG). This was found to be statistically significant at 5% level. This indicates that as the firms sales increases the financial performance will also increase. The ROA has a negative but insignificant relationship with firm’s size as measured by the total assets. This may be the case where the firm’s assets are under utilized in generating profits. Further ROA was found to have a negative association with the firm’s leverage at 1% level of significant. This means that the firm’s profitability will decrease as the firm’s leverage increases. This may be the case due to increased finance costs.
4.2.1 TEST FOR MULTI-COLLINEARITY

Table 4.2 shows high correlation between current ratio (CR) and quick ratio (QR) of 0.985 which was statistically significant at 1% level of significant. This was corrected by dropping the quick ratio (QR). The QR was dropped because it had a weak relationship with the dependent variable (ROA) of 0.286 compared to CR with a 0.294.

4.3 REGRESSION BREAKDOWN

The researcher conducted a multiple linear regression analysis to examine the impact of the liquidity on financial performance of quoted nonfinancial companies. The model used for the regression analysis is expressed in the general form as follows;

\[ \text{ROA}_t = \beta_0 + \beta_1 \text{(CR)} + \beta_2 \text{(QR)} + \beta_3 \text{(LR)} + \beta_4 \text{(LnTA)} + \beta_5 \text{(SG)} + \beta_6 \text{(DR)} + \varepsilon \]

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
<th>Change Statistics</th>
<th>Durbin-Watson</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.398*</td>
<td>.159</td>
<td>.136</td>
<td>11.3038202</td>
<td>7.130</td>
<td>.000</td>
</tr>
</tbody>
</table>

| Source: Research Findings |

From table 4.3, it can be observed that there exists a weak positive association among the predictor variables and the dependent variable of 0.398. This means that as the liquidity of listed nonfinancial companies increases their profitability also increases and as the liquidity decreases the profitability increases. These results are steady with those of Mutenheri and Zawaira (2013), however they contradict the findings of Shin & Soenen (1998), Deloof (2003), Eljelly (2004) who found a negative association between liquidity and firms’ profitability. This can be argued that as companies listed in the NSE maintain sufficient liquidity, it is capable of paying its suppliers on time thus guaranteed of continuous supply of goods. This minimizes the risk of stock outs and the costs associated with stock outs. Saving on stock out costs makes the firm to be profitable. The R² of 15.9% shows that the predictor variables cause 15.9% of the variation in the dependent variable. The 84.1% balance can only be explained by other factors that influences profits. This shows that liquidity is not only the determinant of profitability but there are other factors that require to be identified through further studies. The F statistics of 7.130 is at 5% level of significant.

4.3.1 TEST FOR AUTOCORRELATION/ SERIAL CORRELATION

The Durbin Watson statistic of 1.190 indicates that there is no auto correlation between the observations of the dependent variables and therefore multiple regressions is suitable for the analysis. In presence of auto correlation time series analysis would be suitable.
Table 4.4: Analysis of Variances (ANOVA)

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>4555.164</td>
<td>5</td>
<td>911.033</td>
<td>7.130</td>
<td>.000b</td>
</tr>
<tr>
<td>Residual</td>
<td>24149.730</td>
<td>189</td>
<td>127.776</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>28704.895</td>
<td>194</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Dependent Variable: ROA
b. Predictors: (Constant), SG, CR, LnTA, DR, LR

Source: Research Findings

Table 4.4 show the sum of squares due to regression is 4555.164 and the sum of squares due to error (residual) is 24149.730. This indicates that the variations that are explained by the independent variables are much less than the deviations caused by other dynamics not captured in the study. The unexplained variations forms the basis of further studies to establish what mainly influences profitability of nonfinancial firms quoted at NSE.

Table 4.5: Regression Coefficients (ROA)

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
<th>95.0% Confidence Interval for B</th>
<th>Collinearity Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
<td>Lower Bound</td>
<td>Upper Bound</td>
</tr>
<tr>
<td>1</td>
<td>(Constant)</td>
<td>12.652</td>
<td>8.505</td>
<td>1.487</td>
<td>.139</td>
<td>-4.126</td>
</tr>
<tr>
<td></td>
<td>CR</td>
<td>.858</td>
<td>.364</td>
<td>.203</td>
<td>2.359</td>
<td>.019</td>
</tr>
<tr>
<td></td>
<td>LnTA</td>
<td>.193</td>
<td>.503</td>
<td>.028</td>
<td>.383</td>
<td>.702</td>
</tr>
<tr>
<td></td>
<td>DR</td>
<td>-.130</td>
<td>.045</td>
<td>-.220</td>
<td>-2.878</td>
<td>.004</td>
</tr>
<tr>
<td></td>
<td>SG</td>
<td>.054</td>
<td>.024</td>
<td>.157</td>
<td>2.304</td>
<td>.022</td>
</tr>
</tbody>
</table>

a. Dependent Variable: ROA

Source: Research Findings

Table 4.5 shows the β coefficients of the model of the form:

\[ \text{ROA}_t = \beta_0 + \beta_1 \text{ (CR)} + \beta_2 \text{ (QR)} + \beta_3 \text{ (LR)} + \beta_4 \text{ (LnTA)} + \beta_5 \text{ (SG)} + \beta_6 \text{ (DR)} + \varepsilon \]

The predictive model for the firms quoted at the NSE was therefore formulated as follows; ROA\(_t\) = 12.652 + 0.858 CR + 0.173 LR + 0.193 LnTA + 0.054 SG - 0.130 DR

The coefficient shows that ROA increases by 0.858 if CR is increased by 1 unit at 95% level of significance. The results are statistically significant with a P value of 0.019 at 5% level of significant. This means that as the companies boost its outlay in liquid assets, the firm’s profitability shall also increase. The results also indicate that an increase in cash ratio (LR) by 1 unit would increase profitability by 0.173 at 95% level of significance. This is statistically insignificant with a P value of 0.840 at significance level of 5%. A commonly given rule of thumb is that multi-collinearity exists when Tolerance is below 0.1 and values of Variance Inflation Factor (VIF) that exceed 10 are often regarded as indicating multi-collinearity. From the analysis to test whether there is existence of multi-collinearity, it was found that correlations among independent variables are moderate since they do not exceed the general rule of thumb. Moreover tolerances for the variables are moderately high which
also are beyond the specified minimum of 0.10 and VIF do not exceed the specified rule of thumb of 10. This indicates absence of multi-collinearity within the independent variables.

4.4 INTERPRETATION OF THE FINDINGS
The conclusions of the research demonstrate that profitability of nonfinancial companies is positively correlated with company profitability. This may be taken to mean that as company increases its liquidity level; its profitability would also increase. Therefore managers can increase value for share holders by maintaining an optimal liquidity level that will ensure that the firm is in a position to meet the short term obligations as they fall due.

5. SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 SUMMARY
This study anticipated to establish the impact of current ratio, quick ratio and cash ratio (liquidity) and financial performance of the nonfinancial companies quoted at the Nairobi Securities Exchange. The management is able to generate wealth for their equity holders by increasing the level of current assets to a rational level. In so doing, the performance of the company is projected to amplify. From the correlation analysis, it was noted that there exists a positive relationship between the liquidity and financial performance at 1% level of significance. Therefore, efficient management of current assets reduces the cost of possible interruptions in the production process and the loss of business due to scarcity of products and stock outs.

5.2 CONCLUSION
Nonfinancial companies in Kenya to improve financial performance should put more emphasis in the area of efficient working capital management. It is with no doubt that the efficiency in working capital management practices has pressure on the increase in companies’ sale, market share, profits and total assets and consequently plays a role in the financial performance of a company.

5.3 RECOMMENDATIONS FOR POLICY
The study therefore recommends that nonfinancial companies should ensure that they maintain sufficient current assets to meet their short term financial obligations when they fall due while at the same time avoid holding excessive current assets which result to excess liquidity which only yields minimum return for the shareholders. The nonfinancial companies need to observe the most advantageous liquidity point in order to capitalize on company’s profitability and shareholders’ wealth maximization. Nonfinancial firms ought to pursue profit maximization since by so doing simultaneously enhances liquidity.

5.4 LIMITATIONS OF THE STUDY
The study focuses on nonfinancial companies listed in NSE in Kenya. Since the research is wholly based on listed nonfinancial companies, the outcomes of the study are only indicative and not conclusive. The results
are therefore applicable only to nonfinancial companies in Kenya and any attempt to generalize findings to other firms outside this scope should be approached with care or may lead to misleading results. The sample size was only 39 nonfinancial companies listed on NSE and this may also have affected the results of the study and thus the findings should not be universally applied.

5.5 SUGGESTIONS FOR FURTHER RESEARCH

This study can be replicated in the financial companies to establish mechanisms in which liquidity can be optimized in a bid to increasing the company’s financial performance.

6. REFERENCES


Apuoyo, B.O. (2010). The relationship between working capital management policies and Profitability for companies quoted at the NSE. *(Unpublished MBA project)*, *University of Nairobi*, Kenya


