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The Moderating Role of Firm Characteristics on the Relationship Between Equity Financing and Financial Performance of Micro, Small and Medium Enterprises in Nakuru County

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Abstract

Micro, Small and Medium Enterprises (MSMEs) are important drivers of economic development in many countries and thus is a medium of job creation and poverty alleviation. Although equity financing is increasingly recognized as a sustainable financing option for MSMEs, many enterprises in Kenya continue to experience poor financial performance, with high closure rates reported in urban centers such as Nakuru. Existing studies have explored the direct relationship between financing strategies and performance but have paid little attention to the moderating role of firm characteristics. This study therefore investigates the moderating role of firm characteristics on the relationship between equity financing and financial performance of MSMEs in Nakuru County. The study was informed by the financing life cycle of the firm theory. The study adopted an exploratory research design and targeted 7,384 MSMEs operating in Nakuru County. From this population, a sample of 379 enterprises was drawn using stratified and simple random sampling techniques. Data was gathered using a 5-point Likert scale questionnaire. A pilot study involving 37 MSMEs in Eldoret town was conducted to assess the validity and reliability of the research instrument. Validity was examined through factor analysis, while reliability was tested using Cronbach's Alpha, with coefficients of 0.7 and above considered acceptable. Data was analysed descriptively and inferentially using SPSS Version 23 and presentation employed bar graphs, tables, explanation and pie charts. Findings revealed that equity financing had a positive and significant effect on MSME financial performance ($\beta = 0.147$, $p = 0.008$). Firm characteristics also had a significant influence on financial performance ($\beta = 0.182$, $p = 0.000$). Moreover, the interaction between equity financing and firm characteristics demonstrated a positive moderating effect on financial performance ($\beta = 0.251$, $p = 0.000$). This implies that firm attributes such as production capacity, managerial competence, and operational factors strengthen the contribution of equity financing to MSME growth and

sustainability. The study recommends strengthening MSMEs' internal financial capacity, promoting equity-friendly financing models, and encouraging profit reinvestment alongside modern management and technology adoption to boost performance and sustainability.

Keywords: Micro, small and medium enterprises, firm characteristics, equity financing, financial performance, Nakuru County

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Introduction

MSMEs constitute an important driver of economic development in countries and they are the critical to increase competitiveness and the creation of important innovation systems for development countries (Safari, 2020). SMEs are a net worth driver of economic development being vital to most economies across the world and play a role in job creation, poverty alleviation and economic growth, but they encounter many functioning barriers (Zafar & Mustafa, 2017). Verma (2019), states that SMEs covers many economic sectors such as agriculture, health sectors, education among others which forms the major pillars of Sustainable development goals.

Globally, SME accounts for 90% of business and 50% of total employment. MSMEs are the most common type of business in the Europe and they are not only the predominant business, but also the primary driver of employment gross domestic product, and innovation (Garcia-Martinez, Kraus, Breier & Kallmuenzer, 2023). Katsinis et al. (2024), reported that SMEs make up over 99% of business in European Union and the backbone economy and in 2022 about 24.3 million SMEs were active in the EU-27 and SMEs accounted for 99.8% of the enterprises in the non- financial business sector. They added that these SMEs employed 84.9 million people in the EU-27 in the year 2022. SMEs are the backbone of the European economy with strong contribution to employment, innovation, growth and social cohesion (Di Mattia, 2023). Di Mattia adds by saying that SMEs need better regulation, better access to markets and finance, enhancing skills and

training and also digitization and entrepreneurship education.

In Sub Saharan Africa (SSA), SMEs sectors accounts for 90% of the private sector and 50% employment in most African countries. Despite that, SSA faces numerous economic and social challenges such as sustainability which have necessitated the intensification of policy enactment directed towards the development of the SMEs, (Mamman, Bawole, Agbebi & Alhassan, 2019). In Nigeria for instance, most business operate in the form of SMEs and they play a significant role in economic development of Nigeria (Nwachukwu & Ogbo, (2012). Also, an increasing number of SMEs formations have led to growth of the economy. However, an increase in the amount of SMEs enterprises does not contribute to the development of the economy more than the existing business in Nigeria, (Adeosun & Shittu, 2022). Furthermore, Gbandi and Amissah (2014) study indicated that SMEs in Nigeria accounted for more than 90% of firms in the economy. Therefore, this advocated that SMEs played an important role in Nigerian economic growth and development. The contribution of SMEs was clear as they contribute to GDP, employment, export creation and introduction of new technologies.

In South Africa, the SMEs have formed an integral part in the economic development policy and the National Development Plan (NDP) envisaged that 90% of the 11 million jobs will be generated by SMEs in 2030 (Dorasamy & Kikasu, 2024). The Gazette states that support for SMEs constitute major lover in the inclusive transformation of the economy of South Africa. Despite the South Africa government desires to encourage economic growth through SMEs, attempts to ameliorate the difficulties encountered by SMEs are often hindered by lack of resources one of which is business incubation (Rens, Iwu, Tengeh & Esambe, (2021). Rens et al. suggested that at present the volatility of SMEs in South Africa makes them an unreliable part for SA government this is because the government has provided a limited support system. Additionally, government can provide support systems such as policy interventions such as formation of a database for SMEs, improving startup capital and de-risking SMEs finance through credit guarantee (Dorasamy & Kikasu, 2024). In Tanzania, the MSME sector is a key driver of employment, income generation, and GDP growth, with over 3 million enterprises operating in manufacturing, trade, agriculture, and services. Despite their economic significance, MSMEs face major challenges such as inadequate financing, limited market access, low entrepreneurial skills, and bureaucratic barriers, which constrain their growth. Financing remains a critical yet unmet need for stimulating their performance and contribution to the economy (Tonya & Samwel, 2024).

Kenya Vision 2030, the long- term development blue print that seek to transform Kenya into a newly industrialization high middle-income country recognizes the key role of MSMEs in attaining its goals (Marwah, 2023). The report suggests that similarly SMEs are considered as the bedrock for manufacturing and have been identified as central enablers towards realizing the Big Four Transformative Agenda under manufacturing. Approximately 7.41 million MSMEs operate in the country, contributing about 40% of GDP and providing nearly 80% of employment opportunities (Krishnan, Were & Velde, 2019). However, despite their contribution, only about 21% of these enterprises are formally registered, with

the majority operating in the informal sector where access to finance and business development support remains limited (Ministry of Industrialization, Trade and Enterprise Development, 2020). Limited financing capacity has been identified as one of the major barriers hindering MSME growth and sustainability in the country.

Equity financing is one of the most important sources of capital available to MSMEs. It includes retained earnings, owner contributions, and ploughed-back profits, which strengthen financial independence and reduce the cost of borrowing (Noor & Simiyu, 2020). Unlike debt financing, which requires repayment with interest, equity financing provides a safer and more flexible avenue for enterprises, particularly those with limited collateral. Studies show that equity financing has the potential to improve profitability, competitiveness, and long-term financial performance of MSMEs (Muturi & Njeru, 2019; Noor & Simiyu, 2020). Nevertheless, the impact of equity financing on financial performance is not uniform, as it may vary depending on firm-specific characteristics.

Firm characteristics such as firm size, age, management style, and adoption of technology strongly influence how financing decisions translate into financial outcomes. Larger firms benefit from economies of scale, better access to external finance, and reduced information asymmetry, while smaller firms often face financing constraints and higher risks (Beck, & Demirguc-Kunt, 2006). Similarly, younger firms may rely heavily on equity financing for survival and growth, while older firms may diversify into debt financing due to established creditworthiness. These characteristics can therefore moderate the relationship between equity financing and financial performance of MSMEs.

In Nakuru County, MSMEs are a major contributor to the regional economy, accounting for part of the county's 6.1% share of Kenya's GDP in 2017, second only to Nairobi (Nakuru County Statistical Abstract, 2022). The elevation of Nakuru to city status in 2021 has further expanded opportunities for trade, investment, and industrial development, positioning the county as a fast-growing business hub (Nakuru City Board, 2022). Despite these, Nakuru sub counties MSMEs are facing challenges which include inadequate funding and delay disbursement of funds from county treasury, political interference in project implementation, trickle down effects of post covid 19 pandemic, the implementation of the hustler funds and the market expansion and reorganization of trade areas and investments due to the elevation of Nakuru town to city status which has enhanced the county visibility through increase in meetings, incentives, conferences and exhibitions (County Government of Nakuru report, 2023). These challenges raise critical questions on how MSMEs in Nakuru County can effectively use equity financing to improve their financial performance. This study therefore seeks to investigate the moderating role of firm characteristics on the relationship between equity financing and financial performance of MSMEs in Nakuru County.

Theoretical Review

Financing Growth Life Cycle of the Firm Theory

The study was informed by the financing life cycle of the firm theory which was developed by Berger and Udell 1998. According to the financing growth life cycle theory, as with individuals' products entrepreneurial firms go through a life cycle (Berger, Saunders, Scalise &

Udell, (1998). An entrepreneurial firm may be at the idea stage the prototype stage, the rapid growth stage, or the maturity stage. According to the theory, financial needs and financial options vary as the business grows and become more experience. The different forms of financing are closely related to the life cycle of the firm and during the startup period, the sole sources of financing available for SME managers is materialized by the owner's personal capital and public aid. Once in place, the growth phase is generally financed by bank debt through venture capital and finally, during the maturity phase, the objection will be to reduce financial costs and ensure more stable funding. In addition, first firm can finance their operations using internal funds, defaultable long-term debt, and costly equity and secondly firm learn about their profitability over time and face specific volatility (Gamba & Triantis, 2008). The theory is important to the study because during the earliest stages of the firm financing typically comes from the entrepreneurs' personal financial resources and savings or from family and friends. This is because at this stage firm often lacks a viable product, customers or stable resources.

Empirical Review

Equity Financing and MSMEs Financial Performance

A study was done by Chindengwike, (2021), on the effects of equity on financial performance among small business firms in East Africa Countries. The study adopted a panel data research design and cross-sectional survey research design where by secondary data were used. The population applied on the financial records of the 2868. The sample size was 828 observations from 296 small firms registered as manufacturing service. Results revealed that, the equity had statistically negative influence on the financial performance among small business firms of EAC in terms of Return on Capital Employed (ROCE) and Return on Equity (ROE) with P- Values -0.001 and -0.14 respectively and a significant positive influence on the financial performance of small and business firms of EAC in terms of Return on Assets (ROA) with P- Value 0.001.The study recommends small business firms to consider the essential determinants like size of the business which influence the financial performance among small business firms and minimize liquidation risk.

Another study by Safitri and Rita (2022), was carried out on the effects of equity crowding and business partnership relationships on business performance of MSMEs in Santara. The analysis used was a multiple linear regression approach which was processed with SPSS 26.0 software. The sampling technique used was purposive sampling method. Questionnaires were distributed to 83 MSMEs registered. The study proved that equity crowd-funding has a significant positive effect on the performance of MSMEs.

A study was done by Kato and Tsoka (2020), on the impact of venture capital financing on Small and medium sized enterprises performance in Uganda. The study adopted a mixed method and used survey questionnaires administered to 90 SMEs and complemented with data from semi-structured interviews. The results were that the empirical evidence exhibited tremendous growth of venture capital-backed companies in sales turnover, profitability and return on assets matched to the non-venture capital backed firms.

A study was done by Wekesa *et al.* (2023), on effects of equity financing on performance of SMEs in Bungoma County, Kenya. The target population was 4721 licensed SMEs and descriptive and inferential research designs were used. The descriptive statistics results established that majority of the SMEs in Bungoma County have been making use of equity financing in terms of retained earnings, personal savings and contribution from friends. Moreover, the study found that equity financing has a positive correlation with performance of SMEs. Similarly, the study established that equity financing has a positive and significant relationship with performance. Muturi (2019) did a study on effects of equity finance on financial performance of SMEs in Kenya. The target population was 291,449 licensed SMES. Simple random techniques were used to collect the sample for the study. The findings were that equity finances significantly predicted the performance of SMEs in Kenya. The correlation results indicated that there was also a significant positive correlation between equity funds and the size of SMEs. Based on the above discussion, this study hypothesized that;

H_{01}: *There is no significant effects of equity financing on the financial performance of Micro, Small, and Medium Enterprises (MSMEs) in Nakuru County.*

Firm Characteristics and MSMEs Financial Performance

Another study by Sabiya and Joel (2023), examined the influence of firm characteristics on financial performance of pension fund administrators in Nigeria. A sample of 10 was selected through purposive sampling and descriptive Pearson correlation and multiple regression models were employed to analyze data with the help of STATA Version 11. Firm age, board size and expenditure of firms were found to be jointly responsible for about 97% of the change in financial expenditure.

Mugwe, (2019) in his study which sought to determine firm characteristics and capital structures of small and medium enterprises in Kenya correlation survey was adopted and ordinary least square model was applied and descriptive and regression analyses were adopted to analyse the data. The findings were that firm size and age negatively associated with the capital structure. Therefore, firm characteristics will be employed as a moderator to fill in the gap in the existing literature. Based on the above discussion, this study hypothesized that;

H_{02}: *There is no significant effects of firm characteristics on the financial performance of Micro, Small, and Medium Enterprises (MSMEs) in Nakuru County.*

Moderating role of Firm Characteristics

Globally, recent empirical work shows that firm-level traits such as size, age, governance, and technology adoption change how financing affects performance. Prakash and Hawaldar (2024) did a study on moderating role of firm characteristics on the relationship between corporate social responsibility and financial performance, evidence from India. Fixed effect panel regression and generalized method of moments models were employed for data analysis. Firm life cycle was found to have a significant negative moderating effect on private ownership. Ahmed (2023) finds that firm size moderates the capital-structure–profitability relationship: larger firms exhibit different responsiveness to financing choices than smaller firms, which alters the net effect of external equity on performance. Yao et al. (2022) report that firm size and financing constraints jointly shape performance outcomes, with size reducing the negative

effects of financing constraints on performance. Studies of equity crowdfunding, venture capital and disclosure practices also suggest that managerial capacity and information transparency influence whether equity injections translate into higher sales, profitability or firm value (Troise et al., 2022; Singh, 2021). Together, these global studies imply that treating equity financing as a uniform input misses important heterogeneity driven by firm characteristics (Ahmed, 2023; Yao et al., 2022; Troise et al., 2022).

In Africa, the literature similarly reports moderating effects of firm traits on financing–performance links. Evidence from East Africa shows venture capital and equity injections boost SME outcomes where firms possess managerial capability and governance structures that can absorb and deploy new capital (Kato & Germinah, 2021). Studies across African contexts find that firm size, formalization, and governance quality change how external equity (including VC and crowdfunding) impacts growth and profitability: better-capacitated firms capture more value from equity funding, while smaller or informal firms often fail to convert equity into sustained performance gains (Kato & Germinah, 2021; Kato, 2020; Troise et al., 2022). These results point to policy and investor implications: equity programs are more effective when delivered alongside measures that strengthen firm-level capacity and transparency.

In Kenya, empirical work points to a conditional relationship where firm characteristics moderate the equity–performance nexus. Mutende (2017) and related Nairobi Stock Exchange studies show that firm-specific features (size, managerial practices, reporting) alter the strength and direction of financing effects on performance metrics. County-level SME studies in Kenya report positive associations between equity sources (retained earnings, owner contributions, crowdfunding/VC where available) and performance, but note that the benefits vary with firm size, age and managerial competence: better-governed or larger SMEs extract larger performance gains from equity financing than informal, smaller peers (Wekesa, Nderitu, & Muthoni, 2023; Muturi & Njeru, 2019; Mutende, 2017). Based on the above discussion, this study hypothesized that;

H_{02}: *There is no significant moderating effects of firm characteristics on the relationship between equity financing and the financial performance of Micro, Small, and Medium Enterprises (MSMEs) in Nakuru County.*

Conceptual Framework

The conceptual framework of this study (Figure 1) was structured around the effect of equity financing on the financial performance of MSMEs, with firm characteristics serving as the moderating variable. Equity financing, which consists of retained earnings, dividends, crowdfunding, and advances from customers, is the independent variable expected to influence MSMEs' financial performance, measured through indicators such as profitability, sales growth, and return on investment. Firm characteristics, including production capacity, managerial factors, and operational factors, are introduced as moderators that can either strengthen or weaken the relationship between equity financing and financial performance. The framework assumes that while equity financing provides MSMEs with essential resources for growth and expansion, the extent of its impact on financial performance depends on the internal capacities and characteristics of the firm.

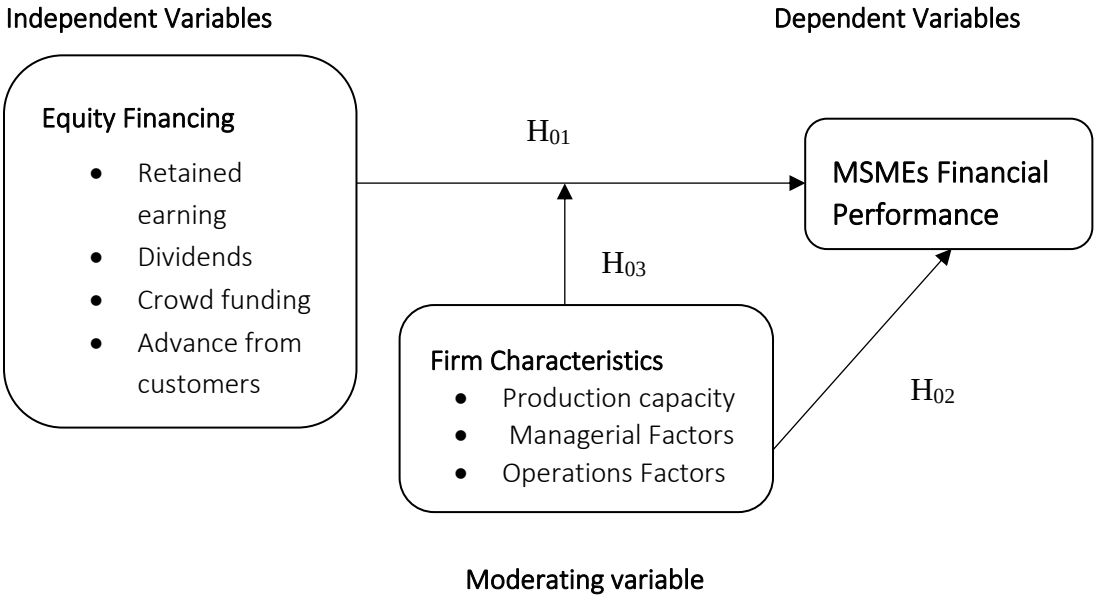

Figure 1: Conceptual framework for the study

Methodology

This study adopted an explanatory research design to investigate the effects of equity financing on the financial performance of Micro, Small, and Medium Enterprises (MSMEs) in Nakuru County, with firm characteristics as a moderating variable. Explanatory research design was appropriate because the study sought to establish cause–effect relationships and provide evidence to support or refute explanatory predictions concerning how equity financing influences financial outcomes among MSMEs when firm characteristics are considered.

The study was conducted in Nakuru County, which is one of the fastest growing business hubs in Kenya with 11 sub-counties and a diverse MSME sector. According to the Nakuru County Statistical Abstract (2022), there are 7,384 registered MSMEs distributed across manufacturing, wholesale and retail trade, transport and storage, accommodation and food services, and agriculture and fishing. These sectors were considered in the study because they represent the major areas in which MSMEs contribute to the local economy.

The target population comprised the 7,384 MSMEs operating in the county. To determine a representative sample size, Taro Yamane's (1967) formula was applied at a 95% confidence level and a 5% margin of error, resulting in a sample of 379 MSMEs as indicated in Table 1.

Table 1: Sample Frame

No.	Stratum	Size of stratum	Sample Size
1.	Manufacturing	1,029	53
2.	Whole sales and retail shops	2,417	124
3.	Transport and Storage	1,924	99
4.	Accommodation and food services	529	27
5.	Agriculture and fishing	1,485	76
Total		**7,384**	**379**

Source: Nakuru County Statistical Abstract (2022).

Stratified random sampling was then used to ensure adequate representation across the five main sectors, after which simple random sampling was applied within each stratum to select respondents.

Primary data was collected using structured questionnaires administered to owners and managers of the sampled MSMEs. Questionnaires were considered appropriate because they are economical, efficient, and reduce interviewer bias. Research assistants trained in finance were engaged to assist in administering the instruments, and ethical considerations were observed in approaching respondents. The questionnaires included both closed-ended and Likert-scale items that captured information on equity financing practices, firm characteristics, and measures of financial performance.

In this study, the independent variable was equity financing, measured through constructs such as retained earnings, dividends, crowdfunding, and advances from customers. The dependent variable was financial performance, measured through profitability, growth, liquidity, and return on equity. The moderating variable was firm characteristics, measured through production capacity, managerial factors, and operational factors. Control variables included internal auditing and managerial experience, as these have been shown in prior studies to influence performance.

Reliability of the research instrument was tested using Cronbach's Alpha, with values of 0.7 and above considered acceptable. Validity was established through content validity checks by experts in finance and business management, and pilot testing was conducted on 37 MSMEs in Uasin Gishu County to refine the questionnaire before the actual survey.

Collected data was processed through editing, coding, and entry into SPSS version 23 for analysis. Descriptive statistics such as frequencies, percentages, means, and standard deviations were used to summarize the data, while inferential statistics, including correlation and multiple regression analysis, were applied to test the study hypotheses. Regression assumptions of linearity, normality, homoscedasticity, and multicollinearity were tested to ensure accuracy of results.To assess the moderating role of firm characteristics, hierarchical regression analysis was applied. The first model tested the direct effect of equity financing on financial performance. The second model incorporated firm characteristics to test their direct influence. The third model included the interaction term between equity financing and firm characteristics to determine the moderating effect. The change in R^2 values between models was used to assess whether firm characteristics significantly moderated the relationship between equity financing and financial performance.

Model 1: Direct effect of equity financing on financial performance

$Y = \beta o + C + \beta 1EQF +$ ε …..$\Delta R2$……Model 1

Model 2: Effect of equity financing and firm characteristics on financial performance

$Y = \beta o + C + \beta 1\mathrm{EQF} + \beta 2\mathrm{FC} +$ ε. …$\Delta R2$……Model 1

Model 3: Moderating effect of firm characteristics

$Y = \beta o + C + \beta 1\mathrm{EQF} + \beta 2\mathrm{FC} + \beta 3M +$ ε. …$\Delta R2$……Model 3

Where:
Y= Dependent Variable (Financial Performance)
β_o = The Constants, β_1, β_2, β_3, are coefficients of estimate
C= Control variables internal auditing and experience
X_1 = Equity Financing
M= Moderator (Firm Characteristics)
ε = Error term

Results and Discussion

Reliability Test

The Cronbach's Alpha reliability analysis in Table 2 showed that equity financing sources value =.614, firm characteristics value=.710, and financial performance value=.674 with the 5 items having a reliability statistic of .698 which is .7. This signified that there was a strong internal consistent and items of measurements were reliable (Izah, Sylva & Hait, 2023).

Table 2: Data reliability test statistics

Scale Mean if Deleted	Scale Variance if Item Deleted	Corrected Item-Total Correlation	Cronbach's Alpha if Item Item Deleted
Equity Financing	12.583	2.781	.531	.614
Firm Characteristics	12.7444	3.208	.314	.710
Financial Performance	12.7197	3.190	.391	.674

Source: Field Data (2024)

Factor Analysis Results

Factor analysis was conducted to test the adequacy of the measurement items for the main study variables: equity financing sources, firm characteristics, and financial performance of MSMEs. The Kaiser-Meyer-Olkin (KMO) measure of sampling adequacy and Bartlett's Test of Sphericity were used to assess data suitability (Table 3).

Table 3: Summary of factor analysis results

	KMO Value	Bartlett's Test (χ^2, df, Sig.)	No. of Items	Factors Extracted (Eigen > 1)	% Variance Explained (Cumulative)
Equity Financing Sources	0.685	χ^2 = 307.423, df = 78, p < 0.001	13	4	44.619% (first 4 factors)
Firm Characteristics	0.666	χ^2 = 94.353, df = 15, p < 0.001	6	2	45.111% (first 2 factors)
Financial Performance (MSMEs)	0.727	χ^2 = 178.197, df = 21, p < 0.001	7	1	28.891% (single factor)

Source: Field Data (2024)

A KMO value of 0.6 and above indicates that the data is appropriate for factor analysis, while a significant Bartlett's test ($p < 0.05$) confirms sufficient correlation among items to justify the procedure (Shrestha, 2021).

The results indicate that all three constructs were suitable for factor analysis. Equity Financing Sources had a KMO value of 0.685 and Bartlett's χ^2 = 307.423 ($p < 0.001$), showing adequacy for analysis. Four factors were extracted, accounting for 44.619% of the cumulative variance, which suggests that multiple dimensions underlie equity financing sources for MSMEs. Firm Characteristics had a KMO of 0.666 and Bartlett's χ^2 = 94.353 ($p < 0.001$). Two factors were retained, explaining 45.111% of the cumulative variance. This shows that firm characteristics are multi-dimensional, with items clustering under two main factors. Financial Performance of MSMEs recorded the highest KMO (0.727) with Bartlett's χ^2 = 178.197 ($p < 0.001$).

Descriptive Results

Equity Financing and Financial Performance

To determine the effects of equity financing on financial performance of micro, small and medium enterprises in Nakuru County, the descriptive statistics results are presented in Table 4.

Table 4: Descriptive statistics for equity financing sources

		Mean	Std. Deviation	Variance	Skewness	Kurtosis
1.	The business Emphasizes on getting funds from retained earnings	2.90	1.432	2.049	.207	-1.328
2.	The business is frequently financed by retained earnings	2.83	1.305	1.704	.347	-0.995
3.	Retained earnings helps in reducing cost operation	3.02	1.490	2.221	0.46	-1.437
4.	Management considers retained earnings as best source of finance	3.41	1.318	1.736	-.378	-1.075
5.	The business is very dynamic and considers donations from different sources	3.17	1.376	1.895	-.101	-1.280
6.	The business is committed in ensuring that donations are effectively and efficiently utilized	3.09	1.302	1.696	0.33	-1.114
7.	The size of investment considers donations as the good form of finance	3.07	1.358	1.843	-.015	-1.221
8.	The business define success on the basis of having the most unique or newest donation	2.94	1.316	1.733	0.89	-1.176

9.	The business considers ploughed back profit as major source of finance	2.94	1.350	1.823	.099	-1.227
10.	Most frequently the business plough back profit	3.09	1.305	1.704	-.060	-1.127
11.	The business considers investing through ploughed back profit	3.11	1.344	1.807	-0.116	-1.225
12.	The profit is always available for the use by the business	3.09	1.375	1.891	-0.030	-1.301
13.	Advance from customers enhances business expansion	3.07	1.389	1.928	-0.081	-1.299

Valid N (listwise)

Source: Field Data (2024)

From Table 4 it was evident that MSMEs emphasizes on getting funds from retained earnings as indicated by (Mean-2.9 and Std Deviation of 1.432). The business also is frequently financed by retained earnings (Mean 2.83 and St. Deviation of 1.305). Retained earnings by MSMEs helped in reducing cost of borrowing (mean of 3.02 and Std. Deviation of 1.490). Management also considered retained earnings as best source of finance (Mean of 3.41 and Std. deviation of 1.318). From the results also, the MSMEs were very dynamic and considered donations from different sources as indicated by a mean of 3.17 and Std. deviation of 1.376. The businesses also were committed in ensuring that donations are efficiently and effectively used as indicated by a mean of 3.09 and Std. deviation of 1.302. On the other hand, size of investment considered donations as the good form of finance by a mean of 3.07 and std. deviation 1.358. The businesses defined success on the basis of having the most unique or newest donation as indicated by a mean of 2.94 and std. deviation of 1.316. To add, Nakuru MSMEs considered ploughed back profit as major source of finance (mean 2.94 and Std. deviaon1.50. Furthermore, most frequent the MSMEs ploughed back profit (mean 3.09 and Std. deviation 1.305) and considered investing through the ploughed back profit (mean 3.11 and Std. devaition1.344). Finally, the profit is always available for the use by the business (mean 3.09 and std. deviation 1.375) and advance from customers enhanced business expansion (mean 3.07 and std. deviation1.389).

Firm Characteristics and Financial performance

To explore the moderating role of firm characteristics on financial performance of micro, small and medium enterprises, the below Table 5 presented the descriptive statics results. The results were that consultation in decision making influenced Nakuru MSMEs financial performance as indicated by the mean of 3.13 and Std. deviation of 1.286 and the use of modern technology influenced MSMEs financial performance as shown by the mean of 3.36 and Standard deviation of1.331. Financial reporting style also affected MSMEs credit source as indicated by a mean of 3.33 and Standard deviation of 1.280. Additionally, the total output influenced MSMEs performance and financial assistance and indicated by a mean of 3.34 and Standard deviation of 1.317. Through the descriptive statistics, it

was evidence that there was an initiative in new innovation of MSMEs as shown by a mean of 3.17 and Std. deviation of 1.348. Finally, the frequency of MSMEs owners' meetings affected their financial performance as indicated by a mean of 3.02 and standard deviation of .1.307.

Table 5: Descriptive statistics for firm characteristics

		Mean	Std. Deviation	Variance	Skewness	Kurtosis
1	Consultation in decision making, influences your firm financial performance	3.13	1.286	1.653	.017	-1.138
2	Use of modern technology influences your firm financial performance	3.36	1.331	1.771	-.272	-1.158
3	Your financial reporting style affects your credit source	3.33	1.280	1.639	-.216	-1.115
4	Your total output influences your performance and financial assistance	3.34	1.317	1.734	-.344	-1.079
5	You have an initiative in new innovation of your firm	3.17	1.348	1.816	-.135	-1.232
6.	Frequency of meetings affects your firm financial performance	3.02	1.307	1.709	0.52	-1.142

Source: Field Data (2024)

Financial Performance of MSMEs in Nakuru County

From the data analyses on financial performance the results presented in Table 6 indicated that business sales of Nakuru MSMEs have been increasing as indicated by a mean of 3.00 and standard deviation of 1.276. There was also more customer inflow (mean 3.2 and Std. deviation1.334). Additionally, internal finances supported Nakuru MSMEs higher profits (Mean 3.25 and Std. deviation1.339) and external finance source increased profits (mean 3.28 and std. deviation 1.304).

The management style promoted the MSMEs financial performance 3.14 and 1.351 and the production capacity also promoted Nakuru MSMEs financial performance (Mean 3.05 and Std. deviation) 1.405. Operations of the business affected financial performance as indicated by mean 3.18 and standard deviation of 1.32. Furthermore, the data was normally distributed with skewness in the range of -1 to +1, and kurtosis was within the range of -3 to +3.

Table 6: Descriptive Statistics for MSMEs Financial Performance

		Mean	Std. Deviation	Variance	Skewness	Kurtosis
1	The business sales have been increasing	3.00	1.276	1.629	.160	-1.1
2	There has been more customer	3.20	1.334	1.779	-.210	-1.1

	inflow					
3	There is a need for internal finances to support your business for higher profits	3.25	1.339	1.793	-.203	-1.2
4	There is a need for external resources to support your business for high profits	3.28	1.304	1.702	-.157	-1.1
5	Your management style promotes The business financial performance					
6.	Your production capacity promote the business financial performance	3.05	1.405	1.973	-.015	-1.3
7.	Operations of the business affects financial performance	3.18	1.321	1.745	-.166	-1.1

Source: Field Data (2024)

Hypothesis Testing

Effects of Equity Financing Sources and MSMEs Financial Performance

The first hypothesis (H_{01}) stated that equity financing has no significant effect on the financial performance of MSMEs in Nakuru County. Results from Model 1 presented in Table 7 showed that equity financing explained 15.2% of the variation in financial performance (R^2 = 0.152, Adjusted R^2 = 0.141), with a weak but significant correlation (R = 0.390). The ANOVA results confirmed model significance (F = 13.294, p = 0.000). Coefficients indicated a positive and significant effect of equity financing on MSME performance (β = 0.147, p = 0.008).

Table 7: Effect of Equity Financing on MSMEs Financial Performance

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of Estimate
2	.390	.152	.141	.552

ANOVA[a]

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	20.283	5	4.057	13.294	.000b
Residual	112.901	370	.305		
Total	133.184	375			

Coefficients[a]

Predictor	B	Std. Error	Beta	t	Sig.
Constant	1.905	.209	–	9.100	.000
Equity Financing Sources	.147	.055	.162	2.678	.008

Dependent Variable: MSMEs Financial Performance
Source: Field Data (2024)

These findings led to the rejection of H_{01}, demonstrating that equity financing contributes positively to the financial performance of MSMEs in Nakuru County.

This outcome is consistent with earlier evidence that equity-based sources such as retained earnings, personal savings, and crowdfunding enhance firm growth and profitability. Chindengwike (2021) found that equity financing positively influenced financial performance among small business firms across East African countries, using panel and cross-sectional survey data. Similarly, Safitri and Rita (2022) reported that equity crowdfunding significantly improved MSME performance in Santara, indicating the growing relevance of alternative equity sources. In Uganda, Kato and Tsoka (2020) established that venture capital-backed SMEs exhibited superior growth in sales, profitability, and return on assets compared to non-venture capital-backed firms, further supporting the positive effect of equity financing. Wekesa et al. (2023) revealed that equity financing sources such as retained earnings, personal savings, and contributions from friends were positively and significantly correlated with SME performance in Bungoma County. Likewise, Muturi (2019) demonstrated that equity finance significantly predicted financial performance of SMEs in Kenya, with a strong positive correlation between equity funds and firm growth.

Effects of Firm Characteristics on MSMES Financial Performance

The second hypothesis (H_{02}) proposed that firm characteristics have no significant influence on the financial performance of MSMEs in Nakuru County.

Table 8: Effect of firm characteristics on MSMEs financial performance

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of Estimate
3	.435	.189	.176	.541

ANOVA[a]

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	25.176	6	4.196	14.335	.000b
Residual	108.008	369	.293		
Total	133.184	375			

Coefficients[a]

Predictor	B	Std. Error	Beta	t	Sig.
Constant	1.527	.225	–	6.789	.000
Equity Financing	.139	.054	.154	2.590	.010
Firm Characteristics	.182	.045	.201	4.089	.000

Dependent Variable: MSMEs Financial Performance

Source: Field Data (2024)

Results from Table 8 showed that the relationship was statistically significant (R^2 = 0.189, F = 14.335, p = 0.000). The coefficients confirmed a positive effect of firm characteristics on financial performance (β = 0.182, p < 0.05). This implies that firm-specific factors such as size, managerial practices, and operational capacity play an important role in driving MSME performance, leading to the rejection of H_{02}. These findings align with global evidence. Nisha (2024) found that firm life cycle significantly moderated the

relationship between CSR and financial performance in India, while Sabiya and Joel (2023) showed that firm age, board size, and expenditure strongly influenced financial outcomes in Nigeria. Regionally, Mugwe (2019) established that firm size and age affected capital structure choices of SMEs in Kenya, with younger and smaller firms facing financing constraints, unlike larger and more experienced ones that perform better due to stronger networks and managerial capacity.

Testing of the Moderation

The third hypothesis (H03) stated that firm characteristics do not moderate the relationship between equity financing and the financial performance of MSMEs in Nakuru County. Results from Model 3 showed otherwise. According to the results presented in Table 9, the interaction between firm characteristics and equity financing was statistically significant ($R = 0.466$, $R^2 = 0.218$, $F = 14.383$, $p = 0.000$). The coefficients revealed a positive moderating effect ($\beta = 0.251$, $t = 3.628$, $p < 0.05$), indicating that firm characteristics strengthen the influence of equity financing on MSME financial performance. Consequently, H_{03} was rejected. These findings align with global evidence that firm-level traits shape financing outcomes. Ahmed (2023) and Yao et al. (2022) showed that larger firms benefit more from external financing and face fewer constraints, while Troise et al. (2022) and Singh (2021) highlighted managerial capacity and transparency as key for translating equity funding into profitability. In Africa, Kato and Germinah (2021) found that equity injections improved SME outcomes only when firms had strong governance, with larger and formalized firms performing better than smaller, informal ones (Kato, 2020; Troise et al., 2022). Mutende (2017) and county-level evidence (Wekesa, Nderitu, & Muthoni, 2023; Muturi & Njeru, 2019) show that firm size, age, and governance moderate the equity–performance link, with better-managed MSMEs gaining more from equity financing than their smaller counterparts.

Table 9: Regression results for the moderating effects of firm characteristics

Model Statistics	Values
R	0.466
R^2	0.218
Adjusted R^2	0.202
F Statistic	14.383
Sig. (p-value)	0.000

Variable	β	t	p-value
Constant	1.669	7.352	0.000
Equity Financing Sources (EF)	0.078	1.394	0.164
Firm Characteristics (FCHAR)	0.170	3.825	0.000
Interaction: Firm Characteristics × EF	0.251	3.628	0.000

Dependent Variable: Financial Performance (FP)
Source: Field Data (2024

Conclusion

The study investigated the relationship between equity financing and the financial performance of Micro, Small, and Medium Enterprises (MSMEs) in Nakuru County, Kenya and assessed the moderating role of firm characteristics. Descriptive results revealed that retained earnings, ploughed-back profits, donations, and customer advances are key in financing business operations. Regression results further confirmed that equity financing positively and significantly affects MSMEs' performance, as indicated by increased profitability, sales growth, and operational sustainability. Firm characteristics such as decision-making processes, adoption of modern technology, financial reporting styles, production capacity and managerial practices also showed a strong positive and significant effect on financial performance. Moreover, the moderating test revealed that firm characteristics strengthened the relationship between equity financing and financial performance. This implies that equity financing alone cannot guarantee strong financial outcomes unless supported by internal firm capacities such as sound governance, efficient operations, and managerial competence. The study therefore concluded that equity financing, when complemented by favorable firm characteristics, enhances MSME growth and financial sustainability.

Recommendations

The Nakuru County Government, particularly the Department of Trade and MSME Development, should shift its focus from merely facilitating external credit to promoting internal financial capacity building. Given that retained earnings and ploughed-back profits are the primary and most valued sources of finance, the government should prioritize funding for subsidized training programs focused on financial management, strategic profit retention, and working capital optimization. Furthermore, to address the proven importance of firm characteristics, policy should encourage the adoption of modern technology and standardized financial reporting. This can be achieved through small grants or subsidies for business software and by collaborating with professional bodies to simplify and standardize templates for formal financial statements, which would, in turn, reduce information asymmetry and ease MSMEs' access to formal external credit.

Financial institutions, including commercial banks and microfinance entities, need to innovate beyond traditional debt financing. They should develop equity-friendly financial products such as flexible venture debt, revenue-based financing, or profit-sharing agreements that require less upfront collateral and align more closely with the risk profiles and preferences of MSMEs.

MSME owners must adopt a more strategic and formal approach to internal capital management. They should institute a mandatory policy for systematic profit retention and reinvestment (ploughing back profits) rather than relying on ad-hoc decisions, treating this internal equity as the foundation for sustainable growth. Given the significant moderating role of firm characteristics, managers should also view investment in technology adoption, quality financial record-keeping, and improved management consultation styles not as costs, but as essential investments that directly amplify the returns generated from their equity financing, thereby improving overall firm performance and creditworthiness.

Suggestion for Further Study

The study concentrated on the moderating role of firm characteristics on

the relationship between financing sources and financial performance of MSMEs in Nakuru County. The independent variable were equity financing sources, debt financing sources and government financing programs, the moderating variable was firm characteristics while the independent variable was financial performance. The study took place in Nakuru County, Kenya. Therefore, other study should be carried out to incorporate other variables that affect financial performance of MSMEs.

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