

## EFFECT OF FINANCING CASH FLOW MANAGEMENT ON FINANCIAL PERFORMANCE OF MUTUAL FUNDS IN KENYA

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### ABSTRACT

This study focused on effect of financing cash flow management on financial performance of mutual funds in Kenya. The objective of the paper was to look into relationship between financing cash flow management and financial performance of mutual funds in Kenya. The study employed causal research design. Secondary panel data from the audited financial statements of 22 mutual funds was retrieved from financial reports for the period 2011-2016. Descriptive statistics namely; mean, median, minimum, maximum and standard deviation were generated using Eviews software. The inferential statistics such as R square, t-tests and F-tests were used to test the significant of the relationship between the variables under the study and establish the degree to which the predictor variables explain the variation in dependent variable. The data was evaluated using the regression technique, random effect model and fixed effect model based on Hausman specification tests. Jargue-Beta test, coefficients of skewness and kurtosis were used to assess normality of the data for modeling and parametric inference. Durbin-Watson test was used to test for autocorrelation. The p-value at 5% level of confidence for each t-test was used to make conclusions on whether to accept or reject the null hypotheses. The results indicated that financing cash flow management had significant and negative effect on return on assets and return on equity. The study conclude financing cash flow management had significant and negative effect on return on assets and return on equity. The relationship between financing cash flow management and financial performance was established to be negative relationship. Hence it is recommended that Managers of the firms should decrease in over investment through the expansion programs but efforts be made by management to increase the value of the company through other means like the funding policy and coming up with effective financing policy to improve company performance.

**Keywords:** Financing Cash flow Management, Financial Performance; Mutual funds.

### INTRODUCTION

Cash flow management plays a major role in the company's operations and financial performance (Efobi, 2008). Cash flow management is an ongoing challenge for organizations managers as they pay little attention to it and they have failed to recognize the effect of cash deficiency on the return on assets, equity and operation of the company (Uwonda & Okello (2013). Kroes and Subramanyam (2012) linked business success or failure to the volume of the net cash inflows and outflows from a firm's activities as inability to generate cash in order to sustain its operations. A company is forced to source finances from lending institutions or dispose of assets in order to settle financial obligations. Failure to raise funds on time leads to collapse, bankruptcy and finally closure of business operations of a company. According to Ebben and Johnson (2011) cash flow management is a mechanism used to improve financial

performance, although the prevalence of academic studies into the link between cash flow management and financial performance inspects the issue from a stationary benchmarking perception (Ebben & Johnson, 2011). Nerlove (2005) conclude that the stationary approach has resulted into a affluence of insight of the importance of efficiency and effective cash flows management and performance.

In United Kingdom, nearly half of Britain's mutual fund businesses were concerned about managing their cash flow that year (Hutchison, 2013). Keswani and Stolin (2008) investigate the smart money effect using UK data for the years 1991-1999 and contained exact cash inflow and outflow information for both individual and institutional investors. They confirmed that both individual and institutional investors are smart, although this is revealed by the cash inflows rather than the cash outflows of the funds.

In Pakistan, Ahmed and Javid (2009) investigated cash flow management on performance of non firms listed in Karachi Stock Exchange and found out that cash flow management had significant and positive relationship performance. A positive relationship effect between cash flow management and performance of firms indicated that firms with larger free cash flow pay larger dividends. Research by Goldstein, Jiang and Ng (2015) on corporate bond funds in US showed that cash flows are more susceptible to reduced performance than good performance and that the relationship is more stronger in situation where market liquidity is limited. They argued that an illiquid corporate bond market make a first mover benefit in fund managers investing in this segment of the market.

Thanh and Nguyen (2013) stated that for a company to achieve its objective of financial performance must come up with best strategy in identifying and selecting the best cash flows components. Cash flows index decisions can lead to corporate failure. Thanh and Nguyen (2013) further stated that due to poor and weak governance in companies in managing cash flows, managers tend to engage and put their interest first before the management and shareholders goals. Thanh and Nguyen (2013) stated that cash flow management and company performance had significant and positive relationship. However, on a divergent views Ali *et al.* (2013) studied the association between various earnings and cash flow measures of firm performance and stock returns in Iran. The study revealed that cash flow had a significant and negative effect on a company's performance. The different findings from previous scholars created gap that need more observation and further investigation the phenomenon.

Mutual funds play a fundamental function in Kenya economy by offering investors the advantages of portfolio diversification and professional management at low cost (CMA, 2016). Investors, Government and lenders have invested heavily in mutual funds financially and expect such fund managers to perform to the expected standards. However, the potential for the sector have been significantly hindered by declining performance. According to PWC (2015) the number of mutual funds grew from virtually zero in 2001 to twenty five in 2015 while the asset portfolio grew by an average of ksh.1.9 billion annually to Ksh.38.1 billion. Mutual funds posted declining financial performance of 9.3 percent in the year 2016 from 9.7 percent in the year 2015 and from 12.2 percent in 2014 respectively (CMA, 2016). Vahid *et al.*(2012) cited cash flow management as a determining success or failure of firm in business financial performance due to its effect on firm's profitability.

To establish the effect of financing cash flow management on financial performance of a firm, research has been undertaken globally by various researchers particularly on cash flow

management. Robert and Theresa (2015) investigated the effect of cash flow management on performance of mutual funds in America, concluded that the improvement in cash flows positively affected the financial performances measured by ROA. A study by Turcas (2011) found out that the solvency, flexibility and the financial performance of the Bucharest firm's are set on the firm's ability to generate positive cash flows from the operating cash flow, investing cash flow and financing cash flow. In Japan, Chikashi (2013) on investigating effect of cash flow and firm performance in the case of the electric appliances industry of the Tokyo Stock Exchange. The study revealed that cash flows and firm performance have a significant negative relationship. In another study by Thanh and Nguyen (2013) on the effect of Banking Relationship on firm performance in Vietnam. The study indicated that cash flow has negative relationship with firms, return on equity, while assets had a negative association with return on assets. In Iran, Ali *et al.* (2013) studied the association between various earnings and cash flow measures of firm performance and stock returns in Iran. The study revealed that cash flow had a significant and negative effect on a company's performance; furthermore, earning based measures were more related to stock returns and represent the company performance better than cash flow measures in some companies with higher accruals.

On the divergent, In Ghana Hamza, Mutala and Antwi (2015) assessed cash management practices and its effect on the financial performance of SMEs in the Northern Region of Ghana. The findings of the study indicated that cash management had positive effect on financial at one per cent significance level. In Iran, Poorzamani and Khademi (2014) on the effect of corporate governance factors on cash flow resulting from operating and financing activities of the firm listed at Tehran Stock Exchange. Research findings showed that there was no meaningful relationship between corporate governance factors and financing cash flow and in capital market in Iran. Mirfakhraldini, Moeinaldin and Ebrahimpour (2009) investigated effect of accrual earnings, financing cash flows, investing cash flows on predicting future cash flow.

In Kenya; Ndungu and Oluoch (2016) studied Effect of cash flow management on market performance of public construction companies in Kenya and concluded that cash flow management has significant relationship on market performance. Although, the literature contains numerous studies that examine the relationship among cash flow management and firm's financial performance, show that cash flow management is a challenge in developing countries in general and Kenya in particular did not address the effect of financing cash flow management on financial performance of mutual funds. In addition the studies did not give in depth evaluation of the effect financing cash flow management on financial performance. In summary, the existing literature is not clear on how financing cash flow management affects performance of mutual funds in Kenya and similar regulatory environments. The current study sought to fill the knowledge gap by establishing the effect of financing cash flow management on financial performance of mutual funds in Kenya for years 2011 to 2016.

## **THEORETICAL REVIEW**

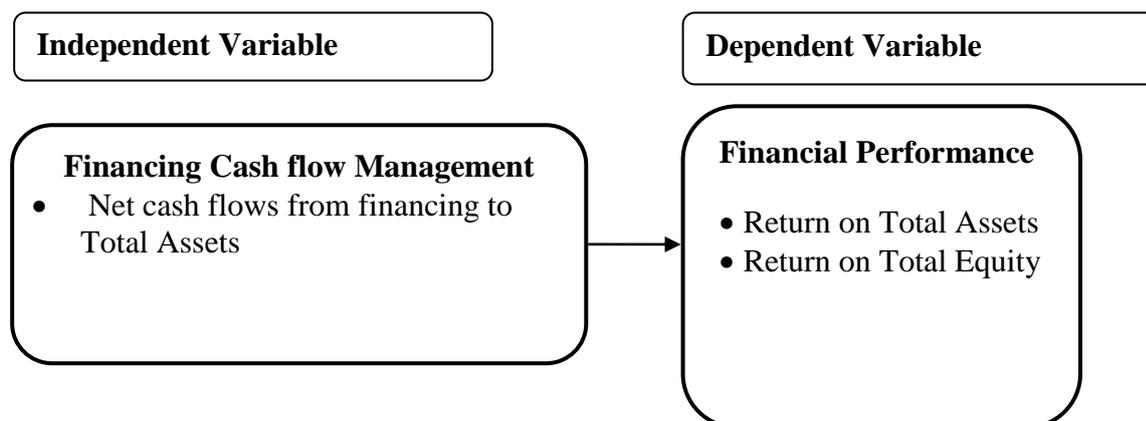
A theory is a combination of different constructs, such as descriptive ability, explanatory power, heuristic value, testability, integration, parsimony, clarity, comprehensiveness, and delimitation (Gelso & Samstag, 2008). It is a description of phenomenon and the interactions of its variables that are used to attempt to explain or predict (Stam, 2010). A theory should be evaluated for its ability to be used to predict or explain a phenomenon rather than the ability to utilize it to depict reality (Davies, 2008). In this study, a theory of measuring financing

cash flow management on financial performance of mutual funds in Kenya is addressed. In particular Trade Off theory is reviewed since all of them support both the dependent and predictor variable as shown in the conceptual framework.

### Trade off theory

Trade-Off theory suggested by Myers (1984) emphasize a balance between tax saving arising from debt, decrease in agent cost and bankruptcy and financial distress costs. According to the trade-off theory suggested by Myers (1984), the more financing cash flow a profitable firm has, the more debt it generate. Within the trade-off theory, managers seek optimal capital structure. While, Sheikh & Wang (2010) stated that Trade Off theory expected to choose a target capital structure that maximizes the firm value by minimizing the costs of prevailing market imperfections.

The trade off theory also called tax based theories and bankruptcy costs. The theory assumes that every sources of funds has its own return and costs and these are associates with the firm's earning capacity and its business and insolvency risks (Awan & Amin, 2014). Thus, a firm with tax benefit will issue more debt to financed business operation and the cost of financial distress and benefit from tax shield are balanced (Cheng, Cullina & Zhang, 2014). The theory predicts a relationship between average asset risk and debt ratios, asset type, profitability and tax status. Decision on sources of financing depends on the preference order: internal finance like reserves and retain earnings; debt; equity and companies maximize their value by opting for a new investments with cheapest available sources (Sheikh & Wang, 2011).



**Figure 1.1**

### Empirical reviews

According to Nwanyanwu (2015) cash flow from financing activities include: inflows and outflows of cash involved in obtaining cash from external sources for the purposes of financing the company and its operations. According to the (IAS, No.7), financing cash flows are cash proceeds from issuing debentures loans notes, bonds, mortgages and other short-term or long –term borrowings, cash proceeds from issuing shares or other equity instruments, cash payments to owners to acquire or redeem the entities shares and cash repayments of amounts borrowed (IAS, No.7).

Ndungu and Oluoch (2016) examined the effect of cash flow management on market performance of public construction companies in Kenya. The study adopted a descriptive research design. They collected secondary semi-annual data was collected for the 5 listed

construction companies at the Nairobi Securities Exchange (NSE) over a seven year period from January 2008 to December 2015. They used the modified capital asset pricing model (CAPM) in their analysis. The results showed that cash flows from operations have a positive effect of market performance of construction companies and while the cash flows from investing, financing and free cash flows all have a negative effect of the market performance of construction companies.

Hamza, Mutala and Antwi (2015) assessed cash management practices and its effect on the financial performance of SMEs in the Northern Region of Ghana. In this study, a descriptive cross-sectional survey research design was adopted that allowed collection of primary quantitative data through structured questionnaires. The study target population was 1000 owner/ managers of SMEs. The study employed stratified random sampling technique in obtaining a sample of 300 SMEs comprising 164 trading 26 manufacturing, 10 hairstyling, 62 dressmaking, and 38 carpentry enterprises. Descriptive and inferential statistics was used to analyze the collected data. The findings of the study indicated that cash management had positive effect on financial at one per cent significance level.

In another study conducted by Poorzamani and Khademi (2014) on the effect of corporate governance factors on cash flow resulting from operating and financing activities of the firm listed at Tehran Stock Exchange. In their research they investigated about 193 firms enlisted during the time period between 2007 and 2012. The statistical method used was panel data method. Multiple variable linear regression model was employed to analyze data. Research findings showed that there was no meaningful relationship between corporate governance factors and financing cash flow and in capital market in Iran. Corporate governance factors had insignificant and positive effect on financing cash flows. Also there was meaningful relationship between corporate governance factors and operating cash flows and in capital market in Iran corporate governance factors have had a very important role in cash flows resulting from operating activities.

In a study made by Chikashi (2013) on investigating effect of cash flow and firm performance in the case of the electric appliances industry of the Tokyo Stock Exchange. The researcher adopted explanatory design and used the data for the fiscal year of 2009 to 2011 and employed the pooled regressions. The study revealed that cash flows and firm performance have a significant negative relationship. In addition, comprehensive incomes published by the firms were superior to other earnings or cash flow variables in predicting their future stock returns.

In another study by Thanh and Nguyen (2013) on the effect of Banking Relationship on firm performance in Vietnam. The study employed multiple regression in analyzing data collected from a sample of 465 companies listed in Vietnam for a period 2007 to 2010. The study revealed that firm performance decreases as the number of bank relationships increases. Additionally, the study also indicated that cash flow has negative relationship with firms, return on equity, while assets have negative association with return on assets.

Ali *et al.* (2013) studied the association between various earnings and cash flow measures of firm performance and stock returns in Iran. The study employed a simple and multiple regressions to analyze the data for a period of nine years from 2003 to 2011. The study revealed that cash flow had a significant and negative effect on a company's performance; furthermore, earning based measures were more related to stock returns and represent the

company performance better than cash flow measures in some companies with higher accruals.

Mirfakhraldini, Moeinaldin and Ebrahimpour (2009) investigated effect of accrual earnings, financing cash flows, investing cash flows on predicting future cash flow. The study adopted explanatory research design and collected data from 73 companies in Tehran Stock Exchange over the period of time from 1380 to 1385 years in the research. The results indicated that earnings, financing cash flows, investment cash flows and earnings accruals components, have predictive ability of the future cash flows, but there is no difference among three predicting models. The financing and investment cash flows and current earnings plus depreciation expense had meaningful and positive relationship with performance.

## RESEARCH METHODOLOGY

According to Denzin and Lincoln (2011) research design is methodological connection between the philosophies and subsequent selection of data collection methods. This study used causal research design. Causal research or explanatory is designed to collect raw data and create data structures and information that allow the researcher to model the cause-and-effect relationships between two or more variables (Hair, Money & Samouel, 2007).

### Target Population

The target population of the study comprised all 25 mutual funds in Kenya. The CMA had 25 mutual funds registered from 1<sup>st</sup> January 2011 to 31<sup>st</sup> December 2016. Twenty two (22) firms were however studied as data for two firms (Natbank Trustee and Investment Services Limited and I & M Capital ) was not available since the two firms were newly registered in the year 2016 and had not submitted any financial reports to CMA for the period under study.

## RESULTS

### Descriptive Statistical Analysis of Financing Cash flow Management

**Table 1.1 Results of Descriptive statistics of FCF**

	Mean	Max	Min	Std.Dev	Skewness	Kurtosis	Jarque	Prob.
FCF	0.0243	0.9413	-0.5773	0.2583	0.6951	2.4054	12.5741	0.0792

The results in table 1.1 indicates that financing cash from management to total assets of the mutual funds for 132 observations had a minimum and maximum value of -0.5773 and 0.9413 respectively, a mean of 0.0243 and standard deviation of 0.2583. All mutual funds however reported positive skewness of 0.6951 on their cash flows to show that majority lied on the right tail of the distribution, implying that majority of mutual funds did not finance the operations through borrowings. The kurtosis coefficient of 2.4054, which measured of thickness of the tails of the distribution, were considered to be within accepted range of normality. Tabachnick and Fidell (2007) and Hair *et al.*(2007) argued that skewness values should not be greater than 2 while kurtosis values should not be greater than 7 for data to be considered normal. The Jarque-Bera test value of 12.5741 with p value 0.0792 for FCF was more than 0.05, an indication that all variables are approximately normally distributed and hence we fail to reject the null hypothesis and conclude that the data was normally distributed (Gujarat, 2008).

**Regression Analysis**

Regression results in table 1.2 indicate the goodness of fit for the regression between financing cash management and ROA was satisfactory in the linear regression. An R squared of 0.544199 for ROA indicates that 54.4% of the variances in financial performance of mutual funds in Kenya are explained by the variances in financing cash flow management in the linear model. The result review that financing cash flow management is statistically significant in explaining financial performance of mutual funds in Kenya. An F statistic of 4.598873 for ROA indicated that the model was significant. This is supported by the probability of (0.000000) less than the conventional probability of (0.05) hence significant.

With regards to ROE R squared of 0.580352 for ROE indicates that 58.0% of the variances in financial performance (ROE) of mutual funds in Kenya are explained by the variances in financing cash flow management in the linear model. An F statistic of 5.326910 indicated that the model was significant. This is supported by the probability value of 0.000000. The reported probability of 0.000000 is less than the conventional probability of (0.05) hence significant.

**Table 1.2 Panel estimation of FCF and Financial Performance**

Dependent Variable: ROA and ROE

Method: Panel Least Squares

Total panel (balanced) observations: 132

Cross-section fixed (dummy variables)

Period fixed (dummy variables)

Model	R <sup>2</sup> Squared	Adjusted R- Squared	S.E of Regression	F-statistic	Prob (F- statistic)	Durbin- Watson
ROA	0.544199	0.425866	0.104470	4.598873	0.000000	1.918731
ROE	0.580352	0.471405	0.113092	5.326910	0.000000	1.977441

Results in table 1.3 show that the coefficient of financing cash flow management with respect to ROA was -0.155609 hence financing cash flow had a negative effect on ROA. The p value was 0.0015 for ROA which was less than 5% level of significance. This indicate that financing cash flow management had an significant negative impact on ROA.

With regards to ROE the results show that the coefficient of financing cash flow management with respect to ROE was -0.138226, hence financing cash flow had a negative effect on ROE. The p value was 0.0088 for ROE which was less than 5% level of significance. This indicate that financing cash flow management had an significant negative impact on ROE. Therefore we fail to accept the null hypothesis that financing cash flow management has no significant effect on financial performance of mutual funds in Kenya and fail to reject the alternative hypothesis.

**Table 1.3 Regression Coefficient Results for the Effect of FCF and Financial Performance**

Model	Variable	Coefficient	Std. Error	t-Statistic	Prob.
ROA	C	0.094414	0.009167	10.29946	0.0000
	ICF	-0.155609	0.047794	-3.255810	0.0015
ROE	C	0.110627	0.009923	11.14804	0.0000
	ICF	-0.138226	0.051739	-2.671614	0.0088

## DISCUSSION

Results showed that firm financing cash flow management had significant negative effect on ROA and ROE at 5% level of significance. The analysis produced a coefficient of determination which shows that the variations in mutual fund's financial performance are explained by financing cash flow management. The significance test showed the effect of financing cash flow management on financial performance (ROA and ROE) was significant and hence null hypothesis was rejected. This implies that the null hypothesis that financing cash flow management has significant effect on financial performance of mutual funds in Kenya failed to be accepted and the alternative hypothesis failed to be rejected.

The findings for ROA and ROE Models are consistent with the trade off theory. The study findings are in line with that of Ali *et al.* (2013) and Chikashi (2013) which showed that company's performance and financing cash flow had a significant negative relationship. The study is also supported by that of Thanh and Nguyen (2013) who found out that cash flow had negative relationship with firms, return on equity, while assets had negative association with return on assets. The study is supported by results of (Ndungu & Oluoch, 2016) who showed that cash flows from cash flows from investing, financing and free cash flows all had a negative effect of the market performance of construction companies. The study contradicts that of Poorzamani and Khademi (2014) who found that there was insignificant positive relationship between corporate governance factors and cash flow resulting from financing activities and in capital market. The study by Hamza, Mutala and Antwi (2015) revealed that SME financial performance was positively related to efficiency of cash management (ECM) at one per cent significance level. The results also contradict a study by Mirfakhraldini, Moeinaldin and Ebrahimpour (2009) who found that the financing and investment cash flows and current earnings plus depreciation expense had meaningful and positive relationship with performance.

## CONCLUSIONS

The study concludes that net cash flow from financing activities which revealed to be more negative as an indicator of the weakness of financial efficiency of mutual funds of its ability to meet its financial obligations without having to drain their assets. Converse results were found regarding the effect of financing cash flow management on financial performance as the study revealed a weak and significant negative relationship between financing activities on ROA and ROE explained by the poor net cash flow from financing activities.

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