An Assessment of Liquidity and Shareholders' Earnings of Listed Firms at The Nairobi Securities Exchange, Kenya

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ABSTRACT

The global changes in the business environment and the increased demand for improved shareholder's earnings have prompted big firms to re-examine their liquidity levels. During the 2008 global economic crisis, many big institutions experienced liquidity challenges which led to the decline in the earnings of shareholders. The current study was therefore necessary to analyse the effect of liquidity on shareholders earnings of listed firms at the Nairobi Securities Exchange. The liquidity theories, were used to guide the research. A descriptive research design was used in this study. The study's target population was all listed companies on the Nairobi Securities Exchange over the period 2015 to 2021. The 64 companies were analyzed using the census study. Data had been collected using a secondary data collection sheet. The study employed secondary data obtained from the published financial statements of the respective firms, from the Nairobi Securities Exchange and the Capital Markets Data. A panel regression model was employed in the analysis of data with the aid of the stata version 14. The study found out that Liquidity had a positive significant effect on the shareholders earnings. The study recommends that listed firms should enhance its liquidity by investing more on liquid assets. This should entail more investments in treasury bills, treasury bonds and other liquid stocks. They should also diversify their investments by investing in money markets. Additionally it should enhance its liquidity by controlling its overheads through getting rid of unnecessary expenses. Secondly, the listed firms need to expand its asset base.

Keywords: Liquidity, Shareholders Earnings.

BACKGROUND OF THE STUDY

Globally the business environment is becoming more and more dynamic coupled with a demand towards improved shareholder's earnings. As a result, many firms are shifting the focus towards examining their firms' liquidity (Salah, 2018). With the collapse of several institutions during the financial economic crisis of 2008, focus was also shifted towards earning quality, as earnings manipulation was found to be one of the dishonest accounting practice that gave the shareholders of most companies like Enron and WorldCom a false impression that their firms were stable and performing relatively well (Hassan & Farouk, 2014). Earnings manipulation is mainly used by some executives to maximize profits while reducing risks and the main reason behind earnings manipulation is to meet the financial expectations of the shareholders while increasing the value of its market shares. Liquidity therefore play a paramount role in understanding the earnings quality for the reason that they influence the internal and external decisions of the firm (Salah, 2018).

In the United States of America, the widely publicized case was that of WorldCom, Enron and Lehman

Brothers which were found to have collapsed as a result of poor earnings management practices. It was established that the audit firms failed to warn the companies on its poor earnings management practices (Turegun, 2016). In Asia, firms are also increasingly putting efforts on the financial soundness indicators to enhance the shareholders' earnings. While examining the Tehran stock exchange, Moghaddam and Abbaspour (2017) underscored the importance of liquidity as a tool for financial soundness since liquidity has a significant and positive effect on earnings management. Nazal and Al-Fasfus (2018) observed with Jordanian banks that if there is liquidity risk, the shareholders' returns were adversely affected therefore firms should ensure that there is adequate level of liquidity at all time. In Kenya, firms are also increasingly paying much attention to earnings of the shareholders driven by the goal of maximizing the shareholders earnings (Nyatichi, Iraya, Mwangi&Njihia, 2020). Listed firms have also faced this challenge in the recent past for instance during the period, 2014 to 2019, some of the listed companies issued profit warnings. Kenya Airways for instance which was known to make profits started making huge losses raising a lot of questions as to the liquidity status.

Statement of the Problem

Financially distressed firms reduce shareholders' earnings. It is not clear if the financial distresses are caused by decisions regarding liquidity levels. As reported by NSE (2019) some of the firms listed at NSE have witnessed a decline in the shareholders earnings. Listed firms like Kenya Airways, Uchumi supermarkets, Mumias Sugar Company and the East African Portland Cement had witnessed a decline in earnings. According to a report by NSE (2019) twenty eight listed firms had issued profit warnings as at 2018 which had ramifications on the shareholders earnings. Among the financial institutions like the National Bank of Kenya had experienced reduced earnings occasioned by severe losses.

With an increase in listed companies issuing profit warnings and with some like Kenya Airways making huge losses, a lot of focus is shifting towards the liquidity in relation to the shareholders earnings. The main goal of every firm is to maximize the wealth of the shareholders by ensuring that the conditions within the firm reinforces its profit making ability which have a bearing on the shareholders earnings. To manage in this environment, firms are being forced to employ innovative tools including maintenance of adequate liquidity and leverage levels to maximize on the shareholders wealth.

As evidenced from the studies carried out in different countries, a firm should not ignore the firms' characteristics that directly influence the earnings of the shareholders as shown by the case of collapsed companies like Enron, WorldCom among others. A study by Salah (2018), examine the nexus between firms characteristics and earnings quality. In the study earnings quality was measured as the ratio between net cash flows and net income. The current study established the relationship between liquidity and earnings of shareholders as measured based in the Earnings per share. Another research by Nyabaga and Wepukhulu (2020) sought to determine the relationship between the liquidity and financial performance as measured by profitability. Consequently, this study aimed at ascertaining the effect of liquidity on shareholders' earnings as measured through earnings per share.

Research objective

To assess the effect of firms' liquidity on the shareholders earnings among firms listed at the Nairobi Securities Exchange in Kenya.

Research Hypothesis

Ho_1: Liquidity has no significant effect on the shareholders' earnings of the firms listed at the NSE, Kenya

THEORETICAL REVIEW

This assessment was guided by the theories of liquidity. The theories of liquidity were propounded by Markowitz (1952) and further improved on by Bhattacharyya (2011). Markowitz (1952) mainly focused on liquidity on the basis of liability management. According to Markowitz's (1952) liability management theory, financial institutions have a better chance of meeting their liquidity needs by taking advantage of market gains to raise additional funds to pay for their liabilities. This necessitates striking a balance between the liquidity of assets and liabilities. According to the notion, a company can finance its investments and activities using liquid assets if external financing is not an option. Bhattacharyya (2011) advanced the theory by arguing that owning or investing in legal capital capable of switching only to other investments in order to acquire liquid equipment is the level of defendable financial institution liquidity management. This indicates that the theory recommends that financial institutions grant credit that is paid with notice before they request to pawn commercial paper. This theory informs the liquidity study variable in trade off between liquidity and liabilities.

Empirical Literature Review

Liquidity is very crucial for any company as it indicates the ability of a business to pay its business obligations (Kibet, 2012). According to Majakusi (2016), there is a positive correlation between an adequate liquidity level and profitability of a business (Majakusi, 2016) hence most financial managers are often confronted with the reality of ensuring that there is a proper balance between funds generated and the payments to be made or expenses to be incurred. The liquidity problems may arise if there is a mis-match between assets and liabilities mainly due to maturity mis-match. According to Saunders and Cornett (2005), low assets market and fall in the prices of assets are the main indicators of bad management of liquidity. Poor liquidity may also result in low dividend payouts. The measure for liquidity of a firm is based on the liquidity ratio which is the ratio between liquid assets and liquid liabilities. In the current study liquidity was examined using the ratio of current assets to current liabilities of the firms listed at NSE.

The relationship between liquidity and profitability management of banks listed at the Tehran Stock Exchange from 2010 to 2015 was evaluated by Moghaddam and Abbaspour (2017). The liquidity ratio was used to calculate liquidity. The outcomes of the multivariate study demonstrated that the management of earnings is significantly and favorably impacted by liquidity. The listed banks were the sole subject of this study. The current study looked at every bank listed on the NSE across all industries. Also, a panel regression model was utilized in the current study to examine how liquidity and shareholder earnings relate to one another. Finally, the current study used shareholders' earnings as assessed by earnings per share rather than earnings management, which was the dependent variable in the previous study.

The effects of liquidity risk on shareholder returns at the Jordanian Bank from 2009 to 2016 were examined by Nazal and Al-Fasfus (2018). The market price of shares served as the basis for calculating the shareholders' returns. An inverse link between liquidity risk and shareholder returns was found after data analysis. Since the current study concentrated on the relationship between liquidity and shareholders returns across diverse industries, there is a contextual gap in the study. Second, although the current study evaluated shareholder returns in light of earnings per share, previous studies evaluated shareholder returns based on the market price of shares. The study also placed a lot of emphasis on the liquidity risk rather than liquidity and its connection to earnings per share.

Sitorus, Toni, and Hwee (2020) investigated how liquidity affected shareholder dividends at publicly traded food and beverage companies. The study was conducted between 2015 and 2017. Multiple regression analysis was used to analyze the data, and the results showed that liquidity had a positive and significant impact on dividends. While the current study concentrated on listed firms at NSE drawn from other

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industries to get a broader perspective on the nexus between the liquidity and shareholders earnings, this study was limited to the food and beverage companies. In terms of the contextual scope, the current study looked at earnings per share as the dependent variable while this study looked at dividends given to shareholders.

Conceptual Framework

The conceptual framework shows that the relationship between liquidity and shareholders' earnings. Liquidty was measured using the ratio of current assets to current liabilities while shareolders' earnings was measured based on the earnings per share. Liquidity was the independent variable while shareholders earnings was the dependent variable. Figure 1 illustrates the relationship.

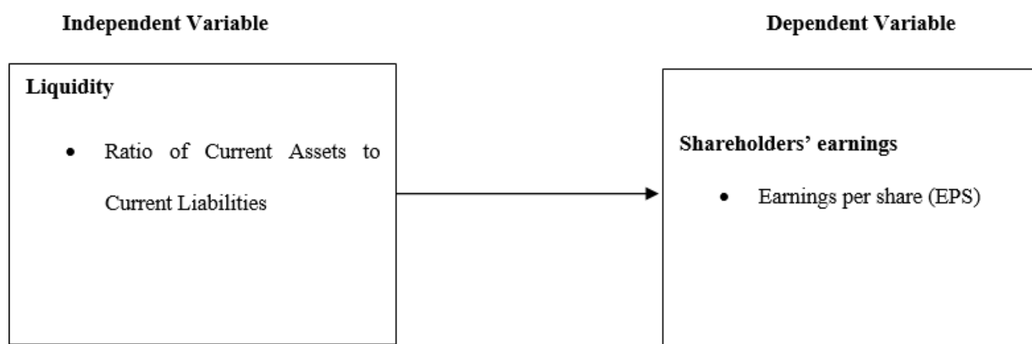

Figure 1. Conceptual framework

RESEARCH METHODOLOGY

In reviewing the Effect of Liquidity on the shareholders earnings of listed firms at the NSE Kenya, this study employed a descriptive design which as described by Mugenda and Mugenda (2013) helps in describing the features or characteristics of a population therefore answering the question what, when and how. It encompasses collection of data and testing of the hypothesis presented with an ultimate purpose of answering the questions in an examination.

The population target was all firms listed in the Nairobi Securities Exchange as at December 2021. As at 2021, there were 64 listed firms. A census technique was carried out. A census is a technique used to examine all the number of firms in a research population that are of interest to the researcher (Kothari, 2014). This implies that all the listed financial firms without exceptions were subjected to the current study hence all the 64 firms were studied.

The collection of data relied on the secondary data. The data was obtained from the financial statements of the respective companies as well as additional information from the Capital Markets Authority and the Nairobi Securities Exchange for the period 2015 to 2021.

Measurement of Study Variables

Table 1 shows the measurement of the various variables employed in the study.

Table 1. Measurement of Variables

Variable	Type	Measurement
Shareholders Earnings (Y)	Dependent	Earnings per share (EPS)
Liquidity (X1)	Independent	Ratio of liquid assets to liquid liabilities

Source: Researcher (2023)

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Data Analysis and Presentation

Data analysis was based on simple linear regression analysis. Additionally, the analysis was aided by the Stata version 14. The model to be used is as follows;

$Y = \beta_0 + \beta_I X_I + \varepsilon$

Y = Shareholders earnings (EPS)

X_1 = Liquidity

$\beta_{0=}$ Constant

$\beta_{1,}$ =Regression Coefficients

ε = Error term

RESULTS AND DISCUSSION

This study analysed 64 listed firms at the NSE, Kenya. Descriptive statistics and inferential statistics were analysed.

Descriptive Statistics

The essence of employing descriptive statistics in a research is to enable the researcher to give a description of the basic characteristics of the data used (Wooldridge, 2003). The data capturing the shareholders earnings was based on the EPS. The data on liquidity is presented on the basis of the ratio between the current assets and current liabilities. Table 2 therefore presents the descriptive statistics.

Table 2: Summary of Descriptive Statistics

Variable	Mean	Std. Dev.	Min	Max
Liquidity	0.4367	0.1464	0.2700	0.9240
EPS	14.9606	21.4340	0.5600	89.8800

Source: Research Data (2023)

From the findings the mean liquidity of firms was 0.4367 which represents 43.67% and this is an indicator of the high liquidity levels of firms since it is above the 20% requirement for listed firms (CMA, 2020). Finally, the EPS of the five piloted firms was 14.9606 which represent the average shareholders' earnings. As indicated by Kothari (2014) a standard deviation of more than 1 shows a high variation among firms or objects under study. The standard deviation was relatively high (more than 1) which is an indicator that the EPS among the piloted firms had much variations.

Inferential Statistics

The inferential statistics in this section involves the correlation analysis and the regression analysis.

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Regression analysis was done using the panel regression model using the fixed effect model. A hausman test was also done to determine whether the fixed effect model or the random effect model will be used.

Correlation Analysis

Correlation is a statistical analysis method that shows how and if a pair of variables are strongly associated. . According to Bluman, (2005), values between -0.6 and -0.8 or +0.6 and +0.8 account for 36 percent to 64 percent of the variance, which shows a moderately strong to strong association. Values between -0.8 and -1.0 or +0.8 and +1.0 account for more than 64 percent of the variance, which might show a very strong relationship therefore exceptionally high values above 0.8 in absolute value imply that certain match ups of variables aren't giving independent information. This test was done using the Pearson's correlation and the findings are presented in Table 3.

Table 3: Correlation test results

	EPS	Liquidity
EPS	1	
Liquidity	0.5116*	1
	0.0017	

Source: Research Data (2023)

From the findings in Table 3, liquidity has a positive and significant correlation with EPS meaning that as liquidity levels increase the shareholders' earnings as determined using EPS tend to increase. This could be due to the fact that as the firm's liquidity increases in terms of liquid assets, it is able to marginally reduce the operational costs. The findings are consistent with the findings by Oktaviani (2020) which established that liquidity has a positive and significant effect on earnings per share.

Panel Regression Analysis

Table 4 presents the findings from the panel regression model.

Table 4: Panel Regression Model

fixed-effects GLS regression				Number of obs = 420		
Group variable: Firms				Number of groups = 60		
R-sq: within = 0.2047				Obs per group: min = 2		
between = 0.1973				avg = 5.5		
overall = 0.2001				max = 6		
wald chi2(6) = 175.08						
corr(u_i, x) = 0 (assumed)				prob > chi2 = 0.0000		
EPS	**Coef.**	**Std. Err.**	**T**	**p>|t|**	**[95% Conf.**	**Interval]**
Liquidity	0.642	0.037	17.32	0	0.569	0.715
_Cons	0.61	0.056	1.102	0.273	-0.049	0.172
sigma_u	43.327					
sigma_e	7.412					
Rho	0.884					

Source: Research Data (2023)

From the findings on panel regression output, the coefficient of determination (R2) is 0.2047. According to Green (2008), r^2 helps in explaining the percentage of variation of the dependent variables due to changes in the independent variables hence based on the results, there was 20.47% variation in the shareholders earnings due to changes in liquidity.

The null hypothesis was that liquidity has no significant effect on shareholders earnings. The p value was .00 which is less than 0.05 hence we reject the null hypothesis and conclude that Liquidity has a positive and significant effect on the shareholders earnings as shown by the coefficient of 0.642 and p value of .000. This implies that as liquidity increases earnings to shareholders also increase significantly. The findings are consistent with the findings by Moghaddam and Abbaspour (2017) which established that liquidity had a positive and significant effect on earnings.

From Table 4 , the simple regression model was fitted as;

$Y = 0.610 + 0.642X_1 + e$

Where: Y is the Shareholders' earnings

X_1 is the Liquidity of listed firms

e- is the stochastic variable

From the model, the coefficient of liquidity was 0.642. This value was positive indicating that an increase in liquidity led to increase in shareholders earnings. Furthermore, the findings indicated that increase in shareholders earnings by one unit leads to an increase in liquidity by 0.642 units on average.

CONCLUSION AND RECOMMENDATIONS

Conclusion

The research objective was to evaluate the effect of liquidity on shareholders' earnings of the firms listed at the NSE, Kenya. From the findings, the study concludes that liquidity has positive and significant effect on shareholders earnings. The study also concludes that as liquidity increases, the shareholders' earnings also increases significantly.

Recommendation

The study recommends the following based on the findings of the study;

First the listed firms should enhance its liquidity by investing more on liquid assets. This should entail more investments in treasury bills, treasury bonds and other liquid stocks. They should also diversify their investments by investing in money markets. Additionally it should enhance its liquidity by controlling its overheads through getting rid of unnecessary expenses.

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