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Financial Reporting, Tracking, and Analysis Practices Effect on Financial Performance of Commercial State Corporations in Kenya

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Abstract

In Kenya, legislative acts by parliament establish state corporations to promote social and economic progress. The state corporations advisory committee has identified eight distinct categories of these entities, which include financial, commercial, industrial, regulatory, public universities, training and research, service, regional development authorities, as well as tertiary education corporations. Out of the 33 state corporations in commercial and manufacturing category, 18 fall under manufacturing while 15 are commercial-oriented and therefore by their operational nature expected to make profits or operating surplus. The study focused on the fifteen (15) profit-making state corporations. Most commercial state corporations are in a state of perennial loss-making. Their financial performance trend between 2016-2020, shows that out of the 15 corporations in the commercial sector, only four (26.67%) are sustainable from their operations. This leaves over 73.33% of them struggling to survive and have to depend on government funding to address their liquidity challenges. This study sought to assess the impact of financial reporting and analysis on the financial performance of commercial state corporations in Kenya. The study assumed a descriptive study design. The study used a census procedure since all fifteen State Corporations under the commercial category were studied. Data was analysed using descriptive and inferential statistics. The inferential statistics results indicate that financial reporting and analysis have a positive and statistically significant effect on financial performance of commercial SOEs. The study found that improved financial performance was observed upon conducting periodical operational budget estimations, capital project estimations, periodical cash flow projections, and comparison of actual costs and budget variance analysis. The management and finance department to ensure that financial reporting processes are strengthened to enhance accuracy, openness, and compliance with governing requirements.

Keywords: *Financial Reporting, Tracking, Analysis, Financial Performance, Commercial State Corporations*

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1. Introduction

Poor financial management practices are the main reason for downturns in companies and businesses in terms of financial difficulty, resources and funds mismanagement, and lack of long-term funds to cover obligations as they fall due, operating expenses, and capital expenditure. Therefore, financial management practices inclusion aims at improving financial performance. Companies and businesses with properly aligned financial management systems remain productive and efficient. Integrating financial management practices in running a company or a business ensures timely planning and coordination of different activities of the company as well as deficiency correction and in so doing, financial performance improves (Hunjra, Butt & Rehman, 2018). Scheers, Sterck and Bouckaert, (2017) summarized its financial management practices reviews in Australia, the both the UK and the USA are included in this phrase. Financial activities, funding choices, and asset allocation were the three main components of financial management practices. A company's financial well-being depends on effective financial management, which is only one of many available management tools. Due to poor financial management and an unstable business climate, many companies face significant difficulties and most of them eventually fail.

In Kenya, commercial state corporations continue under-performing, with increased economic and financial losses leading to high opportunity costs for the greater economy. Researchers argue that the main cause for the myriad under-performance experienced in commercial state corporations is because of the need to follow and adopt specific financial management practices and other key elements at a considerable cost. These guidelines and demands not only limit the practice of discretion by business managers but also give rise to risk exposures. The fear of going against these requirements and regulations is because of resultant criminal sanctions. Nevertheless, World Bank (2021) highlights that state corporations remain key players and contributors to socio-economic development and growth in Kenya. In addition, corporations remain the key vehicles for monitoring, delivering, and implementing large-scale government projects for the betterment of the citizens. However, World Bank (2021) notes that most of Kenya’s commercial state corporations experienced financial performance issues before the outbreak of COVID-19, which in most cases were consolidated through the pandemic. Further, in the past three years about one-third of commercial state corporations recorded losses. In 2021, The National Treasury in partnership with the World Bank conducted a financial evaluation of 18 State Corporations in Kenya based on the services they provide. The selection of the 18 major state corporations based on the size of their activities, strategic importance, and financial risks to undertake an in-depth financial evaluation and fiscal risk analysis. The evaluation found that only two out of the eighteen state corporations were profitable while the others were either classified as unprofitable or were found to be technically insolvent, while eight other corporations were operating below the cost of recovery.

In the global context, Elliott and Yan (2018) highlight that China continues making fundamental improvements in the financial systems since they are major in improving economic growth *and* development in various industries. The national government of China has made progress in the implementation of appropriate financial management observes and policies, which continue to push the nation to grow and turn out to be the second biggest economy globally. The state through uncompromised professional ethical practices has played a huge role in the success of the commercial industry with increased yields from investment. The Chinese régime has managed to tone down corruption and misappropriation of public funds, hence ensuring effective and efficient resource allocation and use.

In America, McKinney (2015) highlights that for financial management practices to work; policies and regulations that strengthen the public financial management and governance need to be in place. However, the institutions targeted must have stringent financial planning and reporting systems to help in tracing the use of available resources. For a business or corporation to thrive, it needs to create and implement sound management of risk strategies. Alshatti (2015) illustrates that managing uncertainty is not fit for profit profit-making segment but can be applied in state background and any other industry. It is because of the circumstance that all companies and businesses require sufficient resources for the timely delivery of goods and services.

In Beijing, Paraniangtong (2017) posits that organizations and businesses are expected to take advantage of opportunities, adapt to difficulties, and outdo their competitors to thrive and flourish in the increasingly competitive market. In a challenging setting, sound financial management practices are important for these companies as one of the many ways to overcome competition in the various sectors. In the current dynamic setting and commercial state corporation environment, long-term competitive advantage is one of the key objectives. Therefore, the management must ensure that they make sound financial management decisions to gain a competitive advantage.

Nkwag (2018), research on how changes in fiscal policy affected public sector accountability in Nigeria reveals that accounting practices have to improve with better personal finance, especially in the public sector. No information on the financial management or results of service parastatals is included in the studies. Good value, fiscal discipline, and spending control and priority are all becoming increasingly important aspects of Kenya's governmental financial management (Ong'onge & Awino, 2017). To ensure transparency in civic sector financial management in the global donor community, national governments, accounting professional organizations, and regulators must work together.

In the regional context, Kolawole (2021) examined how fiscal management practices affect financial routine of listed consumer goods corporations. The study highlights that financial management plays a fundamental role in boosting a business’s market value. This automatically results in growth, effectiveness, and general success of the business in particular and the economy. Nigerian consumer products have been experiencing financial shortages, poor financial practices, and incapacity to compete with imported and indigenous raw materials. In addition, Fwamba (2017) notes that consumer goods organization in Nigeria suffer due to constant business losses, unpredictable economic environment, and stringent operational policies and regulations, which cumulatively impair the industry’s performance. Getahun (2016) states that poor financial management practices are a key aspect that influences general performance of consumer products.

Locally, Simiyu (2015) highlights the introduction of performance contracting aspect in a move to improve state departments' performance and productivity. The introduction and implementation of performance contracting suffered huge resistance from the major stakeholders. Nevertheless, its introduction contributed to efficient resource allocation and improved service delivery in state departments. Muriungi et al., (2017) research on risk management highlights that in finance, the management is responsible for the growth and success of a company. In that case, they bear the sole responsibility of creating risk management and avoidance systems to alleviate distress of financial losses. One measure organization can caution themselves is by transferring the risks through taking insurance covers and policies. In addition, these companies can spread their investment sets such that when a single industry of the economy depreciates, the company can leverage on the flourishing investment portfolios. Mucheru (2016) opines that creating a risk-managing section or risk moderation policies guarantees comprehensive FM.

Kitonga (2019) argues that financial management is largely concerned with financing and investment choices, in addition to other management ideas that may be applied to financial resources. If funding is required, how secure was it? These are the things one should think about while making important financial choices. How much money is required and where will it come from are crucial pieces of information when arranging finance? In addition to rooting out unethical practices, state-run enterprises' accounting staff has to tighten up its budgeting, reporting, risk analysis, and governance structures (Cangiano, Curristine & Lazare, 2018). This was so that the public sector could more effectively generate economic benefits.

1.1 Problem Statement

Commercial state-owned corporations operate under parliamentary law, where their major objective is increasing the quality of commodities and service delivery to the public. Implementing sound financial management practices in both investment and expenditure verdicts of state-owned corporations is the only way to attain production and service delivery (Mukah, 2015). However, the major challenge most commercial state-owned corporations face is bad financial management as seen in misappropriation of monetary possessions and inner control schemes inefficiencies. The National Treasury was responsible for identifying and quantifying the fiscal uncertainties and risks arising from the State Corporations sector. This aligned with the state's mandate to create, develop, and implement policies that support prudent financial management. The main aim of the task was to determine the level of fiscal exposure from this sector, which can move to the national budget and adversely affect the economy. Three major and interconnected groups defined the significant budgetary risks to the national government stemming from these Kenyan corporations. One, expenditure and profit risk from unforeseen dynamics and developments such as massive operating costs or lower sales that lower the net revenue or raise losses. Second, liquidity risks and accumulation of arrears result from negative profit and expenditure developments and uncompensated public service liabilities where corporations fail to increase revenues or recover costs. These may lead to a call on the government where the State Corporation lacks enough working capital to cover short-term liabilities, whereby debts accumulate, become uncollectable, or are written off. Lastly, fiscal risks in State Corporations arise from direct and contingent obligations to which the national government may have a definite or implicit liability.

A recent financial assessment of 18 significant SCs indicated the poor economic performance of these corporations and the massive levels of indebtedness, arrears, and contingent obligations. In a no-reform case, commercial State Corporations had an estimated financial deficit or liquidity gap of Ksh. 382 billion. In the context of financial risk analysis, 18 major SCs reported that these risks mainly relate to liquidity issues that originate from adverse revenue and financial performance. The assessment showed that eleven State Corporations are loss-making, and the other eleven (11) show a high liquidity risk, which means they cannot meet short-term liabilities when they arise. Subsequently, 14 State Corporations have accumulated huge arrears, tallying Ksh—211 billion, 2.2 percent of the country's GDP. It is important to note that some SCs are set up to maximize social well-being and benefits in service delivery. However, Nation Treasury report showed that entities supporting social welfare have experienced losses in recent years primarily because of their restricted incomes and are more probably to ask for or need government financial support in addressing their liquidity issues, because of their important roles.

Before COVID-19, pandemic many State Corporations were experiencing financial performance challenges, which in most cases piled through the pandemic. World Bank (2021) report shows that about one-third of commercial state corporations made losses in the past three consecutive years. In financial year 2019/2020, the aggregate running performance of commercial state corporations turned negative for the first time. Despite several sectors showing performance improvement in 2018 and 2019, the state corporations experienced a downturn in terms of both incomes and net profits. Yet, the total decreasing performance pattern is mainly controlled by a few huge state organizations, some of which, despite profit increases, showed a fall in profitability due to increasing expenditures. The decreasing aggregate financial performance of commercial state corporations, before COVID-19 pandemic is evident in falling profitability ratios such as ROE and ROA. Therefore, financial reports of state corporations show poor allocation of resources, misuse of funds, and limited accountability, which has led to poor service delivery, economic deterioration, and poor quality of manufactured commodities (Tanjeh, 2016). The poor performance of commercial State Corporations is associated with poor financial management (FM) practices, poor financial planning which affects decision-making, poor financial reporting and analysis, and incompetence in financial resource handling. Despite the recommendations and propositions by various stakeholders including international bodies on how to mitigate operational risks and improve performance, state corporations have constantly failed to make changes and necessary arrangements. Therefore, it is crucial to assess how the adoption and execution of effective FM techniques, including but not limited to working capital management, budgeting, evaluating investment choices, and conducting business reporting and analysis, can enhance overall financial results. This study sought to determine the impact of financial reporting and analysis on the financial performance of commercial state corporations in Kenya.

2. Literature Review

2.1 Theoretical Review

The concept of signaling theory, as introduced by Spence in 1973, holds significance in elucidating how individuals or entities behave when they possess different sets of information. In such scenarios, there is usually a sender who must make choices about whether and how to convey or communicate the information, while the receiver must determine the most appropriate way to understand and respond to the signal. Consequently, Signaling Theory holds a fundamental place in a different management literature. Focusing on the indications that a company delivers to its consumers; this idea has merit. Companies that are more lucrative tend to give out more and better financial data to attract investors. Financial reports allow companies to communicate with various shareholders about their financial muscle, performance, and long-term outlook. Stakeholders use the financial reports to make investment decisions based on the facts supplied. managers can take advantage of the fact that financial reporting has such a noteworthy effect on shareholder choices by manipulating the facts contained in these reports (Bjurman & Weihagen, 2018).

Ross (1977) argues that management can use dividend policy in any inefficient market to send a signal to the market about critically important information that they alone know. It is a signal to prospective investors that the company is financially solid, and thus will attract new stakeholders in the future when company's management agrees to give more or bigger dividends. Consequently, the share price rises because of this. Modigliani and Miller (1961) assume that all stakeholders have access to the same information, however, numerous scholars have argued that management can receive more current information compared to investors who are about an organization. The reasoning consequently concludes that management and investors share a fundamental level of equality. A company's lower revenue and performance gives a negative signal to potential investors, while its better profitability and performance send a positive signal to potential investors. This is the simplest way to explain the phenomenon. Because of the signaling impact financial statements have on a company's financial success, managers may feel compelled to participate in smart financial planning.

World Bank (2021) notes that the major source of revenues for the government of Kenya originates from dividend payments from commercial State Corporations. In the financial year 2019/2020, commercial State Corporations paid the government Kes 44,748 million in dividend payments. In that case, the increasing amounts of dividend payments by commercial state corporations to the government signal financial stability and success. However, dividend payments or policies are not the major indicators of financial health of organizations. This is because the huge amounts of dividend payments to the government originate from a few selected firms. Therefore, such concentration invites revenue loss in case of unexpected performance decline.

2.2 Empirical Review

Financial reporting encompasses mining and presentation of data from accounting systems in a manner that enhances analysis (Simson, Sharma & Aziz, 2011). Financial statements and reports aimed at improving budget submission. They offer an avenue for both internal and external players to examine management progress and performance. There are different financial reports and statements government enterprises produce. Main reports include but are not limited to cash flow statements, management accounting reports, audit reports, and annual financial reports among others. These statements form the starting point for the auditor’s general assessment of government enterprises' performance. According to Wetosi et al., (2018), financial management includes maintaining complete and accurate records of all financial activities and transactions, relating to budget to the company’s strategic and operation objectives. Accounting is a term used to explain the process of gathering, assessing, grouping, and recording information that is important to operations and events that affect government finances. Gathering entails putting purchasing orders, receipts, invoices, and other supporting documents. An analysis of these documents must happen especially for an individual unfamiliar with events and transactions and cannot understand what the whole thing entails (Wakiriba et al., 2015).

Akhidime & Ekiomado (2015) highlight that in public sector financial management; financial reporting is very fundamental and is seen as the appropriate metric of accountability. Financial reporting by county governments facilitates delivery of data on financial position and performance. However, Korutaro, Nkundabanyanga, & Nakulenge (2017) highlight that financial reporting and analysis in local governments are required to be pertinent and consistent to ensure that people can measure and assess performance in terms of productivity and cost-cutting.

Birech, Kevin & Alang’o (2016) reviewed budgeting and execution in Nandi County, Kenya. Sixty-six (66) people were chosen at random from a pool of 80 people to serve as the study's subject population. Statistics were used for explanatory analysis purposes to examine the evidence collected from the assessments. In Nandi County, financial planning as per the research, there is a strong correlation between and business acumen. When this research concluded, stated accountability was enforced throughout all stages of selection. Effective financial planning resulted in a higher overall financial performance. In this case, however, there is a void of context because the previous study concentrated on Kenya's Nandi County,

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but the present study will look at the financial performance of Kenya's commercial state enterprises.

Macharia (2017) researched financial preparation of financial efficiency of public sector firms in Kenya. The specific focus was on commercially oriented public service organizations. A whole sample of 47 managers from commercial parastatal organizations was drawn for this study using census sampling. Focusing on organizational goals, allocating resources, managing risks, and financial performance were all shown to be connected in the research. Because of this disparity in scope, the current study will focus on how the government-owned enterprises that are aimed at profit generating are doing financially rather than Kenya's public service organizations.

Cheruiyot, Namusonge & Sakwa, (2017) sought to determine whether financial reporting, planning, and budgeting in Kenyan counties are examined to see if they affect the functioning of the county administrations. With this research, we hoped to add new perspectives on how public resources are managed and how public services are provided. Purposive sampling was utilized in conjunction with a descriptive research approach. Many counties use Prompt transmission and budget deployment are the basic means of execution, while the Metropolitan Sustainable Planning System serves as the fundamental action plan for all plans and initiatives. The data is based on how municipal economic factors in Kenya affected local municipalities, whereas the study would investigate whether capital budgeting techniques influence commercial public entities.

Mutune, (2018) examined the link between Kenyan cement manufacturing companies' financial strategy and financial performance. All of Kenya's six cement production companies were studied using a census technique. Semi-structured questionnaires employed a combination of open-ended and close-ended to collect information. According to studies, proper financial preparation is crucial to the success of most initiatives and organizational policies. Many cement production companies were unable to make predicted earnings due to a lack of financial and business planning efforts. Based on the research results, the future prosperity of a company is significantly impacted by its financial planning efforts, its strategic business planning initiatives, and how often it undertakes actions that can positively impact budget management. In addition to evaluating Kenya's cement producers, this study will also scrutinize the effect of state-owned corporations.

2.3 Conceptual Framework

Independent Variable **Dependent Variable**

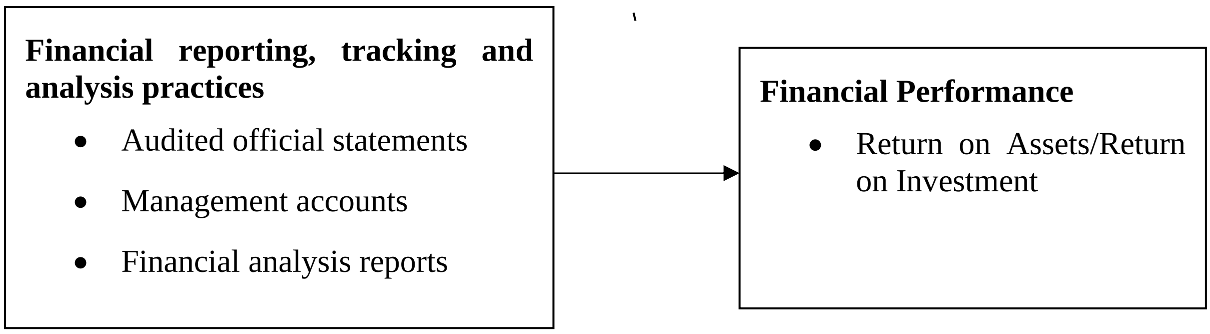

Figure 1: Conceptual framework

3. Methodology

The study assumed a descriptive study design. The study used a census procedure since all fifteen State Corporations under the commercial category were studied. The study targeted top management of these entities but utilized a sample scope of 75 participants from a populace of 90 individuals. Raw information was collected through surveys, and auxiliary measurements were made using information-gathering forms based on publicly accessible financial reports. Statistics, both descriptive and inferential, were computed on numerical data. Descriptive techniques and statistical package for social sciences (SPSS) software assisted in evaluating secondary data. The significant influence of each predictor coefficient correlation was examined using a regression analysis.

4. Results and Discussion

4.1 Descriptive Analysis

4.1.1 Financial Reporting and Analysis

The study assessed how financial reporting and analysis affected the financial performance of commercial state companies in Kenya. Table 1 indicates respondents' views on statements measuring financial reporting and analysis.

Table 1: Analysis of Financial Reporting

Statement	Mean	SD
Periodical operational budget estimations	3.51	0.86
Capital projects estimate	3.69	0.88
Periodical cash flow projections	3.68	0.92
Activity-based budgeting	2.97	1.16
Comparing actual costs and budget variance analysis	4.12	0.81
Average	**3.62**	**0.94**

Outcomes show that majority of respondents agreed with the statement on periodical operational budget estimations (Mean=3.51, SD=0.86), capital projects estimate (Mean=3.69, SD=0.88), periodical cash flow projections (Mean=3.68, SD=0.92), and comparing actual costs and budget variance analysis (Mean=4.12, SD=0.81). In addition, the respondents moderately agreed with the statement on activity-based budgeting (Mean=2.97, SD=1.16). In general, the respondents supported the importance of financial reporting and analysis in improving organizations' financial performance. In that vein, the findings agree with those by Birech, Kevin & Alang'o (2016), and Mutune (2018) who argued that the future prosperity of a company is significantly impacted by its financial planning efforts, its strategic business planning initiatives, and how often it undertakes actions that can positively impact budget management.

4.1.2 Financial Performance

This section highlights descriptive results on financial performance of commercial state corporations in Kenya.

Table 2: Analysis of Financial Performance

Statement	Mean	SD
Investors get a good return on capital employed	2.24	0.70
Return on Investment increase indicates sound financial management practices	3.76	0.84
Average	**3.00**	**0.77**

The findings in Table 2 show that the respondents agreed to a minimal degree with the statement that investors get a good return on capital employed (Mean=2.24, SD=0.70). Further, they agreed to a higher degree that ROI increase indicates sound financial management practices (Mean=3.76, SD=0.84).

Table 3: ROA Analysis

Period	N	Mean	Std. Deviation
2016	15	-0.02	0.1373
2017	15	-0.047	0.1407
2018	15	-0.02	0.1082
2019	15	-0.16	0.5193
2020	15	-0.173	0.3693

Table 3 shows that the average annual ROA for state corporations was highest in 2016 and 2018 (0.02), and lowest in 2020 (0.173). During the period 2016-2020, the average annual ROA for state corporations remained negative, which is an indication of poor financial performance.

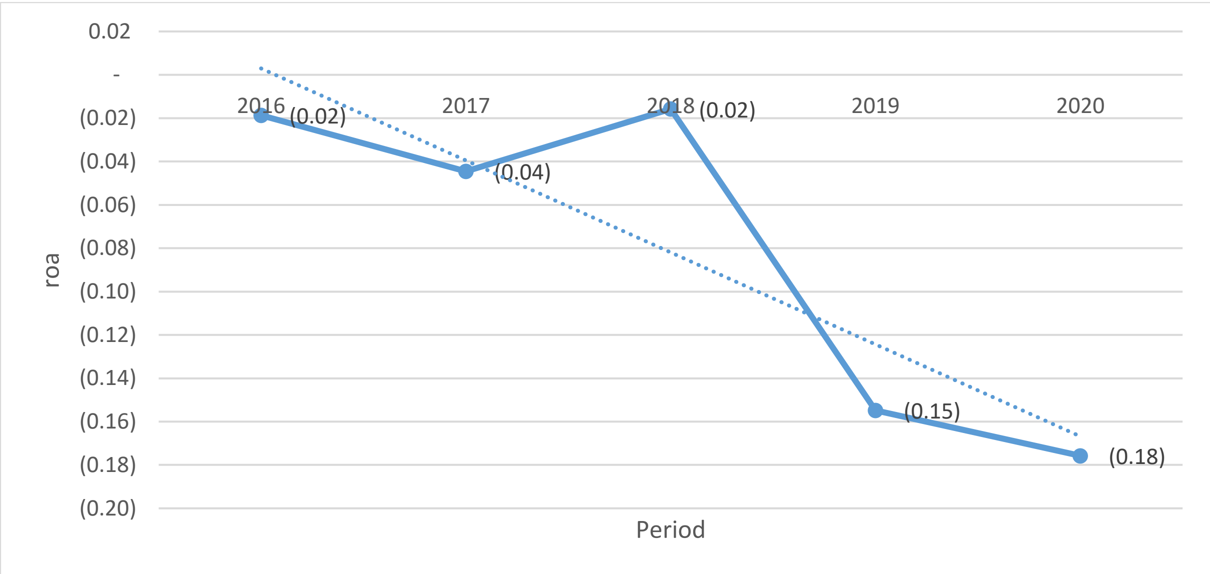

Figure 1: Trend Analysis for ROA

Figure 1 shows the trend analysis of ROA for state corporations during the five years. The diagram indicates a downward trend in financial performance of state corporations as measured using ROA.

4.2 Regression Analysis

Regression analysis was carried out to establish how financial reporting and analysis impact the financial performance of commercial state corporations in Kenya.

Table 4: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-0.53	0.392		-1.351	0.182
	Financial reporting	0.364	0.094	0.4	3.88	0.000

a Dependent Variable: Financial performance

Financial reporting, tracking, and analysis have a positive and significant effect on financial performance ($\beta=0.364$, $P=0.000<.05$). This infers that a unit increase in financial reporting, tracking, and analysis would increase commercial state corporations' financial performance by 0.364 units.

5. Conclusion

Financial reporting, tracking, and analysis have a positive and significant effect on financial performance. This infers that a unit increase in financial reporting, tracking, and analysis would increase commercial state corporations' financial performance. The study found that improved financial performance was observed upon conducting periodical operational budget estimations, capital project estimations, periodical cash flow projections, and comparison of actual costs and budget variance analysis. Therefore, findings support the importance of financial reporting and analysis in improving organizations' financial performance.

6. Recommendations

Findings indicate that financial reporting, tracking, and analysis have a positive and significant effect on financial performance. Therefore, the management and finance department needs to ensure that financial reporting processes are strengthened to enhance accuracy, openness, and compliance with governing requirements. Also, these organizations need to implement standardized reporting guidelines and metrics to enhance comparability and benchmarking. Lastly, organization's management needs to support financial ratios, trend analysis, and variance analysis usage in gaining insights into financial performance drivers and identifying areas that need improvement.

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