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MARKET CAPITALIZATION AND FINANCIAL PERFORMANCE OF MANUFACTURING FIRMS LISTED ON THE NAIROBI SECURITIES EXCHANGE

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ABSTRACT

Purpose of the study: The study examined the effect of market capitalization on financial performance of manufacturing firms listed on the Nairobi Securities Exchange.

Statement pf the problem: The contribution of manufacturing and associated industries to Kenya's GDP has been declining, from 9.3% in 2016 to 7.8% in 2022, significantly below the 15% target set by Vision 2030 and the 20% goal outlined by the Kenya Kwanza Government

Methodology: The target population included eight manufacturing and allied companies listed on the NSE, after excluding Mumias Sugar Company due to its receivership status. A correlational research methodology was employed, with secondary data collected using a data collection template covering a 10-year period from 2014 to 2023.The data was analyzed using both descriptive and inferential statistics, including regression and correlation analyses.

Findings: Correlation analysis found a positive and significant association between market capitalization and financial performance ($r=0.4215$, $p=0.0001$). Regression analysis further confirmed that market capitalization significantly predicts financial performance ($\beta=0.7490$, $p=0.0050$), with an R-squared value of 0.1776, indicating that market capitalization explains 17.76% of the variation in financial performance.

Conclusion: The study concludes that strengthening market capitalization positively impacts the financial performance of manufacturing companies listed on the NSE, and that enhancing corporate governance, operational efficiency, strategic asset utilization, and dividend policies are crucial levers for growth.

Recommendations: The study recommends that manufacturing companies listed on the NSE implement strategies to strengthen market capitalization by enhancing corporate governance, improving operational efficiency, conducting strategic share buybacks when appropriate, regularly assessing asset utilization efficiency, and establishing clear dividend policies. The Capital Markets Authority should support these efforts by developing policies that reduce transaction costs and promote greater market participation to help the sector approach its Vision 2030 contribution targets.

Keywords: *Market Capitalization, Financial Performance, manufacturing firms, Nairobi Securities Exchange, Kenya*

BACKGROUND OF THE STUDY

The manufacturing sector is vital to economic growth by driving industrialization, job creation, technological innovation, export earnings, and broader economic development through its linkages with other industries (Ferdaous & Rahman, 2019; Perera et al., 2022; Ihugba, Orji & Duru, 2023). The performance of companies refers to their overall effectiveness in achieving financial and operational goals, encompassing aspects like revenue, profitability, market share, operational efficiency, and return on investment (Prempeh & Peprah-Amankona, 2020; Surasmi & Yasa, 2022). In manufacturing and allied companies, performance is further evaluated through sector-specific metrics such as production efficiency, inventory management, and supply chain effectiveness, and is influenced by both internal and external factors (Intrisano, Micheli & Calce, 2020). Understanding and evaluating company performance is crucial for investors, stakeholders, and managers as it provides insights into the company's competitive position, financial health, and prospects (Tondok, Pahlevi, & Aswan, 2019). The performance in the current study is determined by revenue or sales performance. The performance of companies can be significantly influenced by market capitalization, which represents the total market value of a company's outstanding shares.

Market capitalization serves as a crucial indicator of a company's size, growth potential, and market perception. It reflects investor confidence and provides insights into how the market values a company relative to its fundamentals. For manufacturing firms, market capitalization can significantly impact their ability to access capital, invest in technology, expand operations, and maintain competitive positions. According to Chen et al. (2022), market capitalization and trading volume significantly influenced the stock returns of manufacturing firms listed on the Shanghai and Shenzhen stock exchanges, demonstrating its importance as a performance determinant. Similarly, Thompson and Lee (2021) revealed that larger market capitalization was associated with higher price-to-earnings ratios for manufacturing companies in Canada, suggesting that market valuation correlates with improved financial metrics.

In the African context, several studies have established the link between market capitalization and company performance. Kipesha and Moshi (2021) found that companies in Tanzania's manufacturing sector listed on the Dar es Salaam Stock Exchange with larger market capitalization maintained higher company values. Agyapong (2020) demonstrated that market capitalization has a substantial effect on economic development in Ghana, while Elsayed and Elbardan (2018) showed a favorable correlation between market capitalization and GDP performance in Egypt. These findings suggest that market capitalization not only reflects individual company value but also contributes to broader economic outcomes through its impact on firm performance, investment attractiveness, and resource allocation efficiency.

The Kenyan context presents particular challenges and opportunities regarding market capitalization and manufacturing performance. Muthike and Sakwa (2020) found that financial structure and market capitalization significantly impact the financial performance of non-financial enterprises listed on the NSE. Shikumo (2021) observed that raising share capital—a component directly related to market capitalization—significantly enhanced the financial performance of non-financial firms on the NSE. These studies suggest that in Kenya's developing market context, strategies to improve market capitalization could serve as effective mechanisms for enhancing the financial performance of manufacturing companies, potentially addressing the sector's contribution to GDP, which has declined from 9.3% in 2016 to 7.8% in 2022, falling well short of the Vision 2030 target of 15% (KNBS, 2023).

Hence the study examined the effect of market capitalization on the financial performance of manufacturing and allied companies listed on the Nairobi Securities Exchange. By analyzing data from eight manufacturing firms over a ten-year period (2014-2023), the research established a positive and significant relationship between market capitalization and financial performance. The findings confirm that market capitalization serves as both an indicator and driver of financial success, with companies possessing larger market values demonstrating superior profitability through advantages including enhanced access to capital, stronger market positioning, and improved operational capabilities. These results align with global and regional research while providing specific insights into Kenya's manufacturing sector, which has struggled with declining GDP contribution. The study contributes valuable knowledge for developing strategies to strengthen market valuations of manufacturing firms, ultimately supporting Kenya's industrialization goals and helping the sector approach the Vision 2030 target of 15% GDP contribution.

STATEMENT OF THE PROBLEM

The financial performance of manufacturing companies listed on the Nairobi Securities Exchange (NSE) has shown a concerning decline in recent years, posing a significant challenge to Kenya's economic development goals. Empirical data reveals a systematic deterioration in key financial performance metrics across the sector. According to the Capital Markets Authority (2023), the average net profit margin of manufacturing firms listed on the NSE has declined from 12.3% in 2018 to just 7.1% in 2022. Similarly, return on assets (ROA) has decreased from 9.8% to 5.4% during the same period, while return on equity (ROE) has fallen from 16.7% to 9.2%. This declining financial performance has contributed to the sector's diminishing contribution to Kenya's GDP. The Kenya National Bureau of Statistics (KNBS) Economic Survey 2023 reports that the manufacturing sector's contribution to GDP decreased from 9.3% in 2016 to 7.4% in 2021, with only a marginal increase to 7.8% in 2022. This falls significantly short of the Vision 2030 target of 15% and the Kenya Kwanza Government's goal of 20%.

The deterioration in financial performance has also negatively impacted investor returns. NSE (2024) reported that the Manufacturing and Allied Index experienced a 15.3% decline in 2023, significantly underperforming the overall NSE-20 Share Index. Average dividend yields for manufacturing companies dropped from 4.8% in 2020 to 2.6% in 2023, making the sector less attractive to investors seeking stable returns. Furthermore, price-to-earnings ratios have contracted from an average of 12.8 in 2019 to 8.4 in 2023, indicating diminished market confidence in the sector's future earnings potential. The Kenya Association of Manufacturers (KAM) 2023 report identifies several challenges contributing to poor financial performance, including unfair competition from subsidized imports, weak export performance, and rising operational costs. Rising input costs have increased the cost of goods sold by an average of 18.2% between 2020 and 2023, directly impacting profit margins. Additionally, manufacturing companies' average debt-to-equity ratio has increased from 0.73 in 2019 to 0.92 in 2023, indicating increased financial leverage and potentially higher financial risk.

Despite the critical importance of understanding how market factors influence financial performance in this sector, there is limited research examining the relationship between market capitalization and financial performance of manufacturing companies listed on the NSE. Previous studies have focused on different aspects of financial performance in various contexts. Tondok, Pahlevi, and Aswan (2019) investigated capital structure effects on manufacturing companies in Indonesia, while Chen et al. (2022) examined market capitalization's influence on stock returns in China. Regionally, Kipesha and Moshi (2021) explored market capitalization's relationship with company values in Tanzania, and Agyapong (2020) studied its effects on economic development in Ghana. In the Kenyan context, Mutua and Atheru (2020) analyzed capital structure's impact on manufacturing firms' ROE, and Shikumo (2021) examined share capital's influence on non-financial firms' performance.

However, these studies have not comprehensively addressed the specific relationship between market capitalization and financial performance within Kenya's manufacturing sector, particularly during its period of declining contribution to GDP. This research gap limits our understanding of how market valuation affects operational outcomes and profitability in this critical sector. The current study addresses this gap by providing a focused examination of market capitalization's effect on the financial performance of manufacturing and allied companies listed on the NSE. By analyzing data from eight manufacturing firms over a ten-year period (2014-2023), this research offers insights that can inform strategies to enhance market capitalization, improve financial performance, and ultimately help the sector progress toward the Vision 2030 target of 15% GDP contribution.

OBJECTIVE OF THE STUDY

To examine the effect of market capitalization on financial performance of manufacturing firms listed on the Nairobi Securities Exchange.

RESEARCH HYPOTHESES

H_0: Market capitalization does not have a significant effect on financial performance of manufacturing firms listed on the Nairobi Securities Exchange.

LITERATURE REVIEW

This chapter presents a review of relevant theory, the conceptual framework and empirical

Theoretical Framework

The theoretical framework of this study was built upon efficient market hypothesis. The theory is based on the premise that market participants are rational and that prices adjust rapidly to new information. It further assumes that market players will quickly arbitrage away any inefficiencies or anomalies (Lo, 2007). These assumptions underpin the belief in the overall efficiency of financial markets. According to the EMH, market prices always provide the most accurate reflection of a security's true value, which implies that active investment strategies generally fail. As a result, index funds and other forms of passive investing have gained popularity (Malkiel, 2005). This research aims to examine the influence of market capitalization on the performance of manufacturing and allied industries listed on the Nairobi Securities Exchange (NSE).

The Efficient Market Hypothesis (EMH) is relevant to inform market capitalization measures and financial performance variables in the study. This is because EMH posits that stock prices and market valuations reflect all available information about a company, making market capitalization ratio (market capitalization/total assets) a meaningful indicator of a company's fundamental value. In manufacturing firms, where substantial assets are deployed for production, the market's assessment through capitalization relative to assets reflects collective market wisdom about asset utilization efficiency and management effectiveness. The theory suggests that changes in market capitalization should precede or coincide with changes in financial performance, as market participants efficiently process and react to information that will affect future performance. Additionally, EMH supports the study's use of net profit margin as a performance measure, as efficient markets should price in expectations about a company's ability to convert revenue into profits.

Furthermore, EMH helps explain why market-based measures like market capitalization ratio might serve as leading indicators of financial performance. This is because in an efficient market, stock prices quickly adjust to new information about a company's prospects, including its ability to generate profits from its asset base. For manufacturing companies listed on the NSE, the theory suggests that market capitalization ratios should reflect not only current performance but also expectations about future operational efficiency, market conditions, and management effectiveness. The relationship between market values and assets implies that markets efficiently price in both tangible and intangible factors affecting company performance, making market capitalization ratio a comprehensive measure of market assessment.

Conceptual Framework

A conceptual framework in Figure 1 depicts the relationship between independent and dependent variables.

Independent Variable

Market capitalization ratio	→	**Financial Performance**
• Market Capitalization / Total Assets		Net profit margin (net profits after tax/gross sales

Dependent Variable

Figure 1: Conceptual Framework

Empirical Literature

Tondok, Pahlevi, and Aswan (2019) found that larger manufacturing firms listed on the Indonesia Stock Exchange demonstrated higher profitability and greater market value, establishing a positive relationship between company size, market capitalization, and financial performance in developing economies. Their study highlighted that firms with larger market capitalization benefited from economies of scale, stronger market influence, and easier access to resources, which ultimately enhanced their overall performance. Similarly, Aulia and Gandakusuma (2020) analyzed manufacturing companies across five ASEAN countries and found that company size, used as a proxy for market capitalization, significantly influenced different performance indicators such as return on assets (ROA), return on equity (ROE), and Tobin's Q. Their findings emphasized the complex and variable effects of market capitalization on company success, depending on the specific performance metric under consideration.

Mutua and Atheru (2020) examined manufacturing firms in Kenya and reported that company size had a significant positive effect on ROE performance, suggesting that greater market capitalization contributes to better financial outcomes in the sector. Their study emphasized the strategic advantage that larger firms enjoy in accessing capital, markets, and other key resources, ultimately leading to enhanced financial performance. Likewise, Shikumo (2021) focused on non-financial companies listed on the Nairobi Securities Exchange and found that share capital—closely tied to market capitalization—positively and significantly influenced both profits per share and market capitalization itself. His results showed that share capital accounted for substantial variances in profitability and market value, reinforcing the crucial role of market capitalization in shaping company performance.

Intrisano, Micheli, and Calce (2020) explored the effect of public listing on company value and performance in Europe and found significant differences in profitability and value creation between listed and unlisted companies. Their study indicated that firms listed publicly, with higher market capitalization levels, tended to outperform their private counterparts in terms of ROE and value creation, suggesting that public market dynamics linked to market capitalization strongly influence company outcomes. In a broader national context, Kithandi, Moragwa, and Mutunga (2023) conducted a systematic review in Kenya and concluded that increases in market capitalization and stock market development positively impact economic performance. However, their findings noted that this relationship depends heavily on other external factors such as political stability, government policies, financial infrastructure, and foreign investments.

Okeke, Emeka, Ezeilo, Nwobodo, and Duruzor (2022) investigated listed companies in Nigeria and found that corporate governance structures significantly affected stock price performance, with market capitalization closely tied to these outcomes. Their results showed that better governance practices enhanced investor confidence, thereby boosting stock prices and overall firm market value. Finally, Wondem and Batra (2019) studied Ethiopian share companies and found that larger companies with greater market capitalization achieved better financial outcomes, particularly in terms of ROA and ROE. Their study concluded that market capitalization serves as a critical determinant of firm performance in developing countries, reinforcing the importance of size and structure in achieving financial success.

RESEARCH METHODOLOGY

The study employed a correlational research design to examine the relationship between market capitalization and financial performance of manufacturing firms listed on the Nairobi Securities Exchange. This non-experimental approach was selected as it effectively allows researchers to investigate relationships between variables in their natural state without manipulation (Curtis, Comiskey & Dempsey, 2016; Seeram, 2019). The research targeted eight manufacturing companies listed on the NSE: B.O.C Kenya Ltd, British American Tobacco Kenya, Carbacid Investments Ltd, East African Breweries Ltd, UNGA Group PLC, Eveready East Africa PLC, Kenya Orchards Ltd, and Flame Tree Africa Ltd. Mumias Sugar Company was excluded due to its receivership status and trading suspension, which would have compromised data reliability for the study period. Data collection utilized a secondary data template from company financial reports, NSE publications, and Capital Markets Authority disclosures covering a ten-year period (2014-2023). The analytical framework combined descriptive statistics and inferential statistics.

RESULTS AND DISCUSSION

This chapter analyzes the impact of stock market indicators on the financial performance of manufacturing and allied firms listed on the NSE, covering descriptive statistics, trend analysis, correlation analysis, diagnostic tests, regression analysis, hypotheses testing, and a summary.

Descriptive Statistics

This section provides descriptive statistical analysis of market capitalization and financial performance, including minimum, maximum, mean, and standard deviation values for eight NSE-listed manufacturing firms from 2014 to 2023, as shown in Table 1.

Table 1: Descriptive Statistics

Variable	Observation	Mean	Std. Dev.	Minimum	Maximum
Market capitalization Ratio (Market Capitalization / Total Assets)	80	0.120668	0.232083	-0.51658	0.985257
Financial Performance (Net profit margin (net profits after tax/gross sales)	80	0.16398	0.513772	-1.59201	3.175812

The study found that market capitalization varied significantly among manufacturing firms listed on the NSE, with a mean of 0.120668 and a standard deviation of 0.232083, indicating substantial differences in market valuations relative to asset bases and suggesting diverse investor perceptions and market positioning across companies. Financial performance also showed wide variation, with a mean of 0.16398 and standard deviation of 0.513772, highlighting significant disparities in profitability, where some firms achieved strong profits while others suffered losses. Overall, the positive sector means for both market capitalization and financial performance reflect resilience and potential within the manufacturing sector, despite notable challenges faced by individual firms.

The study corroborates with the findings of Chen et al. (2022) who identified significant variations in market capitalization among manufacturing firms in China and its influence on stock returns. Similarly, Thompson and Lee (2021) found diverse market capitalization patterns among Canadian manufacturing companies that corresponded with varying price-to-earnings ratios. Kipesha and Moshi (2021) also observed substantial differences in market valuations among Tanzanian manufacturing firms, with higher-valued companies demonstrating superior financial outcomes. In Kenya specifically, Muthike and Sakwa (2020) identified considerable variations in market capitalization among NSE-listed firms and confirmed its significant impact on financial performance. Additionally, Shikumo (2021) found that share capital enhancement positively influenced financial performance of firms on the NSE, aligning with this study's findings regarding the relationship between market valuation and profitability. Furthermore, Agyapong (2020) demonstrated that varying levels of market capitalization had differential effects on economic development in Ghana, supporting the present study's observation of the relationship between market valuation and performance outcomes.

Correlation Analysis

The correlation analysis examines the association between market capitalization and financial performance using Pearson correlation coefficients. The analysis will quantify the strength and direction of these relationships.

Table 2: Correlation Analysis

		Financial Performance	Market capitalization	Stock value traded	Stock turnover	Market liquidity
Financial Performance		1.0000				
Market capitalization	Pearson Correlation	0.4215	1.0000			
	Sig. (2-tailed)	0.0001				

The study found that market capitalization has a positive and significant correlation with financial performance (r=0.4215, p=0.0001), indicating a moderate but meaningful relationship between these variables. This finding corroborates with several previous studies across different contexts. Chen et al. (2022) identified similar positive correlations between market capitalization and performance measures for Chinese manufacturing firms, while Thompson and Lee (2021) found comparable associations in Canadian markets. In the African context, Kipesha and Moshi (2021) demonstrated positive correlations between market capitalization and company values in Tanzania, and Agyapong (2020) found significant positive relationships in Ghana. The Kenyan-specific findings by Muthike and Sakwa (2020) also revealed positive correlations between market capitalization and financial performance of NSE-listed companies, while Shikumo (2021) identified similar positive associations between share capital—a component of market value—and financial outcomes. This consistency across diverse markets strengthens the validity of the current study's findings and confirms the importance of market capitalization as a correlate of financial performance in manufacturing sectors.

Regression Analysis

The study examined regression analysis to establish the relationship between market capitalization, and financial performance. The regression analysis results are presented in Table 3

Table 3: Regression Analysis

Financial Performance	Coef.	Std. Err.	z	P>z
Market capitalization	0.7490	0.2680	2.7900	0.0050
_cons	0.0736	0.1176	0.6300	0.5310
R squared=	**0.1776**			
Wald chi2(1) =	**7.81**			
Prob > chi2 =	**0.0052**			

The model was;

$Y_{it}= 0.0736+0.7490X_{it}$

The regression analysis revealed that market capitalization significantly predicts financial performance of manufacturing firms listed on the NSE, with a coefficient of 0.7490 (p=0.0050), indicating that a unit increase in market capitalization ratio leads to approximately 0.749 units increase in net profit margin. The model's R-squared value of 0.1776 demonstrates that market capitalization explains 17.76% of the variation in financial performance, suggesting that while significant, other factors also influence manufacturing firms' profitability. The overall model fit is confirmed by the Wald chi-square value of 7.81 with a probability of 0.0052, establishing the statistical significance of the model. These findings corroborate with Chen et al. (2022) who found comparable explanatory power of market capitalization on manufacturing firm performance in China, and with Muthike and Sakwa (2020) who identified similar coefficient magnitudes in their Kenyan study. The results also align with Thompson and Lee (2021) who found that market capitalization significantly predicted performance metrics in Canadian manufacturing firms, and with Kipesha and Moshi (2021) who observed comparable R-squared values when examining market capitalization's effect on Tanzanian manufacturing companies. Shikumo's (2021) finding that share capital explained 11.62% of the variance in market capitalization performance of NSE-listed firms further validates the explanatory power found in this study.

Hypotheses Testing

The study tested the following hypothesis.

H_{01}: Market capitalization does not have a significant effect on financial performance of manufacturing firms listed on the Nairobi Securities Exchange.

Table 3 shows a p-value of 0.0050, which is less than 0.05, confirming that market capitalization significantly affects the financial performance of manufacturing firms listed on the Nairobi Securities Exchange.

The rejection of this hypothesis aligns with Tondok, Pahlevi, and Aswan (2019) who found that larger manufacturing firms exhibited higher profitability and market value in Indonesia. Moreover, Mutua and Atheru (2020) demonstrated that company size significantly affected the ROE performance of manufacturing firms listed on the NSE, suggesting that manufacturing firms with greater market capitalization in Kenya may benefit from advantages that lead to improved financial performance. Shikumo (2021) found that share capital, strongly linked to market capitalization, positively and significantly influenced financial performance. Additionally, Intrisano, Micheli, and Calce (2020) found significant differences in profitability and value creation between listed and unlisted firms, suggesting that market dynamics associated with public listing, which impact market capitalization, can significantly affect company performance. Furthermore, Kithandi, Moragwa, and Mutunga (2023) found that increases in market capitalization enhance economic performance. in Kenya, though this relationship is influenced by various factors including political stability and government policies.

CONCLUSION

The study concludes that market capitalization plays a fundamental role in determining the financial performance of manufacturing companies listed on the NSE. Market capitalization reflects not just the size but the overall market valuation and confidence in these companies. Higher market capitalization enables manufacturing firms to access better financing options, negotiate favorable terms with suppliers and creditors, and maintain stronger market positions. Companies with substantial market capitalization benefit from economies of scale, increased operational efficiency, and enhanced ability to invest in technological improvements and expansion opportunities. The positive relationship between market capitalization and financial performance suggests that larger market valuations contribute to improved profitability through reduced cost of capital, better resource allocation, and stronger competitive positioning in the manufacturing sector.

RECOMMENDATIONS

Since market capitalization showed a positive and significant effect on financial performance (β=0.7490, p=0.0050), manufacturing companies should focus on enhancing their market capitalization by implementing robust corporate governance frameworks, increasing operational efficiency to improve investor confidence, and considering strategic corporate actions such as share buybacks when their stocks are undervalued. The Capital Markets Authority should support these efforts by developing policies that reduce transaction costs and promote greater market participation. Companies should regularly assess their asset utilization efficiency since the market capitalization ratio directly measures how effectively companies create market value from their asset base. Furthermore, clear dividend policies that balance reinvestment needs with shareholder returns should be established to maintain investor interest and support strong market valuations.

Additionally, manufacturing firms should strengthen investor relations functions to improve market visibility and perception, providing transparent, timely information about company performance, strategy, and prospects. These companies should also invest in technological innovation and process improvements to enhance productivity and competitiveness, which would positively impact investor confidence and market valuation. The NSE could develop specialized indices and trading platforms focused on manufacturing sector companies to increase investor awareness and participation. Government agencies should consider tax incentives specifically designed to encourage investment in manufacturing stocks, helping companies build their market capitalization. Furthermore, manufacturing companies should pursue strategic partnerships and mergers where appropriate to achieve economies of scale that could improve profitability and market valuation. Finally, companies should develop comprehensive risk management frameworks to address market volatility and operational challenges, thereby stabilizing performance and enhancing investor confidence, which would contribute to stronger and more sustainable market capitalization over time.

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