

# EFFECT OF WORKING CAPITAL MANAGEMENT ON FINANCIAL PERFORMANCE OF SAVINGS AND CREDIT COOPERATIVE SOCIETIES IN KIAMBU COUNTY, KENYA

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**Abstract:** Working capital management is considered to be an important element in determining the financial performance of an organization. In this study, the purpose was to investigate working capital management and their effect on financial performance among savings and credit cooperative societies in Kiambu County, Kenya. Specifically to establish how receivables management and Cash management influences financial performance of SACCOS and extent to which accounts payable management influences financial performance of SACCOS in Kiambu County. Inventory management was not be considered since these institutions don't have inventories. The target population for this study consisted of all SACCOS in Kiambu County licensed as at December, 2016 by Ministry of Trade, industry and Co-operatives and the Sacco Societies Regulatory Authority (SASRA). A total population of 35 SACCOS was studied. Using descriptive research design, a total of 35 managerial staff members from the 35 SACCOS were targeted by way of completing a structured questionnaire. Primary and secondary data was collected. Secondary data was collected from SACCOS' financial statements and other financial records using document review guide. Data was processed and then analyzed using descriptive statistics and correlation analysis. The study concluded that cash management had a negative but significant effect on financial performance of SACCOS in Kiambu County. Deloof (2003), contend in their working capital management principle that the larger the cash conversions cycle the greater the investment held in working capital. The study also concluded that accounts receivable management had a negative but significant effect on financial performance of SACCOS in Kiambu County. The study further concluded that accounts receivable management had a negative but significant effect on financial performance of SACCOS in Kiambu County. The study makes a number of recommendations. First, the study recommends that SACCOS in Kiambu County should reduce their average cash collection period in order to improve their financial performance. The study also recommends that SACCOS in Kiambu County should reduce their receivables collection period in order to improve their financial performance. The study further recommends that SACCOS in Kiambu County should increase their average payable period in order to improve their financial performance. Increasing the average payable period for the suppliers will reduce the amount of cash moving out and this will release the funds for other profitable ventures which in turn will enhance the financial performance.

**Keywords:** cash management, accounts receivable management and accounts payable management.

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## 1. INTRODUCTION

SACCOS are voluntary organizations which are democratically controlled by the members to mobilize savings and give out loans to them at affordable interest rates. They are financial institutions that are involved in the business of buying and selling finances. The role of cooperative societies in the economy need not be over emphasized. National economies have benefited from well-governed co-operatives. Co-operatives are governed on the cores corporate values of democracy, self-help, equality, effectiveness, self-responsibility, and solidarity. Members uphold ethical values of transparency,

accountability, honesty, social responsibility and interest for others. Cooperatives throughout the world have the same universal principles which include member's economic participation, and cooperation among cooperatives, democratic control, concern for community, autonomy and independence and education of members.

## 2. STATEMENT OF THE PROBLEM

Financial performance of SACCOS in Kiambu County is low. The average rate of return on assets in SACCOS in the year 2014 was 8% as compared to the targeted county rate of 10%. The average rate of return on deposits was 5.4% as compared to the statutory minimum of 7%. Report indicates that 44% of the SACCOS didn't meet this set statutory minimum. The average results of SACCOS in Kiambu County in the year 2015 were even worse. The rate of return on deposits reduced to 5% and rate of return on assets to 7.5%. (Department of Trade, industry Tourism and Co-operatives Kiambu County, 2015).

SACCOS like Ekeza, Orient, UNES, and Jetegemee have not been able to pay dividends and have been placed under statutory management of SASRA and State Department in the Ministry of Trade, Industry and Co-operatives Development. In order for these SACCOS to be sustainable in future, their financial performance need to be improved. To achieve this however, there need to know what factors are causing this dismal performance and this study intends to do. Most SACCOS in Kiambu County that have collapsed had liquidity problems, low profitability and high loan delinquency. (Department of Trade, Industry Tourism and Co-operatives Kiambu County, 2015). Some researchers have credited poor financial performance to working capital administration. A research by Agha (2014) on effect of working capital administration on profitability utilizing recorded information of 1996 and 2011 from the contextual investigation of a pharmaceutical organization listed in securities exchange of Pakistan, demonstrate that there is sure impact of working capital management on overall profitability.

A number of studies on the relationship between working capital management and financial performance have been done in Kenya though very little research has been conducted on the SACCOS sector in Kenya. For instance, Mathuva (2010) conducted a study on working capital management components on corporate profitability of Kenyan Listed Firms in the NSE. A similar study was conducted by Apuoyo (2010). Nyabwanga et al (2011) conducted a study on the effect of working capital management practices on financial performance of small scale enterprises in Kisii South District, Kenya. Kiilu (2010) conducted a study on working capital management practices among large construction firms in Kenya. Wainanina (2010) studied the relationship between profitability and working capital of small and medium enterprises in Kenya. More studies done in Kenya also include; Mathai (2010) who conducted a study on the relationship between working capital management and profitability of retail supermarkets in Kenya. Mutungi (2010) conducted a study on the relationship between working capital management policies and financial performance of oil marketing firms in Kenya.

There is a paucity of published work on effect of working capital management on financial performance of SACCOS in Kiambu County, particularly in the context of developing countries in the dynamic African region and specifically in Kenya. This study was to intend to bridge this gap in knowledge that exists. Therefore, it is against that background that the study intends to evaluate effect of working capital management on financial performance of SACCOS in Kiambu County.

### Objectives:

- i. To determine how cash management influences financial performance of SACCOS in Kiambu County.
- ii. To investigate how accounts receivable management influence financial performance of SACCOS in Kiambu County
- iii. To establish the extent to which accounts payable management influences financial performance of SACCOS in Kiambu County.

## 3. THEORETICAL REVIEW

### Cash conversion theory

Cash conversion theory is based on the duration taken to convert resources put in the firm system into liquid cash. Mostly business buy a stock on credit from the suppliers and can also sell on credit therefore account payable. The firm may have debtors, inventories and accounts payable. How quick the firm is able recover debts from the debtors in order to settle the

payable determines the liquidity position of the firm. The lower the cycle the better financial health. Cash conversion system is given by the number of days stocks are held plus the numbers of days to the collection of debts minus the accounts payable settlement period. Businesses attempt to improve their financial performance by shortening the cash conversion cycle by delaying payments to creditors and accelerating recoveries from debtors.

### Operating Cycle Theory

Operating cycle is figured as the length of every component of the working cycle including raw materials, work-in-progress, completed products and debtors. The longer the operating cycle, the higher the business requirement for working capital. It should be noted that the more working-capital necessity, the higher the stock holding cost, including interest payments, and the more noteworthy the opportunity cost because of the failure to put assets in a better utilization. shorter operating cycle are characterized by many operating cycles hence higher profits and returns

### Transaction Cost Theory

The transaction cost theory stresses that there are costs those individuals typically bring about without realizing that they are an expense to them. These costs must be brought about at whatever point an exchange happens. These expenses are known as transaction costs. Transaction cost theory stresses that this costs vary from one firm to another 'The hypothesis' primary case is that the transactions will be taken care of so as to limit the costs associated with completing them an transaction, an exchange of goods or administration is the unit of examination in transaction cost hypothesis and the methods for affecting the exchange is the key result of intrigue (Williamson, 1975). Accounts payable expenses can be clarified by this hypothesis in that the discount lost from the supplier is an expense to the borrower.

### Conceptual Framework

A conceptual framework is a set of broad ideas and principles taken from relevant fields of inquiry and used to structure a subsequent presentation (Reichel& Ramey, 2010). It is a tool intended to assist a researcher to develop awareness and understanding of the situation under scrutiny. It helps the research to explain the relationship among interlinked concepts such as the dependent and independent variables (Kombo, 2006). In this study, the researcher seeks to establish the effect of project management practices on project performance of construction projects in Kenya. It will be conceptualized within the dependent-independent variable components and their indicators. The figure below shows a diagrammatic representation of the relationship between the dependent and independent variables.

### Conceptual Framework

The conceptual structure in Figure 1 clarifies the connection between the independent and dependent variables.

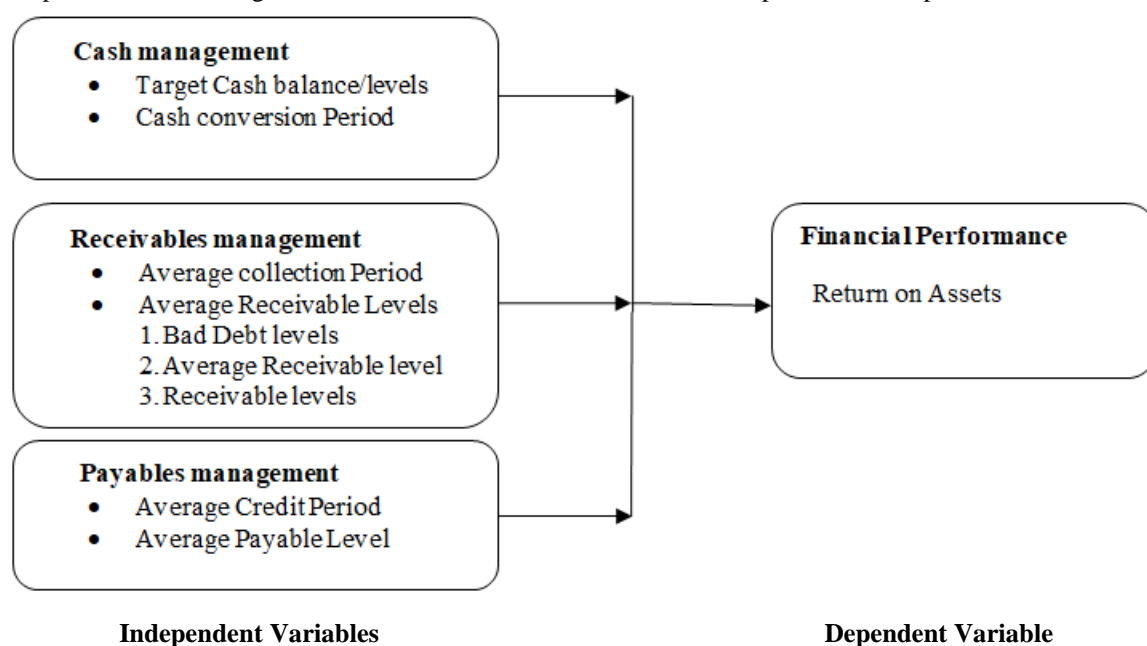


Figure 1: Conceptual model

### Research gaps

The environment in which SACCOs operates has been changing due to macro and micro factors in the environment. Saccos rely on members contributions in order to give credit/loans to members. Loan interest income is the major source of SACCO revenue, accounting for at least over 80 % of total revenue (SASRA, 2011). Loans are repaid with interest that influences the financial performance. Despite the fact that working capital management area is researched by many scholars in accounting and finance, there is a very little study carried out on Saccos. Most studies carried out recommends further studies on relationships between various working capital items and performance. Most researchers cited have been carried out in manufacturing firms, oil producing firms, small medium enterprises etc. However Waweru, K. M. (2011) demonstrated a study in Saccos in Nakuru County and recommended further studies on practices and how they influence profitability in SACCOs. Nyabiraga *et al.* (2012) affirms that working capital management is low among SSES as most had no formal policies consequently low financial performance. This may not apply to SACCOs.

Rehaman and Nasr (2007) proposed that further research be directed on a similar theme with various firms. They likewise contended that further research be stretched out to working capital parts administration including money, short term investment securities, receivables and stock administration. There has been no investigation on receivables, cash management and stock management since the proposition to think about on the same was given. This investigation is an endeavor to fill the hole in information concerning working capital practices and how they influence financial performance of SACCOs in Kenya.

## 4. RESEARCH METHODOLOGY

The research design used in this study was descriptive research design. The population was all SACCOS in Kiambu County licensed as at December, 2017 by State department in the Ministry of Trade, Industry and Co-operatives Development and the Sacco Societies Regulatory Authority (SASRA). A total population of 35 SACCOS was studied. The researcher was used both secondary data as well as data survey sheet as the research instrument to gather the relevant information needed related to the study. The Data survey sheet was administered to the respondents through drop and pick method. The statistical Package for Social Sciences (SPSS) was used for data analysis purpose.

### Model

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$$

Where:

Y= Financial performance

X1: Cash management

X2: Accounts receivable management

X3: Accounts payable management

### Regression Results

Table 4.1: Significance of Independent Variables

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	.769	.279		2.649	.002
Cash management	-.389	.123	-.407	3.257	.002
Account Receivable	-.221	.125	-.213	2.578	.003
Account Payable	-.149	.123	-.151	4.260	.002

The results in Table 4.6 show that cash management had a negative effect on financial performance and this effect was significant (B =-0.389, p = 0.002).

The results also show that accounts receivable management had a negative effect on financial performance of SACCOS in Kiambu County but the effect was significant (B =-0.221, p =0.002).

The study also found that accounts payable management had a negative effect on financial performance of SACCOS in Kiambu County but the effect was significant ( $B = -0.149$ ,  $p = 0.002$ ).

$$Y = 0.769 - 0.389X_1 - 0.221X_2 - 0.149X_3 + \varepsilon$$

## 5. INTERPRETATION OF THE FINDINGS

The study sought to establish the effect of working capital management on financial performance of SACCOS in Kiambu County. Working capital management was measured using three variables namely cash management, accounts receivable management and accounts payable management.

The study examined the effect of cash management on the financial performance of SACCOS in Kiambu County. Cash management was measured as the cash conversion ratio and multiplying the ratio by 365 days. The study found that cash management had a negative effect on financial performance and this effect was significant ( $B = -0.389$ ,  $p = 0.002$ ). This means that financial performance of SACCOS in Kiambu County is influenced by the cash management. A unit increase in cash management leads to a 0.001 units decrease in financial performance. This supports previous studies such as Richards and Laughlin (1980) who found that an improving liquidity position coincided with a shorter and more certain cash conversion cycle. Lazaridis and Trfonidis (2006) found a statistically negative relationship between profitability and the cash conversion cycle. Moss and Stine (1993) argue that a firm with a long cash conversion cycle is more likely to seek external financing. Therefore, to reduce the threat of debt firms should work towards reducing the cash conversion cycle.

The study assessed the effect of accounts receivable management on the financial performance of SACCOS in Kiambu County. Accounts receivable management was measured as the average collection ratio and multiplying the result by 365 days. The results also show that accounts receivable management had a negative effect on financial performance of SACCOS in Kiambu County but the effect was significant ( $B = -0.221$ ,  $p = 0.002$ ). This suggests that the average accounts receivable management influence financial performance of this SACCOS. For instance, by reducing the average collection period (ACP) to customers it is possible for the SACCOS to speed up the cash collection process. This will avail the funds which will be used for other profitable investments opportunities.

The study assessed the effect of accounts payable management on the financial performance of SACCOS in Kiambu County. Accounts payable management was measured as the average payable ratio and multiplying the result by 365 days. The results also show that accounts payable management had a negative effect on financial performance of SACCOS in Kiambu County but the effect was significant ( $B = -0.149$ ,  $p = 0.002$ ). This suggests that the average accounts payable management influence financial performance of this SACCOS. This implies that by increasing the average payable period for the suppliers will reduce the amount of cash moving out and this will release the funds for other profitable ventures.

## 6. CONCLUSION

The study concluded that cash management had a negative but significant effect on financial performance of SACCOS in Kiambu County. A longer cash conversion cycle may improve profitability in firms as it may lead to higher sales. But profitability may also decrease in the case where the cost of investment in working capital exceeds the benefits of holding large inventories. The study further concluded that accounts receivable management had a negative but significant effect on financial performance of SACCOS in Kiambu County. This implies that shorter average collection period will have an effect of increasing available cash for investment and consequent financial performance. The study finally concluded that accounts receivable management had a negative but significant effect on financial performance of SACCOS in Kiambu County. This implies that the study has indicated an inverse relationship between average payables period and return on asset.

## 7. SUGGESTIONS FOR FURTHER RESEARCH

One of the suggested areas of further research is the inclusion of listed commercial banks in a similar study. This may lead to a more generalized conclusion on findings and policy recommendation across the industry. Future research could expand this scope to include other parameters that are used to measure financial performance. Other factors such as the stock turnover and how they relate to the overall financial performance of SACCOS can be considered as moderating or

controlling variables in future studies. The study on effect of working capital management on financial performance of SACCOS should also be done on other SACCOs across other Counties besides Kiambu County to find out if the same results would be achieved

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