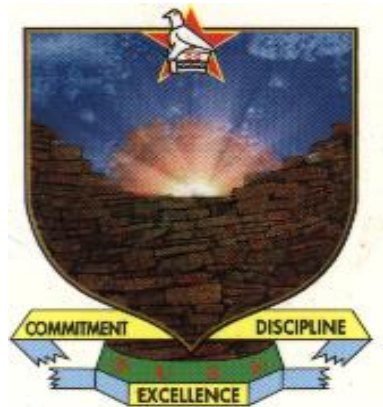# BINDURAUNIVERSITY OF SCIENCE EDUCATION

FACULTY OF COMMERCE

BACHELOR OF COMMERCE IN BANKING AND FINANCE

THE IMPACT OF FINANCIAL LEVERAGE ON FIRM PERFORMANCE IN ZIMBABWE: A CASE OF FURNITURE MANUFACTURING SMES AT GLEN VIEW COMPLEX IN HARARE (2017-2022).

BY

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2022

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[iii]

DEDICATION

I dedicate this report to my sister, Linah Bwanya.

ABSTRACT

In this research a theoretical and an empirical framework that helps to analyse the impacts of financial leverage on manufacturing firms in Zimbabwe. The research used a case of SME's at Glenview complex. The research objectives were to ascertain the effect of financial leverage on profitability, assess the relationship between financial leverage and liquidity of SME's and to ascertain the effect of financial leverage on efficiency of SMEs. Secondary data came from HRM reports, financial reports and financial statements. Primary data came from key informant interviews.The firm profitability (return on equity) is positively associated with short term debt (0.1974),long term debt (0.0116) and negatively associated with equity (-0.4316). There is a significant negative relationship between the use of debt and firms profitability measured by return on equity which is in opposition to Modigliani and miller, agency theory and trade off theory. All these theories postulate that in the presence of corporate tax, profitable firms will be motivated to increase their financial leverage.Thers is a moderate leverage positively affected the financial performance of furniture manufacturing SMEs. These findings were in collaboration with results of Wainana (2014) of the 100 SMEs in Kenya which concluded that there was a positive relationship between financial leverage and profitability.

ACKNOWLEDGEMENT

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CHAPTER ONE

INTRODUCTION

1.0 Introduction

The Zimbabwean economy has been in a quagmire for over the past two decade, despite the emergency of the second republic in 2017 the situation seems to be perpetuating with inflation hitting the triple digits in a short time frame. The economic turmoil has not spared SMEs who also bear most of the burden of the financial meltdown because they are pre-requisite to the economic growth. However, financial leverage and liquidity are the convenience sources of financing for these manufacturing company. Against this background, the consistently repeated conception of SMEs about their problems regarding the impact of financial leverage on firm performance is a priority area of concern, which if not properly addressed, can endanger the survival and growth of the SMEs sector. This chapter is set to introduce the background of the study where the reader will be familiarised with financial leverage and company performance. The chapter is going to focus on previous conducted researches that have been carried out globally, regionally and locally pertaining the establishment of correlation of financial leverage and company performance. The research study is going to cover the furniture manufacturing industry and is going to give an overview of the organization in which the research is going to be taken.

The research questions of the study are going to discuss the effect of financial leverage on the performance of furniture manufacturing, the objectives of the study which the research is going to centre on is going to be covered in this chapter as well as the comprehensive problem statement which seeks to address and justify the rationale of carrying out the study. The chapter will be followed by the justification of study which is the value addition of the study. The assumptions, delimitations and limitations of the study will also be detailed in the chapter. The chapter shall end with the definition of terms the thesis intends to take as well as a summative conclusion. This introductory chapter sets the tone for the rest of the study as other chapters will be guided by the same.

1.1 Background of the Study

An increase in financial leverage result in increased returns and risk, while decrease in leverage result in decreased return and risk (Chesang, 2016). Basically, there are two types of leverage that is operating and financial leverage. Financial leverage is the use of the fixed charges of resources, that is preference and debt capital along with the owners' equity in the capital structure while operating leverage is degree in which the firms uses much of fixed expenses, the higher the fixed expense the higher the operating leverage (Chesang, 2016).

Most financial analysts and scholars across the globe, have however, for the past decades being principally concerned and interested about the issue of financial leverage and firms' performance decisions. Studies across the globe revealed the significance of financial leverage in influencing profitability in companies. Many have found a significant relationship between the two but changing extent. These studies include: in the Kingdom of Jordan (Al-Shamaileh & Khanfar, 2014), in Pakistan (Nawaz, Salmani & Shamsi, 2015), who found that financial leverage has a statistically significant inverse impact on profitability at 99% confidence interval. Other cases include Banchuenvijit (2011) in Thailand, Nickell, Srivastava (2014) in India who established a positive relationship among financial leverage and profitability.Nicolitsas(1999) in United Kingdom also established a positive relationship while a negative effect was found for Japan (Pushner, 1995) with the same firm performance measure used.

Several studies from developing countries, however found that the relationship between the financial leverage and firm performance measures is negative. For example, the study of 16.5 thousand Ukranian firms over the period 2001-2010 years by Iavorskyi (2013), proposes that financial leverage positively affects firm performance through disciplining managers, tax shield and signalling effects. It was discovered that the relationship between the financial leverage and firm performance measures is negative. These results do not support the free-cash-flow or trade-off theories of capital structure whilst the validity of the pecking order theory is confirmed (Lavorskyi, 2013). One more study via a sample of 237 Malaysian listed companies over the period 1995-2011 established that firm performance, which was measured by return on assets, return on equity and earnings per share had negative relationship with short, long-term debt and total debt while it was not related to Tobin's Q used as a measure of performance where a significant positive relationship was observed (Salim & Yadav, 2012).

The relationship between the two types of leverage is also confirmed in a number of studies in Africa such as: Enekwe, Agu & Eziedo (2014) in Nigeria, Boachie, Boachie, Ezidisi, Nyanese & Gyabeng (2013) in Ghana & Joshau, (2007) in South Africa. In East Africa, there is the study by Ishuza (2015) who sought to the influence of financial leverage on commercial banks' profitability in Tanzania. In Kenya there are studies such as Gweyi & Karanja (2014) on the effect of financial leverage on financial performance of Deposit Taking Savings and Credit Co-operative in Kenya; and Kale (2014) on the impact of financial leverage on firm performance: the case of non-financial firms in Kenya; Mule (2015) on the financial leverage and performance of listed firms in a frontier market: panel evidence from Kenya; and Chesang (2016) on the effect of financial leverage on profitability of listed agricultural firms at the Nairobi securities exchange. These several studies established a significant relationship between financial leverage and profitability. This is despite the fact that these studies were not carried-out in Zimbabwe and they did not assess the association in furniture manufacturing firms in Zimbabwe.

Nyamwanza, Haufiku, Ellen & Mhaka (2020) also carried out a study on the impact of debt finance on the profitability of a furniture retail company in Kadoma, Zimbabwe. The study used the mixed methods approach and employed quantitative data from financial statements and qualitative data from interviews. The target population was 25, and the research indicated that debt financing was significantly and statistically negatively affecting the return on assets of the company. The regression yielded a p-value of 0.018 and a coefficient of 0.9992 thus confirming a 99.92% that the variability in profitability is well explained by the independent variable used in this research which is debt finance. Obuya (2017) and Lemma and Negash (2013) share a similar view that a significant positive impact might be experienced when a company adopts debt financing as this can help the company invest in long term viable projects and improve the company's profits and growth opportunities but this has not been the case for the furniture retail company. Most of the aforementioned studies principally concentrated on listed companies and large manufacturing companies in develop countries and some of which in developing countries as well, hence providing a gap for the researchers to explore and analyse the impact of debt financing on the profitability of furniture manufacturing SMEs using a case study of one company at Glen View Industry in Zimbabwe.

As positioned by Banafa et al. (2015), financial leverage is one of the important components of financial structure decisions, and henceforth it is a prerequisite for firm's management in developing countries to examine the pros and cons before outsourcing for their operations. It

is important to note that financial leverage is another sources for generating funds for financing business operations and decisions made by both the financial manager and management can positively have an impact on firm performance through the acquisition of assets and expansion of their activities. More so, as espoused by Hongli, Arjosu and Bakpa (2019) the decision on financial leverage can principally increase the firm profit depending on the company activities or have a negative impact on performance due to default payment of borrowed fund. Financial leverage in an external source of funds that an organisation acquired to purchase more assets and finance its project without employing too much equity to operate its activities. Additionally, financial leverage integrates the firms' long-term liability, short term-liability, shareholders equity and profit, which are the main sources of financing firm's activities and growth (Hasan et al., 2014).

In Zimbabwe, most of the SMEs are facing some challenges surviving in the competitive environment and the triple digit inflation raging environment due to financial issues confronting management in paying their short-terms and long-terms obligations to achieve an optimum financial structure that would minimize the firms' cost of debt and improves the firm performances. Some of these challenges are high cost of acquiring new machinery, feeding the industry with raw materials and funds needed to pay wages and salaries to workers and meeting other financial obligations which are persistently reducing the number of industries in the country. However, financial leverage and liquidity are the convenience sources of financing for these SMEs (Sibanda, Sibanda & Shava, 2018). Meanwhile, providers of credit prefer short-term credit market to long-term market, because of the higher inflation rate in Zimbabwe compared to other developing countries, which have the tendency of reducing the demand for future cash flows. In current theory, most authors postulate that a firm can benefits from using debt because payments of interest are not taxable and that it can increase firm performance and contrary, default payment of borrowed funds can result to bankruptcy (Hongli, Arjosu & Bakpa, 2019).

Similarly, managers of these SMEs are having issues on how to combine debt and equity in their operations, so as to strategically establish a precise combination that will efficiently minimize cost and boost the performance of the manufacturing sector. With the above situation combined by financial distress caused by illiquidity and insolvency, and other sources of financing manufacturing industry are scarce, it is henceforth significant that small scale industries in Zimbabwe have to strategically manage their capital and resources efficiently and to become profitable. The term illiquid entail the inability of a firm to settle its short-terms

obligations or current expenditure whereas insolvency also refers to incapability of a firm to pay for long-terms liabilities (Hongli, Arjosu & Bakpa, 2019).

In such a circumstance SMEs in Zimbabwe must ensure the efficient use of debt and liquidity management which are a requirement for the improvement in the performance as well as growth of the existing firms in dealing with the country's unemployment situation and ensuring economic stability. Deriving from the above mentioned challenges facing the SME sector, several strategies are being taken by the government and relevant stakeholders with the intents to revive the country's manufacturing sectors to create employment and also boost the locally produced products. Henceforth, management and financial managers need to have a clear guideline of whom to consult when taking decisions concerning the financial structure of the manufacturing firms. The purpose of this study is to investigate and empirically analyse the effects of financial leverage on the performance of furniture manufacturing SMEs at Glen View Industry in Zimbabwe.

Even though several authors have been trying to explain the effects of financial leverage on firm performance, conclusions have been quite different, which justifies this study. Also, there is a dearth in studies and little has been said of financial leverage on firm's performance in the furniture manufacturing SMEs, with most studies being conducted on liquidity and financial leverage in the banking industries. Therefore the main objective of this study is to investigate the effect of financial leverage on the performance of listed furniture manufacturing SMEs at Glen View Industry in Zimbabwe from 2017-2022.

1.2 Statement of the problem

In Zimbabwe most of the furniture manufacturing SMEs use financial leverage as their external source of fund for their operations but has no idea about how to use an ideal level of debt that will not negatively influence their financial performance and hence increase shareholder's return. Also, many of the firm's assets are been held in liquid states which creates another problem for managers by not able to settle their short-term debt when maturity is due. All these depend on managerial skills and capability to clear their debt burden by increasing sales through exportation of locally produced goods to improve the economic conditions of Zimbabwe. This research serves as a tool for financial managers to analyse their financial needs, minimises the level of debt for their operations hence generate more returns on shareholders' equity and finally improve the furniture manufacturing performance to boost the economic growth of Zimbabwe.

1.3 Purpose of the Study

The major purpose of this study was to assess the impact of financial leverage on the Performance of furniture manufacturing SMEs at Glen View Complex in Harare (2017-2022).

Research objectives

- To ascertain the effect of financial leverage on profitability measured by Return on Capital Employed.
- To assess the relationship between financial leverage and liquidity of SMEs measured by current ratio
- To ascertain the effect of financial leverage on efficiency of SMEs measured by Assets Turnover Ratio

1.4 Research Questions

- How does financial leverage affect profitability measured by Return on Capital Employed?
- What relationship exists between financial leverage and liquidity of SMEs measured by current ratio?
- What effect does financial leverage have on efficiency of SMEs measured by Assets Turnover Ratio?

1.5Statement of the hypothesis

H0: Financial leverage does not have any significant effect on the efficiency of SMEs measured by Assets Turnover Ratio.

H0: There is no significant relationship between financial leverage and liquidity of SMEs measured by current ratio.

1.6Significance of the study

The study is relevant to the following stakeholders;

1.6.1 Finance Managers

This study will guide financial managers of furniture manufacturing SMEs in Zimbabwe to analyse the financial decision impact that liquidity and financial leverage both have on firm profitability and therefore, which may enable them to meet short- term and long- term financing

obligations and ultimately improve their performance. It will aid decision-making relating to the proper mix between debt and equity that will be of advantage to the firm. This will in turn establish a proper financial planning that will bring about improvement in the overall rate of return of the firm since cost of debt capital is lower than that of equity.

1.6.2 Policy Makers

Policy makers in the furniture manufacturing industry would be able to formulate appropriate debt and profitability management policy that would put the company above others in the same industry because the use of debt increases the earnings on equity capital as long as the rate of return on the firm's investment exceeds the explicit cost of financing the investment.

1.6.3 The Academic Community

The study would add more fresh empirical evidence to existing financial literature in Zimbabwe in tandem to the relationship between financial leverage and business performance and would be of great benefit to the academic field as it will serve as a reference point for students and future researchers who will want to research more on the topic.

1.7 Assumptions

Financial leverage does not have any significant effect on the efficiency of SMEs measured by Assets Turnover Ratio.

There is no significant relationship between financial leverage and liquidity of banks measured by current ratio.

1.8 Delimitations

The study is specifically fixated on the concept of financial leverage focused on how the financial leverage of quoted furniture manufacturing SME affects the financial performance measured by return on capital employed, liquidity and efficiency. Out of the 1300 furniture manufacturing SMEs at Glenview Complex who are involved in the direct manufacturing of wood and steel furniture that constituted the population of the study, annual report for 5 years was only obtained from one of them since most of them had not fully updated their financial reports. As such, the study collected data from one furniture manufacturing SME at Glen View Complex, with a firm of more than 5 years; and who complied with the definition of a small and medium enterprise contained in the Confederation of Zimbabwean Industries (CZI). The

study adopted a five year period (covering the years 2017-2022) which was considered sufficient to establish a relationship among the variables.

1.9 Limitations

During the course of the study, the investigator was aware of some limitations that could have affected the quality of this research study. Suggestions to overcome the effects of the identified limitations were put forward.

The major challenge faced by the investigator, was in the area of inconsistency in obtaining data for the study. Out of the 1300 furniture manufacturing SMEs at Glenview that constituted the population of the study, annual report for 5 years was only obtained from one of them since most of them had not fully updated their reports. The investigator thereafter made use of the available data which was nevertheless considered sufficient to test the hypothesis.

The investigator had limited finance to carry out a proper and extensive research, for instance travelling and photocopying expenses. However, to overcome the financial challenges, she had to engage in part time jobs.

1.10 Definition of terms

Debt Ratio- Financial ratio that indicates the percentage of a company's total debt to its total assets.

Financial Leverage- According to Pandey (2008) it is the existence of debt in a firm's capital structure of a firm. In other words it is the degree to which operating assets are financed with debt versus equity.

Financial Performance- It is a general measure of a firm's overall financial health over a given period of time. Leontief (2011).

Liquidity- It's the ability of a firm to meet its financial obligations in a timely manner. In essence, the assets owned by a company are liquid if they can quickly and cheaply be converted to cash.

Profitability- The state or condition of yielding a financial profit or gain. It is often measured by price to earnings ratio.

Return on assets- The percentage that shows how profitable a company's assets are used in Generating income.

ROA-This is calculated as net income divided by average total assets.

1.11 Summary

Introduction of the study was expressly undertaken in this chapter, the problem statement of the study established the purpose as well as the research questions of the study. Henceforth,

significance of the study to the society stated including to the academia and the country as a whole were stated in the chapter. The chapter also highlighted the assumptions, limitations and delimitations of the study. The chapter which follows is a review of related literature and is conducted to establish what other researchers have revealed in relation to financial leverage and how it influence firm performance.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This section of the study looks at variety of literature included in articles, journals, internet, published books and other writing identified with the issue under study. Along these lines the study investigates different literary works on financial leverage and firm performance. It inspects key ideas connected to financial leverage and firm performance in both the developed and developing world and varieties that exist between them. The significance of the review is to highlight the gaps from existing board of knowledge, identifying areas of convergence and divergence of diverse authors in the subject of financial leverage and firm performance. The exceptional focus of the chapter is on the effect of financial leverage on profitability measured by Return on Capital Employed, the relationship the between financial leverage and liquidity of SMEs measured by current ratio and the effect of financial leverage on efficiency of SMEs measured by Assets Turnover Ratio.

2:1 THEORATICAL FRAMEWORK

Pecking Order Theory

The study adopted the Pecking order theory as the theoretical framework. According to Frank & Goyal, (2003) Pecking order theory states that companies prefer internal funds, if available, and use debt or issue equity last. In line with Myers (1984), companies prefer internal sources to external finance due to asymmetric information. As pointed out by Chesang (2016), the utilisation of external financing sources are indicators to information that a firm is not profitable, which can decrease stock prices. When external financing sources are obligatory, firms choose debts to equity because of lower information costs relate with debt. Issuing new stock, instead of acquiring new debt, signals the news that directors think firms' stocks are overpriced (Chesang, 2016). In relation to the financial decisions process, the Pecking order theory (a capital structure theory) as advanced by Myers & Najfuf (1984) encourages companies to use the cheapest form of finance to run their operations first. In several cases, businesses follow hierarchy of financing sources and mostly choose internal sources first and debt is preferred over equity owing to information irregularity between the firm and outsiders (Chesang, 2016). Internal sources may not be efficient to meet certain financial decisions therefore the firm may consider external borrowing. Too much external borrowing affects financial decision.

According to the pecking order theory, firms that are in the growth stage of their cycle usually tend to finance that growth through debt since they have low cash flows, whereas more stable and established firms typically generate high cash flow hence need less debt to finance growth as its revenues are stable and proven (Baskin, 1989; Myers, 1977; Chesang, 2016).

A detailed number of support as well as criticism of the pecking order theory has been reviewed, with those in support who include Friend & Lang (1988), Baskin (1989), Rajan & Zingales (1995) and Ku (1997) have found a significantly negative correlation between profitability and leverage, consistent with the pecking order hypothesis. Kjellman & Hensen (1995) conducted a survey on determinants of capital structure using listed firms in Finland and establish that managers of the listed firms tended to follow the pecking order theory. De Miguel & Pindado (2001) also verified the theory using 133 listed Spanish firms and found evidence in support of the pecking order theory. De Medeiros & Daher (2004), in a comparative study, tested both the pecking order and trade-off theories using a sample of listed Brazilian firms and found that the former provides a better explanation of capital structure behaviour of the firms than the latter.

On the other hand, Frank & Goyal (2003) compared the pecking order theory against the trade-off theory and revealed that pecking order theory's suggestion of information asymmetry may not hold for small firms. Frank & Goyal, (2003) postulated that the management of a company usually knows more about its company's business and financial information than average outside investors do and the company administration don't expect to issue new stock when they think the stock price is undervalued in the market. When the market is fairly priced or overpriced management tend to issue shares. Henceforth, external investors may interpret the declaration of a stock issue as a negative signal for the current stock price (Tang & Jang, 2007).

This theory is relevant to this study considering SMEs particularly furniture manufacturing ones operate in a financial environment that fits the Pecking order. In most cases, businesses adhere to hierarchy of financing sources and mostly prefer internal sources first, and debt is preferred over equity due to information asymmetry between the firm and outsiders. Internal sources may not be efficient to meet certain financial decisions, therefore the firm may consider external borrowing however Too much external borrowing affects financial decision. When furniture manufacturing businesses out-source finance, preference capital is to be used in the subsequent command of funding sources: convertible securities, debt, preferred stock and common stock (Chesang, 2016). The theory suggests that firms should use the cheapest form

of finance to run their operations first. An appropriate debt to equity ratio and current ration needs to be maintained.

Trade off theory

The trade off theory is credited to the works of Kraus and Litzenberger (1973) who factored in the inefficiency created when theirs is no balance between debt financing and equity financing. The theory asserts that for companies with many assets should finance their projects using debt to avoid the issue of illiquidity which can have dire impact on day to day running of the firm (Rayan, 2010).It further reveals that before financing projects using debt the firm needs to carryout cost benefit analysis. Debts are associated with high rates which can hamper the going concern of the firm as well as the repercussions which they have to the firm when they are not repaid on time. The benefit they have is that of the taxation as they do not attract taxation (Al-Tally, 2014). All these factors have to be considered before deciding on using debt financing.

The term trade off comes from the opportunity cost decision that has to be made between financing through debts which has so many negative effects to the firm against the benefits associated with it which include the ease with which it can be accessed (Nwaolisa & Chijindu, 2016). The theory insists on the costs which the firm has to consider before embarking on using debt. Many scholars have asserted that it's impossible for a firm to achieve the phenomenon of optimal financing but it's theory asserts that it's very likely to be achieved (Al-Tally, 2014).

The theory asserts that a firm should borrow funds upon a point where additional debt will impact on the shareholders of the firm through share dilution (Abdu, 2016). The benefits associated with debt apply up to a point where they outweigh the costs. The reason why the theory prefers financing through equity is because its interest is exempted from taxation. Also, the theory further asserts that high ratio of debt financing is shy's ways the potential investors as they consider them risky investments and when they invest they demand high interest rates as an incentive for those risks (Chesang & Ayuma, 2016). As per trade-off theory, manufacturing and allied firms can increase their debt levels to the point where additional debt is offset by the marginal value of tax shield on interest so that they can improve their financial performance

2.2 Conceptualising Leverage

Leverage refers to the extent to which firms make use of their money, borrowings (debts financing) to increase profitability and is measured by total liabilities to equity. Leverage refers to the proportion of debt to equity in the capital structure of a firm. The financing or leverage decision is a significant managerial decision because it influences the shareholder's return and risk and the market value of the firm (Omondi & Muturi, 2013). Leverage is viewed as a result of events that determines companies' source of financing to run the business (Alkhatib, 2012). Firms that borrow large sums of money during a business recession are more likely to default to pay off their debts as they mature; they will end up with high leverage and are more likely to end up with a potential risk of bankruptcy (Nwanna & Glory, 2017). Firms with a high leverage are expected to disclose more information than firms with low leverage. The disclosure of information can be used to lower the monitoring costs of creditors. Creditors would like more information to be disclosed to control their own credit risk. Business owners seek to increase their wealth and the performance of their firms. Njeri & Kagiri (2013) opine that leverage increases the level of the debt in the capital structure and the turnover of the business and hence its profit, resulting in an increase in returns to the business owners. They also claim that an increase in interest rate is expected to result in reduced borrowing, increased interest expenses and thus reduced returns to business owners.

2.2.1 Determinants of Leverage

1. Firm size: Large sized firms normally have more business diversification than small firms in terms of credit ratings, constant cash flow, and lower risk of bankruptcy (Nwanna & Glory, 2017). Furthermore large firms are capable of decreasing transaction costs of issuing long-term debt at a favourable low rate of interest (Nwanna &Glory, 2017). Consequently, since it is easier for large sized firms to raise funds from creditors.

2. Growth: Growth is defined as the annual percentage growth in the firms' total assets between two successive years divided by the preceding year (Nwanna & Glory, 2017). A rise in growth rate is regarded as an indication of a firm's financial strength and may cause higher demands for raising equity funds from external sources. Firms with large volume of growth rate need to raise additional financial support to back up their capital expenditure strategies.

3. Tangibility: Tangibility is a fundamental element of determining the firm's leverage. Firms with little tangible assets generally have low leverage ratio and therefore would be difficult to collateralize such assets to raise additional funds accompanied with the risk of bankruptcy (Nwanna & Glory, 2017). On the contrary, firms with large volume tangible assets are more

likely to collateralize their assets to raise additional funds with little risk due to the investments diversifications which at the end reduces the risk of bankruptcy (Jensen, 1986).

2.2.2 Financial Leverage

This study is limited to financial leverage, thus a lucid description is necessary. Financial leverage is a measure of how much firm uses equity and debt to finance its assets (Nwanna & Glory, 2017). It takes the form of a loan or other borrowing (debt), the proceeds of which are re-invested with the intent to earn a greater rate of return than cost of interest. Financial leverage is the use third party funds in financing in order to increase operating profit and taxes, which is loans ratio to total liabilities (Nwanna & Glory, 2017). It is the firm's ability to use fixed financial charges to magnify the effects of changes in the earnings before interest and tax on the firm's earnings per share (Abdul & Adelabu, 2015). Pandey (2010) states that financial leverage occurs when there are no fixed financial charges (interest and preference dividend). Firms are either levered or unlevered. An unlevered firm is an all-equity firm, whereas a levered firm is made up of ownership equity and debt (Andy, Chuck & Alison, 2002). As debt increases, financial leverage increases.

2.2.2.1 Measures of Financial Leverage

Debt Ratio (DR): Ezeamama (2010) states that debt ratio (DR) measures the amount of the total funds provided by creditors in relation to the total assets of the firm. This is measured by the total debt to total assets and is a proxy to leverage (Nwanna &Glory, 2017). Debt ratio = Total debt/Total Assets. The formula is given below as the ratio of Total debt to Total Assets.

Debt to Equity Ratio: Enekwe (2012) posits that debt to equity ratio is a financial ratio indicating the relative proportion of equity and debt used to finance a company's assets which is an indicator of the financial leverage. Nwude (2003) defines debt to equity ratio as a measure of the proportion of debt to shareholders funds (Net Worth) in the total financing of a business. The ratio indicates how much naira was raised as debt per US$ of equity. Debt equity ratio has implications for the shareholders' dividends and risk, this affect the cost of capital and the market value of the firm (Pandey, 2010).

Interest Coverage Ratio: This measure of financial leverage is also commonly known as coverage ratio. It indicates the capacity of a firm to meet fixed financial charges. Interest coverage ratio is a ratio that recognizes that many firms lease assets and incur long-term obligations under lease contracts for the payment of lease premium (Ezeamama, 2010). Pandey

(2010) states that it indicates the ratio of net operating income (or EBIT) to interest charges. Investors usually have an idea of financial risk of a firm by comparing the coverage ratios of similar firms with an accepted industry standard, the investors (Nwanna and Glory, 2017).

2.2.3 Financial performance

According to Iswatia, & Anshoria (2007), performance is the function of the ability of an organization to gain and manage the resources in several different ways to develop competitive advantage. Financial performance emphasizes on variables related directly to financial report.

Soub (2012) argue that there are various measures of financial performance. For instance return on sales reveals how much a company earns in relation to its sales, return on assets explain a firm's ability to make use of its assets and return on equity reveals what return investors take for their investments (Nwanna & Glory, 2017). Company's performance can be evaluated in three dimensions.

Profitability: Profit is the ultimate goal of business organisations, SMEs inclusive. As noted by Nwanna and Glory (2017) all the strategies designed and activities performed are meant to realise this grand objective. Leverage levels are likely to influence profitability since it affects the Weighted Average Cost of Capital (WACC). On a different note, profitable firms can issue debt at low rates of interest since they are seen as less risky by the creditors (Mazur, 2007). Profitability ratios include: Return on Assets, Earnings per Share, Return on Equity and Return on Capital Employed.

Return on Capital Employed: ROCE is a financial ratio that refers to how much profit a company earned compared to the total amount of capital invested or found in the statement of financial position (Ongore & Kusa, 2013). It is the return per U$ of capital employed in the firm. A business with high returns on capital employed is more likely to be one that is capable of generating cash internally (Nwanna & Glory, 2017). Thus, the higher the ROCE the better the company is in terms of profit generation.

Firm size: All firms exist to grow very large. This is because firm growth serve as a motivation for stakeholders like Investors, Employees, Suppliers, Government and the Society at large (Nwanna & Glory, 2017). When firms enlarge, there is a level of satisfaction that board of directors and management are making use of organisational resources and using opportunities to the advantage of the firm. As espoused by Nwanna & Glory (2017), size is proxy using the natural logarithm of total assets.

Liquidity: Liquidity is the ability of a firm to meet their current liabilities as they fall due. Excessive amounts of current assets owned by a firm would perhaps increase the chances of internal funding resulting in a relation between leverage and liquidity (Bhunia & Das, 2012; Nwanna & Glory, 2017). Eljelly (2004) stated that liquidity involves planning and controlling current assets and current liabilities in a manner that eliminates the risk of inability to meet short-term obligations on one hand and avoid excessive investment in these assets on the other hand. Furthermore, sufficient liquidity has an impact on the financial strength of a firm (Bei & Wijewardana, 2012). Agyei & Yeboa (2011) stated that in the banking sector, liquidity is a measure of performance, at least for two reasons; to meet regulatory requirement and to guarantee enough liquidity to meet customers' unannounced withdrawals. Current assets therefore must be sufficient to allow daily operations. Firms with too few current assets may incur shortages and difficulties in maintaining smooth operations (Van Horne & Wachowicz, 2000). Liquidity in this study will be measured using current ratio.

Current Ratio: Current ratio is computed by dividing current assets by current liabilities. It shows how many times the current assets of a firm can take care of its short-term obligations (Nwanna & Glory, 2017).

Efficiency: Efficiency is one of the key internal factors that determine the performance of SMEs. Efficiency is the capability of management to deploy its resources efficiently, maximise income and reduce operating costs (Nwanna & Glory, 2017). The efficiency of organisations is often expressed qualitatively through subjective evaluation of management systems, organizational discipline, control systems, quality of staff, and others (Ongore & Kusa, 2013). One of the ratios used to measure efficiency is the Asset turnover Ratio. Others are total asset growth, loan growth rate and earnings growth rate. The higher the ratio, the more efficient the organisation is believed to be (Nwanna & Glory, 2017).

Asset turnover Ratio: This ratio tells the revenue generated from the total assets employed (Nwanna & Glory, 2017). It shows how much was generated from the companies' investment of assets.

2.3 Empirical studies on financial leverage and firm profitability

This section is spotlighted on the relationship between the independent variables (debt to equity ratio, long term debt, current ration and firm size and their relevance on the dependent variable which is profitability as measured by ROA. With the acknowledgement of previous studies, knowledge gaps in literature will be identified and propose study's actions to close the gaps.

Profitability is conceptualised as the ability of a business organisation to generate earnings as compared to its operating expenses and all other relevant costs incurred during a specific time period (Pandey, 2009). In this sense, for the firm's profitable performance, revenue generated is more than the overall expenses incurred. Profitability is the prime necessity for the long survival of businesses. Henceforth, it is important to measure the past, current and projecting future profitability of firms.

As postulated by Frank & Goyal (2009), profitable firms do not expect to face serious liquidity issues thus do not forecast accruing costs of financial distress such as bankruptcy costs. With such a development, Myers (1977) argued that profitable and liquid companies prefer to use internal funds to finance their operations with outside sources being pursued only when necessity calls for the same. However, on the other hand, in line with the Modigliani and Miller and trade-off theories, some such firms will find interest tax benefits rising from use of debt more important to them. Profitability and corporate leverage, according to various studies(Artikis, et al., 2007; Kayo & Kimura, 2011; Rajan & Zingales, 1995), therefore, signifies both a positive correlation, which supports trade-off theory, and a negative correlation which supports the pecking order theory.

With profitability business enterprises are able to endure negative shocks and to strengthen their business surroundings. As such, the majority of business organizations are started with the aim of seeking to earn profit and providing an exchange of sufficient incomes to its shareholders (Devi & Devi, 2014). Profitability is one of the most important objectives of financial management since one goal of financial management is to maximize the owners' wealth, and profitability is a vital determinant of performance (Sivathaasan et al., 2013). Profitability is an important principle of the majority of business entities (Devi & Devi, 2014). As such, maximising the profits of the firm is one of the main objectives of managers (Nousheen & Arshad, 2013). In order to survive and to succeed in a competitive market, firm must focus on maximising profit, or they will eventually be driven out of business (Schmidt, 2014). A business that is not profitable cannot survive while a highly profitable business has the ability to reward its owners with a large return on their investment. Hence, the ultimate goal of any business entity is to earn profit in order to make sure the sustainability of the business in the prevailing market conditions (Malik, 2011; Sivathaasan et al., 2013; Chesang, 2016).

Several studies have been conducted on the determinants of profitability of firms across the globe and came up with mixed results. For example, Salim & Yadav (2012) using a sample of

237 Malaysian listed companies over the period 1995-2011 established that firm performance, which was measured by return on assets, return on equity and earnings per share had negative relationship with short, long-term debt and total debt while it was not related to Tobin's Q used as a measure of performance where a significant positive relationship was observed. Another study by Dav & Devi (2014) on Pakistanian firms established a positive association between financial leverage, firm size and corporate profitability. Pratheepan (2014) also explored the determinants of profitability of Sri Lankan listed manufacturing companies over the period of 2003 – 2012. The study findings established that size had a positive, statistically significant relationship with profitability whereas tangibility had a negative statistically significant relationship with the profitability of selected listed manufacturing companies in Sri Lanka. As such, the findings revealed that leverage and liquidity had an insignificant impact on profitability.

More so, Zaid, Ibrahim & Zulqernain (2014) in Malaysia, studied public constructions companies from 200-2012 and discovered that liquidity and size have a significant correlation with profitability while capital structure had a negative insignificant relationship with profitability. Another study on the impact of firm's macro-economic factors on the profitability of the food sector in Pakistan by Nousheen & Arshad (2013), established that that tangibility, growth of the firm and food inflation had an insignificant positive relationship with profitability while debt ratio had an insignificant negative relationship with profitability. It established a significant negative relationship between size and profitability.

In a study carried out by Ebaid (2009) on the effect of capital structure on performance of firms in Egypt securities exchange, financial leverage did not appear to influence the firms' performance. Multiple regression technique was applied to determine the association between the leverage and performance. The result showed that financial leverage has no impact on company's performance. Mwangi, Makau and Kosimbei (2014) examined the relationship among capital structure and firms' performance of 42 non-financial companies in the Nairobi Securities Exchange. The study used secondary panel data contained in the experimented financial statements of the listed companies, and employs panel data using random effects and feasible 27 Generalized Least Square (FGLS) model. The findings were that financial leverage is negatively correlated to performance which is measured by return on assets.

Kirmi (2017) in his research on the relationship between capital structure and profitability in Nairobi, Kenya discovered that there is a relationship that exists between short and long term

debt on the profitability of a firm, although the correlation might differ depending on the type of debt. Another study in Kenya by Habib, Khan & Wazir (2016) established a positive relationship existing between debt financing and profitability of a firm, thus an increase in debt subsequently leads to an increase in the profitability of the firm all things being equal according to the research findings. Yegon & Koske (2018) on the effects of capital structure on profitability on the Kenyan Banking sector, revealed a positive relationship between debt financing (being one of the pillars of an optimal capital structure) and profitability. Muchiri et al. (2016), Saeed and Gull (2013), and Achaempong (2014) all agree on a relationship existing between debt financing and financial performance, specifically profitability.

The study of 16.5 thousand Ukranian firms over the period 2001-2010 years by Iavorskyi (2013), proposes that financial leverage positively affects firm performance through disciplining managers, tax shield and signalling effects. It was discovered that the relationship between the financial leverage and firm performance measures is negative. These results do not support the free-cash-flow or trade-off theories of capital structure whilst the validity of the pecking order theory is confirmed (Lavorskyi, 2013).

Nyamwanza, Haufiku, Ellen & Mhaka (2020) also carried out a study on the impact of debt finance on the profitability of a furniture retail company in Kadoma, Zimbabwe. The study used the mixed methods approach and employed quantitative data from financial statements and qualitative data from interviews. The target population was 25, and the research indicated that debt financing was significantly and statistically negatively affecting the return on assets of the company. The regression yielded a p-value of 0.018 and a coefficient of 0.9992 thus confirming a 99.92% that the variability in profitability is well explained by the independent variable used in this research which is debt finance. Obuya (2017) and Lemma and Negash (2013) share a similar view that a significant positive impact might be experienced when a company adopts debt financing as this can help the company invest in long term viable projects and improve the company's profits and growth opportunities but this has not been the case for the furniture retail company.

An analysis of the impact of capital structure on company performance of firms in Jordan securities exchange was conducted by Tian and Zeitun (2007). The analysis was done by using a panel data approach of 167 companies for a span of 15 years from 1989 to 2003. The study used Return on Equity, Return on Assets, Earnings before Interest and Tax and tax plus depreciation to total assets, market value of ordinary equity to book value of equity,

price/earnings ratio and market value of equity plus total liabilities divided by book value of equity as market performance measures. The results show that firms' performance and capital structure has negative relationship. It was also established that short term debt to total assets as a determinant of leverage has an association which is positive on the market performance proxy by Tobin's Q (Zeitun and Ian, 2007).

However, on the contrary, Dencic-Mihajlov (2014) and Sivathaas et al. (2013) all agree on a weak and insignificant relationship between debt financing and financial performance of a firm, they rather present other variables that might impact the financial performance of a firm which can be the size of the firm, market share, and many other factors. Pratheepkanth (2011) is also of the view that the relationship between debt financing and profitability exists but confirms that it is weak according to the findings of the research conducted.

2.4 The effect of Long term debts to capital employed on profitability

The firm's financial leverage can be presented by a long term debt to capital employed ratio. This ratio is according to Chesang (2016) calculated by dividing the long term debt with the total capital accessible by a firm. The total capital of the firm encompasses the long term debt and the stock of the firm.

The formula of calculating Long Term Debt to Capitalization Ratio is:

Long term debt / Common Stock +Preferred Stock+ Long term debt

A long term debt to capital employed ratio greater than 1.0 shows business has more debts than capital employed in essence is not a worthy practice to a business entity as it can indicate financial difficulties, particularly the firm running to bankrupt (Chesang, 2016). As advanced by Myers & Majluf (2004), a tall long term debt to capital employed ratio would show the financial limitation of the company and the debt would most likely increase the risk of the firm.

A study by Kaumbuthu (2011) on the connection between capital structure and return on equity for allied industrial sectors in the Kenyan Stock Exchange from 2004-2008, using a regression examination, established a negative correlation between debt to equity ratio and return on equity. However, the results cannot be generalised to the other sectors considering the fact that the study was centered to one sector of the firms listed in Nairobi Securities Exchange and concentrated on aspect of financing decisions. As such details on the effect of debt on the performance of the company is still sketch.

Other researchers such as Al-Shamaileh & Khanfar (2014) in Jordan had to reason that the effect is negative. They pointed out that debt makes the companies chart dissimilar output and investing strategies, in that differs with regard to the make-up of the debt. As such, long term debts enhance the company to pick higher output and financing heights besides higher expertise up progression payments. Though, the short-term debts, which make the company conformist with reference to output and financing strategies, might have a harmful impact on the financial performance of the companies (Al-Shamaileh & Khanfar, 2014).

In Germany, a study Marcky (2019) observed at the effect of the firm's capital structure on firms financial performance of companies scheduled in Germany Securities Exchange. Secondary data used was acquired from financial statements of listed firms, and used stratified random sampling technique. Multiple regression technique was used to explain the association between financial leverage, debt interest and cost of equity and companies performance. The findings presented that positive association exists among cost of equity, financial leverage, debt interest and organization financial performance.

Innocent, Ikechukwu & Nnagbogu (2014) conducted a study on the impact of financial leverage on financial performance on scheduled pharmaceutical companies in Nigeria stock exchange for the period 2001 to 2012. Financial leverage represented by debt ratio, debt to equity ratio, ratio on interest coverage were used as independent variable while financial performance proxy by return on assets as dependent variable. The study employed secondary data information sourced from audited financial statements of 3 pharmaceutical firms listed on the Stock Exchange of Nigeria. Pearson correlation and descriptive statistics were utilised in order to establish the association amid financial leverage variables and performance degree adjustable identified in the research. The results showed that debt ratio and debt to equity ratio contain harmful association with Return on Assets, while interest coverage ratio has a positive relationship with ROA. The study also displayed that on whole financial leverage variables has no significant effect on financial performance of sampled companies (Innocent, Ikechukwu and Nnagbogu (2014).

2.5 Effects of Current Ratio on the firm Profitability

High current ratio indicates a higher level of liquidity, a lower ratio shows a small amount of liquidity, linking an increasing reliance on operating cash flow and outside financing to meet immediate requirement (Chesang, 2016). The firm's capacity to take on debt is liquidity.

On the correlation between the working capital management and the company's profitability in the 8 Saudi Arabia's cement manufacturing companies between 5 years from 2008-2012, Regression and Pearson bivariate examination were used. The study found out that Saudi cement company current ratio is indispensable liquidity estimate which realised profitability, therefore, the cement companies should put a trade-off between these two objectives found neither the liquidity nor profitability suffers. More so, Almazari (2013) contended that if size of a company increases, profitability increases and vice versa. Besides, when the debt financing is improved, profitability is declined. Linear regression tests established a high degree of association among the profitability and working capital management.

According to Padron, Apolinario and Santana (2005), performance of companies with liquid assets are likely to be more and better as they are capable to get money at given period to meet up its requirement and are less open to the elements of liquidity risks. By not having sufficient cash or liquid assets, listed firms end up selling their securities at a substantial low price in order to settle debts quickly. Though, there are divergent views of investors with regard to liquidity and performance in relation to the agency theory cost. A study by Kayo and Kimura (2010) observed that high liquidity could increase agency expenses incurred by the owners by providing administrators with inducements to misuse excess cash-flows by investing in projects with harmful net present prices and appealing in excessive privilege consumption. Liquidity measures the ability of managers to meet their immediate commitments to shareholders and other creditors without having to increase profit from investment activities and/or liquidate financial assets.

Eljelly (2004) looked at the relationship between profitability and liquidity measured by current ratio cash breach and cash conversion cycle on an example of joint stock firms in Saudi Arabia using method of correlation and regression examination. Eljelly (2004) established a harmfulassociationamid profitability and liquidity signify, and it was established that Cash Conversion Cycle had a large effect over profitability than Current ratio factor affecting firm profitability. Itwas found out there wasgreat difference among firms with respect to the assessment of liquidity Eljelly (2004) Suhaila (2014) investigated the effect of liquidity and leverage on financial performance of commercial publiccompanies in the tourism trade in Kenya. The study adopted descriptive research design where information was recovered from the financial statements and Notes of ten (10) Profitable State Companies in the travel industry in Kenya during the study period 2008-2012. A positive relationship was found to exist

between tourism industry liquidity and profitability of Commercial State Corporations in the tourism sector in Kenya.

In general, the above literature sought to establish whether or not there is a significant relationship between financial leverage and profitability and no conclusion has been reached as to whether say the relationship does exist or not. This relationship seeks to add to the already existing literature on how financial leverage is related to profitability by exploring how short term, long term, and total debt is related to return on asset which is the measure of profitability employed in this research. Also, most of the aforementioned studies principally concentrated on listed companies and large manufacturing companies in both developed countries and developing countries, hence providing a gap for the researchers to explore and analyse the impact of debt financing on the profitability of furniture manufacturing SMEs using a case study of one company at Glen View Industry in Zimbabwe.

2.6 Summary

The chapter has demonstrated on the theoretical foundations guiding understanding of the companies' preference of funding and the Pecking order theory even suggested that firms should use the cheapest form of finance to run their operations first. It revealed the relationship between the independent variables (debt to equity ratio, long term debt, current ration and firm size and their relevance on the dependent variable which is profitability as measured by ROA. The chapter also provided the scholarly view of the phenomena, theoretical framework. The next chapter will be on research methodology.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This chapter critically looks at the research methodology and the corresponding justification of the methodology adopted. The chapter looks at the research design, research philosophy, research strategy, population and sampling techniques that were used in the research. Furthermore, the chapter highlights the instrument used to collect the data, including methods implemented to maintain validity and reliability of the instrument. Finally the chapter will indicate the procedures that were used to collect data and how the data was presented and analysed. The research limitations will also be discussed.

3.1 Research Design

The investigator conducted a descriptive research design. According to Mugenda & Mugenda (2003) a descriptive research design is a systematic, empirical analytical which the examiner does not have a direct control of independent variable as their manifestation has already occurred because the inherently cannot be manipulated. As such descriptive design is most relevant to test hypothesis and determining the way things are reported.

Descriptive studies are concerned with how, where and what of a phenomenon thus placed to build a profile on that phenomenon (McNabby, 2017). Descriptive design was therefore important for this study considering that it wanted to build a profile about the effect of financial leverage on furniture manufacturing SMEs profitability using specific variables such as debt to equity ratio, long term debt to capital employed and current ratio.

3.2 Population and Sampling

A population is the universe of all of the units or elements to which we want to generalize the findings (Stommel & Wills, 2019). According to Yin (2014), population refers to the aggregate or totality of all the objects, subjects or members which conform to a designated set of specifications.

A target population is defined as a community, in which a given intervention is directed and to whom results will be generalized to (Coolican 2006). A target population constitutes the following age group, geographical area and gender participants. The research's target population was the 1300 furniture manufacturing SMEs at Glenview Complex who are involved in the direct manufacturing of wood and steel furniture.

The study was conducted at one of the 1300 furniture manufacturing SMEs at Glenview Complex who are involved in the direct manufacturing of wood and steel furniture. The study collected both primary and secondary data,which called for a need to visit the organization physically at their head offices to carry out the survey. Annual report for 5 years was obtained from the management of one furniture manufacturing SME which had fully updated financial reports. For primary data, the accessible population was made up of the CEO, accounting officer and the finance manager. These were preferred in the study because they were in a strategic position to provide information needed for this study.

3.2.1 Sampling

Bhattacharrya (2009), sampling is the art of selecting a portion or fraction of a whole population under study. The study's sample size was drawn from three of the 15 employees at FTM furniture who are 20% of the total population. The investigator wanted to use a larger sample but due to financial resources and time factor. It should be noted that the most expedient acceptable sample is one that meets the requirements of reliability, flexibility, and representation of the total population, and whose results can be generalised to those elements that were not included or were part of the sample . According to Cohen et al. (2011), in many cases, purposive sampling is used to access knowledgeable people, who have in-depth knowledge about specific issues due to their professional role, power, and access to networks, expertise, or experience. In addition, the investigator analysed annual report for 5 years which were obtained from the management at FTM furniture.

Table 3.1: Number of Research Participants

Participant	Sample size
Chief Executive officer and owner	1
Finance Manager	1
Accounting Officer	1
Total	**3**

3.3 Sampling Procedures

The researcher used purposive sampling. As argued Bryman (2012) it refers to a deliberate procedure whereby a researcher recognizes specified entities with abundant information, knowledge on the phenomena under study. Punch (2010) enlightens that purposive sampling is a calculated course with some emphasis in mind. This method gave the investigator room in

choosing the contributors that provided the best information to answer research aims. This enabled the investigator to select the participants with pertinent features that enabled exploration and considerate of the study. In this regard, the researcher target all the CEO and owner, managerial employee and middle manager who was the accounting officer because they are actively involved in the daily financial operations of the organisation. This method was also employed because it saves time, money, and effort. The part of purposive comes out on the part of the investigator purposely selecting as the organisation suitable for the study.

3.4 Data sources

Data used was extracted from secondary literature and primary literature

3.4.1 Primary data

Pattern and Newheart (2017) accentuated that primary data collection is the collection of first hand data directly from the sample population, this data is found in its original unprocessed state. Primary sources of data include interviews, unpublished documents such as board meetings. The primary data which was used for this study was collected through interviews.

3.4.2 Secondary data

According to Creswell and Clark (2011), secondary data is the data collected from already published sources that includes books, reports, journals, census data and other historical informational collected for other purposes other than the original use. The investigator used the HRM reports, financial reports, productivity reports, published financial statements and loss control reports to obtain data about financial leverage and its relationship with profitability.

3.4.3 Research Instruments

According to Elsevier (2009), a research instrument is a testing device used to measure a specific phenomenon, such as a paper and pencil test, a questionnaire, an interview, a research tool, or a set of observational guidelines. The investigator made use of interviews.

3.4.4 Interviews

Interviews are loosely structured discussions with people who have specialized knowledge about the topic being studied (Patton, 1990). The researcher designed an interview guide to

interview the CEO and owner, managerial employee and middle manager who was the accounting officer who are considered specialists in the overall picture of financial leverage and profitability under their jurisdiction.

Because the information came directly from knowledgeable people, key informant interviews produced value neutral data rather than value laden data. As a result, the data collected was rich and accurate. The key informant helped to reveal confidential information that would not be revealed in other circumstances. The key informant interviews were beneficial to this research because they allowed for the exploration of new ideas and issues that might not be anticipated in the report's planning but relevant to its purpose. The researcher was able to establish rapport with the respondent and clarify questions through key informant interviews.

3.5 Data Collection Procedures

Data collection procedure is the detailed report on how the study was implemented on data collection. In order to gather data, the investigator sought permission from the responsible authorities at Bindura University and the sample firm, to conduct the research study. When permission was granted by the relevant businesses and individuals, the investigator collected HRM reports, financial reports, productivity reports, published financial statements and loss control reports from the financial manager. Consequently, interviews were conducted with the CEO, Finance manager and Accounting Officer at their work place. The data was collected in English or Shona depending on the choice of the respondents and written transcripts were later translated into English Language.

3.6 Data Presentation and Analysis Procedures

Data analysis is the practice of extracting useful information from raw data. It is carried out to reduce, organize and give meaning to data (Grove, Burns & Gray, 2013).Data analysis is the process of organising the data collected for example into categories (Kothari, 2008). Data presentation is defined as the process of using various graphical formats to visually represent the relationship between two or more data sets so that an informed decision can be made based on them (Braun and Clarke, 2006).

The data from the study was manually analysed and presented in thematic form. A thorough check on completeness and correctness was made before the actual coding and data entry was done using Excel. After the data cleaning process, Microsoft word was used to present data. The findings were presented and analysed in accordance with the report's questions and

objectives. The investigator analysed the data using themes. Data was presented in figures and tables.

Thematic analysis is a rich description and analysis of data through systematic and structured data coding and identification of themes (Kondracki and Wellman, 2002). The major strength of thematic analysis is that it can pattern qualitative data and identify its implicit and explicit meaning (Guest et al, 2012). The major weakness of thematic content analysis is that it often leads to paraphrasing and generalisation of the research findings and its application often lacks rich theoretical grounding (Braun and Clarke, 2006).

3.7 Summary

This chapter gave a clear picture of how the research was conducted. However a descriptive design with the application of interviews and secondary data are regarded as the best methodology and methods to collect data from respondents, relative to other methods. The chapter is mainly focusing on research design, population, sampling, sampling technique and procedure; research instruments, data collection and data analysis. The next chapter will present the study findings, presentations and analysis.

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND DISCUSSION

4.0 Introduction

The aim of this chapter is to present the study's findings. In this chapter descriptive data are presented in the form of tables and figures to answer the research questions.

A total of 03interviews administered by a questionnaire were fully conducted, accounting to a 100% response rate.

4.1 Demographic characteristics of respondents

The study presented different demographic characteristics of respondents which include: age, gender and length of work experience in the current company.

Table 4.1: Demographic characteristics of the respondents   N=03

Variables	Frequency (n)	Percentage (%)
Gender		
Male	02	66.7
Female	01	33.3
Age range		
18-25 yrs.	00	00
26-35 yrs.	01	33.3
36-45 yrs.	01	33.3
46+ yrs.	01	33.3
Length of working experience in the current company		
>1 year	00	00
1-3 years	00	00
3+ years	03	100
Total	**03**	**100%**

Demographic results in Table 4.1 show that 02 (66.7%) respondents were males and 01 (33.3%) was a female. This is an indication that there are more male staff than female in the finance departments. Another factor might be that women were getting interested in performing duties which are not of managerial nature symbolised by the sampled women representing the accounting officers while males were the Finance Manager and the Chief Executive Officer. Though basically, the views of both genders were well represented.

The three respondents indicated that they were of age ranges between 26-35 years, 36-45 and 46 and above years individually. This therefore, means that the officers interviewed included youth and adults. Thus furniture manufacturing SMEs in Zimbabwe are occupied by accounting officers of different age groups.

When asked to indicate how long they have been working in the same company and in the current position, all the 03 (100%) indicated that they had worked in the same company for a period of more than 3 years (See Table 4.1 above). This implies that having worked for a period of more than 1 year they understand the operational dynamics of the company. Thus, the study capitalised on the experiences gained by the respondents.

4.2 Effect of financial leverage on profitability

Table 4.2: Rating of the effect of financial leverage on profitability in furniture manufacturing SMEs

Variables	Frequency	Percentage

Very low	00	00
Low	01	33.3%
Moderate	02	66.7%
High	00	00
Total	03	100%

As shown on Table 4.2, 66.7% rated the effect of financial leverage on profitability in their organisation as moderate, while 33.3% rated it as low.This proves that the effect of financial leverage was slightly moderate. Moderate leverage positively affected the financial performance of furniture manufacturing SMEs. These findings were in collaboration with results of Wainana (2014) of the 100 SMEs in Kenya which concluded that there was a positive relationship between financial leverage and profitability.

4.3 Effect of current ratio on Liquidity

In order to establish the effect of Current ratio on liquidity, various indicators were tested to determine the extent of the effect, means were computed, and the results are shown on Table 4.3 below.

Table 4.3: Effect of current ratio on liquidity

Variables	Minimum	Maximum	Mean	Std. Deviation
Receivable days	1.00	4.00	2.0358	1.6350
Payable days	3.00	5.00	3.2000	0.6369
Inventory days	1.00	4.00	2.1579	1.0468
Inventory turnover	1.00	4.00	2.2670	1.1037

As shown on Table 4.3 above, the mean scores recorded by the indicators are Receivable days (M=2.0358), Payable days (M=3.2000), Inventory days (2.1579) and Inventory turnover (2.2670). This proves that receivable days, payable days, inventory days and inventory turnover affected the firm's liquidity. As it has been emphasised that any ratio below 1.0 is an indicator that the company may not be generating cash enough to meet the short term obligations(Morrel, 2007). The means were high than the 2.0 mean mark which tests that the company has twice as much in current assets as current debt. This means the company can meet its short term debt obligations 2.1536 times over, hence the degree of independence of the firm against creditors and its ability to face crises and unexpected difficulties is high. The payable days had an effect on the company's liquidity.

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The results of this study relates with Chesang (2017) who established that accounts payable ratio had negative and significant impact on profitability. It is shown that working capital of the company had an effect on the financial performance of furniture manufacturing SMEs. This is in synch with the findings of Marimo (2018) who discovered the association between working capital management and the profitability of SMEs at Gaza Highfields markets in Harare. It was revealed in the study that inventory turnover moderately affected the profitability of furniture manufacturing SMEs. However, a past study of Luchinga (2014) discovered that inventory turnover in days has negative relationship with Return on Assets using a regression model, meaning that companies financial performance may be increased by reducing inventory in days. Company's profitability can also be affected by inventory days. Optimum inventory levels as noted by the study of Aminu et al. (2013) depended on sales, hence sales were estimated before target inventories were established. As such, due to errors in setting inventory levels, there were lost sales or excessive carrying costs, which entails that inventory management is relatively important. A study by Nyamwanza et al. (2020) revealed that accounts receivable had positive and significant effect on profitability. Henceforth, these current ratio dimensions were significant in determining the performance of the furniture manufacturing SMEs.

4.4 Effects of debt on performance

Table 4:4

Variables	Measurement	Expectation
Return on equity	Net income divided by shareholders equity	
Short term debt to total assets	Total short term debt divided by total assets	negative
Long term debt to total assets	Total long term debt divided by total assets	Negative
Equity to total assets	Total shareholder's equity divided by total assets	

Table 4:5

	Mean	minimum	Maximum	Std deviation
Return on equity	10.36	-16.00	100.00	14.32
Short term debt ratio	37.63	11.57	73.12	15.41
Long term debt ratio	13.38	0.10	57.21	13.38
Equity ratio	47.94	02.00	85.00	18.02

Table 4.5 represents descriptive statistics of dependent and independent variables. The mean values of profitability measures ROE is 10.36, short term debt ratio is 37.63, long term debt ratio is 13.38 and equity ratio is 47.94. Total assets are financed by around 50% debt and 50% equity and the portion of short term debt is more than long term debt on an average. So this can be concluded that the firm is much more interested in risky mode of financing.

4.5 CORRELATION COEFFICIENT

Table 4:6

Variables	Return on equity	Short term debt ratio	Long term debt ratio	Equity ratio
Return on equity	1.0000			
Short term debt ratio	0.1974	1.0000		
Long term debt ratio	0.0116	-0.3475	1.0000	
Equity ratio	-0.4316	-0.6160	-0.4553	1.0000

Note: significant at 1% level

Table 4:6, the correlation matrix shows that firm profitability (return on equity) is positively associated with short term debt (0.1974),long term debt (0.0116) and negatively associated with equity (-0.4316). There is a significant negative relationship between the use of debt and firms profitability measured by return on equity which is in opposition to Modigliani and

miller, agency theory and trade off theory. All these theories postulate that in the presence of corporate tax, profitable firms will be motivated to increase their financial leverage.

4:6 SUMMARY

This chapter presented the research findings which were provided by the respondents through financial records and interviews conducted. The findings finds a negative relationship between profitability and short term debt ratio, long term debt ratio and equity ratio The next chapter focuses on the summary and conclusions of the research findings and also recommendations.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.0 INTRODUCTION

This chapter describes a summary of the results of the data survey on the impact of financial leverage on firm's profitability, focusing on furniture manufacturing firms to draw conclusions and recommendations. Therefore the structure of this chapter is the summary of the survey results, conclusions, recommendations and research fields.

5:1 SUMMARY

The study was conducted to assess the impact of financial leverage on firm's profitability basing on furniture manufacturing firms. The study aim to answer the research question stated in chapter one. The impact of financial leverage and profitability was brought into light through correlation coefficient analysis of financial reports of 2017-2022. In the second chapter, the study explained the looked at theoretical and empirical literature on the effects of financial leverage on firm's profitability. It also reviews the empirical researches done by other scholars in other countries. The empirical researches in chapter two formed the basis on which chapter three of the study is based on.

The study went on to research methodology where it highlighted the methodology in the statistical test of the relationship that exists between leverage and firm's profitability and secondary data was used in the research. Results obtained based on the research methodology used in chapter four were presented and analysed in chapter four. These findings were in

collaboration with results of Wainana (2014) of the 100 SMEs in Kenya which concluded that there was a positive relationship between financial leverage and profitability. On liquidity, the company can meet its short term debt obligations 2.1536 times over, hence the degree of independence of the firm against creditors and its ability to face crises and unexpected difficulties is high. The payable days had an effect on the company's liquidity. accounts receivable had positive and significant effect on profitability. Henceforth, these current ratio dimensions were significant in determining the performance of the furniture manufacturing SMEs .The results obtained showed that there is a positive relationship between profitability and short term debt ratio and long term debt ration and there is a negative relationship between profitability and equity ratio.

5:2 CONLUSION

From the above, there is a significant negative relationship between use of debt and firm's profitability which is measured by return on equity which is in position with the agency theory and trade of theory. Also the firm use external debt as a source of finance as they do not have sufficient internally generated funds to use and subsequently new equity financing is also raised to meet up the financing needs. The outcome of the study is in support of the pecking order theory and suggests that internally generated funds should be used first. Low return on equity was due to the dependence on risky mode of financing, increasing competition, inefficient use of funds to generate profit. As a result of low profitability, financial institutions and other debt holders may have charged high costs of debt. As firms are having higher obligations to pay and insufficient internally generated funds because of less profitability, most firms are also issuing new equity which might be just to cover up their cost of debt. This may happen that the new equity funds are not used in generating profit. Moderate leverage positively affected the financial performance of furniture manufacturing SMEs and current ratio dimensions were significant in determining the performance of the furniture manufacturing SMEs.

Notwithstanding, it can be presumed that the use of financial leverage is crucial for any profitable firm. So the negative relationship is a reminder of administration and directory of the manufacturing firm to consider the expenses related with obligations and its effects to the shareholders who bears the remaining expenses of diminished benefits. The results found using study period might be affected by the overall financial conditions at that time.

5:3 RECOMENDATIONS

The results of the research led to the conclusion that financial leverage does not affect the financial performance of firms. The study therefore recommends that the management of furniture manufacturing firms should hold optimum debt levels in their financial structure to avoid bankruptcy and debt related effects.

The findings of the research led to the conclusion that asset structure has a direct and sidnificant effect on the financial performance. The study recommends that furniture manufacturing firms should invest some of there funds in fixed asstes since they held to generate revenue which in turn affects the financial performance of the firm as a whole.

5:4 SUGGESTIONS FOR FURTHER RESEARCH

This study only focused on furniture manufacturing firms, hence the study recommend an additional study on the effects of financial leverage in other business sectors. This study also recommends finding the impacts on financial leverage on firm's investment.

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