CURRENT ASSETS MANAGEMENT PRACTICES OF SMALL AND MEDIUM ENTERPRISES IN KENYA: EVIDENCE FROM SELECTED ENTERPRISES IN NAIROBI

BY

DENNIS OTIENO ONYANGO

UNITED STATES INTERNATIONAL UNIVERSITY

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A research Project submitted to the Chandaria School of Business, United States International University in Partial Fulfillment of the Requirement for the Degree of Masters in Business Administration (MBA)

UNITED STATES INTERNATIONAL UNIVERSITY

SUMMER 2014
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 the United States International University in Nairobi for academic credit.

Signed: ________________________  Date __________________________

Dennis Otieno Onyango (ID: 621494)

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

Signed: ________________________  Date __________________________

Dr. Timothy Okech

Signed: ________________________  Date __________________________

Dean, Chandaria School of Business
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ABSTRACT
The purpose of this study which was to investigate the current asset management practices of small and medium enterprises in Nairobi County. The research was guided by the following research objectives: firstly to determine the cash management practices of SMEs; secondly to ascertain the account receivables management practices of SMEs; finally to examine the inventory management practices of SMEs. Descriptive research design was adopted due to the population under study. Stratified random sampling was used because the population can be segregated into several mutually exclusive subpopulations, or strata therefore, it was easier to make inferences on the specific groups of the population because the groups share attributes or characteristics. There were five strata representing sectors. The first represented agriculture sector, the second was the industry and manufacturing, the third one was technology, the fourth one hospitality and the final one the energy sector. Data was collected using a structured questionnaire while analysis was done using Statistical Package for Social Sciences (SPSS) and spreadsheet and presented by way of figures and tables.

In terms of findings, the study revealed that The SMEs used mostly used their own cash sources to finance their business. Most of the SMEs do not regularly set cash targets for their business. In the event of cash shortages the financial institutions are mostly used in order to plug this gap. The SMEs are ambivalent on the need of budgeting their cash. Furthermore the SMEs used the banks as a source of both storage and source of cash. All SMEs record their daily cash transactions. Finally, the surplus cash generated by the SMEs is re-invested back into the business.

More than half of the SMEs sell their products and services on credit. The average collection period is 30 days, although this varies depending on the individual agreements between the SMEs and their buyers. The fear of credit defaults makes some of the SMEs not to sell their goods and services on credit. The SMEs also use formal credit investigation to determine the credit worthiness of their debtors. They check the debtors’ credit history with their business and also cross reference with other businesses. In case of a default most of the SMEs take legal action against the defaulters or cease from supplying them with their products and services. The SMEs record the credit history on IOUs and delivery notes.
The SMEs source their inventory both in the local market and in the foreign market with some using a hybrid of the two markets. In order to prevent large inventory holding costs most SMEs do not stock-pile their inventories. Inventory record is well entrenched practice with these SMEs. Some SMEs conduct regular stock takes, with the stock take on average happening periodically on a monthly basis. The SMEs lack re-order level policies to monitor the inventory re-order levels.

In conclusion the findings from this study show that most of the investors conformed to the conventional liquidity management mechanisms of business institutions. They did this by safeguarding financial records, supplementing cash shortages with loans from the bank, saving profits on a daily basis and spending within their financial capability. Investors also use credit sales geared to promote growth in their industries. Furthermore buying of stocks from local companies at moderate quantities and regular stock-taking were the strategies used by the operators in managing their inventory machineries.

On the basis of the findings, it is recommended that in order to optimize cash asset management SMEs need to identify their investment priorities particularly those that are crucial in sustaining their businesses in the long run. They should pursue strategies that can generate sufficient funds to augment their cash target. The medium and small entrepreneurs should also formulate a credible credit policy for their enterprises. In crafting such a policy criteria should be set as to the conditions and terms for credit granting. On the inventory front a re-order level policy should be established that will create an enabling environment for them to request for the supply of moderate and high quality stocks therefore optimizing their cash utility.
ACKNOWLEDGEMENT

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DEDICATION

This work is dedicated with all my love to my late father Nashon Onyango, my mother Mrs. Jennifer Onyango, my siblings Willis Odhiambo, Jessica Akinyi, Stephen Onyango (junior) and my auntie Alice Ochieng, my uncle Moses Ayiemba, my teacher and mentor Mrs. Ochola and Mama Lilian.
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LIST OF ABBREVIATIONS AND ACRONYMS

AP  Accounts Payable
AR  Accounts Receivable
AIMS Alternative Investment Market Segment
CMA Capital Markets Authority
CED Committee for Economic Development
CCC Cash Conversion Cycle
EC European Commission
FSD Financial Sector Deepening
MIMS Main Investments Market Segment
MSME Micros, Small and Medium Enterprises
NBSSI National Board for Small Scale Industries
NSE Nairobi Stock Exchange
NWC Net Working Capital
RIA Research ICT Africa
SME Small and Medium Enterprise
SMME Small, Medium and Micro Enterprise
UNEP United Nations Environment Programme
UNON United Nations Office in Nairobi
USA United States of America
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CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Study

Small and medium enterprises comprise of organizations that usually provide services and job opportunities to employees numbering 1 – 50 (RoK, 2009). These SMEs are present in all the economic sectors and play a very critical role in alleviating poverty, as a source of income and for the reduction of unemployment. According to Stella (2011) SMEs are the backbone of both emerging economies and developing economies. For instance, in the United States of America the SME sector provides employment opportunities to an estimated 70% of the total employable population. In Kenya this sector contributes 39% of the country’s GDP (RoK, 2009).

In Kenya, the SME sector is central to the countries Vision 2030 blueprint. This is a roadmap for the country’s attainment of development goals. This sector is expected to contribute towards the realization of the millennia goals. It is estimated that the sector shall contribute towards the employment of 80% of the population (RoK, 2009). The SME sector contribution to Kenya’s GDP has extrapolated from 14% in 1994 to 35% in the year 2008 (Rok, 2009). Kenya National Bureau of Statistics (2013) demonstrates that this sector accounts for 90% of the new jobs created in Kenya annually. There exist 3 pillars that buttress Vision 2030. These are the social, economic and political pillars. The economic pillar is central to the attainment of the Vision 2030 goals as it is tasked with wealth creation, the generation of employment opportunities and equity in the distribution of the national wealth. In addition, youth employment is also strongly tied to this pillar. In recognition of the essential part that the small and medium enterprises are expected to play, the Kenya government has begun enacting mechanisms that will help support SME sector (RoK, 2010).

According to Ngugi et al (2012) the SME sector in Kenya is a vital element to the Kenya socio-economic vision. This is because; other economic contributions emerge from this sector. These are income generation through exports, new employment opportunities,
pioneering innovations, initiating and spurring competition and also as a cog of development. Ngugi et al (2012), also posits that the SME sector’s importance towards the current knowledge-based economic situation that is presently being practiced in Kenya. This is because the intellectual resources employed by the small and medium enterprises from a repertoire of intellectual capital, (Ngugi et al, 2012).

Ngugi et al (2012) also identified that the innovation brought about by the management significantly influence the development of SMEs in Kenya. The ability of managers to create an enabling ecosystem with the business organization will go towards nurturing unconventional thinking that will spring innovativeness.

Kauffmann (2005), points out that small and medium enterprises in the African context are affected by the existence of inadequate local markets, lack of regional integration, and extremely difficult business conditions. This includes bureaucratic official procedures, weak infrastructure, inadequate legal systems, and ineffective financial systems and unattractive regimes.

Smaller enterprises do not usually appreciate the core of financial management and hence have poor understanding of the essence of good financial management (Ngugi et al, 2012). Furthermore the proximity of the SME business to the urban center and the magnitude of the business is negatively correlated to awareness of financial management. That is, the lesser the magnitude of the business and the more distant a business is from the city center the less aware the organization is about the financial management instruments. These situations expose the business negatively, to external shocks to their sales and operational costs and thus limit their growth and expansion.

The government in the Economic Survey of 2009 noted that there is a chronic financing gap that limits the access of funds for Kenyan SMEs. This is mainly due to the overlap and inconsistencies in the legal and sectorial policy formulation, opaque boundaries governing the institutional mandates; inadequate legal infrastructure; obsolete council by-laws; lack of collateral and security; the exemption of local authorities in policy formulation; lack of access to credit; and the lack of a centralized coordination process.
Mwarari (2013) argues that the enactment of a securities market for SMEs will be an important direction for the sector. He says that efforts have already been initiated by the capital markets authority to attract small and medium enterprises to the Nairobi Stock Exchange (NSE). This has happened through the initiation of the Alternative Investment Market Segment (AIMs) that contains fewer restrictions (Mwarari, 2013). Currently out of a total of 60 companies on the NSE, only 11 of them are SMEs, representing 19% (NSE, 2012). Stella (2011), says listing on the NSE is mostly affected by lack of adequate information by SMEs. A key recommendation by stakeholders is for the NSE to lessen some of the listing restrictions placed on SMEs like the minimum assets rule. These rules ought to be restructured to align them with SME needs.

In small firms, current asset management is important to their liquidity and profitability. Current assets involve the investment in cash, accounts receivable and inventory which are non-interest bearing assets. It’s possible for a firm to avoid purchasing capital assets like land, but it’s impossible for a business to run without the provision of adequate current assets. Current asset management has gained increased prominence as firms began to be aware of the difference between profitability and liquidity. This is particularly true as the major role of the financial manager of an SME business is to spend a great deal of their time managing current assets and current liabilities. In addition the financial manager is involved in arranging for short term funds, negotiating credit terms, monitoring the usage of cash, managing accounts receivable and keeping an eye on inventory movement (Deloof, 2003)

According to Eljelly (2004) the management of cash, accounts receivable, and inventory and the interrelationship that exists between them may be referred to as current asset management. It requires much of the financial managers time. It is also primarily concerned with the issues that emerge with regards to monitoring of cash, accounts receivables and inventory. It is a very important point in the financial management and it attempts to control cash, accounts receivables and inventory in order to optimize profitability and improve the liquidity of the business. It is vital to know that liquidity and profitability play a pivotal role on the life of a business. While a firm may continue to survive without making profits, there is absolutely no way firm may exist without liquidity.
Mathuva (2009), posits that the lack of efficient current asset management practices by SMEs exposes them to a lot of financial distress. This inefficiency declines the growth potential of the business. Current asset management makes it very difficult for a firm that wants to expand to invest in profitable projects. Furthermore it makes it extremely difficult to conduct strategic operational plans and therefore the firm fails to meet its operational budget targets. The inefficiency of current asset management is very detrimental to the utilization of the fixed assets which are a fixed cost to the business. This slows down the return of investments. The mismanagement of current assets is linked to the lack of or expensive credit facilities availed to an organization. This situation will make the organization to lose face, as it will fail to honor its debt obligations.
1.2 Statement of the Problem

Current asset management is poorly understood by most small and medium scale enterprises in many parts of the developing world of which Kenya is one. Lazridis and Tryfonidis (2006) say that while current asset management is of importance to all firm size operating in both developed and emerging countries, current asset management is of particular importance to the business firms operating in emerging markets.

One of the other major difficulties SMEs come across, however, is the issue of access to finance. SMEs, especially in developing countries, suffer from lack of access to appropriate (term and cost) funds from both the money and capital markets (Oteh, 2010). This is due in part to the perception of higher risks resulting in high mortality rate of the business, information asymmetry, poorly prepared project proposals, inadequate collateral, absence of, or unverifiable history of past credit(s) obtained and lack of adequate historical records of the company’s transaction (Oteh, 2010). Therefore many small and medium scale enterprises which are profitable are forced to cease their operations due to the inability to meet their short term debts obligations. Not that they do not have funds to operate, but the problem is how they manage their current assets.

The importance of efficient current asset management is not new to the finance literature. The careful management of cash flow, accounts receivables and inventory is more vital in small and medium enterprises than it is for large organizations particularly as they are not likely to have access to financial expertise like the large enterprises, (Peel and Wilson, 1994).

To gain empirical insight on current asset management, there was need to conduct an investigation into the current asset management practices and challenges of small and medium scale enterprises.
1.3 Purpose of the Study

The general objective was to examine the current asset management practices of small and medium scale enterprises in Kenya with reference to Nairobi County.

1.4 Research Objectives

Specifically, the study sought to:

1. To determine the cash management practices of SMEs
2. To ascertain the account receivables management practices of SMEs
3. To examine the inventory management practices of SMEs

1.5 Importance of the Study

An empirical analysis of the cash flow management by the small and medium enterprises will have incremental benefits to this sector as a whole. This study will assist the SME entrepreneurs to value the significance of managing their cash flow. The policy makers will also gain relevant insights from this study and structure policies to address the cash flow constraints faced by SMEs.

1.5.1 SME Entrepreneurs

To improve the book keeping and accounting practices in SME”s to facilitate growth. To help the SMEs gain access to finance and improve their financial management skills. Help SMEs to adopt prudent managerial policies as well as professional expertise for efficient managerial works.

1.5.2 Government

This study would provide useful information for designing strategies to influence the growth of small-scale enterprise. The information would also assist officials of the Ministry of Industrialization and Enterprise Development in formulating small-scale industries growth policies and programs which are responsive to entrepreneur’s local needs. Such information
may be useful to non-governmental organizations playing vital roles in small-scale entrepreneurial skills and development in Kenya and the Nairobi County.

1.5.3 Researchers and Academicians
Researchers and academicians will need the information to aid further their research as far as cash flow management is concerned.

1.5.4 Organizations
It is hoped that the result of this study concerning cash flow management in the Nairobi County would contribute to current knowledge on growth of small scale enterprises to the investment fund managers, the Kenya Bankers Association, the micro financial institutions in Kenya and other SME promotion agencies.

1.5.5 Other Stakeholders
Secondly, the findings unearthed will be useful not only to small scale business in the Nairobi County but also to all small-scale business throughout the country. This would also help stakeholders in business to formulate and implement policies that will help them to effectively manage working capital. Determining ways management can effectively improve their working capital management.

1.6 Scope of the Study
It is worth mentioning that, the study was limited to the small and medium enterprises under the governing jurisdiction of Nairobi County. The study was conducted between May 2014 and June 2014. The limitation of this study is the selection of one county among a population of 47 counties in Kenya. This selection has been based on the fact that Nairobi County has the largest number of established SMEs in Kenya.

The small-scale enterprise in the County operates under either physical structures or non-permanent physical structures. The non-permanent physical structures include kiosk, container and garage. The permanent physical structures are part of own related premises.
1.7 Definition of Terms

1.7.1 Micro, Small and Medium Enterprises (MSMEs)

Micro, small, and medium enterprises (MSMEs) are defined as any business activity/enterprise engaged in industry, agri-business/services, whether single proprietorship, cooperative, partnership, or corporation whose total assets, inclusive of those arising from loans but exclusive of the land on which the particular business entity's office, plant and equipment are situated, must have value falling under the following categories:

1.7.2 Vision 2030

The Kenya national development footprint, that seeks to create a globally competitive and prosperous nation with a high quality life by 2030. It aims to transform Kenya into a newly industrializing, middle-income country providing a high quality of life to all its citizens by 2030 in a clean and secure environment (Kenya Vision 2030, 2007)

1.7.3 Gross Domestic Product

Is the market value of all officially recognized final goods and services produced within a country in a year, or other given period of time. GDP per capita is often considered an indicator of a country's standard of living (Deloof, 2013).

1.7.4 Working Capital

Working capital (abbreviated WC) is a financial metric which represents operating cash flow liquidity available to a business, organization or other entity, including governmental entity (Bagchi, 2013).

1.7.5 Treasury Bills

A government bond is a bond issued by a national government, generally with a promise to pay periodic interest payments and to repay the face value on the maturity date (Filbeck and Tavakoli, 2005).
1.7.6 Capital

“Capital” can mean many things. Its specific definition depends on the context in which it is used. In general, it refers to financial resources available for use (Cooper and Schindler, 2001).

1.8 Chapter Summary

This chapter highlights the background of the study, statement of the problem, purpose of the study, research questions, and justification of the study, scope of the study and definition of terms.

In chapter two a review of relevant literature on working capital management practices of small and medium scale enterprises was done.

Chapter three presents the research design and methodology used for the study and gives a detailed overview of the population sampling technique, the research design, research instrument, the data collection procedures and data analysis procedures. It also provided analytical framework and the relevant variables that were included in the model. Chapter four provides the results and findings while chapter five provides summary of the findings, discussions, conclusions and finally recommendations.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

The objective of this chapter was to review existing literature on the subject of current asset management among SMEs. The study looked at the concept and definition of current asset management, cash management, accounts receivables management and inventory management. The study reviewed the literature on the current assets management practices of SMEs. Furthermore it also reviewed the literature on SME cash management, accounts receivable management and inventory management.

2.2 The Concept and Definition of Current Asset Management

According to Khanqah, et al (2012), the current asset, management is a very vital sector of the discipline of financial management, Current assets comprises a greater portion of the total assets of a business. The definition of current assets is that it comprises of receivables, inventory, work-in-progress and cash that flow in and out of a firm during the operations of a business. In essence cash is converted into products and it cycles back into cash again. A current asset in accounting is considered to be an asset that is short term in nature, usually less than a year. Sanger (2001) however argues that current assets restrict the financial performance of a business as it does not contribute towards the return on equity. Due to this some financial managers disregard current asset management during financial decision making.

Ray (2012) has argued that the management of current assets should be accorded prominence in the financial decision making. This is because current assets are a portion of the total assets invested in a business. Current assets also have a positive correlation effect on liquidity and profitability.

Khanqah et al (2012) posit that the short-term financing needs of a business are closely tied to the efficient management of current assets. If the firm optimizes its current assets management it will have the leverage to make available additional capital in order to conduct
more strategic objectives, increase profitability and minimize the interest costs. Khanqah et al. (2012) say that the fundamental objectives of the management of current assets is as follows: to maximize the investments in current assets and to minimize the amount of current liabilities in order for the company to free working capital and improve the return on capital for the business; an efficient company must always have the capability to fulfill their current obligations using the current asset generated by the business. The downside is that if a business has surplus current asset, this means that the business is potentially losing out on returns; to manage the firm’s current assets in order to balance the marginal return on investments vis-à-vis the cost of capital that has been deployed to finance the acquisition of the current assets. The marginal return on investment should always be greater than the cost of capital.

Due to the current economic and environmental business ecosystem, there is growing pressure on the limited resources within the business. Therefore the efficient utilization of current assets cannot be gain said. It will be a major competitive advantage for the firm that shall optimize its current assets management.

According to Ashraf (2012), the term current asset management is one of the most fundamental topics in the field of corporate finance. It refers to the firm’s investment in inventory, accounts receivable, cash and liquid securities, all of which constitute short-term assets. Current asset management is essential due to many reasons. The holding of excess current assets in a business might lead to unrealized opportunities. On the other hand firms with less current assets in their books may encounter shortages and expect difficulties in running their operations. Therefore many firms want to maintain an optimal level of investment in both the current assets and current liabilities. This is done in order to eliminate the risk that emanates from the inability of the business to meet its short term obligations. They will also avoid investing in non-essential current assets.

Eljelly (2004), posits that current asset management is the process of planning and monitoring investment in current assets to eliminate the risk of defaulting in the short-term obligations and to also avoid over investment in these assets. In order for a firm to generate shareholder value, the firm’s financial managers need to efficiently manage the current assets. Current assets are the efficient, management of cash, inventory and accounts
receivable. The firm’s policies for managing current assets have a direct impact on the level of liquidity and profitability to the company.

The reason for the existence of any firm is for the goal of profit maximization. This should not negate the fact that firms need to be liquid in order to be profitable. Increasing profits at the expense of managing liquidity is always a detriment to the success of many firms. The firm should always maintain equilibrium to match these two objectives. The biggest dilemma in the area of current asset management and working capital management is the balancing of liquidity and profitability (Raheman and Nasr, 2007). In the theory of risk and return, the investor who takes on more risk will most likely generate the greatest return. Therefore the firms with the highest liquidity of current assets may have lower risk and therefore lower profitability. On the other hand, firms with minimum liquidity in current assets shall have a higher risk and therefore, a high profitability return.

Current asset management is derived from the problems that occur in trying to manage cash, accounts receivable and inventory and the interrelationship that exists between them. If the firm is not able to maintain an optimal level of current assets it is most likely to become insolvent and may go into bankruptcy. Altman’s (1968) multivariate predictor that was modelled on the companies domiciled in the USA includes current assets as one of the model components.

Abuzayed (2011) states that the fundamental aim of current asset management in a firm is to essentially manage short term funds that are essential in the day to day operation of a business. The firm requires an effective current asset management policy for uninterrupted operating and revenue activity.

Fathi and Tavakoli (2009) examined the relationship between current asset management and financial performance. They concluded that there exists a very big association between the reduction in the collection period, the duration of the inventory holding period and as a result a shorter liquidity cycle and the increase in profitability of the firms. If the firms have an optimal liquidity cycle then they can maximize the company’s profitability.

Mohammadi (2009) conducted a study titled “Effects of working capital management on the profitability of listed companies in Tehran Stock Exchange”. He investigated 92 companies
between the years (1996 – 2005). In his study the current asset criteria were the variables of collection period, inventory turnover period and the cash conversion cycle while the portion of profitability was gross profit to total asset ratio. The study results pointed to a significant inverse relationship between the company’s profitability and the accounts receivable collection period, inventory turnover period and the cash conversion days.

Filbeck and Krueger (2005) argue that the importance of effective current asset management is indisputable. Current asset management is the management of cash, the most liquid asset, accounts receivable and inventory. The objectives of current asset management are to maintain the optimal balance of the current assets components. The current asset is the lifeblood of the business. Therefore a firm relies on the ability of its managers to manage cash, receivables and inventory efficiently. Efficient current assets management enables the firms to expand the funds that are available to pursue expansion by minimizing the funds tied up in the current assets. The managerial keenness that is required to bring sub-optimal level of current assets to the optimal level is quite time consuming. An optimal level is described as a perfect harmony between risk and efficiency.

According to Padachi (2006), management of current assets is very essential in the financial health of all the firms despite magnitude and size. Particularly for manufacturing firms, a significant sum of its funds is mostly invested in stock and work-in-progress which are very key components of the current assets and therefore adequate management is therefore essential for the success of the firm. Sound current asset management will help an organization succeed and adequately meet its short-term obligation.

According to Sunday (2011), effective current asset management enables the firm to curb the accumulation of non-productive resources that are not generating returns or as mentioned previously ensure that there is enough resources to meet the short-term financial obligations. It therefore explains why the efficient current asset management is critical in the achievement of over-arching goals of a business, which is the goal of shareholder wealth maximization.

Akoto, Awunto-Vitor and Angmor (2013), note that the requirement to have effective current asset management within SMEs is vital to the liquidity and solvency of the small and medium enterprises. The problem is most SMEs lack adequate appreciation of their current
asset position, most have little regard for their current asset position and do not even have standard credit policy. Most also have less regard for their financial position, they only run their firms and mostly focus on the receipt of cash and their bank statements.

2.3 Cash Management

Kithii (2008) explains that the cash on the books of the SMEs are bank deposits that are either in the bank accounts or are in the certificate of deposits. The cash is a key component of the firm’s current assets as it’s the most liquid. The cash is used in the payment of short-term payables and operational expenses. In the context of current asset management, the deposits in the bank are components of current assets.

Kithii (2008) also notes that some costs are incurred due to the shortages or excesses of current assets. Therefore the goals of the business become dual. The first goal is to manage the excessive costs and the second goal is to maintain optimal liquidity to fulfill all the current expenses which include petty cash payments to ensure all the operations occur smoothly. The latter goal effectively ensures that the business is able to sustain routine operations (Owolabi et al, 2012). The management of liquidity, that is funds that are available to immediately meet daily expenses while keeping a lid on excesses, affects the profitability of the firm and is like maintain the optimal amount of stock in inventory management (Hofmann 2005). The reason for this is that the cash available and the bank deposits constantly fluctuate, as customer demand for a finished product. This imposes uncertainty and the risk of the business being insolvent. (Chakravarty, 2009).

Bagchi (2013) postulates that firms, in particular SME frequently fail to meet their operational goals as a result of lack of cash liquidity. This is because they constantly need cash and bank deposits to meet routine operational expenses. Therefore without appropriate liquidity a firm may end up bankrupt. Cash on hand is the cash and bank deposit available on the first trading day. When sales occur, cash is generated and flows in, same with bank deposits. When standing orders are paid, or when cheques are written, cash flows out of the business. The balance of the cash that will be left at the end of the month will be carried over to the beginning of the next month.
Instead of having raw cash and bank deposits, firms may also put excess cash into marketable securities. These are very liquid assets that are promptly converted to cash if there is need (Bagchi, 2013). Cash management is geared towards evading cash and bank deposit gaps that exists between incoming and outgoing cash for the operations of the business. During the lifetime of a business, in order for the owners to ensure survival of the business they must always ensure that they have enough cash flow in order to achieve their sales targets, expansion targets, hiring and firing of employees and payment of statutory taxes. A firm which tracks its cash flow can be able to pinpoint when there is need for cash injection, perhaps via a loan without which the business will become insolvent. If the money is being held by the inventory or accounts receivable, the business might be profitable or illiquid to finance its routine obligations. The remedy is for the business to increase its inventory turnover and to collect their receivables to free cash flow.

According to Bagchi (2013), many businesses confuse cash management with profitability. Cash management is the tracking of cash that flows in and out of the business. The management of cash aims at having sufficient cash and bank deposits to meet a firm’s financial mandate in a timely manner. This is ensured by having maximum liquidity. Profits are the residual money from sales and other income transactions (as presented in a firm’s annual income statement) after deducting all the operational expenses incurred in that year.

According to Keynes (1973), cash is held in companies in order to act as a bridge between the sales receipts and the incurred business costs. In summary, companies will hold a significant cash amount to be able to meet their regular obligations. It therefore follows that if a firm has a higher ability to manage its cash flows that is the more predictable the better, the weaker the transactions motive for holding cash will be. The transaction motive is mostly applicable to SMEs as it illustrates the cash holding motives of firms. The precautionary motive is in regards to a firm’s ability to provide for unseen expenses and unforeseen opportunities of advantageous gain. Therefore a firm that operates in a market with volatility will have a higher affinity to be cautious than a firm operating in a less risky operating environment. Firms also hold out cash for the purposes of speculation. The speculation motive is premised on the case that an increase in interest rates will reduce demands of security and vice versa. Thus the company will most likely invest it’s idle cash in securities
during the period when interest rates fall. Due to this speculation the firm will generate additional cash when selling these securities as the prices of these securities will have risen as a result of anticipated decline in interest rates.

2.4 Accounts Receivable Management

Bagchi (2013), states that accounts receivables are a means of attracting customers and increasing sales for a business. This is because it allows a customer the privilege to access a service or a product and enjoy its consumption before delivering payment. This kind of arrangement will generally increase the sales but will have the additional effort of increase the receivables that the firm should recover later. If the firm does not collect its receivables, it risks turning it into bad debt, never to be repaid. In addition slow payment by the customers might end up running the business to the ground. Therefore to minimize this, the business sets up a credit sale policy. In general an increase in accounts receivable will raise current asset requirement.

According to Deloof (2013) the managers can maximize the wealth of their shareholders by minimizing the number of days of accounts receivables and increasing inventory turnover. There is a negative relation between profitability and accounts receivables. This is consistent with the fact that mostly less profitable firms have higher lead times for paying bills.

Padachi (2006) has examined the trends in current asset management and its impact on a firm’s performance for 58 Mauritanian small manufacturing firms during the period 1998 – 2007. He says that a well designed and implemented current asset management can contribute significantly towards the realization of a firm’s value. The results demonstrated that a higher investment in receivables is generally associated with low profitability and as a result leading to the firm requiring having short term current asset financing.

According to Vural, Sokmen and Cetenak (2012), a firm’s profitability is negatively related to the collections of receivables and cash conversion cycle. Therefore if the firm shortens its receivables collection period and therefore reduces its cash conversion cycle is most likely able to increase its profitability. This will render the relationship between other working capital components and firm’s profitability insignificant. The relationship between a firm’s
leverage and its profitability is negative whereas the relationship between a firm size and its profitability is positive.

One of the components of current asset management is the accounts receivables collection. In general, the fundamental goal of the firm’s managers is to maximize the shareholder value. With this in mind, optimal receivables management is effective in achieving this goal. An increase in the receivables account of a company leads to an increase in working capital as well as an increase in the cost of receivables account management and maintenance. In principle generally, the collections period is a criterion for the measurement of the time required for the collection of cash from customer sales.

Deloof (2003) using a sample of 1,009 large Belgian non-financial firms from the period (1992 – 1996) found a significant negative relationship between gross operating income and the number of days of accounts receivable, inventories and accounts payable for Belgian firms. Deloof suggests that in order for managers to increase the profitability they should therefore minimize the number of inventory turnover days and the accounts receivable collection days.

Mathuva (2009) used a sample of 30 listed firms in the NSE to try and illustrate the influence of current asset management components on a firm’s profitability for the period 1993 – 2008. The following were the key findings from this study: i) there exists a highly significant negative relationship between the time it takes for firms to collect cash from their customers (accounts collection period) and profitability, ii) there exists a highly significant positive relationship between the period taken to convert inventories into sales (the inventory conversion period) and profitability, and iii) there exists a highly significant positive relationship between the time it takes the firm to pay its creditors (average payment period) and profitability.

2.5 Inventory Management

Deloof (2003) found that there exists an inverse relationship that is significant between cash conversion cycle and its components. These components are the accounts payables turnover, accounts receivable days outstanding and the inventory turnover period, together with the
firm’s profitability. Therefore some financial managers can increase the liquidity of their firms immensely by reducing inventory turnover period, which is a component of the cash conversion cycle.

In order to fully appreciate the importance of inventory management the managers must first visualize it as stacks of money sitting on the forklifts, shelves, pallets, storage tanks, trucks, tanks and planes while in transit. This money is idle as it is not earning any interest and neither is it being immediately invested to churn profits. Therefore a firm’s goal should be to minimize its inventory as much as possible. However inventory also serves as a precautionary measure as it decouples systems working in tandem and helps the business to manage uncertainty.

In financial terms, inventory constitutes a paramount portion of current asset management and its prudent management mitigates the risk of work or supply stoppages. Inventory ensures that the firm has excellent customer relations and this therefore ensures demand for the firm’s products leading to higher sales and increased profitability (Danuri and Satoto, 2011). Inventory in accounting is an estimate of the appropriate monetary value of the goods to be held by a company. Raw material inventory is the free on board price that is paid during the time of the purchases, while finished goods is the value of the cost of sales or the cost of goods sold (Danuri and Satoto, 2011).

The inventory turnover period is a vital component of the current asset management. It indicates the approximate length of time it takes for products to be sold. A low frequency turnover generally implies a high investment in inventory. If the business is sub-optimal in maintaining products, this will result in financial resources being held captive in non-productive cases.

2.6 Chapter Summary

This chapter reviewed the literature on the concept and definition of current asset management. Furthermore this chapter explored the cash management, the management of accounts receivables and the management of inventory. The next chapter will look into the
research methodology. This will include the research design, population and sampling design, research procedure and data analysis.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This chapter provides a discussion of the research methodology that will be used in this study. It started by addressing the research design of the study. It then proceeded to discuss the population and sample design. The research procedure was also discussed. Under the research procedure, it reviewed the method of pre-testing adopted. This chapter further discusses the data collection technique to be used and data analysis.

3.2 Research Design

The research design is both qualitative (descriptive) and quantitative in nature. Descriptive statistics is that branch of statistics that deals with the collection, organizing, summarizing and presentation of sample data (Harshbarger and Reynolds, 2007). Descriptive statistics is therefore, critical in quantitatively describing the main features of a collection of information.

This study employed the use of the survey method to collect data from the respondents. Surveys are methods of data collection in which information is gathered through oral or written questioning (Sarandakos, 2005). Saunders et al (2003) have indicated that surveys form one of the most frequently utilized methods in business research since it allows the collection of a large amount of data from a sizeable population in a highly economic way.

3.3 Population and Sampling Design

3.3.1 Population

Coopers and Schindler (2003) define a population as the total collection of elements about which we wish to make inferences. The population of this study will consist of small and medium enterprises in Kenya. Due to the size and dispersion of this target population, the study will limit the survey to small and medium enterprises within Nairobi County. This
county represents a good sampling frame since it has the highest number of business enterprise per square meter in Kenya.

In this research, the target population comprised of the small and medium enterprises within Nairobi County. Since it is time consuming, expensive and impractical in most cases to collect data from all potential units of analysis, inferences were be drawn on a sample of sixty (60) from a population based on the study of a small number of representative units / sample (Frankfort-Nachmias and Nachmias, 1996). This study was conducted among twelve firms in each of the following economic sectors: agriculture, industry and manufacturing, technology, hospitality and energy.

3.3.2 Sampling Design

3.3.2.1 Sampling Frame

This is a complete listing of all the sampling units (Frankfort-Nachmias and Nachmias, 1996) it is also a list of elements from which the sample is drawn. It represents a complete and correct list of population of members only (Cooper and Schindler, 2001).

In this study the sampling frame was therefore the population of small and medium enterprises that are based in Nairobi with annual sales revenues of between five hundred thousand and 5 million Kenya shillings.

3.3.2.2 Sampling Technique

Stratified random sampling was adopted. The logic behind stratified random sampling is that most populations can be segregated into several mutually exclusive subpopulations, or strata therefore, it would be easier to make inferences on the specific groups of the population. In this study stratified random sampling technique was used to collect data. The dealers were grouped depending on the management level. The strength of this technique lies in its ability to allow all population groups to be represented in the final sample (Sarandakos, 2005), thus, reducing variability.
3.3.2.3 Sample Size

A sample size represents a subset (any combination of sampling units that does not include the entire set of sampling units that has been defined as the population) of a sampling units from a population (Nachmias, 1996). This gives the entire number of population elements from which data is to be actually collected. The study targeted 60 SMEs which are registered and licensed to operate in Nairobi County. This sample size was selected due to availability of the small and medium enterprises management, time and cost of data collection.

Table 3.1 Total sample size

<table>
<thead>
<tr>
<th>Category</th>
<th>Sample size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>12</td>
</tr>
<tr>
<td>Industry and Manufacturing</td>
<td>12</td>
</tr>
<tr>
<td>Technology</td>
<td>12</td>
</tr>
<tr>
<td>Hospitality</td>
<td>12</td>
</tr>
<tr>
<td>Energy</td>
<td>12</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>60</strong></td>
</tr>
</tbody>
</table>

3.4 Data Collection Method

The study used both secondary and primary data. Secondary data sources consisted of SMEs annual financial statements, budgets and monetary records, cash flow statement, asset register, tax schedule among others.

Primary data was justified as very few studies have been done on the research objectives. Questionnaires were used to capture the requisite information from the target population. A structured questionnaire with open and closed questions was administered.
Primary data was collected using a questionnaire developed in line with the research questions. The questionnaire consisted of both open-ended and closed questions covering the variables of study. Open-ended questions permitted free responses from the respondents, without providing or suggesting any structure for the replies. The closed ended questions enabled responses of the respondents to be limited to stated alternatives (Bryman and Bell, 2003). The use of closed ended questions method was employed because it enables isolation of the responses from external influences (Bryman and Bell, 2003) unlike the open ended questions which gave the respondents total freedom to express their views and attitudes in unconstrained manner.

3.5 Research Procedures

The piloting of the research instrument was conducted among 6 SMEs and thereafter relevant amendments were made on the final data collection instrument. The researcher and the assistants selected distributed the questionnaire to the sample respondents on the first visit and gave time before its collection. A follow up was made to a cross section of respondents in order to help them with the filling of the questionnaire. The third visit was used to collect the questionnaires.

3.6 Data Analysis Method

In this study the data that was gathered from the field of study was edited to ensure that the questionnaire had been properly completed and contained accurate information. The data was then coded and entered on the computer. MS Excel data analysis tool pack program was used for data coding, entry and analysis to develop a quantitative inference to the subject of study. The data analysis and presentation was done by using relevant descriptive statistics such as tables, bar charts and pie chart.

3.7 Chapter Summary

This chapter presented the methodology for the study and gave a detailed overview of the population sampling technique, the research design, research instrument, the data collection
procedures and data analysis procedures. It also provided an analytical framework and the relevant variables that were included in the model to be used in the study.

In chapter four, a detailed analysis of the data collected was done and findings presented by the use of table and figures.
CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction

The section presents an analysis of the information designed to respond to the research questions as outlined in the study. There are two sections presented on the questionnaire. The first is a general information section which answers the respondents’ characteristics and the other section answers cash management, accounts receivable management and inventory management. Data was collected from thirty (60) respondents out of the forty one (60) targeted, indicating 100% response rate. The results are presented as shown below.

4.2 General Information

The study was conducted amongst 60 SME entrepreneurs based in Nairobi County. The study achieved a 100% response rate. This section provides the respondent attributes and characteristics.

4.2.1 The Nature of Business

Table 4.1 illustrates that the most of the respondents were sole proprietors at 33%, closely followed by family business at 25%, limited liability at 22% and finally partnerships at 20%.

Table 4.1: Nature of Business

<table>
<thead>
<tr>
<th>Nature of enterprise</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sole proprietorship</td>
<td>33%</td>
</tr>
<tr>
<td>Partnership</td>
<td>20%</td>
</tr>
<tr>
<td>Family Business</td>
<td>25%</td>
</tr>
<tr>
<td>Limited Liability</td>
<td>22%</td>
</tr>
</tbody>
</table>

Source: Field data, 2014
4.2.2 Age Group of Respondents

From the table 4.2 you can witness that the majority of the respondents were over fifty years which constituted 23% of the respondents while the respondents in the age brackets 18 – 25 years, 31 – 40 years and 40 – 50 years constituted 20% respectively. Finally the age group 26 – 30 accounted for 17%.

Table 4.2: Age Group of Respondents

<table>
<thead>
<tr>
<th>Age of respondents</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>18 – 25</td>
<td>20%</td>
</tr>
<tr>
<td>26 – 30</td>
<td>17%</td>
</tr>
<tr>
<td>31 – 40</td>
<td>20%</td>
</tr>
<tr>
<td>40 – 50</td>
<td>20%</td>
</tr>
<tr>
<td>50+</td>
<td>23%</td>
</tr>
</tbody>
</table>

Source: Field data, 2014

4.2.3 Sex of the Respondents

Figure 4.1 indicates that the gender distribution comprised of an even distribution of 50% male and 50% female.

Figure 4.1: Sex of the Respondents

Source: Field data, 2014
4.2.4 Marital Status

Figure 4.2 illustrates that 42% of the respondents were married, 37% of the respondents were single, 12% of the respondents were widowed and 10% of the respondents were divorced.

![Marital Status Bar Chart](image)

**Figure 4.2: Marital Status**

Source: Field data, 2014

4.2.5 Level of Education

Figure 4.3 demonstrates that the majority of the respondents were secondary educated at 32%, followed by university educated respondents at 23%. Twenty two percent of the respondents were polytechnic educated while the rest were primary school educated.

![Level of Education Bar Chart](image)

**Figure 4.3: Level of Education**

Source: Field data, 2014
4.2.6 Number of Employees

From the study as shown in figure 4.4 the highest frequency of respondents indicated that their businesses employed employees numbering between 20-27 years. This was 35% of the total number of respondents. Thirty three percent of the respondent’s business employed between 11 – 15 respondents, while 18% employed between 5 – 10 employees. Last but not least 13% of the respondent’s business employed between 16 – 20 employees.

Figure 4.4: Number of Employees

Source: Field data, 2014

4.2.7 Keeping of Financial Records of Business Operations

As illustrated in table 4.5 all the respondents said that their business kept financial records. This demonstrates the appreciation by these businesses to track the financial performance of their organizations.

Figure 4.5: Keeping of Financial Records of Business Operations

Source: Field data, 2014
4.2.8 Methods of Financial Record Keeping

Compared to other financial record keeping, the cash book method was used by the highest number of respondents. This was 40% of the respondents as shown on figure 4.6.

![Figure 4.6: Methods of Financial Record Keeping](source: Field data, 2014)

4.2.9 Academic Qualification of Accounting Personnel

From figure 4.7 we can see that not all of the accounting personnel were accountants by profession. Thirty three percent of the respondents possessed a diploma in business studies, 27% were CPA holders while 20% had a degree in accounting. The rest possessed other qualifications.

![Figure 4.7: Academic Qualification of Accounting Personnel](source: Field data, 2014)
4.2.10 Accounting Seminars Attended by Entrepreneurs or Accounting Personnel

Figure 4.8 depicts that 52% of the respondents attended accounting seminars while 48% did not. This might demonstrate why the accounting procedures for SMEs are still not optimal.

![Figure 4.8: Accounting Seminars Attended by Entrepreneurs or Accounting Personnel](image)

Source: Field data, 2014

4.2.11 Benefits of the Training

As illustrated in figure 4.9 of those 52% who attended the accounting training 48% found it to be very beneficial while 24% found the training to be just beneficial. On the other hand 28% found the trainings not to be beneficial.

![Figure 4.9: Benefits of the Training](image)

Source: Field data, 2014
4.3 Cash Management

4.3.1 Source of Start-up Finance

From figure 4.10 self-financing is the most preferred mode of start-up capital comprising 37% of the respondents in this study. Thirty two percent funded their business from borrowing from friends, while 23% went to the financial institutions to get capital. Finally, 8% of the respondents purchased goods assets on credit.

Figure 4.10: Source of Start-up Finance

Source: Field data, 2014

4.3.2 Setting Cash Target

Figure 4.11 shows that 58% of the businesses set cash targets for their businesses. The remaining 42% of the businesses do not.

Figure 4.11: Setting Cash Target

Source: Field data, 2014
4.3.3 Management of Cash Shortage

Figure 4.12 illustrates that when the businesses face cash shortages 20% of the businesses borrow from the banks to plug their cash deficit. Eighteen percent of the businesses purchase goods on credit from their suppliers. Seventeen percent ploughed back their profits, 13% used self-financing.

Figure 4.12: Management of Cash Shortage

Source: Field data, 2014

4.3.4 Cash Budget

Fifty three percent of the respondents stated that they prepare cash budgets to guide their usage of cash. Forty seven percent of the respondents indicated that they do not prepare cash budgets as can be seen on figure 4.13.

Figure 4.13: Cash Budget

Source: Field data, 2014
4.3.5 Daily Cash Management

Figure 4.14 indicates that the 62% of the respondents remit their daily cash to the bank for safe keeping. Of all the respondents 25% keep the cash in the office till while 13% normally spend the daily cash proceeds.

Figure 4.14: Daily Cash Management

Source: Field data, 2014

4.3.6 Spending of Cash within the Budget

Of the 53% respondents who said that they normally budget for their cash, only 63% indicated their adherence to this budget. Figure 4.15 shows that 37% of the respondents do not follow their budgets when spending the cash.

Figure 4.15: Spending of Cash within the Budget

Source: Field data, 2014
4.3.7 Recording of All Cash Transactions

Figure 4.16 depicts that 90% of the respondents record the cash transactions. This is very important as cash is the most liquid of all the assets.

![Figure 4.16: Recording of All Cash Transactions](source: Field data, 2014)

4.3.8 Frequency of Sending Money to the Bank

Figure 4.17 illustrates that depending on the volume of operations and cash transactions, cash collected is sent to the bank on different occasions. Sixty five percent of the respondents send their cash to the bank on a daily basis, 27% on a weekly basis and 8% on a monthly basis.

![Figure 4.17: Frequency of Sending Money to the Bank](source: Field data, 2014)
4.3.9 Investment of Surplus Cash

Figure 4.18 show that 50% of the businesses investment their surplus cash back into the business. Twenty five percent deposit the surplus cash with the banks, while 13% of the business invests the surplus cash in company shares. In addition 12% of the businesses invest in treasury bonds.

![Figure 4.18: Investment of Surplus Cash](source: Field data, 2014)

4.4 Accounts Receivables Management

4.4.1 Credit Sales

Figure 4.19 illustrates that of all the 60 respondents 67% of the respondents provided their sales on credit terms. 20 which is 33% of the respondents did not provide their sales on credit.

![Figure 4.19: Credit Sales](source: Field data, 2014)
4.4.2 Receivable Days

Figure 4.20 illustrates that for the businesses that offer credit sales, 30% of these businesses offer collection periods of more than a month, 25% offer credit sales of 14 days or less, while for 18% of the businesses it depends with the arrangements.

![Figure 4.20: Receivable Days](source: Field data, 2014)

4.4.3 Reasons for not Giving Credit

For the 20% of the businesses that do not give credit, 40% gave their reasons for not giving credit as the fear that the creditors may not pay their debts, another 40% indicated that they sell on cash and carry basis while 20% of the respondents indicated that they have no basic information about the creditors as shown on figure 4.21.

![Figure 4.21: Reasons for not Giving Credit](source: Field data, 2014)
4.4.4 Formal Credit Investigation

Figure 4.22 illustrates that for the businesses that conduct credit sales, 50% conduct due diligence on their debtors while the other 50% do not.

![Figure 4.22: Formal Credit Investigation](image)

Source: Field data, 2014

4.4.5 Procedures for Investigating Prospective Credit Customers

Table 4.3 depicts the procedures for investigating prospective credit customers.

<table>
<thead>
<tr>
<th>Procedures for Investigating Prospective Credit Customers</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Check customers past records from other business firms</td>
<td>68%</td>
<td>33%</td>
</tr>
<tr>
<td>Check customers past financial dealing with the company</td>
<td>75%</td>
<td>25%</td>
</tr>
<tr>
<td>Check customers bank reference</td>
<td>50%</td>
<td>50%</td>
</tr>
<tr>
<td>Other measures</td>
<td>45%</td>
<td>55%</td>
</tr>
</tbody>
</table>

Source: Field data, 2014

4.4.6 Evidence of Customer Indebtedness

Figure 4.23 shows that in order for the businesses to have proof of customer indebtedness they had to have kept the records. Sixty three percent of the respondents ensure that their debtors sign on a delivery not or other receipts of the document, 33% show that the debtors have to sign an IOU while 5% show that the businesses kept the names of the debtors off hand.
4.4.7 Cash Discount Offered to Credit Customers

Figure 4.24 depicts that 58% of the businesses that sold goods on credit did not offer cash discounts to entice their debtors to pay. This was only done by 43% of the businesses.

4.4.7 Action Taken on Debt Defaulters

In case of a default figure 4.25 illustrates that 25% of the businesses take legal action against their debtors while 20% of the businesses issue a warning to their debtors. Thirteen percent of the businesses ensure their debtors either pay a fine or they cancel their debts. 8% of the businesses stop having business transactions with the delinquent debtor.
4.5 Inventory Management

4.5.1 Sources of Inventory

Figure 4.26 demonstrates that the main source of inventory is the local market at 70%, followed by the foreign market at 18%. Twelve percent of the businesses source their inventory from both local and foreign markets.

Figure 4.25: Action Taken on Debt Defaulters

Source: Field data, 2014
4.5.2 Experience of Inventory Pile-Up

Most of the respondents said that their businesses do not experience an inventory pile up at 52%, while 48% of the respondents believed that their businesses experience an inventory pile up. This is shown in figure 4.27.

![Figure 4.27: Experience of Inventory Pile-Up](image1)

Source: Field data, 2014

4.5.3 Inventory Records

It was noted that 92% actually kept inventory records for their businesses while 8% of the respondents did not. This is demonstrated in figure 4.28.

![Figure 4.28: Inventory Records](image2)

Source: Field data, 2014
4.5.4 Inventory Stock Take

The figure 4.29 illustrates that 58% of the respondents conduct a periodic stock take while 42% of the respondents indicated that they do not carry periodic stock takes.

![Figure 4.29: Inventory Stock Take](source)

Source: Field data, 2014

4.5.5 Frequency of Stock Take

In figure 4.30, the respondents who said that they carry regular stock takes majorly conduct monthly stock takes. This was represented by 71% of the respondents. The other 20% of the respondents’ conduct their stock takes yearly while 9% of the respondents conducted their stock takes daily.

![Figure 4.30: Frequency of Stock Take](source)

Source: Field data, 2014
4.5.6 Re-Order Level Policy

Figure 4.31 shows 47% of the businesses have a reorder level policy in their businesses while 53% of the businesses do not have a re-order level policy.

![Figure 4.31: Re-Order Level Policy](source)

Source: Field data, 2014

4.6 Chapter Summary

The chapter described the process followed in gathering data for this study. The outcomes of the data analysis are then presented methodically in line with research questions presented in section 1.4 of this study.

The scrutiny aimed at highlighting descriptive characteristics of the data collected as well as establishing relationships between the various variables at play to help in understanding of the characteristics of the data collected. More insights and inferences are elaborated in chapter five.
CHAPTER FIVE

5.0 SUMMARY, DISCUSSIONS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary, conclusions and recommendations of the research. The summary highlights the salient findings per the specific objectives. Conclusions and recommendations were drawn based on the summary of the findings. The study covered 60 operators of SMEs in the Nairobi County, Kenya.

5.2 Summary

The purpose of this study was to investigate the current asset management practices of small and medium enterprises in Nairobi County, the research was guided by the following research objectives firstly to determine the cash management practices of SMEs; secondly to ascertain the account receivables management practices of SMEs; finally to examine the inventory management practices of SMEs.

The research methodology used was a descriptive design. A survey was employed for collection of the primary data. The sample frame was developed from the number of registered small and medium enterprises established within Nairobi County. The respondents were 60 in total. The study engaged the use of structured questionnaires that were pilot tested in order to ensure that the questions asked were relevant, data validity as well as reliability. Data coding was done using the MS Excel spreadsheet to generate the descriptive statistics for instance the frequencies as well as the percentages. The results were then presented in form of tables, as well as figures.

The SMEs used mostly used their own cash sources to finance their business. Most of the SMEs do not regularly set cash targets for their business. In the event of cash shortages the financial institutions are mostly used in order to plug this gap. The SMEs are ambivalent on the need of budgeting their cash. Furthermore the SMEs used the banks as a source of both storage and source of cash. All SMEs record their daily cash transactions. Finally, the surplus cash generated by the SMEs is re-invested back into the business.
More than 67% of the SMEs sell their products and services on credit. The average collection period is 30 days, although this varies depending on the individual agreements between the SMEs and their buyers. The fear of credit defaults makes some of the SMEs not to sell their goods and services on credit. The SMEs also use formal credit investigation to determine the credit worthiness of their debtors. They check the debtors’ credit history with their business and also cross reference with other businesses. In case of a default most of the SMEs take legal action against the defaulters or cease from supplying them with their products and services. The SMEs record the credit history on IOUs and delivery notes.

The SMEs source their inventory both in the local market and in the foreign market with some using a hybrid of the two markets. In order to prevent large inventory holding costs most SMEs do not stock-pile their inventories. Inventory record is well entrenched practice with these SMEs. Only 55% of the SMEs conduct regular stock takes, with the stock take on average happening periodically on a monthly basis. The SMEs lack re-order level policies to monitor the inventory re-order levels.

5.3 Discussions

5.3.1 Cash Management

As to how issues on cash flow management were tackled, the major findings for objective one depicted that: The majority of respondents kept records of their financial transactions. Many of the entrepreneurs did not employ professional accountants who could appropriately keep financial records for their industries. Most investors could not send their accountants for professional training seminars and workshops.

In terms of findings, the study revealed that The SMEs used mostly used their own cash sources to finance their business. Most of the SMEs do not regularly set cash targets for their business. In the event of cash shortages the financial institutions are mostly used in order to plug this gap. The SMEs are ambivalent on the need to budget their cash. Furthermore the SMEs used the banks as a source of both storage and source of cash. All SMEs record their daily cash transactions. Finally, the surplus cash generated by the SMEs is re-invested back into the business.
Most investors personally generated funds to establish their enterprises. More of the operators borrowed money from the bank to augment their investment funds. The interviewees hardly prepared budgets to guide their expenditure patterns.

Many entrepreneurs saved their business proceeds on a daily basis with a bank. Most respondents carried out expenses within their financial means. The investors did not invest their surplus cash, but rather saved it with a bank. Many of the SME respondents did not have the financial muscle to invest in the buying of securities.

Kithii (2008) explains that the cash on the books of the SMEs are bank deposits that are either in the bank accounts or are in the certificate of deposits. The cash is a key component of the firm’s current assets as it’s the most liquid. The cash is used in the payment of short-term payables and operational expenses. In the context of current asset management, the deposits in the bank are components of current assets.

Kithii (2008) also notes that some costs are incurred due to the shortages or excesses of current assets. Therefore the goals of the business become dual. The first goal is to manage the excessive costs and the second goal is to maintain optimal liquidity to fulfill all the current expenses which include petty cash payments to ensure all the operations occur smoothly. The latter goal effectively ensures that the business is able to sustain routine operations (Owolabi et al., 2012). The management of liquidity, that is funds that are available to immediately meet daily expenses while keeping a lid on excesses, affects the profitability of the firm and is like maintain the optimal amount of stock in inventory management (Hofmann 2005). The reason for this is that the cash available and the bank deposits constantly fluctuate, as customer demand for a finished product. This imposes uncertainty and the risk of the business being insolvent. (Chakravarty, 2009).

Bagchi (2013) postulates that firms, in particular SME frequently fail to meet their operational goals as a result of lack of cash liquidity. This is because they constantly need cash and bank deposits to meet routine operational expenses. Therefore without appropriate liquidity a firm may end up bankrupt. Cash on hand is the cash and bank deposit available on the first trading day. When sales occur, cash is generated and flows in, same with bank deposits. When standing orders are paid, or when cheques are written, cash flows out of the
business. The balance of the cash that will be left at the end of the month will be carried over to the beginning of the next month.

As to how issues on cash flow management were tackled, the major findings for objective one depicted that: The majority of respondents kept records of their financial transactions. Many of the entrepreneurs did not employ professional accountants who could appropriately keep financial records for their industries. Most investors could not send their accountants for professional training seminars and workshops.

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5.3.2 Accounts Receivable Management

More than half of the SMEs sell their products and services on credit. The average collection period is 30 days, although this varies depending on the individual agreements between the SMEs and their buyers. The fear of credit defaults makes some of the SMEs not to sell their goods and services on credit. The SMEs also use formal credit investigation to determine the credit worthiness of their debtors. They check the debtors’ credit history with their business and also cross reference with other businesses. In case of a default most of the SMEs take legal action against the defaulters or cease from supplying them with their products and services. The SMEs record the credit history on IOUs and delivery notes.

Investors sometimes sold their goods on credit and were paid on time by their debtors. The majority of operators embarked on formal credit investigations before entering into an agreement with their customers. Though the respondents sold on credit and undertook investigations before selling goods on credit, many of them did not have a comprehensive credit policy to monitor credit granting within their industries. Investors who credited their
goods, prepared documents to suggest debtor indebtedness and also issued cash discount to them. Most respondents, who rendered sales on credit, used this to stimulate growth in their businesses. The operators also negotiated credit terms with their debtors to build and sustain a fruitful business relationship between the parties.

Bagchi (2013), states that accounts receivables are a means of attracting customers and increasing sales for a business. This is because it allows a customer the privilege to access a service or a product and enjoy its consumption before delivering payment. This kind of arrangement will generally increase the sales but will have the additional effort of increase the receivables that the firm should recover later. If the firm does not collect its receivables, it risks turning it into bad debt, never to be repaid. In addition slow payment by the customers might end up running the business to the ground. Therefore to minimize this, the business sets up a credit sale policy. In general an increase in accounts receivable will raise current asset requirement.

According to Deloof (2013) the managers can maximize the wealth of their shareholders by minimizing the number of days of accounts receivables and increasing inventory turnover. There is a negative relation between profitability and accounts receivables. This is consistent with the fact that mostly less profitable firms have higher lead times for paying bills.

Padachi (2006) has examined the trends in current asset management and its impact on a firm’s performance for 58 Mauritanian small manufacturing firms during the period 1998 – 2007. He says that a well designed and implemented current asset management can contribute significantly towards the realization of a firm’s value. The results demonstrated that a higher investment in receivables is generally associated with low profitability and as a result leading to the firm requiring having short term current asset financing.

5.3.3 Inventory Management

The inventory turnover period is a vital component of the current asset management. It indicates the approximate length of time it takes for products to be sold. A low frequency turnover generally implies a high investment in inventory. If the business is sub-optimal in maintaining products, this will result in financial; resources being held captive in non-productive cases.
The SMEs source their inventory both in the local market and in the foreign market with some using a hybrid of the two markets. In order to prevent large inventory holding costs most SMEs do not stock-pile their inventories. Inventory record is well entrenched practice with these SMEs. Some SMEs conduct regular stock takes, with the stock take on average happening periodically on a monthly basis. The SMEs lack re-order level policies to monitor the inventory re-order levels.

The majority of respondents did not have a re-order level policy in their industries in requesting for stocks. Deloof (2003) found that there exists an inverse relationship that is significant between cash conversion cycle and its components. These components are the accounts payables turnover, accounts receivable days outstanding and the inventory turnover period, together with the firm’s profitability. Therefore some financial managers can increase the liquidity of their firms immensely by reducing inventory turnover period, which is a component of the cash conversion cycle.

In order to fully appreciate the importance of inventory management the managers must first visualize it as stacks of money sitting on the forklifts, shelves, pallets, storage tanks, trucks, tanks and planes while in transit. This money is idle as it is not earning any interest and neither is it being immediately invested to churn profits. Therefore a firm’s goal should be to minimize its inventory as much as possible. However inventory also serves as a precautionary measure as it decouples systems working in tandem and helps the business to manage uncertainty.

In financial terms, inventory constitutes a paramount portion of current asset management and its prudent management mitigates the risk of work or supply stoppages. Inventory ensures that the firm has excellent customer relations and this therefore ensures demand for the firm’s products leading to higher sales and increased profitability (Danuri and Satoto, 2011). Inventory in accounting is an estimate of the appropriate monetary value of the goods to be held by a company. Raw material inventory is the free on board price that is paid during the time of the purchases, while finished goods is the value of the cost of sales or the cost of goods sold (Danuri and Satoto, 2011).
5.4 Conclusions

Evidence gleaned from the summaries of the results suggests that:

5.4.1 Cash Management

The investors conformed to the conventional liquidity management mechanisms of business institutions by safeguarding financial records, supplementing cash shortages with loans from the bank, saving profits on a daily basis and spending within their financial capability.

The entrepreneurs managed account receivables in their investments by selling on credit to customers. Prior to such an arrangement, formal credit investigations were made to ascertain the credit worthiness of customers. Thereafter, documents were prepared and compiled as proof for customers’ indebtedness. When a default in payment arose, legal action was taken against most debtors.

5.4.2 Accounts Receivable Management

Sales on credit geared towards promoting growth in the industries, the negotiation of credit terms with debtors, the utilization of short-term funds for short-term goals and the use of cash to assess the management of working capital, were the methods used by investors to manage their current assets.

5.4.3 Inventory Management

The buying of stocks from local companies at moderate quantities and regular stock-taking were the strategies used by the operators in managing their inventory machineries. However, often times, they eventually bought expensive and poor quality stocks, as they did not have a re-order level policy in requesting for stocks from the appropriate buyers or manufacturers during peculiar seasons.
5.5 Recommendations

5.5.1 Recommendations for Improvement

The recommendations of the research were premised on the summary of and conclusions from the results and discussion. Based on the summaries of the analyses and conclusions, SME entrepreneurs are urged to:

5.5.1.1 Cash Management

Prepare budgets each time they intend to embark on major expenses. This will forestall unnecessary, unwanted, overestimated and underestimated expenses.

Identify their investment priorities particularly those that are crucial in sustaining their businesses in the long run. They should sacrifice to channel a chunk of their funds to finance and achieve these priorities that will enable them to generate extra cash or profits to plough back into other sectors of their industries. When this strategy has been achieved, they can generate sufficient funds to augment their cash target, buy treasury securities and finance other relevant investments that are instrumental to the success of their businesses.

5.5.1.2 Accounts Receivable Management

Formulate a credible credit policy for their enterprises. In crafting such a policy criteria should be set as to the conditions and terms for credit granting. The policy should also take cognizance of the maximum number of days creditors can defray their debts. Where necessary, grace periods can be added to these numbers of days. This will spare operators the head ache of undertaking formal credit investigations about their customers and from chasing or policing them if they became bankrupt. When creditors are unable to service their debts, legal action can be taken against them.

5.5.1.3 Inventory Management

Create a re-order level policy for their institutions that will create an enabling environment for them to request for the supply of moderate and high quality stocks. An institution of such a policy paves the way for businesses to identify the best sellers of their wanted stocks in the market at peculiar seasons. Another spillover effect of such a policy shall be the eschewing of price fluctuations and pirated goods.
5.5.2 Recommendations for Future Studies

Since current asset management is a very broad subject and includes more elements than this paper presents. It is very interesting to study firms with global business and can therefore include topics such as currency risk management. Larger organizations with bigger range of customers and higher turnover where the payment routines are more complex can be interesting to investigate.

Due to the limitations imposed on this study by its identified objectives, some areas that are relevant to this study were not covered and are suggested for further study: first, further study could be done to establish the effect of e-book keeping on proper management practices of small and medium scale enterprises. Second, further study could be done on the effect of use of financial accounting information on financial performance of large scale enterprises. Third, further research could also be done on the effect of business records management on the financial performance of private limited companies.

This research was carried out only on small and medium enterprises within Nairobi County. One would evaluate whether other entities outside Nairobi County would exhibit similar current asset management practices as far the responses were concerned.
REFERENCES


Consumer Unity and Trust society. Integrating SMEs in the devolved government system, policy options for institutional and regulatory framework in Kenya by David Ong’olo, Samson Awino.


APPENDIX

Appendix I: Cover Letter

Survey: Current Asset Management Covering Letter

School of Business
United States International University Africa (USIU - A)
P.O. Box 14634
Nairobi
13 June 2014

<Address>
Dear <Name>

Survey: Current Asset Management

The Small and Medium Enterprises are presently the life blood of the Kenyan economy. This is an empirical fact with circa 60% of new jobs created emanating from SMEs according to the Kenya Economic Survey of 2012. But the major challenge facing SMEs is financial discipline more so in the arena of current asset management.

I am undertaking an important survey of Kenyan SMEs in fulfillment of my degree requirement and also in an attempt to find out how current asset is managed by the SMEs in Kenya. At present there is very little information on how current asset is managed in Kenya, and to the best of my knowledge a survey of this nature has not yet been undertaken.

Neither you nor your organization will be identified as a respondent without your consent. You may at any time withdraw your participation, including withdrawal of any information you have provided. If you complete the questionnaire, however, it will be understood that you have consented to participate in the research and consent to publication of the results of the research with the understanding that anonymity will be preserved.

As a gesture of our appreciation of your participation, a copy of the main survey findings will be forwarded to you if you provide either your business card or address.
The success of this research depends on your participation. We look forward to receiving your response.

Yours sincerely
Dennis Onyango
Master of Business Administration student

UNITED STATES INTERNATIONAL UNIVERSITY AFRICA (USIU - A)
CHANDARIA SCHOOL OF BUSINESS
EMPIRICAL SURVEY
CURRENT ASSET MANAGEMENT

CONSENT
I have read and understood the covering letter detailing information of this research. On this basis I agree to participate as a subject in the research, and I consent to publication of the results of the research with the understanding that anonymity will be preserved. I understand also that I may at any time withdraw from the research, including withdrawing any information I have provided.

Signed:

Dated:
INSTRUCTIONS

This survey should take you approximately 15 minutes to complete and may be completed by more than one person.

In appreciation of your participation in this survey a summary of the main findings will be posted to all respondents.

This questionnaire comprises two main sections, Section A, biographic information, and Section B, which is the survey, the management of current assets.

Please record your response by circling or ticking the number of the appropriate response, and providing additional information, such as comments or descriptions of processes used, in the spaces provided.
Appendix II: Questionnaire

QUESTIONNAIRE

SECTION A
Biographic

1) What is the type of the business?
   a. Sole proprietorship [ ]
   b. Partnership [ ]
   c. Family/Business [ ]
   d. Limited liability [ ]
   e. Other (please specify).................................

2) Age group of the respondents
   Please specify..............................................

3) Respondent gender
   a. Male [ ]
   b. Female [ ]

4) Marital status
   a. Married [ ]
   b. Single [ ]
   c. Divorce [ ]
d. Widow [ ]

5) What is your highest level of Education?
   a. Primary [ ]
   b. Secondary [ ]
   c. Polytechnic [ ]
   d. University [ ]
   e. Other (please specify)..................................................

6) What is the current work force of your enterprise..............................................................

7) Does the business keep financial records of the operations?
   a. Yes [ ]
   b. No [ ]

8) If yes to question 8, what kinds of records are kept?
   a. Sales daybook
   b. Purchases daybook
   c. General Journal
   d. Cash Book

9) What is the academic qualification of the personnel who keeps the records?
   a. Bsc. Administration (Accounting option)
   b. CPA/ACCA
   c. Diploma in Business Studies
   d. Others

10). Does the owner, manager and or account personnel attend workshops or seminars aimed at improving accounting practices in the business?
a. Yes [ ]

b. No [ ]

11) If yes to question 11, how beneficial has the training been to your enterprise?

   a) Not beneficial [ ]
   b) Beneficial [ ]
   c) Very beneficial [ ]
SECTION B
Current Assets Management

12) How did you finance your business initially?
   a. By borrowing from Bank [ ]
   b. By borrowing from friends [ ]
   c. Self-financing [ ]
   d. Purchasing on credit [ ]

13) Do you normally get cash target in advance for your business?
   a. Yes [ ]
   b. No [ ]

14) How do you manage the difference in your required cash where there is shortage?
   a. Borrow from the bank
   b. Self-financing
   c. Borrowed from friends and relatives
   d. Plough back profits
   e. Manage with what we want
   f. No action taken
   g. Purchase goods for credit

15) Do you write down such estimates of cash requirement as a plan or budgeted document?
   a. Yes [ ]
   b. No [ ]

16) How do you control the proceeds generated on a daily basis?
   a. Keep it in office cash till
   b. Keep it in the bank
   c. Spend the proceeds
   d. Others specify.................................
17) Do you spend within your budget?
   a. Yes [ ]
   b. No [ ]

18) Do you normally record all cash transactions?
   a. Yes [ ]
   b. No [ ]

19) How often do you send money to the bank?
   a. Daily [ ]
   b. Weekly [ ]
   c. Monthly [ ]
   d. Other (please specify) ..................................................

20) How does the business invest its surplus cash?
   a. In deposit account with Commercial Bank [ ]
   b. In treasury security [ ]
   c. In long-term deposit (bond etc) [ ]
   d. In stock/shares [ ]
   e. Other (please specify) .....................................................
SECTION C: ACCOUNTS RECEIVABLES

21) Do you sometimes sell on credit?
   a. Yes [ ]
   b. No [ ]

22) If yes to question 21, how many days or period do you give to your customers to pay their bills?
   a. 7 days [ ]
   b. 14 days [ ]
   c. 21 days [ ]
   d. More than one month [ ]
   e. Depends on the agreement [ ]

23) If no to question 21, then give reasons..............................................................................................................................

24) Do you undertake formal credit investigation before granting credit to your customers?
   a. Yes [ ]
   b. No [ ]

25) Are the following procedures adhered to in investigating prospective credit customer? (TICK THE APPROPRIATE ONE)
   YES  NO

   a. Check customers past records from other business firms
   b. Check customers past financial dealing with the company
   c. Check customers bank reference
   d. Other measures

26) What evidence exists for a customer’s indebtedness?
   a. Signing of delivery note or other receipts document [ ]
b. Signing of formal IOU document [ ]

c. Other (please Specify)..........................................................................................

27) Do you give cash discount to your customers?

a. Yes [ ]

b. No [ ]

28) What actions are taken on customers who refuse to pay their debt?.................................................................................................................................
D: MANAGEMENT OF INVENTORY
29) What are the sources of your inventory?
   a. Local [ ]
   b. Foreign [ ]
   c. Both [ ]

30) Do you often experience a large pile-up of inventory?
   a. Yes [ ]
   b. No [ ]

31) Do you keep records of your inventory?
   a. Yes [ ]
   b. No [ ]

32) Do you do regular stock taken?
   a. Yes [ ]
   b. No [ ]

33) If yes in question 34, how often do you do it?
   a. Daily [ ]
   b. Monthly [ ]
   c. Yearly [ ]
   d. Other (please specify)........................................................................................

34) Do you have a re-order level policy for requesting stock or materials?
   a. yes [ ]
   b. no [ ]