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EFFECTS OF FINANCIAL MANAGEMENT PRACTICES ON FINANCIAL PERFORMANCE OF PUBLIC UNIVERSITIES IN KENYA

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Abstract

Financial management in public organizations is concerned with ensuring funds are available when needed and that they are obtained and used in the most efficient and effective way to the benefit of the citizens. Financial management practices requirements can impose a significant burden on public academic institutions. Managing the movement of funds in relation to the budget is essential for a public academic institutions performance. But experience reveals that the financial management processes of public academic institutions are generally weak and dominated by conditions of resource scarcity vis-à-vis the ever increasing agenda of development activities on which such funds could be spent. This has led to financial crisis in some of the universities in Kenya hence impairing the quality of services delivered. Therefore, this study sought to find out the effects of financial management practices on performance of public universities in Kenya. The study focused of annual budget adherence, financial monitoring, investment decision and financial planning as the specific objective and also as the independent variables while financial performance as the dependent variable. The study deployed four theories; Resource Based Theory, Theory of budgeting, Agency theory and Complexity Theory to form the basis of discussion for the variables. All the study variables; annual budget adherence, financial monitoring, investment decision and financial planning were found to have a significance effect on the financial performance of public universities in Kenya. Investment decision had the highest effect while financial planning being the least. Given that all the variables had a positive effect on financial performance, the study concluded that they are a key determinant to the progress of the universities. Based on the finding the study recommended the university management to puts stand measures and focus on the study objectives to enhance financial performance in the respective institutions. The gap in the R- square provide an area for further studies, in order to exploit all the financial management practices that affect financial performance in public universities in Kenya.

Keywords: Annual budget adherence, financial monitoring and financial performance

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1.0 Introduction

Financial management refers to the process of managing organizations financial resources, including management decisions concerning accounting and financial reporting, forecasting, and budgeting, as well as capital budgeting decisions, which include decisions whether to lease or buy, and whether to issue debt or equity (Demba, 2013). Demba (2013) further noted that financial management framework comprises the processes, systems, internal controls and practices relating to the way the department manages its revenues, expenses, assets, liabilities and contingencies. It also includes its systems for managing risk and monitoring its financial and operational performance, including budget performance and reporting on these functions, both internally and externally.

Globally, financial management has been researched by various scholars. Ahmed, Babar and Kashif (2010) did a study on financial management practices and their impact on organizational performance. This study measured the relationship between organizational performance and financial management practices like capital structure decision, dividend policy, investment appraisal techniques, working capital management and financial performance assessment in Pakistani corporate sector. Sample of the study consisted of forty companies operating in Pakistan, related to different sectors and listed at Karachi Stock Exchange. The finance executives and financial analysts of the companies responded to questionnaire that was identified through company profiles and references. The results showed a positive and significant relationship between financial management practices and organizational performance in Pakistani corporate sector.

Locally, Mungai (2013) did a research on the relationship between working capital management and financial performance of private hospitals in Kenya. The objective of this study was to examine the relationship between working capital management and financial performance of private hospitals in Kenya. The study established a positive relationship with working capital management. This implies that profitability increases with increase in inventory and decreasing in average accounts payable while decreasing with increasing average accounts payable. The study concluded that management must continue to manage their working capital in a more efficient way as this will always affect profitability if not managed efficiently. Demba (2013) asserted that there are certain financial management practices that are essential for a healthy functioning of any public organizations. Some of the listed practices in the study were to budgeting process, financial reporting and internal controls. Budgeting therefore becomes a critical activity for these organizations and therefore these financial management practices are critical for any organization.

Higher education has been identified as a critical element of development in which developing countries must build in an interest, if they are to make progress in a world that feeds on knowledge and breeds on competition (Mange, 2013). Mange noted that University education is a critical pillar of human development world over. Kenya being among the developing countries has been in the forefront to foster the education level by increasing the number of universities. Since independence the number of public universities has grown spontaneously.

Financial management in public organizations is concerned with ensuring funds are available when needed and that they are obtained and used in the most efficient and effective way to the benefit of the citizens (Waddell, 2000). Financial management practices requirements can impose a significant

burden on public academic institutions. Managing the movement of funds in relation to the budget is essential for a public academic institutions performance. But experience reveals that the financial management processes of public academic institutions are generally weak and dominated by conditions of resource scarcity vis-à-vis the ever increasing agenda of development activities on which such funds could be spent.

1.2 Statement of the problem

Financial management practices requirements can impose a significant burden on academic institutions. Managing the movement of funds in relation to the budget is essential for a public academic institutions performance (Demba, 2013). Experience reveals that the financial management processes of academic institutions more so the public institutions, are generally weak and dominated by conditions of resource scarcity vis-à-vis the ever increasing agenda of development activities on which such funds could be spent. Following the cut in funding by the government, public universities have been facing challenges in meeting their financial obligations, to unlimited cost center in the institutions. Despite the decrease in funding some of the public Universities have continued to perform well financially. For instance, Kenyatta University has been growing positively in terms of infrastructure development, project completion, Kimathi University and Maasai Mara University have also recorded a positive performance regarding financial management in terms of cash flow management, technology innovation & implementation, effectiveness and efficient service delivery (Internal Audit report 2015). This good performance has been geared by the financial management strategies adopted in the institutions.

This aspect that some universities are experiencing progressive development with the little funding allocation while others are growing negatively, the alarm of poor performance has changed direction. This poor performance is not only related to limited funds but also on how the available funds are managed in such institutions. The problem of funds management has led to incomplete project development, delayed payments to both suppliers and part-time lecturers in these institutions. Transparency International (2011) indicated that proper planning, budgeting, financial monitoring, investment decision making were a booster to the good performance in some of the public institutions. However, the relative importance of each of these variables remains unclear on how they enhance positive financial performance in the public Universities in Kenya.

Despite of the several detected challenges affecting financial management in both private and public universities in Kenya, very little research has been conducted to curb the situation. Mobegi (2009) conducted a survey of the extent of implementation of integrated financial management information system (IFMIS) as a tool for sustainable financial management in government. Existing studies such as Maina and Kondongo (2013); Murekefu (2012) and Nyamao et al., (2012), have not incorporated all the key financing decisions in a single study to comprehensively analyse the effect of financing decisions on performance. The most related study by Demba (2013) on the effects of financial management practices on financial performance of Kenya Medical Training Colleges, generalized the findings to all other universities and failed to acknowledge that these institutions face different challenges. Therefore, this study seeks to find out the effects of financial management practices on financial performance of public universities in Kenya.

1.3 objectives of the study

1. To determine the effects of annual budget adherence on financial performance of public universities in Kenya
2. To examine the effects of financial monitoring on financial performance of public universities in Kenya

2.0 LITERATURE REVIEW

2.1.1. Resource Based Theory

The early writing of Wernerfelt (1984) provide that resource based view (RBV) essentially argues that any form of sustainable competitive advantage that a firm may develop results from the unique resource endowments of the firm. This view of the importance of a firms' resources is reflected in the value resources- inimitability organization (VRIO) framework popularized by Barney, (1991) as cited in Sanchez, (2004) which proposes that an analysis of a firms' internal strengths and weaknesses should address the four questions on the value and rareness of a resource, ease of imitability of a capability and resource, and organizations capability to exploit its resources. The organization determines the value, rareness, imitability to ensure sustainability of resources that are required during the period of strategy implementation process (Gitau, 2012).

The key concept in the RBV framework is the identification of properties of resources that are necessary in creating a sustainable competitive advantage to ensure effective strategy implementation, growth, sustainability and earn above average profits. According to Peteraf,

(2003), firm's resources must be heterogeneous. The resources and capabilities that a firm develops, for its value creation and strategy implementation processes must be distinctive and different from the resources used by or available to other firms (Gitau, 2012).

Secondly the heterogeneous resource that makes a firm successful must originate in imperfect factor of markets, which means that a competing firm either cannot acquire the distinctive resources that a successful firm possesses or must pay such a high price for such a resource or capability to an economic profit (Waithaka, 2016).

2.1.2 Theory of Budgeting

One of the first attempts to apply the principle of marginal utility in a 'theory of budgeting' was made by Verne Lewis. Lewis argues that analysts should focus on increments of public expenditure, at the margin, since 'this is the point of balance at which an additional expenditure or any purpose would yield the same return'. Lewis

(1952) argues that the relative value of these increments can then be assessed in terms of their 'relative effectiveness in achieving a common objective'. It is the task of politicians to determine this common objective and assess the relative effectiveness of alternative applications of public expenditure in achieving this goal. Budgeters can assist decision makers by presenting alternative proposals at varying levels of expenditure for each programme. In this way the trade-offs between alternative applications of additional funding can be revealed. Lewis argues that the concept of 'relative effectiveness' with regard to a 'common objective' effectively circumvents the problem presented by the lack of a common measure of utility.

The difference between normative and descriptive budget theory may be as simple as the difference between what should work and what works (Demba, 2013). It has been complicated in our field by the difference in perspectives that sometimes characterize academics and practitioners.

Normative theory is usually associated with reformers, and reformers usually come from the policy or academic community. This theory supports the annual budget adherence variable and its aspect in financial management in an institution.

2.2 Empirical literature

2.2.1 Annual Budgetary adherence

A budget provides an appropriate analysis for past performance which will help an organization chart its future direction (Maritim 2013). The study has largely highlighted the significant emphasis on organizations to put on budgeting systems, as key elements of management control. Budgets occupy a leading place among the special tools of management employed to direct and control the affairs of large and multifarious organizations (Burke and Modarresi, 2000).

They are used not only by governments, where budgeting had its origins, but in other public bodies, in industry and commerce and in private entities. A budget is a basic tool in management. In this regard it serves as a tool for planning and controlling the use of scarce financial resources in the accomplishment of organizational goals. The budget is an invaluable aid in planning and formulating policy and in keeping check on its execution (Premchand, 2004). It stipulates which activities and programs should be actively pursued, emphasized or ignored in the period under scope, considering the limited financial resources available to the organization.

Demba (2013) noted that an appropriate budgeting process needs to attain three important objectives, namely, maintenance of fiscal discipline, attaining allocative efficiency, and operational or technical efficiency. Attainment of fiscal discipline has been the main goal of budget reforms. Enlargement of the legislature's role in budgeting is a new contemporary issue budgetary approaches. With legislative budgeting, new responsibilities must be accommodated both to longstanding appropriation processes, and to political relations with government. Further, legislature's new role in budgeting cannot come from government's weaknesses. The budget is an end product of a lengthy process of monitoring and controlling public finances involving the Ministry of Finance and other agencies. If the government is incapacitated in managing the institution's finances, the legislature also will be unable to do so. Historical evidence also indicates that legislatures had fiscal powers before the executive, and the result was that legislative action became an inadequate means of fiscal control. This means that the legislature's role must be defined more in terms of policy, accountability and performance, and less in terms of control and restriction, (Wagacha, 2000).

2.2.2 Financial monitoring

Monitoring is a process where program data is collected and analyzed routinely on an ongoing basis, and may involve the use of a management information system (Patton, 1997). It is the systematic and continuous process for assessment of the progress of the activities over a period of time with the aim of obtaining gaps and enhancing accountability in an organization so as to attain its desired objectives (Masago, 2013). The purpose of financial monitoring is to; understand and assess financial and management systems and capabilities, ensure compliance with rules, regulations, and requirements, safeguard state funds against fraud, waste, and abuse, help identify potential audit issues, identify technical assistance and training needs, identify needed improvements and follow up on issues or corrective actions (Bonnie, 2008). Effective financial monitoring systems are required in the quest to maximize the efficient use of resources, create the highest level of transparency

and accountability in an organization's finances and to ensure long-term economic success. Recent literature has also highlighted the importance of financial monitoring via sound financial management systems to service delivery, poverty reduction and the achievement of the millennium development goals (Pretorius & Pretorius, 2008). Some schools of thought have identified several criteria that the financial management systems of public institutions and other donor funded projects must meet in pursuance of financial monitoring. One such major classification is proposed by Shizhen (2005) which includes financial reporting, accounting records and source documentation, internal control, budget control, cost allowance and cash management and compliance frameworks.

A number of funding agencies have also developed financial governance assessment frameworks along the areas of the mode of budget planning, execution, internal control and monitoring required of funded projects (AfDB Group, 2006) and thereby inferring the level of governance as practiced by an institution based on the presence of such predefined systems. Financial monitoring is the centre-piece of the organizational success. Monitoring and evaluation contribute to sound governance through policy development, management and accountability.

2.3 Financial Performance

Financial performance is the process of measuring the results of a firm's policies and operations in monetary terms (Campbell, 2012). Organizational performance encompasses accumulated end results of all the organization's work processes and activities. Financial measures of organizational performance include; return on assets, return on sales, return on equity, return on investment, return on capital employed and sales growth (Gerrit & Abdolmohammadi, 2010). According to Donald & Delno (2009), appropriate performance measures are those which enable organizations to direct their actions towards achieving their strategic objectives.

Gerrit and Abdolmohammadi (2010) contends that, performance is measured by either subjective or objective criteria; arguments for subjective measures include difficulties with collecting qualitative performance data from small firms and with reliability of such data arising from differences in accounting methods used by firms. Donald & Delno (2009) mentioned accounting based performance using three indicators: return on assets (ROA), return on equity (ROE), and return on sales (ROS). Each measure was calculated by dividing net income by total assets, total common equity, and total net sales, respectively.

3.0 RESEARCH METHODOLOGY

Descriptive survey method was applied in this research in attempting to describe and explain the effects of financial management practices on financial performance of public universities in Kenya, by using unstructured questionnaires to fully describe the phenomenon. The population of the study includes all the public universities in Kenya. According to the board of higher learning institutions there are 22 chattered public universities in Kenya. The target population was the employees in the finance departments of the various public universities in Kenya.

The primary data was collected using unstructured questionnaire. The semi- structured interviews and use of questionnaire was administered to the respondents. The data was analyzed using descriptive statistics. Data was presented by use of cross tabulation charts and graphs, tables, percentages and frequencies to display a visual presentation of the data, for ease of understanding and analysis. The analysis was done with the application of the statistical package for social sciences (SPSS) software, IMB 2015 version.

The study also used a linear regression analysis to establish the relationship between the dependent and the independent variables. The regression model is as follows:

$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \varepsilon$ Where:

Y = Financial performance

β_0 = Constant Term

β_1 = Beta coefficients

X1 = Annual budget adherence

X2 = Financial monitoring

ε = Error Term

4.1 RESEARCH FINDINGS AND DISCUSSION

4.1.1 Correlation Analysis

Table 4.1 Correlation Analysis

	Financial performance	Annual budget adherence	Financial monitoring
Financial performance	1		
Annual budget adherence	0.770 0.000	1	
Financial monitoring	0.677 0.000	0.463 0.000	1

The correlation analysis was conducted to assess the multicollinearity problem. From table 4.1 it can be observed that the correlation between the independent variables and the dependent variable was high and positive at 0.77, 0.677, for annual budget adherence and financial monitoring respectively. The implication was that the high correlation between financial performance of the universities and it determinants was good for regression analysis. The interpretation was that the level of multicollinearity between the independent variables was not very high which meant that the influence of each variable in the regression model could be isolated individually.

Table 4.2 Regression Results

	Coefficient	Standard Error	t-statistic	p-value
(Constant)	1.034	0.370	2.7946	0.012
Annual budget adherence	0.291	0.078	3.730	0.000
Financial monitoring	0.223	0.068	3.279	0.000
F=> 57.050	P=> 0.000			Adjusted R-squared 0.739

The fitted regression model is

$$Y = 1.034 + 0.291X_1 + 0.223\ X_2 + \varepsilon$$

Standard error	0.37	0.078	0.068
t- statistics	2.79	3.730	3.279
p- value	0.012	0.000	0.000

Where; Y = Financial performance, X1 =Annual budget adherence, X2 = Financial monitoring, , β_0 = Intercept, β_1, β_2, = Coefficients, ε = Error Term

4.2.1 Annual budget adherence

From the regression model and table 4.2, the coefficient of annual budget adherence was found to be 0.291. This value shows that holding other variables in the model constant, an increase in annual budget adherence by one unit causes financial performance of the universities to increase by 0.291 units. The value of the coefficient is also positive. The positive effect shows that there is a positive relationship between the annual budget adherence and financial performance.

The coefficient is not just positive but also statistically significant with a t-statistic value of 3.730. In statistics, a t-statistic of 2 and above is normally accepted to be significant in statistical inference. The standard error was found 0.078 and

the p-value was found to be 0.000. The variable was also found to be the second most influential variable on financial performance of universities in Kenya. The findings support those of (Demba, 2013), (Wanyungu, 2001), (Osman, 2007), who found that budget adherence has an effect in the financial performance at the university.

The results thus show that the effective budgeting and adherence enhance financial performance in the Universities. The implication is that all the universities in Kenya should make sure that budget adherence is prioritized for effectiveness and efficient utilization of the available resources.

4.2.2 Financial monitoring

From the regression model and table 4.2, the coefficient of financial monitoring was found to be 0.223. This value shows that holding other variables in the model constant, an increase in financial monitoring by one unit causes financial performance to increase by 0.223 units. The value of the coefficient is also positive. The positive effect shows that there is a positive relationship between the financial monitoring and financial performance in the universities.

The coefficient is not just positive but also statistically significant with a t-statistic value of 3.279. In statistics, a t-statistic of 2 and above is normally accepted to be significant in statistical inference. The standard error was found 0.068 and the p-value was found to be 0.000. The variable was also found to be the third most influential variable on the performance of universities. The findings support those of (Demba, 2013), Wanyungu, 2001), (Osman, 2007), (Mugo, 2013) who found that financial monitoring had an effect on financial performance of an organization.

The results thus show that financial monitoring by Universities in Kenya enhance the financial performance. The implication is that all the universities in Kenya should make sure that financial monitoring is effected in the institutions to enhance performance.

5.1 SUMMARY OF THE FINDINGS

5.1.1 Annual budget adherence

From the findings, the constructs of annual budget adherence were found to be of good reliability that allowed the researcher to proceed to the actual data collection, qualitative and inferential analysis. All the measurers of annual budget adherence were also found to have effect on the financial performance as shown by the various responses from the respondents that were presented using table where the response was also in percentage form. This variable was found to have a positive effect on financial performance. This meant that improvement in budgeting process enhance better financial performance of public universities in general.

The findings therefore showed that for the public universities in Kenya to improve on strategy relating to budgetary control systems. These findings support those of (Mwajuma, 2013), (Demba, 2013), who found that proper budgeting enhance effective utilization of available funds hence better financial performance.

5.1.2 Financial monitoring

From the findings, all the measurers of financial monitoring were found to have effect on the financial performance as shown by the various responses from the respondents that were presented using table where the response was also in percentage form. The constructs were found to be of good reliability that allowed the researcher to proceed to the actual data collection, qualitative and inferential analysis. This variable was found to have a positive effect on financial performance. This meant that improvement in financial

monitoring facilitate the better financial performance

The findings therefore showed that for the public universities in Kenya to improve on financial monitoring and control to reduce the amount of deficit and account payables. These findings support those of (Gitau, 2012), (Wanyungu, 2001) and (Demba, 2013) who found that financial monitoring has a significant effect on financial performance of an organization.

5.2 Conclusions

The study concludes that annual budget adherence has significant effect on financial performance among public universities in Kenya. The revelation that annual budget adherence had a positive effect on financial performance, was a good indication that increase in proper annual budget adherence management motivates good performance in the universities. This variable was found to have a statistically significant effect on financial performance in the universities. The influence of this variable was the second highest on the effects of financial performance.

The study concludes that financial monitoring has significant effect on financial performance in public universities in Kenya. The revelation that financial monitoring had a positive effect on financial performance, was a good indication that increase in financial monitoring and control practices motivates financial performance in the universities in Kenya. This variable was found to have a statistically significant effect on financial performance. The influence of this variable was the third highest effect of performance.

5.3 Recommendations

Annual budget adherence variable was found to be among the key determinant of financial performance of the universities in Kenya. The management should make sure that they put more emphasis on the budget statement and every departmental unit should adhere to the allocated fund. They should come up with strategies on how to avoid over expenditures. The management should come up with proper financial monitoring and control system in the institution, the management should also ensure that periodic review and project assessments are conducted for effectiveness and efficiency purposes.

5.4 Area for further research

Future research should be directed towards identifying more variables that affect financial performance in the public universities. Good examples are, management competences, internal factors, legal political, policies and regulation among others. From the regression model it was noted that the variables included were only able to explained 73.9 % of the variation while 26.1% was not explained. This study therefore recommends the improvement of this model by including more variables that are relevant in explaining the variation some of which have been mentioned above. This research paper also recommends further research to include studies in other organizations apart from learning institutions. This recommendation is based on the premise that all other private universities were left out in this research though the findings were generalized to all universities in the country.

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