WORKING CAPITAL MANAGEMENT PRACTICES AND PERFORMANCE OF SMALL ENTERPRISES IN KAPSABET TOWN, KENYA

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ABSTRACT

Small enterprises account for 75 per cent of the total employment and 30 per cent of the Kenya's gross domestic product. However two thirds of small enterprises fail within the first few months of operation which may be caused by the failure of understanding working capital management practices. This study sought to examine the effect of working capital management on performance of small enterprises Kapsabet town, Kenya. Correlational research design was adopted .The target population for the study was 712 small scale traders in Kabsabet town from which a sample of 256 respondents were selected using the simple random sampling technique. Data was collected using structured questionnaire and was analyzed both descriptively and inferentially using SPSS 26. Descriptive statistics such as mean and standard deviation were used to summarize responses. The correlation coefficient (r), coefficient of determination (R^2) and analysis of variance (ANOVA) were calculated. The analysis showed working capital management practices had statistical significant effect on performance of Small enterprises in Kapsabet Town, Kenya. The study concluded that adoption of working capital management practices that is sound leads to better performance. The study recommended for small organizations in both county and National governments to embrace working capital management practices since it enhances improvement on performance.

Key words; Working Capital Management Practices Financial Managements, Performance

INTRODUCTION

In the modern economy, small enterprises (SEs) in the industrialization process have gained much prominence in developing countries. Their prominence came into the limelight in the late 1970s and early 1980s due to the economic recession originating from the UK which led to the closure of big manufacturing firms and a decline of industrial growth in many developing countries (Prasad, Rogoff & Kose, 2015). Governments of such countries adopted a new policy approach towards the Small Scale Industries which were viewed as giving a suitable option in contrast to the enormous scope businesses which were so reliant on remote trade (Ankomah, 2012). From that point forward little scope ventures have kept on developing and the idea has since changed from little scope businesses to little scope enterprises to include businesses undertaking activities in other sectors of the economy.

Today, the economic roles played by small enterprises (SEs) have been well manifested in many countries of the world including Malaysia, Japan, South Korea, and Zambia SEs contribute substantially to the Gross Domestic Production (GDP), export earnings and in the creation of employment for a larger population in these countries. In India they contribute 8% of the national GDP, comprises 50% of total manufactured exports, 45% of India's total industrial employment and 95% of all industrial units (Ravi, 2009). In Kenya, SEs accounted for estimated 30 per cent of the country's GDP (GoK, 2008). Therefore they act as the springboard for a country's sustainable economic development. Promotion of MSE development encourages the development of indigenous entrepreneurship, enhance regional economic balance through industrial dispersal and generally promote effective utilization of local resources that are considered critical in engineering economic development (Osotimehin, Jegede, Akinlabi & Olajide, 2012).

Despite the role they play in the economy, SEs sector has had their peculiar challenges hindering growth, performance and achievement of their purpose in the economy. The problem of poor performance in the MSE sector spreads small business closures stood at 85per day during the global economic crisis in early 2009 (ILO, 2009). In Nigeria, this sub-sector has fallen short of expectation (Osotimehin, Jegede, Babatunde & Olajide, 2012). In Kenya, three out of five enterprises fail within the first few months of operation (Kenya National Bureaus Statistics, 2007). This has a negative impact to the economies affected. Osotimehin (2012) has shown a high correlation between the degree of poverty, hunger, unemployment, and economic well -being of the citizens of countries and the degree of vibrancy of the respective countries micro and small scale enterprises. Studies on the causes of the challenges to the survival of SEs have revealed various reasons behind the high mortality rate and suppressed growth in SEs. In Malaysia statistics show that not many SEs graduated into becoming large corporations despite the increasing number of SEs established each year. Some of the challenges identified in the MSE sector include: leverage on financial structure, tough competition, inadequate margin, low collection in account receivables, incapacity to go for technological advancements, high employee turnover, credit risks and interest rate risks (Rufai, 2013).

Ever since the ILO recognized the important role played by SMEs informal Sector in employment creation, various policies have been put in place to promote the establishment of the Small Enterprise Development (SED) which is taxed with the role of creating an enabling environment for small enterprise growth including analysis and adjustments to the regulatory environment that has been a hindrance to prospective small business owners. Formal small enterprise development policy encompasses entrepreneurship development programs under a heading Non-Financial Promotional Programs (DaeSuh, 2011).

According to Olang and Onyango (2015), problems encountered by enterprises in the informal sector

include the issue of legality, lack of infrastructure, substandard structures, and the threat of demolition. Informal enterprises are also considered an environmental hazard and urban planners argue that they can be a danger to the public, especially those that are carried out along roads and sidewalks. However, most of these problems would be eliminated if urban planners allocated land for the enterprises. In order for SEs to perform well in any economic situation firms should try to adopt the working capital practices that can lead to a greater performance. Firer, Ross, Westerfield and Jordan (2014) state financial management involves making decisions about investment opportunities and how working capital management practices can be applied for organizations improvement. Improper working capital management practices have proven to be a main cause of failures in companies in terms of financial difficulty, mismanagements of fund and shortage of long term funds to meet the operating cost and capital expenditure (Brigham & Ehrhardt, 2010). Inclusion of working capital management practices is aimed at improvement of the financial performance. Firms having well aligned working capital management practices are efficient and effective. The integration of the working capital management practices ensures timely coordination of various activities of the firms and correction of deficiencies and in so doing, the financial performance is improved.

The importance of working capital management practices cannot be over emphasized since many of the factors that contribute to business failure can be addressed using strategies and financial practices that drive growth and the achievement of organizational objectives (Savan & babu et al., 2009). The finance factor is the main cause of financial distress (Memba & Nyanumba, 2013). The goal of all working capital practices is richest expansion and the prompt method for measuring the nature of any financing choice is to look at the impact of such a choice on the association's execution (Kegode, 2010).Working capital

management practices are the standard operating procedures developed by an entity to assist in executing the effect of creditors, cashflows, debtors and inventory (Wolmorans, 2015). They are the activities performed by the accountant and financial officers on working capital management. The most frequently used working capital management practices in the SEs entail profit retention, average debtor, average creditors and cash cycle (Marembo, 2013). The success of most SMEs is attributed to sound financial management inclusive working capital practices, resources alongside creative marketing skills and good start-up idea. The presence of adequate initial start-up financing and good accounting system although vital to the development of effective financial management practices, they are only the starting points in the process of having a sound financial system (Marembo, 2013). In most SMEs, working capital management practices include: maintaining good financial records which are used for planning, keeping track of credit history and ensuring business bills are paid on time, developing a good system to collect funds owed to the business, and computing and filing the annual tax returns (Kipsang, 2014). Having these practices carried out in the most effective way will ensure that the business stays in business for a long time. Success of Small and medium business and their survival is a concern globally with much of the SMEs failure being associated with financial problems such as poor management of funds (Githinji, 2016). The importance of working capital management practices have on organization is imperative as most challenges facing Small Enterprises may be prevented by proper financial management practices (Uluyol, 2013). All these when properly integrated in the SEs operations is aimed at improving their financial performance.

Statement of the Problem

Since their invention, SEs continue to play a key role in economic development globally through contribution to the GDP, employment creation, utilization of local resources and ensuring balance

in regional development. They act as spring boards for economic development. Ideally, business enterprises are expected to grow in size by transitioning from one stage to the next; from micro enterprises with less than ten employees to large enterprises employing more than 250 people. However, 33% to 41% of new SMEs globally fail within the first five years of their business operation due to lack of well managed working capital management practices (Thaimuta, 2014). The mortality rate of SMEs in Africa remains very high; it is within their first three years of operation in Kenya (RoK, 2007). The failures of SMEs have been attributed to working capital management practices (Waweru & Ng u g i, 2014). This indicates that only few SMEs in the county are able to raise profits, create employment opportunities and reduce poverty level as at now it stands at 57.0% (KNBS, 2015). Bratland *et al.* (2013) on empirical study of relationship between working capital management practices and organization's performance in Sweden found working capital management does affect the performance of organizations. Some scholars among them; Narwal and Jindal (2018) asserted working capital management practices had less to do with the organization's performance. This study is therefore designed to address scholarly research gap of some scholars supporting the significant correlation of working capital management practices and organization's performance while other scholars had least support. This study investigated the effect of working capital management practices on performance of small scale enterprises in Kapsabet, Kenya.

Objective of the Study
This study established the relationship between working capital management practices and performance of Small Enterprises in Kapsabet town.

Research Hypothesis
HO$_1$: Working capital management practices do not significantly affect the performance of Small Enterprises in Kapsabet town.

LITERATURE REVIEW

Resource Based View Theory
Resource based firm theory states that unique organizational resources of both tangible and intangible nature are the real source of competitive advantage (Gottschalk 2007). An organizations performance is shaped by the unique combination of resources it has access to. These resources include physical assets and also competencies. Wade and Hulland (2004) define six attributes of firm resources. Resource attributes which ex ante

Limit competition are value, rarity, appropriability, imitability, sustainability and mobility ex post limit competition. Wade and Hulland (2004) suggest that while some resources generate competitive advantages, others help sustain them. Resources, which generate competitive advantages, can be thought of as ex ante limitations to competition, whereas resources that sustain competitive advantages can be identified as ex post limitations to competition.

The application of resource-based theory on the effect of financial practices like working capital, asset management, liquidity management and financial reporting are aimed to improve the performance of SEs and firms to gain competitive advantage as well as sustain. Financial resources such as capital are a major source of competitive advantage in a firm because it enhances growth and investment (Vicente-Lorente, 2011). Therefore, the success in performance of any firm, big or small can be attributed. They include working capital, liquidity asset and financial reporting management.

Residual Equity Theory
In the residual equity theory, changes in asset valuation, income and in retained earnings and changes in interest of other equity holders are all reflected in the residual equity of the common stockholders (Staubus, 2009). The specific equities include the claims of creditors and the equities of preferred stockholders. The balance sheet equation becomes as follows: Assets minus specific equities are equal to Residual equity. The equity of common

stockholders in the balance sheet should be presented separately from the equities of preferred stockholders and other specific equity holders (Kirschenheiter,, Mathur & Thomas, 2004)..

According to Hendrickson (1982) the residual equity point of view is a concept somewhere between the proprietary theory and the entity theory. The objective of the residual equity approach is to provide better financial reporting as a consequence of good financial management practices. In a going concern situation, the current value of common stock is dependent primarily upon the expectation of future dividends. Future financial status is dependent upon expectations of total receipts less specific contractual obligations, payments to specific equity holders and requirements for reinvestment (Kabiru & Rufai, 2014).

Since financial statements are not generally prepared on the basis of possible liquidation, the information provided regarding the residual equity should be useful in predicting possible future financial status to common stockholders (Parsons, 2003). In the balance sheet format this is stated as follows: Assets minus liabilities are equal to residual equity. The assets are assumed to be owned by the proprietor and the liabilities are the proprietors' obligations. Revenues are increases in proprietorship and expenses are decreases. Thus, the net income accrues directly to the owners, that is the net value of the business to the owners. It is a wealth concept (Nyongesa, 2011).

Pecking order theory

Besides, Myers (1984) pecking order theory which states that firms have a preferred hierarchy for financing decisions. The highest preference is to use internal financing which includes retained profits before resorting to any form of external funds. Myers (1984) argues that internal funds incur no flotation costs and require no additional disclosure of proprietary financial information that could lead to more severe market discipline and a possible loss of competitive advantage. If a firm must use external funds, the preference is to use the following order of financing sources: debt, convertible securities, preferred stock, and common stock (Vicente-Lorente, 2011).

However, Myers (1984) theory does not sufficiently stand to explain the behaviour of financing SMEs in developing countries due to the unique circumstances. Pecking order theory to date remains essential part of corporate finance. It is considered as one of the most influential theories. In 1958 Modigliani and Miller (1958) presented their theory of investment and held that capital structure decision has no impact on a firm's value, it becomes irrelevant how it is financed given that under perfect market conditions exist and in absence of bankruptcy, tax and other associated costs. After their initial research many modern theories such as Trade-off theory and Pecking order theory came into being (Jibran, Wajid, Waheed & Muhammad, 2012).

The main difference was that the assumptions were more realistic, so they could be easily tested. According to Lemmon and Zender (2010), static trade off model firms determines their optimal debt levels, by comparing cost and benefits of debt financing. This point is where marginal present value of interest tax shield is equal to the marginal present value of the costs of financial distress. But on the other hand pecking order theory suggests that the manner in which firms cover their financing deficits does not depend on the current levels of debt and that the firms always prefer internal funds to external funds and debt to equity (Vanacker and Manigart, 2010)
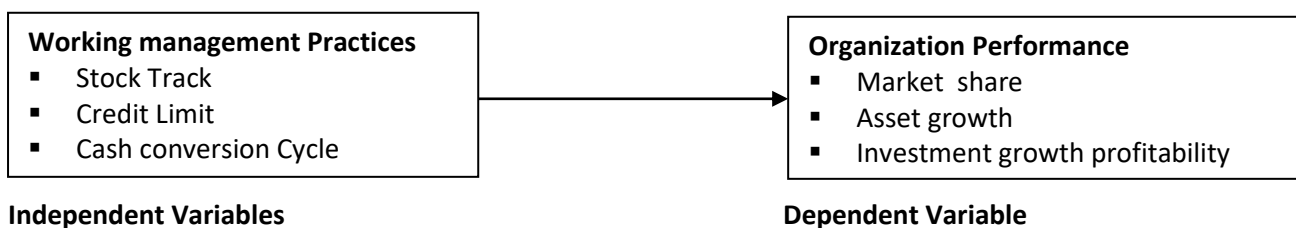
Bram, Charles, Frank, Cadsby, Murray, and Maksimovic, Vojislav. (2008) analyzed the prescient influence of balance strength in test markets where firms with venture openings have an enlightening bit of leeway over potential financial specialists and are allowed to buy a cash consuming sign. Balance predominance regularly neglects to anticipate well when a Pareto-prevalent successive balance is additionally benefit capable. Rather, harmony determination gives off an impression of being identified with the potential income of an

increasingly significant firm that can flag its sort effectively by abandoning from the consecutive balance.

One of the aspects of pecking order theory implies that when it comes to profitable firms, they would always prefer internal financing rather than taking up new debts or equity. Even though, debt is considered cheaper than equity within certain proportions. Myers (1984) suggests that it is because the value of firm and wealth of shareholders associated with firm is disturbed by asymmetry of information. This argument is supported by Famma and Fench (2000) who found that profitable firms were less levered as compared to non-profitable firms. Murray Frank and Goyal (2003) held that large firms tend to accumulate debts in order to support and keep up with the payments of dividends while small firms tend to behave in opposite behavior.

Conceptual Framework

Working management Practices	Organization Performance
▪ Stock Track ▪ Credit Limit ▪ Cash conversion Cycle	▪ Market share ▪ Asset growth ▪ Investment growth profitability
Independent Variables	Dependent Variable

Figure 1: Conceptual Framework
Source: Author

METHODOLOGY

Research Design: The study adopted a correlational research design. In correlational research designs, investigators use the correlation statistical test to describe and measure the degree of association (or relationship) between two or more variables or sets of scores (Mugenda & Mugenda, 2008). Therefore, correlational research design would be appropriate in explaining how financial management practices influence business performance of SE in Kapsabet Town.

Target Population: The study population for this study was the SEs in the trading business in Kapsabet town. SEs in trading industry was preferred because the nature on their business involves a great deal of management of working capital, liquidity and assets to enable continuous operations and growth. Kapsabet town was chosen because currently it has a large number of emerging shops. The study targeted the owners of SEs in Kapsabet town.

Sampling and Sampling Techniques: The sample size for this study was obtained using (Mora & Kloet, 2010) formula for finite population as follows;

$$n = \frac{N}{\left(1 + Ne^2\right)}$$

Where;
n = the sample size
N = the size of population
e= the error of 5 percentage points

$$n = \frac{712}{\left(1 + 712 \times 0.05^2\right)} = 256$$

The Sample size was therefore comprised of 256 small scale traders from Kabsabet town. The individual traders to take part in the study were selected using the simple random sampling technique to ensure equal representation.

Data Collection Instruments: The study relied on primary data to be obtained from SEs owners. Their opinions were sought using structured questionnaires. Questionnaires were preferred in this study because they allow investigation with an

ease of accumulation of data in a highly economical way (Graveter & Forzano, 2003).

Pilot Study: In collecting data, the study first obtained an introductory letter from the Graduate school of Jomo Kenyatta University of Agriculture and Technology. Before conducting the actual study, the questionnaires were first tested through a pilot study among selected small-scale traders in Kehancha town. Reliability was tested by use not included in the final data collection process. This was meant to avoid response bias in case they happen to complete the same questionnaire in the main study.

Data Processing and Analysis: The quantitative data collected was analyzed by Statistical Package for Social Sciences (SPSS 24) where descriptive statistics was computed to help in describing and interpreting data in line with study objectives. For variable relationships, correlation and regression analysis was also examined. Analyzed data was presented by use of tables and in prose form. The Analytical model for the study took form of:

$$Y = \alpha + \beta_1 X_1 + \varepsilon$$

Where;

Y= Organization Performance

α= Constant Term

β= Beta Coefficient –This measures how many standard deviations a dependent variable was change, per standard deviation increase in the independent variable.

X_1= Working Capital Management Practices.

ę = Error term

FINDINGS AND DISCUSSIONS

The response rate 92.0% of the total questionnaires administered which is an adequate response rate for statistical reporting (Nulty, 2008). Those who did not return the questionnaires cited their tight work schedules as the impediment for data collection exercise and others had misplaced them.

Descriptive Statistics: Working Capital Management Practices and Organization Performance

The study set out to determine how often working capital management is practiced by SEs in Kapsabet town. Working Capital was defined along four dimensions namely keeping track of stock, credit limit specifications, cash conversion cycle and optima of working capital.

Table 1: Response on working Capital management practices

Working Capital Management	5	4	3	2	1	μ	S.E
i) We ensure that we keep track of the stocks held at any given time	41 (16%)	155 (60.5%)	35 (13.6%)	19 (7.4%)	6 (2.5%)	3.8	0.1
ii) We have a clearly specified limit on the on the credit limit	32 (12.3%)	164 (64.2%)	35 (13.6%)	22 (8.6%)	3 (1.2%)	3.8	0.1
iii) We ensure that we shorten the cash conversion cycle by ensuring quick resale of our goods	13 (4.9%)	38 (14.8%)	161 (63%)	35 (13.6%)	9 (3.7%)	3.0	0.1
iv) We maintain an optimal working capital to enable a smooth running of our business	3 (1.2%)	13 (4.9%)	66 (25.9%)	104 (40.7%)	70 (27.4%)	2.2	0.1
Summaries			Mean 3.73	S.E Mean 0.11	Std. Dev. 0.96		

Note:μ=Mean, S.E=Standard error, 5- Very often, 4 – Often 3 – Sometimes 2- Rare, 1- Very rare

The results in Table 1 revealed that 60.5% of the respondents indicated that they often ensure that they keep track of the stocks held at any given time with further 16% of the respondents rated it as very often. However, 9.9% of the respondents stated they rarely ensure that they rarely keep track of the stocks held at any given time. The overall mean of 4(often) show that they often ensure that they keep track of the stocks held at any given time.

Similarly, 64.2% of the SEs often have a clearly specified limit on the on the credit limit while further 12.3% do that very often. Nonetheless, 9.8% of the respondents stated that they rarely have a clearly specified limit on the on the credit limit. The overall mean of 4 (often) with standard error of 0.1. However, 63% of the SEs stated that sometimes they ensure that they shorten that cash conversion cycle by ensuring quick resale of their goods while 14.8% of the SEs indicated that they often ensure that they shorten that cash conversion cycle by ensuring quick resale of their goods, furthermore

17.3% of the SEs rarely do that.

The overall mean was 3 (Sometimes) with a standard mean error of 0.1. Furthermore, 40.7% of the SEs and 27.4% of the SEs indicated that rarely and very rarely respectively that they maintain an optimal working capital to enable a smooth running of their business. However, 6.1% of the SEs they often maintain an optimal working capital to enable a smooth running of their business. With a mean of 2(rarely) maintain an optimal working capital to enable a smooth running of their businesses

Inferential Statistics
Before further inferential analysis was conducted, it was necessary to conduct correlation tests to determine the existence, significant, strength and direction of the linear relationship between the study variables. Accordingly, correlation analysis by means of Pearson Product Moment Correlation technique was used. The results are as shown in Table 2.

Table 2: Correlation Analysis results between Financial Management practices and Performance

		WCM	BP
WCM=Working Capital Management	Pearson Correlation	1	
	Sig. (2-tailed)		
	N	236	
BP=Business performance	Pearson Correlation	.716**	1
	Sig. (2-tailed)	.000	
	N	236	236

Correlation between working capital management and performance of SEs
This implied that according to objective of the study, working capital management practices has significant positive effect on performance of SEs in Kapsabet town.

Linear Regression analysis of working capital management practices on organization's Performance
Pearson correlation analysis revealed that the independent variable had significant positive effect on the dependent variable, through R square which is the coefficient of determination. The results are as shown in Table 3.

Table 3: Linear regression results for independent variables

	ANOVA and Model Summary					
	R Square	Adjusted R Square	F	Df Regression	Total	Sig.
Working capital management practices	.512	.506	82.911	1	235	.000

Dependent Variable: organization performance

This is based on significance value which is less than 0.05 and R^2 value of 0.512 and adjusted to 0.506. This shows that working capital management practices explains or accounts up to 51.2% of variation in the performance of SEs in Kapsabet town. It further reveals a statistically significant relationship between predictor variable and the dependent variable with $F_{(1, 235)}$ =82.911, $p<0.05$. This implies that there is a significant effect of working capital management practices on the performance of SEs in Kapsabet town. Therefore, the first hypothesis was also rejected using linear regression analysis.

Table 4 showed the coefficients of the influence of working capital management practices on performance of small enterprises in Kapsabet Town. The Beta coefficients was .363 at a p-value of 0.000 indicate the extent to which organization performance changes due to change in working capital management practices by 36.3%.

Table 4: Coefficients for working capital practices and Performance

| | Unstandardized Coefficients | | Standardized Coefficients | | |
	B	Std. Error	Beta	T	Sig.
(Constant)	-.054	0.340		.159	.874
X1	0.363	0.066	0.411	5.504	000

a. Dependent Variable: Y

The equation;

$Y= \beta_0+\beta_1 X_1+\varepsilon$, holding all other factors constant, this becomes,

$Y_0 =- .054+.363 X_1$

The positive Beta coefficients imply that 36.3% increase in the working capital management practices results in increased organization performance.

Hypothesis Testing

Null Hypothesis (H01): working capital management practices has no significant influence on the performance of small enterprises in Kapsabet Town.

Alt. Hypothesis (Ha1): working capital management practices has a significant influence on the performance of small enterprises of Kapsabet Town.

Model summary results indicate that working capital management practices has significant influence on performance of small enterprises in Kapsabet Town ($\beta_1 = 0.363$ at $p< 0.05$). Other factors remaining constant, working capital management practices, explains 36.3% of changes in performance of small enterprises in Kapsabet Town. The positive beta coefficient implies that a unit change in use of working capital management practices results in a rise in an organization's performance by 0.363 units. As such the null hypothesis was rejected.

CONCLUSIONS AND RECOMMENDATIONS

From descriptive statistics, the average revealed that most respondents agreed on various working capital management practices. Specifically, keeping track of the stock, specified credit limit, shorten cash conversion cycle and optimal working capital were some of the practices that affected performance of SEs. The correlation results indicated that working capital management has significant strong positive effect on the performance of SEs. Regression analysis showed that working capital management significantly predicated performance of SEs in Kapsabet town.

The study established that working capital management practices has significant positive strong effect on the performance of SEs with specific practices like keeping track of the stocks and specifying credit limit.

Based on the findings and conclusions of this study, the following recommendation was made. The overall recommendation is for SEs which has not been using working capital management practices to adopt them in their operations. This will enhance the business overall performance by more than 50%. SEs need to revisit the use of working

management capital practices with special reference to shorten the cash conversion cycle by ensuring quick resale of our goods and maintain an optimal working capital to enable a smooth running of their business. This will ensure that SE there is sufficient working capital for business operations and will increase the SE value.

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