



Research Paper

## Determinants of Material Cost Accounting in Relation to Financial Performance of Listed Manufacturing Companies in Kenya (Case study of Mumias Sugar Company), Kakamega County-Kenya

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**ABSTRACT:** To offer best quality products and services at affordable prices to consumers, management accounting offers a good best opportunity for firms to compete in the market. Over the years, the challenge to keep costs down in order to keep performance has been predominant in most companies and especially those listed on the NSE given the pressure from the shareholders for firms to post better performance. Therefore the general objective of this study was to investigate the effects of management accounting practices on financial performance of listed companies in Kakamega County, specifically carrying out my research on material cost accounting, labour cost accounting, budgeting system and overhead cost accounting. The study was expounded using theories like contingency theory, agency theory, budget theory and cost-benefit theory as found in various books, articles and working papers to explore the factors characterising financial performance. The target population for this study comprised Mumias Sugar in Kakamega County. Simple random sampling method was used to come up with the sample size of 35 respondents from finance, accounting, procurement, production, Auditing departments targeting seven respondents from each department. Primary data obtained using interviews and questionnaires from the respondents were both quantitative and qualitative. Analysis was done using Statistical Package for Social Sciences (SPSS) and coding thus enhancing ability to present the information in form of tables and figures. It was concluded that The findings showed that, material cost accounting practices resulted to increased Return on Equity, Return on Assets and liquidity; however currently the company undergoes financial distress due to insufficient cash (mean=2.21 SD =0.69) that has been brought up by insufficient raw materials, and has stopped production process. In conclusion if modern skills and knowledge to staff and well as use of advanced management accounting practices results to greater financial performance.

### I. INTRODUCTION

#### 1.1 Background

Titer and Larcker (2002) defines management accounting practices as variety of methods specially considered for listed businesses so as to support the organization's infrastructure and management accounting processes. Therefore, Companies use management accounting techniques to assess their operations like budgeting, variance analysis and break even analysis. These methods help organizations to plan, direct and control operating costs and to achieve profitability. It is recognized that management accounting practices enhances organization success. (Horngren, et al., 2009)

Isa &Thye (2006) examined the usage of management accounting practices in listed firms in Malaysia. They also studied the relationship between product variety, complexity of production process, level of competition, company size, overhead expenses and usage of advanced management accounting practices. Management accountants in 500 listed firms were randomly selected from the 2004/2005 Federation of Malaysian Manufacturers Directory. A total of 75 usable responses were received, that represented a response rate of 15%. Respondents comprised of senior level managers, including Chief Executive Officers, General

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Managers and Management Accountants. In this study, the measures for traditional management accounting techniques (TMAT) and Advanced Management Accounting Techniques (AMAT) were adopted from Waldron and Everett (2004). The TMAT were represented by four techniques: full costing, standard costing, job order costing and process costing. The AMAT comprised of: Activity-Based Costing, Activity-Based Management, Target Costing, Value Added Accounting, Cost of Quality, Economic Value Added, Target Cost Planning, Cost Modeling, and Strategic Management Accounting among the others.

Salwar et al., (2012) did a survey of Activity Based Costing Adoption among Listed Companies in Nigeria. The study reveals that inability of the traditional cost systems to provide relevant cost was the most highly ranked reason in their decision to adopt ABC. Traditional methods of allocating overhead were therefore believed to be deficient in terms of improving global competitiveness. Also, 60% of the respondents have adopted ABC due to increased ranges of products, competition and increased overhead. The 40% of respondents who have not adopted ABC cited the cost and complexity involved with implementation as the main reason in non- adoption. However, cost of implementing ABC was enormous which hinder the small scale listed from adopting it. This result may reflect the fact that larger firms are more likely to have the diverse mix of products or services that makes the use of ABC advantages. Consequently, the study recommends that the companies who have not adopted ABC because of its high cost of implementation should endeavor to consider its adoption because in the long run the benefits derive from it will outweigh its cost. Virtually Kenya is a favorite destination investors would wish to put their money in listed sector. Even though the country is not endowed with the mineral wealth it's one of the best workforces in Africa, a productive agricultural sector hence a dependable source of raw materials for agro-based listed, a fairly versatile financial services sector, bankable telecommunications and proximity to port facilities. Wide range of opportunities for direct and joint venture investments exist in the listed sector including processing, manufacture of garments, assembly of automotive components, electronics, plastics, chemicals, pharmaceuticals, metal engineering products for both domestic and export markets (Republic of Kenya 2003).

According to the Major et al., (2005), the productivity growth in the Kenyan listed sector had been zero or negative since the early 1990s. Productivity declined by 0.5% per year between 1991 and 1998. Regression analysis of companies' data suggests that between 1999/2000 and 2002/03; almost no productivity improvement was visible in the average firms. There had been virtually no change in labour productivity. Based on the Kenya Association of Manufacturers (2010), majority of the Kenyan listed firms are slowly adopting modern models of overhead allocation techniques as they have previously been using traditional allocation Methods. The majority are adopting the Activity based costing which they consider superior to other overhead allocation techniques.

Wairegi, (2011),(Makau, Wawire, &Ofafa, 2013), (Waweru, 2012), (Mugambi, 2010), despite this previous research studies being vital, lack of management accounting practices for decision making and lack of technical skills are as much obstacles to developing listed companies as is the inability to access credit (Mbogo, 2011). This study thus sought to establish the effects of management accounting practices on financial performance of listed companies in Kenya.

## **1.2 Statement of Problem.**

Over the years, the challenges to keep costs down in order to keep better performance has been predominant in most companies, where these companies are given pressure from the shareholders to post better performance as suggested by Sarens and Abdul mohammadi (2011). According to Thompson, Strickland and Gamble (2009), management and stakeholders need to intensify and adopt new management accounting techniques to gain competitive advantage. (Makau, Wawire, & Ofafa, 2013, Mugambi 2010), states that, lack of advanced management accounting practices for decision making as well lack of employees' technical skills has thwarted growth and development of listed companies in Kenya . As today's business environment becomes increasingly competitive, business organizations are becoming more aggressive and dynamic in identifying strategies that will ensure profitable existence. Coulter (2010) notes that, competition may be attributed to business innovations, advancement in technology and the changing demand of customers. Competition amongst business organizations may compel the management to develop business techniques and strategies that would guide an organization towards the maximization of profits as suggested by Sundem, Stratton, Schatzberg and Burgstahler (2009:4). This may be achieved through increased sales and reduced cost of production enabling an organization to create a competitive advantage in its industry. Certain management accounting practices provide strategies that may influence a large number of customers to have a lasting preference for a company's products. Thompson, Strickland and Gamble (2009) are of the view that the adoption of management accounting techniques may provide an organization with a sustainable competitive advantage over its rivals.

Most of the existing research literature on accounting in Kenya listed companies tends to be more biased toward the arm of financial accounting, information technology adoption as well as research in credit accessibility for listed companies, more so only remote exists in regard to effects of management accounting

practices on financial performance of listed companies in Kenya (Wairegi, 2011), (Waweru, 2012), (Mugambi, 2010).

### **1.3 Research Objective.**

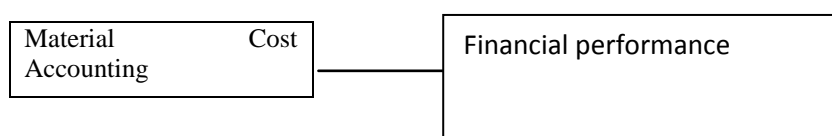
#### **1.3.1 General objective.**

The general objective of this study was to investigate the effects of material cost accounting practices on financial performance of listed companies in Kenya.

### **1.4 Conceptual Framework**

Independent variable

Dependable variable



## **II. LITERATURE REVIEW**

### **2.1 Budget theory**

Theorists describe trends, sequences of events, and infer causes, paying attention to local variations as well as uniformities across cases. They argue that new services should not be included in the budget, only that the cost for doing so should be the lowest possible commensurate with the quality of services demanded. They therefore advocated cost accounting (with its program budgeting implications) and detailed performance budgets based on unit costs. Budgets must contain a work plan and provide funding for future as well as current needs. Some of the reformers went further and argued that budget planning was a way of finding and responding to unmet needs in the community. (Otho Cartwright 2006). There is also need for cutting departmental budgets while improving services. This theory enables budgeters regain the ability to see what is in front of them, and therefore able to make right decisions. (Irene S.Rubin, Northern Illinois University). If this theory is applied in industries, will enhance continual production, and hence increase financial performance.

### **2.2 Cost-Benefit theory**

The process of judging whether or not a project should be accepted is called project evaluation. Cost-benefit analysis is the examination of a decision in terms of its consequences or costs and benefits. In the context of project evaluation a cost-benefit test is a simple decision rule which consists of accepting only those projects which make a positive profit at shadow prices. (Drury (2007) In order to evaluate a project from the point of view of its consequences, it is crucial to have a model which predicts the total effect on the state of the economy of undertaking a particular project. This total effect involves a comparison of the economy "with" the project and the economy "without" it. Formally, we embody the relation between a project and its consequences in the notion of a "policy", i.e. a rule which associates a state of the economy with each public production plan. Dasgupta and Stiglitz (1981).

### **2.3 Empirical Studies**

Traditional management accounting practices have been under substantial criticism for their lack of efficiency and capability in coping with the requirements of a changing environment during the last two decades (Askarany & Smith, 2004). Such criticism relate to the failure of traditional management accounting practices to provide detailed information on activities important for organization.

#### **2.3.1 Material Costing**

Rich Lavelly (1998) asserts that there are two types of inventory calculations that determine the inventory level required for profitability. The two calculations are "cost to order" and "cost to keep". James Healy (1998) highlights that the distributors carry 10-30% of additional inventory that is unnecessary. These inventories unnecessarily increase costs and loss of customers, lost of sales and lost profit due to inefficient inventory management. He points out there is a need to set out procedures to find out physical inventories to determine the true cost of handling cost of the inventory. He further points out some misconceptions of the inventory management such as adequacy of Enterprise Resource Planning System in handling the inventory. The following techniques play important roles in inventory control programmes.

#### **2.3.2 Economic Order Quantity**

These are costs attached to the ordering quantity. These costs are ordering cost and carrying cost. Chopra & Meidl (2001) defines EOQ as an inventory-related equation that determines the optimum order

quantity that a company should hold in its inventory given a set cost of production, demand rate and other variables. This is done to minimize variable inventory costs. In his study, Dave (2001) found out that the addition number of units of inventories enables the company to minimize the total costs of inventory such as holding costs, order cost and shortage cost. Schaidler (2001) echoed his sentiments by stating that EOQ attempts to estimate the best order quantity by balancing the conflicting cost of holding stock and of placing (Ordering) the replenishment orders. Schaieder (2001) States that, EOQ Contributes to strategic inventory management since it is used as part of a continuous review inventory system, in which the level of inventory is monitored at all times, and a fixed quantity is ordered each time the inventory level reaches a specific re order point. According to Schaidler (2001), ordering a large amount at one time will increase holding costs, while making more frequent orders of fewer items will reduce holding costs but increase order costs, the EOQ model finds the quantity that minimizes the sum of these costs and interestingly Lyson& Farrington (2006) asserts that EOQ is a model for making such kind of decisions.

### **2.3.3 Just in Time Inventory (JIT)**

JIT is the latest trend in inventory management. Christopher (2005) defines JIT as the uninterrupted flow of 100% acceptable materials delivered on due date as option cost 100% of time. This entails techniques like supplier certification materials, requirements planning, MRP listed resource Planning, (MRP), bar coding systems, contracting, and electronic data interchange (EDI) Value analysis and work simplification. This type of purchasing production and inventory control has the great advantage of locating and fixing quality problems immediately. The supplier provides full time on site personnel who attend design-engineering meeting, investigates their products and use the company's purchase orders to affect delivery. (Christopher, 2005)

### **2.3.4 ABC Analysis**

Lysons & Farrington (2006) defines ABC Analysis as a method for inventory categorization used in inventory management and/or materials management. In this approach normally 3 types of inventory items are separated: A Items: these require tight control and Just-in-time management, because even if they are present only in small numbers, they make up a large percentage of inventories on a cost basis. B Items: these can be less tightly controlled because they are less expensive than A- Items, C Items: these require only very limited or no control, because they are large in numbers and very cheap. Smarus (2008) contents that; a big organization has a large number of items. All items cannot be given equal attention, it is therefore essential to determine the items or group of items that deserve the maximum control.

## **III. RESEARCH METHODOLOGY**

### **3.1 Research Design**

According to Orodho (2003) research design is a scheme, outline, or plan that is used to generate answers to research problems. This study adopted a case study research design because it was easy and convenient to be conducted using Interview guides, documents and questionnaires as viewed to be appropriate and therefore the researcher collected data relating to management accounting practices (material cost accounting, labour cost accounting, budgeting and overhead cost accounting) on financial performance (ROE, ROA). The data collected described, explored, and quantified social phenomena, particular issues, conditions, and problems that are prevalent in listed companies.

### **3.2 Research Population.**

Target population is the entire group of objects of interest from whom the researcher seeks to obtain the relevant information for the study (Cooper & Schindler, 2011; Kothari, & Onen 2011; Kombo & Tromp, 2011). Based on my research design, Mumias Sugar Company limited in this case was used to carry out a deep study on the topic, '**effects of management accounting practices on financial performance of listed companies in Kakamega Company**'

### **3.3 Sample Design.**

Sampling is the process of obtaining information about an entire population by examining only a part of it. Copper and Schindler (2011) and White (2000) argue that sampling is commonly used in inferential statistics to make predictions on the behaviour of the population. Using simple random sampling techniques, the characteristics of the population were accurately reproduced in the sample. The sample size of 35 respondents comprising of managers and employees of Finance, Accounting, Procurement, Auditing and Production departments, issuing seven questionnaires to each of the above mentioned departments.

### 3.4 Data Analysis and Interpretation.

Data analysis is the process of bringing order, structure and meaning to the mass of information collected (Mugenda & Mugenda, 2003). Given that the study will be conducted using a mixed method approach, analysis will be done using Statistical Package for Social Sciences (SPSS) and coding. SPSS enhanced presentation of information in form of tables and figures. The raw data collected was sorted and edited as the first step towards its analysis. The questionnaires organized and classified according to the patterns given by the respondents and their homogeneity. The responses from the questionnaires organized in line with the research questions and descriptive narratives used to reflect the situation as it occurred. Both descriptive and inferential statistics were used to analyze data. Descriptive statistics included frequencies from which percentages were derived. The analysed data then summarized and findings reported as a description of the total population of the study. Thereafter the data was presented in form of pie charts, histograms, frequency tables and in percentages.

## IV. DATA ANALYSIS, RESULTS AND INTERPRETATIONS

### 4.1 Usage of material cost accounting practice in the respondents' organization.

By the use questionnaires, respondents in the field were asked to clearly indicate the extent to which they agreed with the usage of material cost accounting practice statements in their company. They used a likert scale ranging from 1= (strongly disagree) to 5= strongly agree to show their responses. To measure satisfaction on the tested variables, a mean above 3.0 was regarded to be more satisfactory. On the other hand, standard deviation depicted variations from the mean. A higher standard deviation suggests that data was spread over a wide range of values whereas low standard deviation indicates that data is almost close to the mean. The following results were obtained

**Table 4.1** The usage of material cost accounting practice in the respondents' organization

Material cost Accounting	1	2	3	4	5	Mean	SD
We comprehensively inspect materials upon receipts against some set standards.	0.0	0.0	7.1	50.0	42.9	4.36	0.62
All incoming materials are grouped for coding to enhance controlling and monitoring materials.	0.0	0.0	7.2	21.4	71.4	4.64	0.62
Material codification avoids duplications of items in inventory and ensures correct entries in the bin cards.	0.0	0.0	0.0	21.4	78.6	4.79	0.42
Materials are well and clearly classified purposely to keep total inventory size and cost down.	0.0	0.0	0.0	28.6	71.4	4.71	0.46
Stock out levels of materials area as a result of poor documentations, poor monitoring of inventory levels.	7.1	14.3	14.3	35.7	28.6	3.64	1.25
<b>Overall mean</b>						<b>4.43</b>	<b>0.67</b>

From the findings above, 92.9% of participants indicated that materials were comprehensively inspected upon their receipts, 92.8% agreed that incoming material were grouped for coding, 64.3% agreed that stock out levels of materials are as a result of poor documentation, poor monitoring of inventory levels. Materials were clearly classified, and their codification avoided duplications of items in inventory and ensured correct entries in the bin cards. From the overall mean of 4.43 material cost accounting practice was rated to be highly used in the company. From the above findings it is evident that, the company applies material cost accounting practices that have an impact on the financial performance of listed companies.

### 4.2. Usage of labour cost accounting practice in the respondents' organization.

The researcher examined the effects of labour cost accounting as one of management accounting practices on financial performance of listed companies in Kenya. Below are the results of the findings.

**Table 4.2** Usage of labour cost accounting practice in the respondents' organization

Labour cost Accounting	1	2	3	4	5	Mean	SD
I receive other rewards in addition to my salary.	7.2	21.4	14.2	42.9	14.3	3.36	1.19
All deductions are subjected to gross pay to determine the employee's net pay.	7.1	0.0	7.2	14.3	71.4	4.43	1.14
Sections under payroll department coordinate and reconcile their records before payment.	0.0	7.2	14.3	7.1	71.4	4.43	1.00
Pay systems provide a base on which the company rewards workers of their individuals contribution, skill and performance.	0.0	14.3	35.7	21.4	28.6	3.63	1.06
The selection of the company's pay system is often							



determined by negotiations between management and worker representatives.	21.4	35.7	21.4	14.3	7.2	3.50	1.20
<b>Overall Mean</b>						<b>3.87</b>	<b>1.12</b>

Based on the above findings, it was observed that the company performed labour cost accounting controls. From the results, 57.2% of the respondents received additional rewards on their salaries due to their good performance, 85.7% (mean=4.43, SD=1.14) were subjected to statutory deductions before paid. All sections under payroll department coordinate and reconcile their records before payments are made had, (mean=4.43, SD=1.00). It was also observed that pay systems provide a base on which the company rewards workers of their performance had (mean=3.64, SD= 1.06) and 50% agreed to this. To arrive to this pay system, 52.4% indicated negotiations between management and worker representatives translating to a mean of 3.50 and standard deviation of 1.20. From the above results, it was concluded that listed companies carried out labour cost control activities that ensured that employees received what they deserve as this motivates them to work, thus boosting the company's financial performance.

### 4.3 Regression Analysis

Regression analysis technique identifies the relationship between a dependent variable, whose value is to be predicted, and an independent variable (or variables), about which knowledge is available. The technique also is used to find the equation that represents the relationship between the variables. The researcher conducted a multiple regression analysis so as to test relationship among variables (independent) on the financial performance of listed companies in Kakamega County. Coefficient of determination explains the extent to which changes in the dependent variable can be explained by the change in the independent variables or the percentage of variation in the dependent variable (financial performance of listed companies in kakamega) that is explained by all the five independent variables (material cost accounting, labour cost accounting, budgeting and overhead cost accounting). The study adopted multiple regression guided by the following model:

$$F_{pt} = \beta_0 + \beta_1 X_1 + e$$

Table 4.3.1 shows the regression model summary results where R square, adjusted R square and standard error of estimate are presented.

**Table 4.3 Model Summary**

R	R Square	Adjusted R Square	Std. Error of the Estimate
0.891	0.794	0.642	3.31805

The results in Table 4.3.1 indicate that the management accounting practices had a joint significant effect on financial performance of listed companies in Kenya as shown by r value of 0.891. The R squared of 0.794 shows that the independent variables accounted for 79.4% of the variance on financial performance of listed companies in Kenya.

Table 4.3 shows the ANOVA results which explain the model fit through the F statistic and the probability of F-statistic.

**Table 4.4 ANOVA Summary**

	Sum of squares.	Degree of freedom	Mean of squares	F	Significance
Regression	124.47	8	24.89	2.001	0.18
Residual	220.19	19	11.01		
Total	344.66	27			

The results in Table 4.3.2 show that the F statistic was 2.001 the F statistic was significant. In this case, all the predictor variables (material cost accounting, labour cost accounting, budgeting and overhead cost accounting) explain a variation in financial performance and that the overall model is significant. Also shows the coefficient results for the model variables, the t-values of each of the independent variables as well as the significance.

**Table 4.5 Coefficients**

Model	Un-standardized coefficients		Standardized coefficients	t	Sig.
	B	Standardized error	B		
(Constant)	0.706	0.229		0.670	0.018
Material cost accounting	0.599	0.044	0.245	0.591	0.15

From the findings in the above table the study found that holding material cost accounting constant financial performance will be 0.706, the study also found that an increase in material cost accounting practices will lead to an increase in financial performance by a factor of 0.599.

#### **4.4 Summary and interpretation of findings**

Study findings revealed that the Material cost accounting practices have a joint significance of 79.4% effect on financial performance of listed companies. According to Chenhall and Langfield-Smith (1998b) the greater use of advanced management accounting practices, such as quality improvement, benchmarking and activity-based management, in firms that placed a strong emphasis on product differentiation strategies, ultimately results to high financial performance. It was evident from the study that holding overheads cost accounting, labour cost accounting, material cost accounting and budgeting constant, financial performance will be 74.6%, where budgeting has a greater effect on financial management followed material cost accounting, overhead cost accounting and then labour cost accounting respectively. This concurs with a well-established empirical evidence for an association between MAP and performance.

## **V. SUMMARY, CONCLUSION AND RECOMMENDATIONS**

### **5.1 Summary**

The study used primary data collected using semi-structured questionnaires. Quantitative and qualitative data collected was analyzed using descriptive statistics and content analysis respectively. Further multiple regression analysis was used to establish the relationship between management accounting practices and financial performance of listed companies in Kakamega County.

The study discovered that material cost accounting practices were highly used. These practices included; material inspection, material coding, material classification and proper documentation, monitoring of inventory levels. Operational managers who are engaged in day-to-day operations had skills on budget drafting and use them to exploit company opportunities. It is the responsibility of the costing department of a listed company to ensure that an appropriate method of overhead costs apportionment is adopted to do accurate apportionment that would ensure accurate selling price determination, so that the overall performance of the company could be enhanced. In labour cost accounting, all the data on the number of hours worked should be kept by all departments, reconciled to ascertain the net pay to employees. Performing employees should be rewarded to motivate them to work even better for the common good of the organization. The study also established that management accounting practices have an impact on financial performance of listed companies in Kakamega County. Well established listed companies use advanced management accounting practices that minimize costs and maximize profits. Employees need to equip themselves with skills needed to operate the new machines so as to carry out firm operations effectively and efficiently.

### **5.2 Conclusions of the study**

The findings revealed that, material cost accounting is the highly used management accounting practice in the company, followed by budgeting, overhead cost accounting and labour cost accounting. The study as well showed that due to the advancement in technology, the company had invested in advanced management accounting practices that are believed to be cost effective and more efficient e.g. just –in- time, Target Costing, and Activity Based Costing practice. Employees needed skills and knowledge on how to use these machines as required thus generating more income. Technology as well ensured quality production of products and quality services to its customers enabling the company to be more competitive in the market. Employees with relevant skills and experience were recruited. To qualify for that given job, one needs to go through an intensified interview.

The findings showed that, advanced management accounting practices resulted to increased Return on Equity, Return on Assets and liquidity; however currently the company undergoes financial distress due to insufficient cash (mean=2.21 SD =0.69) that has been brought up by insufficient raw materials, and has stopped production process. In conclusion if modern skills and knowledge to staff and well as use of advanced management accounting practices results to greater financial performance.

### **5.3 Policy Recommendations**

From the practice perspective, this study recommends the creation and enhancement of awareness among firms of the importance of information for material cost accounting practices as this is the most highly used management accounting practice amongst the listed companies. The findings recommend that to achieve a proper measure of financial performance, firms need not only to integrate inspection standards, codification, classification and proper documentation, and monitoring of inventories. In relation to policies, accounting curriculum should be developed consistently to the changing role of accountants. Accounting Education must equip their student with capabilities in coping with the rapid changing of the business environment so that they can always provide relevant management accounting information to managers. Academics and practitioners can

use the findings of this study to fully understand how management accounting practices can help to improve business performance in companies. To make management accounting an ethical practice, it is the responsibility of management accounting professionals to remain relevant in adding value to the companies for which they work as well as their profession by keeping research findings in their area of responsibility.

#### **5.4 Suggestions for Further Research.**

There is need to carry out a research on specific reasons as to why most listed companies are not adopting the new management accounting techniques as well as benefits associated with newly developed management accounting practices. Carry our research outside the country with similar firms and compare between the two firms of two countries on the use of management accounting practices as well their impacts on financial performance. A research should be carried on other companies as well to find out how effective they apply management accounting techniques. In conclusion, even though technology results to efficiency and effectiveness of operations, some organizations does not easily subscribe to them. Therefore a research on why organizations does not easily adopt to this is very necessary.

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