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FINANCIAL MANAGEMENT PRACTICES AND RETURN ON EQUITY OF MANUFACTURING COMPANIES IN NIGERIA AND KENYA

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Abstract

Poor performance of businesses in the manufacturing sector, particularly in third-world countries where manufacturing companies play a significant role in the economy, has remained a persistent challenge. Inefficiencies in financial management practices often lead to poor profitability and the eventual failure of these companies in extreme situations. This study investigated the impact of financial management practices on the return of equity of listed manufacturing companies in Nigeria and Kenya between the years 2011 and 2021. The research design adopted for this study was ex-post facto, and secondary data was collected from the annual reports of selected manufacturing companies (10 each from Nigeria and Kenya) between 2011 and 2021. Panel regression models and various post-estimation tests were employed to validate the assumptions of multiple regression models. The study found that financial management practices have significant effects on the return on equity of companies in the manufacturing sectors of Nigeria and Kenya.

Keywords: Capital structure, Return on equity, Financial Management Practices, Liquidity, Investment.

1. INTRODUCTION

Financial management practices encompass the strategies, techniques, and activities employed by organizations to manage their financial resources effectively. They involve decision-making and implementation to optimize the allocation, utilization, and control of financial assets in pursuit of organizational goals. These practices span various activities, including financial planning, budgeting, financial analysis, investment decision-making, risk management, and performance evaluation. They play a vital role in ensuring an organization's financial health and long-term viability. In the current 21st century, financing has been a key economic driver in many countries across the globe in that many businesses depend on financing as their source of capital. Byoun (2020) defined financial management practices as all aspects dealing with money circulations and money control in all business transactions. It relates to the arrangements and optimal use of financial resources for current and future opportunities to improve financial operations in terms of profit making as well as maximization of profits.

Profitability is the ability of a firm to generate earnings from its operations. It is the general measurement regarding the current financial position of a firm as well as its comparison with other firms (Bernardin & Russel, 2018), it can also be termed as the measurement of proper utilization of the assets in a firm based on its mode of operation and how revenues are generated (McMahon, 2017). Return on equity is a financial ratio that measures the profitability of a company, it measures the ability of management to generate income. It is calculated as net income divided by average shareholder's equity. Some previous authors failed to consider practices in terms of capital structure management practices, liquidity management practices and investment management practices all together. Adequate working capital management and

capital structure management were found to significantly affect business performance among the five financial management practices studied by Somathilake & Pathirawasam (2020). The study revealed that financially well-managed SMEs are operationally effective and more likely to develop, expand, sustain, and strengthen. However, inefficient financial management practises lead to poor financial performance and failure of organisations.

In Nigeria, the consumer goods sector is in its growing phase and as well performing significantly in contributing to the economic growth of the country. This is evidenced by the analogy of the state of growth of the sale volume of the consumer market. According to the report published by the News Agency of Nigeria (NAN) through business day online (press),The McKinsey Global Institute (MGI), reports that Nigeria's consumer market is worth more than $400billion. The report is entitled, "Nigeria's renewal: Delivering Inclusive Growth in Africa's Largest Economy''. The MGI estimated that the value of Nigeria's consumer market could reach $1.4 trillion by 2030 with food and non-food consumer goods accounting for one trillion of the total" (Osagie, 2017).

The manufacturing sector in Kenya is one of the major contributors to the economic development of the country; it's the most sophisticated in East Africa and is relatively diverse. Agriculture being the backbone of Kenya's economy, the Kenyan vision 2030 blueprint, one of the key pillars of the attainment of the objectives of the strategy is the need for the manufacturing sector to grow at the rate of 8 percent over 20 years. This can only be achieved if there is growth in the profits of the sector and this will depend upon identifying all the variables that can influence the profit of a firm including the management of working capital and investment decisions. It is utmost important to examine the financial management practices and performance of listed manufacturing companies in Nigeria and Kenya as manufacturing firms are contributing much to economic growth of their respective country.

Poor business performance in the manufacturing sector has for long remained a puzzle, especially in third-world countries where manufacturing companies occupy a large part of the economy. Inefficiencies in financial management practices result in poor Profitability and eventually lead to the failure of small and medium enterprises (Kilonzo & Ouma, 2019). Therefore, the capital structure practices of some companies were not prioritized due to poor administration of capital which affects the accessibility of required finance to fund future development.

Paucity of studies exist in literature exploring how financial management practices, measured by capital structure management practices, liquidity management practices and investment management practices affects return on equity. This study therefore fills this gap by exploring the effect of financial management practices, (proxied by capital structure management practices, liquidity management practices and investment management practices) on return on equity in the manufacturing sectors of Kenya and Nigeria from 2011-2021.

2. LITERATURE REVIEW

Several studies have been carried out in literature relating to financial management practices and performance. Sulaiman, Mijinyawa, & Tukur (2019) conducted a study on financial management practices and profitability of listed consumer goods firms in Nigeria. The study used return on asset as a dependent variable and financing decision, investment decision and dividend decision as independent variables. The sample for the study consists of twenty-two (22) consumer goods firms listed on the Nigerian Stock exchange (NSE) and period of twelve (12) years from 2006 to 2017. The required data and information for

the study were gathered from financial statements of the 16 sample sample firms for the period of twelve (12).The study also uses secondary data and the panel regression as method of estimation. The study shows that financing decision and investment decision have significant effect on profitability of listed consumer goods firms in Nigeria.

(Opoku, Winful, & Neubert, 2022) investigated the relationship between capital structure and financial performance of firms in Ghana and Nigeria. The annual financial statements of 85 firm listed were used for the study and covered a period of five (5) years, 2014 – 2018. The Pearson correlational method was adopted using regressing capital structure represented by the total debt to equity ratio, long term debt to equity ratio and short term debt to equity ratio to financial performance represented as the return on equity and return on assets. The study revealed a significant relationship between capital structure and fianical performance.

(Sovaniski, 2020) carried out a study on capital structure impact on Profitability of Kurdistan manufacturing firms. The results obtained from the regression equations established a negative relation between total debt, size and Profitability which indicates using more of debt or assets are linked to a decrease in performance in financial perspective. The study further found out that Profitability increased with increase in liquidity and sales growth.

Dinh & Pham (2020) carried out a study on the effect of capital structure on the Profitability of pharmaceutical enterprises which are listing on Vietnam's stock market. The study builds the regression using ROE as dependent variable and four independent variables, including self-financing, financial leverage, long-term asset and debt to assets ratios. In addition, they use other variables as controlling ones, such as firm size, fixed asset rate and growth. We collect data for the period from 2015 to 2019 of all 30 pharmaceutical enterprises which are currently listing on Vietnam's stock market. The least square regression (OLS) is used to test the effect of capital structure to the firms' Profitability. The analysis results show that the financial leverage ratio (LR), long-term asset ratio (LAR) and debt-to-assets ratio (DR) have positive relationship with firm performance, meanwhile the self-financing (E/C) affects negatively to the return on equity (ROE).

Olagunju et al.,(C2019) studied liquidity management and commercial banks' profitability in Nigeria. The study applied quantitative methods of research and adopted the Pearson's correlation data analysis. Its findings indicate that there is a significant relationship between liquidity and profitability of commercial banks in Nigeria, meaning that profitability in commercial banks is significantly influenced by liquidity and vice-versa.

Isaac, (2018) examined the financial management practices and performance of SMEs in Ghana: The moderating role of firm age. He found that receivable management, cash management, inventory management, and asset management practices influence SMEs' performance. The study further disclosed that, firm's age has a moderating effect on the relationship between financial management practice and SMEs performance. The studies indicate that financial management practises affect financial performance. Muchiri (2017) examines Nairobi Securities Exchange-listed non-financial enterprises and finds a link between financial management and performance. Financial management practises affect Nigerian deposit money bank performance, according to Olunuga (2022). Financial management practises improve organisational performance in Pakistani corporations, according to Hunjra et al. (2010). And, Faque (2022) stresses the need of cash management tactics for financial success. These studies emphasise the importance of financial management in improving financial performance.

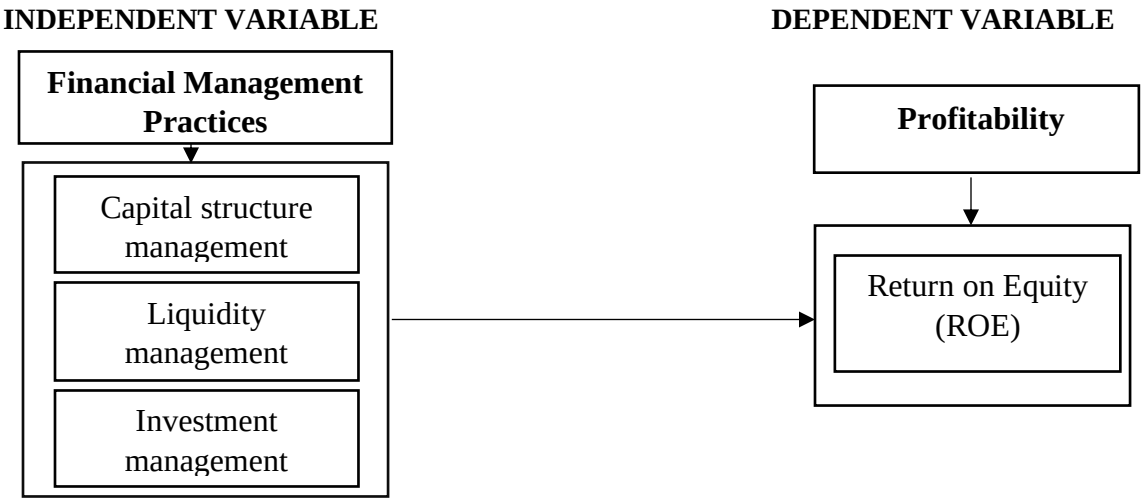

Figure1: Conceptual framework of the study

Source: Author's computation 2023

1.1. THEORETICAL REVIEW

The following theories links with this research work include pecking order theory, modigliani-miller (mm) capital structure theory, modern portfolio theory, and trade-off theory. However, this study is anchored on Pecking order theory which propounded by Myers and Majluf (1984), this is when practicing financial management; firms have particular preference order for capital used to finance their businesses. Firms first use to consider their internal source of funds, or retained earnings, then debt, and lastly equity. Using retained earnings involves lower funding costs and shorter processing times compared to debt funding, yet equity funding involves yet higher funding costs and even longer processing times.

Therefore, debt financing positively affects firm value in terms of market share price, net asset per share, market capitalization. Firms with more profit and liquidity have more retained earnings and do not need external funding. Firms involved in high-risk ventures should not need more debt as more debt means even more financial risk. However, growth opportunities and non-current assets positively affect liability. The retained earnings of high-growth firms might not match their capital requirements, so they add more debt. Moreover, tangible assets can be used as security when firms require debt funding.

It is relevance to this research because pecking order theory relates to a company's capital structure in that it helps explain why companies prefer to finance investment projects with internal financing first, debt second, and equity last. The pecking order

theory arises from information asymmetry and explains that equity financing is the costliest and should be used as a last resort to obtain financing

The Pecking Order Theory, also known as the Pecking Order Model, relates to its capital structure. Made famous by Stewart Myers and Nicolas Majluf in 1984, the theory states that managers follow a hierarchy when considering financing sources. The pecking order theory states that managers display the following preference of sources to fund investment opportunities: first, through the company's retained earnings, followed by debt, and choosing equity financing as a last resort. The key assumption of pecking order theory is asymmetric information. Asymmetric information captures that managers know more than investors and

their actions therefore provides a signal to investors about the prospects of the firm. The pecking order theory states that internal financing is preferred over external financing, and if external finance is required, firms should issue debt first and equity as a last resort. According to Myers (1984), managers are better informed than investors. Investors might see an external equity issuance a bad news about the company, assuming that managers want outside shareholders to share the loss, thus investors will react to this issuance negatively, increasing the issuance cost of external equity. Firms therefore prioritize their sources of financing according to the law of least effort, of least resistance: internal funds are used first, and when that is depleted, debt is issued, and when it is not sensible to issue any more debt, equity is issued.

2. METHODOLOGY

The study adopted *an ex-post facto* research design. *An ex-post facto* research design was adopted because it examines established qualities among selected variables. Proxies of the financial management practices and Profitability was utilized in this study with panel data spanning 10 years (2011 to 2021) from 10 manufacturing firms in Nigeria and Kenya. The population of the study is the manufacturing sector under the Nigeria Stock exchange which has 71 quoted companies as listed. Also, the Nairobi stock exchange has 61 listed companies as at 2021.The study made use of the judgmental sampling technique. All the samples are gathered in a process that does not give all the individuals in the population equal chances of being selected. The top 10 manufacturing firm was been chosen for this study across the Nigeria stock exchange and the Nairobi stock exchange. Manufacturing sector was restricted in this study because it is the engine of every economy

The data collected, presented and analyzed in this research were from secondary source. The secondary source for this study was extracted from annual report and accounts of the companies selected as sample between the years 2011-2021. To conduct the data analysis, STATA 14.2 software was used. The study used panel estimators consisting of Fixed Effect and Random Effect. The estimators were all significant as revealed by their respective F-statistics and probability. In addition, regression diagnostics tests were conducted to ascertain the normality of the residual, multicollinearity problem and heteroskedasticity in order not to produce spurious results.

The empirical model used in this study is specifed as follows;

$ROE_{it} = \beta_0 + \beta_1 CSMP_{it} + \beta_2 LMP_{it} + \beta_3 IMP_{it} + \mu_{it}$

Where:

ROE= Return on equity

μ - error term,

B_0 = Intercept

β_1 = coefficient of independent variables

CSMP= Capital structure management practices

LMP= Liquidity management practices

IMP= Investment management practices

The a priori expectation is that $\beta_1 > 0$.

3. ANALYSIS RESULT AND INTERPRETATION

Table 1: Descriptive statistics

	Mean		Std.dev		Min		Max	
	Nig	**Kenya**	**Nig**	**Kenya**	**Nig**	**Kenya**	**Nig**	**Kenya**
ROE	15.77057	15.12953	41.85103	31.78275	-372.34	-62.37	187.28	171.01
CSMP	2.066429	1.974057	4.298875	2.910188	-2.98	0	47.92	21.15
LMP	1.1195	3.212952	.604605	2.903494	-0.7	.29	3.59	18.76
IMP	5.3105	4.68	7367636	.7689882	3.22	2.76	6.33	5.95

Source: Researcher's Computation (2023

Table 1 shows the summary statistics of all the variables obtained from the sampled Companies in Nigeria and Kenya. The mean value of ROE showed 15.77 and 15.12 for Nigeria and Kenya respectively. When compared to its corresponding standard deviation of 41.85 and 31.78 for Nigeria and Kenya respectively, this implies that there are more fluctuations in the Nigeria and Kenya's ROE for the sampled period and the sampled companies. The minimum values for the Return on Asset (ROE) showed -372.34 and -62.37 for Nigeria and Kenya respectively, which indicates that some of the companies sampled for the purpose of this study recorded losses during the period studied. The maximum values of 187.28 and 171.01 for Nigeria and Kenya respectively, indicated that the highest profit recorded in the sampled period for the sampled companies was from a Nigeria company.

The mean values for the data set of Capital Structure Management Practices (CSMP) for Nigeria is 2.066 while it is 1.974 for Kenya. This shows that the average Capital Structure Management Practices (CSMP) of both countries are same at 2%. The standard deviation measures the extent of dispersion from the mean which suggests some levels of fluctuation in the data. A low standard deviation indicates that the data points tend to be very close to the mean while a high standard deviation reflects that the data points are spread out over a large range of values. The standard deviation for Capital Structure Management Practices (CSMP) is 4.299 and 2.910 for Nigeria and Kenya respectively. This indicates that there exists a higher level of fluctuation in the dataset for Nigeria. However, the dataset for Kenya, with a much lower standard deviation indicates a not so much variation in the dataset.

The mean value of LMP showed 1.11 and 3.21 for Nigeria and Kenya respectively, when compared to its corresponding standard deviation of 0.60 and 2.90 for Nigeria and Kenya respectively. This indicates that no much fluctuations in the Nigeria and Kenya LMP for the sampled period and the sampled companies. The minimum values for the Liquidity Management Practices (LMP) showed -0.7 and 0.29 for Nigeria and Kenya respectively, which indicates that some of the companies sampled for the purpose of this study recorded losses during the period studied. The maximum values of 3.59 and 18.76 for Nigeria and Kenya respectively, indicated that the highest profit recorded in the sampled period for the sampled companies was from a Kenyan company.

The mean value of IMP showed 5.31 and 4.61 for Nigeria and Kenya respectively, when compared to its corresponding standard deviation of 0.73 and 0.76 for Nigeria and Kenya respectively. This suggests that no much fluctuations in the Nigeria and Kenya IMP for the sampled period and the sampled companies. The minimum values for the Investment Management Practices (IMP) showed 3.22 and 2.76 for Nigeria and Kenya respectively, which indicates that some of the companies sampled for the purpose of this study recorded Profit during the period studied. The maximum values of 6.33 and 5.95 for Nigeria and Kenya respectively, indicated that the highest profit recorded in the sampled period for the sampled companies was from a Nigeria company.

Table 2

Series	CSMP	LMP	IMP	VIF	
				VIF	1/VIF
CSMP	1.0000			1.21	0.827209
LMP	-0.1849	1.0000		1.20	0.830041
IMP	0.1757	-0.3990	1.000	1.05	0.953463
				Mean= 1.15	

Source: Researcher's Computation (2023)

Table 2 shows the Variance Inflation Factor (VIF) test. The mean result of VIF is 1.15 which is below the threshold of 10 and indicates the absence of multicollinearity problems among the variable data series. In order to ensure that the estimated parameters are not biased and inefficient, the study used the variance inflation factor for each of the explanatory variables by examining the possibility of multicollinearity among the explanatory variables. The results of the VIF is less than 10 for each of the variables. The variables have VIF of 1.21 (CSMP), 1.20 (LMP) and 1.05 (IMP). The results revealed that CSMP, LMP and IMP have positive association with the performance of listed manufacturing Companies in Nigeria with correlational values of 0.827, 0.830 and 0.953 respectively.

The Table 2 also revealed 0.176 as the highest result figure which implies a positive relationship between Inflation and Size while the lowest is -0.39 which signifies a weak negative relationship. These are lower than the threshold for establishing multicollinearity and an indication of absence of multicollinearity in the data sets used in thus study. The result further confirmed the earlier VIF results discussed.

Finally, the result of the table 2 showed an absence of multicollinearity looking at all the relationship values in the data series with VIF mean of 1.15 less than 10.

Table 3 Correlation Analysis (Kenya)

Series	CSMP	LMP	IMP	VIF	
				VIF	1/VIF
CSMP	1.0000			1.04	0.956988

LMP	-0.1009	1.0000		1.03	0.966834
IMP	0.0015	-0.1813	1.000	1.01	0.989521
				Mean= 1.03	

Source: Researcher's Computation (2023)

Table 3 shows the Variance Inflation Factor (VIF) test. The mean result of VIF is 1.03 which is below the threshold of 10 and indicates the absence of multicollinearity problems among the variable data series. In order to ensure that the estimated parameters are not biased and inefficient, the study used the variance inflation factor for each of the explanatory variables by examining the possibility of multicollinearity among the explanatory variables. The results of the VIF is less than 10 for each of the variables. The variables have VIF of 1.04 (CSMP), 1.03 (LMP) and 1.01 (IMP). The results revealed that CSMP, LMP and IMP have positive association with the profitability of listed manufacturing companies in Kenya with correlational values of 0.95, 0.96 and 098 respectively.

Finally, the result of the table 3 showed an absence of multicollinearity looking at all the relationship values in the data series with VIF mean of 1.03 less than 10.

Table 4
Regression and Post-Estimation Results for ROE

Model – Nigeria					**Model – Kenya**			
Random-effects GLS Regression with Driscoll-Kraay standard errors					Random-effects GLS Regression with Driscoll-Kraay standard errors			
Variable	Coeff	Std. Err	T-Stat	Prob	Coeff	Std. Err	T-Stat	Prob
Constant	47.586	44.926	1.06	0.290	-79.964	18.023	-4.43	0.0000
CSMP	-6.762	-527	-12.82	0.000	2.296	.920	2.49	0.014
LMP	-7.730	4.588	-1.68	0.092	-0.880	.942	-0.93	0.352
IMP	-1.72	8.220	-0.21	0.833	19.855	3.593	5.53	0.0000
Adj. R^2	0.0344				0.2689			
Wald Stat	F(1,19) = 12.19 (0.0160)				$F(3,101)_{)}$ = 13.75 (0.0000)			
Hausman Test	$chi^2_{(3)}$ = 3.39 (0.3352)				$chi^2_{(3)}$ = 481.59 (0.0000)			
LM Test/ Testparm	$chi^2_{(1)}$ = 139.77 (0.0000)				$chi^2_{(1)}$ = 1.28 (0.2629)			
Heteroskedasticity Test	$chi^2_{(1)}$ = 290.52 (0.0000)				$chi^2_{(1)}$ = 3.69 (0.0546)			

Serial Correlation Test	$F_{(1, 9)}$ = 6.504 (0.0242)	$F_{(1, 9)}$ = 0.537 (0.4803))

Source: Researcher's Work (2023)

Dependent Variable: ROE **@5% significance level**

Table 4; At a level of significance 0.05 and degree of freedom of F(1,19), the result of the Wald-statistics is 12.19 while the probability value is 0.0160, which is lesser than the adopted level of significance of 0.05. Therefore, the study reject the null hypothesis One which states that "Financial Management Practices has a significant effect on return on equity of listed manufacturing consumer goods companies in Nigeria. For Kenya, at a level of significance 0.05 and degree of freedom of F(3, 101), the result of the Wald-statistics is 13.75 while the probability value is 0.000, which is lesser than the adopted level of significance of 0.05. Therefore, the study reject the null hypothesis One which states that "Financial Management Practices has a significant effect on return on equity of listed manufacturing consumer goods companies in Kenya. The objective of this model has been achieved, the research question answered, and the research hypothesis tested. The findings are in line with the works of Veeraraghavan (2018) which showed that individually, there is a positive relationship between working capital management; investment decisions; financial decisions, and Profitability. The study further revealed that the combined effect of financial management practices (working capital management, investment decision, and financial decision) have a moderate positive relationship between financial management practices and Profitability.

4. DISCUSSION

In the theoretical viewpoint, some reviewed theories were considered important, appropriate, relevant, and suitable for the study. The following theories were reviewed: Pecking order Theory, The Modigliani-Miller (MM) Capital Structure Theory, Modern Portfolio Theory and The trade-off Theory. The study is anchored on Pecking order Theory. this is when practicing financial management; firms have particular preference order for capital used to finance their businesses. Firms first use to consider their internal source of funds, or retained earnings, then debt, and lastly equity. It is relevance to this research because pecking order theory relates to a company's capital structure in that it helps explain why companies prefer to finance investment projects with internal financing first, debt second, and equity last. The pecking order theory arises from information asymmetry and explains that equity financing is the costliest and should be used as a last resort to obtain financing.

5. CONCLUSION AND IMPLICATIONS

The study examines the effect of financial management practices and return on equity of manufacturing companies in Nigeria and Kenya for the period of ten years (2011-2021). Having reviewed the extant literature about the effect of financial management practices and return on equity of manufacturing companies in Nigeria and Kenya, deriving hypotheses from literature and theories, data collection and data analysis, the study concluded that financial management practices have a significant effect on return on equity of manufacturing companies in Nigeria and Kenya. This result agrees with some findings in literature such as Fwamba (2017); Isaac (2018); Mazzarol (2019); Muchiri (2017); Veeraraghavan (2018). Therefore the study recommends that firms should continuously monitor and evaluate their financial management practices as regular assessment can help identify areas of improvement and emerging trends, ensuring that financial management practices are continuously optimized to enhance profitability and

sustainability. The policy makers in Nigeria and Kenya will find this work helpful and useful in policy direction and fashioning out quality policies that will improve the profitability of manufacturing companies of both Nigeria and Kenya as these economies dictate the developmental of the West African and East Africa continent.

6. LIMITATIONS AND FURTHER STUDIES

This study advances the following suggestions for the benefit of extending the boundaries of knowledge and for further research studies related financial management practices and return on equity of manufacturing companies in Nigeria and Kenya. Further studies could consider more African countries not covered in this study.

As regards the coverage of analysis and period, ten (10) consumer goods companies each from Nigeria and Kenya were sampled while 10 years period covering 2011-2021 were considered. The study suggests more countries to be covered considering the impact of financial management practice on companies return on equity and reduction in number of years so that newly formed manufacturing companies can be considered. Furthermore, other variables in terms of financial management practices and return on equity of manufacturing companies in Nigeria and Kenya not captured in this study can be looked at by other researchers in future.

AUTHOR DECLARATIONS

Author Contributions: Introduction, A.A.T, conceptualization, A.A.T, methodology, O.O.N, data analysis and interpretation, O.O.N, investigation A.A.T, and O.O.N, review, A.A.T, editing, O.O.N. All authors have read and agreed to the published version of the manuscript.

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Conflicts of Interest: The authors declare no conflict of interest.

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