CURRENT RATIO AND FINANCIAL PERFORMANCE OF AGRICULTURAL FIRMS LISTED AT THE NAIROBI SECURITES EXCHANGE, KENYA

ABSTRACT

The significant importance of the Agricultural sub-sector is depicted through its contribution to the economic and social developments of Kenya. The study originates from the Doctoral dissertation of the first author in which the co-authors served as supervisors. A census approach was adopted where secondary data from audited annual financial reports of all the six Agricultural firms listed at the Nairobi Securities exchange, Kenya was used, covering the period 2015 to 2022. Descriptive analysis and panel regression analysis were applied. The findings from the panel regression analysis indicated that current ratio has significant effect on financial performance of the Agricultural firms listed at the Nairobi Securities Exchange, Kenya. The study recommends that agricultural firms listed at the Nairobi Securities Exchange need to increase their current assets holdings for purposes of increasing their liquidity levels. This is due to current ratio positive effect on the financial performance of agricultural firms listed at the Nairobi Securities Exchange, Kenya. However, just as very low current ratio is discouraged for firms, it should notably not to be too high as this will serve as an indication that managers are not efficiently utilizing assets. Managers need to properly assess the short term obligations of their firms so as to ensure a corresponding current ratio is attained. Further researches can be undertaken on current ratio and financial performance relationships in the context of firms in other sectors that are listed at the Nairobi Securities Exchange, Kenya.

Keywords: Current Ratio, Financial Performance, Liquidity Preference Theory and Stewardship Theory

1.1 Introduction

In the context of a firm, liquidity is considered as the ability of firms to efficiently convert assets into cash or money. In this case, cash or money is regarded as the liquid-form of an asset (Ibid, 2016). Broadly, liquidity is a financial condition of a firm having adequate funds (assets and cash or money) for investment, and its operations, as well as, for meeting its short-term obligations. Past financial performance studies confirm that liquidity is statistically a significant measure of a corporation's or firm's financial health, quality, growth, and survival (Omar, 2013).

Past financial performance studies have used various predictors, but liquidity has generally been under studied. In a few cases it has been used as one of the selected measures of financial performance, amongst others; and it has hardly been used as key (or the only) determinant. Yet, McCaw (2018), observed that liquidity plays a central role in fruitful running of any business

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organization. Evidently, prevailing trends of decline in financial performance have mostly contributed towards closures of some of the listed firms, others getting under statutory management or receivership and remainders' operations being reduced to below their capacities; others are forced, to their knees, into merger or acquisition.

Consequently, liquidity has been identified as a source of greater current and future concern to firms and business managers, in both the private and government sub-sectors. Furthermore, past financial performance study by Njoroge (2015) affirms that liquidity plays a vital role in competitive management of any business or a firm. In fact, several other firm challenges have also been linked to firm's illiquidity or liquidity risk. As such, it has become mandatory for firms to exercise stringent watch on their balance levels of both their liquidity and profitability.

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One of the attributes to poor financial performance of firms is their temptation to focus on profitability at the expense of maintaining optimum liquidity levels. Globally, past FP studies have shown that a majority of listed firms have been casualties of this focus, in their bid to reward their shareholders generously, with handsome profit earnings. This has had the effect of a drastic reduction of their liquidity levels to limited amounts. It is evident from past financial performance studies that a firm with limited liquidity levels is likely to face its downfall, and in most cases, its ultimately closure in a short while (Maroa & Kioko, 2016).

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Regarding securities markets, like the Kenya's Nairobi securities exchange (NSE), liquidity in is associated with the speed at which an asset, being traded in the market is converted into cash or money, at a low cost (efficiency). Consequently, an asset is "liquid" if the market in which it is being traded is "liquid". In essence, a liquid securities market is said to have both depth and breadth, which means, having many buyers and sellers, who make it possible for it to quickly avail buyers of assets availed in the market (Mishkin & Eakins, 2012). Based on this discussion, it is evident that the impact of liquidity on firm's financial performance has currently become a very significant aspect of financial performance studies of listed firms, as well as, their respective security markets. Liquidity remains a significant financial performance studies aspect.

This is in the face of the fact that globally most of the firms have tended to focus on their main goal of maximizing profit to cater for their shareholders profit margins; which has become a major goal of their business endeavors. Yet, this is at the expense of their maintenance of optimal

liquidity levels. Optimizing of liquidity levels has, in this currently era, been adversely affected by the on-going global tight-liquidity and on-and emerging financial crisis. All these have been coupled with the challenge of firms being required to meet, on their own, all of their financial obligations. This has been further been impacted on by the global crisis like the 2020s Covid-19 and the Russian-Ukraine war. In view of this, financial performance past studies have shown that optimal liquidity levels have significantly become critical and significant to every business' that endeavors to achieve favorable growth, quality, competence, and survival; coupled with improvement of their financial performance.

2.1 Theoretical Review

2.1.1 Liquidity Preference Theory

This theory was introduced by Keynes (1936). It is also referred to as Keynesian theory of money. It is key to success in acquisition of goods and services and according to it interest rate is the reward for partying with liquidity. Keynes (1936) in his study "The General Theory of Employment, Interest and Money" identified the three motives of firms holding cash or money as to be for: speculative, precautionary, and transactional. Firms hold liquidity for purposes of addressing the day to day needs and expenses as they emerge, that is for transactional motive. Most firms however opt for holding onto their marketable securities especially for purposes of speculation. Such firms may prefer to hold on to these assets until interest rates rise (Akenga, 2015). This suggests that liquidity management has a significant impact on profitability and financial performance in general. On the other hand, precautionary motive has to do with a reservation of most liquid assets for unforeseen obligations (unexpected emergencies, contingencies and accidents) (Ibid, 2015).

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2.1.2 Stewardship Theory

Davis, Schoolman, and Donaldson, (1997) in their publication of "Toward a stewardship theory of management" stated that a steward protects and maximizes shareholder's wealth by optimizing financial performance. Stewards consist of: managers, executives, and board of directors. In this case, stewards are satisfied and motivated when the firm's objectives are attained. This is through stewards not having self-serving behavior, but instead, having a service behavior of satisfying organization objectives, and being concerned about their personal reputation, as expert decision makers. Reputation arises from their effort in achieving better FPs

for their respective firms. All their stewardship drive is always directed towards achieving better and better financial performance for the firms they are serving. In this case, managers' efforts are therefore directed towards maximizing financial performance, as well as, shareholders profit (Omar, 2013; Mauwa, 2016).

2.2 Empirical Review

By taking into account the firm size at companies incorporated in the LQ45 index year 2013–2016, Wikan (2017) assessed the effect of the current ratio on return on assets and price earnings ratio in predicting profit growth with firm size as a control variable. Purposive sampling is the method used to select the sample in this study. For the purposes of this study, companies included in the LQ45 Index must satisfy a number of requirements in order to be sampled. In this research method, multiple regression analysis is utilized to determine the combined and partial effects of independent variables on the dependent variable. With firm size acting as the control variable, the t test is performed to evaluate the impact of each variable change on the current ratio. To determine how much the influence variable has changed, the R2 test (Coefficient of determination) is used. Using firm size as the control variable, it is known from the results of the t test that the variable change in the current ratio has only a minimally significant impact on the profit growth variable. The current ratio change simultaneously substantial effect on profit growth variable at go public firm listed in index LQ 45 in Indonesia with (company size) as control variable is known from the results of the F test. It is recommended that the companies included in the LQ45 Index boost the efficiency of their investment management in order to ensure the total asset turnover boosts since if an organization invests too much in its assets, the capital cost will end up being too excessive and earnings will be depressed. The profitable revenue, on the other hand, are going to be forfeited if the assets remain too minimal. Recommended businesses for wealth investments employing a means of financing that can boost the business's earnings. When borrowing money is predicted to result in operating profits greater than the interest payments, it can be justifiable.

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Onyeka, Nnenna, Nnado, and Okechukwu (2018) looked at the impact of leverage and current ratio on cash and cash equivalents (CASH) and return on assets (ROA). To understand the effects of the predictors and control factors on the dependent variables, ex post research using quantitative panel methods was used. For the fifteen-year period, 2003–2017, data were

compiled from the audited annual reports of 32 manufacturing companies that were traded on the Nigerian Stock Exchange. The data were analyzed using the Westerlund Panel Cointegration Tests, which showed that the variables were not co-integrated, and the Levin-Lin-Chu panel unit-root test, which established the data's stationarity. The comprehensive model with fixed effect regression showed that the current ratio had negligible positive effects on cash and ROA, but that the logarithm of total assets had a considerable positive impact on cash. These findings suggest that finding the optimal liquidity-profitability trade-offs is necessary for maximizing enterprises' earnings.

Hermanto, Ponjatau, and Windyastui (2018) looked at how the current ratio affected the returns on assets and return on equity for businesses in the food and noodle subsector. From 2014 to 2017, a total of 10 firms with stock on the Indonesia Stock Exchange (ISX) were tested. Multiple linear regression analysis was. A strong impact on return on equity and return on asset was found, according to the findings, of the current ratio. Outcomes of the study of the regression coefficients revealed that current ratio described 14.9% of ROA, with the remaining 85.1% being clarified by additional factors, as shown by the coefficient determinants. According to the examination of the regression coefficients for ROE, additional factors not considered in this study accounted for 61.4% of the explanation.

Ariesa, Tommy, Utami, Maharidha, and Nainggolan (2020) in their study of the effect of current ratio, firm size, return on equity, and earnings per share on the stock prices of manufacturing companies listed in Indonesian securities exchange in the 2014 -2018; where purposive sampling technique was used to select 49 companies out of 245 manufacturing companies and their financial statements were used in the study. Quantitative approach with descriptive statistical analysis were used. The study found that variable current ratio, among others, had a significant effect on the variable stock prices of manufacturing companies.

Chibesa (2019) determined the impact of current ratio on financial performance of agricultural firms listed at the Lusaka Stock Exchange (LuSE). The study was based on correlation and regression analysis. The results of the correlation analysis for the first company demonstrate a positive and highly significant relationship between current ratio and ROA. Similar findings for the second company indicate a significant and positive relationship between current ratio and ROA. Regression analysis results for the first company demonstrate a strong and positive

association between current ratio and ROA, which is consistent with the correlation analysis results. The results of the correlation study for the second company, which demonstrate a highly significant and negative association between current ratio and EPS, are also supported by regression analysis. The study advised that, in order to optimize value for shareholders and maintain long-term viability, liquidity and profitability of particular agricultural enterprises listed on the Lusaka Stock Exchange (LuSE) should be effectively matched.

Kajola, Alao, Sanyaolu, and Ojurongbe (2019) investigated the impact of liquidity on the financial performance of Nigerian firms. The study used data from seventeen consumer goods companies listed on the Nigerian Stock Exchange during the financial years 2012 to 2017. Multiple regression was used in the investigation, and pooled Ordinary Least Squares was used as an estimation approach. However, the study was unable to offer empirical proof that the liquidity proxy-current ratio had a substantial impact on the performance of the organizations. The report advised business managers and key decision makers to take advantage of debtors' tax shield from the interest in companies' financial structures and establish solid methods that would monitor and effectively manage liquidity requirements in order to increase profitability levels.

Olugboyega, Adeniyi, Sanyaolu and Ojuorongbe (2019) studied the effect of liquidity and leverage on financial performance of consumer goods firms listed on the Nigerian securities exchange. Multiple regression analysis technique was used on the data obtained from 17 of the listed firms during the financial years 2012 to 2017. However, the study found that current ratio had no significant effect on the financial performance of these firms.

Ohaju (2020) analyzed the effect of current ratio on total equity of manufacturing companies in Nigeria. The objectives of the investigation were met by using a quantitative approach, and its coverage area included ten (10) publicly traded consumer goods companies in Nigeria: Cadbury Nigeria Plc, Champion Breweries Plc, Dangote Flour Mill Plc, Dangote Sugar Plc, Fidson Nigeria Plc, Guinness Nigeria Plc, International Breweries Plc, Nigeria Breweries Plc, Nestle Nigeria Plc, and Northern Nigeria Flour Mill Plc. As the approach of analysis, the random-effects panel regression model was employed. It was shown that the total equity of Nigerian manufacturing enterprises is not significantly impacted by current ratio. Therefore, the report advised the enterprises under investigation to either postpone any capital purchases that would

require cash payments or sell any capital assets that were not producing a profit for the company, utilizing the proceeds to pay down existing debt.

Harahapa, Septiania, and Endria (2020) investigated the impact of current ratio on company value. The four manufacturing businesses in the cable sub-sector that are listed on the Indonesia Stock Exchange (IDX) for the years 2014 to 2018 comprise the sample for the study, and they are examined using the panel data regression approach. Empirical study results show that current ratio has no impact on business value. The company's value is impacted by current ratio when taken collectively. The study's findings suggest that the company's value may increase if it continues to have a capital structure that is balanced between debt and equity, provided that debt is used to fund profitable and productive assets.

Dewinda and Irfan (2021) examined how current ratio affected financial distress in companies in the retail industry that are listed on the Indonesia Stock Exchange. The multiple linear regression analysis approach was chosen as the analysis technique in this study. Altman Z-Score is a method for measuring financial distress. The retail subsector companies registered on the Indonesian Stock Exchange between 2014 and 2019 made up the study's population. Thirteen businesses were selected as the sample for this study using the purposive sampling technique. The study found that current ratio had significant effect on financial distress of firms in the retail subsector listed at the Indonesia Stock Exchange between 2014 and 2019.

Liu, Xu and Shang (2021) determined the factors of financial performance of agricultural companies listed in China used multiple regression approach on a sample of 39 Agricultural listed companies during the six-year period of 2013 – 2018. Financial performance was measured using ROA, ROE, and ROS. Internal factors included firm size, CR, DR, long term liabilities ratio, sales growth rate, capital intensity, research and development intensity, export intensity and ownership. External factors included GDP growth rate and consumer price index (CPI) growth rate. Their second finding was that current ratio had insignificant effect on firms' performance. As such, Agricultural listed companies should take into account the optimum level of liquidity because excess cash-flow that is not invested does not contribute to performance improvement.

Siswohadi (2021) assessed how the current ratio at PT Multi Bintang Indonesia Tbk reflects the impact of financial performance. The information used is secondary and comes from financial filings covering the years 2016 through 2019. The population is represented by PT Multi Bintang Indonesia Tbk's financial reports. Probability sampling is employed for the sample. The method of documenting in PT Multi Bintang Indonesia Tbk's financial statements was utilized to acquire the data. With the aid of the computer application SPSS version 17.0 for Windows, the following data analysis procedures were used: a normality test, multicollinearity test, heteroscedasticity test, autocorrelation test, and multiple linear regression test. The liquidity ratio is the tool used to evaluate PT Multi Bintang Indonesia Tbk's financial performance. According to the study's findings, financial performance is not significantly impacted by the current ratio. Short-term debts cannot be paid using the current ratio. This is due to changes in current assets that have an impact on the amount of current debt that is bigger than current assets showing changes in one of the components of current debt that has a significant nominal level.

Khoiriah (2022) examined the impact of current ratio on return on equity of manufacturing companies listed on the Indonesia Stock Exchange with focus on the food and beverage sector. The financial statements of six companies for the years 2013 to 2020 are used as the primary source of secondary data collection. The financial statements are processed using the Eviews 9 software, and the purposive sampling method is used to determine the sample size. The study's findings indicate that the current ratio has no discernible impact on return on equity.

Current ratio was used by Mugambi, Muturi, and Njeru (2023) to analyze the impact of liquidity on hotel financial performance. The hotel sector was chosen due to its significance to the Kenyan economy and the fact that it has not received much research about the factors that determine its capital structure and how they affect financial performance. This study used an explanatory research design and secondary panel data that was taken from the financial records of the 40 star-rated hotels that were the study's target population. According to the study's findings, Nairobi's star-rated hotels' financial performance is significantly and favorably impacted by liquidity. This demonstrates improved financial performance of Nairobi County's star-rated hotels due to an increase in liquidity. This shows that the operational capability of the corresponding star-rated hotels was not restricted by the share of current assets.

3.1 Research Methodology

3.2 Research Design

Explanatory research design was used in the study. Both descriptive data analysis and panel data analysis were used. The descriptive quantitative analysis provided descriptive and regression (or causal relationships) statistics of the variables involved; while the inferential analysis provided related predictions and estimates (parameters), as well as, the required hypothesis tests (diagnostic analysis).

3.3 Target Population

Target population is any group of individuals that have one or more characteristics in common that are of interest to the researcher is referred to as a population (Best & Kahn, 2004). This study targeted the six (6) agricultural firms listed at the NSE, Kenya. The target period was 2015-2022. The list of target firms included Eaagads Ltd., Kapchorua Tea Company Ltd., Limuru Tea Company Ltd., Kakuzi, Sasini Ltd., and Williams Tea Kenya Ltd.

3.4 Sampling Design

As indicated by Smith and Albaum (2012) a sampling is all the population entities that are used for data collection. And, Cooper and Schindler (2008) adds that they are population elements that may be accessible at the time of data collection. In this study, census approach was adopted where all the six targeted firms were covered. Secondary data of audited financial statements of the sub-sector submitted to the Capital Market Authority (CMA), Kenya was used.

3.5 Data Analysis and Presentation

After the successfully completing the data collection process, analysis of data was carried out. Mean, standard deviation, maximum and minimum values were established for the study variables, based on the descriptive analysis. Panel regression analysis which was informed by the choice of panel data was used in the study. The hypothesis testing was guided by a threshold of 0.05 significance level. A p-value below 0.05 implies a significant effect and a p-value above 0.05 meant an insignificant effect.

3.6 Empirical Model

In the empirical model, current ratio was expressed as a function of financial performance:

$FNP= \beta_0+\beta_1 CRR_{it} +\varepsilon$

Where:

FNP= Financial Performance

CRR = Current Ratio

$_i$ = Firm (1 to 6)

$_t$ = Time period (2015 -2022)

4.1 Data Analysis and Discussions

Data was analyzed based on descriptive analysis and panel regression analysis. The mean, standard deviation, total observations, minimum value and maximum value for each variable were capture in the descriptive analysis. The panel regression analysis provided the basis upon which the conclusion of the study was made.

4.2 Descriptive Analysis

In order the document the basic features of the research data, the descriptive analysis was conducted. Through this, descriptive statistics cutting across mean, total observations, standard deviation, minimum and maximum values were recorded as captured in Table 1.

Table 1: Descriptive Statistics

Variable	Obs.	Mean	Std. Dev.	Min	Max
Financial Performance	48	.249186	.4568764	-.52312	1.635935
Current Ratio	48	6.076224	7.04602	.35268	48.82997

Source: Study Data (2023)

Based on the descriptive summary of the variables, the average financial performance of the firms in the study was 0.249186%, with a standard deviation of 0.4568764%. This means that the financial performance of the firms varied from each other by 0.4568764% on average. The range of financial performance values was -0.52312 to 1.635935. The average current ratio of the firms in the study was 6.076224, with a standard deviation of 7.04602. This means that the current ratio of the firms varied from each other by 7.04602% on average. The range of current ratio values was 0.35268 to 48.82997.

4.4 Panel Regression Analysis

The panel regression analysis was carried out in line with the objective of the study, hence it was utilized as a basis for the hypothesis testing as guided by the threshold of 0.05 significance level. The findings of the panel regression analysis are contained in Table 2.

Table 2: Panel Regression Results

Financial Performance	Coef.	Robust Std. Err.	Z	P>z	[95% Conf.	Interval]
Current Ratio	.1028309	.0366787	2.80	0.005	.0309419	.1747199
_cons	.0598644	.0741373	0.81	0.419	-.085442	.2051708
R^2	0.2284					
Wald Chi2 (4)	27.18					
Prob>Chi2	0.0000					

Source: Study Data (2023)

F-value of 27.18 and p-value of 0.0000 in the results in Table 2 showed that the model is significant in explaining financial performance. The R-square, which was indicated by 0.2284, indicated the model's goodness of fit. This suggested that 22.84 percent of the variations in the financial performance of firms can be attributed to current ratio.

4.5 Hypothesis Testing

H_O: Current ratio has no significant effect on financial performance of Agricultural firms listed at the Nairobi Securities Exchange, Kenya.

The study sought to assess the effect of current ratio on financial performance of agricultural firms listed at the Nairobi Securities Exchange, Kenya. In addressing this objective, the above hypothesis stating that current ratio has no significant effect on financial performance of agricultural firms listed at the Nairobi Securities Exchange, Kenya was formulated and then tested. The results obtained in Table 2 indicates a p-value of 0.005 hence implying significance. It was therefore established that current ratio has significant effect on financial performance of agricultural firms listed at the Nairobi Securities Exchange, Kenya. The coefficient of 0.1028309 further indicates positive relationship between current ratio and financial performance of financial performance of agricultural firms listed at the Nairobi Securities Exchange, Kenya. As such, a unit increase in current ratio translates into a 0.10 increase in the financial performance of agricultural firms listed at the Nairobi Securities Exchange, Kenya.

Current ratio captures the ability of firms in paying up short term obligations upon occurrence and is further utilized by investors in assessing the extent by which managers can current assets in satisfying its current debt among other payables. The research findings collaborate with those of previous empirical studies. Ariesa *et al*. (2019) reported that current ratio had a significant effect on the variable stock prices of manufacturing companies listed in Indonesian securities exchange. Similarly, in the context of Lusaka Stock Exchange (LuSE)-listed agricultural enterprises, Chibesa (2019) established a significant and positive relationship between current ratio and ROA. Kajola *et al*. (2019) reported that liquidity proxy-current ratio had a substantial impact on the performance of consumer goods companies listed on the Nigerian Stock Exchange.

5.1 Conclusion and Recommendations

The study established that current ratio has significant effect on financial performance of agricultural firms listed at the Nairobi Securities Exchange, Kenya. It was consequently concluded that current ratio is an important of financial performance of agricultural firms listed at the Nairobi Securities Exchange, Kenya. Therefore, the extent by which current liabilities are covered by current assets serves as a key determinant of financial performance of agricultural firms listed at the Nairobi Securities Exchange, Kenya. This is a higher current ratio implies higher ability of companies in covering short-term liabilities.

It was established that current ratio has significant effect on financial performance of agricultural firms listed at the Nairobi Securities Exchange, Kenya. In view of the study findings and conclusion with respect to current ratio and financial performance nexus, it is recommended that agricultural firms listed at the Nairobi Securities Exchange need to increase their current assets holdings for purposes of increasing their liquidity levels. This is due to current ratio positive effect on the financial performance of agricultural firms listed at the Nairobi Securities Exchange, Kenya. However, just as very low current ratio is discouraged for firms, it should notably not to be too high as this will serve as an indication that managers are not efficiently utilizing assets. Managers need to properly assess the short term obligations of their firms so as to ensure a corresponding current ratio is attained. Nairobi Securities Exchange should provide favorable terms, services and charges to this subsector to improve their financial performances to this effect.

5.5 Suggestions for Further Studies

The study analyzed the effect of current ratio on financial performance of agricultural firms listed at the Nairobi Securities Exchange, Kenya. Further researches can be undertaken on current ratio and financial performance relationships in the context of firms in other sectors that are listed at the Nairobi Securities Exchange, Kenya.

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