IOSR Journal of Economics and Finance (IOSR-JEF)
e-ISSN: 2321-5933, p-ISSN: 2321-5925. Volume 12, Issue 1 Ser. VII (Jan. – Feb. 2021), PP 33-39
www.iosrjournals.org

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

Phylice Jeruto Gerio (MBA), [1*] Dr. Robert Egessa (Ph.d), [2] Dr. Ondiek Benedict Alala (Ph.d) [3]
[1*] *Jomo Kenyatta University of Agriculture and Technology [JKUAT], Kenya*
[2,3] *Senior Lecturer, Masinde Muliro University of Science & Technology [MMUST], Kakamega, Kenya*

Abstract
The objective of the study was to determine the influence of earnings management on the financal performance of agricultural firms listed in Nairobi Securities Exchange. A descriptive survey research design was applied. A Census of all the 6 companies listed inNairobi 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 financal 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 financal management. Financial managers execute financal management practices that determine the success of an organization. Chung and Chuang, (2010) have classified financal management practice into liquidity management, investment management, financing, earnings management, capital budgeting and accounting information system. Inefficient financal management, combined with the uncertainty of the business environment often leads Business Enterprises to serious problems (Dawson, 2013). Patra (2009) argued that financal 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 financal performance of firms revealed that a considerable negative association between long-term borrowed funds and the financal performance. A study by Hassan and Ahmed (2012) which was conducted in Nigeria, examined the impact of corporate governance and earnings management of firms financal 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 financal 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 financal performance: a case of agricultural firms listed in the Nairobi Securities Exchange found that liquidity was a major tool in figuring out financal performance; efforts to kindle liquidity would see agricultural firms recognize financal performance increase and a significant positive relationship between level of dividend payout and financal 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 financal management practices and financal performance in the shipping industry in Kenya, he found that without proper financal management practices, shipping Industry Companys financal 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 financal 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 companied in terms of financial metrics has become an issue of common concern of the stakeholders including the shareholder, the creditor, the companys 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 financal management practices exclusively. For instance, Nyamao, Ojera, Lumumba, Odondo, and Otieno,(2012) considered financal management practice in terms of efficiency of cash, inventory and receivables management, while Mathuva (2009) considered financal 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 financal performance of agricultural firms listed in Nairobi Securities Exchange. The study was guided by the following hypothesis;

- **H_0:** 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 firms 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 firms return is unknown to investors. They are forced to rely on noisy signals such as the firms level of capital structure to determine the risk of their investment and firms value may be underpriced by the market (Myers 2014).

An associations need 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 financal management practice on performance which enables evaluating the financial viability of a chosen strategy (King, Clarkson & Wallace, 2010).

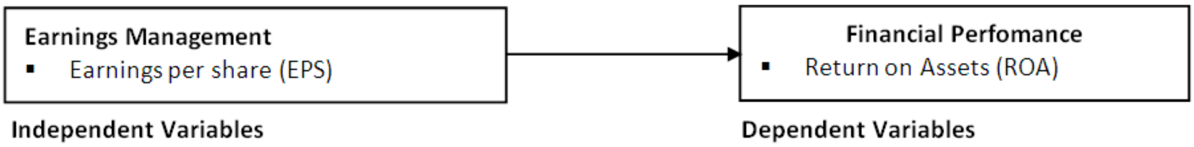

Figure 1: Conceptual Framework

Empirical Review

Concept of Financal perfomance

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 Financal perfomance

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 financal 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 financal 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 exichange. The findings of the study show presence of negative relationship between earnings management and corporate social responsibility but financal 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 exichange, 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 exichange 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 financal management practices and financal performance in the shipping industry in Kenya, he found out that without proper financal management practices, shipping Industry Companys financal 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 financal 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 (financal performance) and the independent variable epitomized by earnings management were taken. The results of simple linear regression were alson done.

Effect of Earnings Management on Financal Perfomance in Agricultural Firms Listed at NSE

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

Correlation between Earnings Management and Financal Perfomance

The Pearson correlation analysis was used to investigate the relationship between earnings management and financal 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 Financal Perfomance

		Earnings Management	Financal performance
Earnings Management	Correlation Coefficient	1.000	
	Sig. (2-tailed)	.	
	N	317	
Financal 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 financal performance, the study established a coefficient of correlation (r) as 0.529**. The results indicated that the relationship between earnings management and financal performance is positive and significant. This implied that financal 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 Financal Perfomance

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 (financal 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 Financal Perfomance

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: Financal performance

b. Predictors: (Constant), Earnings Management

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.472	.171		8.624	.000
	Earnings Management	.585	.053	.529	11.063	.000

a. Dependent Variable: Financal 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 financal 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 financal performance by 0.585

Hypotheses Testing

H_0: 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 financal performance among agricultural firms listed on NSE, since the p < 0.01, r =.529 and β=(.585). Thus the null hypothesis was rejected. This implied that earnings management has a significant effect on financal 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 financal 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 exichange which revealed that earnings has no significant relation on accounting information on forms listed at Tehran stock exchange.

V. Conclusion And Recommendations

The objective was to explore the influence of earnings management on financal performance of agricultural firms listed on Nairobi Securities Exchange. Earnings managements results showed positive effect on financal 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 financal performance of agricultural firms listed at Nairobi Securities Exchange; hence fourth null hypothesis is rejected.

Earnings management had a positive significant effect on financal performance of agricultural firms listed at the Nairobi securities exchange. The revelations above implied that agricultural firms can advance financal performance by efficient management of liquidity and earnings management. For agricultural firms to prosper then it is essential that they have the best financal 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 financal performance of agricultural firms listed on NSE. Performance reviews on the senior management should also focus on earnings management for improved financal 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 financal performance of the same firms under the recent period.

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

Refferences

[1]. Chiraz, Djerbi.(2013). Earnings management and performance of French IPO companies: Journal of Accounting and Taxation. 5. 1-14

[2]. Chung, N. & Chuang, K. (2010). Asymptotic distribution free interval estimation: For an Intra class correlation coefficient with applications to longitudinal data. Methodology, 4(1), 4-9.

[3]. Dawson, J. F. (2013). Moderation in management research: What, why, when and how. Journal of Business and Psychology, 3(5), 4 – 67

[4]. Githire & Muturi (2015). Impact of Capital Structure on Financial Performance: Evidence of Non-Financial Firms Quoted at the Nairobi Securities Exchange. International Journal of Scientific and Research Publications. 5(12)

[5]. Harelimana Jean Bosco (2017). Effect of Diversification of Portfolio Risk management at Rwanda. Social Security Board and Economics Journal 8(4)

[6]. Koskei (2017). Capital Structure and the performance of Private Sugar Manufacturing companies in Kenya. Unpublished project from Jomo Kenyatta University of Agriculture.

[7]. Maksimovic, V. (2011). Capital Structures in Developing Countries. The Journal of Finance, 56

[8]. Muiruri, N.W. & Wepukhulu, J.M. (2018). Effect of financing decisions on financial performance of listed companies at the Nairobi Securities Exchange, Kenya: Journal of International Business, Innovation and Strategic Management, 1(7), 101 - 114

[9]. Munene and Ntoiti. (2016). Effect of accounting information on firm financial performance: a case of agricultural firms listed in the Nairobi Securities Exchange: The strategic journal of management, ©strategic Journals Vol. 3, Iss. 4 (82), pp 1527 - 1543, Nov 28, 2016,

[10]. Myers, S. C. (2014). Interactions of corporate financing and investment decisions implications for capital budgeting: The Journal of finance, 29(1), 1-25.

[11]. Nimalathasan, B., & Valeriu B., (2010). Capital Structure and Its Impact on Profitability; A Study of Listed Manufacturing Companies in Sri Lanka (2010), Revista Tinerilor Economist/The Young Economists Journal, 13, 55-61.

[12]. Omete Ikapel, & Isabwa Harwood Kajirwa (2017), Analysis of long term debt and financial performance of state owned sugar firms in Kenya : International Journal of Commerce and Management Research ISSN: 2455-1627, 3 (2). 108-111

[13]. Peter,E. & Nelson, J. (2020). Empirical Investigation of Effective Management of Working Capital on Firm Performance: Evidence from the Nigerian Agricultural Sector. Asian Journal of Economics, Business and Accounting, 13(4), 1-13.

[14]. Pouraghajan A. and Malekian E. (2012). The relationship between capital structure and firm performance evaluation measures: Evidence from the Tehran Stock exchange: International journal of Business and Commerce Vol. 1 (9) 166 –181.

[15]. Sayari (2013). Impact of earnings management on stock return in Tunisia: The Journal Financial and Quantitative 1(1)

[16]. Wamalwa, C. (2010), Determinants of corporate borrowing, Journal of Financial Economics, 5, 146 175

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