Effects of Liquidity on Financial Performance of Non-Financial Institutions' Listed at Nairobi Securities Exchange, Kenya

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Abstract: **Merger has been undergoing in organizations in Kenya with the main focus on financial performance improvement. However, most of these organizations have never realized their financial targets. Therefore, this study sought to establish the effects of liquidity on financial performance of non-financial institutions listed at the Nairobi Securities Exchange in Kenya. An exploratory research was used. Three non-financial institutions namely: Car and General (C&G) and Cummins, Unga group Holdings and Kenolkobil were targeted. The study used secondary data collection sheet which involved the documentary reviews of data available in the released financial statements, and annual reports for the last 10 years, that is, 2011 to 2020. Analysis of quantitative data was through the use of descriptive statistics that included mean and standard deviation. In addition, determination of how variables relate to each other was done using inferential statistics specifically using analysis of multiple regression. The study established that liquidity had a significant effect on financial performance as indicated by t-value (t= 2.781, p<0.05). The study concludes that due to insufficient market depth or market interruptions, non-financial institutions were unable to efficiently liquidate or offset a particular position at or near the last traded market price, leading them to participate in bank lending to satisfy their daily transactions. The study recommends that the non-financial institutions listed at NSE should aim at maximizing their overhead expenses that consume much of their cash flow.**

***Keywords*:Liquidity, Merger, Financial Performance**

I. INTRODUCTION

Companies are becoming more aggressive in developing strategies to survive and grow in this globalization era. Every organization chooses the best strategy to win the competition and survive in the future (Bansal & Kumara, 2016). Mahmood, Aamir, Hussain and Sohail (2017) observe that with the global financial crises and the rapid advancement in technology has led to the increase on merger which has in turn made the organizations gain a large share of market, become competitive, increase their revenue earning and minimize risk and have a wide range of diversified products. Therefore, it can be argued that organization enters into a merger by gaining access to unique assets that could take long in developing within the organization.

Sharma (2013) observe that the aim of carrying out mergers is mainly for an organization to diversify. For instance, an organization may merge with the aim of diversifying its operations through gaining access to new market of providing unique services or products to that market. Moreover, managers of an organization are commonly found in proposing for a merger so that the risk that an organization may encounter in relation to its day to day activities may be diversified. Additionally, Chatarjee and Banerjee (2013) observe that all the organizations encounters full financial obligations in financing their operations either in settling debt or market equity. Lack of capability in having enough finance may force an organization to merge. Finally the organization will gain a higher financial power that will enable it to enlarge its developmental processes.

In the current market, financial performance improvement is paramount in the sustenance firm's capability, enthusiasm and worth. This is due the fact that the firm gains advantage in attracting managers with different talents and also able to increase their retention rate (Jovanovic& Peter, 2015). Appah and John (2016) observe that combining businesses using merger is now an international practice in achieving the economies of scale and high productivity. The demand for both financial as well as the non-financial institutions to undergo a merger is even very important in dealing with the global competition.

Business combinations are always related to external business expansions, the reasons for business expansions include; obtaining acquiring new ways of facilities that are productive, productions knowledge, firms dealing with marketing, obtaining competent management, achievement of economies of scale and tax advantage (Zaneta& Lina, 2013). According to Sharma (2013) organizations merge on the basis of resource utilization of the already existing firm so as to improve its growth through increase in sales, reaching new markets and achievement of economies of scale. Therefore, it can be argued that the merger is based on the assumption that the consolidation will result to improving efficiency and gain high profits from having high market power, economies of scale, reduction of unpredictability, diversifying and gaining synergy from other financial firms.

Abbas, Hunjra, Azam, Ijaz and Zahid (2014) observe that ratios on banks' liquidity, profits and investments have a significant influence on performance of banks in their finances in Pakistan after engaging into merger. In addition, Abbas *et al.* (2014) show that bank's profits, length of existence and its shareholders are the most critical factors in considering and motivating them to opt for a merger as it is possible to converge resources, improve in technology and skills with the aim of increasing it financial performance and the wealth of its stakeholders. Therefore, it is of great importance to the sector of Pakistan's finance that a strategy meant for merger should be founded on consolidating resources and competency that result to a better financial performance.

Saboo, Sharma, Chakravarty and Kumar (2017) indicate that the financial performance of Banks in Ghana might not necessarily improve due to merger. This is because net margin of these banks was found to be negatively but significantly associated with merger. Boloupremo and Ogege (2019) observe that the highest number of mergers in Ghana perhaps can be found in the banking industry which is driven largely on account of recapitalization where the Bank of Ghana requested commercial banks to increase their capital to a certain threshold. The biggest drivers of mergers and acquisition is the motivation to eliminate or reduce competition, help to increase the size and operations of firms in order to facilitate enjoyment in economies of scale, which could increase their performance in terms of profitability.

Ogada, Njuguna and Achoki (2016) observe that performance, synergy in operation positively relate to the financial synergy and that performance achieved by the financial institutions in Kenya after merger had significantly improved and suggest that these institutions ought to have a critical evaluation of the organization as a whole and how compatible their operations are after merging and focus much in gaining financial synergy in the long run because this positively affects the financial performance. Pandey (2015) observe that merger leads to asset and liability amalgamation together with the interests of stakeholders and the business of the firms merging resulting to financial performance improvement.

Liquidity is amongst essential working capital management goals and a major activity in optimizing revenue and the financial performance of the firm. Managing working capital effectively results to the improvement in firm's operational performance and assists in meeting liquidity in the short run (Maness &Zietlow, 2015). Arnold (2018) observe that net working capital at a lower level also leads to increase in profits and also increases firm's risk in solvency through reduction of funds in the long run transferable to assets that have less profits. In this case reaching the level of optimum liquidity ought to lead to better firm's decision making process aiming at reaching a higher financial performance.

Financial performance is an indicator of a company's effective usage of its properties from the key market mode to produce sales. Investment and asset returns, value of the market and accounting profits mirror the financial performance of the firm (Ngugi, Amanja&Maana (2014). Njanja and Pellisier (2018) observe that the reflection of better financial performance is on how the management is efficient and effective in utilizing the resources of their firm which is presented in terms of growth in sales, profits and stock pricing. Well-organized control of numerous tool in economy directly impacts the financial performance of businesses.

II. STATEMENT OF THE PROBLEM

Firm's performance in finance can be influenced by factors from outside the firm or with that firm. Whereas there are varieties of particular models, the main determining factor of financial performance of a firm constitute the industry features where the firm is competing. The position of the firm in comparison to its rivals and firm's resources quality and quantity (Lewellen, 2015). The 2019 Central Bank of Kenya (CBK) report shows that 25% of the non-financial institutions reported losses in the 2018/2019 financial year. This was an increase over the preceding five years where not more than 20% of the non-financial institutions had reported losses.

The motive of the non-financial to merger is the need to enlarging their capability on management and marketing together with acquiring new products. Mergers regularly occur in firms forming alliances but not necessary operating in the same field. Njoroge (2017) observe that due to lack of lack adequate financial capacity most of non-financial institutions in Kenya opt for merger with another. However, with the amended Banking Act, the regulatory authority has placed them in the same bracket with the financial institutions with regard to capital adequacy and liquidity requirements which puts them in a stiffer competition hence poor financial performance. Therefore, non-financial institutions in Kenya has recorded profit after tax of KSh 20.5 billion in comparison to Ksh 19.92 billion in the year 2017 regardless of their merger. This was believed to be due to lower rate of interest, increasing fee and commissions due to the presence of technological platforms, retardation in economical activities and unpredictable political climate within the Country. Therefore, the current study examined how non-financial institutions' financial performance listed at NSE, Kenya is affected by liquidity.

III. LITERATURE REVIEW

Theoretical Literature Review

The basis of this study was on the theory of financial synergies by Fluck and Lynch (1999) who claim that a business with inadequate assets in liquid form or lack of finance are not able to maximize opportunities on investment that have value to them with asymmetrical information in markets of finance. In this scenario, if the asymmetric information linking the two firms is lower compared to the firm with inadequate finance together with creditors outside that company, the business will maximize its worth by combining with a slack-rich firm. Mergers can thus be an effective means of alleviating asymmetric knowledge and generating synergy in finance. It is predicted from this theory that companies that has more likelihood of merger operations to achieve their goals or acquirer in financial distress but with good investment incentives.

Lewellen (2011) argues synergy in finance can be achieved through merger through combination of imperfect correlation of streams of income or acquisition of other firms from the industry not related in practice. Basically, it is the diversification of the Markowitz portfolio at the corporate level. Bad outcomes in one company can be balanced by good results in another sector that carry lower volatility of earnings into the merger organization. Lower earnings uncertainty leads to lower default risk because both insurers (merger companies) collectively cover each combining company's debt, which is called corporate debt co-insurance. Higher default risk contributes to lower expected default rates and thus improves the combined company's leverage potential or funding strength. The merger business will profit from growing its financial leverage to guarantee tax deductibility on behalf of its shareholders.

This theory is important to the research, because of the way synergy in financial merger is often measured. The synergy forms are associated with enhancement of the already merged measures of business finance in terms of its sales, efficiency in leverage, cost of capital and output. Therefore, financial synergies will lead to greater leverage efficiency, higher cash flows, lower capital expenses, tax benefits etc

Empirical Literature Review

Akenga (2017) study examined how firms' financial performance at NSE, Kenya was affected by liquidity. Adoption of casual design was followed. The technique of purposive sampling was utilized in selecting 30 firms. Analysis of data was done descriptively together with inferential analysis. It was observed that ROA was significantly affected by current ratio and cash reserves. It was also observed that ROA was significantly affected by debt ratio

Onyekwelu, Chukwuani and Onyeka (2018) study examined how deposit money banks in Nigeria financial performance was affected by liquidity. Population comprised of 5 banks. Data from secondary sources was obtained focusing on a 10 years period between 2007 to 2016. Analysis in multiple regressions was used in analyzing data. It was observed that the profitability of the bank was positively and significantly affected by liquidity and also liquidity affected return on capital employed positively and significantly.

Kong, Musah and Agyemang (2019) study investigated how financial performance related to liquidity. It was a correlational study because it aimed at examining how liquidity related with the viability of the firm. The technique in correlation coefficient in Pearson Product-Moment led to the observation that the financial performance of the firm as significantly affected by the its liquidity based on the measurement of Return on Assets (ROA). However, based on the measurement of ROE and ROCE it was insignificant.

IV. RESEARCH METHODOLOGY

In achieving the aim of this study, exploratory design was employed that guided in establishing how non-financial institutions' financial performance listed at the NSE in Kenya is affected by merger. Population for this study was three non-financial institutions that underwent mergers and listed at the Nairobi Securities Exchange, Kenya namely: Car and General (C&G) and Cummins, Unga group Holdings and Kenolkobil. Utilisation of collection sheet of secondary data involving review of documents were used containing available data on statements of finance that have been made available covering a period of 10 years from 2011 to 2020. Nairobi securities exchange was the source of study's secondary data. Measurement of non-financial institutions' financial performance focused mainly on return on assets (ROA). Analysis of data in quantitative nature was descriptively analysed in terms of mean and standard deviation. Inferential analysis focused on use of analysis in correlation and multiple regressions as the study has more than two variables to be examined.

V. FINDINGS

Results of Descriptive Statistics

The study sought to establish the effect of liquidity on financial performance of non-financial institutions listed at Nairobi Securities Exchange. The results are presented as follows:

Table 1: Descriptive Statistics

Variables	Min	Max	Mean	Variance	Standard Deviation
ROA	-261.290	23.199	2.464	386.780	19.667
Liquidity	3.310	107.700	44.629	357.945	18.919

Source: Researcher (2021)

According to 1, ROA has a minimum of -261.29 and a maximum of 23.199 of the extent to which the variable deviates from its main value. The difference between ROA and the mean value of 2.464 is 19.667. The finding implies that the financial performance of Kenyan non-financial institution listed at NSE is average. According to Naser and Mokhtar (2018) utilization of resources and sales growth of a firm effectively and efficiently is reflected in its financial performance as measured by profitability and stock prices.

The results in Table 4.1 show that liquidity had a highest standard deviation measure of dispersion from its main value of 18.919 as compared to the market prospect and leverage. Also, liquidity had the highest maximum of 107.700 of the extent to which it deviates from its main value of 18.919. In addition, 18.919 is the extent to which liquidity deviates from the mean value of 44.629. Liquidity had a variance of 357.945 indicating the deviation from its value of 18.919. Due to insufficient market depth or market interruptions, non-financial institutions were unable to efficiently liquidate or offset a particular position at or near the last traded market price, leading them to participate in bank lending to satisfy their daily transactions. This is in line with Kong, Musah and Agyemang (2019) study that investigated how financial performance related to liquidity and observed that the financial performance of the firm as significantly affected by the its liquidity based on the measurement of Return on Assets (ROA).

Results of Inferential Statistics

Correlation Analysis

In order to establish the relationship among the different variables in the study, Pearson correlation analysis was conducted on the liquidity, market prospect, leverage and financial performance indicators at 5% significance level.

Table 2: Correlation Analysis

	ROA	Liquidity	Market prospect	Levera ge
ROA	1.00			
Liquidity	0.123	1.00		

Source: Researcher (2021)

The results as presented in Table 2, were supposed to give spearman correlation coefficient which is to range from -1 to +1, where 1 is total positive correlation, 0 is no correlation, and −1 is total negative correlation. If the results are less than 0.5, it implies weak correlation. If the results are greater than 0.8, it implies a strong correlation. For variables to be correlated, one variable has to be dropped to avoid multicollinearity problem. The results indicate leverage was highly correlated with a value of 0.945, hence the variable has to be dropped from the model.

Regression Analysis

The following is the output for the regression analysis, with significant importance on the R^2

Table 3: Regression Analysis

Mode l	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.636[a]	.805	.772	.454

Source: Researcher (2021)

Table 3 shows that the coefficient of correlation was 0.805, indicating that the liquidity had a strong link with the financial performance. The R square value at 0.805 also gives a goodness of fit measures. Table 3 further revealed that the adjusted R^2 was 0.772. This means that 77.2 percent of all differences in the financial performance of non-financial institutions listed at NSE can be described by liquidity with the remaining 22.8 percent described by factors not included in the model.

Table 4: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	0.539	.490		6.610	.000
	Liquidity	0.729	.046	0.066	2.781	.001

Source: Researcher (2021)

The results as demonstrated in Table 4 is that 0.539 as the value of constant represents the value at which financial performance of non-financial institutional listed at NSEchanges when liquidity are kept at constant.

The establish regression equation was:

$$Y = 0.539 + 0.729X_1$$

Y = Financial Performance

X_1= Liquidity

The study found that a 0.729 represented the amount by which financial performance of non-financial institutional listed at NSEchanges when liquidity is changed by one unit keeping market prospect and leverage constant. The t-value ($t= 2.781$, $p<0.05$) indicates a significant influence between liquidity and financial performance. This is in line with a study conducted by Kong, Musah and Agyemang (2019) that investigated how financial performance related to liquidity and found that the financial performance of the firm as significantly affected by the its liquidity based on the measurement of Return on Assets (ROA).

VI. CONCLUSIONS AND RECOMMENDATIONS FOR FURTHER STUDIES

The study concludes that due to insufficient market depth or market interruptions, non-financial institutions were unable to efficiently liquidate or offset a particular position at or near the last traded market price, leading them to participate in bank lending to satisfy their daily transactions. Liquidity helps organizations to get an idea on the liquidity position of the company, shows how a current asset-rich company is it, how much debt an organization can pay off only using the cash on hand, helps organization to understand the strength of the company and shows how quickly a company can pay off its debt.

The study recommends that the non-financial institutions listed at NSE should aim at maximizing their overhead expenses that consume much of their cash flow. Keep a tight rein on accounts receivable by ensuring effectiveness in the collection of payments from their own customers. Maximize productivity and profits with process automation like immediate savings through automation of high-volume, repetitive tasks and elimination of human error, improved cycle times and accuracy for purchase order and invoice processing and improved overall vendor management.

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