Quest Journals
Journal of Research in Business and Management
Volume 12 ~ Issue 5 (2024) pp: 137-141
ISSN(Online):2347-3002
www.questjournals.org

Research Paper

Effect of Financial Reporting Quality on Financial Performance of Listed Agricultural Companies in Nairobi Securities Exchanges

Wanjau Boniface Muriithi [1] Gacheru Michael mutugi[2]
[1] Catholic University of Eastern Africa [2] Jomo Kenyatta University of Agriculture and Technology
Corresponding author: Wanjau Boniface Muriithi

Abstract
Although, wealth maximization principle is the main agenda in profit making entities. It is not always guaranteed due to conflict of interest between agency and principal. This is manifested through quality of financial reporting and odds of compliance with acceptable standards. It is against this backdrop the current study aimed at examining the effect of financial reporting quality on financial performance of listed agricultural companies in Nairobi securities exchanges. The study applied correlation research design and was anchored on unbalanced panel data of listed agricultural companies from 2015 to 2022. Fixed effects regression model was fitted and it depicted that contingent income, audit committee characteristics and accruals quality of working capital has positive statistically significant effect on financial performance of listed agricultural companies in Nairobi securities exchanges.

Key words*: Agricultural company, Contingent income, audit committee characteristics, Accruals quality of working capital, financial performance.*

R*eceived 04 May, 2024;* ***R****evised 14 May, 2024;* ***A****ccepted 16 May, 2024 © The author(s) 2024.*
P*ublished with open access at* ***www.questjournals.org***

I. Introduction

Agency theory supports on the need for adoption of strategies aimed at minimizing agency conflicts and minimization monitoring cost (Jensen & Mecklin, 1976). Achievement of this would be possible through improvement on the quality of financial reporting and ultimately maximize shareholders wealth through improved financial performance.

Maalimu et al. (2023) revealed positive and statistically significant effect of audit committee characteristics and financial performance of listed manufacturing companies. Muneer and Hashim (2017) had inverse effect of financial reporting quality on cost of debt. There are conceptual gap since the study relied on cost of debt as an outcome. Windy and Riyla (2017) financial reporting quality had inverse effect on financing though it positively affected investment. The study may have relied on scientific approach to select companies for inclusion in the study.

Lari et al. (2019) operationalized as contingent income, accrual items and accrual quality of working capital. Abd-Elnaby et al. (2021) had positive effect of financial reporting quality on return on equity while it negatively affected earnings per share. There were methodological issues with the study. Kania (2016) depicted that financial reporting quality significantly affected information asymmetry and investment efficiency of pension firms in Indonesia. There were conceptual issues since the current study response variable was financial performance. Thus, the study sought to examine the effect of financial reporting quality on financial performance of listed agricultural companies in Nairobi securities exchanges. Specifically, the study answered the following questions:

i. What is the effect of contingent income on financial performance of listed agricultural companies in Nairobi securities exchanges?
ii. What is the effect of audit committee characteristics on financial performance of listed agricultural companies in Nairobi securities exchanges?

iii. What is the effect of accruals quality of working capital on financial performance of listed agricultural companies in Nairobi securities exchanges?

II. Theoretical Review

Agency theory was brought forth by Jensen and Meckling (1976). The theory argues that there exists principal agent relationship between shareholders and management of a firm which is involved in day-to-day operations of a firm. In this case there is an assumed relationship between county government officials and citizens hailing from a particular county. It is expected that the management should minimize the level of information asymmetry through disclosure of relevant information. This can be achieved through community participation activities. Even though, management is entrusted with implementation of ethical corporate governance there are chances of management pursuing their own selfish interest. This will corroborate arguments by Jensen and Meckling (1976) who reported that controlling interest has significant influence on agency conflicts which is amplified by pursuance of individual interests which may contravene another stakeholder's role. Although, agency theory examination is propelled by the desire to minimize degree of information asymmetry (William, Ginter & SHewchuk, 2006), there is need to add accounting notes which will enhance corporate governance of a given institution. The theory is applicable in the study since there is need for compliance with acceptable accounting standards while preparing financial reports. This would minimize likelihood of drawing biased conclusions and minimize monitoring and agency costs.

III. Empirical Review

Maalimu et al. (2023) studied the effect of financial reporting quality on financial performance of manufacturing companies listed in NSE. The study applied correlational research design and relied on panel data from 2015 to 2021. Regression and correlation analysis analyzed the data. Results of the study depicted that there was positive and statistically significant effect of audit committee characteristics and financial performance of listed manufacturing companies. The study has contextual gaps since the findings may not be generalized in agricultural listed companies due to differences of industry specific characteristics.

Muneer and Hashim (2017) explored the effect of financial reporting quality on cost of debt in Oman. The study applied correlational research design and sourced panel data among 68 listed companies from 2012 to 2018 in Muscat securities exchanges. Through, regression analysis the study depicted that there was an inverse effect of financial reporting quality on cost of debt. The study has conceptual gaps since it conceptualized that cost of debt is inversely affected by financial reporting quality. Further, the study was carried out amongst companies listed in different sector without consideration of industry characteristics thus the need for the current study.

Windy and Riyla (2017) examined the effect of financial reporting quality on financing and investment among Indonesian companies. The study applied correlational research design and relied on panel data that was drawn from 15 purposively selected companies dependent on market capitalization and rating as per standard and poor rating scales. Through, regression analysis it was found that financial reporting quality had inverse effect on financing though it positively affected investment. Since the study relied on purposively selected companies it was appropriate to control for the effect of market capitalization and credit rating.

Iranian evidence on the relationship between financial reporting quality and corporate performance was documented by Lari et al. (2019). The study applied correlation research design and sourced secondary data from annual financial statements of 80 listed companies from 2006 to 2018. Financial reporting quality was operationalized as contingent income, accrual items and accrual quality of working capital. Through regression analysis the study documented that there was no statistically significant effect of financial reporting quality on market value added while economic value added was significantly affected.

Abd-Elnaby et al. (2021) studied the effect of financial reporting quality on financial performance in Egypt. Descriptive research design was applied and panel data of 61 listed firms was gathered from 2014 to 2018. Results of the study depicted that there was positive effect of financial reporting quality on return on equity while it negatively affected earnings per share. The study may have considered reporting on diagnostic tests that guided on the adoption of panel least generalized least squares model.

Kania (2016) examined the effect of financial reporting quality on information asymmetry and investment efficiency of pension firms in Indonesia. Descriptive research design was applied and secondary data sourced. Results of the study depicted that financial reporting quality significantly affected information asymmetry and investment efficiency of pension firms in Indonesia. Since listed and pension fund schemes are regulated differently there is need for customized study that will focus on those firms which are listed.

IV. Methodology

The current study applied correlational research design and sourced secondary data from annual financial statements of listed agricultural companies. A census approach was used to select 7 agricultural listed companies for the period 2015 to 2022. The population for the study was Kakuzi limited, Kapchorua tea company limited, Limuru tea company, Rea vipingo plantations limited, Eaagards limited, Williamson tea Kenya and Sasini limited. The study applied unbalanced panel data. Collected data was cleaned and analyzed using correlation and multiple regression analysis. The regression model for the study was of the form:

$Yit = \beta_0 it + \beta_1 x_{1it} + \beta_2 x_{2it} + \beta_3 x_{3it} + e$

Y = dependent variable (financial performance)

β_0 = Constant Term

$\beta_1\beta_2\beta_3$= coefficient of determination

x_1= Contingent Income

x_2= Audit committee characteristics

x_3= Accrual quality of working capital

e = Error Term

V. Findings and Discussions

Correlation Analysis

Product moment correlation coefficient was applied to evaluate the strength of the relationship between financial reporting quality and financial performance of listed agricultural listed companies. Findings in Table 4.1 depicts that there was a positive statistically significant relationship between contingent income and financial performance (rho= 0.617, p value < 0.05). Secondly, there was a positive statistically significant between audit committee characteristics and financial performance (rho = 0.452, p value < 0.05). Further, accrual quality of working capital has positive statistically significant effect on financial performance (rho = 0.503, p value < 0.05). Correlation coefficient among predictor variables was not exceeding 0.7, thus there were odds of multicollinearity.

Table 4.1 Correlation Analysis

	1	2	3	4
(1) Financial Performance	1			
(2) Contingent Income	0.617	1		
	0.000			
(3) Audit committee characteristics	0.452	0.036	1	
	0.000	0.108		
(4) Accrual quality of working capital	0.503	0.081	0.043	1
	0.000	0.442	0.741	

Diagnostic Tests

Before fitting regression model to examine the effect of financial reporting quality on financial performance of agricultural listed companies. Panel data diagnostic tests were executed and study findings are reported below.

Normality Test

Normality test of the error term was examined with the assumption that the error term of the data was normally distributed against an alternative that it was not. Findings in Table 4.2 has a p value of 0.4253 and Jarque Berra coefficient of 1.2546. This indicates that the error was normally distributed thus there was no need for data transformation.

Table 4.2 Normality Test

	Financial Performance
Jarque-Bera	1.2546
Probability	0.4253

Lagragian Multiplier Test

Lagragian multiplier test was carried to examine the null hypothesis that there were no panel effects against an alternative that there were panel effects. Results in Table 4.3 depicts that there was enough evidence for rejection of the null hypothesis and conclusion that there were panel effects thus pooled effects model was not the most appropriate for examination on effect of financial reporting quality on financial performance of listed agricultural companies in Kenya.

Table 4.3 Lagragian Multiplier Test

	Var	Sd=sqrt (var)
Creative accounting	6.5826	2.5657
e	1.4258	1.1941
u	0.5263	0.8180
Chi square =10.256, p value <0.0002		

Serial Correlation Test

Serial correlation test was carried to examine the relationship between current period and past period error terms. Results in Table 4.4 depicts that there was no first order serial correlation since the p value was less than 0.05 thus the null hypothesis that stated that there was no first order serial correlation was rejected.

Table 4.4 Serial Correlation Test

	F (1,5)	P value
Wooldridge test for autocorrelation	13.26	0.0013

Heteroskedasticity Test

Heteroskedasticity test was carried to examine the uniformity of variance of error term of variables under examination. Results in Table 4.5 depicts that there was enough evidence to support rejection of the null hypothesis and conclusion that there was no uniformity of variance of error term since the p value was less than 0.05. Hence, the model fitted in the study had robust standard errors.

Table 4.5 Heteroskedasticity Test

	Chi square	P value
Modified Wald test	275.26	0.0000

Multicollinearity

Multicollinearity is a condition in which there is a high correlation amongst predictor variables. It was examined using variance inflation factors. Results in Table 4.6 depicts that none of the variables had variance inflation factors greater than 4. Thus, these variables were not highly correlated.

Table 4.6 Multicollinearity

	VIF
Contingent Income	1.03
Audit committee characteristics	1.00
Accruals quality of working capital	1.01

Hausman Test

Hausman test was carried to examine the most appropriate model to fit between fixed and random effects model. Results in Table 4.7 depicts that the most appropriate model to fit was fixed effects since the p values was less than 0.05. Thus, the study adopted fixed effects model while examining the effect of financial reporting quality on financial performance of listed companies in NSE.

Table 4.7 Hausman Test

Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
13.25	3	0.003

Regression Analysis

Regression analysis results in Table 4.8 depicts that 63.4% of changes in financial performance of listed agricultural companies can be accounted for by contingent income, audit committee characteristics and accruals working capital while the remaining portion is attributed to others issues excluded in the model. Since F statistics has p value less than 0.05 then at least one of the slope coefficients is none zero. Contingent income has positive statistically significant effect on financial performance of listed agricultural companies in Nairobi securities exchanges (β= 3.52, p value < 0.05). Thus, it can be concluded that while holding constant audit committee characteristics and accruals working capital unit increase in contingent income increased financial performance by 3.52 units. Audit committee characteristics has positive statistically significant effect on financial performance of listed agricultural companies in Nairobi securities exchanges (β= 2.54, p value < 0.05). Thus, it can be concluded that while holding constant contingent income and accruals working capital unit increase in audit committee characteristics increased financial performance by 2.54 units. Accruals quality of working capital has positive statistically significant effect on financial performance of listed agricultural companies in Nairobi securities exchanges (β= 10.32, p value < 0.05). Thus, it can be concluded that while holding constant audit committee characteristics and contingent income unit increase in accruals quality of working capital increased financial performance by 3.52 units.

Table 4.8 Regression Analysis

Financial reporting	**Coef.**	**St.Err.**	**t-value**	**p-value**
Contingent income	3.52	0.964	3.65	0.001
Audit committee characteristics	2.54	0.587	4.33	0.000
Accruals quality of working capital	10.32	2.701	3.82	0.000
Constant	2.452	1.19	2.06	0.000
R-squared	0.634			
F-test	18.43	Prob > F	0.000	

VI. Conclusion and Recommendations

Based on the study findings there is need for consideration of measures aimed at enhancing the quality of financial reporting quality. This can be achieved through consideration of contingent income, audit committee characteristics and accruals quality of working capital.

References

[1]. Abd-Elnaby, H., Abd-Elkareem, K., & Adel, H. (2021). The Impact of Financial Reporting Quality on Firm's Financial Performance: Evidence from Egypt. *International Journal of Academic Research in Accounting Finance and Management Sciences, 11*(1), 529-545.

[2]. Lari, M. D., Marzieh, H., & Molavi, A. (2019). The relationship between financial reporting quality and corporate performance: Evidence from Iran. *Iranian Journal of Accounting, Auditing and Finance,* https://doi.org/10.22067/ijaaf.v2i2.72064

[3]. Maalimu, O. V., Alala, O., & Maniagi, M. (2023). Effect of quality of financial reporting on performance of manufacturing firms listed in the Nairobi securities exchange in Kenya. *African Journal of Empirical Research, 4*(2), 1-6.

[4]. Muneer, A., & Hashim, H. A. (2017). The effect of financial reporting quality on the cost of debt: Sultanate of Oman evidence. *International Journal of Economics, Management and Accounting, 28* (2), 393-414.

[5]. Windy, A., & Riyla, A. (2017). The effect of financial reporting quality on financing and investment. *Jurnal Ekonomi, 16*(1), 81-92.