Financial Management Practices and Financial Performance of Construction Companies in Nairobi County

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Abstract: **Nowadays, competition is becoming very stiff in the business environment Due to this fact, business firms are trying hard to create better interaction with customers and suppliers. Similarly, wise decision making is very crucial to the success of the business firm. This study sought to establish the relationship between financial management practices and financial performance of construction companies: A case study of construction companies in Nairobi County. Specifically, the study sought to establish the effect of internal controls on financial performance of construction industry in Nairobi County. The target population consisted of 167 registered construction firms in Nairobi County. This study adopted census sampling technique since the population size was small. The mean and standard deviation stood in for the descriptive technique.Correlation and regression analysis were the inferential statistics used in the study. The study concludes that internal control has a positive influence on financial performance of construction companies in Nairobi County in Kenya.**

Key words: **internal controls, financial management practices and financial performance**

I. INTRODUCTION

Many people who start to run a business do not engage themselves in financial matters. The reason may be because they do not have enough knowledge or interest in recording transactions, preparation and analysis of financial statements and secondary they are extremely involved in other aspects of business like managing people, sales, purchases and production. These entrepreneurs rely on their accountants to run the financial side of their business. While financial management is a critical element of the management of a business as a whole, within this function the management of its assets is perhaps the most important. In the long term, the purchase of assets directs the course that the business will take during the life of these assets, but the business will never matures if it cannot plan an appropriate policy to effectively manage its working capital. This cause the poor financial management of owner or lack of financial management is the main underlying cause affecting the construction companies' financial management (Chung & Chuang, 2013).

Among the many function of management, Financial management is deemed to be core and vital in the success of any business enterprises (Uwalomwa&Uadiale, 2012). Inadequate management of the finances, in conjunction with the uncertainty surrounding the business entities result to enormous problem associated with firm. According to Kawame (2010), misallocation of the finances and misplaced agenda result into failure of the business in most of the business firms. The profitability and the returns will be adversely affected if there exist poor management practices irrespective whether the firm is being managed by the core owners or the hired management. More importantly the profitability will further be affected by the inefficient financial management practices. Falling in the the financial management skills eventually result to the business failure accompanied with it operation both in the short and long-term. The uncertainties surrounding many of the business have resulted to many businesses relying on equity as the sole source of the financing. Excessive relying on the equity as source of the capital requires business to maintain high levels of liquidity in its operation which may have an adverse effect on the profit in the (Chung & Chuang, 2013).

This study will focus on four financial management practices namely: internal controls, corporate governance, working capital management and capital budgeting techniques. According to Hamed (2014) internal controls is a systematic way of carrying out organization's activities and procedures, within specified company rules and regulations for the overall success of the enterprise. Corporate governance are the practices that shape the behavior of managers of the organizations in achieving the organizational goals. The strategies developed will help the managers in planning, monitoring and evaluating its overall financial performance in the management of risks and any uncertainties. Sound corporate governance activities can improve the financial performance of the companies. Good corporate governance practices aim at creating wealth for the stakeholders of the business entities who include the suppliers, shareholders, creditors and financial institutions. It will also ensure the rights of the shareholders are protected, shareholders are treated equally, their rights are protected and disclosures on the financial results are fully revealed by the management (Manne, 2015).Working capital management constitutes managing the assets and liabilities in an organization to ensure that an organization has the required liquidity.Capital budgeting is the process through which the various proposals are discriminated based on a given criteria for the purpose of

choosing the best among them for investment (Shim and Siegel, 2014). In performing this process, managers can act intuitively or apply some criteria through the use of capital budgeting techniques

Statement of the Problem

The Kenya Economic Survey (2018) confirmed that the construction companies have relatively low performance as compared to other sectors in the economy as evidenced by a slow growth rate of 4.3% per year. This has brought mainly by the uncertainty of the business environment and lack of knowledge on financial management practices which causes construction companies to experience difficulties with regards to financial output. Additionally, the poor financial management practices create an environment that is prone to malpractices and low transparency thus reduces returns. There have been numerous studies conducted for the purpose of establishing how financial management practices influence the construction companies' financial performance.

One role of the financial management in an organization is to ensure that funds are readily available when needed and the allocation is done on cost effective basis to benefit all the stakeholders (Afolabi, 2013). The practice and requirement of the financial management can be a nightmare and troublesome burden to the construction companies on the utilization of funds in regards to the well outlined budget that need to be well kept and adhered (Olango, 2014). The process of the firm financial management tend to be weaker and dominated mainly by the attributes of the financial scarcity result to inefficient financial management related issues thus increasing the cost of operations and the associated cost in both the short and long term. ,wastage and frauds negatively impacting on the performances of the entire firm (Khan & Rahim, 2015).The above mentioned implications make the researchers and scholars to attempt and have the urge to research and study the effect of the financial management practices on the financial performance of construction companies in Nairobi county.

Most of studies have been carried out regarding the relationship between the performance and practices of the financial management. According to Taiwo and Adejare (2014) analysed the impact of the international financial reporting standard (IFRS) applicability of a Nigerian firm empirically. The findings outlined out that a strong positive relationship co-existed between the application of the IFRS and the firm performance. Ahmed (2012) researched the effect of the management of the working capital on the performance of listed non-financial firm in Pakistan. The finding indicated a strong relationship between the performance and current assets over the total assets, inventory turnover, debtor turnover and current ratio. According to Nyakundi, et al (2014) the international control has a great impact on the performance of small business enterprises in Kisumu city, Kenya. The study specifically outlined that a slight change in the internal control systems have a more significant change on the performance of the firm. Kumar (2015) researched the correlation between the performance and strategic planning of the firm. The empirical study was conducted between the American and Asian firms without consideration of the size factors, a positive relation between the performance and strategic planning was revealed. Considering that all the variables had a positive association with the firm performance.

Most notably, none of the studies and research reviewed has been conducted on financial management practices and financial performance mainly in the construction industry in Kenya as a focus. This have left a wide gap of literature in the construction industry and urgency of effort applied to closing the gap hence the research attempts to focuses and address the gap by researching and studying the effect of the financial management practices on financial performance of theconstruction industry Kenya.

Objectives of the Study

The general objective of this study was to establish the relationship between financial management practices and financial performance of construction companies in Nairobi County

Specifically, the study sought to establish the effect of internal controls on financial performance of construction industry in Nairobi County

II. THEORETICAL LITERATURE REVIEW

This study wass guided by AgencyTheory. Among the outstanding scholarly work done by Jensen was the agency theory Jensen and Meckling (1976). The agency relationship is one of the contributors of the agency theory. The principal party delegates his/her authority and power to carry out his/her mandates to another party, the agent party. The agency relationship is a contractual obligation where one party knowns as the principal delegate the authority and power to carry out the task to another party known as the agent and also to take down the role of the decision making and implementation. (Jensen &Meckling, 1976). According to Noreen (1985) agency theory can be used to authenticate parables of the instructive series that well outlines the negative outcome of the free and uncompromised behavior that deemed to be opportunistic in nature, form a basis of setting up an ethical case of business relationship. According to the well explained definition the individuals have the right to act in an opportunistic manner but also have to exercise the stringent restrain in one way or the other. The circumstance, institutional, background and culture context are main underlying factors on how they take down their activities.

The growing concerns which have piled over in the year was well addressed by the agency theory, where the shareholders interest was being disregarded by the management due to their focus and concentration on the empire building over the time. This is what the famous Michael Jensen framed as "shareholders and bondholders

systematic fleecing" (1989), using the strained and stringent prescriptions outlines how the principle should control the agents to control the managerial opportunism and self (Daily *et al*., 2013). The market do appreciate and responded to this change in a logical and well-versed manner, within a span of the time the agency became institutionalized in the corporate world of the management practices, education related to business, and media and research and (Shapiro,2015).

The relevancy of the theory to this study is that, it well outlines the agency relationship between the shareholders and management of the construction companies. The management are deemed to be the agent of the shareholders and the principal are the shareholders. Some time the management may not act in the best interest of the shareholders mainly in the concern of the financial management of the companies. In this relation the management should basically focus on the working impartially for the betterment of the success of the construction industry financial management.

Empirical Review

Abdi (2015) investigated how internal controls impacted on financial performance among private banks in Mogadishu. The demographic profile of the respondents was age, gender, qualification and experience. The main objectives were to assess the functionality of internal control systems in Mogadishu private banks and to examine financial performance of private banks in Mogadishu. The study was based on 33 target population especially Accountants, finance directors, chief cashiers, internal auditors and managers of private banks in Mogadishu Descriptive analysis was used. It administers questionnaire as a research instrument. The findings of this study reveal that majority of the private banks in Mogadishu have enough cash to meet its intended goals. Also there is a clear separation of duties. This study suggests that the internal auditors perform their duties fast, efficient and reliable.

Mwakimasinde, Odhiambo and Byaruhanga (2014) sought to determine how internal controls influenced financial performance. The study was done in sugar cane growing firms in Kenyan context. The design adopted was correlational. The study covered all out grower companies of sugar cane. Data was collected with the aid of questionnaire hence it was primary in nature. Additional data was sought from published accounts of the respective companies which was secondary in nature. Key informants that included internal audit heads and finance managers were involved in answering the formulated interview guides. In total, 9 companies were covered. The findings indicated that internal controls systems have direct and significant influence on financial performance of the studied firms.

Hamza, Mutala and Antwi (2015) studied how the practices of managing cash influenced financial performance. The study was done in the SME context, in Ghana. The design adopted was descriptive. A total of 1000 owners of SMEs were targeted. Through stratification of this population and randomly selecting respondents, 300 SMEs were established as the study sample size. The findings indicated that cash management practices positively and significantly influenced financial performance.

Using a case of SMEs in Kenya, Nyakundi, Nyamita and Tinega (2014) analysed how internal controls systems influence their financial performance. ROI was used as a proxy for financial performance. The techniques used for sampling included stratified and sample random methods. The design adopted was mixed methods with cross sectional design. Questionnaires and published statements were used in collection of data. The study established that any change in internal control is directly linked with financial performance of the firms. It was revealed that internal control systems influence financial performance significantly.

In Ghana, Ibrahim, Diibuzie and Abubakari (2017) sought to determine how systems of internal controls influenced financial performance. The study covered 5 health centres. The sample size comprised of 50 respondents. The findings indicated that internal controls positively influence performance. Among tertiary institutions in Nigeria, Adetula, Balogun, Uwajeh and Owolabi (2016) looked at how internal controls affected performance. Data was collected through primary source using questionnaire. The study established that internal controls influence performance of the studied institutions.

Dineshkumar and Kogulacumar (2013) sought to study the impact of the internal control systems on performance of the Sri Lanka telecom limited. A sample of 60 employees were selected to be employed tin the study. The SWOT analysis and coefficient of correlation and percentage were the main tools to be employee in the study. A strong relationship was depicted from the study between the internal control systems and the performance of the organization of the telecom firm in Sri Lanka.

Magu and Kibati (2016) carried out a research on the influence of internal control systems on the performance of the firm financially in the Kenya farmers association limited. A sample of 78 managers was drawn to be involved in this explanatory study. The design of the census was to be adapted from the inception to the end. Descriptive statistics and inferential was used as the main tools in the data analysis. The results obtained showed that, the relationship between the control system and financial performance of KFA Ltd was positive in the nature of the association. The variations in the financial performance were 61.3% mainly contributed by the control activities and control environment.

Nyakundi, Nyamita and Tinega (2014) investigated the effect of internal controls on financial performance of the firm. A small and medium scale firms in size were selected in study mainly drawn from Kisumu city in upper Kenya. A sample of 168 SMEs registered with the ministry of the labour were drawn for the study from Kisumu ministry of the labour, Kisumu office dated 31 December 2012. The outcome of the

study revealed out that to a small change in performance result change in internal control system study. The findings specifically revealed that a significant change in financial performance is linked to internal controls systems. With the findings of the research, internal controls are well supported by the study that significantly influences the performance of the small medium scale enterprises.

Conceptual Framework

This conceptual framework gives an informative schematic relationship between the study variables. The independent variable in the study was measured by internal controls, corporate governance, Working Capital Management and Capital Budgeting Techniques. The financial performance formed the dependent variable for this study and was measured by ROA.

Independent variables *Dependent Variable*

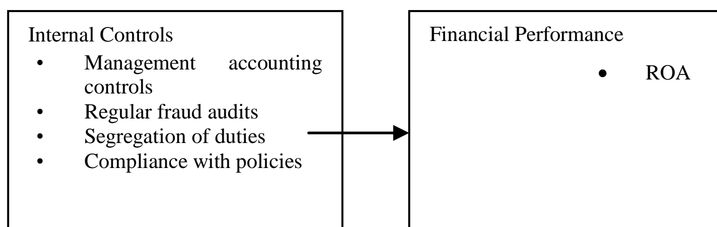

Figure 1: Conceptual Framework

III. RESEARCH METHODOLOGY

Research Design

The descriptive research design was employed in the study with both descriptive and inferential statistics to evaluate the financial management practices and performance of the construction companies in Nairobi County. In a descriptive survey, sampling is a very vital process and must be done using the right method to avoid bias (Onwuegbuzie & Leech, 2005). The choice of this research design is informed by the fact that, a descriptive design allows an individual obtain huge amounts of data using a cheap and relatively simple technique.According to (Creswell, 2013)

Population

The target population consisted of 167 registered construction firms in Nairobi County. The list of the firms is obtained from the National Construction Authority which is the governing body.

Sample and Sampling Technique

This study adopted census sampling technique since the population size is small. Therefore, the sample size was 167 respondents. The respondents were the finance manager for all the registered construction firms in Nairobi County.

Data Collection Procedures

The study collected both primary and secondary data. Questionnaire was used to collect primary data with regards to internal control, corporate governance and financial performance. The applicability of the questionnaire was used to collect the primary data. The data was collected from the targeted respondents with the use of Likert scaled questionnaire. Secondary data was used to get information with regards to working capital and capital budgeting. In order to situate the study theoretically and produce the conceptual framework report, the secondary sources was obtained from financial and annual statements of the firms over a period of 5 years (2015-2019)

Data Analysis and Presentation

Data was analysed using descriptive and inferential analysis under the SPSS software. The mean and standard deviation stood in for the descriptive technique. The strength of the association between the variables both independent and dependent (financial performance) was analysed using correlation of coefficient. The summary model, analysis of the variance and regression of the coefficient were analysed using the regression model. The parameter used to test the relationship and the significance between the independent and dependent variable was the parameter of the regressionwhich tohelped achievethis.

ModelSpecification

In specific the below regression model was adopted:

$Y = \alpha + \beta_1 X_1$Where:

Y= Financial Performance

Terms of profitability and related financial performance. Return on Assets=Net Profit/ Total Assets

X_1= Internal Controls

IV. RESULTS AND DISCUSSION

The results were computed to produce percentages, frequencies, mean and standard deviation for efficiency in interpretation. Qualitative analysis was conducted to supplement the quantitative analysis.

Descrptive Statistics

The study sought to establish the extent of agreement with various statements on the effect of internal controls on financial performance of construction industry in Nairobi County. The status of this variable was rated on a 5 point Likert scale ranging from; SA-strongly agree (5), Agree(4), U- undecided(3), D-disagree(2), SD-strongly disagree(1). The study findings are depicted in Table 1.

Table 1: Internal Control and Financial Performance

	SA	A	U	D	SD	Mean	Std. Deviation
The internal Control activities used by the company are detective and preventive in nature henceimproving financial management	40	90	0	2	0	4.2727	.53987
Information and communication flows well in the company's department ensuring prompt use and action of information	11	107	13	1	0	3.9697	.46132
The monitoring activities adopted by the company have improve financial management over the years	30	91	10	1	0	4.1364	.56315
Risk assessment and mitigation in the firm has effectively enabled the firm only invest in the most profitable/	19	101	5	5	2	3.9848	.68779

According to the study findings, majority of the respondents strongly agreed that the internal Control activities used by the company are detective and preventive in nature hence improving financial management (Mean=4.2727) and that the monitoring activities adopted by the company have improve financial management over the years (Mean=4.1364). In addition, respondents agreed that risk assessment and mitigation in the firm has effectively enabled the firm only invest in the most profitable (Mean=3.9848) and that information and communication flows well in the company's department ensuring prompt use and action of information (Mean=3.9697). This implies that internal control activities used by the construction companies in Nairobi County are detective and preventive in nature hence improving financial management and that the monitoring activities adopted by the construction companies in Nairobi County have improved financial management over the years

Correlation Analysis

Correlation analysis was done to establish the relationship between internal control, corporate governance, working capital management as well as capital budgeting techniques and financial performance.

Table 2: Correlation Analysis

	Financial performance	Internal control
Financial performance	1	
Internal control	0.83	1

A very strong positive relationship was established between the internal control and financial performance of construction companies in Nairobi County in Kenya as indicated by the Pearson's r =0.83. In tandem with the study findings, Mwakimasinde, Odhiambo and Byaruhanga (2014) sought to determine how internal controls influenced financial performance. The study was done in sugar cane growing firms in Kenyan context. The design adopted was correlational. The study covered all out grower companies of sugar cane. Data was collected with the aid of questionnaire hence it was primary in nature. Additional data was sought from published accounts of the respective companies which was secondary in nature. Key informants that included internal audit heads and finance managers were involved in answering the formulated interview guides. In total, 9 companies were covered. The findings indicated that internal controls systems have direct and significant influence on financial performance of the studied firms.

Regression Analysis

The predictor variables and their influence was determined using a multiple regression analysis that was conducted by the study. The multiple regression's measurements were coded, entered and computed using the statistical package for social sciences (SPSS V 21.0).In order to test how how internal control impacts on the financial performance of construction companies in Nairobi County.

Table 3: Model Summary

R	R Square	Adjusted R Square	Std. Error of the Estimate
.916[a]	.839	.799	1.211

The results in Table 3 indicate that the internal control, had asignificant effect on financial performance of construction companies in Nairobi County as shown by r value of 0.916. The R squared of 0.839 shows that the internal control accounted for 83.9% of the variance on financial performance of construction companies in Nairobi County.

Table 4: Coefficients

	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
(Constant)	3.936	0.451		8.727	0.00 00
Internal control	0.741	0.213	0.14 6	3.479	0.00 31

The overall regression model for this model was:

$Y = 3.936 + 0.741X_1$

Internal controls have a positive influence on financial performance of construction companies in Nairobi County in Kenya. It indicates that any unit increase in the internal control will cause financial performance of construction companies in Nairobi County in Kenya to increase by 0.741.

V. CONCLUSION

The study concludes that internal control activities used by the construction companies in Nairobi County are detective and preventive in nature hence improving financial management and the monitoring activities adopted by the construction companies in Nairobi County have improved financial management over the years. In addition, a very strong positive relationship was established between the internal control and financial performance of construction companies in Nairobi County in Kenya. The study also concludes that any unit increase in the internal control will cause financial performance of construction companies in Nairobi County in Kenya to increase

VI. RECOMMENDATIONS

It is important that the construction companies establish a robust internal control system that enhances risk assessment and monitoring. Notably, risk management benefits firms since risks can be identified and mitigating measureundertaken before the risks materializes.

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