

**EFFECT OF WORKING CAPITAL MANAGEMENT PRACTICES ON  
PROFITABILITY OF SMALL AND MEDIUM ENTERPRISES IN MAKUENI  
COUNTY**

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FULFILLMENT OF THE REQUIREMENT FOR THE AWARD OF MASTER  
DEGREE IN BUSINESS ADMINISTRATION**

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## DECLARATION

### **Declaration by the Student**

I declare that this research thesis is my original work and has not been presented to any other examination body. No part of this research should be reproduced without my consent or that of Kenya Methodist University.

Sign:.....

Date:.....

**Victoria Mutheu Mbathi**

BUS-3-2613-2/2016

### **Declaration of the supervisors**

This research thesis has been submitted for defense with my approval as the Kenya Methodist University supervisor.

Sign:.....

Date:.....

**Prof. Felix Mwambia**

Sign:.....

Date:.....

**Mr. Moses Kithinji**

## **DEDICATION**

I dedicate this thesis to my beloved family; to husband Stephen Mbathi, my Children Wesley, Cecily and Cecile for all their tireless support, moral, financial and academic that they accorded me to complete this piece of work. With their encouragement I am where I am now. I owe it to the Almighty God too for good health, energy to carry on and perseverance all through. To my friends and colleagues, I say thank you all.

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## **ABSTRACT**

The purpose of this study is to examine the influence of Working Capital Management practices (cash conversion cycle, inventory holding period, account receivable collection period and accounts payable period) on the profitability of Small and Medium size Enterprises (SMEs) in Makueni County. The purpose was achieved by conducting a descriptive survey research design based on the views of managers drawn from a final sample of 71 SMEs from Wote town. Findings indicate that cash conversion cycle, inventory-holding period and accounts payable period have significant positive effect on profitability of SMEs. On the contrary, results indicate that there exists a negative relationship between accounts receivable period and profitability of SMEs. The results suggest that SMEs in Makueni should strive to improve cash conversion cycle, inventory holding period, accounts receivable collection period and accounts payable period to enhance their efficiency. The financial institutions are called upon to offer more trainings to SMEs on effective working capital management practices before giving a loan facility. The finding is also in handy to the government and other policy makers to guide the development of policies geared towards improvement of SMEs sector since it is a key contributor to the Gross Domestic Product of the country. Specifically, the government should come up with training programs that can improve the business management skills of the SMEs owners.

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## LIST OF ABBREVIATIONS

APP	Accounts Payable Period
ARP	Accounts Receivable Period
AWC	Approaches of Working Capital
CAPM	Capital Asset Pricing Model
CCC	Cash Conversion Cycle
CRM	Corporate Risk Management
CSE	Common Stock Equity
EOQ	Economic Order Quantity
GMM	Gaussian Mixture Model
GS	Growth in Sales
GTA	Growth in Total Asset
IHP	Inventory Holding Period
ROA	Return on Assets
ROE	Return on Equity
SMEs	Small and Medium Enterprises
WCM	Working Capital Management

# CHAPTER ONE

## INTRODUCTION

### **1.1 Background of the Study**

In the current business environment, for an organization to survive even though they are making profits, they ought to also focus on offsetting short term debts as they fall due. Sound corporate management involves the Working Capital Management (WCM) that is construed as the force behind the performance of an economic entity and forms the most fundamental function. It is important to acknowledge the fact that working capital is a necessity for every organization because it maintains the level of the organization's liquidity, improves the organization's chances of survival in a very competitive environment, guarantees solvency of the business and improves profitability (Gorondutse et al., 2017).

According to Chen et al. (2020), the level of profitability as well as liquidity of the organization is affected by effectiveness of WCM. Accordingly, disregard of WCM effectiveness spells the beginning of failure of an organization and the inevitable risk of bankruptcy because tradeoff between profitability and liquidity is hinged on working capital management (Alvarez et al., 2021). To maintain a healthy and robust economy, there is need to focus on Small and Medium Enterprises (SMEs) which have a huge contribution to the economy.

A good number of jobs are created in the economy because of promotion of entrepreneurial culture by SMEs. They have remained a vital component of industrialization process with their intrinsic ability to produce entrepreneurs as well as nurture potential for skilled workforce for the industries not just nationally but globally (Abimbola & Kolawole, 2017). Inefficiencies in proper administration of current assets and liabilities due to incompetence of financial managers of various organizations account for the massive failure of the businesses especially Small and Medium Enterprises (Smith, 1973). Firms require good working capital

management in today's business environment since it provides a financial statistic for easy availability of liquidity (Azeez et al., 2016). Working capital is a term that refers to a mixture of working capital and fixed assets like equipment and plants. For example, if a company has assets and profits but cannot convert the profits into cash, it needs liquidity. As a result, it is critical for companies to maintain a positive working capital position to meet both short-term debt maturities and upcoming operating needs (Kasiran et al., 2016).

Working capital has been a vital discussion in the financial decision-making discipline according to Azeez et al. (2016), because all asset investments require appropriate financing. Even so, since it involves short term financing, it has often been overlooked when discussing financial decisions (Kimeli, 2014). Working capital is always at its optimal level in businesses that generate optimum value return. According to Owele and Makokeyo (2015), a firm with more inventories reduces the risk associated with stocking because some clients would rather see the quality of the stock before paying hence it increases the sales. Accounts payable is additionally a part of the working capital. In this one, the amount owed to suppliers is delayed and thus there is more time to verify the quality of products before buying them.

Abimbola and Kolawole (2017) state that when bills are paid late, the firm's costs climb, especially if a discount was promised for early payment. The basic purpose of every commercial firm, according to Owolabi et al. (2012), is to maximize profitability on behalf of the business proprietors. Balancing firm liquidity and profitability during everyday operations makes it easier for the company to run smoothly and pay its obligations. WCM has a direct impact on corporate profitability and growth, according to Uremandu et al. (2012), therefore the amount of money spent on working capital should be comparable to the total assets employed. To establish the effect of working capital management to firm performance, this study was anchored on the pecking-order theory, cash conversion circle theory and transaction cost theory.

### **1.1.1 Working Capital Management**

WCM can be construed as establishing a balance between an organization's assets and liabilities in the short term. According to Mathuva (2015), the interface of these two forms the focal subject of theory of WCM practices. The duration of time it takes to get the raw materials which are used in production and the collection of revenues forms working capital for an organisation. On the same note, the entire process mirrors an organization's capacity to fund its essential processes using vendor credit.

Effectiveness in the management of an organization's receivables, inventory as well as payables by managers translates to business success (Owolabi et al., 2012). In this regard, the main objective of WCM is to make sure that an organisation can smoothly carry out its processes with enough cash to facilitate short-term debt that need to be offset plus any other imminent operational expenses (Gorondutse et al., 2017).

The focus of existing literature on WCM has been on long-term financial decisions by large firms. Consequently, there has been a lot of emphasis by researchers on analysis of investments, capital structure, dividends as well as company valuations. The WCM is viewed as a vital component in enhancing Pakistan's financial performance on a global scale (Bagh et al., 2016). Firms with a healthy WC level can improve their financial performance.

According to Bagh et al. (2016), the profitability of firms in Pakistan were improved greatly through effective WCM practices employed. The most vital practices were Cash Conversion Cycle (CCC) and average payment period. They had the largest strength and impact on profitability and other related financial performance measures. Baveld (2012) evaluated how receivables related to profitability of Dutch firms. It was demonstrated that its effect depends on whether it's a crisis period or not since during one, it had a negative impact and otherwise during a period of no crisis, it had a positive impact. It was thus recommended that to maximize profits during a period of crisis, there was a need for the firms to reduce the

receivables period. According to Mohamad and Saad (2010), current ratio can negatively impact on financial performance of publicly traded Malaysian enterprises. According to the study's findings, the profitability and firm value were greatly reliant on the WCM practices pursued by the firms. In agreement, Gorondutse et al. (2017) demonstrated that indeed current ratio negatively affected the growth of Saudi Arabian firms.

Working capital management methods focused at reducing inventory and trade receivables have enhanced the profitability of South African businesses. According to Louw et al. (2016), retailers should use innovative inventory management technologies to boost inventory levels and revenues. According to the reasons documented by Akoto et al. (2013), most South African SMEs suffer from poor profits due to high receivable days. Luqman (2014) looked at the WCM of all Nigerian brewery companies and found that cash balances, receivables, payables, inventories, and debtors all had a substantial impact on profitability. Leverage has a small but unfavorable effect on a company's profitability.

Additionally, the amount of dividends available for sharing was affected in a significant manner by the trade cycle (Oladipupo & Okafor, 2013). Even though size and other macro-economic factors could dismally affect the profitability of commercial banks in Ghana setting, CCC was one of the greatest determinants of the performance of these entities (Yeboah & Yeboah 2014). Companies not listed on the Ghana Stock Exchange outperformed those who were not listed.

According to Akoto et al. (2013), managers can advance shareholder money by reducing accounts receivable days to 30 days. Internal limits were implemented in Ghana to safeguard local firms and prevent them from being hurt by importers, while simultaneously increasing demand for locally manufactured items. Locally, Kiplimo (2010) discovered that firms with shorter CCCs generate higher returns, whereas firms with lower current ratios to total asset ratios generate higher returns since they can easily maintain optimal levels of worthless

resources. Working capital characteristics of state-owned commercial enterprises in various economic sectors have an impact on Return on Asset (ROA) (Makori & Jagongo, 2013).

For most manufacturing firms, their CCCs are longer, resulting in lower earnings. The profitability of manufacturing companies listed on the NSE is heavily influenced by working capital (Makori & Jagongo, 2013). The days taken for receivables and payables among the manufacturing entities based in Kenya, greatly affect their overall returns (Nduati, 2014). Furthermore, Kiilu (2010) discovered that the majority of the companies surveyed had a written declaration on how much cash, both in hand and bank, to hold. The amount of cash to hold was established by the cash requirement at the time, according to the companies that did not have a written statement. One of the most common WCM techniques discovered was the use of cash budgeting.

### **1.1.2 Firm's Profitability**

The profitability of an organisation can be construed as the extent to which financial gain is yielded by the firm. It is measured by income and expenses. Different activities of an organisation result to its income. Profitability can also be explained as measure of the degree to which an organisation makes profit from the factor's pf production. Some of the measures are of financial performance are ROA, Return on Equity (ROE) and Net Income as well as Operating Profit Margin. Capacity to pay off maturing financial debts without interfering with owner equity is measured by liquidity by use of asset market value.

According to Dong (2010), some of the practices of WCM influence profitability of a firm. Fixed as well as current assets are deemed important in the effective functioning of any organization according to empirical results (Chatterjee, 2010). In this regard, a decrease in the size of working capital in comparison to sales translates to an increase in a firm's profit or loss margins. To improve a firm's liquidity, there is need therefore for the firm to augment its working capital. As already pointed out, the ability of a firm to address any maturing

financial debts without interfering with owner equity is measured by liquidity by use of market value of assets.

### **1.1.3 The relationship between WCM and Profitability**

The association of WCM to profitability of a firm is one area that most research has focused on (Akoto et al., 2013; Gul et al., 2013; Maradi et al., 2012; Oladipupo et al., 2013). On the same note, Singhanian and Mehta (2017) argued that the purpose of WCM practices is to enhance balance among all the components of working capital such that they are not too little or too great as this will result to illiquidity as well as a significant loss of sales. There is a tradeoff between risk and returns resulting from the amount of investment in working capital as well the manner in which this investment is financed (Singhanian & Mehta, 2017).

It therefore follows that a higher return if obtained from an investment deemed to have higher risk. A discrete statement of the objectives of an organisation which in most cases is to maximize the returns and profitability of a firm translates to effectiveness of WCM. This according to Abimbola and Kolawole (2017) makes it important to maintain the liquidity of a firm. Singhanian and Mehta (2017) acknowledge the characteristic tradeoff between the objective of profitability and that of liquidity and advice establishment of a balance between the two aspects because according to them, augmentation of profit in place of liquidity may bring forth issues to a firm. They therefore suggest adoption of effective WCM practices to address the liquidity-profitability tradeoff.



#### **1.1.4 SMEs in Kenya**

SME is a non-subsidary, independent formally registered firm which employs fewer than a given number of employees mostly less than 250 but differs from one country to another. They are regarded as susceptible to variations of working capital hence need a good reserve of cash (Douglas et al., 2017). To finance their investments, SMEs rely on equity financing, short-term bank loans as well as trade credit (Ogola et al., 2017).

When compared to the equity of a company, securing bank loans is an expensive process which necessitates WCM practices which are an integral element of profitability of SMEs. The Kenyan economy is greatly dependent on the effectiveness of SME setup as this sector creates over 50% of new jobs each year (Ogola et al., 2017). One of the main benefits of SME sector that backs economic development of Kenya is the cultivation of entrepreneurial culture that results to establishment of employment opportunities for many citizens of the country (Babu, 2017).

For an economy to thrive, Mwaniki and Ondiek (2018) observed that there must be a robust association between the vigor as well as nature of SMEs. To manage and avoid failures of these SMEs, it is good to have a clear comprehension of the challenges plaguing the development of the SME sector (International Labour Organization, 2010). Hence, this research established effect of WCM practices on the profitability of trading SMEs in Makueni County.

## **1.2 Statement of the Problem**

The government of Kenya has been fighting unemployment problem in the country and SMEs have been reportedly helped to curb the problem. According to Chalmers et al. (2020), the largest component of businesses throughout the world are SMEs that also result to the establishment of employment opportunities for a good number of citizens. The fact that this sector enhances self-employment, minimizes the impact of poverty, and speeds up the process of economic growth in has sprung the Kenyan government to attach more importance to the development of the sector. A report by the Kenya National Bureau of Statistics (2019) indicates an alarming failure rate of nearly 60 percent of SMEs just after a few months into commencement of operations.

There exists inconclusiveness on the challenges leading to the collapse of SMEs. Deficiency of suitable WCM skills by SMEs makes it hard for them to get any kind of financial help as most financial institutions insist on financial discipline, a key component of which is proper WCM (Afrifa & Tingbani, 2018). Apparently, there are challenges plaguing SMEs in their quest to establish a suitable balance between excess and deficiency of working capital and this lack of proper WCM practices eventually affects profitability of the SMEs.

Consequently, slow growth rate of SMEs coupled with deficiency of working capital chiefly due to lack of sound WCM accounts for the inability of SMEs to settle daily expenses. This calls for adoption of effective as well as efficient WCM practices by SMEs for the purpose of meeting the daily operational expenses and long-term pursuit of profitability (Lampsey et al., 2017).

Existing literature on WCM are inconclusive in as far as methodological, conceptual, and contextual aspects of these studies are concerned. A study by Babu (2017) examined the influence of WCM on listed firms in the non-financial sectors. Further, the study used secondary data collected from the published financial statements. On the same note, Makori

and Jagongo (2018) explored the influence of WCM on firm profitability. Their study also used firms listed at Nairobi Securities Exchange (NSE), Kenya and only focused on profitability as the dependent variable. The study adopted secondary data.

Using secondary data from published financial statements, Babu (2017) studied the influence of WCM on manufacturing firm's profitability with specific reference to firms listed at the NSE. Basically, the reviewed studies presented conceptual, contextual, and methodological research gaps which this study sought to fill. Methodologically, the studies adopted secondary data while the current study utilized primary data collected by use of questionnaires. Contextually, the studies were carried out focusing on the firms listed at the NSE.

The scholars did not focus on SMEs but listed at the NSE hence the current study helps to fill that gap by studying SMEs in Wote town Makueni County. Conceptually, the studies did not focus on working capital of SMEs but other firms while the current study analyses the SMEs and working capital management practices. In addition, with this in mind and the fact that the SME sector contributes significantly to the economy of Kenya, there was need to establish the effects of WCM practices on the profitability of SMEs especially in developing and rural areas. This study consequently purposed to establish the effect of WCM practices used by trading SMEs in Makueni County and how they affect their profitability.

### **1.3 Purpose of the Study**

To establish the effect of working capital management practices on the profitability of SMEs in Makueni County.

### **1.4 Objectives of the Study**

#### **1.4.1 Main Objective**

This study's main objective was to establish the impact of working capital management practices on the profitability of SMEs in Makueni County.

#### **1.4.2 Specific Objectives of the study**

The specific objectives of the study were:

1. To determine the effect of cash conversion cycle on the profitability of SMEs in Makueni County.
2. To establish the effect of inventory holding period on the profitability of SMEs in Makueni County.
3. To examine the effect of accounts receivables collection period on profitability of SMEs in Makueni County.
4. To determine the effect of accounts payable period on the profitability of SMEs in Makueni County.

### **1.5 Research Questions**

1. What is the effect of cash conversion cycle on the profitability of SMEs of Makueni County?
2. What is the effect of inventory holding period on the profitability of the SME sector in Makueni County?
3. What is the effect of accounts receivables collection period on the profitability of the SMEs in Makueni County?
4. What is the effect of accounts payable period on the profitability of SMEs in Makueni County?

## **1.6 Significance of the Study**

Financial institutions that finance SMEs and other businesses are a major constituent of working capital creation. The results help these institutions to understand SME sector and their WCM practices and act as a guide while offering credit facilities.

The results can also assist the government that regulates businesses by providing guidance to the kind of regulations they should have for SME's and whether to review the presently available Laws and Regulations. One of the government programs through the Ministry of Trade and Industrialization is to build the capacity of the SMEs (Mugwara, 2000). In understanding these findings, it can help them to build the capacity of SMEs in financial management especially working capital management.

Other beneficiaries of the study can be the SMEs owners in Makueni as well as other regions of the country. The study provides imperative acumens into their management of WC. In establishing how it affects their performance, the study goes a long way in unearthing important concepts which can guide their growth. The academia and future researchers can similarly benefit from the findings of this study. The study provides important empirical evidence of how WCM affects profitability of SMEs. It also goes a long way in building strong theoretical linkages an emerging context. Future research in the area will thus find it important to utilize this in building their future empirical evidence.

## **1.7 Scope of the Study**

The emphasis of the study was on Wote town as the headquarters of Makueni County and has the varied SMEs for the study where the samples were drawn. This included 71 major trading SMEs that are currently registered and based in Wote town, Makueni County according to the KNBS Report 2016. The study was also delimited to interrogation of the effect of CCC, inventory holding period, accounts receivables and accounts payable period on the profitability of SMEs. These were the main conceptual focus of the study.

## **1.8 Operational Definition of Terms**

**Accounts receivable period** refers to the time it takes for a company to sell on credit until the payment from the transaction is used by the company (Mathuva, 2015).

**Accounts receivable period** is the time it takes for the firm's actual cash expenditures to be reimbursed for productive resources from product sales (Gill et al., 2012).

**Average payment period** is the average payment period is the amount of time it takes for a company to buy labor and goods in cash (Ahmad et al., 2014).

**Cash conversion cycle** is the duration during which funds are utilized in working capital (Vural et al., 2012).

**Inventory conversion period** is how long the firm will take to convert its inventory into finished products for sale (Mansoor & Muhammad, 2012).

**Inventory** is made up of, work in progress, the raw materials as well as the stock of finished goods awaiting delivery (Gill et al., 2012).

**Profit** refers to the returns or wealth created by a firm via the use of its available resources (Valentine, 2014).

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This chapter presents theoretical and empirical studies on working capital management and profitability. The first part focuses on theories explaining the relationship between working capital management and profitability. The second part contains empirical studies on working capital management and profitability. The third part looks at the conceptual framework, and lastly part four identifies the research gaps.

#### **2.2 Theoretical Review**

The study hinges on the Pecking-order theory, Cash conversion cycle and Transaction cost theory to explain the theoretical link between the study variables. Specifically, the theories are discussed in this section.

##### **2.2.1 Pecking-order Theory**

This theory is based on the prediction that firms consider giving equity as the last resort. Advanced by Myers and Majluf (1984), it demonstrates that capital budgeting, capital structures as well as WCM decisions are the major components of this theory. The first two are the most commonly adopted mechanisms of investing in long-term projects. This theory postulates that debt is the most favored basis of a firm's external financing. They contend that capital structure results from preference order of varied resources that are focused on the financial obligations of a firm. Accordingly, the debt capability of a firm ultimately determines the firm's selection as well as magnitude of debt financing. In this regard, there is less profit generated by a firm following its issuance of debt as a consequence of lack of enough financing for capital investment.

A combination of the debts and equities applied by a firm to finance its operations constitutes the firm's capital structure. Direct, legal-administrative as well as indirect costs hinged on the

difficulty of running a firm staring at bankruptcy were identified as the main costs connected to likelihood of bankruptcy of a firm (Martinez et al., 2018). The profitability of a firm therefore diminishes due to these costs augmenting from debt capital. The process of financing as well as managing short term investments provide the basis for WCM decisions. Approximation of the costs involved from the different sources of capital purposes to establish the minimum rate of profitability deemed necessary to make the firm's investment of worth. Despite the fact that financial reports of the SMEs may constantly indicate profit, there is candid concern that they may go bankrupt as consequence of ineffective WCM practices they apply (Agyei et al., 2020).

### **2.2.2 Cash conversion cycle theory**

The cash conversion cycle theory was developed by Richards and Laughlin in 1980. The theory states that the liquidity concept can be arrived at by broadening the static growth balance sheet of potential credit risk value and incorporate some measures of the income statement of a company's business activity. The inclusion of account receivables, payables and inventory measures into an operating cycle gives a more suitable view liquidity management than depending on the quick ratio and the current asset ratios as indicators of solvency (Richards & Laughlin, 1980; Nobanee et al., 2011; Afrifa et al., 2014). The authors argue that the cash conversion cycle gives a more clear comprehension for the management of a company's working capital position in a way that would ensure that the firm will be able to meet its liquidity needs using the right amount and of found available and at the correct timing (Richards & Laughlin, 1980).

Account receivables turnover shows the number of times in which a company's investment on receivables is translated in cash in a year and after a how long. Any change in the credit policy of the firm will have a direct effect average remaining receivable balance relative to the company's sales in the year. Average inventory turnover indicates the rate at which a firm changes their total stock, including raw materials, work in progress and finished goods, into



sales. Taking on strategies that will need immense inventory commitments for every shilling of the sales expected will result in a lower turnover and as a result reflect a longer and potentially less liquid inventory holding period. In terms of accounts payables on the other hand, if companies cannot put in place payment practices with trade creditors or access how they obtain short term debt financing by other non-trade creditors, then decisions that create longer liquid holding period will again cause a higher current ratio.

Richard and Laughlin used this theory to analyse how effectively firms are managing their working capital. This would mean that all the other factors held constant, effective and efficient working capital management, that is, a short cash conversion cycle will increase a firm's and profitability while inefficient working capital management lowers a firm's profitability (Ahmed et al., 2017). According to this theory, the cash conversion cycles will affect the profitability of SMEs. This study seeks to establish whether there exists relationship what is the relationship or influence of the cash conversion cycle on the profitability of SMEs.

### **2.2.3 Transaction cost theory**

The transaction cost theory was developed by Stephen Ferris in 1981. The theory states that trade credit can be understood and used a tool that makes possible the exchange of goods and services making the activity of exchange become the focus of analysis. This means that trade credit can stand as payment or a contractual alternative to immediate use of money (Ferris, 1981). This approach shows the intermediary role for trade credit. For example, trade credit can decrease the transaction costs involved in paying bills, that is, rather than paying bills any time the goods are delivered, a buyer may choose to accumulate the transactions and deal with them at once periodically like monthly or quarterly helping the organization not mix the payment cycle and the delivery schedule (Nyamweno & Olweny, 2014).

Emery (1987) contends that the only factor driving the decision to issue trade credit is the desire to increase operational flexibility, which may result in better financial performance.

The transaction cost hypothesis states that businesses use trade credit to lower the cost of their transactions with one another (Nelson, 2002; Banerjee et al., 2007). According to Africa (2013), companies would have to make payments for products and services that were provided without trade credit. By deciding on payment terms, a business can distinguish between its purchasing cycle and its payment cycle. By doing this, firms are able to avoid having to determine whether to pay for purchases of products and services right away.

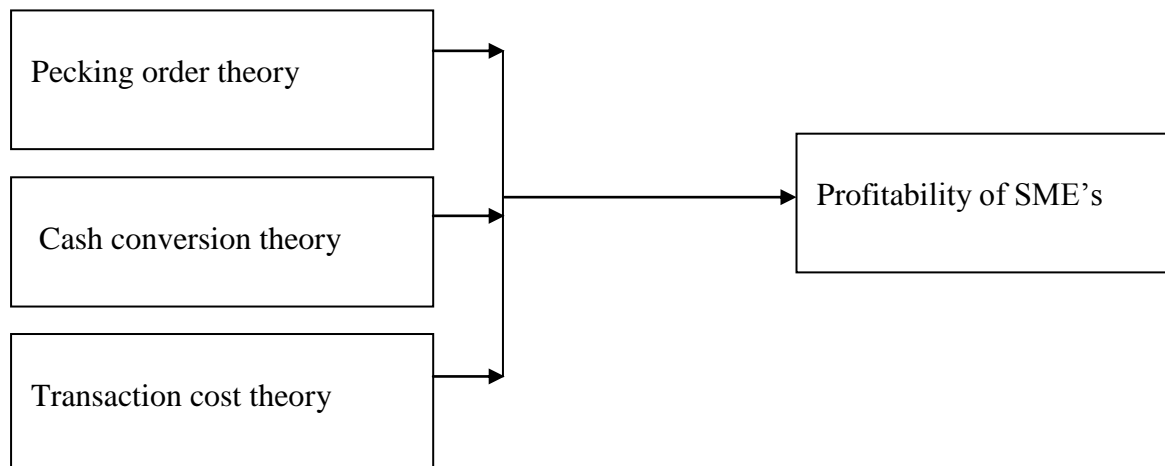
In addition, Ruiz- Fernández (2020) argues that high transaction costs entail high expenses for information collection, bargaining, and compliance monitoring. As expenses rise, businesses become less likely to engage in activities that have been proved to boost total output, such outsourcing. Transactional challenges are primarily caused by bounded rationality, opportunism, small numbers bargaining, and information-impacted news . However, detractors of this theory contend that it ignores the contextual underpinnings of human behavior, leading to an over-socialized view of institutional management and an under-socialized understanding of individual motivation. According to this theory, cash conversion cycle, inventory holding period, accounts receivable period and accounts payable period affect the profitability of a firm. Thus, Transaction cost theory was used as the theoretical foundation to determine the effect of working capital components on profitability of SMEs.

### 2.3 Theoretical Framework

The study is anchored on three theories, namely, pecking-order theory, cash conversion cycle and transaction cost theory as presented in Figure 2.1.

**Figure 2.1.**

#### *Theoretical Framework*



Source: Author (2022)

### 2.4 Empirical review of WCM practices and profitability of SMEs

#### 2.4.1 Cash Conversion Cycle and Profitability of SMEs

The term refers to the amount of time money is kept in working capital. Gill et al. (2012) define the CCC as the time it takes for a firm's expenses to be realized from the sale of products. Shortening the inventory conversion period, which can be accomplished by processing and selling commodities quickly, can cut the CCC in half. The CCC can also be reduced by reducing the duration of receivables, which can be accomplished by hastening the return of sales by creditors (Vural et al., 2012).

Linh et al. (2018) reasoned that the moment CCC affects the business in a negative manner, CCC shortens and doesn't have much impact on operations, hence boosting profit since as the CCC grows longer, so does the demand for external funding, resulting in higher financing

costs. According to Gill et al. (2012), a company's WCM is crucial to determining its profitability. Specifically, they demonstrated that CCC is negatively linked to strong profits implying that longer CCC periods decreases returns.

CCC represents a standard measure of WCM and it spans disbursement of cash and collection of the same. By approximation of inventory conversion period as well as RCP minus PCP, CCC can be obtained. With effective cash management practices, profitability as well as market value are enhanced. The reduction of cash operating cycle thus significantly enhances the performance of the firm. Plenty of studies exist that have attempted to establish and offer alternative explanations to CCC (Linh et al., 2018).

For instance, a study by Brigham and Houston (2012) explored the corporate cash holdings among SMEs and the results indicated that SMEs that have more liquid assets show higher propensity to reduce their cash levels. This was explained by the fact that the assets are an alternative to cash whereby the SMEs that have maintained a greater percentage of short-term debt show tendency of holding more cash.

Another study by Ruiz- Fernández (2020) indicated that an improvement in the efficiency of WCM among 13,287 SMEs in Spain sped up the process of transferring current assets into cash. The existing literature has further indicated that firms that are able to lower the inventories as well as accounts receivable demonstrate ability to accelerate their CCC. The study was conducted in Spain which is outside Kenya. The study therefore reflects contextual knowledge gaps. Furthermore, the focus was not on SMEs. This therefore presented a need to conduct this study focusing on SME in Kenya, specifically Makueni County. Sensini and Vazquez (2021) examined the influence of WCM on profitability and showed that reduction in number of days of inventory as well as accounts receivable gives managers the opportunity

for value creation. The study also showed that CCC was a significant determinant of the gross operating profits of these firms.

In the United States of America (USA), Gill et al. (2010) indicated that CCC indeed affected the performance of the firms positively and significantly as well. The study was conducted in USA which is outside Kenya. The study therefore reflects contextual knowledge gaps. Furthermore, the focus was not on SMEs. This therefore presented a need to conduct this study focusing on small and medium enterprises in Kenya, specifically Makueni County. Similarly, although with the focus on SMEs in Sweden, Yazdanfar et al. (2014) similarly used secondary data and established that CCC can have a significant improvement on performance of the SMEs.

In Washington, Upadhyay et al. (2015) established whether CCC was a worthy determinant of firms profits for the firms in the health sector with a focus on public hospitals in the State of Washington. Using secondary data and fixed panel regression analysis, the study confirmed that indeed, CCC can be used to enhance the performance of the public hospitals in Washington. The study was conducted in USA which is outside Kenya. The study therefore reflects contextual knowledge gaps. Furthermore, the focus was not on SMEs. This therefore presented a need to conduct this study focusing on small and medium enterprises in Kenya, specifically Makueni County.

Farhan et al. (2021) interrogated whether CCC can be used to enhance the performance of firms based in India given board composition. Through a panel focus of 82 firms in 10-year period, the study performed Gaussian Mixture Model (GMM) analysis to find out that the longer the CCC duration, the lower the returns realized from the same thus, it was of supreme importance and urgency to rework towards reducing the CCC duration.

In the same context of India, Marisetty and Madasu (2020) similarly focused on the same theme but the study narrowed down to small SMEs. The time period also adjusted to 20 years up to 2020. The study didn't moderate nor control for firm size as was the other study and similar findings were realized. It was proved that that indeed the longer the CCC duration, the lower the returns realized.

#### **2.4.2 Inventory Holding Period and Profitability of SMEs**

Inventory can refer to any stock be it work in progress or finished goods awaiting delivery as reasoned by Gill et al. (2012). Because inventory is such a large part of working capital, it necessitates a significant amount of investment. The majority of firms fight to keep inventory levels below acceptable limits in order to avoid substantial asset value losses and increase earnings (Brigham & Davis, 2010).

When a corporation utilizes less inventory to support its sales, its return on assets and asset turnover rise. Fast inventory turnover, according to Brigham and Davis (2010), also serves to decrease the probability of inefficient price concessions. Mansoor et al. (2012) argued that inventory conversion period basically means how long the firm will take to convert its inventory into finished products for sale.

It is a better method to indicate how efficient an inventory management practice is. A lower inventory turnover ratio indicates that a firm has more inventory or its sales are deprived (Ruichao, 2013). According to Brigham and Davis, (2010), permanent financing measures such as the use of equity and debts helps to finance the current assets of a firm such as the fluctuating, permanent or non-current assets.

Because of the over-reliance on short-term capital, the company receives a lower return when it is completed. Because it lies halfway between the two extremes, the moderate policy is the

most recommended. However, according to Ruichao (2013), a corporation can adopt a moderate working capital financing policy in which permanent finance, such as debts and equity, are the most suitable for financing long term assets. Ruichao (2013) further showed that regulating inventory as a unit is slower than raw material and finished products which are both components of inventory for the purpose of attaining realistic levels. The study was conducted in Europe which is outside Kenya. The study therefore reflects contextual knowledge gaps. Furthermore, the focus was not on SMEs.

This therefore presented a need to conduct this study focusing on small and medium enterprises in Kenya, specifically Makueni County. In concurring with the results of that study, AutuKaite and Molay (2011) established that order quantity and just-in-time inventories provide the methods for inventory management. Similarly, by reducing the duration of inventory conversion, sales would reduce since the inventory costs rise steadily.

According to Agyei et al. (2020), mismanagement of inventory eventually results to holding excess capital at the cost of more profitable processes. Firms with a poor inventory management will affect their profits in the long-term with a significant reduction in the firm's chances of survival as well. According to Bagh et al. (2016) therefore, there is a significant attainment of optimal inventory by firms that have effective inventory management mechanisms that those that do not resulting to an improvement in their profits. Bagh et al. (2016) further showed that WCM is directly affected by the size of inventory which ultimately affects the level of profitability of the firm.

Nteere (2014) looked at the impact of WCM with a narrow focus in in the hospitality industry. The study's goal was to determine how the CCC and the amount of inventory on hand in Kenya impacted hotel profitability. The study used secondary data collected on a

five-year period among 5-Star Nairobi-based hotels. It was surprisingly demonstrated that in this category of context, WCM had no significant impact.

Using secondary data, Macharia (2012) investigated how WCM affects the performance of publicly traded enterprises. Inventory conversion and manufacturing firm profitability in Kenya are favorably and strongly associated, according to the findings of the study. Luchinga (2014) investigated the profitability of agricultural enterprises that are listed on the NSE, as well as its relationship WCM practices. The study employed both descriptive and quantitative research methods. It was established that ITP, CCC and APP were linked to negatively impact on the performance of the firms.

In India, Chalmers et al. (2020) while focusing on SMEs similarly demonstrated that accounts receivables deteriorate profits when they are on the higher side. On the contrary, accounts payables as well as inventory are associated with an improvement. The validity of our findings was validated by the robustness tests and the same findings were ascertained. The study was however conducted in India which leads to contextual gaps. In addition, using data from Malaysian SMEs, Huan and Huy (2020) showed the structure of the relationship between various components of WCM and its profits trends. It was found that managers of Malaysian SMEs can improve profitability by holding a large amount of inventory, offering more trade credit to customers, and lengthening the CCC.

### **2.4.3 Accounts Receivable Collection Period and Profitability of SMEs**

According to Attari and Raza (2012), the accounts receivable period is the amount of time it takes for a company to sell on credit before receiving payment. This usually entails managing both the credit that the company anticipates from its customers and the receivables. Good



credit criteria, according to San and Heng (2011), enable improved credit and receivables management.

According to Mathuva (2015), a tougher credit standard reduces accounts receivable investment, lowering sales and profit. Michalski (2012) defines accounts receivable as money owed to a business after it has sold items or rendered services. Mathuva (2015) argued that the average collection duration equals the ratio of accounts receivable to average daily credit sales. Higher average collection periods put a company's cash flow operations in jeopardy by reducing the amount of cash available for investment. It's feasible that a company won't be able to run its operations on a daily basis (Mekonnen, 2011). Three unique characteristics define credit based on the argument by Pandey (2014) and it includes the risk and the worthiness to pay. The future is the third quality. A collecting time is required to make future monetary payments, according to (Tokarski et al. 2015).

Firms frequently use a trade credit providing approach to improve their sales, which also leads to the extension of their commercial operations. The creation of an effective trade credit policy, as well as the implementation of good receivables management and the reduction of collection times, leads to a rise in a company's customer base, which in turn boosts profitability. When these activities are carried out properly, the firm's value optimization improves (Afrifa & Tingbani, 2018).

Similarly, as a result of increased sales and market share, businesses report increased profitability. As a result of seeking an appropriate amount of accounts receivable, these businesses report increased results (Owele & Makokeyo, 2015). When the collecting time is longer, it affects the profitability in a negative way since the business will lack cash to operate with.

Padachi (2016) revealed that the relationship between profitability and average collection duration in Mauritius industrial enterprises was negative and insignificant in a study of WCM practices in Mauritius. Padachi (2016) found that in a sample of 58 small enterprises, the relationship between profitability and average collection period in Mauritius industrial firms was negative and insignificant. The research was carried out in Mauritius, which is a small island nation off the coast of Kenya. As a result, the study highlights knowledge gaps in the context. In addition, the focus was not on small and medium-sized businesses. As a result, research focused on small and medium businesses in Kenya, specifically Makeni County, was necessary.

Afza and Nazir (2019) looked into the connection between a company's profitability and its receivables management processes. The study looked at how receivables management affects performance. A negative association was discovered between business profitability and receivables investment and financing policies, according to the research. The research was carried out outside of Kenya, in Pakistan. As a result, the study highlights knowledge gaps in the context. In addition, the focus was not on small and medium-sized businesses. As a result, research focused on small and medium businesses in Kenya, specifically Makeni County, was necessary.

Waweru (2011) on the other hand established whether the value of firms was determined by its accounts receivable practices. The investigation focused on 22 NSE-listed firms. The Accounts Receivable Period (ARP) and the value of the company have a negative association, according to the regression analysis. On the other hand, the results of a variety of receivables management methods were mixed. In Argentina, Sensini and Vazquez (2021) through a focus of 326 SMEs, provided evidence that longer ARP were detrimental to business returns.

Braimah et al. (2021) looked into the relationship between working capital management and SME profitability in Ghana. From 2007 to 2016, 366 small businesses provided data for this study, which was conducted over a ten-year span. Moment estimation was used using a Generalized Methodology (GMM). According to the study, there was a link between the time it took to pay for a deal and profitability and its nature was inverse.

#### **2.4.4 Accounts Payable Period and profitability of SMEs**

According to Ahmad et al. (2014), the average payment length is the time it takes a corporation to buy labor and supplies in cash. Delaying bill payment in account payables is critical for working capital management since it offers the organization with a low-cost stream of cash. According to Ruichao (2013), if early payment discounts are offered, the business may suffer as a result of the opportunity cost of keeping high account payables.

Barak and Modarres (2015) demonstrated the accounts payable period was a good practice in improving firm profits suggesting that if the number of days accounts payable increases by one day, profitability improves as well. Some businesses defer payments to suppliers in order to gain access to better products, reduced costs, and a more flexible finance source. However, in other situations, deferring payments might be harmful to the business, particularly when there is a discount for paying early (Naimulbari, 2012).

Sensini and Vazquez (2021) argued that attainment of short bank financing limit compels SMEs to settle their trade credit. This outcome was found to be a consequence of lack of effective credit management mechanisms. The study was however conducted in the UK which is outside Kenya. The study therefore reflects contextual knowledge gaps. Furthermore, the focus was not on SMEs. This therefore presented a need to conduct this study focusing on small and medium enterprises in Kenya, specifically Makueni County.

Gorondutse et al. (2017) showed that firms that are registering low profitability have the propensity to extend their accounts payable. The study was conducted in Belgium which is outside Kenya. The study therefore reflects contextual knowledge gaps. Furthermore, the focus was not on SMEs. This therefore presented a need to conduct this study focusing on SME in Kenya, specifically Makueni County.

A study that sampled 2,123 non-financial firms in Japan by Nobanee and AlHajjar (2019) for the period 1990-2004 showed that there is an improvement in profitability following extension of payables postponement duration. However, regardless of the effectiveness of this practice, in the long-term the reputation of the firm is compromised which results to adverse effects on the firm's profitability. The study was conducted in Japan which is outside Kenya. The study therefore reflects contextual knowledge gaps. Furthermore, the focus was not on SMEs. This therefore presented a need to conduct this study focusing on small and medium enterprises in Kenya, specifically Makueni County.

Using secondary data on firms listed at the NSE, Kithii (2018) established whether WCM and profitability were significantly related. By focusing on data spanning 2001 – 2006, panel data methods were adopted to establish that average payment period was linked to an improvement in performance of the firm. On the other hand, Gakure et al. (2012) sampled fifteen manufacturing firms and established how the WCM affected their performance captured in terms of profits.

It was established that while some of the investigated practices had a negative effect, some had a positive effect on performance. Longer payment period was linked to negative association with performance. The CCC, on the other hand, can be employed to increase performance. In Pakistan, Gul and Khan (2013) related working capital management to

company profitability, with a particular focus on small and medium businesses. After focusing on a number of WCM practices, the findings indicated that average payment period positively affected the performance of the SMEs in Pakistan. The study was conducted in Pakistan which is outside Kenya. The study therefore reflects contextual knowledge gaps. Furthermore, the focus was not on SMEs. This therefore presented a need to conduct this study focusing on small and medium enterprises in Kenya, specifically Makueni County.

Fernandez et al. (2020) interrogated whether WCM affected the profitability of Spanish firms with a focus on 44 of such firms. The empirical research shows that CCC have a negative impact on firm profitability, implying that cheese-making businesses should reduce their inventory levels. DPO also has a negative relationship with organizational profitability, according to empirical study. The factors that determine profitability in Albanian SMEs were explored by Barbullushi and Kiri (2020). ROE was the study's dependent variable. To separate independent variables into two groups, internal and external indicators were used. Internal variables included working capital measures as well as firm size and the country-specific variables were Gross Domestic Product (GDP) growth and ease of doing business. According to the studies, working capital, as measured by CCC, has no consequence on business profitability, despite other factors such as days accounts payable, days inventory and receivables collection period showed no significant impact.

## **2.5 Summary of Literature Review and Research Gaps**

The existing literature reviewed indicated that WCM is crucial in all processes that involve the running of both large and small organisations. Most research on WCM practice has been done in the manufacturing sector and large firms. The management of current assets and liabilities is as crucial for both SMEs and large organisations despite existing literature mostly focusing on the latter. The fact that SMEs lack the capacity to obtain external long-

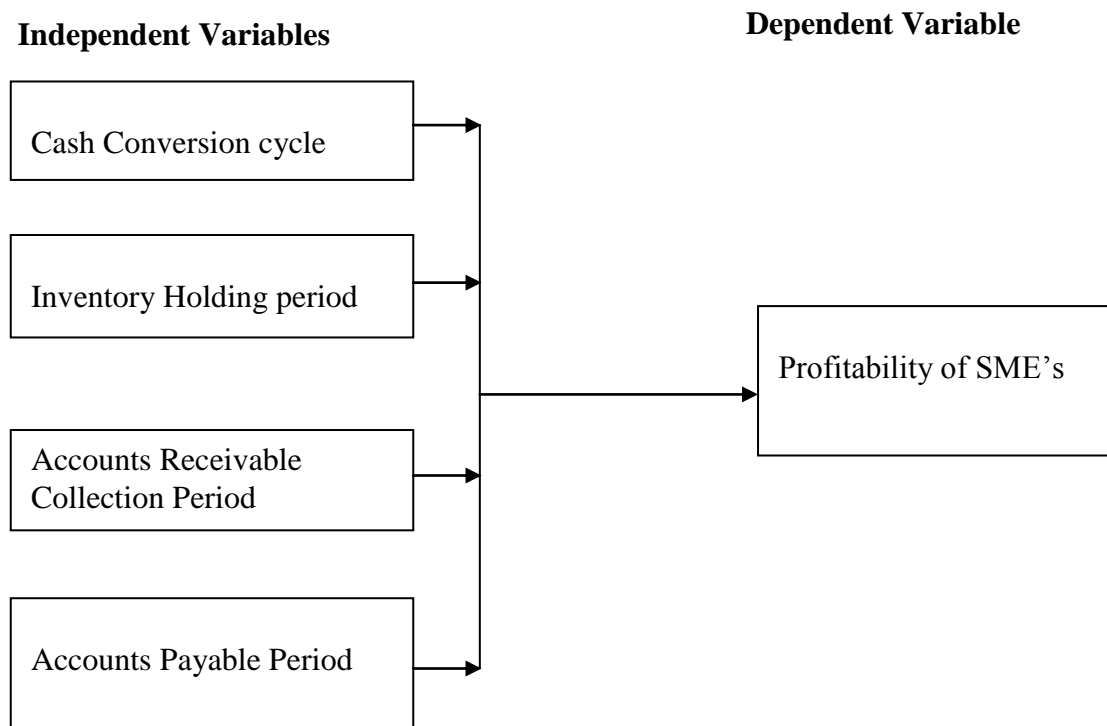
term financing from financial institutions makes them utterly reliant upon current assets and liabilities as the chief source of financing. The existing literature has also presented differing outcomes as regards WCM practices and how these practices influence profitability of firms. This is well illustrated in the difference of the findings of studies with some pointing at the need for shorter CCC for the purpose of improving profitability yet other studies imply the opposite. hence, there was hence a need to study the Kenyan SME sector.

## 2.6 Conceptual Framework

In this study, WCM practices were identified as the independent variables, namely, cash conversion cycle, inventory holding period, accounts receivable and accounts payable. The study dependent variable was the profitability. The conceptual framework in Figure 2.2 depicts the relationship between the study variables.

**Figure 2.2.**

### *Conceptual Framework*

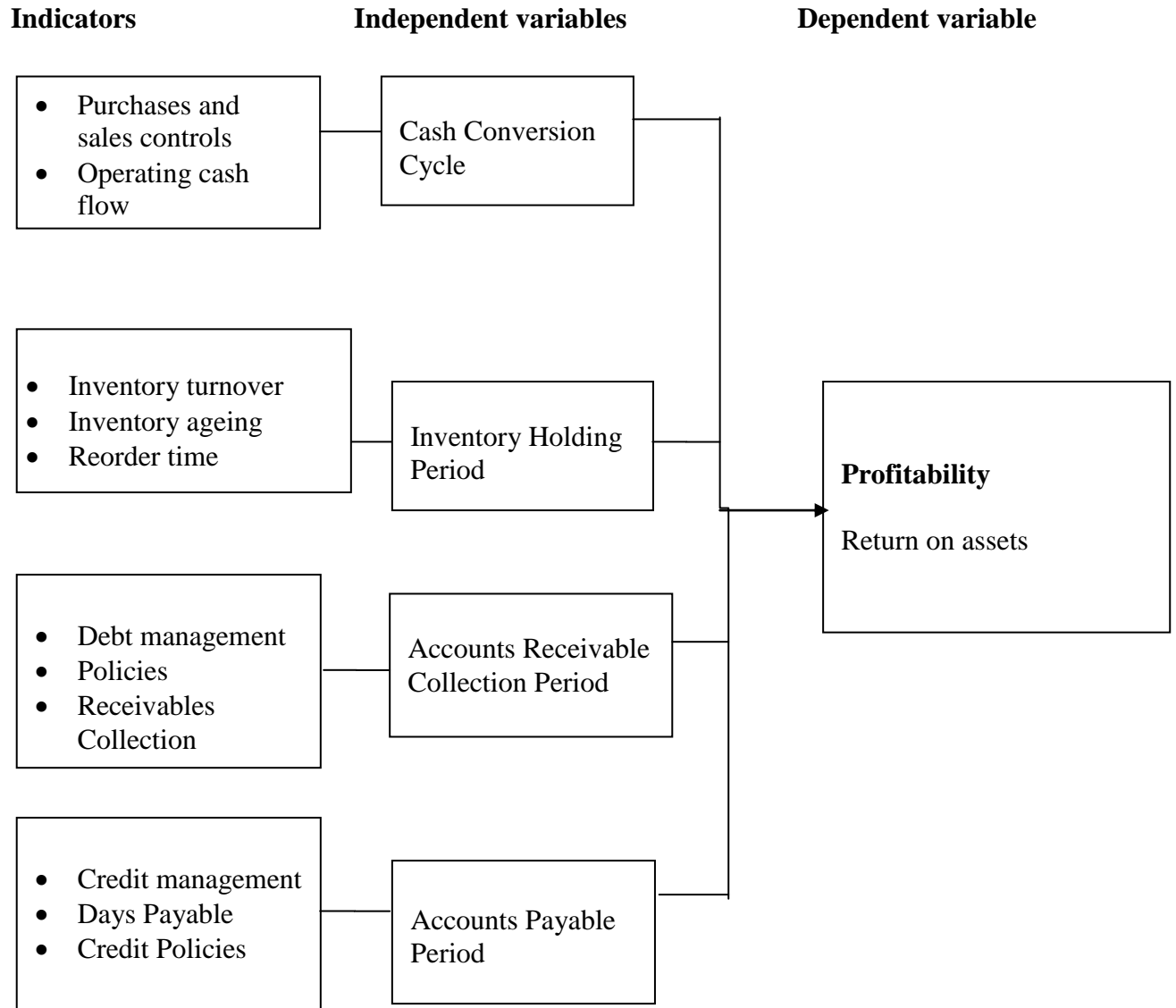


Source: Author (2022)

## 2.7 Operational Framework

Figure 2.3.

### *Operational Framework*



Source: Author (2022)

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

The emphasis of this chapter is on the methodologies applied in answering the objectives of the study. These methodologies include research design, target population, sample size and sampling procedures, reliability and validity, data analysis methods, research instrument, data collection instrument, presentation, reliability, and validity. Finally, ethical considerations are discussed.

#### **3.2 Research Design**

The study implemented descriptive survey research design. According to Mohajan (2018), descriptive design is useful in collecting information about people's attitude, opinions, or habits. Snyder (2019) also assert that descriptive survey outlines detailed specific methods and tools for data collection to answer questions of the study and the problem. This design was found relevant for this study because the researcher sought to find out the effect of working capital management practices on profitability of small and medium enterprises in Makueni County, Kenya.

#### **3.3 Target Population**

The study targets one manager from each of the 245 small and medium enterprises licensed to operate in Wote town, Makueni County as of December 2020 whose details are captured by KNBS (2019). Target population is defined as a total collection of elements from which the sample of the study is obtained (Orngreen & Levinsen, 2017; Zangirolami-Raimundo et al., 2018). The study targeted licensed SMEs in Makueni county which according to KNBS (2019), there are a total of 629 small and medium enterprises licensed in Makueni County. Of this, 78%, that is 245 operate in Wote town. This makes Wote town a viable place to study



current work. Moreover, Wote also presents the rural-urban setting and unique challenges. Besides, there was a need to fill the contextual research gaps from other studies.

The SMEs are distributed across the agriculture, forestry and fishing, manufacturing, gas supply, water supply, sewerage, waste management and remediation activities, construction, wholesale and retail trade, repair of motor vehicles and motorcycles, transportation and storage, accommodation and food service activities, information and communication, financial and insurance activities, real estate activities, professional, scientific and technical activities, administrative and support service activities, education, human health and social work activities, arts, entertainment and recreation as well as other service activities. The unit of observation was the SME owners.

### **3.4 Sample size and sampling procedure**

According to Orngreen and Levinsen (2017), there is need to select a few elements that are illustrative of the target population when the researcher is faced with the constraints of time and financial resources. According to Babii (2020), a sample is defined as an assembly of elements drawn from the target population for the purpose of representation. Kumar (2018) and Yamane (1957) provide a formula that can be used to determine a sample whose population size is above 200. Accordingly, to determine the sample size of SMEs in Wote town in Makueni, the said formula was adopted as follows:

$$n = N / (1 + Ne^2)$$

Where N is the target population set at 245, n is the sample size, e is the error term set at 10%. Replacing the values gave a sample size of 71 hence the study targeted 71 managers drawn from 71 SMEs licensed to operate in Wote town. Thereafter, a purposive sampling was used to identify the 71 SMEs. These SMEs were distributed across the agriculture, forestry

and fishing, manufacturing, gas supply, water supply, sewerage, waste management and remediation activities, construction, wholesale and retail trade, repair of motor vehicles and motorcycles, transportation and storage, accommodation and food service activities, information and communication, financial and insurance activities, real estate activities, professional, scientific and technical activities, administrative and support service activities, education, human health and social work activities, arts, entertainment and recreation as well as other service activities.

### **3.5 Research instrument**

To establish the effect of working capital management practices on performance of SMEs in Wote town, Makueni County, a self-constructed questionnaire was applied. The use of questionnaire was necessary since it is inexpensive, easy to analyze, and highly discreet and less bias. The questionnaires had both closed-ended and open-ended items. Closed ended questionnaires formed the bulk of the questions, making it easy to analyze as well as helpful in curbing social desirability bias. Open ended questions were limited but offered greater flexibility. The closed-ended sections of the questionnaire were based on a 5-point Likert scale that gave respondents opportunity to make definite choices and not propensity for neutral responses. During the data collection period, adherence to safety protocol guidelines issued by the World Health Organization and Ministry of health such as social distancing, wearing of masks, and sanitizing were observed.

#### **3.5.1 Reliability and Validity**

To establish and adjust any weaknesses in the questionnaire, it was pilot tested in five enterprises. The respondents that formed part of pilot study were exempted from the main study. The result of pilot study established that the instrument was both reliable and valid.

Prior to the main study, the questionnaire was framed to capture the descriptive survey research design and aligned to each of the specific objectives. This was to enhance the reliability and validity of the instrument for the main study (Cuervo- Cazorra et al., 2017). Further, to enhance reliability and internal consistency of the questionnaire, Cronbach Alpha statistics was obtained. The threshold for accepting reliability is 0.7 but the researcher established Cronbach Alpha of 0.72 which is above the required threshold of 0.7. Therefore, the questionnaire was accepted as reliable. The findings for reliability test are attached as Appendix III.

### **3.6 Data Analysis Methods**

According to Cuervo- Cazorra et al. (2017) data analysis is the adoption of a detailed process to manipulate the contents of the data collected to establish constant patterns as well as creating a brief account of the relevant specifics unearthed during examination. The data collected from questionnaire were edited, coded, and entered in the computer for analysis with the aid of Statistical Package for Social Sciences (SPSS v24) computer software to enhance accurate and faster analysis. Quantitative data from the questionnaires were analyzed using descriptive statistics such as frequencies and percentages and presented using charts, tables, and graphs. Multiple regression was used to ascertain the effect of working capital management practices on profitability of SMEs. The regression analysis model of the study was framed as follows to capture the association between the specific WCM practices and profitability:

$$PAT = \beta_0 + \beta_1CCC_1 + \beta_2IHP_2 + \beta_3ARP_3 + \beta_4APP_4 + \pi$$

Where,

PAT = Profitability of SMEs

$\beta_0$  = Intercept,

$CCC_1$  = Cash conversion cycle

$IHP_2$  = Inventory holding period

$ARP_3$  = Account receivable collection period

$APP_4$  = Accounts payable period

$\pi$  = Error term normally distributed about the mean of zero

$\beta_1 \dots \beta_4$  are coefficients of the independent variables

### **3.7 Ethical considerations**

The study was carried out with an ethical background in mind. The researcher upheld high levels of objectivity throughout the process and citations were acknowledged by previous authors. The responses were treated with the strictest confidentiality and used solely for the purposes of the study. Further, informed consent was observed in requesting the subjects to participate voluntarily. Authority to conduct the research was also sought and received from the Kenya Methodist University and NACOSTI (Appendix V).

## CHAPTER FOUR

### RESEARCH FINDINGS AND DISCUSSION

#### 4.1 Introduction

This chapter presents data analysis, results and discussions as per the study objectives. Descriptive statistics was presented using means and standard deviation. The study further presented correlation and regression analyses with brief discussions of results. In doing so, the chapter establishes the effect of WCM practices on the profitability of SMEs in Makueni County.

#### 4.2 Response Rate

A total of 71 SMEs in Makueni County were targeted out of which 43 questionnaires were properly responded to as shown in Table 4.1.

**Table 4.1.**

*Response Rate*

	Frequency	Percentage
Response	43	60
Non-Response	28	40
<b>Total</b>	<b>71</b>	<b>100</b>

This gave 60% as the response rate. This is regarded a good representation according to assertions by Snyder (2019) that a response rate of 60% and above is very good to proceed with statistical analysis. The recorded high response was because the researcher made several follow ups with the aim of clarifying any questions that prompted the respondent and also enhanced the response rate (Mohajan, 2018).

### 4.3 Respondent's Background Information

This sub-section presented findings on the general characteristics of the respondents with regard to their gender, age, position in the SME, education level and how long the business had existed, number of employees and the type of enterprise. The results on each of these characteristics are presented in tables using frequency distributions as well as percentages.

#### 4.3.1 Respondent's Gender

The study established the gender of the respondents (male or female).

**Table 4.2.**

*Respondents Gender*

<b>Gender</b>	<b>Frequency</b>	<b>Percent</b>
Male	21	48.8
Female	22	51.2

The findings in table 4.2 indicates that females made 51.2% of the response and therefore the majority while male were only 48.8%. These statistics however, do not affect the findings since it indicated diversity in the response and representativeness of both genders in the study. The findings are consistent with the Micro Small and Medium Enterprises report 2016 that female dominate the SMEs in Kenya.

### 4.3.2 Respondent's Age

Table 4.3 indicates the age spread of the respondents.

**Table 4.3.**

*Respondents Age*

<b>Age Bracket</b>	<b>Frequency</b>	<b>Percent</b>
Under 25	10	23.3
26-40	17	39.5
41-60	13	30.2
Over 60	3	7
<b>Total</b>	<b>43</b>	<b>100</b>

Table 4.3 shows that most respondents were aged between 26 and 40 years were the majority followed by those aged between 41 and 60 years. However, only 23.3% were aged below 25 years. The results of the study concur with the argument by Kagzi and Guha (2018) of the existence of age peaks associated with entrepreneurship which are late twenties and mid-forties. Further, these results are also in tandem with those of Endraswati (2018) as they established the age of 25-40 years ideal for entrepreneurship.

### 4.3.3 Respondent's Position

The respondent's position with regard to the firm was also established as per the results shown in Table 4.4.

**Table 4.4.**

#### *Respondents Position*

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<b>Position</b>	<b>Frequency</b>	<b>Percent</b>
Proprietor	34	79
Senior Management	9	21

---

It can be shown that 79% were proprietors, 21% were senior management and 20.9% were supervisory. Since the study targeted especially the business owners, this representation is good enough to warrant conclusions from the data.

### 4.3.4 Respondent's Highest Level of Education

Table 4.5 below shows the description of the education level. It was distributed from primary, secondary to tertiary.

**Table 4.5.**

#### *Respondent's Highest Level of Education*

---

<b>Highest Level of Education</b>	<b>Frequency</b>	<b>Percent</b>
Primary	6	14
Secondary	14	32.6
Tertiary	23	53.5

---



It shows that 53.5% of the respondents who represent majority had tertiary level of education, 32.6% were secondary school educated while only 14% had primary level of education. The findings agree with Micro Small and Medium Enterprises Survey (2015) which showed that not less than 45% of new entrepreneurial ventures are run by individuals without the requisite skills to start and run them. This also implied that their survival in addition to growth is adversely affected by lack of adequate skills. This is justified by 46.6% of the respondents having secondary and primary level of education.

#### **4.3.5 Age of the Enterprise**

The age of the enterprise that participated in the survey was also determined. The results are shown in Table 4.6 below.

**Table 4.6.**

*Age of the Enterprise*

<b>Age of the Enterprise</b>	<b>Frequency</b>	<b>Percent</b>
Below 5 Years	12	27.9
6 to 8 Years	16	37.2
9- 10 Years	9	20.9
Over 10 Years	6	14
<b>Total</b>	<b>43</b>	<b>100</b>

It was established that the bulk of the enterprises had operated for a period between 6 and 8 years, 20.9% had operated for a period between 9 and 10 years while only 27.9% had operated for a period below 5 years. The implication in this case is that extended existence in business is enough to have developed structures to manage working capital. These findings

are not consistent with Sifunjo (2012) who argued that most SMEs in Kenya fail after just three years of operation.

#### 4.3.6 Number of Employees in the Enterprise

The study further determined the number of employees in the enterprises surveyed, with the results as shown in Table 4.7.

**Table 4.7.**

*Number of Employees in the Enterprises*

<b>Number of Employees in the Enterprises</b>	<b>Frequency</b>	<b>Percent</b>
1 to 5	18	41.9
6 to 15	16	37.2
16 to 40	4	9.3
Above 41	5	11.6
<b>Total</b>	<b>43</b>	<b>100</b>

The findings were that majority of the enterprises, 41.9%, had less than 5 employees. Those that had between 6 and 15 employees were 37.2% while only 11.6% had above 41 employees. The findings imply that majority of SMEs in Makueni employ less than 5 people.

#### 4.4 Descriptive Analysis

The description of the study Likert-scales is presented in this section. Here, there is the mean and standard deviation used to describe the responses per objective as well as the dependent variable.

#### 4.4.1 Cash Conversion Cycle

The study determined the effect of CCC on the profitability of SMEs in Makueni County.

The respondents were asked to rate statements on CCC as shown in Table 4.8.

**Table 4.8.**

##### *Descriptive Statistics of CCC*

<b>Statement</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>Mean</b>	<b>SD</b>
The duration of CCC has a substantial influence on the profitability.	0.00%	4.70%	4.70%	39.50%	51.20%	4.37	0.79
Shorter CCC are preferable	0.00%	4.70%	9.30%	39.50%	46.50%	4.28	0.83
Each SME ought to fix its standard level of CCC	2.30%	2.30%	4.70%	60.50%	30.20%	4.14	0.8
Lower-level staff are responsible for management of CCC	58.10%	20.90%	4.70%	16.30%	0.00%	1.79	1.12
<b>Average</b>						<b>3.65</b>	<b>0.89</b>

The results show, 51.2% of the respondents who were the majority in this case strongly agreed that the duration of CCC has a substantial influence on the profitability while 39.5% agreed on the same. Similarly, 46.5% of the respondents strongly agreed that shorter CCCs are better than longer ones while 39.5% agreed on the statement. Furthermore, 30.2% of the respondents strongly agreed that each SME ought to fix its standard level of CCC while 60.5% agreed on the same. Lastly, 58.1%, of respondents strongly disagreed that lower-level staff are responsible for management of CCC. The average standard deviation of 0.89 indicates that similar views were held by majority of the respondents since there is less variation in the responses.

#### 4.4.2 Inventory Holding Period

The study also aimed to establish the effect of IHP on the profitability of SMEs in Makueni County. The respondents rated statements on a scale of 1 to 5. Table 4.9 shown below shows the results.

**Table 4.9.***Descriptive Statistics of Inventory Holding Period*

<b>Statement</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>Mean</b>	<b>SD</b>
The duration of IHP has a significant influence on the profitability of SMEs.	0.00%	7.00%	0.00%	39.50%	53.50%	4.4	0.82
In order to maintain adequate stocks, there is need for the firms to set EOQ	0.00%	0.00%	4.70%	48.80%	46.50%	4.42	0.59
Profitability is negatively affected by extended IHP	4.70%	4.70%	2.30%	41.90%	46.50%	4.21	1.04
Poor inventory management will affect the long-term profitability and firm's survival chances.	2.30%	4.70%	9.30%	34.90%	48.80%	4.23	0.97
<b>Average</b>						<b>4.31</b>	<b>0.85</b>

In this case, 53.5% and 39.5% of the respondents strongly agreed and agreed respectively that the duration of IHP has a significant influence on the profitability of SMEs. Similarly, 48.8% of the respondents who were the majority in this case agreed that in order to maintain adequate stocks, there is need for the firms to set EOQ while 46.5% strongly agreed on the statement. The findings further showed that 48.8% of the respondents strongly agreed that profitability is negatively affected by extended IHP. Similarly, 41.9% of the respondents agreed on the statements. Lastly the findings showed that 48.8% strongly agreed that poor inventory management will affect the long-term profitability and firm's survival chances. Similarly, 34.9% of the respondents agreed on the statement. The average standard deviation of 0.85 indicates that similar views were held by majority of the respondents since there is less variation in the responses.

#### 4.4.3 Accounts Receivables Collection Period

Further, the study examined the strategies the SMEs use in the administration of accounts receivables and how they affect profitability of SMEs in Makueni County. The respondents rated statements on a scale of 1 to 5. The results are as shown in Table 4.10.

**Table 4.10.**

##### *Descriptive Statistics of Accounts Receivables*

<b>Statement</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>Mean</b>	<b>SD</b>
Provision of trade credit is a strategy to increase sales and expand a business	9.30%	30.20%	2.30%	25.60%	32.60%	3.42	1.45
A short time period should be granted to debtors	0.00%	20.90%	0.00%	44.20%	34.90%	3.93	1.1
Increased levels of accounts receivables increase sales and increased profitability	0.00%	20.90%	11.60%	41.90%	25.60%	3.72	1.08
SME profitability is significantly affected by the length of ARP.	2.30%	7.00%	14.00%	41.90%	34.90%	4.00	1.00
<b>Average</b>						<b>3.77</b>	<b>1.16</b>

The results indicate that 32.6% majority respondent strongly agreed that provision of trade credit is a strategy to increase sales and expand a business while 25.6% agreed on the same. Further, 44.2% strongly agreed that through provision of short-term credit, debt collection period is reduced while 34.9% strongly agreed on the statement. It was also established that 41.9% of the respondents agreed that increased levels of accounts receivables increase sales and increased profitability while 25.6% strongly agreed on the same statement. The findings lastly showed that 41.9% of the respondents also agreed that SME profitability is significantly affected by the length of ARP while 34.9% strongly agreed on the statement. The average standard deviation of 1.16 implies similar views were held by majority of the respondents since there is less variation in the responses.

#### 4.4.4 Accounts Payable Period

The study finally determined influence of APP on the profitability of SMEs in Makueni County. In this case, respondents rated various statements on a scale of 1 to 5. The findings are as shown in Table 4.11.

**Table 4.11.**

##### *Descriptive Statistics of Accounts Payable Period*

<b>Statement</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>Mean</b>	<b>SD</b>
SME profitability is significantly affected by length of APP.	2.30%	9.30%	4.70%	51.20%	32.60%	4.02	0.99
Credit reputation of a company is occasionally affected by stretching payables deferral period.	2.30%	18.60%	4.70%	41.90%	32.60%	3.84	1.15
Firms should agree with suppliers to extent payment period.	0.00%	34.90%	4.70%	34.90%	25.60%	3.51	1.22
Credit discount benefits accrue as a result of effective policies for the management of creditors	0.00%	0.00%	7.00%	46.50%	46.50%	4.4	0.62
<b>Average</b>						<b>3.94</b>	<b>1.00</b>

The results indicated an agreement on the statement that SME profitability is significantly affected by length of APP. On the same note, 32.6% strongly agreed on the statement. A similar percentage strongly agreed that the credit reputation of a company is occasionally affected by stretching payables deferral period while 41.95 agreed on the same. Furthermore, the findings show that 34.9% of the respondents and 25.6% agreed and strongly agreed that there is need for the firm to bargain for extended credit repayment period. Lastly, 93% of the respondents agreed that credit discounts benefits accrue as a result of effective policies for the management of creditors. The average standard deviation of 1.00 indicates that similar views were held by majority of the respondents since there is less variation in the responses.

#### 4.4.5 Profitability in Small and Medium Enterprises

Profitability of the SMEs was the dependent variable of this study and respondents rated statements on it on a scale of 1 to 5. Table 4.12 shows the results.

**Table 4.12.**

##### *Descriptive Statistics of Profitability*

<b>Statement</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>Mean</b>	<b>SD</b>
External financing to the business is enhanced as a result of high percentage in profitability	2.30%	0.00%	20.90%	76.70%	4.72	0.59
Profitability is measured using ROE, Net profit margin and ROA	0.00%	23.30%	25.60%	51.20%	4.28	0.83
<b>Average</b>					<b>4.5</b>	<b>0.71</b>

Results showed that 76.7% of the respondents strongly agreed that external financing to the business is enhanced as a result of high percentage in profitability while 20.9% agreed. Furthermore, 51.2% of the respondents strongly agreed that profitability is measured using ROE, Net profit margin and ROA. A similar statement was agreed upon by 25.6% of the respondents. The average standard deviation of 0.71 indicates that similar views were held by majority of the respondents since there is less variation in the responses.

#### 4.5 Correlation Analysis

The association between CCC, inventory holding period, accounts receivables as well as accounts payable period and profitability of SMEs in Makueni County was established by a correlation analysis. A Pearson correlation was used. A positive value of Pearson correlation denotes a positive association. On the other hand, a negative Pearson correlation value denotes negative association. The findings were shown in Table 4.13.

**Table 4.13.***Correlation Analysis*

	CCC	IHP	ARP	APP	PAT
CCC	1				
IHP	0.435**	1			
ARP	-0.366*	-0.285	1		
APP	0.356*	0.535**	-0.199	1	
PAT	0.569**	0.614**	-0.639**	0.560**	1
N	43	43	43	43	43

\*\* Significance at the 0.01 level (2-tailed) ; \* Significance at the 0.05 level (2-tailed).

The findings indicate that CCC and profitability are positively and significantly associated ( $r = 0.569$ ,  $P\text{-value} = 0.000 < 0.05$ ) at 5% level of significance. This implies that an increase in CCC practices leads to an increase in profitability of SMEs significantly. The findings further showed that inventory-holding period has a positive and significant effect on profitability of SMEs ( $r = 0.614$ ,  $P\text{-value} = 0.000 < 0.05$ ) at 5% level of significance. This implies that an improvement in the inventory holding practices would significantly lead to an improvement in profitability of SMEs significantly.

Accounts receivable period and profitability of SMEs in Makueni are negatively and significantly associated ( $r = - 0.639$ ,  $P\text{-value} = 0.000 < 0.05$ ) at 5% level of significance. This means that higher accounts receivable periods are negatively related with profitability of SMEs in Makueni. Lastly, it was established that Accounts payable period has a positive and significant effect on profitability of SMEs in Makueni County ( $r = 0.560$ ,  $P\text{-value} = 0.000 < 0.05$ ) at 5% level of significance. This implies that an increase in the accounts payable period would significantly lead to an improvement in profitability of SMEs significantly.



## 4.6 Regression Analysis

To determine the association of WCM and SME profitability, the study carried out a multiple linear regression analysis. The model adopted shows the association between the various WCM practices and profitability of the SMEs. It denotes the linear association of WCM and profitability of the SMEs. The model summary results are as shown in Table 4.14.

**Table 4.14.**

### *Regression Model Summary*

<b>R</b>	<b>R Square</b>	<b>Adjusted</b>		<b>Durbin-Watson</b>
		<b>R Square</b>	<b>Std. Error of the Estimate</b>	
0.838	0.702	0.671	0.2937	1.627

Predictors: (Constant), CCC, IHP, ARP, APP  
 Dependent Variable: PAT

The results show that the four WCM practices jointly have a positive effect on profitability of SMEs in Makueni as shown by a positive Pearson correlation value (R) of 0.838. Furthermore, the findings show that up 70.2% of the variations in profitability of SMEs are accounted for by the four working capital management practices as shown by an R-square (coefficient of determination) value of 0.702. The adjusted R-square value of 0.671 shows that the model was a good fit.

Durbin Watson test was used to test for existence of autocorrelation. A value between 1 and 2 indicates absence of autocorrelation. Since the DW value was 1.627, which is between 1 and 2, it can be concluded that there was no problem of autocorrelation meaning that the assumptions of using an ordinary least square regression model were not violated. The regression results also showed that the regression model was fit (significance). Analysis of Variance (ANOVA) was used and the findings are presented in Table 4.16.

**Table 4.15.***ANOVA (Model Significance)*

	<b>Sum of Squares</b>	<b>df</b>	<b>Mean Square</b>	<b>F</b>	<b>Sig.</b>
Regression	7.723	4	1.931	22.386	0.000
Residual	3.277	38	0.086		
Total	11	42			

Dependent Variable: PAT  
Predictors: (Constant), CCC, IHP, ARP, APP

The results showed that the significance value was 0.000, < 0.05 meaning that the overall regression model linking working capital management to profitability was significant (fit). Hence, it could be relied upon to make conclusions on the relationship between the two variables. The study lastly established the model coefficients as highlighted in Table 4.17.

**Table 4.16.***Regression Model Coefficients*

	<b>B</b>	<b>Std. Error</b>	<b>Beta</b>	<b>t</b>	<b>Sig.</b>	<b>Tolerance</b>	<b>VIF</b>
(Constant)	3.131	0.673		4.653	0.000		
CCC	0.205	0.105	0.201	1.943	0.059	0.730	1.370
IHP	0.276	0.117	0.262	2.355	0.024	0.635	1.575
ARP	-0.423	0.093	-0.439	-4.559	0.000	0.846	1.182
APP	0.213	0.087	0.261	2.46	0.019	0.695	1.439

Dependent Variable: PAT

Before interpretation of the findings, a test for multicollinearity between the independent variables was established using the Variance Inflation Factor (VIF) method. One of the assumptions of using a regression model is that the independent variables should not suffer from multicollinearity (high correlations) since it affects the final results. A value less than 10 does not show presence of multicollinearity. Since the VIF values in Table 4.17 are less than

10, it shows that there was no problem of multicollinearity hence it was suitable to use a regression model in this study. It was established that there exists a positive significant effect of Cash Conversion Cycle on profitability of SMEs ( $B = 0.205$ ,  $P\text{-value} = 0.059 < 0.1$ ). The implication in this case is that an improvement in CCC practices involving purchases and sales controls, better operating cash flow management practices and bank collections practices, leads to an improvement in profitability of SMEs.

The findings are consistent with Linh et al. (2018) whose argument suggested that there is fast conversion of current assets to cash because of improved effectiveness in WCM with greater cash holding and profitability resulting from conversion of the balance average investments in stock as well as accounts receivable.

The findings further showed that Inventory Holding Period has a positive and significant effect on profitability of SMEs ( $B = 0.276$ ,  $P\text{-value} = 0.024 < 0.05$ ). The implication in this case is that an improvement in inventory turnover, inventory ageing period and reorder time will lead to a significant improvement in profitability of SMEs. The findings are consistent with Molay (2011) who indicated that inventory management improves performance and that reducing ICP improves stock out costs and consequently leads to loss of sales, deterioration in firm performance. The effect of Accounts Receivable Collection Period on profitability of SMEs in Makueni is negative and significant ( $B = -0.423$ ,  $P\text{-value} = 0.000 < 0.05$ ). The findings imply higher accounts receivable period negatively affects profitability of SMEs significantly. The findings are consistent with Mathuva (2015), who argued that having a sound credit policy, efficient receivables management and shorter creditor's collection period attracts new customers hence increasing the profitability of an organization and SMEs' value optimization. Lastly, it was established that Accounts Payable Period has a positive and significant effect on profitability of SMEs in Makueni County ( $B = 0.213$ ,  $P\text{-value} = 0.019 <$

0.05). The findings imply that an improvement in debtor days management, days Payable and credit policies, leads to an improvement in profitability of SMEs significantly. The findings are consistent with the results of Sensini and Vazquez (2021) that there is an improvement in profitability following extension of payables postponement duration.

#### **4.7 Qualitative Analysis**

The study asked open-ended questions on the study variables to seek more in depth information. On whether the respondents thought SMEs can successfully maintain a good CCC to improve profitability, majority of the respondents indicated that they maintain good cash conversion practices such as having shorter period as well as having a standard CCC, setting favorable prices to allow quick and faster selling of products and having prompt cash in point to reflect each payment.

On which inventory management systems, the respondents would recommend to other businesses to use, majority of the respondents from sampled respondents indicated better supplier relationship management, having par levels for each stock, use of IT to stock take, use of just in time practice, electronic inventory location and use of FIFO. On the question of what debt policies, the respondents use in their organization, majority of the respondents indicated that they pay bills on time, they settle debts within the allowable minimum credit period and that they offer minimum credit facilities for easier recollection, encouraging payments. The respondents were also asked to indicate how they would prefer to settle trade credit. Majority of the respondents indicated that they would prefer to settle within the shortest time.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Introduction**

The sections of this chapter include a summary of the findings particularly on descriptive, correlation in addition to regression analyses. The chapter further presents conclusions that are based on the findings, recommendations and areas for further studies.

#### **5.2 Summary of Findings**

The main objective of this study was to establish the effect of WCM practices on the profitability of SMEs in Makueni County. The study specifically examined the effect of CCC, IHP, ARP and APP on profitability of the firms. After collection of primary data through semi-structured questionnaires, it was analyzed through content, descriptive and inferential statistics. Generally, the study findings indicated that working capital management is an important determinant of profitability of SMEs. This is because up to 21.7% of the variations in profitability of SMEs is accounted for by the four working capital management practices. The subsection presented the findings per objective.

##### **5.2.1 Cash Conversion Cycle**

The first objective of the study was to determine the effect of Cash Conversion Cycle on the profitability of SMEs in Makueni County. The study findings indicated that there exists a positive relationship between Cash Conversion Cycle and profitability of SMEs. The findings imply that an increase in cash conversion practice increases the financial performance of small and medium enterprises in Makueni County.

### **5.2.2 Inventory Holding Period**

The second objective of the study was to establish the effect of inventory holding period on the profitability of SMEs in Makueni County. The study findings indicated that inventory holding period has a positive and significant effect on profitability of SMEs. The findings imply that an increase in inventory holding practices leads to a significant increase in performance of small and medium enterprises in Makueni County.

### **5.2.3 Accounts Receivables Collection Period**

The third objective of the study was to examine the strategies the SMEs use in the administration of accounts receivables and how they affect profitability of SMEs in Makueni County. The study findings indicated that the effect of accounts receivable period on profitability of SMEs in Makueni is negative and significant implying that account receivables affect profitability negatively and significantly. The findings imply that an increase in accounts receivables leads to a significant decrease in performance of small and medium enterprises in Makueni County.

### **5.2.4 Accounts Payable Period**

The fourth objective of the study was to determine the effect of accounts payable period on the profitability of SMEs in Makueni County. The findings indicated that accounts payable period has a positive and significant effect on profitability of SMEs in Makueni County. This implies that managing accounts payables improves profitability significantly. The findings imply that an increase in accounts payable period leads to a significant increase in performance of small and medium enterprises in Makueni County.

### **5.3 Conclusion**

The section presents the conclusion based on the study findings. The conclusions have been presented per objective. The inferential findings guided the formulation of the study conclusions.

#### **5.3.1 Cash Conversion Cycle**

The study concludes that Cash Conversion Cycle has a positive and significant effect on financial performance of SMEs. Cash conversion practices such as purchases and sales controls, better operating cash flow management practices and bank collections practices would significantly affect financial performance of SMEs.

#### **5.3.2 Inventory Holding**

The study concludes that inventory holding has a positive and significant effect on the financial performance of Small and medium enterprises in Makueni County. Inventory holding practices such as improvement in inventory turnover, inventory ageing period and less can increase financial performance of SMEs significantly.

#### **5.3.3 Accounts Receivables Collection Period**

The study concludes that accounts receivables period has a negative and huge effect on financial performance of small and medium enterprises in Makueni County. Longer accounts receivables period affect financial performance of SMEs negatively and in a significant manner.

#### **5.3.4 Accounts Payable Period**

The study concludes that accounts payable period has a positive and huge effect on the financial performance of small and medium enterprises in Makueni County. Holding payables longer would improve financial performance in a significant way.

## **5.4 Recommendations of the Study**

The section presents the recommendations of the study which is based on the findings and conclusions of the study. The section has presented the recommendations per variable. The beneficiaries of the study are the ones targeted by these recommendations. Generally, to the financial institutions, after understanding the effect of working capital management among the SME, there is a need to offer the SMEs training on effective working capital management practices before giving them a loan. To the regulator who is the government and policy makers, the findings can guide development of policies geared towards improvement of the SMEs sector since it is a key contributor to the GDP of the country. Specifically, the government should come up with training programmes that can improve the business management skills of the SME owners. To the small and medium enterprises, the study makes the following recommendations:

### **5.4.1 Cash Conversion Cycle**

Since the study findings indicated that Cash Conversion Cycle has a positive and significant effect on performance of small and medium enterprises in Makueni County, the study recommends that the small and medium enterprises should come up with practices that aim to enhance the CCC. How they should do this by having proper purchases and sales controls, better operating cash flow management practices and bank collections practices.

### **5.4.2 Inventory Holding Period**

Since the findings indicated that inventory holding has a positive and significant effect on the performance of the small and medium enterprises in Makueni, the study recommends that the small and medium enterprises should aim to improve their inventory management practices more. To do that, there is a need to improve on such practices like inventory turnover



management; close monitoring of the inventory ageing period and having working reorder times.

#### **5.4.3 Accounts Receivable Collection Period**

Due to the findings that accounts receivables have a negative effect on the performance of small and medium enterprises, the study recommends the small and medium enterprises in Makueni County to relook at their accounts receivable practices and aim to improve their current practices. How to handle this can range from having policy on debt collection that encourages shorter periods for receivables, having in place effective revenue collection strategies for instance adoption of technology in payments such as having M-Pesa pay bills for customer payments and online money platforms so as to collect more receivables, reduce the period and improve performance.

#### **5.4.4 Accounts Payable Period**

Due to the study findings that accounts payable period has a positive effect on performance of small and medium enterprises in Makueni County, the study recommends that the small and medium enterprises should come up with better debt management policies which can effectively manage their accounts payables. Among the practices is improvement in debtor days management, days Payable and credit policies. There is also a need to embrace the policy of extending the debt period so as to have more time to reinvest the cash in more profitable activities before paying the debtor.

#### **5.5 Areas for Further Study**

Since the study focused on Makueni County, there is a suggestion for other studies on SMEs in other counties in order to present a comparative analysis. The focus on Makueni County cannot be used to generalize to the entire country of 47 counties. Since the study established

that up to 70.2% of the variations in profitability of SMEs is accounted for by the four working capital management practices that is CCC, inventory holding period, account receivable period and accounts payable, the remaining percentage can be accounted for by other actors.

There is thus a need for future studies to focus on establishing what other factors affect profitability of SMEs other than working capital management. Some of the factors can be availability of credit, regulatory framework, training of the SME owners among others. Other studies can also establish the effect of the moderating effect on the relationship between WCM and profitability since this study assumed a direct relationship.

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## APPENDICES

### Appendix I: Letter of Introduction

Dear Sir/Madam,

#### RE: RESEARCH STUDY

I am pleased to inform you that I am a student at Kenya Methodist University pursuing a Master's degree in Business Administration (MBA). As partial fulfillment for my degree, I will be conducting research on the effect of working capital management practices on the profitability of SMEs in Makueni County.

Kindly note that any information you will give will be treated confidentially and will not be used for any other purpose other than this research. Your contribution and assistance will be highly appreciated. I look forward to receiving your response.

Yours faithfully,

Victoria Mutheu Mbathi.

Cell phone: 0726 391659

Email: vickymfelsy@yahoo.com

## Appendix II: Questionnaire

### Instructions

Dear Sir/Madam,

You are kindly requested to answer all questions in this research study questionnaire. The information that you will provide shall be treated with utmost confidentiality and strictly used for the purpose of this research study. This study aims at finding out the effect of working capital management practices on the profitability of SMEs in Makueni County, Kenya. For purposes of confidentiality, kindly do not write your name anywhere on this questionnaire.

### **PART A: General Information**

Please respond to the following questions below by ticking [] on the appropriate option.

1. Gender
  - a. Male
  - b. Female
  
2. Age
  - a. Under 25
  - b. 26-40
  - c. 41-60
  - d. Over 60
  
3. What is your position in your department?
  - a. Proprietor
  - b. Senior management

- c. Supervisory ( )
- 4. Highest level of education attained?
  - a. Primary ( )
  - b. Secondary ( )
  - c. Tertiary ( )
- 5. How old is the enterprise?
  - a) 3-5 years ( )
  - b) 6-8 years ( )
  - c) 8-10 years ( )
  - d) Over 10 years ( )
- 6. What is the number of employees in the enterprise?
  - a) 1-5 ( )
  - b) 6-15 ( )
  - c) 16-40 ( )
  - d) 41-80 ( )
- 7. What type of enterprises do you run?
  - a) Supermarket ( )
  - b) Hard ware ( )
  - c) Bookshop ( )
  - d) Hair salon and Barber shop ( )
  - e) Grocery ( )

**PART B: CASH CONVERSION CYCLE AND PROFITABILITY OF SMEs**

Indicate the extent to which you agree with the following statements by using a scale of 1 to 5 where 1= strongly disagree and 5 = strongly agree

(Key: SA- Strongly agree, A – Agree, UD- Undecided, D- Disagree, SD- Strongly Disagree).

	SA	A	UD	D	SD
The length of cash conversion cycle has a material effect on the profitability of SMEs.	5	4	3	2	1
Shorter cash conversion cycles are better than longer ones.	5	4	3	2	1
Each SME should set its standard level of cash conversion cycle	5	4	3	2	1
Management of cash conversion cycles is the work of the lower level staff	5	4	3	2	1

5. How do you think SMEs can successfully maintain good cash conversion cycles to improve their profitability? .....



**PART C: INVENTORY HOLDING PERIOD AND PROFITABILITY OF SMEs**

Indicate the extent to which you agree with the following statements by using a scale of 1 to 5 where 1= strongly disagree and 5 = strongly agree

(Key: SA- Strongly agree, A – Agree, UD- Undecided, D- Disagree, SD- Strongly Disagree).

	SA	A	UD	D	SD
The length of inventory holding period has a material effect on the profitability of SMEs.	5	4	3	2	1
Firms should set Economic Order Quantity (EOQ) to ensure adequate stocks are maintained	5	4	3	2	1
A longer inventory holding period has a negative effect on the profitability of SMEs	5	4	3	2	1
Poor inventory management will affect the long term profitability and firm’s survival chances.	5	4	3	2	1

5. In your own words what inventory management systems would you recommend your organization to use

.....

.....

**PART D: ACCOUNTS RECEIVABLE PERIOD AND PROFITABILITY OF SMEs**

Indicate the extent to which you agree with the following statements by using a scale of 1 to 5 where 1= strongly disagree and 5 = strongly agree

(Key: SA- Strongly agree, A – Agree, UD- Undecided, D- Disagree, SD- Strongly Disagree).

	SA	A	UD	D	SD
Provision of trade credit is a strategy to increase sales and expand a business	5	4	3	2	1
Debtors collection period should be reduced by granting short credit period	5	4	3	2	1
Increased levels of accounts receivables increase sales and increased profitability	5	4	3	2	1
The length of accounts receivable period has a material effect on the profitability of SMEs.	5	4	3	2	1

5. What debt management policies do you use in your organization?

.....

.....

**PART E: ACCOUNTS PAYABLE PERIOD AND PROFITABILITY OF SMEs**

Indicate the extent to which you agree with the following statements by using a scale of 1 to 5 where 1= strongly disagree and 5 = strongly agree

(Key: SA- Strongly agree, A – Agree, UD- Undecided, D- Disagree, SD- Strongly Disagree).

	SA	A	UD	D	SD
The length of accounts payable period has a material effect on the profitability of SMEs.	5	4	3	2	1
Extending payables deferral period sometimes affects the company's credit reputation.	5	4	3	2	1
Firms should negotiate for a longer credit period with the suppliers.	5	4	3	2	1
Proper creditors' management policies can help a firm to enjoy benefits of credit discounts.	5	4	3	2	1

4. In your own words how would you prefer to settle trade credit.....

...

**PART F: PROFITABILITY IN SMEs**

Indicate the extent to which you agree with the following statements by using a scale of 1 to 5 where 1= strongly disagree and 5 = strongly agree

(Key: SA- Strongly agree, A – Agree, UD- Undecided, D- Disagree, SD- Strongly Disagree).

	SA	A	UD	D	SD
A high percentage of profitability plays a vital role in bringing an external finance in the business	5	4	3	2	1
Profitability is measured using Return On Equity, Net profit margin and Return On Total Asset	5	4	3	2	1

**PART G**

1. Kindly answer the following questions below by ticking [] on the appropriate option and comment where applicable.

a. Does your organization have cash conversion policy?

Yes ( ) No ( )

- If Yes, comment on how it affects profitability.....

b. Does your organization have an Inventory policy?

Yes ( ) No ( )

- If Yes, comment on how it affects profitability.....

c. Does your organization have Accounts Receivable policy?

Yes ( ) No ( )

- If Yes, comment on how it affects profitability.....

d. Does your organization have Accounts Payable policy?

Yes ( ) No ( )

- If Yes, comment on how it affects profitability.....

**PART H:**

1. In your own opinion, what do you think are factors to consider before determining a firm's cash conversion period? .....

2. What do you think should be the best inventory holding period of your organization and why?  
.....

3. Which working capital management policies/approaches do you use in your organization?  
.....

4. In your own opinion, what are the factors influencing Working Capital Management of SMEs?  
.....


Thank you very much.

### Appendix III: Cronbach Alpha Reliability Results

<b>CASH CONVERSION CYCLE</b>				
<b>Reliability Statistics</b>				
<b>Cronbach's Alpha</b>	<b>Number of Items</b>			
0.745	4			
<b>Item-Total Statistics</b>				
	Scale Mean if Item Deleted	Scale Variance if Item Deleted	Corrected Item-Total Correlation	Cronbach's Alpha if Item Deleted
The length of cash conversion cycle has a material effect on the profitability of SMEs.	12.41	5.537	0.258	0.811
Shorter cash conversion cycles are better than longer ones.	11.93	4.924	0.436	0.739
Each SME should set its standard level of cash conversion cycle	12.45	2.828	0.75	0.549
Management of cash conversion cycles is the work of the lower level staff	12.45	3.542	0.799	0.529
<b>INVENTORY HOLDING PERIOD</b>				
<b>Reliability Statistics</b>				
<b>Cronbach's Alpha</b>	<b>Number of Items</b>			
0.751	4			
<b>Item-Total Statistics</b>				
	Scale Mean if Item Deleted	Scale Variance if Item Deleted	Corrected Item-Total Correlation	Cronbach's Alpha if Item Deleted
The length of inventory holding period has a material effect on the profitability of SMEs.	12.07	6.638	0.077	0.856
Firms should set Economic Order Quantity (EOQ) to ensure adequate stocks are maintained	12.72	3.635	0.817	0.533
A longer inventory holding period has a negative effect on the profitability of SMEs	12.62	3.744	0.532	0.716
Poor inventory management will affect the long term profitability and firm's survival chances.	12.66	3.234	0.816	0.512
<b>ACCOUNTS RECEIVABLE PERIOD</b>				
<b>Reliability Statistics</b>				
<b>Cronbach's Alpha</b>	<b>Number of Items</b>			
0.722	4			
<b>Item-Total Statistics</b>				
	Scale Mean if Item Deleted	Scale Variance if Item Deleted	Corrected Item-Total Correlation	Cronbach's Alpha if Item Deleted
Provision of trade credit is a strategy to increase sales and expand a business	11.1	4.239	0.495	0.686
Debtors collection period should be reduced by granting short credit period	11.48	3.973	0.506	0.671
Increased levels of accounts receivables increase sales and increased profitability	12.14	1.98	0.598	0.733
The length of accounts receivable period has a material effect on the profitability of SMEs.	12.24	3.904	0.797	0.587
<b>ACCOUNTS PAYABLE PERIOD</b>				
<b>Reliability Statistics</b>				

<b>Cronbach's Alpha</b>	<b>Number of Items</b>			
0.732	4			
<b>Item-Total Statistics</b>				
	Scale Mean if Item Deleted	Scale Variance if Item Deleted	Corrected Item- Total Correlation	Cronbach's Alpha if Item Deleted
The length of accounts payable period has a material effect on the profitability of SMEs.	12.79	5.67	0.198	0.82
Extending payables deferral period sometimes affects the company's credit reputation.	12.38	4.601	0.629	0.636
Firms should negotiate for a longer credit period with the suppliers.	12.66	3.448	0.767	0.512
Proper creditors' management policies can help a firm to enjoy benefits of credit discounts.	12.97	3.249	0.602	0.636
<b>PROFITABILITY</b>				
<b>Reliability Statistics</b>				
<b>Cronbach's Alpha</b>	<b>Number of Items</b>			
0.759	2			
<b>Item-Total Statistics</b>				
	Scale Mean if Item Deleted	Scale Variance if Item Deleted	Corrected Item- Total Correlation	Cronbach's Alpha if Item Deleted
A high percentage of profitability plays a vital role in bringing an external finance in the business	3.97	0.677	0.709	0.677
Profitability is measured using Return On Equity, Net profit margin and Return On Total Asset	4.69	0.222	0.709	0.222

## Appendix IV: Research Authorization letter



**Kenya Methodist University**

P.O. Box 267-60202  
Meru, Kenya  
Email: [info@kemu.ac.ke](mailto:info@kemu.ac.ke)

Tel: (+254-020) 2118423-7, 064-;  
Fax: (+254-064) 30162  
website: [www.kemu.ac.ke](http://www.kemu.ac.ke)

June 14, 2018

Executive Secretary  
National Council for Science and Technology  
P.O Box 30623 – 00100  
**NAIROBI**

Dear Sir/ Madam,

**RE: VICTORIA MUTHEU MBATHI – BUS-3-2613-2/2016**


This is to confirm that the above named is a bona fide student of Kenya Methodist University pursuing a Master of Business Administration.

Victoria is undertaking a research study on "Effects of Working Capital Management Practices on Profitability of Small and Medium Enterprises in Makueni County". To successfully complete her research work, she requires relevant data in her area of study.


In this regard, we kindly request your office to issue her a research permit to enable her collect the data for her academic research work.

We thank you in advance for your cooperation.

Yours faithfully



Dr. Evangeline Gichunge  
Associate Dean, Research Development & Board of Postgraduate Studies



Nairobi Campus: Koinange Street, P.O Box 45240-00100 Nairobi - Tel. +254-20-2118443/2248172/2247987/0725-751878. Fax +254-20-2248160. Email: [nairobicampus@kemu.ac.ke](mailto:nairobicampus@kemu.ac.ke)  
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## Appendix V: NACOSTI Permit

CONDITIONS	REPUBLIC OF KENYA NACOSTI National Commission for Science, Technology and Innovation RESEARCH CLEARANCE PERMIT Serial No.A 20199 CONDITIONS: see back page
1. The License is valid for the proposed research, research site specified period.	
2. Both the Licence and any rights thereunder are non-transferable.	
3. Upon request of the Commission, the Licensee shall submit a progress report.	
4. The Licensee shall report to the County Director of Education and County Governor in the area of research before commencement of the research.	
5. Excavation, filming and collection of specimens are subject to further permissions from relevant Government agencies.	
6. This Licence does not give authority to transfer research materials.	
7. The Licensee shall submit two (2) hard copies and upload a soft copy of their final report.	
8. The Commission reserves the right to modify the conditions of this Licence including its cancellation without prior notice.	

## Appendix VI: Sampling Frame

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1. Matwiku Ventures
  2. Majoh Enterprises
  3. Kyeekoshire Ventures Limited
  4. Igwet International
  5. Phil Distribution Company
  6. Nikways Investment
  7. Highlife Resources
  8. Sero- Tech International
  9. Ocal Limited
  10. Vicdome Investments
  11. Makutano Dairy Enterprise
  12. Clem Chicken Farm
  13. Bens Capon Suppliers
  14. Kemasiwa Enterprises
  15. Warwick Florist
  16. Irswm Enterprises
  17. Muganees Investments
  18. Stawi Foods And Fruits Limited
  19. Salo Foods
  20. Dylan Horticulturists
  21. Speciality International Agencies Company Limited
  22. Belyot Kenya Limited
  23. County Growers & Supplies
  24. Robertis Ventures
  25. Cocyn Enterprises
  26. Aabash Properties
  27. Footsmile Footwear
  28. Waithaka Timber Products
  29. M-Tech Electronics
  30. Hurricane Cleaning Service
  31. Spruceup Afrika Cleaning Services
  32. Sydon Cleaning Services
  33. Hurricane Cleaning Services
  34. Exterminator Fumigation And Pest Control Services Company
  35. Cylex Cleaning Services
  36. Bola Associates Limited
  37. Wilmar Drycleaners & Laundromat
  38. Jongo Kenya Drycleaners
  39. Elnino Laundry Services
  40. Snow Shine Dry Cleaners
  41. Quintec Dry Cleaners
  42. Protocol Drycleaners Ltd
  43. Nimrod Africa Ltd
  44. Morison Engineering Building  
Integrity Fire Systems
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45. Nimrod Africa Ltd Nairobi
  46. Jullyvin Agencies Printers
  47. Cool Print, Nrb
  48. Unicolor Branding And Printing
  49. Graphix And Print Company
  50. Smart Printers Limited
  51. Kims Printing Services
  52. Copy Queen Services
  53. The Print Store Ltd
  54. Printing Services
  55. Krayons Enterprises
  56. Chapacopy Abc Place Office
  57. Ramco Printing
  58. Inkpaste Printers & Stationers
  59. Print Shop Nairobi
  60. Nimrod Africa Ltd
  61. Bomakwetu Nairobi
  62. Counselling Kenya
  63. Pledge Tax Kenya
  64. Property Developers
  65. Dinara Developers Ltd
  66. Ams Properties Ltd
  67. Kent Consultants Ltd
  68. Giroy Property Management
  69. Murage Estate Agent Ltd
  70. Aldrich Property Consultants
  71. Enmaison Properties
  72. Axis Real Estate
  73. Richland Properties Mombasa
  74. Best Carr Property Consultant Ltd
  75. Sir Francis Marketing And Consultants Ltd
  76. Amazon Valuers Ltd
  77. Financial & Property Consultant Ltd
  78. Gimco Limited Nyeri
  79. Banguro Stores
  80. Thuo Retail Shop
  81. Society Stores
  82. Kamau Traders Thika
  83. Thika Central Stores Ltd
  84. Yara Tika Stores
  85. Spruceup Afrika Cleaning Services
  86. Sydon Cleaning Services
  87. Hurricane Cleaning Services
  88. Exterminator Fumigation and Pest Control Services Company
  89. Cylex Cleaning Services
  90. Bola Associates Limited
  91. Wilmar Drycleaners & Laundromat
  92. Jongo Kenya Drycleaners
  93. Elnino Laundry Services
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94. Snow Shine Dry Cleaners
  95. Quintec Dry Cleaners
  96. Protocol Drycleaners Ltd
  97. Nimrod Africa Ltd
  98. Morison Engineering Building
  99. Nimrod Africa Ltd Nairobi
  100. Jullyvin Agencies Printers
  101. Cool Print, Nrb
  102. Unicolor Branding and Printing
  103. Graphix And Print Company
  104. Smart Printers Limited
  105. Kims Printing Services
  106. Copy Queen Services
  107. The Print Store Ltd
  108. Printing Services
  109. Krayons Enterprises
  110. Chapacopy ABC Place Office
  111. Ramco Printing
  112. Inkpaste Printers & Stationers
  113. Print Shop Nairobi
  114. Nimrod Africa Ltd
  115. Bomakwetu Nairobi
  116. Counselling Kenya
  117. Pledge Tax Kenya
  118. Property Developers
  119. Dinara Developers Ltd
  120. AMS Properties Ltd
  121. Kent Consultants Ltd
  122. Giroy Property Management
  123. Murage Estate Agent Ltd
  124. Aldrich Property Consultants
  125. Enmaison Properties
  126. Axis Real Estate
  127. Richland Properties Mombasa
  128. Lastflight Services
  129. Narrow Bridge Holdings Limited
  130. Oleshavani Holdings Limited
  131. Tarakilishi Company Limited
  132. Jovada Construction
  133. Vanguard Engineering Limited
  134. Carem East Africa Limited
  135. Semilikiy Construction Limited
  136. Beki Electrical Services Limited
  137. La Madu Contractors Limited
  138. Yuty Group Limited
  139. Euromed International (K) Limited
  140. Northern Dykes Limited
  141. Jacrapan Limited
  142. Square Agencies Limited
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143.	Silimack Enterprises
144.	Pejma Consult Limited
145.	Peacelyn Suppliers
146.	Tonistine Investment & Supplies (K)
147.	Lastflight Services
148.	Narrow Bridge Holdings Limited
149.	Oleshavani Holdings Limited
150.	Tarakilishi Company Limited
151.	Jovada Construction
152.	Vanguard Engineering Limited
153.	Carem East Africa Limited
154.	Semiliky Construction Limited
155.	Beki Electrical Services Limited
156.	La Madu Contractors Limited
157.	Yuty Group Limited
158.	Euromed International (K) Limited
159.	Northern Dykes Limited
160.	Jacrapan Limited
161.	Square Agencies Limited
162.	Silimack Enterprises
163.	Flexi Persnnel Ltd
164.	Corporate Staffing Services
165.	Research & marketing (ea)
166.	SBO Research Ltd
167.	Sagaci Research
168.	Consumer Option Ltd
169.	Infinite Insight Ltd
170.	Consultant Market Research Kenya
171.	Rhino Prompt Movers
172.	Removal Goods Services (K) Ltd
173.	Dolex Movers
174.	Emerson Movers Ltd
175.	Pioneer Movers
176.	Digital Movers
177.	Access Movers Kenya Ltd
178.	Ideveloper Technoligies
179.	Retail Management Solutions
180.	Brightermonday Kenya
181.	Changes Sales Solutions Ltd
182.	Vaja's Manufactures Ltd
183.	Smart Outsource Limited
184.	Telesky Limited
185.	Frontier Marketing Agencies
186.	SME Kenya
187.	Swivel Marketing Ltd
188.	2max Group Limited
189.	Outsourced Marketing Services
190.	New Age Public Relation
191.	Strategic Communication And Investments

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192. Square Gold P.R,
  193. Phoenix Communication
  194. Twaweza Generation Pr Firm
  195. Cause Impact Limited
  196. Anyiko Public Consultant
  197. Calla Public Relations
  198. IMG Kenya
  199. Selfless Company Nrb
  200. Agenda Public Relations Kenya Ltd
  201. Advance Public Relations And Marketing
  202. Gin Din Group
  203. Ogilvy Public Relations
  204. Aymart Stores
  205. Machakos Exotic Furnitures
  206. Masaku Tex
  207. Masaku Cosmetics Centre
  208. Kisasi Furniture & Wood Products
  209. Motech Computers
  210. Jojavin Enterprises
  211. Blessed Cereals Chop
  212. Sifado Enterprises
  213. Kaseve Enterprises
  214. Shawa Suppliers
  215. Mwangaza General Store
  216. Machakos Glass Enterprises
  217. Shiro Shop Wholesake & Retail
  218. Mwa Beauty Shop
  219. Kemiwanji Enterprises
  220. Divas Beauty & Cosmetics
  221. Jekawa Agencies
  222. Mugoiri Investments
  223. Wenton Kenya Limited
  224. M-Tech Electronics
  225. Aabash Properties
  226. Footsmiles Footware
  227. Waithaks Timber Products
  228. Da Zone Shoe World
  229. Njara Cosmetics
  230. Shamelle Electricals
  231. Ellonix Footwear
  232. Rozy Beauty Parlour
  233. Lumitech Entepriees
  234. Legacy Shoe Garden
  235. Classic Ice Cream Parlour
  236. Regence Collections
  237. Great Wema Umoja
  238. Biforke Cycles
  239. Ciomack Company Limited
  240. Lizurb Invests
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241.	B.K Enterprises Ltd
242.	Pemuca Investments
243.	Hotiso Ventures
244.	Moonlight Millers & Suppliers
245.	Colana Investments

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