

Influence Of Earnings Management On Financial Performance Of Agricultural Firms Listed In Nairobi Securities Exchange

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Abstract

The objective of the study was to determine the influence of earnings management on the financial performance of agricultural firms listed in Nairobi Securities Exchange. A descriptive survey research design was applied. A Census of all the 6 companies listed in Nairobi Securities Exchange as at July 2014 to July 2019 constituted the study population. The study employed secondary data extracted from audited financial statements and individual companies annual report for the five year period covering July 2014 to July 2019. Record survey sheet was used when collecting data for independent and dependent variables. Data collected was analyzed by using descriptive and inferential statistics. Under descriptive statistics the study considered; Mean, Minimum, Maximum and Standard deviation. For inferential statistics the study considered correlation and multiple regression. Statistical Package of Social Science (SPSS) software program was applied in the analysis of the study with respect to the objectives of the study. The study found out that earnings management has a positive significant effect on financial performance. Earnings management has a positive relationship with the Return on Investment (ROA) of the firms under study. The study recommended that agricultural firms listed in NSE should adopt prudent earnings management.

Key Words: Earnings management, Financial Performance

Date of Submission: 13-02-2021

Date of Acceptance: 27-02-2021

I. Introduction

The success of any organization depends on sound financial management. Financial managers execute financial management practices that determine the success of an organization. Chung and Chuang, (2010) have classified financial management practice into liquidity management, investment management, financing, earnings management, capital budgeting and accounting information system. Inefficient financial management, combined with the uncertainty of the business environment often leads Business Enterprises to serious problems (Dawson, 2013). Patra (2009) argued that financial management helps to improve the profitability position of business organizations with the help of strong financial control devices such as budgetary control and ratio analysis. Therefore the close relationship of agricultural firms performance must grow increasingly for it to prompt economic growth (Nyoro *et al*, 2012)

A study by Ikapel and Kajirwa (2017) on the effects of long-term debt on the financial performance of firms revealed that a considerable negative association between long-term borrowed funds and the financial performance. A study by Hassan and Ahmed (2012) which was conducted in Nigeria, examined the impact of corporate governance and earnings management of firms financial performance of manufacturing firms in the country. The study employed Jones discretionary accrual model to measure earnings management and ordinary least square regression model to measure the relationship between earnings management and performance. Peter and Nelson (2020), in their study on effect of financial management practices on firm performance in Nigeria revealed that, earnings per share and working capital management signified by account receivables is found to have positive and statistically significant effect. The relation between earnings per share and account payables is established to be negative and statistically insignificant for the Nigerian companies under study.

Munene and Ntoiti, (2016) in their study of the effect of accounting information on firm financial performance: a case of agricultural firms listed in the Nairobi Securities Exchange found that liquidity was a major tool in figuring out financial performance; efforts to kindle liquidity would see agricultural firms recognize financial performance increase and a significant positive relationship between level of dividend payout and financial performance. Healthy dividends payouts show that companies are making real earnings. Munene and Ntoiti, (2016) also noted that the companies listed in the Nairobi Securities Exchange should ensure that they have a good dividend policy in place that can improve their profitability level and attract investments as well.

According to Kitonga (2013) in his study of the relationship between financial management practices and financial performance in the shipping industry in Kenya, he found that without proper financial management practices, shipping Industry Companies financial performance would be non-satisfactory if all other factors are held constant. According to Koskei (2017) examined the relation between long-term debt ratio, debt to asset ratio, debt to equity ratio and the financial performance of the private sugar manufacturing companies in Kenya. The study carried out a survey on all six private sugar companies in Kenya and used on secondary data.

Statement of the Problem

According to Kenya National Bureau of Statistics (2016), agricultural sector in Kenya is one of the core sectors backing the Kenyan economic growth. According to the statistics report, it shows that the performance of agricultural firms at Nairobi Securities Exchange keeps on reporting a decline hence raises a major concern to the future of the Kenyan economy. That is, the performance of quoted agricultural based companies in terms of financial metrics has become an issue of common concern of the stakeholders including the shareholder, the creditor, the company's staff and the government administration. According to NSE investors handbook (2017-2018), financial review report showed that out of all the seven listed agricultural firms, four of them indicated poor performance within the period 2014 to 2018. Eaagads Ltd, Limuru Tea Company, Sasini and Rea Vipingo where some experienced decline in profits others experienced losses and some were placed under receivership.

According to Wamalwa (2010), most firms in the agricultural sector have not lived to their expectations and have led to shareholder apathy thereby contributing to the decline of the rural economy due essentially to unstable and low dividend payout by most agricultural firms. Previous studies also conducted in Kenya have not addressed financial management practices exclusively. For instance, Nyamao, Ojera, Lumumba, Odondo, and Otieno,(2012) considered financial management practice in terms of efficiency of cash, inventory and receivables management, while Mathuva (2009) considered financial management practice in terms of the operating cycle, other researchers have only concentrated on working capital. It was against this background that this study was carried out.

Objectives of the Study

The objective of this study was to determine the influence of earnings management on financial performance of agricultural firms listed in Nairobi Securities Exchange. The study was guided by the following hypothesis;

- **H₀:** There is no significant relationship between earnings management and performance of agricultural firms listed on Nairobi Securities Exchange.

II. Literature Review

Pecking Order Theory

The pecking order theory recommends that organizations have a specific inclination request for capital used to back their organizations (Myers, 2016). Inferable from the data asymmetries between the firm and possible speculators, the firm will lean toward held income to obligation, transient obligation over long haul obligation and obligation over value. Myers (2014) contended that if firms issue no new security yet just utilize its held income to help the venture openings, the data topsy-turvy can be settled. That infers that responsible value turns out to be more costly as deviated data insiders and untouchables increment. Firms whose data asymmetry is enormous should give obligation to abstain from selling undervalued protections. The capital structure decreasing events such as new stock offering leads to a firm's stock price decline.

A declaration of expanding capital structure occasions is gotten by the market as uplifting news in light of the fact that money related middle people like speculation bank can become insiders to screen the organizations execution. Supervisors may have inside data that isn't known to the market. Insider financial specialists have more data about the genuine circulation of firm returns than untouchables. Insider financial specialists will in general cutoff the utilization of value so as to hold control of the firm Maksimovic, V. (2011). Moreover, the risk of the firm's return is unknown to investors. They are forced to rely on noisy signals such as the firm's level of capital structure to determine the risk of their investment and firm's value may be underpriced by the market (Myers 2014).

An association needs to design and think about how to stand up to future possible dangers and openings by building up a productive arrangement of control, an indicator of fluctuations between authoritative destinations and execution (Anthony and Govindarajan, 2007). Spending plans are viewed as the center component of a proficient control-process and subsequently imperative part to the umbrella idea of a viable MCS (Nimalathasan, & Valeriu, 2010). As a forward looking set of numbers, budgets project future financial management practice on performance which enables evaluating the financial viability of a chosen strategy (King, Clarkson & Wallace, 2010).



Figure 1: Conceptual Framework

Empirical Review

Concept of Financial performance

As per Jensen (1986) debt financing raises the pressure on managers to perform, in light of the fact that it lessens the ethical peril conduct by decreasing free income at the disposal of managers. Consequently, the organizations with the higher leverage ought to be the most impelled to improve their exhibition. However, as indicated by Jensen and Meckling (2017) on the opposite side, a higher influence implies higher office costs due to the separating interests among investors and debt holders: this ethical risk issue proposes that influence might be adversely connected to execution. As indicated by Grossman and Hart (2012), the influence can function as disciplinary gadget that controls the administration from squandering their organizations assets.

William (2008) discovered that choice for high influence by the administration diminishes the conflict among the board and investors. The investigation directed by Krishnan and Moyer (2010) found a negative and huge connection among influence and firms execution while different components influencing firms execution decidedly incorporates size, development, duty and hazard. The discoveries of Zeitun and Tian (2017) demonstrated that influence has a huge and negative relationship with firms execution. They utilized influence, development, size, expense, hazard and substantial quality as autonomous variable to see their impact on firms execution. They inferred that organizations size and assessment have positive and critical relationship with firms execution while hazard and substantial quality have negative and noteworthy relationship with firms execution.

Earnings Management and Financial performance

Earnings management is the act of controlling firms profit so as to guarantee that fiscal report look superior to their unique status. The meaning of profit the executives contrasts relying upon how somebody think about the act of overseeing income, for the individuals who acknowledge the act of profit the executives demonstrating it is useful for the firm, they characterize income the board as the methods utilized by administrators to improve the money related situation of the firm (Healy &Helen, 1999). For the individuals who see profit the board into a negative way considers the training as control of income by the executives so as to increase out of it or to show that the organization is performing while it isn't to the detriment of the investors riches just as the financial specialists (Ronen &Yaari, 2008). According to Scott (2000), earnings management refers to the power given to managers of the company to choose accounting methods and procedures in order to achieve some specific objectives. By this definition, it means managers select accounting procedures and methods that give them advantage as they help to show that the company is performing well. On the other hand, Fischer (1994) indicated that earnings management is all about managerial operations with aim of increasing or decreasing the reported earnings but which does not change long-term profitability of the economic entity.

Several studies on the relationship between earnings management and financial performance have been carried out; the study by Hassan and Ahmed (2012) which was conducted in Nigeria, examined the impact of corporate governance and earnings management of firms financial performance of manufacturing firms in the country. The study employed Jones discretionary accrual model to measure earnings management and ordinary least square regression model to measure the relationship between earnings management and performance. The study reports presence of significance relationship between the firms performance, corporate governance and earnings management. The investigation by Chiraz and Anis (2013) inspected the connection between earning and execution of French IPO organizations. The discoveries of the investigation show that organizations with forceful profit the executives in the IPO procedure, will in general experience the ill effects of hence helpless returns and to delist for execution. The investigation additionally detailed that, no proof was found to propose that the degree of introductory return is adversely identified with optional current collections.

A study conducted by Ardekan *et al.*(2012) examined the acquisition, earnings management and firms performance in Malaysia. The study focused on examining the relationship between earnings management and performance of the acquiring firms in the country. The study used accumulated abnormal return as the measure of performance while earnings management was measured using discretionary accrual basing on Jones revised model of 1991. The findings of the study show those firms, which acquire shares, manipulate earnings as compared to firm, which acquire by cash especially preceding the acquisition announcement date. The findings of the study also show presence of negative relationship between earnings management and the performance of the firms. Raoli(2013) in Italy examined whether managers do engage in earnings management to support firms market valuation in the countrys financial market. The study used total accrual as the proxy measure of earnings

management, while the firm value was measured using the change in market to book ratio. The findings of the study show that, the firms market value in Italy market is positively associated with earnings management. The study by Gong *et al.* (2008) which assessed earning management and firms performance after open market repurchases in USA. The study used abnormal accruals as a measure for earning management as per Jones modified model of 1991. The study used return on asset (ROA) as the measure of firms performance. The findings of the study show that during the pre-repurchase, the abnormal accruals which are the measure of earnings management is negatively associated with future performance of the firm.

Likewise, other previous studies have examined the relationship between earnings management and other variables of the firm. The study by Izadinia *et al.* (2014) examined the relationship between earnings management and social responsibility of the firms listed at Tehran Stock exchange. The findings of the study show presence of negative relationship between earnings management and corporate social responsibility but financial performance of the firm was found to have positive relationship with earnings management while organization commitment was found to be negatively related with earnings management. Other studies on earnings management include, the study conducted by Putri (2013) on the relationship between earnings management and value relevance in Indonesian Stock exchange, reported that, earnings management has negative impact on value relevance and the book value. Likewise, Eman (2010) also examined the impact of earnings management on the value relevance earnings and book value, the findings of the study indicated that earnings management have negative impact on firm value.

Study conducted by Lukani (2013) on earnings management and firm size in Albanian Market, reported that, firms in Albanian market engage in earnings management activities and there were no significant differences between earnings management initiatives and practices among small and large size companies. This study used Jones modified model for discretionary accruals to measure the earning management level of the firms. The study conducted by Gill *et al.* (2013) examined the relationship between earnings management and value of the firm of manufacturing firm in India. The results show that, the practice of earnings management is so greater and has diverse effect on corporate rate of return on assets. The study also found that, when the market recognizes about the managers behavior on managing earnings or acting on their own motives. The study by Sayari *et al.* (2013) on the impact of earnings management on stock return in Tunisia firms also reported similar findings to the above studies. The results of the study show that earnings management based on discretionary accruals have significant impact on firm value. Study by Fattahi *et al.* (2014) which examined the impact of earnings management on value relevance of accounting information of listed firms at Tehran Stock exchange report different findings contrary to what was reported by the above studies. According to this study, earning management does not have any significant relations to the value relevance of accounting information.

According to Kitonga (2013) in his study on the relationship between financial management practices and financial performance in the shipping industry in Kenya, he found out that without proper financial management practices, shipping Industry Companies financial performance would be non-satisfactory all other factors held constant. Muiruri N.W. and Wepukhulu, J.M. (2018) recommended in their study on effects of investment decisions on listed firms at Nairobi Securities Exchange that since investment decisions affect performance positively and significantly there is need for listed firms to focus more investing in firm machinery, property, plants and equipment so as to boost their investment returns. Peter and Nelson(2020),in their study on effect of financial management practices on firm performance in Nigeria revealed that, earnings per share and working capital management signified by account receivables is found to have positive and statistically significant effect. The relation between earnings per share and account payables is established to be negative and statistically insignificant for the Nigerian companies under study.

III. Methodology

This study employed descriptive survey design. The target population comprised of 6 agricultural companies that had been listed in NSE. These Companies were Eaagads Ltd, Kapchorua Tea, Kakuzi, Limuru Tea, Sasini Ltd and Williamson Tea. The sampling technique used in the study was census. The study adopted census because the size of target population in the area of study was small. The study used secondary sources to obtain data. Secondary data was obtained from audited financial statements of the selected agricultural firms and through published journals and NSE documentations. All the data collected were coded and entered into an SPSS sheet, organized and cleaned for any inconsistencies. The data then was processed using Statistical Packages for Social Sciences software (SPSS 23). Finally the data was analyzed using descriptive and inferential statistics. Statistical analysis was performed using Statistical package of Social Sciences (SPSS version 23.0).

IV. Results And Discussion

Response Rate

The study used secondary data. The target population was 6 agricultural firms listed at NSE. The researcher was able to obtain all the required data pertaining all the six agricultural firms resulting to 100%

response. According to Kothari ,(1993) over 60% return rate was acceptable return for survey study and as such this study is far above the required thresh hold.

Inferential Statistics

The results of correlation analysis were presented where the relationships between the dependent variable (financial performance) and the independent variable epitomized by earnings management were taken. The results of simple linear regression were also done.

Effect of Earnings Management on Financial Performance in Agricultural Firms Listed at NSE

This objective sought to address the relationship between earnings and financial performance in the selected agricultural segment.

Correlation between Earnings Management and Financial Performance

The Pearson correlation analysis was used to investigate the relationship between earnings management and financial performance. The correlation strengths were interpreted using Cohen (1988) decision rules where r values from 0.1 to 0.3 indicate weak correlation, 0.31 to 0.5 indicate moderate correlation strength and greater than 0.5 indicate a strong correlation between the variables. The results were as shown in Table 1.

Table 1: Correlation of Earnings Management and Financial Performance

		Earnings Management	Financial performance
Earnings Management	Correlation Coefficient	1.000	
	Sig. (2-tailed)	.	
	N	317	
Financial performance	Correlation Coefficient	.529**	1.000
	Sig. (2-tailed)	.000	.
	N	317	317

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

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

In determining the effect of earnings management on financial performance, the study established a coefficient of correlation (r) as 0.529**. The results indicated that the relationship between earnings management and financial performance is positive and significant. This implied that financial performance increase with improvement in earnings management. The outcomes were conversely with Chiraz and Anis (2013) who inspected the connection between income the board and execution of French IPO organizations. The discoveries of the examination showed that organizations with forceful profit the executives in the IPO procedure, will in general experience the ill effects of in this way helpless returns and to delist for execution. The examination additionally revealed that, no proof was found to propose that the degree of beginning return is adversely identified with optional current accumulations.

Regression Results of Earnings Management and Financial Performance

Regression analysis was used to tell the amount of variance accounted for by one variable in predicting another variable. Regression analysis was conducted to find the proportion in the dependent variable (financial performance) which can be predicted from the independent variable (earnings management). Table 2 showed the analysis results.

Table 2: Regression Results of Earnings Management and Financial Performance

Model Summary						
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate		
1	.529 ^a	.280	.278	.5115918		
a. Predictors: (Constant), Earnings Management						
ANOVA ^a						
Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	32.033	1	32.033	122.391	.000 ^b
	Residual	82.444	315	.262		
	Total	114.477	316			
a. Dependent Variable: Financial performance						
b. Predictors: (Constant), Earnings Management						
Coefficients ^a						
Model		Unstandardized Coefficients		Standardized Coefficients	Sig.	
		B	Std. Error	Beta		
1	(Constant)	1.472	.171		8.624	.000
	Earnings Management	.585	.053	.529	11.063	.000
a. Dependent Variable: Financial performance						

From table 2 above the value of R square was 0.280 this showed that earnings management explains 28.0% of Agricultural firms listed at NSE. From the ANOVA table significance of the model has a value $F(1,316) = 122.391$, $P < 0.01$ this showed that its significant at 99% confidence level hence the model is feasible. This implies that earnings management is a useful predictor of financial performance in agricultural firms listed at NSE. The un-standardized regression coefficient value of earnings management was 0.585 at significance level of $p < .001$. This indicated that a unit change in earnings management would result to significant change in financial performance by 0.585

Hypotheses Testing

H₀: There is no significant relationship between Earnings management and financial performance of agricultural firms listed in the NSE.

From the Multiple Regression results it showed that earnings management significantly influences financial performance among agricultural firms listed on NSE, since the $p < 0.01$, $r = .529$ and $\beta = (.585)$. Thus the null hypothesis was rejected. This implied that earnings management has a significant effect on financial performance hence rejecting the null hypotheses and encouraging agricultural firms to manage well earnings. These findings agreed with findings from a study carried out by Hassan and Ahmed (2012) which examined the impact of corporate governance and earnings management on firms financial performance of manufacturing firms in Nigeria. And found out that there exists a significance relationship between the firms performance, corporate governance and earnings management. This findings contradicts with the findings of a study carried out by Fattahi *et al* (2014) on his study on the effects of accounting information on the performance of listed firms at Tehran stock exchange which revealed that earnings has no significant relation on accounting information on firms listed at Tehran stock exchange.

V. Conclusion And Recommendations

The objective was to explore the influence of earnings management on financial performance of agricultural firms listed on Nairobi Securities Exchange. Earnings managements results showed positive effect on financial performance. From the ANOVA table significance of model has a value which is significant at 99% confidence level hence model is feasible. This implies that the earnings management is a useful predictor of financial performance of agricultural firms listed at Nairobi Securities Exchange; hence fourth null hypothesis is rejected.

Earnings management had a positive significant effect on financial performance of agricultural firms listed at the Nairobi securities exchange. The revelations above implied that agricultural firms can advance financial performance by efficient management of liquidity and earnings management. For agricultural firms to prosper then it is essential that they have the best financial management practices. So time should be taken to develop and implement strategies geared towards proper Liquidity and earnings management to improve the bottom line.

Relying on the findings of this particular study, the study puts forth that the management team of agricultural firms listed at the NSE should put more emphasis on Earnings management so as to improve the financial performance of agricultural firms listed on NSE. Performance reviews on the senior management should also focus on earnings management for improved financial performance.

Suggestions for further Study

From the findings the researcher recommended the following areas for further study; a study to be carried out to establish the effects of non-financial practices on financial performance of the same firms under the recent period.

Effects of investment management on the relationship between financial management practices and financial performance should also be further investigated to clear any conflicts between theory and Empirical findings by various researchers.

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Phyllice Jeruto Gerio (MBA), et. al. "Influence Of Earnings Management On Financial Performance Of Agricultural Firms Listed In Nairobi Securities Exchange." *IOSR Journal of Economics and Finance (IOSR-JEF)*, 12(1), 2021, pp. 33-39