OPERATIONAL BUDGETARY PERFORMANCE AND ITS INFLUENCE ON EQUITY RETURNS OF MANUFACTURING FIRMS LISTED AT NAIROBI SECURITIES EXCHANGE IN KENYA

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ABSTRACT

This study sought to identify how operational budgetary performance influence equity return of manufacturing firms listed at Nairobi Securities Exchange in Kenya. The study was anchored on theory of budgeting. The study employed both longitudinal and cross-sectional research design. The study's target population included 7 listed manufacturing companies in Nairobi securities exchange. The data was collected from year 2008 to year 2021 for all the listed manufacturing companies. The current study relied on secondary data sources for the period between year 2008 and year 2021 that was gathered from Nairobi Securities Exchange, capital market authority library and in the annual reports of individual companies' that was obtained from their websites. Descriptive and inferential measurements were used to evaluate the secondary data. Descriptive statistics comprised of the mean and the standard deviation. Inferential statistics on the other hand comprised panel multiple regression and Pearson's product moment correlation analysis. Analysis was conducted using Stata 14 software to produce tables, graphs, charts, diagrams and statistical parameter estimates. The study found that operational budgetary performance has positive influence on equity returns of listed manufacturing firms on Nairobi Securities Exchange in Kenya. The influence was found to be significant. This meant that operational budgetary performance has positive significant influence on equity returns of listed manufacturing firms on Nairobi Securities Exchange in Kenya. The study concluded that operational budgetary performance has positive significant influence on equity return of listed manufacturing firms in the Nairobi Securities Exchange.

Key Words: Equity Returns; Manufacturing Firms; Nairobi Securities Exchange; Operational Budgetary Performance

INTRODUCTION

The critical role played by manufacturing sector in economic growth and development in any economy cannot be overemphasized. It is arguably the foundation for sustainable economic growth and development (Velenturf & Purnell, 2021). Further, Holmberg and Sandbrook (2019) argued that sustainable economic growth is a necessary condition for economic development which can only be achieved through a robust manufacturing sector. This is because, the sector drives economic transformation through conversion of raw materials to a vigorous and industrious economy (Afolabi & Laseinde, 2019). The sector contributes to economic development through modernization, creation of both skilled and unskilled employment opportunities, alleviation of poverty and reduction of inequalities (Moyo & Jeke, 2019). Thus, as opined by Yakubu and Jalil (2016), an economy without a healthy manufacturing sector may perhaps only be a provider of raw materials and an end user of finished goods. Consequently, in a modern economy, where industrial development is taking pace and mass production is necessary for domestic consumption and

exports, the conventionally recognized factors of production specifically, land, labour and capital cannot serve this demand (Allais et al., 2021).

African manufacturing sector initially grew in the immediate post-independence period largely due to state sponsored projects and protectionist policies (Moyo, 2020). However, owing to external forces such as ever-increasing oil price, decrease in commodity prices, rise in interest rate, dwindling economic resources and limited domestic markets the growth in the sectors took a down turn (Austin, 2013). As a result of these challenges, the contribution of the manufacturing sector as percentage of GDP had dropped to 10 percent by year 2004. KAM (2014) reported that approximately 70% of East Africa manufacturing companies had lost their market share. Specifically, companies like Eveready East Africa ltd, East African Portland cement Ltd and Sameer Africa Ltd have all been struggling to survive (Nyabiage & Kapchanga, 2014). The sector started growing in 2005 increasing by 3.5% by the year 2014. Countries such as Nigeria and Angola have been experiencing an increase in output of over 10 percent per year.

Production value in sub-Saharan Africa also increased from $75 billion in 2005 to over $130 billion in 2016. manufacturing exports have also increased at an average annual growth rate of 9.5%. At the same time, shipment of heavy manufacture equipment such as industrial equipment, electronics, appliances and transport vehicles have increased by 14%. The manufacturing sector in Africa has even greater potential for growth and many countries such as Egypt, Nigeria, South Africa, Ethiopia, Morocco and Rwanda have increasingly realized that manufacturing is a major factor in helping them achieve economic prosperity (Signé, 2018). Consequently, many African governments are seeking new and innovative ways to attract investment and nurture industry. If successful, it is anticipated that the manufacturing sector in Africa will have an annual output of $1 trillion in 2025 up from $500 billion in 2015. If this happens the sector will create an additional 14 million jobs in the continent (Moyo, 2020).

In Kenya, manufacturing sector was earmarked as one of the pillars of vision 2030, which aims to transform Kenya to an industrial country by 2030, and the big four agenda. This sector is not only poised as the economy's engine of progression but also as a means of expanding it (Esaku, 2020). Over the years, the contribution of manufacturing sector Gross Domestic Product (GDP) has stagnated at around 10%. According to KAM (2023) most manufacturing companies have lost their market share with some companies such as Mumias Sugar, Athi River Mining, East Africa Cables, Eveready East Africa ltd, Sameer Africa ltd and East Africa Portland Cement struggling to remain a float, relocating their operations or forced to shut down their operations. In other cases, companies such as Sameer Africa ltd have been forced to issue profit alerts due to poor performance (KAM, 2023).

There are 9 listed manufacturing companies in Kenya. This study focused on seven, excluding Mumias sugar company which was under receivership in year 2019 and Flame Tree Africa Limited which was listed in year 2015. The performance of listed manufacturing firms in Kenya elicits a mixed trend. In 2008 the equity returns of the manufacturing firms listed at NSE had an average return of -24.2% in 2011, 25.6% in 2013, -18.4% in 2015, 25.9% in 2017, -29.9% in 2018 and 11.1% in year 2021. This trend is further evidenced by a decline in contribution of the sector to the

GDP during the period of this study. For instance, the contribution to the GDP by this sector declined from 10% in 2012 to 9.4% in 2015, 9.2% in 2016, 8.7% in 2017, 8.4% in 2018, 7.9% in 2019 and 7.6% 2020 (KAM, 2021). This trend portrays a phenomenon of deindustrialization which if not reversed will hinder the achievement of the big four agenda and the vision 2030.

Equity return, also known as stock return measures the performance of the stock as a whole or a specific equity security (Amihud, & Mendelson, 2016). It measures financial performance by dividing the gain or loss in market price of a share plus any dividends paid during the year by the base price of the share (Baker & Wurgler, 2016). Stock returns from investment in equity highly depends on variations in share prices which also depends on a variety of factors which may either be internal or specific to the firm like dividends per share, earnings per share, and book value per share or may be from external to the firm for example government regulations, inflation, Gross Domestic Product (GDP), foreign exchange rates and interest rates (Kenya National Bureau of Statistics (KNBS), 2021).

Equity return, is an important factor for investors when making investment decisions, as it reflects the performance of the company and its ability to generate returns for its shareholders. In manufacturing firms listed at Nairobi Securities Exchange (NSE) in Kenya, equity return is a crucial metric for investors to consider. Several studies have examined the relationship between management accounting appraisal metrics and equity return in various contexts. For example, Chen and Wang (2016) found that the use of value-based performance measures, such as Economic Value Added (EVA), had a positive impact on equity returns. Similarly, Knauer Silge and Sommer (2019) found that firms that used value-based performance measures had higher equity returns than firms that did not use such measures. Some studies have found no significant relationship between the two variables (Herath and Pradeep, 2018).

However, these studies were very general and superficial. Given the importance of equity return for investors in the manufacturing sector listed at NSE in Kenya, it is important to examine the influence of operational budgetary performance and equity returns of manufacturing firms listed at NSE in Kenya.

LITERATURE REVIEW

This study was anchored on theory of budgeting. Hirst (1987) proposed the theory of budgeting, which highlights the importance of an effective budgetary control system in an organization. According to Hirst, an effective budgetary control system helps an organization plan and prepare for potential risks and opportunities in the future by establishing an efficient system of control. Shields and Young (1993) define the theory of budgeting as a tool for detecting variances between organizational objectives and performance. Budgets are the core component of an efficient control process and are considered vital for the proper functioning of an organization to achieve its goals and objectives (Hirst, 1987; Shields & Young, 1993). As stated by Hirst (1987), budgets enable an organization to establish an efficient system of control by projecting future financial performance, setting short-term and medium-term objectives, and providing estimates of future sales revenues and expenditure. Budgets also allow for the consideration of optional courses of action, setting

standards for performance, and establishing a comparison of actual results with the created standards.

The theory of budgeting is crucial in understanding the importance of not only budgeting but also budgetary control. Budgets enable forecasting of future revenues and expenditure, which allows companies to plan rationally and appropriately for the future. This is especially important for companies, which operate in a highly competitive financial market and must be able to manage their financial resources efficiently and effectively to remain competitive (Muriuki, 2019). The theory of budgeting highlighted the importance of an effective budgetary control system in organizations. Therefore, it is crucial for organizations, including manufacturing firms, to implement an effective budgetary control system that incorporates the principles of the theory of budgeting to manage their financial resources efficiently and effectively.

Schubert and Kirsten (2021) researched the effect of budgetary control on the financial performance of SMEs in Germany. The study used the quantitative technique where data was gathered from the local business owner of SMEs located in Germany's three cities Munich, Berlin and Stuttgart because they have a high number of SMEs. Surveys were self-administered and also sent out to the business owners. The research instruments adopted included questionnaires and the interview guide. The study found that budgetary control integrates the organization's strategic planning with budgets and processes of cost control. The budgetary control also identifies the budgeting /financial skills required for better decision-making and identifies key financial indicators for the business and how and when to monitor them. The budgetary control identifies sources of financial and business data that provide insights into business and financial strategies when converted into budgets. The budgetary control helps interpret budgets and performance measurements as communication tools and finally helps to think pro-actively beyond budgeting. The study also found that budgetary control economizes management time by using the management by exceptional principle. The study concluded that budgeting control has a significant and positive relationship with financial performance.

Mulani, Chi and Yang, (2015) studied the effects of the budgetary process on SME's performance in an exploratory study based on Selected SMEs in India. A sample of two hundred and sixty-eight firms was selected from SME sector of India. The sample was selected from three districts of Mumbai, Pune and Solapur. Impact of budgeting on firm performance in these firms was tested through detailed analysis. A positive relationship between firm performance and budgeting process was found in this research study. Furthermore, budget planning affects the sales growth of firms in Small and Medium Enterprises more than the budgetary control phenomena. But the impact of budgetary planning on sales becomes very weak and in turn budgetary control strongly affects the profit in small and medium enterprises. Sales and budgetary sophistication have a statistically insignificant relationship and budget sophistication relationship with profit is even negative. The sophistication of budgetary tools includes acquiring and installation of costly financial modelling software, training and expensive training and follow up mechanism.

Chaudhary and Chaudhary (2018) studied budgetary control and financial performance of Nepal Oil Corporation (NOC). To test the practice of budgetary control and financial performance, a

descriptive survey design, as a sample of the study was used to gather data through structured questionnaire distributed to 60 respondents from account, finance, administration, engineering and project department. The findings of this study emphasize that a practice of budgetary control leads to increased profitability but for that management commitment is indispensable. The study concludes that budgetary control process shows a significant positive bearing on the financial performance of NOC through the influences on financial objectives, allocation of funds as well as investment ventures. The study recommends a sensitization of management and employees of NOC along the lines of the importance of budgetary controls in enhancing financial performance, avoidance of unnecessary interference in the budgetary process and use of budgets as tools for management efficiency.

RESEARCH METHODOLOGY

The research applied both the cross-sectional and the longitudinal research design. The justification for using the longitudinal research design was that the collected data was for more than one time period therefore the data had time series characteristics. The population of the research study included 7 listed manufacturing companies in the Nairobi securities exchange. Listed manufacturing firms were selected because they follow guidelines provided by the capital market authority and therefore there are required to maintain complete records. Thus, information as redly available. The study collected data from year 2008 to year 2021 for the 7 listed manufacturing companies. Thus, a panel dataset of 98 firm year observation was obtained, with observation of 7 firms between years 2008 to year 2021. The study focused on listed manufacturing companies since they are consistent in reporting their annual financial statements hence the data was easily accessible. The study examined a panel data of seven listed manufacturing firms from year 2008 to year 2021.

This study used secondary data. Secondary data was the main source of data for this research study. The secondary data was collected using secondary data collection sheet. Secondary data collected related to published data such as actual operational cost, sales level, cost of sales, profit, shareholders' equity, total assets and market price of equity for a period of fourteen years from 2008 to 2021. The data was obtained from the websites of the specific manufacturing firms, the website of the Nairobi Securities Exchange (NSE) and from the website and library of the Capital Market Authorities (CMA).

The secondary data that was analysed by use of descriptive statistics as well as the inferential statistics. Descriptive analysis that was used included the mean (average) and the standard deviation. The inferential analysis that was used included multiple regressions under the panel data framework and Pearson's Product Moment Correlation Analysis (Jack, 2009). The effects of operational budgetary performance on equity returns of quoted manufacturing firms in the NSE was done using multiple regression analysis. The predictive power of the model was determined using coefficient of determination (r^2). The fitness of the model in predicting equity returns was determined using F-critical value at 95% confidence level. Test of hypothesis was based on regression analysis results. The significance of operational budgetary performance in influencing equity returns of quoted manufacturing firms in the NSE was determined using p-values at 0.05 significance level where a p-value<0.05 signify significant influence (Brooks, 2014).

RESEARCH FINDINGS AND DISCUSSION

The overall and within statistic for each variable was calculated over all the 98 observations. The between statistic was calculated over the 14-year period (2008-2021) and the average number of times a variable was observed in the data set was T = 7. The findings also show minimums and maximums.

Table 1: Descriptive statistics

Variable		Mean	Std. Dev.	Min	Max	Observations	
ER	overall	5.780958	34.30757	-87.44966	116	N =	98
	between		18.8495	-24.10784	32.93512	n =	14
	within		29.04623	-60.5013	109.9525	T =	7
OBP	overall	-.1472217	1.221165	-9.330097	.2554172	N =	98
	between		.4440208	-1.328498	.0496329	n =	14
	within		1.142928	-8.14882	1.202515	T =	7

On operational budgetary performance (OBP), the findings show that the companies recorded an average value of -.1472 and the standard deviation (1.2211 >1) suggest that the data value had significant deviations from the mean. The findings also show that the data collected varied from -9.3300 (minimum) and .2554 (maximum). The between findings also show that the average operational budgetary performance for each company varied between -2.4273 and .1112. The results also show that operational budgetary performance within varied between -7.0499 and 2.3031; within number refers to the deviation from each individual's average. Further, the reported between standard deviation (.6571) and within (1.0421) tells us that the variation in operational budgetary performance is not equal to that observed within a company over time; this is because the standard deviations are not equal or almost equal. This means that if we draw two companies randomly from our data, the difference in operational budgetary performance is not expected to be nearly equal to the difference for the same companies in two randomly selected years.

Operational Budgetary Performance

Operational budgetary performance (OBP) refers to the effectiveness and efficiency of an organization's financial plan in meeting its operating costs. Operational budgetary performance was measured by dividing the difference in budgeted operating costs and actual operational costs with budgeted operating costs. Figure 1 presents the trend analysis for the average operational budgetary performance recorded by the seven manufacturing companies between 2008 and 2021.

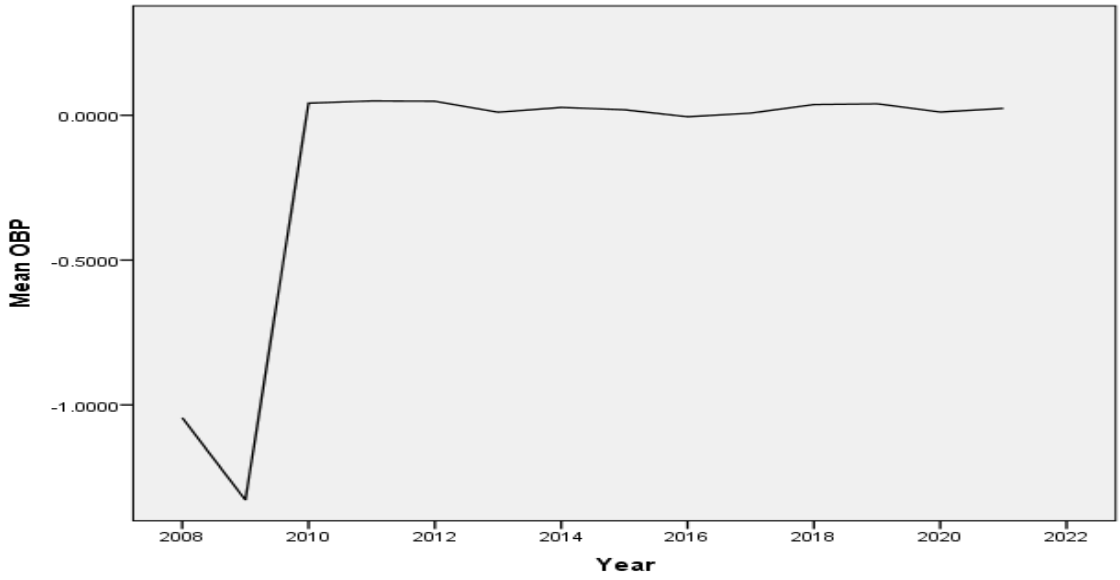

Figure 1: Trend Analysis for Operational Budgetary Performance

The findings show that the average operational budgetary performance has had minimal fluctuations from 2010 to 2021. The least Operational budgetary performance was observed in 2009 which sharply increased in 2010 and tended to stabilise. Do changes in operational budgetary performance have any effect on equity return? This study sought to answer this question. Previous research has shown that operational budgetary performance is a critical determinant of a firm's financial performance (Cheng & Kesner, 2017). Thus, it is essential to understand whether changes in operational budgetary performance have any impact on equity return.

Test of Hypothesis

The specific objective of the study was to determine how operational budgetary performance influences the equity return of listed manufacturing firms in the Nairobi Securities Exchange in Kenya. The associated null hypothesis was that operational budgetary performance does not significantly affect the equity return of listed manufacturing firms in the Nairobi Securities Exchange in Kenya. A univariate analysis was conducted in which equity return of listed manufacturing firms in the Nairobi Securities Exchange in Kenya was regressed on operational budgetary performance. Results were summarized in table 2.

Table 2: Regression Analysis for Operational Budgetary Performance and Equity Return

Fixed-effects (within) regression					Number of obs =	98
Group variable: Year					Number of groups =	14
R-sq:	Within =	0.5291		Obs per group: min =		7
	Between =	0.5469		Avg =		7.0
	Overall =	0.5308		Max =		7
Adj R-sq:=		0.5260		F(1,83) =		52.0184
Corr(u_i, X)		= 0 (assumed)		Prob > F =		0.0044
ER	Coef.	Std. Err.	t	P>t	[95% Conf.	Interval]
OBP	0.105982	0.032153	-3.30	0.001	-8.239753	-.431259
_cons	0.266091	0.094527	2.81	0.004	-8.998858	-1.59141
sigma_u	0					
sigma_e	. 3256153					
rho	0	(Fraction of variance due to u_i)				

From the results in table 2, the following regression model was fitted.

$$Y = 0.26609 + 0.1059\ OBP_{it} + \varepsilon$$

These results show that the overall R-squared for the model was 0.5260 which suggests that 52.6% of variation in equity returns of listed manufacturing firms on Nairobi Securities Exchange in Kenya were explained by changes in operational budgetary performance. On the other hand, the results suggest that 47.4% of all other variations in equity return of listed manufacturing firms on Nairobi Securities Exchange in Kenya were explained by other factors other than operational budgetary performance. The findings further showed that Prob>F=0.0044 was less than the selected 0.05 level of significance. This suggests that the model as constituted was fit to predict equity return of listed manufacturing firms on Nairobi Securities Exchange in Kenya.

The coefficient results showed that the constant had a coefficient of 0.2661 suggesting that if operational budgetary performance was held constant at zero, equity return of listed manufacturing firms on Nairobi Securities Exchange in Kenya would be 0.2661. In addition, results showed that operational budgetary performance coefficient was 0.106 indicating that a unit increase in operational budgetary performance would result in a 0.106 increase in equity return of listed manufacturing firms on Nairobi Securities Exchange in Kenya. It was also noted that the P-value for the operational budgetary performance coefficient was 0.001 which is less than the set 0.05 significance level indicating that operational budgetary performance was significant. Based on these results, the study rejected the null hypothesis and concluded that operational budgetary performance has significant influence on equity return of listed manufacturing firms in the Nairobi Securities Exchange in Kenya.

These results were explained on the basis of descriptive results, trend analysis, theoretical literature and the empirical literature review. On the basis of descriptive results, the study noted that the findings were consistent with descriptive statistics which indicated an average value of -0.1472. The negative value implies that there was an underperformance in terms of the operational budget. Further, the trend analysis showed a general upward trajectory over the years though with huge variations from 2009 to 2010. These results weighed heavily on equity return as indicated by the declining equity returns. Correlation results showed that a strong positive correlation exists between operational budgetary performance and equity return (r=-0.7286). Therefore, an improvement in operational budgetary performance would lead to an improvement in equity return.

The theory of budgeting, proposed by Hirst (1987), provides a framework for understanding the significance of an effective budgetary control system in organizations. It emphasizes the importance of budgets as a tool for planning, setting objectives, and monitoring performance (Shields & Young, 1993). The findings that operational budgetary performance has a significant influence on equity return of listed manufacturing firms in the Nairobi Securities Exchange align with this theory. By implementing an effective budgetary control system, firms can project future financial performance, set performance standards, and compare actual results with the established standards (Hirst, 1987). This enables firms to plan and allocate resources effectively, manage risks and opportunities, and

ultimately enhance their financial performance and equity returns. Therefore, embracing the principles of the theory of budgeting is crucial for manufacturing firms in the Nairobi Securities Exchange to effectively manage their financial resources and achieve better equity returns (Muriuki, 2019).

These findings were also consistent with the findings of Schubert and Kirsten (2021) which has shown that effective budget management can contribute significantly to a firm's success. Therefore, it can be concluded that the ability to manage operational budgetary performance is a critical factor for achieving and sustaining competitive advantage, and ultimately, superior performance in the business environment.

Conclusions

The study found that operational budgetary performance has positive influence on equity returns of listed manufacturing firms on Nairobi Securities Exchange in Kenya. The influence was found to be significant. This meant that operational budgetary performance has positive significant influence on equity returns of listed manufacturing firms on Nairobi Securities Exchange in Kenya. The study therefore rejects the null hypothesis and concludes that operational budgetary performance has positive significant influence on equity return of listed manufacturing firms in the Nairobi Securities Exchange.

Recommendations

Listed manufacturing firms in the Nairobi Securities Exchange in Kenya should focus on improving their operational budgetary performance to achieve and sustain competitive advantage and superior performance. This can be achieved by developing effective budget management strategies and ensuring proper implementation and monitoring of budgets. The study found that the average operational budgetary performance has had minimal fluctuations from 2010 to 2021. Therefore, it is recommended that listed manufacturing firms in the Nairobi Securities Exchange in Kenya continuously monitor and evaluate their operational budgetary performance to ensure that it is consistently improving over time. This will enable the firm to identify areas that need improvement and take corrective action promptly.

Contribution of the Study

The research study provides knowledge on how operational budgetary performance influence equity return of firms hence many businesses may appreciate more on the role of the budgeting. Business management practitioners may be able to find out the effect operational budgetary performance have on their respective business performance based on the results of this research study. They may further use the findings of this study to assess the need to adopt operational budgetary performance with the view of tilting the financial performance curve of their businesses.

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