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FACTORS INFLUENCING EARNINGS GROWTH RATE FOR COMPANIES LISTED AT THE NAIROBI SECURITIES EXCHANGE

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ABSTRACT

This study sought to establish the factors that influence earnings growth rate for companies listed at the Nairobi Securities Exchange. The study adopted a descriptive research design. The study used secondary data obtained from published financial statements of companies listed at the Nairobi Securities Exchange. The population of the study consisted of the 65 companies listed at the Nairobi Securities Exchange over the period 2015 to 2018. A sample of 27 companies was selected using simple random sampling. The study found that net profit; Retention ratio; Total assets turnover; Leverage and Size of the firm were found to have a positive effect on earnings growth rate. The study concluded that net profit margin; retention ratio; total assets turnover; and leverage were significant determinants of earnings growth rate for companies listed at the Nairobi Securities Exchange, while firm size was not a significant determinant of earnings growth rate for companies listed at the Nairobi Securities Exchange. The study recommended that to achieve higher earnings growth rate, corporate managers should focus on increasing the net profit margin.

Key words: Earnings growth rate; Profit margin; Firm size and Nairobi Securities Exchange.

1.0 Introduction

Earnings growth rate refer to the rate of increase or decrease in a firma annual earnings per share (Chandra, 2015). Chen (2011) define sustainable earnings growth rate as the maximum growth rate in earnings that a firm can achieve while maintaining a given set of financial policies. Gitman (2012) suggest that earrings growth is one the valuable parameters for long term financial planning & analyzing corporate performance. It is helpful in determining what should be the company's growth rate in sales so that it can maintain sound operational performance &

financial policy. Fonseka, Ramos & Tian (2012) posit that growth in firms earnings depend mainly in the firms' fundamentals. The simplest way to assess earnings growth rate is based on the retention ratio & the return on equity of a firms projects. Firms that have higher retention ratios & earn higher returns on equity should have much higher growth rates in earnings per share than firms that do not share these characteristics.

Aloke, Gu & Jain (2016) point that earnings growth can stem from two strategies; strategies that increase revenue & strategies that reduce cost. Revenue is the key value driver. Earnings growth that are based on sustainable revenue growth strategy result in better earnings quality, sustained earnings growth & are seen as more valuable by the market (Penman, 2004). A firm can achieve a competitive advantage & grow the demand for its products through product differentiation. Such a strategy may allow a company to retain its competitive advantage in the long run & can charge a premium for their products as long as it is difficult for competing companies to emulate the strategy. The success of the strategy is manifested through sustained earnings growth together with sustained revenue growth (Porter, 1985). Anderson, Baker & Janakiraman (2003) cost leaders create competitive advantage & are able to grow their earnings by identifying opportunities to operate at lower cost than competition. However there is a limit beyond which cost cannot be reduced with having an adverse effect on core operations. Further cost tends to increase faster than they decrease. While cut cutting programs are often reactionary, revenue growth initiatives are usually proactive. As a result cost cutting programs are more likely to curtail revenue growth in the long term.

1.1 Research Problem

Prasangi & Wijesinghe (2016) documented a positive relationship between dividend payout ratio and expected earnings growth rate. Rehana (2012) documented that profitability was a significant determinant of growth for companies in Pakistan while firm size had a negative effect on growth. Odalo, Njuguna and Achoki (2016) found that sales growth had a significant positive effect on return on assets and return on equity. Kiboi (2015) noted that earnings per share had a significant positive effect on dividend per share. Kalama (2013) documented a significant positive relationship between earnings per share and share price. Despite the considerable relevance of earnings data, little is documented about the determinants of earnings growth for companies listed at the Nairobi Securities Exchange. It is this gap in research that motivates this study.

1.2 Objectives of the study

This study sought to examine the factors that influence earnings growth rate for companies listed at the Nairobi Securities Exchange.

1.2.1 Specific Objectives

The specific objectives of the study were:

i. To establish the influence of net profit margin on earnings growth rate for companies listed at the Nairobi Securities Exchange.
ii. To establish the influence of retention ratio on earnings growth rate for companies listed at the Nairobi Securities Exchange.
iii. To examine the effect of total assets turnover on earnings growth rate for companies listed at the Nairobi Securities Exchange.
iv. To examine the effect of leverage on earnings growth rate for companies listed at the Nairobi Securities Exchange.
v. To examine the effect of firm size on earnings growth rate for companies listed at the Nairobi Securities Exchange.

2.0 METHODS

This study used a descriptive research design. The population of the study consisted of the 65 companies listed at the Nairobi Securities Exchange between 2015 to 2018. The study used a sample of 27 firms. The study made use of secondary data. Data was collected from published financial statements of the companies sampled. Multiple regression analysis was used to evaluate the determinants of earnings growth. Earnings growth was regressed against net profit margin, retention ratio, total assets turnover & leverage. Firm size was used as a control variable. The regression model used is of the form:

$Y= \alpha+\beta_1X_1+\beta_2X_2+\beta_3X_3++\beta_4X_4+\varepsilon_i$
Y=earnings growth rate
X_1 =Net profit margin
X_2 =Dividend payout ratio
X_3 =Total assets turnover
X_4=Financial Leverage

3.0 RESULTS

Correlation Analysis

Pearson correlation was used to determine the nature and strength of correlation between the variables. Correlation is considered as an important condition for regression.

Table 1: **Correlations**

		Eps growth	Net Profit Margin	Retention Ratio	Total Asset turnover	Leverage	Firm Size
Eps growth	Pearson Correlation	1	.360	.197*	.556	.710	.195
	Sig. (2-tailed)		.019**	.041*	.068*	.025*	.326
	N		108	108	108	108	108
Net Profit Margin	Pearson Correlation		1	.359**	-.023	.197*	.221*
	Sig. (2-tailed)			.000	.816	.040	.022
	N			108	108	108	108
Retention Ratio	Pearson Correlation			1	.195*	.192*	.154
	Sig. (2-tailed)				.043	.047	.112
	N				108	108	108
Total Asset turnover	Pearson Correlation				1	.111	-.015
	Sig. (2-tailed)					.254	.877
	N					108	108
Leverage	Pearson Correlation					1	-.327**
	Sig. (2-tailed)						.001
	N						108
Firm Size	Pearson Correlation						1
	Sig. (2-tailed)						
	N						108

Table 1 shows the correlation coefficient between the variables in the study. The correlation coefficient between EPS growth and net profit margin was obtained as 0.360 with a p-value of 0.019. EPS growth and retention ratio had a correlation coefficient of 0.197 with a p-value of

0.041. Correlation coefficient between assets turnover and EPS growth was 0.556 with p-value of 0.068. EPS growth and leverage had a correlation coefficient of 0.710 with & a p-value of 0.025. The correlation between EPS growth & size of the firm was 0.195 with a p-value of 0.326.

Table 2: Regression Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-24.791	19.875		-1.247	.215
Net Profit Margin	.136	.037	.073	3.675	.038
Retention Ratio	.081	.011	.134	7.364	.026
Total Asset turnover	.458	.206	.022	2.223	.046
Leverage	.356	.187	.098	1.962	.049
Firm Size	1.019	1.208	.091	.843	.401

Table 2 shows the regression coefficients. The coefficient of the constant was obtained as -24.791 with a p-value of 0.215. Net profit margin had a coefficient of 0.136 with a p-value of 0.038. The slope coefficient for retention ratio was obtained as 0.081 with a p-value of 0.026. Total assets turnover had a slope coefficient of 0.458 with a p-value of 0.046. Leverage had a coefficient of 0.356 with a p-value 0.049. Firm size had a coefficient of 1.019 with a p-value of 0.401. The resulting regression model was of the form

$$Y=-24.791+0.136X_1+0.081X_2+0.458X_3+0.356X_4+1.019X_5$$

4.0 CONCLUSION AND RECOMMENDATION

4.1 Conclusion

The study established that net profit margin and earnings growth rate were moderately positively correlated. The correlation was also statistically significant. Regression analysis indicated that net profit margin had a positive and significant effect on earnings growth rate. The study also established that net profit margin is a significant determinant of earnings growth rate for companies listed at the Nairobi Securities Exchange. Retention ratio and earnings growth rate had a weak positive correlation; however, the correlation was significant. The regression result indicated that retention ratio had a significant positive effect on earnings growth rate. The study concluded that retention ratio is a significant determinant of earnings growth rate for companies listed at the Nairobi Securities Exchange. Correlation analysis showed that leverage was highly positively correlated with earnings growth rate. The correlation was significant. Regression analysis indicated a positive and significant effect of leverage on earnings growth rate. The study therefore concluded that leverage is a significant determinant of earnings growth rate of companies listed at the Nairobi Securities Exchange.

4.2 Recommendation

Based on the conclusions of this study it is recommended that since net profit margin has significant positive effect on earnings growth rate, corporate finance managers should adopt strategies that increase the net profit margin of their entities in order to achieve a higher growth rate in earnings per share. Retention ratio indicated a positive effect on earnings growth rate. The study recommends that in order to achieve higher growth rate in earnings corporate managers should increase the proportion of earnings retained & reinvested in the business. The study recommends for more efficient utilization of assets to generate sales which would result in higher assets turnover thus enhancing earning growth rate.

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