THE IMPACT OF FUNDING SOURCES ON WORKING CAPITAL MANAGEMENT BY SMALL AND MEDIUM ENTERPRISES IN NAIROBI’S CENTRAL BUSINESS DISTRICT

BY

MUSA N. DUMBUYA

UNITED STATES INTERNATIONAL UNIVERSITY - AFRICA

SPRING 2019
THE IMPACT OF FUNDING SOURCES ON WORKING CAPITAL MANAGEMENT BY SMALL AND MEDIUM ENTERPRISES IN NAIROBI’S CENTRAL BUSINESS DISTRICT

BY

MUSA N. DUMBUYA

A Research Project Report Submitted to the Chandaria School of Business in Partial Fulfillment of the Degree of Masters in Business Administration (MBA)

UNITED STATES INTERNATIONAL UNIVERSITY- AFRICA

SPRING 2019
STUDENT’S DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution, or university other than United States International University - Africa in Nairobi for academic credit.

Signed: ………………………….. Date: ………………..

Musa N. Dumbuya (ID 614230)

The project has been presented for examination with my approval as the appointed supervisor

Signed: ………………………….. Date: ………………..

Prof. John Mirichii

Signed: ………………………….. Date: ………………..

Dean, Chandaria School of Business
COPYRIGHT

© Copyright by Musa N. Dumbuya, 2018

All rights reserved. No part of this project report may be produced or transmitted in any form or by any means, electronic, mechanical, including photocopying, recording or any information storage without prior written permission from the author.
ABSTRACT

Small and Medium sized Enterprises (SMEs) encompass a heterogeneous group of businesses ranging from a single artisan working at home and producing handicrafts to sophisticated software product firms selling in specialized global niches. Governments throughout the world are nowadays turning their attention to small-scale enterprises because attempts to promote economic progress by establishing large industries have usually failed to improve the lives of the majority of the populations concerned. Challenges faced by SMEs in many parts of the world have been widely studied but those faced by SMEs in Nairobi’s CBD in Managing Working Capital is yet to be studied.

The purpose of this study was to determine the challenges faced by SMEs in Nairobi’s CBD in managing working capital. The research was guided by the following three specific research objectives: the effect of funding sources on working capital management, the effect of SME management on the management of working capital, and the effect of ethical perceptions and beliefs of the owners of SMEs on working capital management. To realize this, a descriptive research design is adopted. The total population of this study comprised of the 2014 list of top 100 SMEs in Nairobi from which a sample of forty eight (48) was drawn using Yamane (1967) formula. Data was collected using a structured questionnaire, cleaned, coded and formatted before being analyzed using Statistical Package for Social Sciences (SPSS) to obtain both descriptive and inferential statistics. The results were then presented inform of tables and figures.

The analysis revealed that the variable funding sources strongly influence working capital management practices in most of the SMEs in Nairobi’s CBD. It was also revealed that funding sources had a significant and positive correlation with SME owner’s ethical practices. The study also revealed that funding sources had a positive and significant influence on effective management of working capital.

The analysis indicates that 84.3% of observed change in effective management of working capital was caused by a combination of the variations in funding sources, working capital management practices, and SME owners’ ethical practices. The P-value of 0.000 was established, implying that the regression model was significant at the 95% significance level.
From the findings, it was established that one unit change in funding sources results in 0.058 units increase in effective management of working capital, one unit change in working capital management practices results in 0.056 increases in effective management of working capital, while a unit increase in SME owners ethical practices results in 0.0498 unit increase in SME owners’ ethical practices. At the same time when funding sources, SME management and ethical perceptions and beliefs are held constant, effective management of working capital increased by 0.903.

The study concluded that most SMES rely on banks as a means of securing their savings although they were limited on the amount of funds requested as loans from the banks. It was also concluded that majority of SMES make credit sales with an aim of increasing the sales volume. However, many of the institutions were keen in undertaking formal credit investigation on the customers before engaging them in debt. The change in effective management of working capital are affected by the changes in funding sources, working capital management practices, and SME owners’ ethical practices although the firms have a challenge in cash flow management to the extent they experience a challenge of paying salaries on time. Despite this challenge, the firms strive to maintain a good relationship with the suppliers by making timely payments. It was also concluded that there is a need for the institutions to seek favorable credit terms by having adequate security for loan applied or seek loans from other financial institutions not necessarily banks. SMEs should also uphold ethics to minimize cases of theft and work stoppage in the firms. Further, payments to suppliers should be made in time to ensure a constant supply of the goods and services and therefore constant sales.

The study recommended that there is a need for the institutions to seek favorable credit terms by having adequate security for loan applied or seek loans from other financial institutions not necessarily banks. SMEs should also uphold ethics to minimize cases of theft and work stoppage in the firms. Further, payments to suppliers should be made in time to ensure a constant supply of the goods and services and therefore constant sales. The study recommends that future research on the topic should be conducted in other towns within Nairobi County so that an industry wide analysis can help to uncover the factors that explain better performance for some industries and how these best practices could be extended to the other industries.
ACKNOWLEDGEMENTS

I give thanks to the Lord almighty for giving me the energy and strength to complete my studies. I also thank my family and appreciate the support they gave me throughout the study period. Last but not least, I thank my supervisor Prof. John Mirichii for the guidance he gave me during this research; may God bless him.
# TABLE OF CONTENTS

**STUDENT'S DECLARATION** ............................................................................................................ ii
**COPYRIGHT** ..................................................................................................................................... iii
**ABSTRACT** ....................................................................................................................................... iv
**ACKNOWLEDGEMENTS** .................................................................................................................. vi
**LIST OF TABLES** ............................................................................................................................ ix
**LIST OF FIGURES** .......................................................................................................................... x
**LIST OF ABBREVIATIONS** ................................................................................................................ xi

**CHAPTER ONE** ............................................................................................................................... 1
  **1.0 INTRODUCTION** ....................................................................................................................... 1
  1.1 Background of the Problem .......................................................................................................... 1
  1.2 Statement of the Problem ............................................................................................................. 6
  1.3 General Objective ........................................................................................................................ 7
  1.4 Specific Objectives ...................................................................................................................... 7
  1.5 Importance of the Study .............................................................................................................. 7
  1.6 Scope of the Study ....................................................................................................................... 8
  1.7 Definition of Terms .................................................................................................................... 8
  1.8 Chapter Summary ....................................................................................................................... 10

**CHAPTER TWO** ............................................................................................................................. 11
  **2.0 LITERATURE REVIEW** .......................................................................................................... 11
  2.1 Introduction .................................................................................................................................. 11
  2.2 Effect of Funding Sources on Working Capital Management .................................................. 11
  2.3 The Effect of SME Management on the Management of Working Capital ......................... 15
  2.4 Effects of Ethical Perceptions and Beliefs of SMEs Owners on Working Capital Management .................................................. 18
  2.5 Chapter Summary ....................................................................................................................... 24

**CHAPTER THREE** ............................................................................................................................ 25
  **3.0 RESEARCH METHODOLOGY** .............................................................................................. 25
  3.1 Introduction .............................................................................................................................. 25
  3.2 Research Design ......................................................................................................................... 25
3.3 Population and Sampling Design .................................................................................. 25
3.4 Data Collection Method .............................................................................................. 28
3.5 Research Procedures .................................................................................................. 28
3.6 Data Analysis Methods .............................................................................................. 29
3.7 Chapter Summary ...................................................................................................... 29

CHAPTER FOUR ................................................................................................................. 30
4.0 RESULTS AND FINDINGS .......................................................................................... 30
4.1 Introduction ................................................................................................................ 30
4.2 General information ................................................................................................... 30
4.3 Effects Of Lack Of Funding On Working Capital Management In SMES .................. 33
4.5 Effects of Owners of SMEs Belief and Ethical Perception on Working Capital Management .......................................................................................................................... 41
4.6 Descriptive Statistic .................................................................................................. 45
4.7 Regression and Correlation Coefficients .................................................................... 46
4.8 Chapter Summary ...................................................................................................... 50

CHAPTER FIVE .................................................................................................................... 51
5.0 DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS ............................... 51
5.1 Introduction ................................................................................................................ 51
5.2 Summary ................................................................................................................... 51
5.3 Discussion .................................................................................................................. 52
5.4 Conclusion ................................................................................................................ 55
5.5 Recommendations .................................................................................................... 56

REFERENCES ..................................................................................................................... 58
Appendix: Data Collection Instrument .............................................................................. 64
LIST OF TABLES

Table 3.1: Population Distribution ................................................................. 26
Table 3.2: Sample Size per Strata .................................................................. 28
Table 4.1: Gender of Respondents ................................................................. 30
Table 4.2: Age of Respondents ..................................................................... 31
Table 4.3 Funding Sources ........................................................................... 33
Table 4.4: Correlation between the variables of Funding .............................. 36
Table 4.5: Management Practices .................................................................. 37
Table 4.6: Correlation of Variables of Management Practices ....................... 41
Table 4.7: SME Owners Ethical Practices ...................................................... 42
Table 4.8: Correlation of SMES Owners Belief and Ethical Perception .......... 45
Table 4.9: Descriptive Statistics .................................................................... 46
Table 4.10: Correlation Coefficients ............................................................... 47
Table 4.11: Regression Coefficients ............................................................... 49
Table 4.12: Model Summary ......................................................................... 49
Table 4.13: Analysis of Variance (ANOVA) .................................................. 50
LIST OF FIGURES

Figure 4.1: Highest Education .................................................................................. 31
Figure 4.2: Nature of Enterprise .................................................................................. 32
Figure 4.3: Marital Status .......................................................................................... 32
Figure 4.4: Number of Employees ............................................................................. 33
Figure 4.5: Bank account ............................................................................................ 34
Figure 4.6: Frequency of Banking .............................................................................. 34
Figure 4.7: Access to Credit Facilities ........................................................................ 35
Figure 4.8: Gets Funds Requested .............................................................................. 35
Figure 4.9: Adequate Security for Loan Applied ......................................................... 36
Figure 4.10: Selling On Credit .................................................................................... 37
Figure 4.11: Undertaking of Formal Credit Investigation ............................................ 38
Figure 4.12: Piles Up of Goods for Resale ................................................................. 38
Figure 4.13: Record Keeping ....................................................................................... 39
Figure 4.14: Undertake Regular Stock Taking ............................................................ 39
Figure 4.15: Re order level policy .............................................................................. 40
Figure 4.16: Fairness to Employees .......................................................................... 42
Figure 4.17: Fair Remuneration ................................................................................ 43
Figure 4.18: Salaries Paid On Time .......................................................................... 43
Figure 4.19: Suppliers Paid on Time ....................................................................... 44
Figure 4.20: Credit Facilities Paid on Time ............................................................... 44
LIST OF ABBREVIATIONS

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>CBD</td>
<td>Central Business District</td>
</tr>
<tr>
<td>CCC</td>
<td>Cash Conversion Cycle</td>
</tr>
<tr>
<td>CIMA</td>
<td>Chartered Institute of Management Accountants</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>SME</td>
<td>Small and Medium Enterprises</td>
</tr>
<tr>
<td>SPSS</td>
<td>Statistical Package for Social Sciences</td>
</tr>
<tr>
<td>WCM</td>
<td>Working Capital Management</td>
</tr>
</tbody>
</table>
CHAPTER ONE

1.0 INTRODUCTION
1.1 Background of the Problem

According to Fisher, Eillen, Rebecca and Reuber (2000), the term Small and Medium-sized Enterprises (SMEs) encompasses a heterogeneous group of businesses ranging from a single artisan working at home and producing handicrafts to sophisticated software product firms selling in specialized global niches. SMEs have varying definitions among different countries. What is and what is not an SME is usually defined by the number of employees in the firm. According to Fisher et al. (2000), developed nations will have a higher size threshold in their definition of SMEs than those in less developed countries. In Mauritius, SMES are firms with ten to forty nine employees while in Japan firms with less than three hundred employees are considered SMEs. According to Khalique, Isa, Shaari, and Ageel (2011), enterprises that employ between 50-150 full time employees in Malaysia are considered medium size, those employing between 5-50 persons are considered small, while those employing less than 5 employees are considered micro enterprises. For the purpose of this paper, an SME is defined as a firm with one to fifty employees.

Memba, Gakure and Karanja (2012), posit that nowadays governments throughout the world are turning their attention to small-scale enterprises because attempts to promote economic progress by establishing large industries have usually failed to improve the lives of the majority of the populations concerned. They add that Small and Medium Enterprises (SMEs) are now viewed as important in even and equitable economic development. Small and medium-sized enterprises (SMEs) play a critical role in a nation’s economy.

According to Paik (2011), Small Business Administration estimated SMEs to represent 99.7% of all employer firms in the United States of America in 2010 that SMES employed about 50% of the private sector workforce and paid more than 45% of total private payroll in the country. He further contends that similar economic effects are found in the United Kingdom in 2010, where SMEs accounted for about 50% of the GDP of United Kingdom (UK) and almost 60% of manufacturing employment.
According to Smit and Watkins (2012), the importance of small businesses is recognized in numerous African countries such as Togo, Uganda, Ghana, Cote D’ivoire, Nigeria, Kenya, Malawi, Burkina Faso and many others. Further SMEs are dominant in numbers in most economies. They note that in First World countries like the United States of America and the United Kingdom, SMEs play an important role in the economy, accounting for an estimated one third of industrial employment and a lower percentage of output whereas in Third World countries where SMEs dominate economically active enterprises, SMEs prosperity is considered far more important than in First World countries.

Sunday (2011), highlights that SMEs play a key role in economic growth and development of a nation. He states that SMEs account for at least 60% of Gross Domestic Product (GDP) in the United States of America (USA). For example, an SME like Microsoft in the USA started by Bill Gates and Paul Allen on 4th April 1975 with only 11 employees later grew into a well-known corporate body with 128,076 employees as at 30th June 2014. In the Malaysian economy, the role of SMEs is considered the backbone of the economy (Khalique et al., 2008). They add that Malaysian SMEs, particularly those in the manufacturing sectors, play a very important role in the development of the economy. According to them, SMEs comprised of 99.2% of the business establishments in Malaysia in 2006 with a contribution of 47.3% of the GDP. Moreover, the role of SMEs in job creation was also very important and vital. Further, they stated that in 2006 SMEs employed 65.3% of the national workforce in Malaysia.

Muchina and Kiano (2011) also established that in developing countries, over 90% of all firms outside the agricultural sector are SMEs and that they generate a significant portion of GDP. They indicate that in Ecuador, 99% of all private companies have less than fifty employees and account for 55% of employment while in Morocco 93% of all industrial firms are SMEs and account for 38% of production, 33% of investments, 30% of exports and 46% of employment. Closer home in Kenya, the SME sector contributed over 50% of all new jobs created in 2005 and contributed an estimated 18% of the GDP in 2010 (G.O.K, 2012).

According to Khalique et al. (2008), more than 50% of SMEs generally collapse within the first five years of operation. In Kenya, regardless of the contribution SMEs make in
the economy and the support to the sectors earmarked by the government, SMEs continue to face the threat of failure, with past statistics indicating that three out of every five SMEs fail and close within the first few years of starting (Sonia, 2009).

The government of Kenya in its blue print “Vision 2030” aims at moving Kenya towards an industrialized middle-income country, capable of providing a high quality of life for all its citizens by the year 2030. In this blue print, the government acknowledges that SMEs will need to be strengthened (Kenya Vision 2030: The Popular Version, G.O.K, 2010). Bhattacharya (2001) has defined working capital as the excess of current assets over current liabilities. This is a common definition in many finance textbooks. Stice and Stice (2013) share this view that current assets and liabilities expected to be paid within a year are current items.

According to Agyei-Mensah (2012), effective working capital management can free up cash and generate more earnings today. This is particularly important in tight credit markets. He adds that a continuous improvement program focused on cash management, accounts receivable performance and inventory management is part of fundamental business management. He posits that the path to success is a disciplined approach that challenges management to improve the working capital metrics every day. Firms can generate operational capital by minimizing their investment in fixed assets through renting or leasing plant and equipment but they cannot avoid investing in key current assets such as cash, trade debtors, and stock.

The relationship between sales growth and the need to finance current assets is close and direct. The major objective of working capital management is to maintain the optimum balance for each of the working capital components. This includes the firm ensuring that it is able to continue its operations and that it has sufficient ability to satisfy both maturing short-term debt and upcoming operational expenses. The management of working capital involves managing inventories, accounts receivable and payable, and cash. However, such cash may more appropriately be “invested” in other assets or applied in reducing liabilities. Each component of working capital (namely inventory, receivables and payables) has two dimensions: time and money (Agyei-Mensah, 2012).

In managing capital, time is money. Getting money to move faster around the cycle, for example collecting monies due from debtors more quickly enables the business to generate more cash or to borrow less to fund working capital. Consequently, this will
reduce the cost of borrowing or result to additional free cash available to support additional sales growth or investment (Agyei-Mensah, 2012). Further, Moyer et al. (2001) submit that effective cash management is particularly important for small firms for various reasons. One, to prepare financial plans to support application for bank loans; two, to overcome the problem of limited access to capital that the SMEs generally face; three, to avoid cash shortages that entrepreneurial firms with rapid growth face including run out of cash; and four, cash resources to boost entrepreneurial firms and avoid their habits of frequently operating with only a minimum of cash resources owing to the high cost of loans and limited access to capital.

Working capital refers to the cash a business requires for day-to-day operations, or more specifically to cash resources used in financing the conversion of raw materials into finished goods, which the company then sells for revenue. The most important items of working capital are cash, inventories, account receivables, and account payables. The better SME’s manage their working capital the lesser the need to borrow (Agyei-Mensah, 2012).

Optimizing cash flow is a major issue in ensuring the firm’s financial viability and sustainability. An efficiently organized cash flow reflects the financial health of the company. The need to optimize cash flows arises primarily from the movement of material flows of funds in the required quantities at the right time and with the use of the most efficient sources of funding. When companies have cash deficiency they are not able to effectively undertake working capital management (Gafurova, 2015). Even companies with cash surpluses generally need to manage working capital to ensure that those surpluses are invested in ways that will generate suitably high returns for the business. Implementing an effective working capital management system is an excellent way for many SME to improve their earnings. The difficulty in gaining access to resources and financial markets is due largely to the fact that SMEs usually have little or no collateral. The few financial institutions and the Microfinance institutions that give credit to SME’s charge very high interest rates to make up for the high risk of granting credit to SME’s. This prompts entrepreneurs to look for other avenues to fund their businesses, which includes resorting to borrowing from friends and family, ploughing back profit, and using own savings among others to avail funds which are usually inadequate. Due to the challenges SME’s go through in securing funds to operate their activities, it is prudent for
them to effectively and efficiently manage the available components of working capital in order to generate funds to support business operations (Bhattacharya, 2001).

According to Mathur (2003), working capital management encompasses the management of all the individual constituents of the working capital, i.e. the debtors, creditors, inventories stock, and cash, both individually and collectively. It is therefore more complex and requires necessary financial knowledge and information. The working capital of the firm is ever changing with every purchase or sale, because with every purchase or sale transaction, the net current assets and current liabilities change. It is dynamic system as financial resources are continuously transformed from one type of asset to another in what is known as the operating cycle of the business (Ryan, 2008). Ryan (2008) further adds that working capital management is the process of ensuring that all aspects of this dynamic system operate efficiently where inventories are maintained at minimum levels necessary to meet the needs of production and of customers, receivables and payables are settled promptly to minimize bad debts, and cash is put to other use within the business or is returned to investors in form of dividends.

The term operating cycle of a business is sometimes loosely used to imply its cash conversion cycle (CCC). The operating cycle starts with the acquisition of inventory either as stock for resale or for processing to finished goods that are later sold either on credit or by cash. The cycle then ends when cash is collected from the credit (Ross, Westerfield & Jordan, 2008). Ross et al. (2008) continue to define CCC as the number of days it takes before cash is collected from sales measured from when payment for the inventory or raw materials from a sale is actually made. Operating cycle is therefore longer than CCC. The difference between the two is the time it takes to pay for the credit purchases. For example if it takes 30 days for the firm to pay its suppliers, another 45 days to resell the goods and another 60 days to collect the cash from credit sales, then the operating cycle will be 135 days (i.e. 30 days + 45 days + 60 days = 135 days), while the CCC will be 105 days (i.e. 45 days + 60 days = 105 days).

According to Ross et al. (2008), financial managers are concerned with three key decisions: Capital budgeting decisions, Capital structure decisions, and Working capital decisions. Capital budgeting decisions entails what long term investments a firm should undertake or what lines of business the firm will be in and what sort of buildings, machinery, and equipment it will need. Capital structure decisions involve finding out
where the firm will get its long-term financing to pay for its investments, whether the firm will bring in other owners or whether it will borrow the money. Working capital decisions involves finding out how the firm will manage its everyday financial activities (including collecting from customers and paying suppliers). In a nutshell, working capital management is one of the core functions of management and is one of the pillars in financial management of a firm. Proper working capital management will ensure the firm always has the cash to meet its liabilities as they fall due.

1.2 Statement of the Problem

The subject of working capital management in relation to SMEs has been widely studied by academicians. This area in finance has been looked at in various ways. Sunday (2011) covered ‘Effective Working Capital Management in Small and Medium scale Enterprises’ using the working capital ratios to measure the effectiveness of working capital in the selected firms. The study revealed that the selected firms were involved in overtrading and illiquidity, their main concern being profit maximization.


Khalique et al. (2011) concentrated on general management challenges faced by SMEs in Malaysia. From the various studies highlighted it is clear that SMEs in many parts of the world face challenges in working capital management while studies on the challenges facing SMEs in Nairobi’s CBD are not fully exhausted. Further, the environment in which SMES operate in developed countries is quite different from one in which SMES operate in developing countries like Kenya. Therefore, there was a need to carry out studies on how SMEs manage their working capital in less developed countries, hence the motivation behind this study.
1.3 General Objective

The main objective of the study was to investigate the impact of funding sources on working capital management by small and medium enterprises in Nairobi’s central business district.

1.4 Specific Objectives

The specific objectives of this study were:

1.4.1 To determine the effect of funding sources on working capital management in SMEs

1.4.2 To determine the effect of SME management on working capital management in SMEs.

1.4.3 To establish the effect of ethical perceptions and beliefs of the owners on working capital management of SMEs.

1.5 Importance of the Study

1.5.1 Small and Medium Enterprises

The importance of the study stems from the fact that SMEs failure rate is quite high and thus the findings in this study will help SMES in Nairobi to better manage their working capital.

1.5.2 Policy Makers

This research will be significant to policy makers as it sheds light on impact of funding sources on working capital management and give possible solutions and recommendations of the challenges faced.

1.5.3 Financial Institutions

To financial institution, the finding of this study with regard to the adequacy of collateral will help in determining the amount of loan levels that the firm can issue to SMEs as well as any exemptions that can be made in line to collateral needs when loan is applied for.
1.5.4 Scholars

The findings of this research will help other scholars understand the problems of working capital management of SMES. In addition, the research results will be used as a reference for future studies.

1.6 Scope of the Study

This study covered a portion of the Small and Medium-sized Enterprises in Nairobi’s CBD with between 1 to 50 employees. The target population was all SMEs in the Nairobi CBD. Nairobi CBD is home to hundreds of SMEs and therefore, a sample was selected and studied from the SMEs on the 2014 list of top 100 SMEs in Kenya. The total number of SMEs operating in the Nairobi CBD in this list was 54 and a sample of 48 was selected. Lack of cooperation was undoubtedly the greatest challenge encountered by the researcher. Respondents were naturally suspicious and uneasy when asked to cooperate in a study whose consequences they were not aware of. To calm and set at ease the respondents, the researcher explained to them the nature of the study and that it was purely an academic undertaking and that the researcher would hold information divulged in great confidentiality.

1.7 Definition of Terms

1.7.1 Small and Medium sized Enterprises

A firm that is owner managed and employs between 10 to 49 employees (Fisher et al., 2000).

1.7.2 Working capital

Working capital, is that part of the capital of a firm that is employed in its day-to-day trading operations and consisting mainly of trading stocks, debtors, and creditors (Appah, 2011).

1.7.3 Current Assets

Assets that forms part of the circulating capital of a business and turned over frequently in the course of trade. The most common current asset is stock in trade, debtors, and cash (Gafurova, 2015).
1.7.4 Current Liability

Amount owed by a business to other organizations and individuals and that should be paid within one year. It generally consists of trade creditors, bills of exchange payable, taxation, social-security creditors, proposed dividends, accruals, deferred income, payments received on account, bank overdrafts and short term loans. Any long-term loan repayable within one year from the balance sheet date is also be included (Bhattacharya, 2001).

1.7.5 Operating Cycle

The length of time it takes the firm to acquire goods or raw materials, convert them into finished products, sell the finished products and collect the cash (Ross, et al., 2008).

1.7.6 Cash Conversion Cycle (CCC)

The operating cycle less the time, it takes to acquire the goods for resale or raw materials (Ross et al., 2008).

1.7.7 Debtors

Debtor is those who owe money to the organization and expected to be paid within a period of one year. A distinction is made between one who is expected to pay debt during the current accounting period and one who will not pay until later (Hisrich, 2004).

1.7.8 Creditor

One to whom an organization or person owes money. The balance sheet of a company shows the total creditors and a distinction is made between creditors who ought to be paid during the coming accounting period and those who ought to be paid after the accounting period (Pieterson, 2012).

1.7.9 Inventory

Also called stock, these are the goods an organization has for the purposes of trade. It includes raw materials components, work in progress and finished products (Reuvid, 2006).
1.7.10 Gross Domestic Product (GDP)

The aggregate value in monetary terms of all goods and services produced by an economy for its use during a period, usually one year (Pieterson, 2012).

1.8 Chapter Summary

This chapter describes the background of working capital management with regard to small and medium enterprises. The chapter also looked into the research problem and justifies the reason for undertaking this research. In addition, the significance, limitations, and definition of terms of the study were highlighted. Chapter two reviews the literature and provides an insight of the challenges faced by SMEs in working capital management. In chapter three, the research methodology is discussed, while in Chapter four the results and findings are presented. Finally in chapter five, the discussions, conclusions and recommendations are presented.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

This chapter reviews the literature on the challenges faced by Small and Medium Enterprises in the management of working capital. The literature discusses the effect of lack of adequate funding on working capital management, the effect of SME management on management of working capital and the effect of unethical practices and beliefs of owners of SMEs on working capital management.

2.2 Effect of Funding Sources on Working Capital Management

Sources of working capital are many and include family loans, owners’ equity, share capital, loans from friends, leasing, supplier advances, hire purchasing and bank loans. Bank loan is the most common source of finance for SMEs in Kenya. According to Reuvid (2006), bank financing normally include term loans, overdrafts and asset finance. Moreover, according to Hisrich (2004), another common bank finance facility is credit line financing, which is the major form of working capital financing and is popular with SMEs. According to Agyei-Mensah (2012), access to finance continues to be a major challenge to SMEs in other African countries like Ghana.

2.2.1 Difficulty in Accessing Financial Services

SMEs face many difficulties in their endeavour to access financial services. Memba et al. (2012) says that the challenges limiting SMEs access to financial services include lack of tangible collateral coupled with inappropriate and inadequate legal and regulatory framework that does not recognize innovative strategies for lending to SMEs. Hisrich (2004) also shares the view that lack of collateral limit SME’s access to financial services. He posits that when SMEs lack tangible security, banks and other financial institutions can decide to advance loans based on the positive character or reputation of the SMEs or the SME good credit standing. However, the amount advanced is limited due its high exposure to risk of default considering that most SMEs have very uneven cash flows.
Banks and other financial institutions have contributed to the challenges in accessing formal finance by SMEs because the institutions have limited capacity to understand and deliver services to SMEs. Formal financial institutions, and especially commercial banks, believe that SMEs are a high risk and therefore lending to them is not commercially viable (Hisrich, 2004).

According to Agyei-Mensah (2012), an investor who injects funds into SME business, either as debt or equity will want to closely monitor the SME to ensure compliance with the agreed contract and to compel the SME to respect the interests of the financier. SMEs find it more challenging complying with the financiers’ contract than larger corporations do because relative to large firms, SMEs are more likely to be informal. Consequently, financial institutions and particularly banks are likely to ration credit to SMEs extending only the portion of credit requested or applied for by the SMEs, even when the borrower (SME) is willing and capable of paying a higher interest rate than larger companies pay.

2.2.2 Limited Access to Resources

SMEs are often faced with the challenge of limited access to financial and other resources, including time to train workers who often have little formal education. The SME sector is characterized by a wide clash of growth and profitability, relative to larger enterprises (Agyei-Mensah, 2012). SMEs also portray a larger year-to-year volatility in earnings. Further, it is perceived that SMEs inherently have higher risk because their survival rate is considerably lower compared to larger firms. The challenges in accessing financial resources is largely attributed to the fact that SMEs’ usually have inadequate or no assets to act as collateral for loans compared to the large firms. The few financial institutions such as banks and microfinance institutions that extend credit to SME’s set high price for credit facilities to compensate for the high risk they face (Sunday, 2011). Besides, it is usually not easy to differentiate between personal finances of the SME owner from those of their firm. This difficulty is evidenced by the fact that the owners use the firms’ vehicles as collateral to acquire loans for both business and private purposes. In other instances, home appliances are used in the business operations. Furthermore, the relationship between the firm and its stakeholders is likely to reflect personal relationships to a much higher extent than in larger firms, where such relationships are formalized and the distinction between the firm and the owners is very clear. While SMEs tend to largely reflect the personalities of their proprietors, larger firms are unique and separate from the owners (Berger & Udell, 2006). The actors in such firms like auditors,
board of directors and executives are meant to meet set standards in corporate governance, and all their actions are supposed to be transparent. This is not the case with SMEs that tend to reflect much more closely the personalities of their owners.

There are also potential agency challenges in SME business while the financier will require the borrower to operate in such a way that the probability of credit repayment is maximized. SME borrower may take up riskier businesses in search of higher returns. Again, financing is secured; he SME may be tempted to change the initial goal and pursue extremely risky projects, which is driven by expectations of higher return, largely beneficial to the entrepreneur. The financier normally will prefer less risky projects to increase the loan repayment probability (Berger & Udell, 2006). This challenge, which is potentially inherent in all types of financing, is greater in smaller organizations and in particular restricts the SMEs from gaining finance especially from formal financing sources such as banks.

There is also the challenge of lack of information. Information asymmetry is a bigger problem in SMEs than in larger firms. The SME entrepreneur or proprietor will normally have access to better information regarding the business operations than the financiers. Besides, the SME has the freedom to decide whether to share all the information, part of the information or nothing with the outsiders (Appah, 2011). As a result, outsiders are limited to the information made available to them by the entrepreneur. The entrepreneur or the proprietor is also likely to have less technical capabilities and less knowledge in the particular area of trade than those in larger firms (Karanja, 2012). They may however better adapt to an uncertain environment. The SMEs also lack access to appropriate technology, management skills, and training that impede their development.

2.2.3 Management of Funds

Khazi (2006) demonstrates the relationship between sources of funds and effective management of working capital by discussing the effect of excess and shortage of funds to the performance of the SMEs. Holding excess funds means that there is an opportunity cost in form of returns that the business foregoes. On the other hand, shortage of funds will disrupt the firm’s operations. Such a situation requires that organizations design and implement appropriate funds management system to ensure that the best return is derived from every single coin held by the business at any time.
The management of small-scale and medium-size businesses should establish and strengthen the internal controls over funds and other resources to reduce mismanagement and misappropriations (Berger & Udell, 2006). These may include segregation of duties such as approvals and authorization of expenditure, design and implementation, approvals, and authorization of physical controls, ensuring accuracy in accounting, effective supervision of employees, and daily banking of funds received to reduce internal fraud (Wilkes, 2006).

Khazi (2006) further recommends that small-scale businesses should introduce incentives to motivate their employees to use the company funds as intended. For example, businesses can increase salaries, wages, and non-monetary rewards (like presents or gifts) to all employees who diligently carry out their duties in accordance with company policies. This will reduce the number of embezzlement cases and theft of business funds and develop a culture of commitment, honesty, transparency, and accountability that in turn will lead to efficient management of funds. The management of small-scale and medium-size businesses should therefore employ competent staff who have experience and skills in funds management. This will go a long way in putting the company funds into viable ventures and enhance profitability. Further, SMES need to have available capital in order to operate efficiently, enter into new business ventures or to expand their businesses (Gafurova, 2015).

2.2.4 Effect of Sources of Funds on Profitability

Wilkes (2006) argues that if a firm does not manage its funds properly it can easily go into liquidation due to cash flow constrains. This may manifest as failure to pay outstanding liabilities to suppliers and wages to employees, and failure to meet the costs of the day-to-day operations. This has an adverse impact on the performance of the SMEs. According to Beck, Demirgüç-Kunt, Laeven, and Maksimovic (2006), a firm that keeps too much funds foregoes a return, which it would otherwise have earned if it invested the funds in profitable ventures. This is because funds can be lent out even for short periods to earn interest. The organization must therefore establish and install programs on sourcing and use of funds to ensure that there is a balance between benefits and costs. This impact on the working capital of the firm, especially on small scale and medium enterprises.
Shaw (2006) explains that an organization that properly manages its funds and maintains a positive balance on bank accounts may increase its profitability. Having positive funds balance enables a firm to take advantage of discounts from suppliers, purchase more inputs to expand the business and enables the company to venture into investments that are more profitable.

There is also the issue of informational barrier. Asymmetric information is a more serious problem in SMEs than in larger firms. The entrepreneur has access to better information concerning the operation of the business than the suppliers of finance and has considerable leeway in deciding whether to share such information with outsiders (Berger & Udell, 2006). Hence, it may be difficult for the business financiers to determine whether the entrepreneur is making erroneous decisions and to understand the business adequately. As a result, SMEs often cannot obtain long-term finance in the form of debt and equity. In addition, although SMES may be more adapted to operating in an uncertain environment, the entrepreneur is also likely to have less training and therefore less know-how on the daily operations of the business than those in larger organizations.

2.3 The Effect of SME Management on the Management of Working Capital

According to McChlery, Meechan, and Godfrey (2004), proper financial management is vital in the survival and growth of every business. In a research conducted in Quebec-Canada for the Chartered Institute of Management Accountants (CIMA), they identified some of the reasons which spur and hinder sound financial management systems in SME’s to include the access to computerized accounting systems for periodic financial reporting; interference by firm directors or owners with the company funds; the level of employee motivation; qualifications and competence of accounting personnel; the costs and benefits of accounting experts to the firm; and pressure from financiers as they seek collateral for financing. They further indicated that an important number of those organizations surveyed in Quebec were viewed as practicing sound financial management. This included the employment of working capital management and capital budgeting techniques. Data in the study confirm that some of these factors spur the application of sound financial management in organizations. Based on the findings of the study SME owners and managers are encouraged to install and use proper accounting information systems.
In their study on barriers and catalysts to sound financial management systems in small sized enterprises, McChlery et al., (2004) identified several factors that act as hindrances to the development of sound financial management systems. First is the lack of internal accounting staff and lack of motivation, training, and qualification. This can act as a significant hindrance to the development of sound management systems. Secondly, some of the accountants employed by the firm do not add any value to the firm and appear not to have insight to the needs of SMEs. Quite a number of firms surveyed in that study indicated their disappointment at the little support and advice that was extended to them by some of their external accountants. They personally believe that they do not usually get minimal advice on the development of their financial systems especially in the aspect of management accounting. Thirdly poor overall support, inappropriate targeting, and delivery of training are hindrances to the development of sound financial management systems.

2.3.1 Short Term Financial Management Practices

In their study on short-term financial management, Maness and Zietlow (2002) presented two models used for value creation. The first model is the receipts and disbursement model that utilizes the amount of cash expected to be received and spent by the company over the given period. The second model is the adjusted net income model, which provides a representation of changes in asset and liability accounts. The two models incorporated effective short-term financial management activities. However, the two models are generic and do not take into consideration the unique firm or industry influences. The authors discuss industry influences on short-term financial management, and in a short paragraph observed, “An industry in which a company is located in may have more influence on that company’s fortunes than overall GNP.” A careful review of this 627-page textbook reveals only sketchy information on actual firm level working capital management dimensions and virtually nothing on industry factors except for some boxed items with titles such as “Should a Retailer Offer an In-House Credit Card” and nothing on working capital management stability over time.

Financial management is considered one of the functional areas of management that forms the focus to the success of any enterprise. A firm with an inefficient financial management process may often result in the enterprise suffering from cash problems. According to a research by Kawame (2010), unplanned financial management practices are among the major causes of failure for SMES in Ghana. Such practices were also
found to affect the profitability of the company. Consequently, a firm’s profitability could be reduced by utilization of inefficient financial management practices. Moreover, the levels of uncertainty of the firm’s business environment has forced many firms to excessively rely on equity and high liquidity, which adversely affect the financial position and profitability.

According to Waweru and Ngugi (2014), financial innovations have an impact on the performance of Small Enterprises in Kenya. This was because firms undertake innovation with the aim of making profits. The study also established a statistical significance between firms’ performance and working capital. Further, a study by Fatoki (2012), on financial management in South Africa SMES with focus on financial planning and control, accounting information, financial analysis, management accounting, working capital management, and investment appraisal revealed that a majority of new micro-enterprises do not undertake financial planning and control, financial analysis and investment appraisal.

2.3.2 Accounts payable management practices

In a recent research on cash management practices of 123 small firms (SME’s) across a variety of industries in the Canadian provinces of Quebec and Ontario, Anvari and Gopal (cited in Agyei-Mensah, 2012) indicated that fifty three percent of the small firms sampled projected their cash flows. Only twenty-six percent of the respondents to the survey said they used formal techniques such as fixed percentage of sales, purchases, or expenses in determining the level of their cash balances. Approximately seventy-one percent of firms indicated that they regularly monitored their current accounts, with smaller firms (SME’s) less likely to do so than the larger firms did.

Agyei-Mensah (2012) outlines the inventory management practices of a sample of 94 small businesses (SME’s) operating in a range of industries and located in the state of Virginia. It was found that businesses, with higher inventory turnover rate, were more likely to be using some form of inventory management system and to be evaluating the financial attractiveness of investment in inventory using payback period or discounted cash flow measures.

Although most of the respondents in the earlier study by Grablowsky and Rowell (1980) had in excess of thirty percent of their capital invested in inventory, only six percent used a quantitative technique such as “economic order quantity” to optimize inventory, and
fifty four percent had accounting systems which were unable to provide information on inventory turnover, reorder points, and ordering costs. These findings on inventory management practices of small firms (SME’s) in the study failed to take into account recent inventory management techniques such as Just in Time, quality control management, and product engineering techniques.

A survey conducted on accounts payable management practices, particularly those relating to cash discounts by various academicians indicated that less than fifty percent of small businesses (SMEs) owner-managers see accounts payable as a financing source for their businesses (Agyei-Mensah, 2012). More than seventy percent of respondents in the study said that they took advantage of cash discount when made available. The studies however failed to comment on the level of usage of accounts payable management practices by those firms (SMEs). The study was quiet on how frequent such firms reviewed their accounts payable. In another survey on the accounts receivable management practices of small businesses (SMEs) in Virginia, Grablowsky and Rowell (1980), cited in Agyei-Mensah (2012), found negative practices to be predominant. About ninety-five percent of firms that sold on credit had the tendency to sell to whoever wished to buy. Only thirty percent of respondents subscribed to a regular credit reporting service such as Bradstreet and Dun. Most firms did not have credit checking guidelines and procedures and only about fifty-two percent enforced a late payment fee. Further thirty-four percent of firms had no formal procedure for aging accounts receivable. Overall, only twenty percent of the businesses in this survey engaged a full-time credit officer. This factor had the most important influence on management of accounts receivables. In the firms surveyed, many firms viewed accounts receivable levels as being exogenously arrived at and beyond their active control. The finding that owner managers often neglect accounts receivable management may however not be relevant today due to the advancement in use of computer software’s on working capital management techniques (Agyei-Mensah, 2012).

2.4 Effects of Ethical Perceptions and Beliefs of SMEs Owners on Working Capital Management

2.4.1 Ethical Perception

According to Alvares, Merino and Gongzalez (2012), perception is determined by the individual’s intellectual profile. Such profile refers to the set of individual traits that relate
to the varying actions and thought that managers engage in. Workplace Employment Relations Survey (WERS) done in the year 2004 showed that employees in small firms were more satisfied than those in larger one. As such, these employees tend to have a higher job commitment to their job (Forth et al, 2006). However, there are claims that small establishments are more prone to cases of unfair dismissal claims since the 1980s in the UK. As a result of this trend, the UK saw the creation of statutory employment rights in the late 1990s (Kersley et al, 2006). According to Hann (2012) SMEs have become very vulnerable to the statutory rights issue due to lack of resources to keep updated with the changes. In particular, lack of internal Human Resources (HR) expertise is the main concern because of the owners being the final authority in the daily running of staff welfares.

According to Phatshwane (2013), ethical perceptions and beliefs affect people’s attitudes and the degree to which they accept unethical practices or the manner in which they view ethical decisions made by other people. According to the study, examining managers’ ethical perceptions in different organizational and national settings has been useful in shaping and informing ethical behavior and knowledge, hence the growth of academic interest in this area. Researchers tend to agree that there has been more interest in the study of ethical perceptions and behavior of large corporations as opposed to that of smaller businesses. The study adds that the ethics of small business managers in usually about ‘your business, your ethics, your gains and losses’ since business owners stand to gain or lose directly from the outcome of ethical choices made by themselves and their employees. This is in contrast to unethical decisions made by managers in larger corporations, whose effects tend to have much more far-reaching effects on society, because of financial losses either to investors or negative publicity brought to the firm or the country. Managers of small businesses think that ethical standards are lower today than in the previous decades and they feel that they are more ethical than lower level managers are and other employees in their firms (Vitell, Dickerson & Festerrand, 2000).

To this end, Phatshwane (2013) suggests that entrepreneurial activities are directed along the lines of a manager’s codes of ethical behavior. In recent years, the Kenya Government has pinned its economic diversification strategy on the development of Small and Medium Enterprises (SMEs). This is evidenced by the recent creation of the ministry of industrialization and enterprise development and the subsequent introduction of the youth enterprise fund and the women enterprise fund to enable women and youth to start up
small businesses. Some researchers suggest that SMEs in developing countries lack awareness and understanding of business ethics and its importance in advancing one’s business prospects.

Painter-Morland and Dobie (2009) state that in many African settings, small business managers did not believe that corrupt practices are a problem in their society despite the prevalence of bribery in many countries included in the study. The study results suggest that small business managers are often brought into unethical business practices through their association with larger business entities, which they need for financial survival. This then becomes the ‘accepted’ state of doing business and given that subordinates are good learners, they too become contaminated by practices that pervade organizations.

According to Klos (2006), the level of organization remuneration is a factor that has been greatly discussed and according to various research, the extent of employee remuneration varies between firms of different size, age, and category. Employee wages are also determined by their productivity and this is entirely dependent on the employees’ knowledge, experience, and nature of the job. In addition, all types of incentive have been found to influence employees’ motivation to work harder and thus increase a firm’s productivity.

2.4.2 Beliefs of SMEs Owners on Working Capital

There is currently increasing pressure on business organisations to be ethical, in addition to running their operations in the most economical, efficient and effective manner possible to increase performance (Khomba & Vermaak, 2012). Due to continually changing competitive environments, businesses must also find new ways of meeting competition other than the traditional ways of offering better products, or lower prices (McMurrian & Matulich, 2006). It is important to note that modern businesses employ people with diverse backgrounds in terms of nationality, culture, religion, age, education and socioeconomic status. Each of these persons comes into the workplace with different values, goals and perceptions of acceptable behaviour. This diverse background creates ethical challenges for individuals as well as managers (Abiodun & Oyeniyi 2014). Businesses have realised that ethical misconduct can be very costly not only for the organisation but also to society as a whole (Abiodun & Oyeniyi 2014). Furthermore, today’s customers have become increasingly mindful of the reputation of the businesses they patronise. Consequently, small and medium-sized enterprises (SMEs) have become
the worst affected since they lack the funds, strategic information and relevant alliances (Ononogbo, Joel & Edeja, 2016) to implement ethical practices.

Regardless of their size, business enterprises can no longer afford to disregard business ethics (Sraboni & Sharmistha 2011). SMEs, and not small, medium and micro enterprises (SMMEs), are chosen for this study because they are more formal compared to SMMEs. It is notable that SMEs, which have been playing a leading role in the business domain in the last few decades, have remained outside the floodlights of review regarding the issue of business ethics (Werner & Spence 2004). There are also continuous business failures as a result of unethical practices especially those associated with employees (Sraboni & Sharmistha 2011). This in turn has adversely affected SMEs’ reputations (Ononogbo et al., 2016). With the expanding role of SMEs globally, an ethical approach towards business is imperative for them (Sraboni & Sharmistha, 2011). Hence, business organisations and managers need to behave ethically and protect their own business interests (Abiodun & Oyeniyi, 2014) if they are to survive and remain competitive.

There is also increasing awareness of ethics, leading societies to disapprove of businesses that are found to be ethically ill (Ahmad, Amran & Halim, 2012). However, the study of the role and function of ethics in business organisations has unfortunately focused primarily on larger enterprises, even though SMEs exert a strong influence on the economies of all countries, particularly in the fast-changing and increasingly competitive global market (Naidoo, Perumal & Moodley, 2009). While many large companies have gained their reputation by applying ethical standards, SMEs in developed countries are progressively becoming more alert to the significance of trustworthy dealings with employees, clients, suppliers and society. However, SMEs in developing countries still require more understanding and awareness of the implication of business ethics and its benefits. They may be unable to recognise such gains due to lack of a long-term vision (Mahmood 2008). The unique opportunities and challenges that SMEs encounter often tempt them to diverge from ethical practices when interacting with their stakeholders, especially the employees (Sraboni & Sharmistha, 2011). Hence, the study of business ethics has become imperative in today’s competitive business environment.

In developing countries, SMEs employ more than 70% of the labour force (Mahmood 2008). For example, in Thailand, SMEs account for more than 90% of the total number of establishments, 65% of employment and 47% of manufacturing value added, while in Philippines, SMEs comprise 99% of the total manufacturing establishments and
contribute 45% of employment and 18% of value added in the manufacturing sector (Mahmood 2008). In Africa, SMEs account for more than 90% of businesses and contribute about 50% of gross national product (GDP) (Kamunge, Njeru & Tirimbaba 2014). For instance, in Kenya, SMEs contribute 40% of the GDP, over 50% of new jobs and account for 80% of the workforce (Mwarari & Ngugi, 2013). In Uganda, SMEs constitute over 90% of businesses operating in the private sector; they contribute to 75% of GDP and employ approximately 2.5 million people (Hatega 2007; Uganda Ministry of Finance, Planning and Economic Development 2011).

2.4.3 Significance of Business Ethics To Small And Medium-Sized Enterprises

It is important to note that in the 21st century, power in the market has shifted from producers and sellers to buyers and consumers (Weinstein 2012). Where stakeholders have control over markets and can affect business performance, ethical practices are critical success factors when it comes to business (Twomey & Jennings 2011). As such, business owners and employees must exercise good faith in the practices they engage in if they are to continuously make profits. Businesses that operate without regard for ethical values are likely to run into problems with the law, customers, employees and business partners. Consequently, business reputation will suffer and the loss of business from unethical behaviour could be significant and difficult to erase. Customers value ethical businesses and once a business has lost trust by being unethical, customers will seek alternatives and much will be lost to competitors, or in the process of defending against lawsuits (Donovan 2013). However, SMEs must be especially cautious to balance the goals of profits with the values of individuals and society by practising good business ethics (Twomey & Jennings 2011). Hence, businesses need good ethical values to survive.

Ethical and socially responsible practices benefit entrepreneurs financially in the long run. This means that behaviour associated with maintaining honesty and integrity, being trustworthy, engaging in fair commercial practices, taking responsibility and being accountable for one’s own actions are very important for SMEs in the long run (Ahmad 2009). According to Goll and Rasheed (2004), in fast-changing and unpredictable environments, ethical and socially responsible behaviour helps businesses to gain support from different external stakeholder groups. Such behaviour provide them with some protection from the unpredictability they face. As such, a business’s image and reputation may be influenced by the good practices it exhibits to its customers and to the general
public (Jones 2000). The benefits of ethical practices enable competitive advantage to be attained as a business distinguishes itself from its competitors (Ahmad 2009). In fact, businesses with high ethical codes of conduct and a commitment to enhancing integrity are not only profitable but more likely to succeed in a commercially competitive world (Hasnah, Ishak & Sobei 2015).

Although some managers consider ethics programmes in their organisations to be very expensive, activities that are only societally rewarding (McMurrian & Matulich 2006), businesses that are viewed as ethical by their key stakeholders (i.e. customers, employees, suppliers and public) do enjoy several competitive advantages such as higher levels of efficiency in operations, higher levels of commitment and loyalty from employees, higher levels of perceived product quality, higher levels of customer loyalty and retention, and better financial performance (Ferrell 2004). Hence, high standards of organisational ethics can contribute to profitability by reducing the cost of business transactions and building a foundation of trust with important stakeholders (McMurrian & Matulich 2006).

Business activities require the maintenance of basic ethical standards, such as honesty, reliability and cooperation. Businesses cannot survive if their directors never tell the truth, if buyers and sellers never trust each other or if the employees refuse to provide support to each other and to customers (Branko, Drago & Zoran 2015). Good ethics in terms of being fair, honest, responsible and upright helps to build credibility and trust for businesses. Customers and other stakeholders want to engage businesses and business owners whom they can fully trust with their happiness, needs and wants, their money and their safety, health and well-being (Donovan 2013). Therefore, SME owners must see business investment, growth and sales as stemming from a circle of trust (Twomey & Jennings 2011).

SMEs that ethically conduct their businesses are likely to have a positive effect on sales and profits, experience a lower incidence of staff turnover, as well as increased productivity, as employees prefer to work at an ethical organisation, easily attract potential employees wanting to work for the organisation, thereby reducing recruitment costs and helping the company get the right skills, and protect the business from a possible hostile takeover by attracting investors (Wiid et al. 2013). Hence, SMEs need to develop ethical policies and adhere to them in their day-to-day operations.
The lack of general ethics among SME owners affects the growth opportunities of business by negatively impacting customer loyalty, brand building and deterring investment partners (Kalyar, Rafi & Kalyar 2013). This also creates a stereotype and perceptions of a general lack of credibility and reputation among SMEs, thereby affecting their ability to compete with larger businesses and to obtain funding for development. Hence, it is imperative for SMEs to appreciate the nature and importance of business ethics in order to develop strategies and solutions to effectively address existing challenges and minimise business failure, increase opportunities for growth, competitiveness and performance, and improve their general reputation in industry and community (Donovan 2013).

2.5 Chapter Summary

This chapter reviewed literature on the effect of funding sources on management of working capital, the effect of SME management on working capital management and the effect of unethical practices and beliefs by SMEs managers and owners on working capital management. Chapter 3 describes the research methodology used and elaborates on the research design, population, and sampling design, data collection methods, research procedures, and data analysis methods used in the study.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes the research methodology applied in the study. It specifically provides the research design adopted the target population and sampling design, methods used in data collection, research procedures, and data analysis adopted in conducting the research. Finally, the chapter ends with a summary.

3.2 Research Design

Research design is the plan used in satisfying the research objectives and answering research questions. The research was conducted within the conceptual structure. It is the blueprint for collection, measurement and analysis of data in a manner that aims at combining relevance to research purpose with economy in procedures (Saunders, Lewis & Thornhill, 2009).

The study adopted a descriptive research design in view of the fact that it is a study of relatively short duration and involves a systematic collection and presentation of data to give a clear picture of a particular situation. Descriptive design helps identify if a relationship exists between variables, determine the frequency of occurrence, and finally describe the state of a variable (Cooper & Schindler, 2003). This research design was chosen because it would assist the researcher to obtain relevant information related to the challenges faced by SMEs in Nairobi’s CBD in the management of working capital. A survey was conducted using a standardized questionnaire. The dependent variable of the study was the effective working capital management practices while the independent variables were funding sources of working capital, management practices of SME managers, and ethical perceptions and beliefs of SME owners.

3.3 Population and Sampling Design

3.3.1 Population

According to Saunders, Lewis and Thornhill (2009), population is the complete set of cases or group members which the researcher wishes to draw conclusions. The population of the study consisted of the top 100 SMEs located in the Central Business District (CBD) of Nairobi, which are 54 in total. They include 4 in the manufacturing sector, 16 in the
service sector and 34 in the trading sector. Since all these SMEs are located within the
Nairobi CBD, it was easy to reach them and collect data from them for this research.
Primary data was collected from the managers of the SMEs while secondary data was
collected from SMEs reports, annual financial statements, budgets and monetary records,
cash flow statements, asset register, and tax schedules.

Table 3.1 Population Distribution

<table>
<thead>
<tr>
<th>Industry</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>4</td>
<td>7</td>
</tr>
<tr>
<td>Services</td>
<td>16</td>
<td>30</td>
</tr>
<tr>
<td>Trading</td>
<td>34</td>
<td>63</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>54</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

3.3.2: Sampling Design

3.3.2.1 Sampling Frame

A sampling frame is the list from which the sample is drawn. Ideally, the sample frame
should be the target population (Kombo & Tromp, 2006). The population frame for this
study was composed of firms listed in top 100 SMEs in Kenya that are involved in
Service, Manufacturing, and Agribusiness.

3.3.2.2 Sampling Technique

This is the method used in drawing the sample from a population in a way that the sample
selected is representative of the population (Cooper and Schindler, 2003). There are
several techniques used for coming up with a sample size, namely convenience, judgment, simple random sampling, stratified random sampling and cluster sampling.
Stratified random sampling was used to select the sample for this study. The technique
produces estimates of overall population parameters with greater precision and ensures a
more representative sample is derived from a relative homogenous population. This gives
every respondent among the accessible population a chance of participating equally
(Kothari, 2007). The strata was subdivided based on the sector, this include manufacturing sector, service sector and trading sector.

3.3.2.3 Sample Size

A sample is a group or subgroup of participants obtained from the accessible population (Mugenda and Mugenda, 2008). They further say that a sample of thirty percent is good for social science researches. The sample is carefully selected to represent the whole population. The sample size ensures that the information is detailed and comprehensive. Due to limitations especially associated with time and cost, the whole population of 54 was not considered, and instead a random stratified sample of 48 SMEs was selected using the following formula:

\[
n = \frac{N}{1 + N(e)^2}, \text{ where}
\]

\[
N = \text{Population;}
\]

\[
e = \text{margin of error or significance level at 0.05,}
\]

\[
n = \text{sample size}
\]

The formula was used to calculate the sample size with a 95% confidence level and therefore,

\[
n = \frac{54}{(1 + (0.05)^2))}
\]

\[
= \frac{54}{1.135}
\]

\[
= 47.57
\]

\[
= 48
\]

A stratified sampling of 48 SMEs from the Central Business District (CBD) of Nairobi were contacted and constituted of 4 from manufacturing, 14 from service industry and 30 from trading sector as shown in Table 3.2 as follows.

Table 3.2 Sample Size Per Strata

<table>
<thead>
<tr>
<th>Industry</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>4</td>
<td>7</td>
</tr>
<tr>
<td>----------------</td>
<td>-----</td>
<td>-----</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>4</td>
<td>7</td>
</tr>
<tr>
<td>Services</td>
<td>14</td>
<td>30</td>
</tr>
<tr>
<td>Trading</td>
<td>30</td>
<td>63</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>48</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Only 40 responded representing 83% of all the SMEs in the Central Business District (CBD) of Nairobi that were in the top 100 SMEs list released by the Nation media group in Kenya. This sample was representative as Mugenda and Mugenda (2008) suggest that a good sample is ten to thirty percent of the accessible population.

### 3.4 Data Collection Method

Primary data was collected and used in this study to facilitate the realization of the study objectives. Primary data is that information collected directly from the sources (Kothari, 2007). To collect the primary data, a structured questionnaire was used. Kothari (2007) terms a questionnaire as the most appropriate instrument due to its ability to collect a large amount of information in a reasonably quick span of time. It is for the above reasons that the questionnaire was chosen as an appropriate instrument for this study. The questionnaire had four sections: general information, lack of funding, management practices, and SMEs owner ethical practices. It contained both close-ended and open-ended questions. The close-ended questions were necessary for ease of coding while the open-ended questions were important for purposes of clarifications.

The variables on the key objectives of the study was measure in interval scales mostly with a yes or no option to determine respondents’ agreement with the impact of funding sources on working capital management by small and medium enterprises in Nairobi’s central business district.

The research supervisor was consulted to ensure the questionnaire was valid. The information obtained from the questionnaires was free from bias and researcher’s influence and was therefore accurate. The questions addressed by the questionnaire sought to gather descriptive data based on the research objectives.

### 3.5 Research Procedures

Before collecting the information the researcher first conducted a pilot test using the questionnaire on a sample of 10 management staff of the SMEs forming the sample frame.
and who were not included in the main study. The researcher sought appointments with the respondents so as to administer the research instruments. The questionnaires were administered by the researcher and a trained research assistant through a drop and collect method.

The questionnaire was prepared based on specific objectives and was administered to the respondents through drop- and-pick-later method where the respondents filled the questionnaires and the researcher picked them later. This method is more efficient and economical as compared to other methods such as observation. Leaving the questionnaires with the respondents was appropriate because it gave the respondents ample time to give true and accurate information. The letter of confidentiality of information was presented to the respondents to assure them of the propriety of handling the information provided.

3.6 Data Analysis Methods

In this study, descriptive approach was used to analyze the data collected. The data collected was edited, summarized, and analyzed using Statistical Package for Social Sciences (SPSS). The results were presented through graphical and numerical techniques to enhance interpretation. This involved tallying up responses, computing percentages of variations in response as well as describing and interpreting the data in line with the study objectives and assumptions in order to allow greater understanding of results and findings. Content analysis was used to analyze qualitative data collected from the open-ended questions. To analyze the relationship between the dependent and independent variable correlation and regression analysis was undertaken.

3.7 Chapter Summary

Chapter three describes the research methodology applied in the study. Descriptive research approach was conducted using a structured questionnaire. The total respondents was comprised of 48 SMEs located in the Central Business District (CBD) of Nairobi, although only 40 responded. The chapter gives a detailed description of the research design, population, and sampling design, data collection methods, research procedures and data analysis methods. Chapter four discusses research findings.
CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction

This chapter presents analysis and findings of the study based on the specific research objectives. The specific objectives include determining the effect of funding sources on working capital management in SMEs, determining the effect of SME management on the management of working capital and establish the effect of owners of SMEs ethical perceptions and beliefs on their working capital management. The research questionnaire was designed in line with the objectives of the study. The first section of the questionnaire analyzed the general information of the respondents, the second section analyzed the funding sources, the third section analyzed the management practices of SMEs, and the fourth section considered the effects of SMEs owner’s ethical practices. The questionnaires were administered to 48 SME owners within the CBD and only 40 were returned representing an 83% response rate. The second section of this chapter analyses the general information of the respondents.

4.2 General information

The general information of the respondent’s data included gender, age, and marital status, highest level of education, number of clients, number of outlets of the business, and the number of employees in the respective firms.

4.2.1 Gender of Respondents

The study sought to establish the gender of the respondents and according to the findings, 67.5% of the respondents were male while 32.5% were female as shown in Table 4.1. This indicated that the response received include views from all the genders.

<table>
<thead>
<tr>
<th>Table 4.1: Gender of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Distribution</td>
</tr>
<tr>
<td>------------</td>
</tr>
<tr>
<td>Male</td>
</tr>
<tr>
<td>Female</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>
4.2.2 Age of Respondents

From the findings majority of the respondents accounting for 47.5% were aged between the ages of 36-45 years old. This was followed closely by those aged between 26-35 years representing 32.5% of the respondents. Those aged between the 18-25 represented 10% of the total, while those aged between 46-55 representing 7.5% of the total. The least was those aged above 55 years and representing 2.5% of the respondents as shown in Table 4.2.

Table 4.2: Age of Respondents

<table>
<thead>
<tr>
<th>Distribution</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>18-25 years</td>
<td>4</td>
<td>10</td>
</tr>
<tr>
<td>26-35 years</td>
<td>13</td>
<td>32.5</td>
</tr>
<tr>
<td>36-45 years</td>
<td>19</td>
<td>47.5</td>
</tr>
<tr>
<td>46-55 years</td>
<td>3</td>
<td>7.5</td>
</tr>
<tr>
<td>Above 55 years</td>
<td>1</td>
<td>2.5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>40</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

4.2.3 Highest Education Level

As shown in Figure 4.1 the study established that majority of the respondents had a university degree, representing 65% of the respondents. Those whose highest level of education was secondary level represented 25% of the respondents while those whose highest form of education was some other form of education represented 10% of the respondents.

![Figure 4.1: Highest Education](image)
4.2.4 Nature of the enterprises

According to the findings, majority of the respondents were operating in partnerships and this represented 40% of the respondents. This was closely followed by those who operate other form of enterprises, representing 30% of the total while those operating in a limited liability company represented 27.5%. Those operating in a sole proprietorship represented 2.5% of the respondents as shown in Figure 4.2.

![Figure 4.2: Nature of Enterprise](image)

4.2.5 Marital status of the respondents

The study established that 70% of the respondents were married while those who were single represented 22.5% of the total respondents. Those who were divorced represented 7.5% of the total respondents as shown on Figure 4.3.

![Figure 4.3: Marital Status](image)
4.2.6  Number of Employees

As presented in Figure 4.4 majority of the respondents have more than 40 employees representing 60% of the respondents and those with between 11-20 employees represented 20% of the total respondents. Further, 15% of the respondents indicated that they operated with between 30-40 employees while the least frequency was those with between 1-10 employees, representing 5% of the total respondents.

![Figure 4.4: Number of Employees](image)

4.3 Effects Of Lack Of Funding On Working Capital Management In SMES

In this section the study sought to find out the effect of lack of funding on working capital management in SMES. The effects are analyzed in Table 4.3 as below.

**Table 4.3 Funding Sources**

<table>
<thead>
<tr>
<th>Statement</th>
<th>Description</th>
<th>YES</th>
<th>NO</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Does the firm have a bank account</td>
<td>frequency</td>
<td>31</td>
<td>9</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>percentage</td>
<td>77.5%</td>
<td>22.5%</td>
<td>100</td>
</tr>
<tr>
<td>Banking of daily proceeds</td>
<td>frequency</td>
<td>18</td>
<td>22</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>percentage</td>
<td>45%</td>
<td>55%</td>
<td>100</td>
</tr>
<tr>
<td>Access to credit</td>
<td>frequency</td>
<td>26</td>
<td>14</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>percentage</td>
<td>65%</td>
<td>35%</td>
<td>100</td>
</tr>
<tr>
<td>Gets all funds requested</td>
<td>frequency</td>
<td>17</td>
<td>23</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>percentage</td>
<td>42.5%</td>
<td>57.5%</td>
<td>100</td>
</tr>
<tr>
<td>Adequate security for loan applied</td>
<td>frequency</td>
<td>11</td>
<td>29</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>percentage</td>
<td>27.5%</td>
<td>72.5%</td>
<td>100</td>
</tr>
</tbody>
</table>
The findings show that 77.5% of the firms had a bank account, 45% banked their daily proceed and 65% had access to credit. It was also noted that 42.5% get all the funds requested and only 27.5% had adequate security for loan applied.

4.3.1 Bank account

The study sought to find out whether SMEs had bank account. As indicated in Figure 4.6, out of the 40 respondents 77.5% have bank accounts while 22.5% do not have one.

![Figure 4.5: Bank account](image)

4.3.2 Frequency of Banking

The study sought to find out whether SMEs banked their daily proceeds. As presented Figure 4.6, out of the 40 respondents 45% bank daily cash proceeds while 55% do not.

![Figure 4.6: Frequency of Banking](image)

4.3.3 Access To Credit Facilities

The study sought to find out whether SMEs had an access to credit facilities. As presented in Figure 4.7 out of the 40 respondents 65% were positive while 35% of the respondents did not have access.
4.3.4 Getting Funds Requested

The study sought to find out whether SMEs get all the funds requested from financiers and as presented in Figure 4.8 out of the 40 respondents only 42.5% said yes while 57.5% of the respondents did not.

4.3.5 Adequacy of Collateral

The study sought to find out whether SMEs had adequate security for loan applied and as presented in Figure 4.9 out of the 40 respondents only 42.5% had adequate collateral while 57.5% of the respondents did not.
4.3.6 Correlation between the variables of Funding

The study sought to determine if there was a relationship between the firms having a bank account and lack of funding on working capital management. From the results in the correlation table (Table 4.3) there was a positive correlation between the firm having a bank account and undertaking regular banking of proceeds (0.487, pvalue = 0.001); access to credit (0.734, pvalue = 0.000); getting all funds requested (0.463, pvalue = 0.003); and adequate security for loan applied (0.332, pvalue = 0.036).

Table 4.4: Correlation between the variables of Funding

<table>
<thead>
<tr>
<th></th>
<th>Account</th>
<th>Banking</th>
<th>Credit</th>
<th>Access</th>
<th>Security</th>
</tr>
</thead>
<tbody>
<tr>
<td>Account</td>
<td>Pearson Corr</td>
<td>.487**</td>
<td>.734**</td>
<td>.463**</td>
<td>.332*</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.001</td>
<td>.000</td>
<td>.003</td>
<td>.036</td>
</tr>
<tr>
<td>Banking</td>
<td>Pearson Corr</td>
<td>1</td>
<td>.664**</td>
<td>.950**</td>
<td>.681**</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.001</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
<td>Credit</td>
<td>Pearson Corr</td>
<td>.734**</td>
<td>.664**</td>
<td>1</td>
<td>.631**</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.003</td>
</tr>
<tr>
<td>Funds</td>
<td>Pearson Corr</td>
<td>.463**</td>
<td>.950**</td>
<td>.631**</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.003</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
<td>Access</td>
<td>Pearson Corr</td>
<td>.332*</td>
<td>.681**</td>
<td>.452**</td>
<td>.716**</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.036</td>
<td>.000</td>
<td>.003</td>
<td>.000</td>
</tr>
</tbody>
</table>

Figure 4.9: Adequate Security for Loan Applied

The study also sought to find out the overall management practices of SMEs on the management of their working capital. The effects are analysed in Table 4.5 as follows.

**Table 4.5: Management Practices**

<table>
<thead>
<tr>
<th>Statement</th>
<th>Description</th>
<th>YES</th>
<th>NO</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Selling on credit</td>
<td>frequency</td>
<td>21</td>
<td>19</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>percentage</td>
<td>52.5%</td>
<td>47.5</td>
<td>100</td>
</tr>
<tr>
<td>Undertaking formal credit investigation</td>
<td>frequency</td>
<td>25</td>
<td>15</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>percentage</td>
<td>62.5%</td>
<td>37.5</td>
<td>100</td>
</tr>
<tr>
<td>Experience large piles up of raw materials or of goods for resale</td>
<td>frequency</td>
<td>19</td>
<td>21</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>percentage</td>
<td>47.5%</td>
<td>52.5</td>
<td>100</td>
</tr>
<tr>
<td>Keep record of goods for resale or raw materials</td>
<td>frequency</td>
<td>26</td>
<td>14</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>percentage</td>
<td>65%</td>
<td>35</td>
<td>100</td>
</tr>
<tr>
<td>Undertake regular stock taking</td>
<td>frequency</td>
<td>18</td>
<td>22</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>percentage</td>
<td>45%</td>
<td>55</td>
<td>100</td>
</tr>
<tr>
<td>Re order level policy</td>
<td>frequency</td>
<td>26</td>
<td>14</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>percentage</td>
<td>65%</td>
<td>35</td>
<td>100</td>
</tr>
</tbody>
</table>

4.4.1 Selling On Credit

The study sought to find out whether SMEs do credit sales and out of the 40 respondents, 52.5% agreed while 47.5% of the respondents disagreed. This is presented in Figure 4.10.

**Figure 4.10: Selling On Credit**
4.4.2 Undertaking of Formal Credit Investigation

The study sought to find out whether SMEs undertaking formal credit investigation and out of the 40 respondents 62.5% agreed while 37.5% of the respondents disagreed. This is presented in Figure 4.11

Figure 4.11: Undertaking of Formal Credit Investigation

4.4.3 Piles Up of Goods for Resale

The study also sought to find out whether SMEs had piles up of goods for resale and out of the 40 respondents only 47.5% agreed while the majority who are 52.5% of the respondents disagreed. This is presented in figure 4.12

Figure 4.12: Piles Up of Goods for Resale
4.4.4 Record Of Goods For Resale Or Raw Materials

The study also sought to find out whether SMEs keep record of goods for resale or raw materials. Out of the 40 respondents majority who accounted for 65% agreed while only 35% of the respondents disagreed. This is presented in figure 4.13

Figure 4.13: Record Keeping

4.4.5 Undertake Regular Stock Taking

As presented in Figure 4.14 the study also sought to find out whether SMEs undertook regular stock taking and out of the 40 respondents only 45% of the respondents agreed while the majority 55% disagreed.

Figure 4.14: Undertake Regular Stock Taking
4.4.6 Re order level policy

Further the study also sought to find out whether SMEs had an existing reorder level policy and out of the 40 respondents 65% of the respondents agreed while 35% disagreed. This is presented in figure 4.15

![Bar chart showing reorder level policy](image)

**Figure 4.15: Re order level policy**

4.4.7 Correlation of Variables of Management Practices

The study sought to determine if there was a relationship between the impact of credit sales on working capital management. From the result in the correlation Table 4.6 there was a positive correlation between the firm undertaking credit sales and undertaking formal credit investigation (0.775, pvalue = 0.000); experience large piles up of raw matearial or of goods for resale (0.951, pvalue = 0.000); keep record of goods for resale or raw matearials (0.775, pvalue = 0.000); undertake regular stock taking(0.860, pvalue 0.000); and if the firms had a re order level policy (0.775, pvalue = 0.000).
Table 4.6: Correlation of Variables of Management Practices

<table>
<thead>
<tr>
<th></th>
<th>Credit sale</th>
<th>Investigate</th>
<th>Large pile</th>
<th>Record</th>
<th>Stock take</th>
<th>Reorder</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit sale</td>
<td>Pearson Correlation</td>
<td>1</td>
<td>.775**</td>
<td>.951**</td>
<td>.775**</td>
<td>.860**</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.00</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
<td>Investigate</td>
<td>Pearson Correlation</td>
<td>.775**</td>
<td>1</td>
<td>.737**</td>
<td>1.000**</td>
<td>.666**</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
<td>Large pile</td>
<td>Pearson Correlation</td>
<td>.951**</td>
<td>.737**</td>
<td>1</td>
<td>.737**</td>
<td>.904**</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
<td>Record</td>
<td>Pearson Correlation</td>
<td>.775**</td>
<td>1.000**</td>
<td>.737**</td>
<td>1</td>
<td>.666**</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
<td>Stock take</td>
<td>Pearson Correlation</td>
<td>.860**</td>
<td>.666**</td>
<td>.904**</td>
<td>.666**</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
<td>Reorder</td>
<td>Pearson Correlation</td>
<td>.775**</td>
<td>1.000**</td>
<td>.737**</td>
<td>1.000**</td>
<td>.666**</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
</tr>
</tbody>
</table>

4.5 Effects of Owners of SMEs Belief and Ethical Perception on Working Capital Management

The researcher sought to establish the effects of owners of SMEs belief and ethical perception on working capital management. The results are analysed and recorded according to the findings in Table 4.7.
### Table 4.7: SME Owners Ethical Practices

<table>
<thead>
<tr>
<th>Statement</th>
<th>Description</th>
<th>YES</th>
<th>NO</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>SME owner fair to his employees</td>
<td>frequency</td>
<td>21</td>
<td>19</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>percentage</td>
<td>52.5%</td>
<td>47.5</td>
<td>100</td>
</tr>
<tr>
<td>SME owner renumerates fairly</td>
<td>frequency</td>
<td>25</td>
<td>15</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>percentage</td>
<td>62.5%</td>
<td>37.5</td>
<td>100</td>
</tr>
<tr>
<td>The owner pays salaries on time</td>
<td>frequency</td>
<td>19</td>
<td>21</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>percentage</td>
<td>47.5%</td>
<td>52.5</td>
<td>100</td>
</tr>
<tr>
<td>The owner pays suppliers by agreed date</td>
<td>frequency</td>
<td>26</td>
<td>14</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>percentage</td>
<td>65%</td>
<td>35</td>
<td>100</td>
</tr>
<tr>
<td>Make timely payments for the credit facilities</td>
<td>frequency</td>
<td>18</td>
<td>22</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>percentage</td>
<td>45%</td>
<td>55</td>
<td>100</td>
</tr>
</tbody>
</table>

#### 4.5.1 Fairness to Employees

The study sought to find out whether SMEs owners are fair to their employees and of the 40 respondents 52.5% agreed while 47.5% of the respondents disagreed as presented in Figure 4.16.

![Figure 4.16: Fairness to Employees](image)

The bar chart shows the distribution of responses, with 19 respondents disagreeing (47.5%) and 21 agreeing (52.5%) with the statement that the SME owner is fair to his employees. The sum of frequencies is 40, and the sum of percentages is 100.
4.5.2 Fair Renumeration

As shown in Figure 4.17 the study sought to find out whether SMEs have fair remuneration and out of the 40 respondents 62.5% agreed while 37.5% of the respondents disagreed.

![Figure 4.17: Fair Remuneration](image)

4.5.3 Salaries Paid On Time

The study also sought to find out whether SMEs paid salaries on time and out of the 40 respondents only 47.5% agreed while the majority at 52.5% of the respondents disagreed as presented in Figure 4.18.

![Figure 4.18: Salaries Paid On Time](image)
4.5.4 Suppliers Paid on Time

As seen in Figure 4.19, the study also sought to find out whether SMEs paid suppliers on time and out of the 40 respondents, the majority accounting for 65% agreed while only 35% of the respondents disagreed.

![Figure 4.19: Suppliers Paid on Time](image)

4.5.5 Credit Facilities Paid on Time

The study further sought to find out whether SMEs paid credit facilities on time. As presented in Figure 4.20 out of the 40 respondents only 42.5% of them agreed while the majority 57.5% disagreed.

![Figure 4.20: Credit Facilities Paid on Time](image)
4.5.6 Correlation of variables of SMES Owners Belief and Ethical Perception

The study sought to determine if there was a relationship between SME owners practices on working capital management and its various variables. From the result in the correlation Table 4.8 there was a positive correlation that was statistically significant between the SME owner fair treatment to his employees and fair renumerations (0.814, pvalue = 0.000); The owner paying salaries on time (0.860, pvalue = 0.000); The owner paying suppliers by agreed date (0.814, pvalue = 0.000); and if the firms make timely payments for the credit facilities (0.777, pvalue = 0.000).

Table 4.8: Correlation of SMES Owners Belief and Ethical Perception

<table>
<thead>
<tr>
<th>Fairness to employees</th>
<th>Fairness Pearson Correlation</th>
<th>Employee pay Pearson Correlation</th>
<th>Timely Salaries Pearson Correlation</th>
<th>Pay For Supplier Pearson Correlation</th>
<th>Timely Credit Pearson Correlation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fairness</td>
<td>1</td>
<td>.814**</td>
<td>.860**</td>
<td>.814**</td>
<td>.777**</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td></td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
<td>Fair remuneration</td>
<td>.814**</td>
<td>1</td>
<td>.701**</td>
<td>1.000**</td>
<td>.632**</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
<td>Timely salaries</td>
<td>.860**</td>
<td>.701**</td>
<td>1</td>
<td>.701**</td>
<td>.903**</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
<td>Timely supplier</td>
<td>.814**</td>
<td>1.000**</td>
<td>.701**</td>
<td>1</td>
<td>.632**</td>
</tr>
<tr>
<td>payment</td>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
<td>Timely credit</td>
<td>.777**</td>
<td>.632**</td>
<td>.903**</td>
<td>.632**</td>
<td>1</td>
</tr>
<tr>
<td>facility payment</td>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
</tr>
</tbody>
</table>

4.6 Descriptive Statistic

Table 4.8 presents the descriptive statics and the distribution of the variables considered in this research: funding sources, working capital (WC) management practices and the SME owner ethical practices (EP). The descriptive statistic considered were minimum value, maximum value, mean, standard deviation, skewness and kurtosis. From Table 4.9, funding sources had a mean of 0.225 and standard deviation of 0.157. That is, funding
The standard deviation calculated in the analysis indicated the spread of the data from the average response. Skewness on the other hand measures a dataset’s symmetry or asymmetry. Both funding sources and SME owner’s ethical practices were positively skewed.

**Table 4.9: Descriptive Statistics**

<table>
<thead>
<tr>
<th></th>
<th>Min</th>
<th>Max</th>
<th>Mean</th>
<th>Std. Dev</th>
<th>Skewness</th>
<th>Kurtosis</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Statistic</td>
<td>Std. Error</td>
</tr>
<tr>
<td>Funding sources</td>
<td>.01</td>
<td>.73</td>
<td>.2250</td>
<td>.1575</td>
<td>.900</td>
<td>.787</td>
</tr>
<tr>
<td>wc management</td>
<td>.45</td>
<td>.48</td>
<td>.2130</td>
<td>.6011</td>
<td>-1.492</td>
<td>2.105</td>
</tr>
<tr>
<td>SME owner EP</td>
<td>-.38</td>
<td>0.197</td>
<td>.1597</td>
<td>.3609</td>
<td>2.520</td>
<td>10.109</td>
</tr>
</tbody>
</table>

**4.7 Regression and Correlation Coefficients**

Regression analysis was utilized to investigate the relationship between the variables. These included an error term, whereby a dependent variable was expressed as a combination of independent variables. The unknown parameters in the model were estimated, using observed values of the dependent and independent variables.

**4.7.1 Correlation Analysis**

The correlation between funding sources, working capital management practices, and SME owner’s ethical practices is shown in Table 4.10. A Pearson correlation was used to measure the degree of association between variables under consideration i.e. independent variables and the dependent variables. Pearson correlation coefficients range from -1 to
+1. Negative values indicate negative correlation and positive values indicate positive correlation.

**Table 4.10: Correlation Coefficients**

<table>
<thead>
<tr>
<th></th>
<th>Funding sources</th>
<th>WC management practices</th>
<th>SME owners EP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Funding sources</td>
<td>1</td>
<td>0.631*</td>
<td>0.551*</td>
</tr>
<tr>
<td>P value</td>
<td>0.000</td>
<td>1</td>
<td>0.000</td>
</tr>
<tr>
<td>WC management practices</td>
<td>0.631</td>
<td>1</td>
<td>0.451*</td>
</tr>
<tr>
<td>P value</td>
<td>0.000</td>
<td>0.000</td>
<td>1</td>
</tr>
<tr>
<td>SME owners EP</td>
<td>0.551*</td>
<td>0.451*</td>
<td>1</td>
</tr>
<tr>
<td>P value</td>
<td>0.000</td>
<td>0.000</td>
<td>0.051</td>
</tr>
<tr>
<td>Effective WC management</td>
<td>0.124</td>
<td>0.268</td>
<td>0.051</td>
</tr>
<tr>
<td>P value</td>
<td>0.092</td>
<td>0.086</td>
<td>0.112</td>
</tr>
</tbody>
</table>

*Correlation is significant at the 0.05 level (1-tailed).*

The analysis shows that the variable funding sources has the strongest positive Pearson correlation on working capital management practices (0.631; P value 0.000). In addition, funding sources had a significant and positive correlation with SME owners ethical practices (Pearson correlation coefficient = 0.551). The study established that funding sources have a positive and significant correlation on effective management of working capital. The variable working capital management practices was also noted to have a positive, strong and significant correlation with SME owner ethical practices (Pearson correlation coefficient = 0.451).

The correlation matrix implies that the independent variables: funding sources, working capital management practices and SME owners ethical practices are significantly correlated and that there is no autocorrelation between the independent variables taken into account.

The study also found a positive and low relationship between the dependent variable effective management of working capital and funding sources (0.124). A closely similar correlation was noted between effective management of working capital and working capital management practices (0.268). Further, there was a correlation matrix of 0.051 between SME owners’ ethical practices and effective management of working capital.
These findings depict that effective management of working capital has potentially positive correlation with its determinants (funding sources, working capital management practices and SME owners’ ethical practices).

4.7.2: Regression Analysis

The study used multiple linear regression analysis models below to determine the relationship between the determinants (funding sources, working capital management practices, and SME owners’ ethical practices) and effective management of working capital, generally given by:-

\[ Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon, \]

where:

- \( Y \) = working capital management
- \( X_1 \) = funding sources
- \( X_2 \) = working capital management practices
- \( X_3 \) = SME owners’ ethical practices
- \( \beta_0 \) = regression constant
- \( \beta_1 \) to \( \beta_3 \) = regression coefficients
- \( \epsilon \) = error term.

Table 4.11 as follows shows the results of the regression coefficients required to form the multiple regression models and appear as;

\[ Y = 0.903 + 0.058X_1 + 0.056X_2 + 0.0498X_3 + 0.123 \]

The multiple linear regression model indicate that all the independent variables have positive coefficient. The regression results above reveal that there is a positive relationship between dependent variable (effective management of working capital) and independent variables (funding sources, working capital management practices and SME owners’ ethical practices). From the findings, one unit change in funding sources results in 0.056 units increase in working capital management. One unit change in working capital management practices results in 0.058 increase in effective working capital management and for every unit increase in SME owners ethical practices working capital
management increases by 0.036 units. However all the variables had a p value greater than 0.05 and therefore not significant.

Table 4.11: Regression Coefficients

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
</tr>
<tr>
<td>1 (Constant)</td>
<td>0.903</td>
<td>0.123</td>
</tr>
<tr>
<td>Funding sources</td>
<td>0.056</td>
<td>0.028</td>
</tr>
<tr>
<td>WC management practices</td>
<td>0.058</td>
<td>0.027</td>
</tr>
<tr>
<td>SME owners’ ethical practices</td>
<td>0.036</td>
<td>0.030</td>
</tr>
</tbody>
</table>

a. Dependent Variable: effective management of working capital
b. Predictors: (Constant), funding sources, working capital management practices and SME owners’ ethical practices

4.7.2.1: Model Summary

Analysis in table 4.12 shows the coefficient of determination (the percentage variation in the dependent variable being explained by the changes in the independent variables). Adjusted R Square equals 0.805. This means that funding sources, working capital management practices and SME owners’ ethical practices explains 80.5% of observed change in effective management of working capital. The P-value of 0.000 (Less than 0.05) implies that the regression model is significant at the 95% significance level.

Table 4.12: Model Summary

<table>
<thead>
<tr>
<th>Model</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
<th>R Square Change</th>
<th>F Change</th>
<th>df1</th>
<th>df2</th>
<th>Sig. F Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.918(a)</td>
<td>0.843</td>
<td>0.805</td>
<td>0.51038</td>
<td>1.242</td>
<td>4</td>
<td>96</td>
<td>0.000</td>
</tr>
</tbody>
</table>

Predictors: (Constant), funding sources, working capital management practices and SME owners’ ethical practices
Dependent Variable: Effective management of working capital
4.7.2.2: Analysis of Variance (ANOVA)

The researcher sought to compare means using analysis of variance. ANOVA findings (P-value of 0.00) in table 4.12 show that there is correlation between the predictors’ variables (funding sources, working capital management practices, and SME owners’ ethical practices) and the response variable (effective management of working capital).

### Table 4.13: Analysis of Variance (ANOVA)

<table>
<thead>
<tr>
<th></th>
<th>Sum of Squares</th>
<th>Df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>.852</td>
<td>4</td>
<td>.213</td>
<td>1.242</td>
<td>.000</td>
</tr>
<tr>
<td>Residual</td>
<td>20.35</td>
<td>119</td>
<td>.171</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>22.64</td>
<td>123</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Predictors: (Constant), funding sources, working capital management practices and SME owners’ ethical practices

Dependent Variable: effective management of working capital

### 4.8 Chapter Summary

The purpose of the study was to determine the challenges faced by SMEs in Nairobi’s CBD in managing working capital. On analyzing the objectives, it was revealed that funding sources affects 22.5% of the management of working capital. Working capital management practices on the other hand affected 21.3% of effective management of working capital while SME owner ethical practices affected 15.97% of effective working capital management practices. The variable “funding sources” has the strongest positive influence on working capital management practices with a Pearson correlation coefficient of 0.631 and P-value 0.000. In addition, funding sources has a significant and positive correlation with SME owners ethical practices (Pearson correlation coefficient = 0.551). The study also established that funding sources has a positive and significant correlation on effective management of working capital. The variable “working capital management practices” was also noted to have a positive, strong and significant correlation with SME owner ethical practices (Pearson correlation coefficient = 0.451). In chapter five the conclusion, discussion and recommendations as per the objectives of this study are presented.
CHAPTER FIVE

5.0 DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter is a synthesis of the entire study, and contains summary of research findings, exposition of the findings commensurate with the objectives, conclusions, and recommendations on the findings in chapter four.

5.2 Summary

The main objective of the study was to investigate the challenges faced by SMEs in Nairobi Central Business District (CBD) in managing working capital. The specific objectives of the study were to establish the effect of funding sources on working capital management, to determine the effect of SME management on the management of working capital, and to assess the effect of ethical perceptions and beliefs of the owners of SMEs on working capital management.

The target population comprised of 54 companies listed in 2014’s top 100 SMEs located in the Nairobi CBD from which a simple random sample of forty eight (48) was selected for the study. Only forty SMES responded representing an 83% response rate and this was used for this study. Primary data was collected and used to facilitate the realization of the study objectives. To collect the primary data, a structured questionnaire based on specific objectives was administered to the respondents through “drop- and-pick-later” method where the respondents filled the questionnaires and the researcher picked them later. Data analysis was done by using Regression analysis to investigate the relationship between the variables. Pearson correlation was used to measure the degree of association between the independent variables and the dependent variables. The results were then presented in form of tables and figures.

On analysis of the effects of lack of funding on working capital management in SMES the findings revealed that majority of the SME (77.5%) have a bank account while only 45% bank their daily cash proceeds. The study also revealed that SMEs with access to credit accounted for 65% of the responses, and 57.5% of them do not get all funds requested. Further, 72.5% of the respondents do not have adequate security for loans applied for.
To analyze the effects of SME management practices on working capital management the findings indicated that 52.5% of the respondents make sales on credit and 62.5% undertake formal credit investigation. About 47.5% of the respondents experience large piles up of raw material or goods for resale and 65% of the respondents keep record of raw materials and goods for resale. The findings also revealed that only 45% undertake regular stock taking while 65% of the respondents have an existing reorder level policy.

To establish the effects of owners of SMES belief and ethical perception on working capital management, the findings revealed that 52.5% of SME owners are fair to their employees and in addition, 62.5% give fair remuneration. The findings also revealed that only 47.5% of SME owners pay salaries on time. Further, 65% of the respondents were found to pay suppliers by the agreed date. The research also established that only 45% make timely payments for credit facilities. To analyze the relationship between funding sources, working capital management practices and SME owners’ ethical practices the adjusted R Square was found to equal 0.805 meaning that 80.5% of observed change in effective management of working capital could be explained by the changes in funding sources, working capital management practices and SME owners’ ethical practices. The P- value of 0.000 (Less than 0.05) implied that the regression model was significant at the 95% significance level.

5.3 Discussion

5.3.1: The Effects of Funding Sources on Working Capital Management

The findings of the study established that funding sources affects management of working capital to the extent of 22.5%. This agrees with Agyei-Mensah (2012) who found out that access to finance was a major challenge to SMEs in Ghana and Memba et al. (2012) shared this view in her study on Kenyan SMEs.

The findings revealed that majority of the SMES have a bank accounts and this represented 77.5% of the response. Similar results have been presented in various studies and according to Berger, Goulding and Rice (2013) research to determine if small businesses prefer community banks it was established that banks were the most critical source of funding for most of the small firms and provided for sixty percent of their debt financing. The study also revealed that those SMES who have access to credit accounted for 65% of the response. Bhattacharya (2001) established that bank lending has been categorized, as a crucial source of external financing for SME in the developed nations.
and their alternative for funds are large firms. He concluded that it was due to SMEs having very limited alternatives to accessing capital markets.

To determine if firms received all funds requested from the banks as debt funds, the results showed that majority, accounting for 57.5% of the response did not get all the funds requested. These findings concur with those of Sunday (2011) where he established that the challenges in accessing financial resources was largely attributed to the fact that SMEs do not have adequate assets to act as collateral for loans as compared to large firms. Sunday (2011) adds that few financial institutions such as banks and microfinance institutions that give credit to SME’s set high price for credit facilities to compensate for the high risk they face.

The study also sought to determine if respondents did have adequate security for loans applied for and the findings revealed that 72.5% did not have the necessary security. Similarly, Ackah and Vuvor (2011) study to analyse the challenges faced by small and medium enterprises in obtaining credit in Ghana concluded that financial institutions were willing to issue funds to SMEs. However, the SMEs were incapable of meeting the requirements such as collateral, high interest rates and the short repayment periods made it very difficult for SMEs to undertake any developmental projects.

5.3.2 The Effect of Working capital Management Practices on Management of SMEs

According to the research findings, sound financial management was found to lead to the survival and growth of every business. From the study, it was found that 21.3% of the respondents agreed that working capital management had an effect on working capital management. It was also found out that a correlation existed between working capital management and effective management of working capital and working capital management practices.

The study established that SMEs made sales on credit and a majority (52.5%) made credit sales while only 47.5% do not. A similar study by Appah (2011) established that over eighty percent of the SMEs in the Sekondi-Takoradi Metropolis sold some off their materials on credit and this was seen as a way of increasing sales. This study was also set to establish if firms undertook due diligence in credit investigation. It was found that 62.5% of the respondents investigate their customers’ credit worthiness; this is done with the intention of reducing risks of losses associated with account receivables. Appah (2011) has recorded similar findings. In another study to analyze the current asset
management practices in selected small enterprises in Nairobi, Onyango (2014) established that half of the enterprises sell their wares on credit and the average collection period was estimated to vary at about 30 days, although issues related to credit defaults makes SMEs not to sell their goods and services on credit.

The study revealed that inventory management affect working capital management practice in SMEs in Nairobi. The findings established that 47.5% of the respondents experience large piles up of raw material or goods for resale. This is in concurrence with Ndagijima (2014), whose study established that majority of SMEs in Nairobi lacked inventory management tools necessary in the reduction of pile up of raw materials. The study on SMES revealed that a majority (65%) of the respondents keep record of raw materials and goods for resale. This enables them maintain the items of their materials and stock levels and aids in making reorder when necessary. A similar study by Appah (2011) in Sekondi Takoradi Metropolis established that majority of SMEs (77%) kept records of their goods and materials.

The findings of the research indicated that only 45% of SMEs undertake regular stocktaking. This contradicts a study by Misoi (2015) on inventory management practices in SMEs in Kapsabet town where it was established that majority of SMEs had internal controls of goods and maintained proper documentation procedures. She also found out that most of the SMES understood the importance of stock taking exercise and undertook regular training of responsible officials to take charge. The study finding also established that 65% of the SMEs have an existing reorder level policy. Pieterson (2012) recorded similar results when he sought to determine the working capital management practices of small enterprises in Ghana. His findings established that most of the entrepreneurs instituted inventory control policies in their firms in order to minimize raw material wastage.

5.3.3 The Effect of Owners’ Ethical Practices on Working Capital Management

According to the research findings, 15.97% of the respondents agreed that SME owner ethical practices effect working capital management practices. It was also found out that a positive correlation existed between SME owners’ ethical practices and effective management of working capital. According to the findings, 52.5% of SME owners are fair to the employees while only 47.55% were found to be unfair. Similar sentiments were expressed in Workplace Employment Relations Survey (WERS, 2004) which showed that
employees in small firms were more satisfied than those in larger ones. As such, these employees tend to have a higher job commitment to their job (Forth et al, 2006). However, there were claims that small establishments in the UK are more prone to cases of unfair dismissal claims since the 1980s. Because of this trend, the UK saw the creation of statutory employment rights in the late 1990s (Kersley et al, 2006). In addition, 62.5% of SMES were found to have in place a fair remuneration policy and about 47.5% of owner paid salaries on time. According to Klos (2006) the level of organizational remuneration is a factor that has been greatly discussed. The extent of employee remuneration according to various researches varies between firms of different size, age and category (Khaliq, Isa, Shaari & Ageel, 2011). Employee wages are also determined by their productivity and is entirely dependent on the employee’s knowledge, experience, and nature of the job (Misoi, 2015). In addition, all types of incentives have been found to influence employees’ motivation to work harder and thus increase a firm’s productivity.

Despite many of the firms not paying the workers on time, the study established that 65% of the SMEs paid their suppliers by the agreed date. According to Lewis (2009), undertaking prompt payment is not only good for the supplier but also earns the business respect. It also makes suppliers more comfortable towards giving small firm credit. He added that this also enabled the firms to negotiate for better discount and these improved trading relationships. The findings in this research also established that only 45% make timely payments for the credit facilities. The results are in line with Ackah and Vuvor (2011) where it was established that 75% of the SMEs in the Accra and Tama metropolis of Ghana faced many challenges in their operations and the main one was lack of access to finance.

5.4 Conclusion

The conclusions drawn from this study follow

5.4.1: The Effects of Funding Sources on Management of Working Capital

The study concluded that most SMES rely on banks as a means of securing their savings and this was because of the majority having a bank account. However, due to the daily operational activities, there was a high need for cash and this explains why only a few of them bank their daily collections. In addition, while majority of the firms have access to credit they were limited on the amount of funds requested as loans from the banks. This
may be attributed to the fact that a huge number of them lack the adequate security for loans applied.

5.4.2 The Effect of Working Capital Management Practices in SME

Majority of the firms were found to make credit sales and this was with an aim of increasing the sales volume. In addition, many of the institutions were keen in undertaking formal credit investigation on the customers before engaging them in debt. This was seen as a good strategy for minimizing credit risk. In addition, few of the firms have experienced large piles up of raw material or goods for resale in order to ensure that customers can conveniently get the products. In addition, firms were found to keep good record of raw materials and goods for resale and this enabled them organize their stock levels. However, the firms still have a challenge in undertaking regular stocktaking.

5.4.3 The Effect of SME Owners’ ethical practices on Management of Working Capital

The change in effective management of working capital are affected by the changes in funding sources, working capital management practices, and SME owners’ ethical practices. In addition, SME owners know the importance of employees and as such, the firms treat their employees fairly and offer good remuneration to maintain them. However, from the study it is apparent that the firms have a challenge in cash flow management; hence they experience a challenge of paying salaries on time. Despite this challenge, the firms strive to maintain a good relationship with the suppliers by making timely payments.

5.5 Recommendations

5.5.1 Recommendation for Improvement

5.5.1.1 The Effects of Funding Sources on Management of Working Capital

The findings show that a majority of the firms had a bank account, and access to credit although only 42.5% get all the funds requested. This is attributed to SMEs being ranked as high-risk ventures. To mitigate this, it is recommended that institutions (SMES) seeking favorable credit terms provide adequate security for loans applied or sought from other financial institutions (not necessarily banks).

5.5.1.2 Effect of Working Capital Management Practices
It is further recommended that effective working capital management should be used to set targets for cash management and undertake initiatives to effectively improve cash flows. This will acts as a drumbeat to ensure change in practice is implemented.

5.5.1.3 The Effect of SME Owners’ Ethical Practices on Management of Working Capital

Ethics demands that employees should be fairly treated and offered fair and timely remunerations. It is therefore recommended that SMEs should treat their employees fairly and pay them commensurate and competitive remuneration to minimize cases of theft and work stoppage in the firms. SMEs should also pay other stakeholders like suppliers in a timely manner as per the agreed dates to ensure that there is a constant supply of the goods and services and therefore constant sales.

5.5.2 Recommendations for Future Research

This research identified that there is a pressing need for further empirical studies to be undertaken on working capital management, particularly in the area of working capital practices. This can be achieved by extending the sample size so that an industry-wide analysis uncover the other factors that influence working capital management. This would assist policy-makers and educators to identify the requirements of, and specific problems faced by small and medium enterprises in Kenya. Additionally, due to many of the firms issuing stock on credit there is need to determine the procedures to mitigate risks associated with this practice.
REFERENCES


Lewis, B. (2009). Paying on time is Good for Business. Hanson,UK: ICM.


Appendix: Data Collection Instrument

SECTION A: GENERAL INFORMATION

1) What is the nature of the Enterprise?
   a. Sole proprietorship ( ) b. Partnership ( ) c. Limited Liability Company ( )
   d. Other ( ) (please specify) ..................................................

2) Where is the enterprise located?
   a. Downtown CBD ( ) b. Suburb ( ) c. Open market ( ) d. Rural ( ) e. Other
      (please specify) ........................................

3) Age of the respondent in years ..............................................

4) Sex of the respondent
   a. Male ( ) b. Female ( )

5) Marital status of the respondent
   a. Married ( ) b. Single ( ) c. Divorced ( ) d. Widow ( )

6) What is your highest level of Education?
   a. Primary school ( ) b. Secondary school ( ) c. University ( )
      d. Other ( ) (please specify) ........................................

7) How many employees does the enterprise have?..........................

SECTION B: FUNDING SOURCES

1) Does the enterprise have a Bank account?
   a. Yes ( ) b. No ( )

2) If the enterprise has a bank account, does it bank its daily proceeds?
   a. Yes ( ) b. No ( )

3) Does the enterprise have access to credit facilities from their Bank?
   a. Yes ( ) b. No ( )

4) If no to 3 above, does the enterprise have access to credit facilities elsewhere?
   a. Yes ( ) b. No ( )

5) If yes to 4, please specify where the credit facilities are held.
   .................................................................

6) How do you fund your working capital requirements?
   a. Bank debt ( ) b. Internally generated resources by the enterprise ( )
      c. resources pumped in by the owner ( ) d. debt from other financial institutions
      ( ) e. from government set funds ( ) f. from NGOs ( )
7) If working capital is funded through debt, does the enterprise usually get all the funds it requests?
   a. Yes ( ) b. No ( )

8) Do you have tangible security to act as collateral when borrowing?
   a. Yes ( ) b. No ( )

9) If yes to no. 8, does the Bank find the security to be adequate for the borrowing applied for?
   a. Yes ( ) b. No ( )

10) If No to no 8 above, how does it affect your ability to borrow?
    ………………………………………………….

SECTION C: MANAGEMENT PRACTICES

1) Do you sometimes sell on credit?
   a. Yes ( ) b. No ( )

2) If yes to 1 above? How much time in days do you allow before payment is made against the sell? (Please specify) ………………………

3) If No to 1 above, please give reasons why …………………………………………………..

4) Do you undertake formal credit investigation before granting credit to your customers?
   a. Yes ( ) b. No ( )

5) What evidence exists for a customer’s indebtedness to you firm?
   a. Signing of a delivery note or other receipt documents ( )
   b. Signing of a formal IOU document ( )
   c. Other (please specify) ……………………..

6) What are the sources of raw material used in you production process?
   a. Local ( ) b. foreign ( ) c. Both ( )

7) If a trading firm, what is the source of your goods for resale?
   a. Local ( ) b. foreign ( ) c. Both ( )

8) Do you experience large pile ups of raw materials or of goods for resale
   a. Yes ( ) b. No ( )

9) Do you keep a record of your goods for resale or the raw materials?
a. Yes ( ) b. No ( )

10) Do you undertake regular stocktaking?
   a. Yes ( ) b. No ( )

11) If yes to 10 above, how often do you do it?
   a. Daily ( ) b. monthly ( ) c. yearly ( ) d. other (please specify)

12) Do you have a re-order level policy for requesting for goods for resale or for the raw material input?
   a. Yes ( ) b. No ( )

SECTION D: SME OWNERS ETHICAL PRACTICES

1) Is the SME owner fair to his employees?
   a. Yes ( ) b. No ( )

2) Does the SME owner remunerate fairly?
   a. Yes ( ) b. No ( )

3) Does the owner pay salaries on time?
   a. Yes ( ) b. No ( )

4) Does the owner pay suppliers by the agreed date?
   a. Yes ( ) b. No ( )

5) If No to 4 above, how does this affect future supplies?...................................................

6) Does the firm make timely payments for the credit facilities?
   a. Yes ( ) b. No ( )

7) If No to 6 above, how does this affect future borrowings?
   ..............................................

8) How does the firm tender for work?
   a. Applies for the tender formerly ( )
   b. Applies for the tender formerly and pays an amount to facilitate winning the tender ( )

9) If the response to No 8 above is b., how does this affect the firm?
   ..............................................