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Effects of Working Capital Management on the Financial Performance of Small and Medium Enterprises in Mombasa County

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Abstract : *For a long time, working capital management has not been given priority in SMEs instead it has always been regarded as a function of the financial managers in big corporations. This study was aimed at establishing the effects of working capital management on the financial performance of the SMEs in Mombasa County. SMEs play a very crucial role in todays' economy by ensuring continuity in the supply of goods and services demanded in the market. Apart from the provision of goods and services to the market, SMEs have also created employment opportunities for many people at the same time contributing to GDP hence spurring socioeconomic development. Working capital management involves the acquisition and controlling the four components of working capital namely cash, debtors, inventory and creditors. This means that, for SMEs to operate smoothly, the managers and owners, who are involved in decision making, must strike a balance on what levels of the working capital components to hold at any given time in order to enjoy the benefits and also minimize the risks involved in holding such components of working capital. Therefore working capital management should be given priority as it affects both liquidity which is the ability of the business to meet its financial obligations when they fall due and profitability which is the reason venturing into business. The target population was 23,964 SMEs while the researcher examined 393 respondents selected randomly from six sub counties in Mombasa County. A descriptive research design was adopted to enable the researcher describe the variables identified in the study without changing their status. Data was collected through questionnaires which were administered by the researcher to the respondents. Processing and analysis of data was done with the aid of statistical software like the SPSS to help the researcher summarize the findings and draw conclusions thereof. Pearson correlation was also used to analyze the relationship between the dependent variable and the independent variables. From the study, it is evident that financial performance is strongly influenced by working capital management whereby SMEs profitability and liquidity can be improved by efficiently managing working capital. The study concluded that SMEs can improve both liquidity and profitability by reducing the cash conversion cycle, average accounts receivable days and the average inventory days. The study recommended that SMES prepare cash budget, formulate policies to be adopted in evaluating customers, debt collection and inventory management and clearly communicate the same to all stakeholders.*

1.3 Objective of the Study

1.3.1 General Objective

The general objective of the study was to determine the effects of working capital management on the financial performance of SMEs in Mombasa County.

1.3.2 Specific Objectives

i) To determine the effects of cash management on the financial performance of SMEs in Mombasa county.

ii) To analyze the effects of inventory management on the financial performance of SMEs in Mombasa county.

iii) To evaluate the effects of debtors management on the financial performance of SMEs in Mombasa county.

iv) To establish the effects of trade payables management on the financial performance of SMEs in Mombasa county.

1.4 Research questions

i) Does cash management affect financial performance of SMEs in Mombasa County?

ii) What is the effect of inventory management on the financial performance of SMEs in Mombasa County?

iii) What is the effect of debtors' management on the financial performance of SMEs in Mombasa County?

iv) What is the effect of trade payables management on the financial performance of SMEs in Mombasa County

LITERATURE REVIEW

2.1 Introduction

This chapter reviews literature concerning the theoretical review and the empirical evidence on how the working capital management affects the financial performance of SMEs. In this chapter, the researcher will focus on the different approaches for managing working capital and also do a review of the variables identified in the study in order to be able to answer the research questions raised in the previous chapter.

2.2 Theoretical framework

2.2.1 Hedging Approach

This is a risk reducing investment strategy which involve transactions that are simultaneous but opposite in nature such that the effect of one is counterbalanced by the other. This approach involve the matching of the maturities of debt with the maturities of the financial needs. It's also referred to as the matching approach since it matches assets and liabilities maturities (Mkhopadhyay, 2004). The hedging approach suggests that, long term funds should be used to finance the fixed portion of current assets requirements in a manner similar to the financing of fixed assets. Therefore, this approach divides the requirements of funds into permanent and seasonal components, each being financed by a different source (Atrill, 2006).

This approach is used to determine an appropriate financing mix hence making it a high profit and high risk approach. According to (Atrill, 2006), the hedging approach is adopted by SMEs wishing to balance the benefits and drawbacks of the other approaches, such as the aggressive approach, with an attempt to increase profitability. The advantage of this approach is that it helps SMEs maintain optimum levels of cash, save on interest cost, no refinancing cost and interest rate fluctuation risk (Boisjoly, 2009).

The hedging approach is more of idealistic approach because it follows the principles of finance where long term assets are financed by long term sources of finance while sort term assets are financed by the short term sources of finance (Arnold, 2008). Although this approach is the most desirable, it is very difficult to implement due to the uncertainty involved in the business environment making it difficult to predict future cash flows with certainty.

2.2.2 Conservative Approach

This approach suggests that the estimated requirements of funds should be met from long-term sources leaving the short-term sources of funds for only emergency situation or unexpected outflow of funds. Atrill, (2006) argues that, the conservative approach is expensive compared to the hedging approach because the available funds are not fully utilized during certain periods (Afza & Nazir, 2007). Therefore, interest is paid for funds which are not needed but are held for emergency situation. Under this approach, the SMEs do not use their short term finances enabling them to have sufficient funds to cater for emergencies hence making this approach less risky (Mkhopadhyay, 2004). Therefore, the conservative approach is a low profit, due to the high cost of funds, and a low risk approach due to availability of funds.

The conservative approach is beneficial to SMEs working in very uncertain environment where they need extra buffer of inventory in order to reduce the risk of stock-outs and lost sales (Arnold, 2008). This is because they sometimes give their customers longer credit period than what they are given by their suppliers (Pandey , 2009). The main aim of working capital management is to maintain solvency or liquidity and profitability of the SMEs. To ensure solvency, businesses have to be very liquid meaning that they have to hold more current assets to enable them meet the obligations of the creditors as and when they fall due, and be able to handle all the sales orders (Pandey, 2009).

While maintaining liquidity reduces the risk of the SMEs, the cost associated to it is high because more funds will be tied up in current assets thereby forfeiting interest which could have been earned from investing such funds (Reheman, Afza, Qayyum, & Bodla, 2010). For higher profitability, the SMEs may sacrifice solvency and maintain relatively low level of current assets, hence the need to strike a balance between solvency and profitability as they are both crucial for survival and profitability (Atrill, 2006).

2.2.3 Aggressive approach

The aggressive approach is a working capital management approach whereby SMEs use more short term financing for their operations than what is warranted by the matching plan (Arnold, 2008). Under this approach, the SME finance part of their permanent current assets with short term financing and sometimes they even use the short term financing to finance fixed assets. According to Pandey (2009), the use of more short term financing makes a business more exposed to risk than when they adopt the other approaches. Adopting aggressive approach result into the SME working with low levels of current assets as a

percentage of total assets while having high level of current liabilities as a percentage of total liabilities (Nazir & Afza, 2009). The risk associated with the aggressive approach is that, low levels of current assets could lead to solvency problems and stock outs which may hinder smooth running SMEs. Arnold (2008) argues that, this approach is commonly adopted by businesses operating in an environment which is certain and can predict the future cash flows with certainty.

This approach involves holding minimum levels of cash and inventory and operates by pushing customers to pay early while at the same time requesting trade creditors to extend their credit limit hence delaying payments (Boisjoly, 2009). As a result, this may erode trust between the business and both their debtors and creditors which are the most important components of working capital. Despite the risks involved in adopting this approach, there are a number benefits accruing to it like above average profit margins and high proportion of current liabilities financing.

2.3 Discussion of Variables

2.3.1 Cash Management.
Cash is one of the important components of current assets needed for performing all the activities of the business, from acquisition of raw materials to marketing of finished goods. It is therefore essential for the finance manager to match the inflows and outflows of cash in order to maintain an adequate cash balance for smooth operations (Biger, Mathur, & Gill, 2010). Apart from holding cash for transaction motive, there are others like precautionary and speculative motives which involves meeting unexpected demands and taking advantage of favorable market conditions respectively (Dolfe & Koritz, 2000).

2.3.2 Inventory Management
Inventory is composed of raw materials, work in progress, finished goods and consumables (Gitman, 2009). The composition of inventory among the SMEs depends on the operations or the nature of business they undertake. In most cases the inventory is a cost that cannot be avoided despite the nature of business the SMEs are involved in (Prasanna, 2000). Generally, efficient management of inventory is important in maximizing shareholders earnings as it ensures continuity in production and sales. Inventory management involves maintenance of a smooth flow of raw materials for production and sales, at the same time minimizing investment in inventory in respect to its cost of acquisition and storage (Prasanna, 2000). Therefore, the finance manager has a responsibility of calculating a level of inventory where these two conflicting interests are balanced.

2.3.3 Accounts Receivables Management
Accounts receivables are amounts owed to the retailers as a result of selling on credit to customers, within the ordinary course of business. Due to uncertainty of payment by debtors, sales managers should establish a good policy that would control the advantages of selling on credit with the associated risks (Egbide, 2009). It is one of the significant components of working capital apart from cash and inventory. The volume of accounts receivables depends on the credit sale and debt collection policy adopted by the SMEs as these policies significantly influence the requirements of working capital. A cost benefit analysis has to be done by the managers for them to come up with a credit policy that will not jeopardize the profitability of the business.

According to (Berry & Jarvis, 2006), a liberal credit policy increases sales volumes but at the same time increases investment in receivables which may increase bad debt in the long run. Where offering credit to customers is expected to increase sales volume, it is also associated with risks like bad debts losses and debt collection cost (Berk, Demarzo, & Harford, 2015). Since growth is important, it should be viewed as a separate factor in determining trade receivables policies in addition to profits. Sometimes businesses can accept short term setbacks with respect to profits if a credit policy will enable them increase sales volumes and consequently the market share significantly (Biger, Mathur, & Gill, 2010).

2.3.4 Accounts Payables Management
Accounts payables or creditors are one of the important components of working capital as they provide a cheap and spontaneous source of financing to the SMEs. Creditors arise as a result of the retailers buying supplies on credit from their suppliers (Afza & Nazir, 2007). The general guidelines for optimizing accounts payables involves the timing of payments (Brigham & Houston, 2013). Finance managers usually try to prolong the time of payment as long as possible in order to enjoy the advantage of their suppliers financing their investments until payment is made (Maness & & Zietlow, 2005). After buying the products, SMEs needs time to sell the same to customers either on cash or on credit terms, hence justifying the need to prolong payments to creditors. Sometimes suppliers may offer discounts to convince their customers to pay early which may be appealing to the businesses but this may not be prudent as they will not enjoy the advantage of the cheap, short term financing from the suppliers (Gill & Shah, 2012).

2.4 Financial performance

Financial performance is a measure of how well SMEs utilize assets form its ordinary course of business to generate revenue. Measuring of financial performance is a very important part of running a growing business (Berry & Jarvis, 2006). In the current economic climate, businesses fail because of poor financial management or planning. Atrill, (2006) argues that, any business success depend on developing and implementing sound financial management systems followed by frequent reviews of the same. The main objective of financial management is to maximize returns and minimize the associated financial risks simultaneously (Biger, Mathur, & Gill, 2010).

3.1 Introduction

This chapter focused on the research design, target population, sampling technique and the sample size used for this study. It also shows the type of data used, data collection methods, data collection tools as well as data analysis and presentation.

3.2 Research Design

A research design is the blueprint of how research data was collected, analyzed and presented (Kothari, 2003). This study adopted a descriptive survey research design which enables identification and description of the status of the variables identified in the study. According to Cooper & Schindler, (2003), a descriptive research design is a scientific method which involves observing and describing the behavior of a subject without influencing it in any way. Data collection was done through cross sectional survey method which enabled collecting information that represents the views of the whole population (Cooper & Schindler, 2003). SMEs are many and scattered throughout the county hence the researcher needed to adopt a method which ensured that the sample used for the study represented the whole population. Descriptive survey was more appropriate for this research as it enabled collection of information by interviewing or administering questionnaires to a sample of the target population (Smith, 2005).

3.3 Target Population

The population in this study consisted of the SMEs operating in the six sub counties of Mombasa County. The county had 23964 registered SMEs as at September 2016 according to the county government of Mombasa.

Sub County	N	Percentage	Sample size
Mvita	7429	31%	122
Changamwe	3355	14%	55
Likoni	4314	18%	71
Kisauni	4074	17%	67
Nyali	1917	8%	31
Jomvu	2875	12%	47
Total	**23964**	**100%**	**393**

3.4 Sampling Techniques and sample size

Sampling refers to the process of selecting a number of individuals or objects from a population which contain the same elements and characteristics found in the entire group to be studied (Orodho, 2004). This study adopted a stratified random sampling technique which involves dividing the population into strata and then choosing randomly from each stratum the respondents to participate in the study (Mugenda & Mugenda, 2003). Stratified random sampling is commonly used in research where the population to be studied is considerably large (Smith, 2005). It is relatively inexpensive, easy to administer and can satisfy a desirable population proportions. The researcher did a random sampling on the strata in order to determine the respondents to participate in the study. Since the target population was large, the researcher used the slovin's formula to determine the sample size.

$$n = N/\{1 + N(e)^2\}$$

$$n = 23964/1+23964*0.05^2$$

3.5 Data collection instruments

This study used both primary and secondary data that was collected using questionnaires as the instruments of collecting primary data as well as journals and other literature for the secondary data (Mugenda & Mugenda, 2003). Questionnaires were administered to the managers and owners of the SMEs as they are the ones involved in the decision making and formulation of policies to guide the daily operations of the SMEs.

3.6 Data processing and analysis

Data processing and analysis involved categorizing, manipulation and summarizing the data collected through questionnaires in order to get answers to the research questions raised (Kothari, 2004). The researcher had to check for completeness and consistency on the questionnaires before editing, coding and tabulation of the data collected. Data was then be summarized and

analyzed using descriptive statistics. The researcher used statistical packages for social studies (SPSS version 20) software tools to analyze the data which was then presented in tables and charts (Cooper & Schindler, 2003). The data obtained from the respondents was further used to explain the various variables in the study in order to answer the research questions. Inferential statistics was also applied to help summarize the findings in order to draw conclusions on the significance of the study (Kombo & Tromp, 2006)

RESEARCH FINDINGS AND DISCUSSIONS

4.2.1 Reliability Results

Table 4.2 Item-Total Statistics

	Scale Mean if Item Deleted	Scale Variance if Item Deleted	Corrected Item-Total Correlation	Squared Multiple Correlation	Cronbach's Alpha if Item Deleted
qualification	9.6390	5.460	.852	.726	.860
identification	9.9231	4.810	.886	.784	.830
contractaward	9.7824	5.135	.912	.846	.842
performance	9.8114	4.728	.911	.847	.862
Overal					.853

Cronbach's alpha was used to test the reliability of the proposed constructs (Ali *et al*., 2016). The result shows that the overall reliability Cronbach's Alpha is 0.853. All other variables had Cronbach's Alpha of more than 0.9. This shows that the tools used to collect the data set were reliable and consistent. Therefore the resultant is adequate for further analysis.

4.3 Working capital Management

Most of the respondents, 84.2% admits that working capital requirements are determined by both internal and external factors.7.3% feel that working capital requirements are determined by internal factors only while 8.5% said that external factors are the major determinants of working capital requirements. This analysis is in consistent with the fact that working capital management affects the financial performance of SMEs in terms of both liquidity and profitability (Brigham & Ehrhardt, 2010).Majority of the SMEs admits that working capital requirements are determined by both internal and external factors hence they should both be considered in deciding the levels of each working capital component be held at any given time to ensure smooth operations of the retail trading entities (Afza & Nazir, 2009).

Table 4.3 Determinants of Working Capital Requirements

Working capital requirements determinants	Frequency	Percentage
Internal factors	25	7.3
External factors	29	8.5
Both internal and external factors	288	84.2
	342	100.0

Most of the respondents use overcapitalization policy to finance their working capital needs. This is an approach where the SMEs use more short term financing to finance their operations than what is warranted by the matching approach (Arnold, 2008). Although this approach is more risky, it is the most profitable compared to the other policies since it involves working with low levels of current assets as a percentage of total assets while having high levels of current liabilities as a percentage of total liabilities (Afza & Nazir, 2007).

Table 4.4 Working capital policy

	Frequency	Percent
Overtrading	107	31.3
Neutral	60	17.5
Overcapitalization	175	51.2
Total	342	100.0

Most respondents agreed that it is important to review the working capital policy though at different intervals in order to accommodate any changes that might have occurred in the economy. Majority of them, 61.7% review their working capital policy once a year while 10.5% and 16.1% of the respondents carry out working capital policy review quarterly and semi-annually respectively. 11.7% of the respondents thought that review of working capital policy should only be reviewed when there are major changes whether internally or externally that affects the implementation of the existing policy (Afza & Nazir, 2009).

Table 4.5 Working Capital Policy Review

	Frequency	Percentage
Quarterly	36	10.5
Semi-annually	55	16.1
Annually	211	61.7
Rarely	40	11.7
N	342	100.0

All working capital components are important as they are all used to calculate the Cash Conversion Cycle which is inversely proportional to the profitability of the retail businesses (Atrill, 2006). However, debtors and cash are perceived to be more important by the retailers with a mean of 3.61 and 3.69 respectively. This is due to the level of risk involved in holding each one of them. Credit selling is crucial to the retail business and its absence would translate to heavy losses due to less sales volume while cash is needed for meeting the daily transactional needs of the business. Inventory and Creditors have a mean of 3.75 and 3.72 respectively which means that most SMEs wish to minimize the same and maintain low levels of creditors and stock levels that are economical as possible (Bragg, 2004). Buying on credit is much expensive than buying in cash as the vender would factor in the time value of money and also the risk of late or nonpayment at all while the buyer loses cash discounts as a result of buying on credit (Berk, Demarzo, & Harford, 2015). On the other hand, selling on credit increases the sales volume but also result to loss of interest on the outstanding amount, may lead to bad debts and also high costs of collecting debts.

Table 4.6 Working Capital Components

Working capital components	N	mean	Standard deviation
cash	342	3.69	.507
inventory	342	3.75	.436
Debtors	342	3.61	.555
Creditors	342	3.72	.451

4.4 Cash Management

Majority of the respondents acknowledge the importance of preparing cash budget as part of the cash management process as this helps them estimate the expected income and expenditure for a certain period of time. As a matter of cash control, majority of the respondents with a mean of 3.56 bank their daily collections so as to avoid impulse spending (Allen, Brealy, & Myers, 2011). Aggressive debt collection policy was another practice that was given great importance by the SMEs with a mean of 3.63. However, majority of the respondents indicated that holding cash and setting minimum and maximum cash balances was not important in process of cash management with a mean of 2.71 and 2.43 respectively.

Table 4.7 Cash Management Measures

	N	Mean	Standard deviation
Cash budget	342	3.68	.656
Daily banking	342	3.56	.563
Holding cash	342	2.71	.864
Max and Min cash levels	342	2.43	.671
Debt collection policy	342	3.63	.709

Majority of the respondents indicated that their main motive for holding cash was transactional motive with a mean of 3.62 followed by precautionary motives with a mean of 2.43. Speculative motive was least with a mean of 1.91 which meant that most of the SMEs do not have much interest in undertaking other adventures. On the transactional motives, the SMEs held cash for meeting daily transactional needs like paying bills and making petty cash payment (Boisjoly, 2009). Cash held on precautionary motives was held to meet any emergencies and eventualities that would occur due to the uncertainty in the business world. This would make the retailers less exposed in case of adverse economic conditions or take advantage of increased demand.

Table: 4.8 Cash holding motives

Cash holding motives	N	Mean	Standard Deviation
Transactional motives	342	3.62	.554
Speculative motive	342	1.91	.853
Precautionary motive	342	2.43	.835

In respect to managing cash shortfalls, majority of the respondents with a mean of 3.76 indicated that they aggressively collect debt and encourage their debtors to pay early even if it means giving them some discount (Boisjoly, 2009). Short term borrowing and prolonging payables had a mean of 2.55 and 2.80 respectively indicating that such practices are not embraced by most SMEs as measures of managing cash shortfall. This is due to the different elements of cost involved in each option. Short term borrowing is part of external sources of funds which is relatively expensive compared to internal sources (Arnold, 2008). Though some SMEs admit that they sometimes postpone payments to their vendors whenever they find themselves in such a scenario, this option also has some setbacks as it may result into erosion of the trust between the parties which may lead to supply shortages or even cancellation of future credit arrangement.

Table 4.9 Cash short fall management

	N	Mean	Standard Deviation
Prolong payables	342	2.80	.585
Borrowing	342	2.55	.605
Debt collection	342	3.76	.435

4.5 Inventory Management

Majority of the respondents, 77.8% use the Economic Order Quantity in managing inventory which involves determining maximum and minimum stock levels and making orders whenever the minimum stock level is reached. 19.3% of the respondents adopted the Just In Time while only 2.9% use the ABC. This is in consistent with prior

studies which indicates that the EOQ system is the most efficient inventory management system to maximize profit for small businesses (Prasanna, 2000). This is because it involve a continuous review of the inventory to enable the retailers calculate the economical number of items to be ordered at any time in order to minimize cost and maximize value whenever making orders.

Table 4.10 Inventory management approach

	Frequency	Percent
EOQ	266	77.8
ABC	10	2.9
JIT	66	19.3
Total	342	100.0

This study sought to determine the inventory turnover period which is the length of time stock items stay in store before being sold. For efficiency SMEs try to reduce the stock turnover period to as low as possible since longer periods means low sales as well as profitability (Quayyum, 2012). Majority of the respondents, with a mean of 3.85 carry out stock taking monthly followed by those carrying out stock taking quarterly with a mean of 3.24 while semi-annually and annually stock taking had a mean of 2.25 and 1.54 respectively. Monthly stock taking was most preferred because it enables the SMEs identify fast moving items of stock which is crucial in decision making (Atrill, 2006).

Table 4.11 Stocktaking frequency results

	N	Mean	Standard deviation
Monthly	342	3.85	.465
Quarterly	342	3.24	.672
Semi-annually	342	2.25	.715
Annually	342	1.54	.856

For efficiency management of inventory, the respondents agreed that regular stock taking was necessary in order to ensure that the inventory turnover is as short as possible and that orders made are economical to the business in terms of quantity and the cost of placing orders (Prasanna, 2000). Average inventory days refers to the average number of days stock items remain in store before they are sold out to customers. A shorter average creditors days implies an increase in the sales volume hence high liquidity and profitability (Boisjoly, 2009). Lead time is another important aspect of inventory management as it's the length of time from when an order is placed to the time goods are delivered to the buyers premises. Reducing lead time is one way of improving profitability of a business, that is, Short inventory lead time equals more profit. Trends have indicated that quality and delivery often surpass costs in terms of customer's values and satisfaction. Therefore, a short inventory lead time is advantageous to the SMEs. On the other hand, long lead time translates to more time customers are kept waiting which may result to lost sales and customers hence reduced profits.

Table 4.12 Inventory Management Measures

	N	Mean	Standard Deviation
Regular stock taking	342	3.74	.446
Average inventory days	342	3.72	.451

Lead time	342	3.76	.442
Re-order level policy	342	3.62	.554

4.6 Debtors Management

This study sought to find out why SMEs extend credit to their customers instead of selling on cash. Debtors is one of the working capital management components and also an important tool for increasing sales volume even though it has some level of risks associated to it hence the need to strike a balance between its benefits and setbacks (Afza & Nazir, 2007). Different SMEs held different levels of debtors. Majority of the respondents, 67.5% make between 20-30% of their total sales on credit while 31.6% make credit sale of up to 50% on credit which is a very significant figure. High levels of debtors are not economical to the SMEs as this may lead to increased bad debt and high collection cost hence low profitability as evidenced in the findings where only 0.9% of the respondents had more than 50% of their sales as debtors.

Table 4.13 Credit sales

Credit Sales	Frequency	Percentage
20-30%	231	67.5
40-50%	108	31.6
60-70%	3	.9
Total	342	100.0

Debtor management is crucial for ensuring SMEs has sufficient working capital to reinvest and grow. Different SMEs have adopted different aspects involved in the debtor management process. This study sought to establish the importance of some of these aspects like preparing a credit policy, evaluating customers, having a payment and recovery policy in place and frequent review of the credit policy (Eljelly, 2004). All respondents agreed that these aspects were important with customer evaluation rated the most important with a mean of 3.52 followed closely by credit policy and recovery policy with a mean of 3.61 and 3.62 respectively while credit policy review had a mean of 3.29. For efficiency, the credit policy should be clearly articulated, made available to all debtors and understood by all staff. Recovery policies should be clear and cover areas such as prepayments, down payments and any discounts for early payment. It should provide measures to be taken when a debtor fails to pay in time and extra costs have to be incurred in collecting the same and whom should bear such costs.

Table 4.14 Debtor management

Debtor management measures	N	Mean	Standard Deviation
Credit policy document	342	3.61	.634
Customer evaluation	342	3.52	.500
Recovery policy	342	3.62	.486
Credit policy review	342	3.29	.765

4.7 Creditors Management

SMEs rely on good relations with creditors to ensure smooth operation of their businesses. To avoid conflicts with vendors, the respondents agreed that it is important to set up a general policy on payment and make sure the suppliers understand and an agreement is reached between the two parties (Arnold, 2008). Trade payable is a very important component of working capital which when well managed can be a less risky and readily available source of short term capital as evidenced by the findings of the study. Majority of the respondents, 37.4% indicated that over 60% of their total purchases are on credit followed by 35.1% whose credit purchases range between 50-60% of their total sale while 27.5% have credit purchases of less than 40%.

Table 4.15 Credit purchases

Credit purchase	Frequency	Percent
10-20%	18	5.3
30-40%	76	22.2
50-60%	120	35.1
Over 60%	128	37.4
Total	342	100.0

This study also sought to establish the effects of average creditors' days on liquidity and also profitability. Majority of the respondents indicated that all trade payable measures outlined by the researcher in the questionnaires were equal important in managing trade payables. The study established that a purchasing department was important as it was vested with the responsibility of ensuring that there no stock outs experiences in the business (Biger, Mathur, & Gill, 2010). The in charge of the department was to determine which items to be purchased, at what quantities and from which suppliers at any given time. Previous studies showed that SMEs have a tendency of prolonging payments to their suppliers as much as possible as long as it does not result in to conflict and erosion of the trust between them. This is because they also sell on credit so they need time to collect cash from their customers before they can pay their vendors (Brigham & Ehrhardt, 2010). For efficiency, business should be able negotiate a longer creditors days outstanding than their average debtors days outstanding (Moyer, McGuigan, & Kretlow, 2012). To avoid conflicts between the SMEs and their suppliers, majority of the respondents agreed that it was necessary to have a payment policy clearly articulated and understood by all parties involved. The payment policy was mainly meant to guide the SMEs to come up with a payment plan that would be fair to all parties involved.

Table4.16 Trade Payables Measures

Trade Payables Measures	N	Mean	Standard Deviation
Purchasing Department	342	3.69	.516
Average Creditors Days	342	3.63	.554
Payment Policy	342	3.86	.524
Timely Payment	342	3.72	.452

4.8 Financial Performance

The study measured financial performance of the SMEs on various working capital management components like debtors management, cash management, inventory management and creditors management. The study sought to establish the importance of financial ratios which are used to measure liquidity and profitability of any business (Sharma & Kumar, 2011). The findings indicate that the SMEs recognize the importance of the financial ratios in measuring financial performance in terms of liquidity and profitability. Profit margin was perceived to be the most important ratio with a mean of 3.76, which was followed closely by current ratio and return on equity with a mean of 3.37 and 3.35 respectively. Return on assets and quick ratios had a mean of 3.33 and 3.28 respectively showing that they are not commonly used by the SMEs in measuring financial performance. The respondents agreed that the profit margin was easy to understand, calculate and interpret hence its popularity among SMEs (Berry & Jarvis, 2006).

Table 4.17 Financial Ratios Results

Ratios	N	Mean	Standard deviation
Current Ratio	342	3.37	.484
Quick ratio	342	3.28	.566
Profit margin	342	3.76	.438
Return on assets	342	3.33	.428
Return on equity	342	3.35	.478

Table 4.18 ANOVA

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	2.618	4	.655	31.555	.000[b]
Residual	6.990	337	.021		
Total	9.608	341			

a. Dependent: financial performance Variable
b. Predictors: (Constant), Debtors management, Inventory management, Creditors management, cash management.

At a significant level of 5%, the model shows that the data is reliable at a sig. of .000 and the independent variable explains the dependent variable. The sum of squares shows that 2.618 of the variance can be explained by the independent variables while the residual of 6.990 cannot be explained by the independent variables.

Table 4. 19 Regression Analysis Results

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.641	.144		4.459	.000
cash management	.630	.032	.720	19.585	.000
debtors management	.169	.035	.175	4.809	.000
creditors management	-.005	.023	-.007	-.200	.842
inventory management	.062	.021	.097	2.975	.003

a. Dependent Variable: performance

All the factors were found to be statistically significant at 5% level significance apart from creditor's management. The significant factors have a positive influence on financial performance. The regression model is given as

$$y_i = 0.641 + 0.630x_1 + 0.169x_2 - 0.005x_3 + 0.062x_4$$

Which implies that a unit change in the dependent variables is as a result of a positive change of 0.630, 0.169 and 0.062 of independent variables one, two and three respectively. This is inconsistent with previous studies which proved that there is a relationship between working capital management and profitability.

Table 4.20 Model summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.594[a]	.352	.345	.13589

a. Predictors: (Constant), Creditors, Debtors, cash, Inventory

This shows that there is a good measure of fit of the model since R^2 is more 0.31. R^2 of 35.2% implies that 35.2% of all the variation in Financial performance is explained by the relationship between the financial performance and the other independent variables (Cash, Inventory, Debtors and Creditors). Other factors contribute 64.8% of all the variation in financial performance.

Table 4.21 Descriptive statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Average creditors days	342	32	48	39.72	.593

Cash conversion cycle	342	18	35	31.74	.346
Average inventory days	342	18	37	33.62	.554
Average debtors days	342	31	46	39.21	.461
Net profit margin	342	15	27	25.00	.025

The descriptive analysis shows that the minimum number of days the SMEs were allowed by their vendors to pay for goods delivered to them on credit terms was 32 days while the maximum days were 48 days. The results also indicated that SMEs offered credit to their customer and expected them to pay within a period of 31 days and a maximum of 46 days. This is in consistence with previous studies which showed that it was prudence for SMEs to give less credit days to their customers than the credit days they are given by their vendors (Prasanna, 2000) . Most respondents indicated that their minimum average inventory days was 18 and the maximum was 37 days. The study also established that most SMEs had a minimum cash conversion cycle of 18 days and a maximum of 35 days with a standard deviation of 34.6%. The results therefore indicated that most SMEs have a shorter cash conversion cycle which implied that they are not facing liquidity problems and their going concern is not questionable (Boisjoly, 2009).

Table 4.22 Pearson Correlation Results

		Financial performance	**cash_management**	**debtors_management**	**creditors_management**	**inventory_mgt**
Financial Performance	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	342				
cash management	Pearson Correlation	.803**	1			
	Sig. (2-tailed)	.000				
	N	342	342			
debtors management	Pearson Correlation	.549**	.526**	1		
	Sig. (2-tailed)	.000	.000			
	N	342	342	342		
creditors management	Pearson Correlation	-.102	-.148**	-.099	1	
	Sig. (2-tailed)	.059	.006	.068		
	N	342	342	342	342	
inventory management	Pearson Correlation	.010	-.104	-.058	.293**	1
	Sig. (2-tailed)	.853	.056	.285	.000	
	N	342	342	342	342	342

**. Correlation is significant at the 0.01 level (2-tailed).

Based on the correlation results on table 4.22, it is evident that there is a correlation between the independent variables and the dependent variable. The study established that there is a negative correlation between cash management and financial performance of SMEs which implies that shorter cash conversion cycles are crucial in improving both liquidity and profitability of the retailing entities (Maness & & Zietlow, 2005). The results also indicated that inventory management affect financial performance since a higher inventory turnover means more sales thus translating to more profitability. For efficiency SMEs have to reduce the average debtor outstanding days to as minimum as possible as evidenced in the correlation table results (Gitman L. J., 2009). This is in agreement with previous studies which proved that shorter average debtors is key to profit maximization (Berry & Jarvis, 2006). The results of the study indicated that a higher creditor turnover ratio is key to improved financial performance of SMEs. A higher creditor turnover ratio is an indication that the creditors are paid in good time which is crucial

in building trust and ensuring good relations among the parties.

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

The study sought to establish the working capital management approach adopted by different SMEs operating in Mombasa County and how they affect the business financial performance. This revolved around the working capital components such as cash, inventory, debtors and creditors. The study revealed that most SMEs understood the importance of working capital management and how it affects the financial performance of their businesses. Though different SMEs have adopted different working capital policies, their main objective was to hold working components at levels that would maximize profits and minimize the risks associated to each one of the working capital components. Majority of the respondents adopted the overcapitalization approach which meant that they were holding low levels of current assets and high levels of current liabilities. The overcapitalization approach has proved to be the most profitable though very risk approach hence preferred by most risk takers.

The main motive for holding cash among the SMEs was precautionary and transactional motives. This indicates that most SMEs were aware of the uncertainty in the business world hence the need to set cash aside to cater for any eventualities. This is to make sure that their businesses are less exposed to the harsh economic conditions. The study also established that SMEs hold cash for transactional motive to enable them meet their daily expenses and ensure that the daily operations of the business are not interfered with due to lack of cash.

All SMEs agreed that they extend credit to their customers and they have a credit policy in place which guides them on the limit of credit to be extended to each customer. Customer evaluation is one aspect that all respondents acknowledged its importance in managing debtors so that each customer's credit worthiness is established before credit is extended to them. For efficiency, credit policy have to be well understood by all customers who are given credit so that they know the credit terms outlined therein. Apart from increasing sales volume, credit selling can lead to increased bad debts and high cost of debt collection.

Under inventory management, most SMEs adopted the EOQ approach which involves a continuous monitoring of the stock items visa vie the sales report to ensure that orders are made on time to reliable suppliers with the shortest lead time possible in order to avoid stock outs. EOQ also enables SMEs to determine the reorder level when orders are to be made and also the economical quantity to be ordered at any given time. Lead time is becoming an important aspect in evaluating suppliers as customers are focus more on quality and delivery. Therefore suppliers that are not able to meet customers expectation on delivery time may find it very difficult to stay in the market due to high competition. The study established that all SMEs enjoy credit facilities from different suppliers hence the need for a payment policy which guides them on determining what is due and needs to be paid. Majority of the respondents agreed that though t prolonging payments to creditors may seem to be favoring them, it is not a best practice as it brings about conflicts which may be costly resolving and also results to loss of trust and future supplies.

5.2 Conclusions

The research established that there is a relationship between the various working capital components and the financial performance of the SMEs. The findings indicate that if the SMEs hold more cash rather than reinvesting the same back to the business, hence profitability is reduced at the margin of the foregone interest. Other than the transactional motive for holding cash, majority of the SMEs held cash for speculation motive due to fear of uncertainty. The study also established that SMEs prefer aggressive debt collection whenever they are faced with cash shortage instead of borrowing from financial institutions. They tend to shy away from such facilities because they feel that external funding is expensive compared to internal sources of financing as well as the lack of collateral by most SMEs.

From the findings of the study, credit sales is a powerful tool for ensuring high sales volume. However proper controls must be put in place so that the SMEs are able to mitigate the risks associated with nonpayment of debts as they enjoy the benefits accrued to it. It is evidence that shorter debtors average days ensures good liquidity position and high profitability for the SMEs. Under Inventory management, Economic Order Quantity was adopted by most SMEs because it is a continuous process of monitoring the stock items to determine what needs to be ordered and what level to be ordered. Majority of the SMEs agreed that this approach is economical, easy to understand and implement.

The study concluded that all SMEs have credit arrangements with their suppliers even though each supplier offer different terms. They also agreed

that adhering to the terms of credit as provided by the suppliers is key to maintaining good relationship which is vital for the business. Timely payment to creditors ensures continuous supply of inventory thus avoiding lost sales due to stock outs. Financial performance is a product of different factors one of them being working capital management which has not been given much attention by the SMEs for a very long time. Given that working capital affects both liquidity and profitability, all the working capital components should be managed efficiently and a review of the working capital policy be done regularly for the business to remain afloat.

5.3 Recommendations

From the findings of the study, it is evident that efficient management of working capital is key to financial performance therefore should be given priority as one of the functions of the finance manager regardless of the size of the business. The study therefore recommends that;

1. SMEs should prepare cash budgets and adhere to the provisions therein. Cash collected should be banked daily and a reconciliation of the daily sales report and the amount banked each day be done to resolve any variances. Instead of holding cash for speculative motive due to fear of the uncertainty, SMEs can insure their businesses thus transferring the risk and getting assurance that they will be compensated in case of risk materializing.
2. Before extending credit to any customer, detailed evaluation should be done to establish their credit worthiness and also previous dealings with the customer can be a basis of making informed decisions. Credit policy should be clearly articulated and its terms be made clear to all credit customers and penalties if any in case those terms are breached. Debt collection should be done with professionalism to avoid loss of customers.
3. Stock taking should be done regularly to determine whether all stock items not sold are in the store some inventory is missing. A reconciliation should be done to determine whether the inventory not in store was actually sold and delivered to the right customers. Orders should be done only when the reorder level is reached and ensure that the quantity ordered is economical for the SMEs to cut on frequent ordering costs.
4. Trade creditors should be paid on time in order to avoid conflicts and also maintain a good relationship with them. Credit purchasing should be done only when necessary and at economical levels as this denies the SMEs cash discount given to cash buyers.

5.4 Arrears of further research

From the findings of the research, the study concludes that working capital management has a great influence on both the liquidity and profitability of SMEs and large firms as well. It is clear that this arrear is of great interest to both researchers and other stakeholders hence to need to have much focus on the issues concerning working capital management and its impact on the firms. The researcher therefore suggests that further studies can be done on the effects of working capital management on the growth of SMEs, Challenges faced by SMEs in accessing capital and how the SMEs can adopt new technology and strategic management practices to enable face the challenges in the dynamic business world.

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